Maybank Kim Eng

Consumer Staples

Singapore

Japfa Ltd (JAP SP)

2H19: More to do with oink, not cluck

Receding ASF impact is the key catalyst to watch for

Indonesian soft poultry prices remains a focus area for some investors but the YoY drop from the exceptionally high price environment of 2018 has been tracking our expectations so far. The real wild card for Japfa's 2H19 performance lies with the near-term unpredictability of ASF on Vietnam hog volumes and prices. Valuations, while attractive, will stay in the back seat for now, but current risk-reward may be interesting for long term investors. Our est.'s and SOTP-based TP are unchanged. BUY.

The chickens are alright

July/Aug PT Japfa farm-gate broiler prices were higher than the seasonal lows of 1H19. While this still appears to be the main concern in the market, the YoY monthly price declines are to be expected with the unusually high base of 2018. The YTD average of IDR17.1k has so far been tracking in line with our full-year outlook of cIDR17k and we think there may be some incremental upside to these levels in 2H19 with the government mandated culling in the past couple of months.

It's uncertainty in VN ASF timeline that concerns us

ASF spread rapidly across China's farms for 10-12 months before some provinces saw a deceleration in the number of new monthly outbreaks. In Vietnam there is still limited clarity on this front; ASF broke out in North Vietnam in early-2019. New outbreaks are reportedly slowing there and pork prices inched up MoM for July. But South Vietnam, where ASF broke out a few months after the North is not seeing any such slowdown or signs of pork price inflexion yet. Moreover, the heavy rains in the South could possibly fuel its spread across farms in coming months.

2018 star to YTD 2019 flop - what's next?

Japfa was one of the best performing stocks in our coverage in 2018 (+44% abs; +55% rel) but may close 2019 as amongst the worst (YTD -32% abs; -37% rel). Stock price is at the lows seen in 1Q18 in the aftermath of the China pork ban that resulted in a c20% industry oversupply. Japfa's evaluation of a worst-case ASF scenario patterned on some of China's worst affected provinces is a c25% stock cull. In a sense, markets appear to have already largely priced in such a worst case. Price catalysts may take time to materialise but forward valuations are attractive and the risk-reward may be interesting for long-term investors.

FYE Dec (USD m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	3,190	3,533	3,659	3,784	3,895
EBITDA	284	446	372	397	413
Core net profit	16	145	67	91	108
Core EPS (cts)	0.9	7.8	3.6	4.9	5.8
Core EPS growth (%)	(88.0)	777.0	(53.8)	36.3	18.3
Net DPS (cts)	0.5	2.0	1.0	1.0	1.0
Core P/E (x)	43.0	6.9	9.8	7.2	6.1
P/BV (x)	1.0	1.3	0.8	0.8	0.7
Net dividend yield (%)	1.3	3.7	2.8	2.8	2.8
ROAE (%)	3.0	13.6	6.6	11.0	11.9
ROAA (%)	0.6	5.1	2.2	2.8	3.3
EV/EBITDA (x)	6.0	5.4	5.6	5.3	5.1
Net gearing (%) (incl perps)	69.4	92.8	86.1	76.2	66.2
Consensus net profit	-	-	59	79	88
MKE vs. Consensus (%)	-	-	(12.1)	16.0	22.2

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BUY

Share Price	SGD 0.49
12m Price Target	SGD 0.73 (+51%)
Previous Price Target	*SGD 0.73*

Company Description

Produces protein staples, dairy and packaged food. Has presence in five countries with a vertically integrated business model.

Statistics

52w high/low (SGD)	0.84/0.45
3m avg turnover (USDm)	0.5
Free float (%)	19.2
Issued shares (m)	1,881
Market capitalisation	SGD912.3M
	USD664M

Major shareholders:

Santosa Family	56.7%
Kolonas Family	15.2%
Santosa Handojo	4.4%

Price Performance

	-1M	-3M	-12M
Absolute (%)	0	(13)	(20)
Relative to index (%)	(1)	(13)	(22)

Source: FactSet

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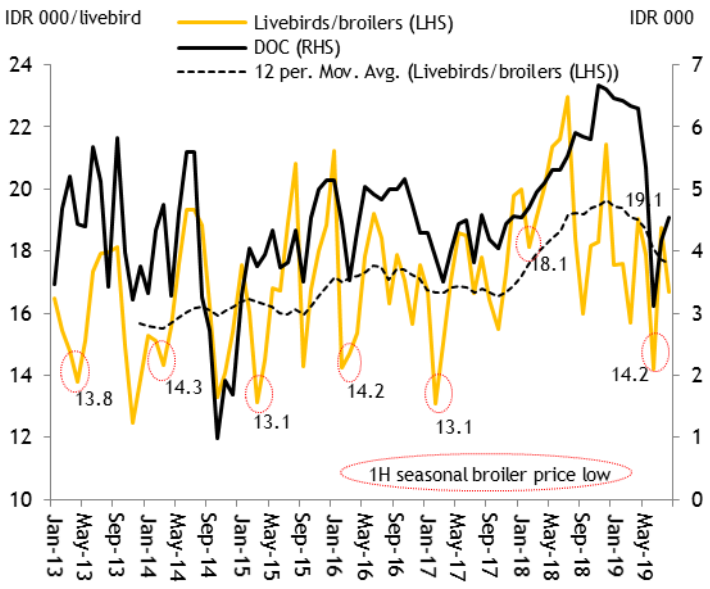
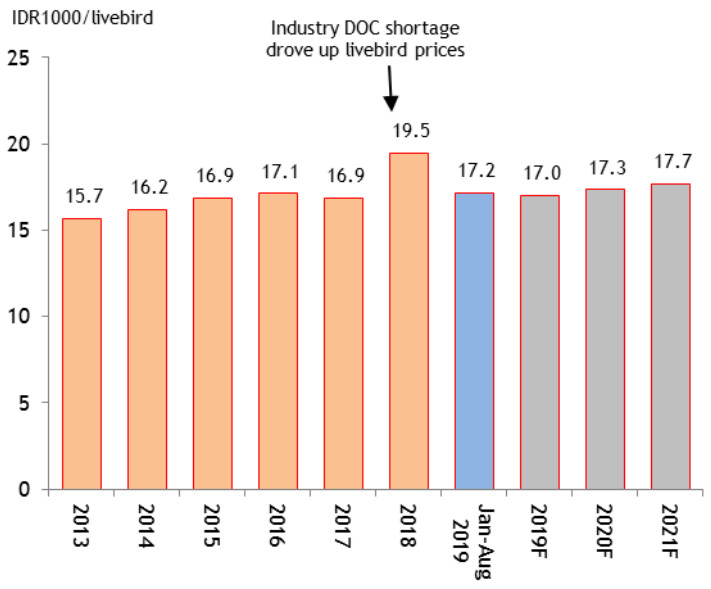
Indonesia poultry price trends

Fig 1: PT Japfa Tbk DOC & broiler farm-gate price



Source: Company

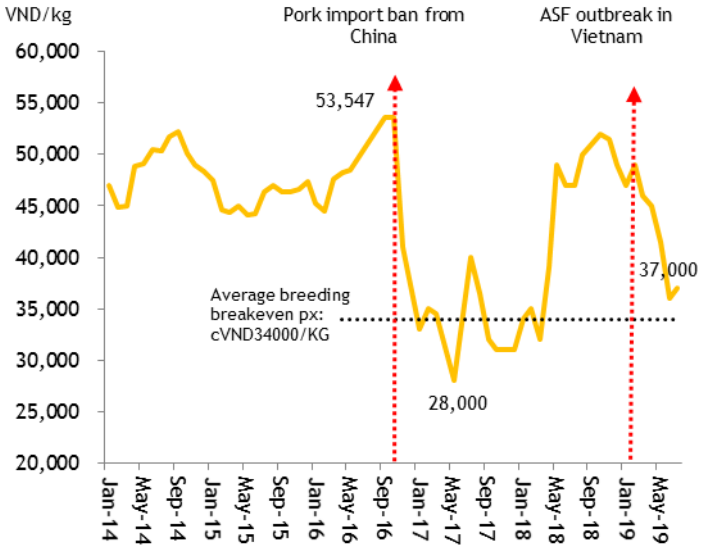
Fig 2: PT Japfa Tbk annual average broiler farm-gate price



Source: Company, Maybank Kim Eng

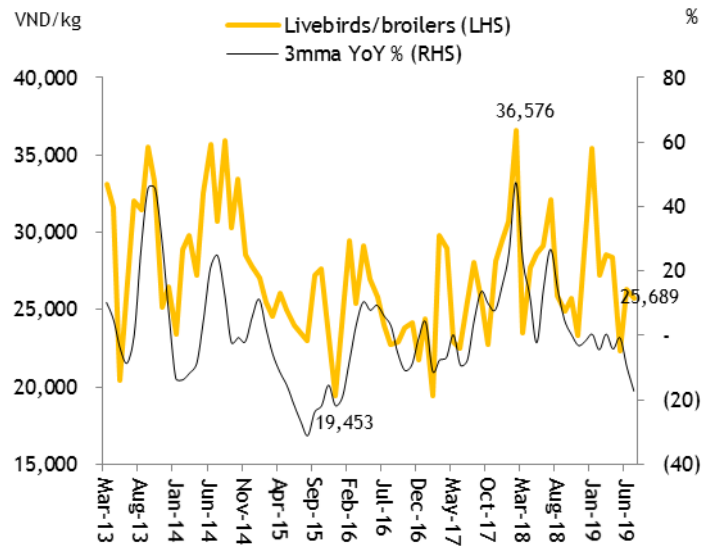
Vietnam poultry and pork price trends

Fig 3: Vietnam swine average market price



Source: Genesus Genetics Market Report, Maybank Kim Eng

Fig 4: Vietnam broiler average market price



Source: CP Foods PLC

Vietnam ASF update

ASF has spread rapidly throughout Vietnam since the first reported outbreak in Feb-2019. The country's Ministry of Agriculture and Rural Development (MARD) reported that the disease had spread to all 63 of its provinces. There is no vaccine treatment for ASF and stringent biosecurity practices are the only way to control its spread at the moment.

MARD also reported that around 4.7m hogs had been culled since the outbreak (we estimate this is c16% of its pre-outbreak hog population).

While the spread of ASF was initially across backyard and small farms, industrial farming companies, including Japfa, have also been affected in recent months.

Japfa management have estimated a couple of impact scenarios based on the Chinese experience where the disease has been widespread for almost two years. Some of China's worst affected provinces have seen around 25-28% of stocks get culled from pre-outbreak levels.

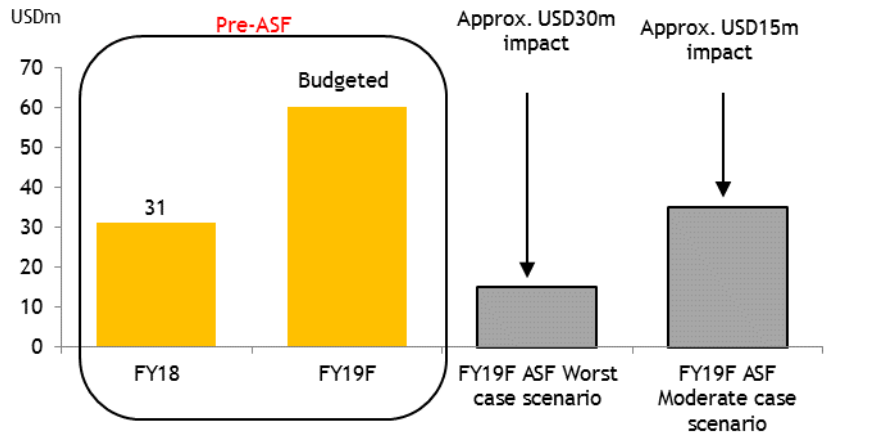
- Worst case: Japfa management estimates that if 25% of its commercial stock were to be culled, the negative impact to operating profit could be to the tune of USD30m if pork ASP stays low throughout the year.
- Moderate case: In a more moderate impact scenario that involved 25% of stock getting culled but an ASP recovery in the 2H19, the estimated operating profit impact would be cUSD15m.

There are three potential offsets to these ASF impact scenarios above:

- Firstly, as an industrialised farming company, the risk to Japfa's stock is arguably lower due to wide site diversification and higher biosecurity measures than posed to hybrid and backyard operations; we estimate Japfa to be amongst the three largest industrialised farmers in the country. Its hog operations have one Great Grandparent, six Grandparent farms, 22 Parent farms and over 300 company and contract fattening farms diversified geographically across the country.
- Secondly, pork prices could rise much sharper than assumed and potentially offset the loss of stock, like in China where shortages have resulted in pork prices skyrocketing in some provinces and even at a national level with increases of as much as 30-50% YoY in recent months (Aug 2019 prices up 47% YoY);
- Thirdly, Japfa's poultry operations in Vietnam would possibly benefit from some consumption substitution from pork to poultry.

In the medium term, the impact of ASF would be to shift the percentage share of industry production towards industrialised farming from backyard and hybrid farms. The estimated share in hog farming for industrialised farms at end-2018 was estimated at c35%.

Fig 5: Japfa Vietnam operating profit impact from ASF scenarios



Source: Company

Valuation and risks

Our forecasts, TP and valuation methodology are unchanged. Japfa is trading at 7.1x FY20 P/E, half the levels of its APAC protein peer average of 20.6x.

Fig 6: Japfa SOTP estimate

Segment	FY20 EBITDA	Multiple	EV	Debt	Cash	Net debt	Equity value	JAP stake	% to JAP
	USDm	X	USDm	USDm	USDm	USDm	USDm	USDm	USDm
PT Japfa TBK	256	6	1,535	(821)	81	(740)	795	52%	417
Dairy	97	8	776	(99)	32	(67)	709	100%	709
APO	40	6	239	(211)	14	(197)	42	100%	42
Consumer (fwd 3Y cum. losses)			(24)	(47)	5	(42)	(66)	100%	(66)
Total			**2,526**	**(1,178)**	**132**	**(1,046)**	**1,480**		**1,102**
10% conglo discount									(110)
JAP equity value									**992**
JAP o/s shares									1,865
USD/share									0.53
USD/SGD conversion rate									1.37
SGD/share									0.73

Source: Maybank Kim Eng estimates

Fig 7: Peer valuations summary

BBG	Company	Price	MC	3M ADV	Rec	TP				P/E (x)		DY (%)	ND/E (x)	EV/ EBITDA	FYE
Code		LC	USDb	USDm		LC	Act	FY1	FY2	FY3	FY1	FY2	FY1	FY1	
JAP SP	Japfa	0.48	0.7	0.5	Buy	0.73	4.6	9.7	7.1	6.0	2.3	2.3	1.1	6.6	Dec
	APAC Protein														
JPFA IJ	Japfa Tbk	1,650	1.3	3.6	-	-	8.8	11.0	10.0	9.6	2.9	2.6	0.6	6.6	Dec
MAIN IJ	Malindo Tbk	985	0.2	0.9	-	-	7.8	7.7	6.4	5.6	2.6	2.5	0.7	7.6	Dec
CPIN IJ	CP Indo Tbk	5,375	6.3	4.0	-	-	19.4	24.7	20.9	20.2	1.9	1.6	0.1	15.6	Dec
CPF TB	CP Foods PLC	28.50	8.0	28.6	-	-	15.6	16.7	14.7	13.9	2.5	2.7	1.4	12.1	Dec
LHIB MK	Leong Hup	0.82	0.7	0.9	Buy	1.08	-	15.2	13.0	11.2	2.5	2.4	0.9	7.3	Dec
000876 CH	New Hope Liuhe	18.16	10.8	184.7	-	-	45.4	21.9	10.5	9.2	0.3	1.2	0.2	18.8	Dec
GOAGRO IN	Godrej Agrovet	467.60	1.3	0.0	-	-	32.2	29.1	24.8	23.3	1.1	1.2	0.2	18.4	Mar
	Average						**27.6**	**20.6**	**14.6**	**13.6**	**1.5**	**1.8**	**0.5**	**15.2**	
	China Dairy														
600887 CH	Inn. Mongolia Yili	29.73	25.5	247.3	-	-	28.0	25.9	23.3	20.3	2.4	2.7	(0.3)	16.7	Dec
600597 CH	Bright Dairy	11.11	1.9	21.0	-	-	28.6	20.1	18.4	0.0	1.6	2.1	0.0	7.9	Jan
2319 HK	China Mengniu	30.00	15.0	35.3	-	-	33.1	27.3	22.9	19.3	1.0	1.1	0.1	16.1	Dec
1117 HK	China Modern	1.22	1.0	0.7	-	-	-	17.1	13.7	11.6	0.1	0.1	0.7	9.4	Dec
1230 HK	Yashili Int'l	0.95	0.6	0.1	-	-	74.0	34.4	31.7	22.8	0.2	0.2	(0.3)	17.8	Dec
	Average						**29.8**	**26.1**	**22.9**	**18.9**	**1.8**	**2.0**	**(0.1)**	**16.0**	
	Overall average						**28.9**	**23.9**	**19.6**	**16.8**	**1.7**	**1.9**	**0.1**	**15.7**	

Source: Maybank Kim Eng

Risks

Aside from the usual cyclical product ASP swings, potential regulation change, raw material cost volatility and weather risks inherent to agri-businesses, specific risks to our outlook lie in JAP's consumer foods business posting higher-than-forecast losses and the unknown extent of ASF impact.

Value Proposition

- One of the largest industrialised agri-food companies in a populous region housing 40% of the world's population.
- No. 1 milk yields in China; No. 2 poultry-feed production capacity in Indonesia & Myanmar; No. 2 DOC production in Indonesia, Vietnam & Myanmar.
- Diversified geographically and by protein product. Over 70 breeding farms and 30 poultry hatcheries. 150K head of cattle, seven dairy-milking farms and five aqua-feed mills.
- PT Japfa TBK, a 52%-owned subsidiary of Japfa, has 30 years of good financial and listing track record in Indonesia.

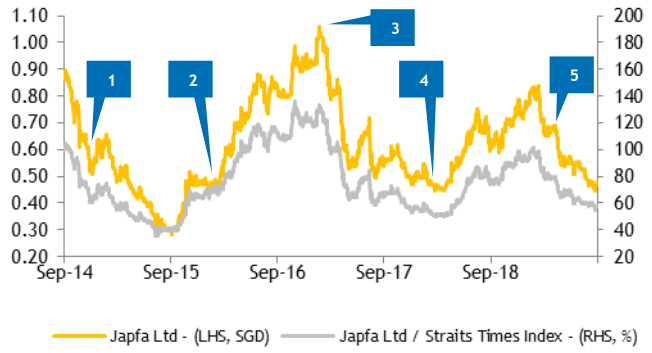
Leading market positions in multiple protein staples

Segment	Country	Mkt share	Mkt position
Milk yield	China	37 kg/day	No. 1
Poultry feed capacity	Indonesia	24%	No. 2
DOC production	Indonesia	29%	No. 2
DOC production	Vietnam	20%	No. 3
Poultry feed capacity	Myanmar	31%	No. 2
DOC capacity	Myanmar	21%	No. 2

Source: Company

Price Drivers

Historical share price trend



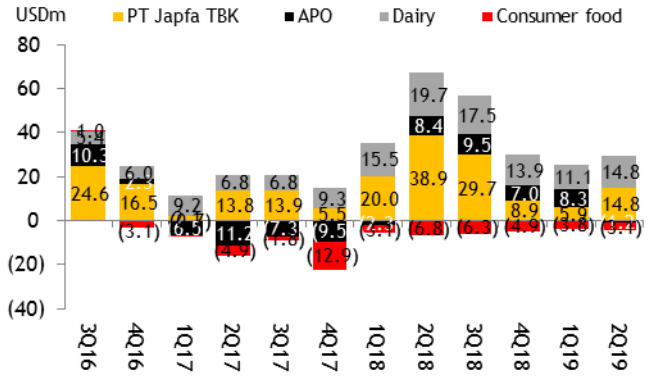
Source: Company, FactSet, Maybank Kim Eng

1. Large earnings miss due to demand supply imbalances of DOC and broiler, which impacted ASP.
2. Earnings beat consensus expectations. Poultry oversupply issue improved in 2H15 after the government coordinated an industry-wide culling program.
3. China's import ban of pork products from Vietnam where the company has swine-farming operations; swine prices collapse due to market oversupply.
4. 1Q17 reported a strong recovery in earnings due to better Indonesia poultry and Vietnam swine prices.
5. Concern over falling Indonesian poultry prices and African Swine Flu spreading across Vietnam; 2Q earnings miss.

Financial Metrics

- FY18 saw unusually strong earnings rebounding from a crisis year with revenue growth driven by a mix of volume, ASP and margin. FY20E/FY21E profit levels to normalise to USD90-110m from modest volume growth.
- Expect OCF to improve in tandem with core earnings.
- Adjusted core earnings could be viewed as close proxy for staple-consumption growth in ASEAN's emerging markets.
- FY17-FY19E capex elevated at USD200m+ levels with capacity build in PT Japfa Tbk and Dairy segments. Capex should normalise to cUSD150m levels from FY20E onwards

Core PATMI by segment



Source: Company

Swing Factors

Upside

- Better-than-expected volume and ASP growth for key Indonesia poultry segment.
- Turnaround in branded consumer food that has struggled due to competition in the ambient products.
- Improvement in Vietnam swine operations to sustain over VND48-50K/kg ASP over the long run.
- Improvement in raw milk price in China.

Downside

- Outbreak of diseases affecting Japfa's livestock could lead to reduced demand and mandatory culling.
- Unforeseen import restrictions or regulations on tariffs for protein imports by regional markets.
- Volatile or prolonged low market prices for its protein and dairy products due to demand and supply imbalances.
- Execution risks in expansion to new markets and/or facilities.

