ESG Grading Band ★

midf RESEARCH

Leong Hup International Berhad

(6633 | LHIB MK) Main | Consumer Products & Services| Agricultural Products

Margin Pressures Persist Despite Solid Demand

***Downgrade* to NEUTRAL**

(previously BUY)

***Revised* Target Price: RM0.50**

(Previously RM0.90)

KEY INVESTMENT HIGHLIGHTS

- **Virtual briefing**
- **Softer 1QFY23 sales volume in Feedmill segment**
- **Better growth of Livestock sales volume**
- **Revised earnings projection for FY23F-25F**
- **Downgrade to NEUTRAL (from BUY) with a lower TP of RM0.50**

Virtual briefing. We attended Leong Hup International ("LHIB") analyst briefing for 1QFY22 yesterday and turned cautious about its FY23 outlook. The salient highlights are as follows: -

Softer 1QFY23 sales volume in Feedmill segment. The feedmill division sales volume declined by -1.6%yoy to 648.4kmt in 1QFY23. Among the countries within the segment, Malaysia witnessed the largest decline of -7.3%yoy, followed by Indonesia (-3.8%yoy), and Vietnam (-1.7%yoy). Meanwhile, Philippines recorded a significant increase in feedmill sales volume (+102.5%yoy) mainly attributed to the higher feedmill production capacity (+43.8%yoy). As such, the group production capacity increased by +3.1%yoy 1.07m mt 1QFY23. However, the group utilization rate reduced from 63.3% in 1QFY22 to 60.4% in 1QFY23. Overall, Indonesia remained the top producer in the group's feedmill output.

Better growth of Livestock sales volume. Leong Hup reported an increase in sales volume for the group's broiler day-old chicks (DOC) by +7.1%yoy, reaching 145m chicks. Additionally, the sales volume for group broiler chickens rose by +4.8%yoy to 40.4m birds. The group also experienced a growth of +8.5%yoy in egg sales volume, totaling 449.2m eggs.

Table 1: Livestock sales volume across geographical segments

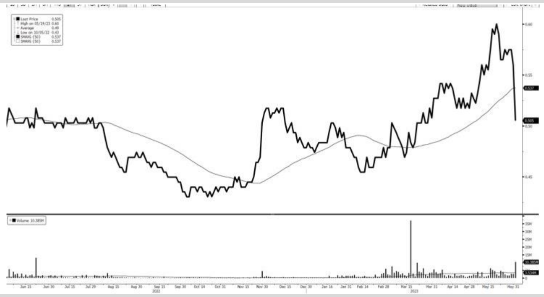
	1QFY23 vs. 1QFY22		
	DOC	Chicken	Egg
Vietnam	-51.5%	-5.6%	+2.9%
Indonesia	+26.6%	+21.4%	
Philippines	+5.3%	+102.8%	
Malaysia	-0.9%	-4.5%	+9.4%

Source: Bloomberg, MIDFR

Sustain capex allocation target for FY23F. The management maintain the target of a total capital expenditure for FY23F will be less than RM200m, as compared to RM291.5m in FY22, given the current challenging business environment. Note that the group's capex for FY21 was RM345.9m, RM498.6m for FY20, and RM400.2m for FY19.

RETURN STATISTICS	
Price @ 1st June 2023 (RM)	0.49
Expected share price return (%)	+1.30
Expected dividend yield (%)	3.07
Expected total return (%)	**+4.37**

SHARE PRICE CHART



Price performance (%)	Absolute	Relative
1 month	-5.6	-3.4
3 months	-3.8	9.2
12 months	-2.9	9.1

INVESTMENT STATISTICS

FYE Dec	2023F	2024F	2025F
Revenue	9,338.8	9,753.9	10,139.2
EBITDA	**689.6**	**756.6**	**866.0**
Profit before tax (PBT)	245.4	292.3	352.4
Core PATANCI	**183.3**	**218.3**	**263.2**
Core EPS (sen)	5.0	6.0	7.2
DPS (sen)	1.5	1.8	2.2
Dividend Yield (%)	3.1	3.7	4.4

