

# Japfa Ltd

## Growing Appetite for Animal Protein

SINGAPORE | CONSUMER | NON-RATED NOTE

26 October 2015

We attended an analyst site visit in Vietnam last week, an opportunity for us to understand the transformation of Japfa as it expands outside its primary market in Indonesia.

Throughout the trip, the CEO and CFO of Japfa, as well as the General Managers of the Vietnam, Myanmar and India operations, have shared with us some of their market insights and technical knowledge in relation to their operations.

After visited its Xuan Tay Swine Farm (Dong Nai), Binh Thuan Feedmill (Binh Thuan) and Poultry Breeding PS Farm (near Binh Thuan), we are positive on the company's prospect. Below are the key takeaways from the site visit.

### Key trends and development in the India and Indochina markets

- **India's dietary shift: More meat on Generation Z's palate.** There is a notable trend where more young Indians are more open to non-vegetarianism. Demand for chicken could surge once the age group matures into working adults (with own spending power).
- **Vietnam's turnaround story: Spelling porcine profit.** Pork is the most popular meat consumed by Vietnamese households, followed by poultry.
- **Myanmar's more room to grow: Opportunities behind Myanmar's open door.** Tapping into a country that is just opening up gives Japfa first-mover advantage – Japfa will be prepared to absorb the demand for more animal protein as Myanmar has a higher disposable income amidst urbanization.

### Preparation for the sector's further expansion

- Capitalizing on its:
  - i) knowledge about local consumers behavior (effectively combining quality with local tastes, seasonality for inventory planning, etc.); and
  - ii) experience on farm management and the technical know-how, Japfa could identify the cash cows in respective markets, then focus to grow the identified cash cows by replicating its business model (within the country or cross border).
- Japfa increases its market share via technology advancement and educating farmers or prospective clients.
- **India: Investing in feedmills while preparing Day-Old Chick (DOC)**
  - i) There is potential demand for quality DOC in the market as livestock's breeding environment in India is relatively more challenging as compared to the other markets (due to its lack of infrastructure, disease challenges and subpar genetics).
  - ii) While conducting R&D to improve the DOC genetics, the animal feed businesses will remain the core earnings driver. The new mills and hatchery will be coming online in the next 1-2 years' time, providing room for the company to prepare a more disease resistant DOC. The ultimate goal is to replicate its Indonesia business model in India.

### Non-rated

LAST TRADED PRICE	SGD 0.375
FORECAST DIV	N/A
TARGET PRICE	N/A
TOTAL RETURN	N/A

### COMPANY DATA

O/S SHARES (MN) :	1765
MARKET CAP (USD mn / SGD mn) :	469 / 653
52 - WK HI/LO (SGD) :	0.79 / 0.28
3M Average Daily T/O (mn) :	0.68

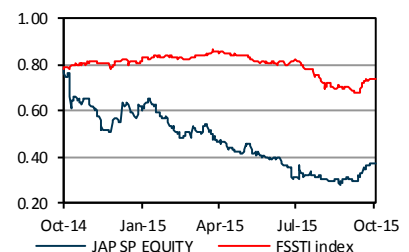
### MAJOR SHAREHOLDERS (%)

Rangi Management Limited	52.61%
Morze International Limited	16.01%
Tasburgh Limited	7.18%

### PRICE PERFORMANCE (%)

	1M TH	3M TH	1YR
COMPANY	23.3	17.5	(50.7)
STI RETURN	5.04	(8.99)	(2.35)

### PRICE VS. STI



Source: Bloomberg, P SR

### KEY FINANCIALS

RM MN	FY 11	FY 12	FY 13	FY 14
Revenue	2,030	2,322	2,697	2,947
EBITDA	174	242	262	259
NPAT (adj.)	44	53	42	31
EPS (USD)	0.03	0.04	0.03	0.02
PER, x (adj.)				21.1
P/BV, x				1.1
DPS (USD)			-	-
ROE, %		18.0%	11.4%	5.8%

Source: Bloomberg

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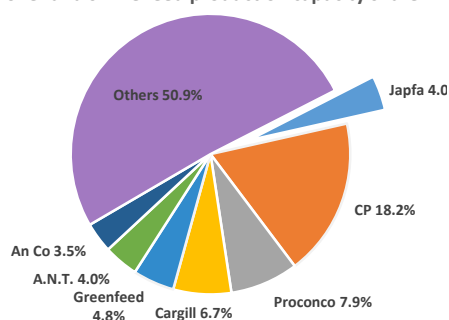
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➤ **Vietnam: Focusing on swine while regaining lost ground on poultry market**

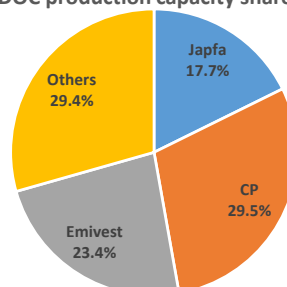
- i) Emivest Vietnam Co, its closer competitor in Vietnam, has the second-largest share in the poultry market. This was mainly due to its aggressive expansion during weak poultry prices in 2012 to 2013, while Japfa took a defensive stand by reducing production then. Nonetheless, the management intends to start picking up on its poultry business.
- ii) Poultry pricing is expected to remain competitive amid strong competition from both domestic and external suppliers (mainly from the U.S. imported frozen poultry). However, Vietnamese's preference for fresh meat consumption provide certain protection to domestic production.
- iii) Meanwhile, swine business turned around from an operating loss of US\$2.2 mn in 2QFY14 to a profit of US\$8.0 mn in 2QFY15, through improvements in productivity. Vietnamese preference on swine will continue to support the swine business and somewhat mitigate the margin pressure from poultry.

**VN: 2014 Markets share and position**

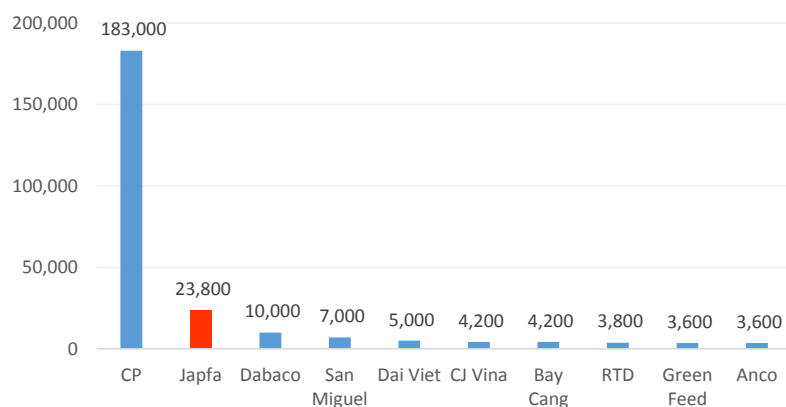
Broiler and swine feed production capacity share



DOC production capacity share



Swine Parent Stock Population (Top 10 Players)



Source: Company, Phillip Securities Research (Singapore)

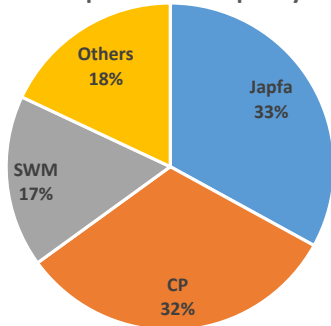
➤ **Myanmar: Converting its broiler feed buyers to DOC buyers**

- i) The broiler feed customers serves as a pool of potential DOC takers. In view of its high market penetration in the broiler feed market, Japfa has a potential upside in the DOC market.
- ii) The company intends to invest in a parent stock farm in Yangon to support the potential demand and boost its market share up to one-third of total DOC breeding market.
- iii) Meanwhile, in view of its strong position in the animal feed market, the

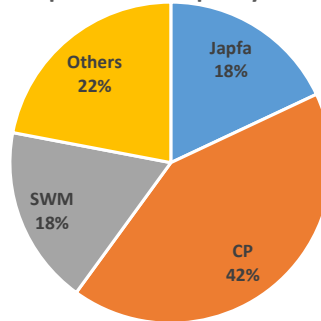
Company will continue to grow the cash cow by expanding feedmills in both Mandalay and Yangon.

**MM: 2014 Markets share and position**

Broiler feed production capacity share



DOC production capacity share



Source: Company, Phillip Securities Research (Singapore)

**Diversified business model across products and countries cushioned sluggish prices**

- **Indonesia.** Oversupply of DOC and broiler chickens, weakness in IDR, and lower purchasing power of Indonesians. Since 4Q14, the Group has been reducing CAPEX and scaling back on DOC production.

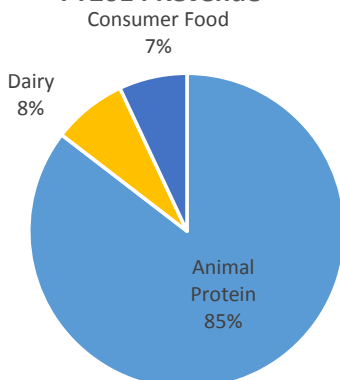


Source: Bloomberg, Phillip Securities Research (Singapore)

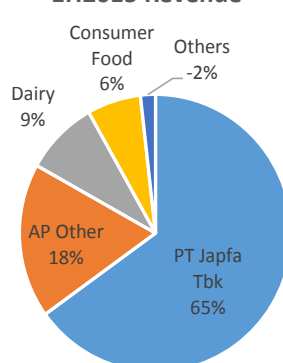
- **China.** Slowdown in China drags on raw milk prices in China, and the Group expects it to remain sluggish in near term. Average raw milk prices declined %y-y, but sales in volume and milk yields improved

**Diversified business model**

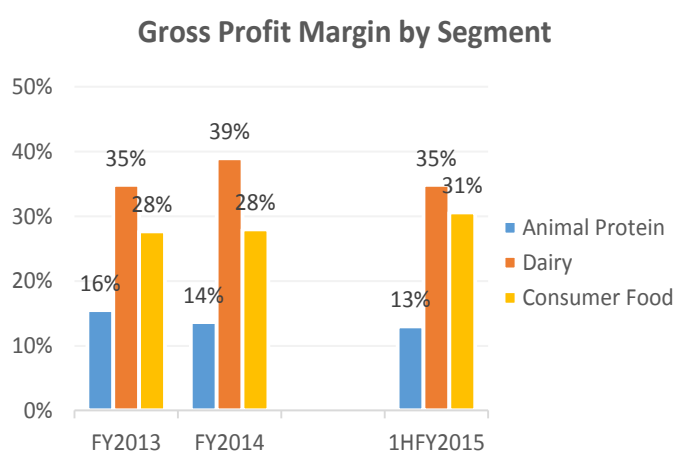
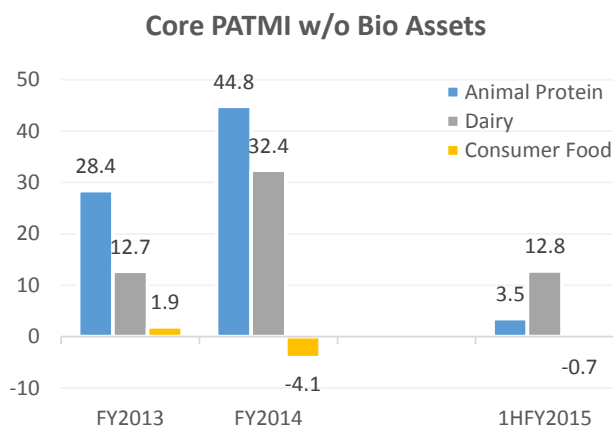
FY2014 Revenue



1H2015 Revenue



Source: Company, Phillip Securities Research (Singapore)



Source: Company, Phillip Securities Research (Singapore)

## Cutting costs, enhancing efficiency, improving yields and productivity

### ➤ Feedmills:

- i) **R&D to focus on quality.** Despite the Feed Conversion Rates (FCRs) differ slightly in each market (due to different management, environment, source of raw materials) According to the management, it has achieved an average FCR of 1.6-1.6x for its premium poultry feed, as compared to that of competitors' ~1.8x of its competitors'. This allows Japfa to charge a premium price over its competitors'. It will continue to focus on improving its feed quality.
- ii) **Availability of raw materials locally.** Locally sourced raw materials (e.g. soybean and corn available in India, and corn in Myanmar), will help the company to cushion against FX and supply shock.

### ➤ Farming: Moving towards semi modern farming.

The company is implementing energy and manpower costs savings initiatives, such as:

- i) Improving the design specifications of new farms (e.g. automation in feeding, remote monitor and control on room temperature, etc.), particularly in North Vietnam; and
- ii) Introducing bio-digesters in the swine breeding farms.

## Feedmills, Poultry and Swine Operations & Facilities Outside of Indonesia

Country	Animal Protein Segment	Principal Facilities	Annual Capacity	Locations
India	Animal Feedmills	6 Feedmills	336,000 MT	<b>Owned:</b> Supa, Kondamadugu, Kharagpur, Vaishali <b>Rental:</b> Siliguri, Ranchi
	Poultry	1 Parent Stock Breeding Farm	150,000 birds	Maharashtra
		2 Hatcheries		Maharashtra, Telangana
		8 Commercial Broiler branches	10 million	Maharashtra (5), Karnataka (1), Telangana (2)
		Over 400 Contract Farms		
		1 Diagnostic Lab		
<b>Upcoming</b>				
	Animal Feedmills	2 Poultry Feedmills		Bihar (Expects to commission on 1Q16) Uttar Pradesh (In the midst of acquiring land)
		1 Aqua Feedmill in West Bengal (Target to venture into this segment in 2016)		
		Cattle Feedmill (Long term target)		
	Poultry	1 Hatchery		Maharashtra (Expects to commission on 4Q15)
		1 Animal Health Lab		Maharashtra
Vietnam	Animal Feedmills	5 Swine & Poultry Feedmills	900,000 Ton	Huong Canh, Hoa Binh, Thai Binh, Long An, Binh Thuan
	Swine	1 Great Grandparent Stock Farm	700 heads	Binh Phuoc
		5 Grandparent Stock Farms	6,000 heads	Binh Thuan, Binh Duong, Vung Tau, Hoa Binh
		16 Parent Stock Farms	28,500 heads	Hoa Binh, Vinh Phuoc, Bac Giang, Vung Tau, Dong Nai, Xuan Loc, Binh Duong
		3 Nursery Farms & over 50 Contract Farms	300,000 heads	Across Vietnam
		12 Fattening Farms & over 80 Contract Farms		
	Poultry	10 Breeding Farms	517,000 Parent Stock	Phu Tho, Vinh Phuc, Thai Binh, Binh Thuan, Dong Nai, Binh Phuoc
		4 Hatcheries		
		Commercial Farms (Over 30 Company Farms & over 230 Contract Farms)	52 million birds	Across Vietnam with more than 300 partnership farms
		1 Slaughterhouse	2.9 million birds	Hop Chau
<b>Upcoming</b>				
	Swine	Grandparent farms and artificial insemination centres To introduce bio-digesters to generate power for own use		
Myanmar	Animal Feedmills	2 Poultry Feedmills	210,000 MT	Yangon, Mandalay
	Poultry	2 Breeding Farms	280,500 Parent Stock Female	Yangon
		2 Hatcheries		
		Commercial Farms (Company Farms & about 100 Contract Farms)	2.82 million birds	Yangon, Mawlamying, Pyay, Pakokku, Naypyitaw, Meiktila, Mandalay
	<b>Upcoming</b>			
	Poultry	Expand feedmills in Mandalay and Yangon Invest in a parent stock farm in Yangon		

## Peer Comparison Table

Company	Bloomberg Ticker	Mkt Cap (SGD mn)	EV (SGD mn)	EV/EBITDA TTM	EV/EBITDA FY1	EV/EBITDA FY2	P/E FY1	P/E FY2	P/E FY1	P/E FY2	Best PEG FY1	Net D/E (%)	ROA (%)	ROE (%)	P/B
JAPFA LTD	JAP SP	652.9	2,127.3	6.9	7.2	5.1	13.5	13.3	6.3	N/A	71.5	1.5	5.8	0.7	
<b>Singapore</b>															
CHINA FISHERY GROUP LTD	CFG SP	361.0	1,485.7	9.4	4.9	4.4	5.0	4.7	3.5	N/A	89.6	1.1	2.2	0.2	
<b>Hong Kong</b>															
CP POKPHAND CO LTD	43 HK	4,154.5	5,595.7	10.0	7.9	6.9	12.9	11.3	11.3	0.9	48.3	8.8	24.9	2.9	
<b>Japan</b>															
CHUBU SHIRYO CO LTD	2053 JP	386.3	490.5	5.7	N/A	N/A	13.8	15.2	14.8	N/A	27.8	3.2	5.6	0.7	
FEED ONE CO LTD	2060 JP	331.2	678.2	12.0	N/A	N/A	11.7	N/A	N/A	N/A	114.2	N/A	N/A	1.1	
SHOWA SANGYO CO LTD	2004 JP	877.6	1,314.6	8.7	N/A	N/A	15.5	13.3	12.4	N/A	50.3	3.0	7.4	1.1	
<b>Average</b>				8.8	N/A	N/A	13.7	14.2	13.6	N/A	N/A	3.1	6.5	1.0	
<b>Korea</b>															
FARMSCO	036580 KS	752.4	948.4	18.5	14.3	10.6	49.6	21.6	11.6	0.3	65.4	1.8	4.6	2.2	
DAEHAN FLOUR MILLS CO LTD	001130 KS	423.2	324.4	2.5	N/A	N/A	9.3	N/A	N/A	N/A	Net Cash	4.1	6.0	0.6	
EASY BIO INC	035810 KS	450.0	1,459.8	10.5	N/A	N/A	10.8	N/A	N/A	N/A	207.1	2.1	12.9	1.4	
<b>Average</b>				10.5	14.3	10.6	23.2	21.6	11.6	0.3	136.3	2.7	7.9	1.4	
<b>Taiwan</b>															
GREAT WALL ENTERPRISES	1210 TT	636.4	1,232.8	13.5	24.4	20.6	18.2	20.0	18.4	N/A	39.8	1.9	5.7	1.0	
<b>Australia</b>															
RIDLEY CORP LTD	RIC AU	387.3	445.3	7.5	7.7	7.0	18.1	15.6	12.9	N/A	16.5	4.3	8.5	1.7	
<b>Simple Average (Excl. SSG)</b>				9.8	11.8	9.9	16.5	14.5	12.1	0.6	73.2	3.4	8.6	1.3	

Source: Bloomberg, Phillip Securities Research (Singapore) Estimates

## SWOT Analysis

### Strength:

- Vertically integrated business across entire value chain
  - enable Japfa to extract value via direct dealing with the farmers, customer or consumer
  - complement its other business arm
  - food safety assurance as products are traceable across the entire supply chain
  - well diversified portfolio, across protein segments and geographies strengthened its operational resilience
- Capacity to scale up and reap efficiency gains from economies of scale
- Strong brand name and distribution network induced growing market share
- Able to pass on raw material cost increases to customers

### Opportunities:

- Government's support to build sustainable locally based food and agricultural systems and limit reliance on imports
- Urbanization/ growing urban population, and increasing purchasing power
- Protein consumption is still low in the emerging markets
- Change in food consumption patterns and trends
- Rising health awareness (e.g. drinking milk products, which are perceived to be healthy, benefited from this growing awareness, particularly among mid- to higher-income consumers)
- Ongoing technology advancement to improve productivity and yield
- Trade policies and Trans Pacific Partnership (TPP) will open up Export to neighboring markets with similar diets
- Development of modern retailing and fridge penetration helps boost sales

### Weakness:

- Lack of infrastructure in these countries
- Demand affected by religion and seasonality (festive seasons, especially religious festivals)

### Threats:

- Intensified competition landscape from rivals and substitutes (e.g. more convenient dietary supplements to replace milk for daily calcium intake)

## Key Risks

- Oversupply of DOC in Indonesia
- Change in climate affecting growth of livestock
- Natural hazard causing supply chain / infrastructure disruption
- Costs of animal feed ingredients
- Disease
- Food scare
- Change in food consumption patterns and trends
- Macro-economic performance of the countries it operates in
- Foreign exchange risk
- Government red tapes and policies
- WTO's trade policies, export/import tariff/quota

## Investment Actions

No stock rating or price target provided, as we do not have coverage on Japfa Ltd.

**A Peek Into the Xuan Tay Swine Farm (Dong Nai)**

**Figure 1. Entrance to the Swine Farm**



Source: Company, Phillip Securities Research (Singapore)

**Figure 2. Clean and well-maintained pig-shed**



Source: Company, Phillip Securities Research (Singapore)

**Figure 3. Thermometer to monitor the temperature**



Source: Company, Phillip Securities Research (Singapore)

**Figure 4. Fans to regulate air temperature**



Source: Company, Phillip Securities Research (Singapore)

**Figure 5. Breeding mount used to collect semen from boars**



Source: Company, Phillip Securities Research (Singapore)

**Figure 6. Layout of Farrowing house**



Source: Company, Phillip Securities Research (Singapore)

**Figure 7. A sow suckling her piglets**



Source: Company, Phillip Securities Research (Singapore)

### A Trip to the Binh Thuan Feedmill and Poultry Breeding PS Farm

**Figure 8. In-house vaccine stored in a refrigerator**



Source: Company, Phillip Securities Research (Singapore)

**Figure 9. Broiler chickens in poultry house**



Source: Company, Phillip Securities Research (Singapore)



**Figure 10. Hen in her nesting box**



Source: Company, Phillip Securities Research (Singapore)

**Figure 11. Hatching eggs stored in the cooling room after selection and waiting to be transferred to hatchery**



Source: Company, Phillip Securities Research (Singapore)

**Figure 12. Packing of raw materials**



Source: Company, Phillip Securities Research (Singapore)

**Figure 13. Raw material: Soy bean powder**



Source: Company, Phillip Securities Research (Singapore)

**Figure 14. Machineries**



Source: Company, Phillip Securities Research (Singapore)

**Figure 15. Control room**



Source: Company, Phillip Securities Research (Singapore)

**Figure 16. Final product to ship out**



Source: Company, Phillip Securities Research (Singapore)

**Figure 17. Loading bay**



Source: Company, Phillip Securities Research (Singapore)

**Figure 18. Feed samples with various customisation**



Source: Company, Phillip Securities Research (Singapore)

**Figure 19. Quality check**



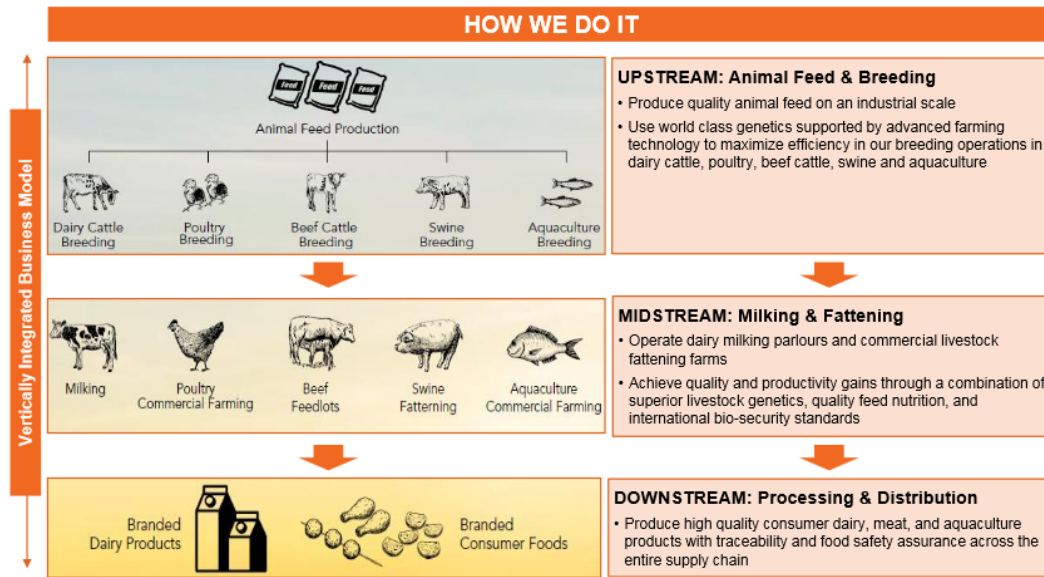
Source: Company, Phillip Securities Research (Singapore)

## Company Background

Japfa Ltd. (“Japfa”) is a leading pan-Asian industrial agri-food company, with an integrated network of modern farming, processing and distribution facilities in Indonesia, China, Vietnam, India and Myanmar. It specializes in producing quality dairy, multiple protein staples (poultry, beef, swine & aquaculture) and packaged food.

## Business Model

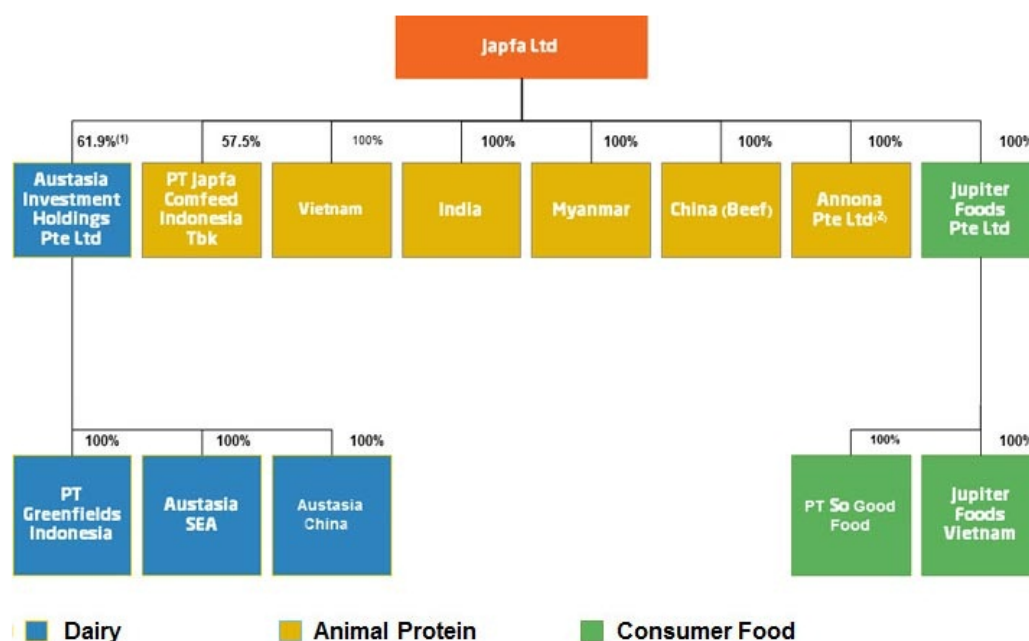
### Vertically Integrated Business Across Entire Value Chain



Source: Company

## Corporate Governance

### Group Structure



Note:

(1) The Group also owns options that are likely to be exercisable before Aug 2018 (at a cost of US\$15.2 million) that will increase our interest in AIH to 68%.

(2) The Group procures raw materials for its feed production segment from international suppliers via Annona Pte Ltd.

(3) This diagram is for illustrative purpose only.

Source: Company

#### Board of Directors

Goh Geok Khim	Non-Executive Independent Chairman	Joined the Board since 30 June 2014
Handojo Santosa @ Kang Kiem Han	Executive Deputy Chairman	Joined the Group since 1986
Hendrick Kolonas	Non-Executive Non-Independent Director	Joined the Group since 2012
Tan Yong Nang	Executive Director and Chief Executive Officer	Joined the Group since 2007
Kevin John Monteiro	Executive Director and Chief Financial Officer	Joined the Group since 1999
Ng Quek Peng	Independent Director	Joined the Board since 29 July 2014
Lien Siaou-Sze	Independent Director	Joined the Board since 29 July 2014
Liu Chee Ming	Independent Director	Joined the Board since 29 July 2014

Source: Company

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