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FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Key Metrics					
P/E (reported) (x)	37.7	8.2	12.8	7.2	6.1
Core P/E (x)	43.0	6.9	9.8	7.2	6.1
P/BV (x)	1.0	1.3	0.8	0.8	0.7
P/NTA (x)	1.0	1.3	0.8	0.8	0.7
Net dividend yield (%)	1.3	3.7	2.8	2.8	2.8
FCF yield (%)	nm	nm	9.0	7.0	9.0
EV/EBITDA (x)	6.0	5.4	5.6	5.3	5.1
EV/EBIT (x)	9.1	7.0	8.1	7.8	7.4
INCOME STATEMENT (USD m)					
Revenue	3,189.9	3,533.3	3,659.3	3,784.3	3,895.1
Gross profit	574.2	770.3	723.8	751.9	779.7
EBITDA	284.5	446.0	371.8	396.9	413.1
Depreciation	(95.8)	(104.2)	(112.8)	(125.6)	(128.1)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	188.6	341.8	259.0	271.3	285.0
Net interest income /(exp)	(63.2)	(78.3)	(93.7)	(83.1)	(75.6)
Associates & JV	(0.1)	0.1	0.0	0.0	0.0
Exceptionals	(17.0)	(44.3)	(15.5)	0.0	0.0
Other pretax income	20.4	24.4	(1.1)	0.0	0.0
Pretax profit	128.8	243.6	148.8	188.2	209.5
Income tax	(51.3)	(65.4)	(44.4)	(48.9)	(54.5)
Minorities	(54.9)	(77.8)	(52.9)	(47.9)	(46.9)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	22.6	100.4	51.5	91.4	108.1
Core net profit	15.7	144.7	67.1	91.4	108.1
BALANCE SHEET (USD m)					
Cash & Short Term Investments	234.9	168.3	185.6	136.3	77.0
Accounts receivable	179.0	194.4	200.5	207.4	213.4
Inventory	670.6	817.3	841.6	870.4	895.9
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	1,010.9	1,010.1	1,243.8	1,268.2	1,290.1
Intangible assets	10.4	12.1	12.1	12.1	12.1
Investment in Associates & JVs	6.1	5.7	5.7	5.7	5.7
Other assets	631.2	681.3	730.3	784.8	845.5
Total assets	**2,743.1**	**2,889.3**	**3,219.6**	**3,284.8**	**3,339.6**
ST interest bearing debt	317.7	440.2	440.2	440.2	440.2
Accounts payable	623.0	388.8	652.3	673.9	692.3
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	626.5	777.4	777.0	700.0	600.0
Other liabilities	153.0	152.0	152.0	152.0	152.0
Total Liabilities	**1,720.3**	**1,758.9**	**2,022.0**	**1,966.5**	**1,884.9**
Shareholders Equity	693.6	779.4	793.7	866.5	956.0
Minority Interest	329.2	351.0	403.9	451.8	498.7
Total shareholder equity	**1,022.8**	**1,130.4**	**1,197.6**	**1,318.3**	**1,454.7**
Total liabilities and equity	**2,743.1**	**2,889.3**	**3,219.6**	**3,284.8**	**3,339.6**
CASH FLOW (USD m)					
Pretax profit	128.8	243.6	148.8	188.2	209.5
Depreciation & amortisation	95.8	104.2	112.8	125.6	128.1
Adj net interest (income)/exp	63.2	78.3	93.7	83.1	75.6
Change in working capital	(86.0)	(117.7)	184.1	(68.6)	(73.8)
Cash taxes paid	(80.2)	(72.2)	(44.4)	(48.9)	(54.5)
Other operating cash flow	16.8	17.1	0.0	0.0	0.0
Cash flow from operations	73.2	173.5	397.6	193.9	207.9
Capex	(238.3)	(237.2)	(240.0)	(150.0)	(150.0)
Free cash flow	(163.6)	(61.5)	59.0	46.3	59.3
Dividends paid	(12.5)	(6.5)	(37.2)	(18.6)	(18.6)
Equity raised / (purchased)	2.4	(224.2)	0.0	0.0	0.0
Change in Debt	100.8	271.7	(0.4)	(77.0)	(100.0)
Other invest/financing cash flow	(22.6)	(39.8)	(98.6)	2.4	1.4
Effect of exch rate changes	(3.1)	(3.7)	0.0	0.0	0.0
Net cash flow	(100.1)	(66.3)	21.4	(49.3)	(59.3)

FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Key Ratios					
Growth ratios (%)					
Revenue growth	5.2	10.8	3.6	3.4	2.9
EBITDA growth	(27.9)	56.8	(16.6)	6.8	4.1
EBIT growth	(39.4)	81.2	(24.2)	4.7	5.1
Pretax growth	(49.4)	89.2	(38.9)	26.5	11.3
Reported net profit growth	(81.0)	344.6	(48.7)	77.3	18.3
Core net profit growth	(87.9)	821.6	(53.7)	36.3	18.3
Profitability ratios (%)					
EBITDA margin	8.9	12.6	10.2	10.5	10.6
EBIT margin	5.9	9.7	7.1	7.2	7.3
Pretax profit margin	4.0	6.9	4.1	5.0	5.4
Payout ratio	39.2	37.0	36.2	20.4	17.3
DuPont analysis					
Net profit margin (%)	0.7	2.8	1.4	2.4	2.8
Revenue/Assets (x)	1.2	1.2	1.1	1.2	1.2
Assets/Equity (x)	4.0	3.7	4.1	3.8	3.5
ROAE (%)	3.0	13.6	6.6	11.0	11.9
ROAA (%)	0.6	5.1	2.2	2.8	3.3
Liquidity & Efficiency					
Cash conversion cycle	43.8	50.0	57.3	42.3	42.6
Days receivable outstanding	19.2	19.0	19.4	19.4	19.4
Days inventory outstanding	88.3	96.9	101.7	101.6	102.0
Days payables outstanding	63.6	65.9	63.8	78.7	78.9
Dividend cover (x)	2.6	2.7	2.8	4.9	5.8
Current ratio (x)	1.3	1.5	1.2	1.2	1.2
Leverage & Expense Analysis					
Asset/Liability (x)	1.6	1.6	1.6	1.7	1.8
Net gearing (%) (incl perps)	69.4	92.8	86.1	76.2	66.2
Net gearing (%) (excl. perps)	69.4	92.8	86.1	76.2	66.2
Net interest cover (x)	3.0	4.4	2.8	3.3	3.8
Debt/EBITDA (x)	3.3	2.7	3.3	2.9	2.5
Capex/revenue (%)	7.5	6.7	6.6	4.0	3.9
Net debt/ (net cash)	709.3	1,049.3	1,031.6	1,003.9	963.2

Source: Company; Maybank

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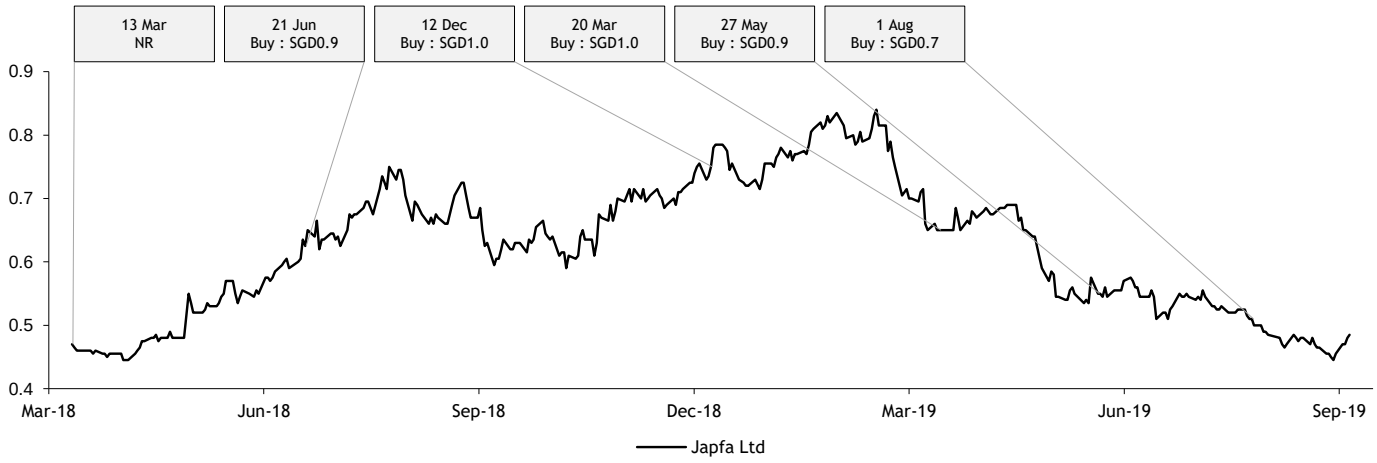

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