KEY STATISTICS	
FBM KLCI	1,383.01
Issue shares (m)	3650.00
Estimated free float (%)	16.99
Market Capitalisation (RM'm)	1,843.25
52-wk price range	RM0.4 - RM0.6
3-mth average daily volume (m)	3.41
3-mth average daily value (RM'm)	1.82
Top Shareholders (%)	
Emerging Glory Sdn Bhd	52.80
CLARINDEN INV PTE	8.56
Amanah Saham Nasional Bhd	7.07

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Reduced Indonesia Sunny' chick outlets in 1QFY23. LHI operated 52 Sunny'chick outlets as of 1QFY23. These outlets consist of 48 kiosks, 3 dine-in locations, 1 mother store, and 1 food truck. This was a slight decrease compared to the 54 Sunny'chick stores reported in 4QFY22. For FY23F, the group allocated RM4m in capex for the expansion of the Sunny'chick business-to-business (B2B) channel.

Capex initiatives in Philippines. The group converted an old broiler house into a parent stock farm (PS farm) with a capex of RM12.2m and had begun operating in March 2023. Additionally, the expansion of the 2nd Palleting line in the existing Tarlac Feedmill has reached 82% completion in terms of construction work and is expected to be fully completed by 2QFY23, which will increase the capacity of the feedmill to 28k /mt per month. Furthermore, under a franchise basis, LH Deli has opened 45 kiosks as of 1QFY23, representing an increase from the 42 kiosks reported in 4QFY22.

Capex updates in Malaysia. The cold room project at Grisek Muar is currently at a 70% completion rate and is expected to be fully completed in 3QFY23. The cold room will serve as a cold storage and distribution warehouse, enhancing storage and logistics capabilities. Additionally, the installation of solar PV panel within Teo Seng Capital Berhad across 10 locations throughout Malaysia is expected to be complete in 3QFY23, aiming to decrease net energy consumption by -25% for the installed locations. This initiative demonstrates a commitment to sustainability and reducing environmental impact. As of 1QFY23, the number of outlets for Bakers Cottage has reached 160 as compared to 161 outlets in 4QFY22.

Revised earnings projection for FY23F-25F. Post analyst briefing, we cut our earnings expectation for FY23F by -35.5%, FY24F by -33.5% and FY25F by -30.3% to reflect our cautious outlook. This was after factoring in weaker sales volume performance from the Indonesia operation, and higher animal feed, labor and finance costs.

Downgrade to NEUTRAL (from BUY) with a lower TP of RM0.50. Our **TP** is based on a FY24F PER of 8.3x (above it -1SD 3-year historical PE) that is pegged to FY24F EPS of 6.0sen. We turned cautious on Leong Hup's FY23 outlook due to the persistent margin compression caused by rising feed, labor, and electricity costs as well as the ongoing retail price ceiling for chicken and eggs in Malaysia. Furthermore, the group's high gearing ratio of 0.8x poses the risk of increased finance costs, potentially further compressing the margin in the current rising interest rate environment. On a positive note, the company's vertical integration of poultry, eggs, and livestock feed, along with geographic diversification, can partially offset potential downsides. Hence, we downgrade our call to **NEUTRAL** from BUY on Leong Hup. **Downside risks** are (1) a substantial increase in the cost of raw materials; (2) adverse regulatory change; and (3) fierce competition.

