

Singapore Company Guide

Japfa Ltd

Edition 1 Version 1 | Bloomberg: JAP SP | Reuters: JAPF.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

28 Oct 2015

BUY

Last Traded Price: S\$0.39 (STI : 3,052.53)

Price Target : S\$0.46 (18% upside)

Potential Catalyst: Better than expected 3Q15 and 4Q15 results

Analyst

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Price Relative



Forecasts and Valuation

FY Dec (US\$ m)	2014A	2015F	2016F	2017F
Revenue	2,947	2,928	3,217	3,590
EBITDA	255	216	308	409
EBITEDA (ex. BA gains)	263	246	319	403
Pre-tax Profit	74	82	172	268
Net Profit	31	36	74	116
Net Pft (Pre Ex.)	71	36	74	116
Net Pft (ex. BA gains)	58	36	74	116
EPS (S cts)	2.5	2.8	5.9	9.1
EPS Pre Ex. (S cts)	5.7	2.8	5.9	9.1
EPS Gth (%)	(91)	14	109	56
EPS Gth Pre Ex (%)	(76)	(50)	109	56
Diluted EPS (S cts)	2.5	2.8	5.9	9.1
Net DPS (S cts)	0.0	0.0	0.0	0.0
BV Per Share (S cts)	52.4	59.0	64.9	74.0
PE (X)	15.8	13.9	6.7	4.3
PE Pre Ex. (X)	6.9	13.9	6.7	4.3
P/Cash Flow (X)	4.0	4.2	3.3	2.1
EV/EBITDA (X)	6.0	7.4	5.6	4.6
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	0.7	0.7	0.6	0.5
ROAE (%)	5.8	5.0	9.5	13.2

Earnings Rev (%)	-	-	-
Consensus EPS (S cts)	-	-	-
Other Broker Recs:	B: 3	S: 0	H: 0

Source of all data: Company, DBS Bank, Bloomberg Finance L.P

NORMALISING GROWTH

Better 3Q15 EBITDA expected. We believe the steep share price correction YTD has more than priced-in Day Old Chicks (DOC) oversupply in Indonesia and softer raw milk prices in China. We expect Japfa's 3Q15 earnings to show a sequential improvement, given higher feed prices and relatively resilient broiler and DOC prices despite steeper translation FX losses from subsidiary Japfa Comfeed's US\$225m bonds. We expect 3Q15 EBITDA to come in between US\$70.9-76.0m (+20-28% y-o-y) and earnings (ex. fair value changes in biological assets) of US\$7.4-10.1m (16-38% lower y-o-y)

Weak purchasing power may linger in the short term.

Continued weakness in the Rupiah would progressively raise Japfa's feedstock costs, and at the same time lift cost of living for Indonesian consumers (implying weaker purchasing power). We expect the DOC oversupply situation to balance out and prices recover as government-mandated nationwide cull of 6m parent stock takes place (expected in 4Q15).

Long term growth potential remains intact. Japfa is forecast to book EBITDA (excluding biological asset gains/loss and FX gains/losses) CAGR of 15% between 2014 and 2017 – mainly driven by higher dairy volumes. Japfa intends to double dairy farm production capacity in China by constructing another five farm hubs in Inner Mongolia. In the Animal Protein segment, we expect Japfa's combined regional DOC output to expand less aggressively by 5% CAGR between 2014 and 2017, given DOC overcapacity and weak purchasing power in Indonesia. Demand will continue to be driven by rising per capita income.

Valuation:

Our SOP-based TP is S\$0.46. We expect reduced contribution from Japfa Comfeed given losses in poultry breeding operations and FX losses. Our BUY rating for the counter is maintained on 15% upside potential.

Key Risks to Our View:

Japfa's share price is driven by DOC, broiler and China raw milk price movements and to a certain extent, by USD/IDR exchange rate. A strong recovery in the group's ASP and/or Rupiah would boost Japfa's share price higher than our fair value, and vice versa.

At A Glance

Issued Capital (m shrs)	1,765
Mkt. Cap (S\$m/US\$m)	691 / 494
Major Shareholders	
Rangi Management (%)	52.6
Morze International (%)	16.0
Tasburgh Ltd (%)	7.2
Free Float (%)	24.2
3m Avg. Daily Val (US\$m)	0.2

ICB Industry : Consumer Goods / Food Producers

CRITICAL DATA POINTS TO WATCH

Earnings Drivers:

DOC capacity expansion in Indonesia. Hampered by oversupply in CY14-15, Japfa’s DOC production in Indonesia is due to fall, due to the government-mandated cull of c.960k Parent Stock (Japfa’s estimated share) by end of CY15. Post-culling, Japfa is expected to expand its Indonesian DOC output in line with GDP and population growth. As at end Jun15, Japfa has DOC capacity of 630m chicks per annum in Indonesia and 736m chicks per annum in total.

Feedmill capacity expansion in Indonesia. Capital expenditure in poultry feedmill capacity is likewise expected to remain on hold until capacity utilisation rates are in excess of 90%. However, we expect continued expansion in fish and shrimp feeds. Volatility of raw material costs (as well as changes in government regulations with regards to importation of raw materials) and exchange rates may adversely affect profitability, if Japfa is unable to pass on cost pressures.

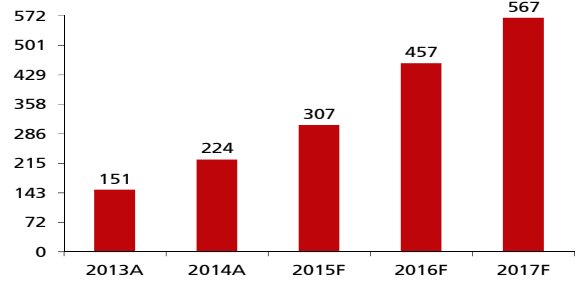
Expansions of Animal protein operations in Vietnam, India and Myanmar. The group is expanding its geographical operations in Vietnam for both poultry and swine segments; swine profitability in Vietnam should improve next year on the back of improved genetics. The group’s Myanmar operations have expanded poultry operations into Mandalay this year; we expect higher earnings vs. last year, following the purchase of the remaining 15% in minority interest earlier this year. Japfa’s operation in India is only marginally increasing its geographical presence, and is expected to expand its feedmill capacity there. Contribution of animal protein operations outside Indonesia is expected to grow at 9% CAGR between CY14 and CY17F – thanks to steady pricing and capacity expansion.

Expansion in dairy farms. The group intends to expand its dairy business in China through continued replication of its successful business model. The fifth farm of the first *five-farm hub* in Shandong province was completed early this year. A second *five-farm hub* is planned for construction between this year and CY18 in Inner Mongolia. Farm 6 in Inner Mongolia is expected to start milking by end of this year, and fully milking a quarter thereafter. When completed, the second hub would increase the group’s herd size in China to 120k heads of cattle by end of CY18. Japfa is also expanding its dairy capacity in Malang, East Java to hold an additional 9,000 heads. Completion is expected by the end of this year.

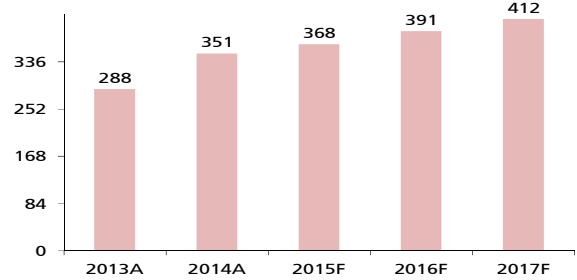
Expansion of beef cattle feedlot. Japfa now has a beef cattle feedlot in Shandong province with production capacity of 10,000 heads per annum. The bull calves produced by Japfa’s five dairy farms in Shandong will be the livestock input into the new beef cattle feedlot in China. In Indonesia, imports of cattle are subject to government approvals and regulations, including quotas.

Further investment in high-growth Consumer Food brands. The group intends to expand its manufacturing and processing capacities in Indonesia and Vietnam, as it seeks to expand the reputation and market reach of its brands, including *Real Good* for UHT milk and *So Good, So Nice* and *Best Chicken* for processed meats.

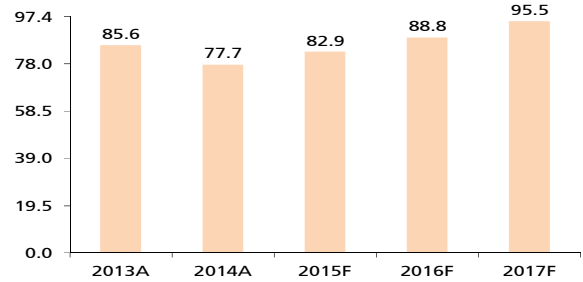
Raw & fresh milk output (k MT)



Broiler sales (mn birds)



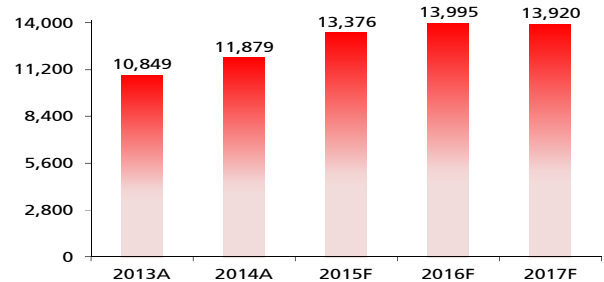
Consumer foods volume (k MT)



China raw milk price (CNY/kg)



Average USD/IDR rate



Source: Company, DBS Bank

Balance Sheet:

Japfa's net debt-to-total equity ratio is forecast to arrive at 70% by end of this year and 68% next year on rising equity. We also assume that the group will refinance its US\$225m bonds (due 2018) with Rp500bn bank borrowings

Share Price Drivers:

DOC oversupply issues. The Indonesian poultry industry is dominated by a few players, which collectively control more than 75% market share. Overinvestment and/or miscalculated demand often lead to depressed DOC and broiler prices on top of an already volatile market. Changes in prices would have instant impact on Japfa's profitability even with cuts in Parent Stock (PS) numbers. Hence, we believe completion of nationwide PS culling would send a positive signal to share prices.

Rupiah movements. Japfa's US\$225m bonds have created translation FX losses in Japfa's subsidiary, Japfa Comfeed, together with Rupiah depreciation YTD. Hence, Rupiah movements would impact reported earnings.

Key Risks:

Outbreak of diseases. Outbreak of diseases affecting livestock would have material effect on the group's business and financial status.

Intense competition. Excess capacity and intense competition in Indonesia may continue to result in DOC oversupply and slower-than expected price growth

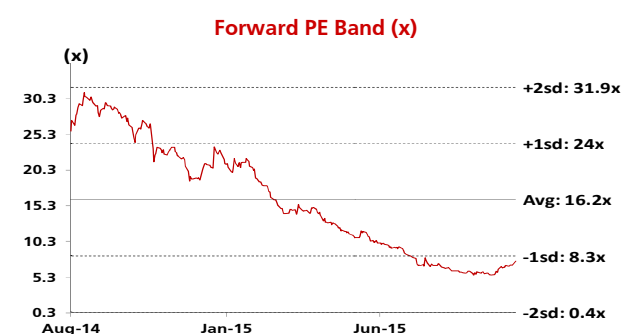
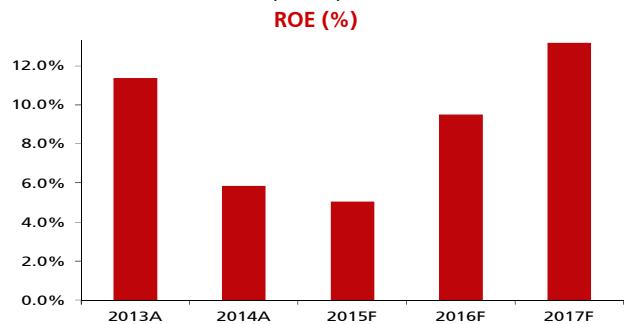
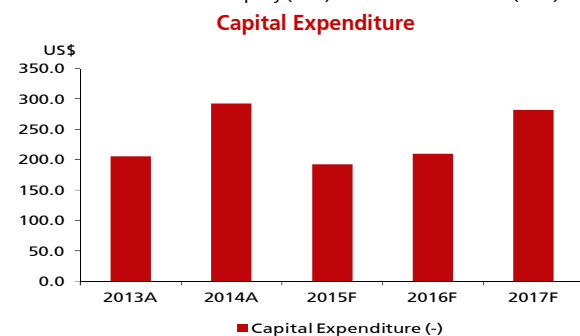
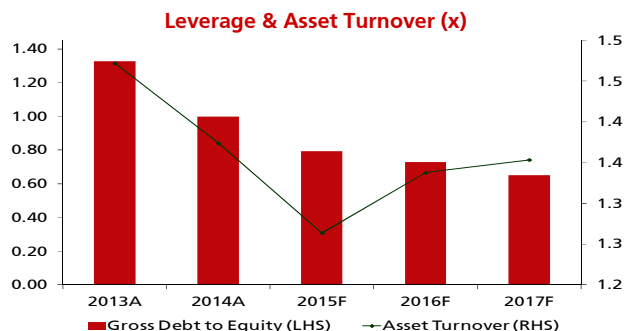
Movements in raw material costs and currencies. Japfa is exposed to volatile movements in raw material costs and currencies. For example, weakness in Rupiah and consumer purchasing power caused delays in passing on raw material costs.

Changes in regulations. Changes in government regulations/licensing/ interventions /price or volume controls may adversely affect Japfa's profitability.

Vulnerable to liquidity and credit risks

COMPANY BACKGROUND

Japfa Limited is a leading industrialised producer of multiple animal proteins, dairy and consumer food products in Asia. The group is involved in production of animal feeds, poultry breeding, poultry commercial farms, beef cattle feedlots, swine breeding, swine commercial farms, dairy farms as well as frozen and ambient temperature consumer food products.



Source: Company, DBS Bank

Key Assumptions

FY Dec	2013A	2014A	2015F	2016F	2017F
Raw & fresh milk output (k)	151	224	307	457	567
Broiler sales (mn birds)	288	351	368	391	412
Consumer foods volume	85.6	77.7	82.9	88.8	95.5
China raw milk price	4.51	4.90	4.40	4.50	4.55
Average USD/IDR rate	10,849	11,879	13,376	13,995	13,920

Segmental Breakdown

FY Dec	2013A	2014A	2015F	2016F	2017F
Revenues (US\$ m)					
Dairy	122	224	268	417	536
Animal protein	2,347	2,513	2,461	2,590	2,821
Consumer foods	228	211	200	210	234
Total	2,697	2,947	2,928	3,217	3,590
EBITDA (US\$ m)					
Dairy	39	70	71	128	182
Animal protein	207	184	167	182	212
Consumer foods	11	9	9	9	10
Total	257	263	246	319	403
EBITDA Margins (%)					
Dairy	32.0	31.5	26.3	30.7	33.9
Animal protein	8.8	7.3	6.8	7.0	7.5
Consumer foods	4.8	4.3	4.4	4.3	4.1
Total	9.5	8.9	8.4	9.9	11.2

Income Statement (US\$ m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Revenue	2,697	2,947	2,928	3,217	3,590
Cost of Goods Sold	(2,198)	(2,441)	(2,433)	(2,629)	(2,887)
Gross Profit	499	506	495	588	703
Other Opng (Exp)/Inc	(297)	(315)	(315)	(338)	(371)
Operating Profit	202	191	180	250	332
Other Non Opng (Exp)/Inc	(29)	2	(30)	(10)	6
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(64)	(79)	(68)	(68)	(71)
Exceptional Gain/(Loss)	6	(40)	0	0	0
Pre-tax Profit	115	74	82	172	268
Tax	(33)	(15)	(16)	(34)	(54)
Minority Interest	(40)	(28)	(30)	(63)	(99)
Preference Dividend	0	0	0	0	0
Net Profit	42	31	36	74	116
Net Profit before Except.	43	58	36	74	116
Net Pft (ex. BA gains)	43	58	36	74	116
EBITDA	227	255	216	308	409
EBITDA (ex. BA gains)	257	263	246	319	403
Growth					
Revenue Gth (%)	16.2	9.3	(0.7)	9.9	11.6
EBITDA Gth (%)	(3.8)	12.3	(15.3)	42.6	32.8
Opg Profit Gth (%)	5.4	(5.1)	(6.0)	39.1	32.6
Net Profit Gth (%)	(21.5)	(25.3)	13.7	109.2	55.5
Margins & Ratio					
Gross Margins (%)	18.5	17.2	16.9	18.3	19.6
Opg Profit Margin (%)	7.5	6.5	6.1	7.8	9.3
Net Profit Margin (%)	1.5	1.1	1.2	2.3	3.2
ROAE (%)	11.4	5.8	5.0	9.5	13.2
ROA (%)	2.3	1.5	1.5	3.1	4.4
ROCE (%)	9.1	8.1	6.9	9.3	11.2
Div Payout Ratio (%)	0.0	0.0	0.0	0.0	0.0
Net Interest Cover (x)	3.2	2.4	2.6	3.7	4.7

Source: Company, DBS Bank

Quarterly / Interim Income Statement (US\$ m)

FY Dec	2Q2014	3Q2014	4Q2014	1Q2015	2Q2015
Revenue	767	785	705	676	704
Cost of Goods Sold	(626)	(661)	(580)	(568)	(582)
Gross Profit	141	123	126	107	122
Other Oper. (Exp)/Inc	(74)	(80)	(79)	(76)	(78)
Operating Profit	67	43	47	31	44
Other Non Opg (Exp)/Inc	4	(3)	(7)	(13)	(5)
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(20)	(21)	(20)	(17)	(18)
Exceptional Gain/(Loss)	(6)	(2)	(35)	7	(18)
Pre-tax Profit	45	17	(15)	9	3
Tax	(6)	(2)	(1)	(4)	(2)
Minority Interest	(18)	(4)	3	2	2
Net Profit	21	11	(14)	7	3
Net profit bef Except.	27	13	21	0	20
EBITDA	94	59	61	50	63

Growth

Revenue Gth (%)	11.2	2.3	(10.1)	(4.2)	4.2
EBITDA Gth (%)	85.1	(36.7)	3.3	(17.7)	25.8
Opg Profit Gth (%)	92.0	(34.8)	7.4	(32.6)	40.2
Net Profit Gth (%)	53.0	(48.2)	nm	nm	(57.6)

Margins

Gross Margins (%)	18.4	15.7	17.8	15.9	17.3
Opg Profit Margins (%)	8.7	5.5	6.6	4.7	6.3
Net Profit Margins (%)	2.7	1.4	(2.0)	1.0	0.4

Balance Sheet (US\$ m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Net Fixed Assets	653	834	886	950	1,080
Invt in Associates & JVs	0	0	0	0	0
Other LT Assets	275	310	409	509	594
Cash & ST Invt	225	287	140	102	91
Inventory	543	598	539	568	608
Debtors	135	151	142	152	165
Other Current Assets	133	148	191	223	264
Total Assets	1,964	2,327	2,307	2,503	2,802
ST Debt	457	486	422	521	643
Creditor	195	233	213	236	266
Other Current Liab	65	16	17	27	37
LT Debt	469	507	457	386	310
Other LT Liabilities	81	91	90	88	86
Shareholder's Equity	406	662	745	819	935
Minority Interests	291	332	363	426	525
Total Cap. & Liab.	1,964	2,327	2,307	2,503	2,802
Non-Cash Wkg. Capital	550	648	641	679	733
Net Cash/(Debt)	(701)	(706)	(739)	(805)	(861)
Debtors Turn (avg days)	18.1	17.7	18.2	16.6	16.1
Creditors Turn (avg days)	27.9	32.9	34.4	32.1	32.6
Inventory Turn (avg days)	87.7	87.5	87.7	78.9	76.2
Asset Turnover (x)	1.5	1.4	1.3	1.3	1.4
Current Ratio (x)	1.4	1.6	1.5	1.3	1.2
Quick Ratio (x)	0.5	0.6	0.4	0.3	0.3
Net Debt/Equity (X)	1.0	0.7	0.7	0.6	0.6
Net Debt/Equity ex MI (X)	1.7	1.1	1.0	1.0	0.9
Capex to Debt (%)	22.2	29.5	21.9	23.1	29.6
Z-Score (X)	2.1	2.2	2.1	2.2	2.2

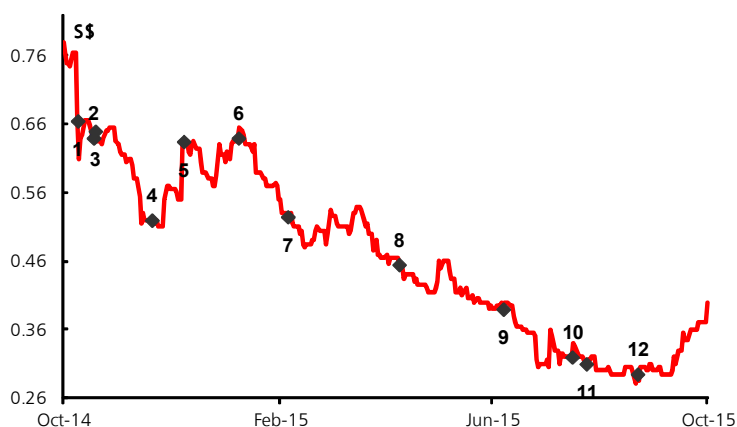
Source: Company, DBS Bank

Cash Flow Statement (US\$ m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Pre-Tax Profit	115	74	82	172	268
Dep. & Amort.	55	62	66	68	71
Tax Paid	(33)	(38)	(16)	(34)	(54)
Assoc. & JV Inc/(loss)	0	0	0	0	0
Chg in Wkg.Cap.	(80)	(88)	(31)	(78)	(83)
Other Operating CF	0	0	0	0	0
Net Operating CF	89	125	116	149	230
Capital Exp.(net)	(206)	(293)	(193)	(210)	(282)
Other Invts.(net)	0	0	0	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	1	(6)	(3)	(3)	(3)
Net Investing CF	(205)	(299)	(195)	(212)	(285)
Div Paid	(9)	(4)	0	0	0
Chg in Gross Debt	125	68	(113)	27	46
Capital Issues	131	198	48	0	0
Other Financing CF	(63)	(27)	(2)	(2)	(2)
Net Financing CF	183	235	(68)	25	44
Currency Adjustments	0	0	0	0	0
Chg in Cash	68	62	(147)	(38)	(10)
Opg CFPS (US cts.)	80.8	12.1	8.3	12.9	17.8
Free CFPS (US cts.)	(55.7)	(9.5)	(4.3)	(3.4)	(2.9)

Source: Company, DBS Bank

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date	Closing Price	Target Price	Rating
1:	03 Nov 14	0.67	1.16	BUY
2:	12 Nov 14	0.64	1.00	BUY
3:	13 Nov 14	0.65	1.00	BUY
4:	15 Dec 14	0.52	0.80	BUY
5:	02 Jan 15	0.64	0.80	BUY
6:	02 Feb 15	0.64	0.80	BUY
7:	02 Mar 15	0.53	0.76	BUY
8:	04 May 15	0.46	0.54	HOLD
9:	02 Jul 15	0.39	0.46	HOLD
10:	10 Aug 15	0.32	0.46	BUY
11:	18 Aug 15	0.31	0.46	BUY
12:	16 Sep 15	0.30	0.46	BUY

Source: DBS Bank

DBS Bank recommendations are based on Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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