FINANCIAL SUMMARY

Income Statement (RM'm)	2021A	2022A	2023A	2024F	2025F
Revenue	**7,153.5**	**9,042.7**	**9,338.8**	**9,753.9**	**10,139.2**
Change in biological assets	42.8	7.9	8.2	8.4	8.7
Change in closing inventories	228.6	29.6	30.7	31.4	32.4
Purchase of inventories and livestock	(5,514.4)	(6,865.4)	(7,019.3)	(7,228.6)	(7,401.4)
Gross Profit	**1,910.5**	**2,214.8**	**2,358.5**	**2,565.1**	**2,778.8**
Other Income	39.1	188.8	86.9	90.7	94.3
Employee benefit costs including Directors' remuneration	(645.8)	(677.4)	(727.5)	(786.5)	(829.8)
Utilities costs	(185.6)	(221.4)	(256.1)	(299.5)	(326.9)
Repair and maintenance	(80.0)	(91.2)	(101.2)	(110.9)	(118.8)
Transportation expenses	(149.9)	(181.4)	(191.1)	(203.6)	(215.8)
Other operating expenses	(366.7)	(467.0)	(479.9)	(498.7)	(515.8)
EBIT	**237.9**	**464.0**	**413.9**	**464.1**	**532.9**
Profit before tax (PBT)	**140.3**	**326.6**	**245.4**	**292.3**	**352.4**
Profit After tax (PAT)	95.9	243.9	183.3	218.3	263.2
Core PATANCI	**78.8**	**243.9**	**183.3**	**218.3**	**263.2**
Core EPS (sen)	2.2	6.7	5.0	6.0	7.2
DPS (sen)	0.7	1.8	1.5	1.8	2.2

Balance Sheet (RM'm)	2021A	2022A	2023A	2024F	2025F
Property, plant and equipment	2,770.3	2,784.5	2,671.1	2,578.8	2,496.0
Total Non-current assets	**3,411.2**	**3,431.8**	**3,327.7**	**3,250.3**	**3,167.4**
Inventories	973.5	1,025.9	1,159.2	1,184.3	1,181.3
ST - Trade and other receivables	740.1	823.2	915.7	951.9	969.7
Cash and cash equivalents	764.6	840.3	824.4	852.4	877.3
Total current assets	**2,918.6**	**3,160.4**	**3,467.9**	**3,546.4**	**3,589.8**
Total Assets	**6,329.8**	**6,592.2**	**6,795.7**	**6,796.7**	**6,757.2**
Total Equity	**2,359.8**	**2,589.6**	**2,793.0**	**2,732.1**	**2,513.0**
LT Loans and borrowings	1,054.6	1,046.4	1,015.0	1,035.3	1,087.1
Total Non-current liabilities	**1,321.4**	**1,339.5**	**1,317.0**	**1,349.5**	**1,412.7**
ST Trade and other payables	534.7	629.8	710.4	699.1	715.3
ST Loans and borrowings	2,070.1	1,986.3	1,926.7	1,965.2	2,063.5
Total Current Liabilities	**2,648.5**	**2,663.1**	**2,685.7**	**2,715.1**	**2,831.5**
Total Liabilities	**3,970.0**	**4,002.6**	**4,002.7**	**4,064.6**	**4,244.2**

Cash Flow (RM'm)	2021A	2022A	2023A	2024F	2025F
Pretax profit	140.3	326.6	245.4	292.3	352.4
Cash flow from operations	44.2	620.9	786.0	453.7	431.5
Cash flow from investing	(392.6)	(277.6)	(195.3)	(236.9)	(287.6)
Cash flow from financing	264.3	(362.1)	(322.3)	(188.8)	(119.2)
Net cash flow	**(84.1)**	**(18.8)**	**268.4**	**28.0**	**24.8**
(+/-) Adjustments	13.4	(0.3)	0.0	0.0	0.0
Net cash/(debt) b/f	**645.8**	**575.1**	**556.1**	**824.4**	**852.4**
Net cash/(debt) c/f	**575.1**	**556.1**	**824.4**	**852.4**	**877.3**

Key Metrics	2021A	2022A	2023A	2024F	2025F
Effective tax rate (%)	31.7	25.3	25.3	25.3	25.3
PER (x)	20.9	8.2	9.8	8.2	6.8
Cash per share (RM)	0.0	0.2	0.2	0.1	0.1

Profitability Margins	2021A	2022A	2023A	2024F	2025F
Gross Profit Margin (%)	26.7	24.5	25.3	26.3	27.4
EBIT Margin (%)	3.3	5.1	4.4	4.8	5.3
Core PATANCI Margin (%)	1.1	2.7	2.0	2.2	2.6

Source: Bloomberg, MIDFR

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STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology