

Japfa Ltd (JAP SP)

Consumer Non-cyclical - Food & Beverage Products

Market Cap: USD459m

Not Rated

Target Price:

NA

Price:

SGD0.36

Building a Credible Regional Agri-business

Macro

Risks

Growth

Value



Source: Bloomberg

Avg Turnover (SGD/USD)	0.21m/0.15m				
Cons. Upside (%)	38.9				
Upside (%)	NA				
52-wk Price low/high (SGD)	0.28 - 0.78				
Free float (%)	15				
Share outstanding (m)	1,765				
Shareholders (%)					
Rangi Management Ltd	52.6				
Morze International Ltd	16.0				
Tasburgh Ltd	7.2				
Share Performance (%)					
	YTD	1m	3m	6m	12m
Absolute	(34.6)	18.0	1.4	(28.0)	(50.7)
Relative	(24.5)	13.0	11.2	(13.8)	(46.2)

We attended a company-organised analyst plant trip in Vietnam last week. This gave us the opportunity to observe first-hand Japfa's growing poultry, swine and feedmill business in its second-largest market after Indonesia. We also met up with country managers from Myanmar and India, who shared the Japfa's progress in building up an integrated and credible regional agri-business.

- ◆ **More than just Indonesia.** Japfa owns 57.5% of Japfa Comfeed Indonesia (JPFA IJ, SELL, TP: IDR370), the vehicle for all its Indonesian operations. While the latter still accounted for 66% of 1H15 group revenue, management has been actively building up Japfa's businesses in other growth markets – ie India, Vietnam, Myanmar and China – and products, ie swine, dairy and consumer food. We also met with most of its other country managers based outside Indonesia during our trip.
- ◆ **Growing swine business.** We visited the Dong Nai Swine Farm on the outskirts of Ho Chi Minh City, which is one of Japfa's 16 parent stock farms in Vietnam. This is a relatively newer business for the company, but is fast growing on the back of a fragmented market share. With the existing infrastructure of its grandparent/great-grandparent stock, there is potential for Japfa to double its current annual capacity of 300,000 heads. It can also replicate this model in its other markets in the future.
- ◆ **Feedmill and poultry farms.** We also visited Japfa's poultry breeding farm in Binh Thuan and its adjacent feedmill plant. The company is now the third-largest player for day-old-chick (DOC) production in Vietnam, with an annual capacity of 52m DOCs. The feedmill industry is expected to consolidate, with more than 50% of the market still held by small-scale players. We estimate Vietnam as a market currently accounting for around 15-20% of Japfa's profitability.
- ◆ **Near-term challenges in Indonesia.** Due to weak demand and over-capacity, Japfa's main market – Indonesia – posted a loss. This resulted in group core net profit declining by 13.6% YoY to USD14.3m. Its performance in other markets has been strong though, with core net profit growing to USD16.9m (from USD3.7m) in the same period. We believe Japfa has leadership positions in enduring businesses in the long term. However, short-term profitability may suffer from cyclical over-capacity. Annualising its 1H15 core net profit indicates that the stock is trading at 14x P/E.

Forecasts and Valuations	Dec-11	Dec-12	Dec-13	Dec-14
Total turnover (USDm)	2,030	2,322	2,697	2,947
Reported net profit (USDm)	79	110	81	59
Recurring net profit (USDm)	79	110	81	59
Recurring net profit growth (%)	0.0	38.9	(26.3)	(27.3)
Recurring EPS (USD)	0.05	0.07	0.06	0.04
Recurring P/E (x)	4.84	3.48	4.73	6.50
P/B (x)	0.21	0.16	0.13	0.08
P/CF (x)	na	na	7.30	7.88
EV/EBITDA (x)	28.6	31.4	34.7	31.7
Return on average equity (%)	0.0	37.3	22.1	11.1
Net debt to equity (%)	79.1	115.7	108.0	71.0
Our vs consensus EPS (adjusted) (%)				

James Koh +65 6232 3839

james.koh@rhbgroup.com

A Visit To Dong Nai Swine Farm

The growing swine business in Vietnam. The swine business in Vietnam is dominated by the Charoen Pokphand Group (CP), which has – by far – the largest number of swine parent stock. In Vietnam, pork is an important source of protein, accounting for more than 70% of per capita meat consumption in the country. Over the past few years, Japfa has been building up this business, and is now the second-largest player in a fragmented space (outside of CP). With 700 great-grandparent stock, Japfa has the existing infrastructure to ramp up its capacity of 300,000 heads pa. Compared to poultry, the swine business is growing faster and management may seek to replicate this business in other markets. This business just turned profitable in 2Q15.

Visited a parent stock swine farm. In this business, Japfa imports pure-line (great grandparent) pigs and cross breeds them to produce suitable offspring for commercial pig production. We visited the Dong Nai Swine Farm on the outskirts of Ho Chi Minh City, which is a parent stock swine farm. At the farm, semen is extracted every week from male pigs. The males are separated from the females. These females are then inseminated with semen and, in turn, give birth to offspring that are used for commercial growing at another farm.

Figure 1: Male pigs kept in separate cages



Source: RHB

Figure 2: Female swine kept in separate cages with their litter



Source: RHB

Figure 3: Male swine can grow as big as 200kg



Source: RHB

Figure 4: A litter feeding on swine milk



Source: RHB

Visit To Binh Thuan Poultry Farm/Feedmill

Stable poultry business in Vietnam. Japfa is now the third-largest player for DOC production in Vietnam, with an annual capacity of 52m DOCs. Chicken meat is a distant second to pork in terms of per capita consumption in Vietnam. Furthermore, the preference is for coloured chicken (64% of the poultry market) rather than broiler variants. The upside for this business is likely to come from the growing number of fast-food restaurants. Japfa is an integrated player, ie it is involved in the production of DOCs and commercial live chickens. The company has an annual capacity of 2.9m birds.

Visited a parent stock chicken farm. At the parent stock farm, both roosters and hens are kept in the same compound, and are allowed to mate at a ratio of one rooster to 11 hens. The hens lay eggs that are then collected daily. These eggs are subsequently kept in an air-conditioned room. After checking for defects, the eggs are allowed to hatch into DOCs that have to be delivered to Japfa's customers. This business, therefore, requires a strong distribution network given the time-criticalness of it all. After a cycle of 65 weeks, the chickens used for laying DOCs are culled and sold as processed chicken.

Figure 5: Parent stock chickens used to lay eggs for DOC



Source: RHB

Figure 6: Eggs kept in controlled temperature



Source: RHB

Feedmill visit. We visited one out of five of Japfa's feedmills in Vietnam, which together have a total annual capacity of 900,000 tonnes. The company has a 4% market share of the feedmill business in Vietnam, which is very fragmented – the Top 3 players control less than 43% of the market. More than 90% of Japfa's output is used for external customers. The company procures raw materials (corn and soy meal are the main ones) from local or international sources – depending on prices – and produces the most efficient feed based on its internal formulation. Feedmill is customised for different livestock at varying stages of their lives. It is also customised by grade.

Figure 7: Storage tanks at the feedmill plant



Source: RHB

Figure 8: Finished products



Source: RHB

Figure 9: Samples of different feeds



Source: RHB

Figure 10: Manufacturing processes are well-monitored



Source: RHB

Presence In Myanmar And India

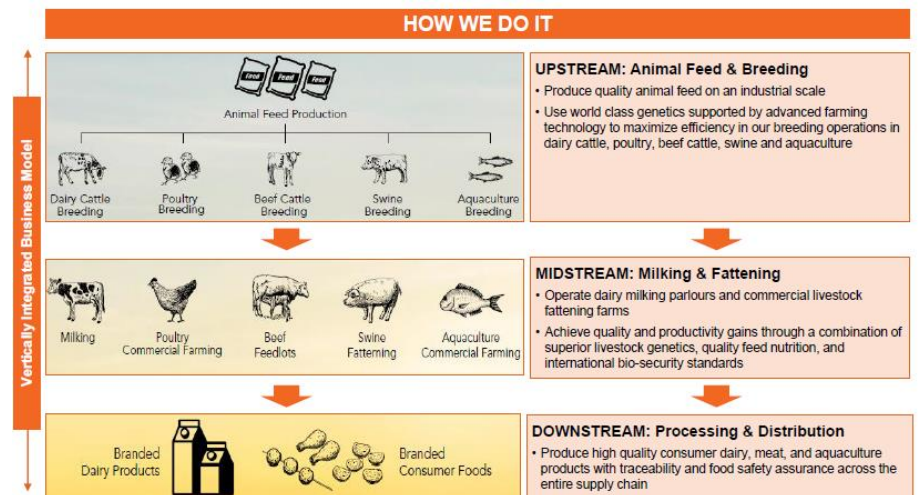
Strong no. 2 in Myanmar. Japfa has managed to build up a leadership position over a relatively short span of a few years in Myanmar. It is now the second-largest player for broilers, DOCs and animal feed. This has been achieved by breaking through into the premium market, and building a reputable and recognisable animal feed brand. We estimate Myanmar accounts for less than 10% of group profit currently, but has strong potential to grow.

India is still a small contributor. Per capita consumption of chicken is only 3kg pa, which is largely due to eating habits. This is still a relatively small business for Japfa, which is present in eight states. However, the business is expected to grow quickly as the company scales up. Japfa is already a market leader (excluding production for internal uses in other companies) in these states and currently has six feedmills with a total capacity of 336,000 tonnes.

Company Overview

Tapping into the burgeoning Asian consumer market. With businesses in five fast-growing Asian countries, Japfa is involved in the farming, processing and distribution of multiple classes of protein foods. Key products include milk, poultry and beef. These mainly cater to the middle- and lower-income consumer groups in the region. Japfa's latest figures – with revenue breakdown by segments – reflects the continued reliance on animal protein as the core sales driver of the company, with services comprising animal feed manufacturing, breeding and commercial farming.

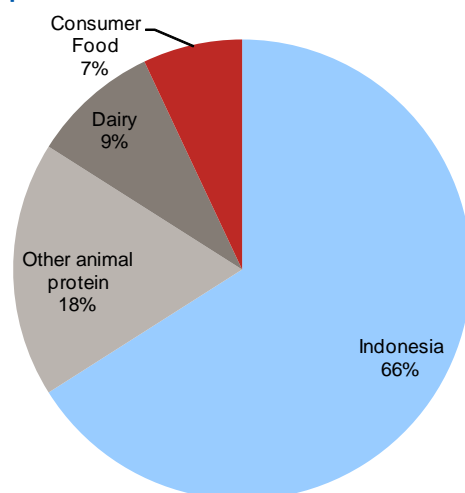
Figure 11: Japfa's business model



Source: Company

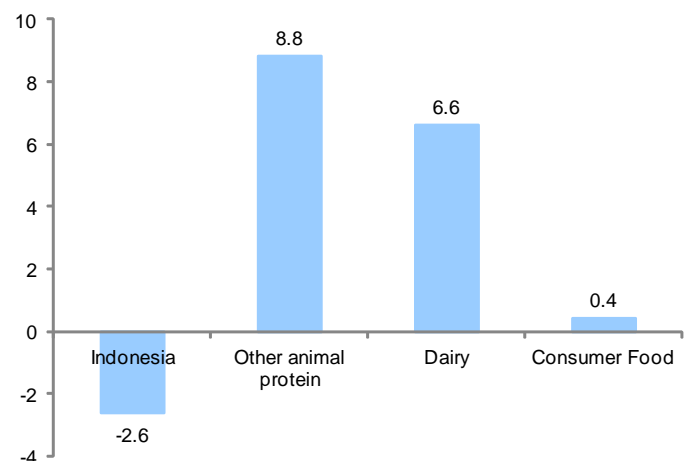
Strategic geographical network and presence. Leveraging on its market leader position in Indonesia, Japfa has extended its network regionally, with the newest entry into frontier markets like Myanmar. Although India and China are still only a small percentage of total revenue, the mass consumer markets in both countries are likely to provide ample headroom to grow, even with slower growth. The high urbanisation rate and demand for poultry staples in these economies is likely to provide healthy demand for Japfa's products. Moreover, this regional footprint provides strong upstream channels while allowing the company to continue building up its processing and distribution downstream capabilities.

Figure 12: Japfa's 2Q15 revenue breakdown



Source: Company data, RHB

Figure 13: Japfa's 2Q15 core profit breakdown



Source: Company data, RHB

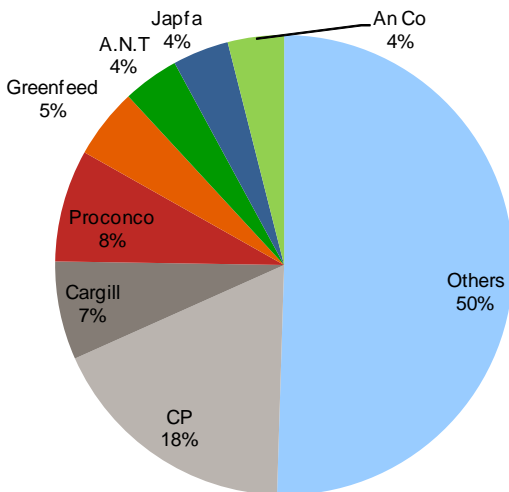
Replication of vertically-integrated business model. Capturing the entire value chain of diversified products is one of the key strategies Japfa employs to remain competitive and resilient across countries. Building on the success of the business model in Indonesia, the company has been ramping up efforts in expanding to developing economies through highly-standardised production facilities. Currently, Japfa is well-positioned to exploit the entire agri-food chain by actively seeking upstream, middle-stream and downstream activities. This would not only avoid the vulnerability of supply chain operations, but also enables a stable and secure source of food products.

Figure 7: Japfa’s products and services

Animal Protein	Dairy	Consumer food
Feed manufacturing	Dairy farming	Ready-to-eat
Breeding	Milk processing	Ready-to-cook
Commercial farming	Distribution	Manufacturing, sales and distribution
Feedlotting		Consumer marketing
Processing		
Swine fattening		

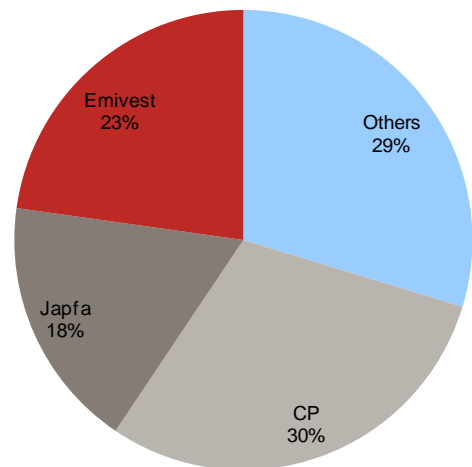
Source: RHB

Figure 85: Vietnam broiler and swine feed market share



Source: Company data

Figure 96: DOC production capacity share



Source: Company data

Financial Exhibits

Profit & Loss (USDm)	Dec-11	Dec-12	Dec-13	Dec-14
Total turnover	2,030	2,322	2,697	2,947
Cost of sales	(1,663)	(1,874)	(2,198)	(2,441)
Gross profit	367	448	499	506
Gen & admin expenses	(147)	(174)	(202)	(208)
Selling expenses	(85)	(83)	(95)	(107)
Other operating costs	(4)	(6)	(33)	(12)
Operating profit	131	186	169	180
Operating EBITDA	167	229	224	243
Depreciation of fixed assets	(35)	(42)	(53)	(62)
Amortisation of intangible assets	(1)	(1)	(1)	(1)
Operating EBIT	131	186	169	180
Other recurring income	22	14	10	(27)
Interest income	3	6	3	3
Interest expense	(42)	(57)	(67)	(82)
Pre-tax profit	114	149	115	74
Taxation	(35)	(38)	(33)	(15)
Profit after tax & minorities	79	110	81	59
Reported net profit	79	110	81	59
Recurring net profit	79	110	81	59

Source: Company data, RHB

Cash flow (USDm)	Dec-11	Dec-12	Dec-13	Dec-14
Operating profit	131	186	169	180
Depreciation & amortisation	36	43	55	63
Change in working capital	(144)	(163)	(53)	(91)
Other operating cash flow	16	8	(20)	14
Operating cash flow	39	73	151	166
Interest received	3	6	3	3
Interest paid	(42)	(57)	(67)	(82)
Tax paid	(59)	(45)	(35)	(38)
Cash flow from operations	(59)	(23)	53	49
Capex	(140)	(202)	(207)	(250)
Other new investments	(0)	(2)	(42)	(21)
Other investing cash flow	(11)	(44)	1	(30)
Cash flow from investing activities	(151)	(248)	(248)	(301)
Proceeds from issue of shares	-	-	77	176
Increase in debt	-	131	328	145
Other financing cash flow	256	147	(150)	(7)
Cash flow from financing activities	256	278	255	315
Cash at beginning of period	104	150	157	225
Total cash generated	46	7	59	62
Forex effects	-	-	8	(0)
Implied cash at end of period	150	157	225	287

Source: Company data, RHB

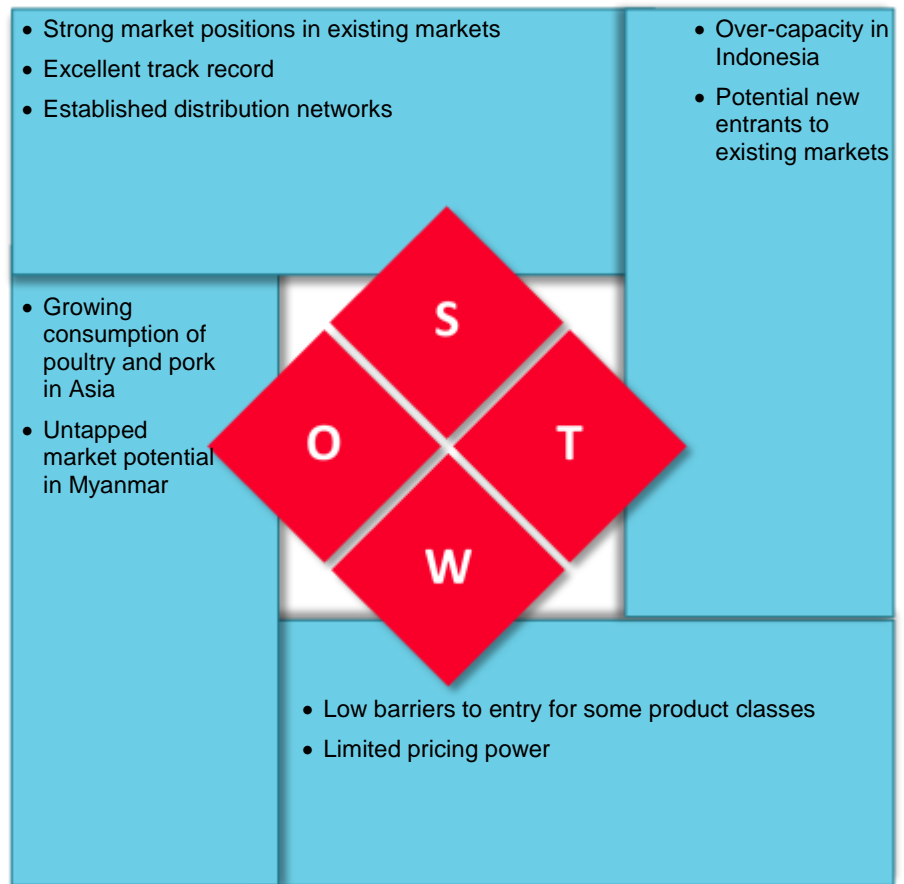
Financial Exhibits

Balance Sheet (USDm)	Dec-11	Dec-12	Dec-13	Dec-14
Total cash and equivalents	150	157	225	287
Inventories	332	487	543	598
Accounts receivable	113	134	135	151
Other current assets	99	124	133	148
Total current assets	694	902	1,036	1,184
Total investments	4	3	2	6
Tangible fixed assets	404	600	653	834
Intangible assets	92	170	248	270
Total other assets	26	27	25	34
Total non-current assets	526	799	928	1,143
Total assets	1,220	1,701	1,964	2,327
Short-term debt	379	547	509	486
Accounts payable	88	132	190	233
Other current liabilities	16	20	18	16
Total current liabilities	483	699	717	734
Total long-term debt	164	304	469	507
Other liabilities	78	98	81	91
Total non-current liabilities	241	402	549	598
Total liabilities	724	1,101	1,267	1,333
Share capital	86	86	163	938
Retained earnings reserve	125	172	215	239
Other reserves	51	71	28	(514)
Shareholders' equity	263	330	406	662
Minority interests	233	270	291	332
Total equity	496	600	697	994
Total liabilities & equity	1,220	1,701	1,964	2,327

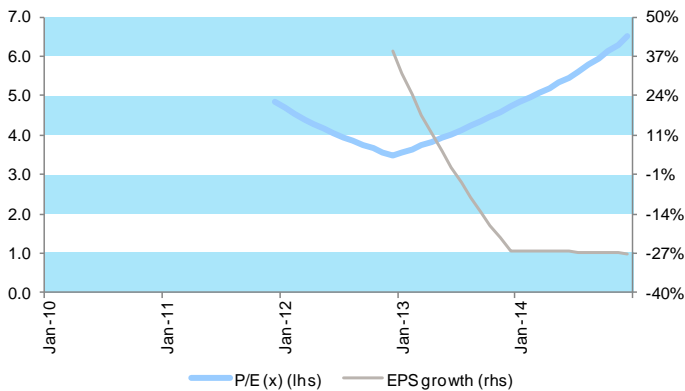
Source: Company data, RHB

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SWOT Analysis

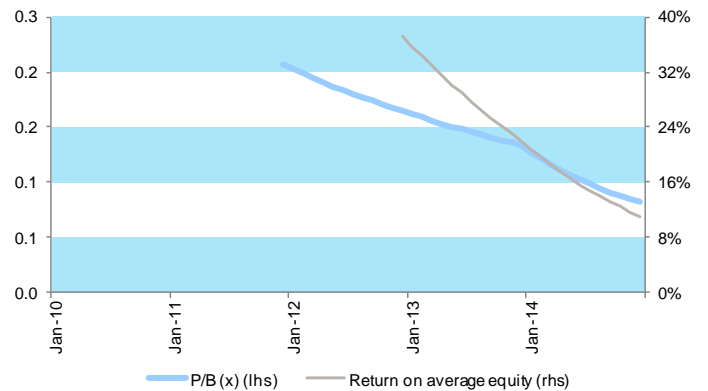


P/E (x) vs EPS growth



Source: Company data, RHB

P/BV (x) vs ROAE

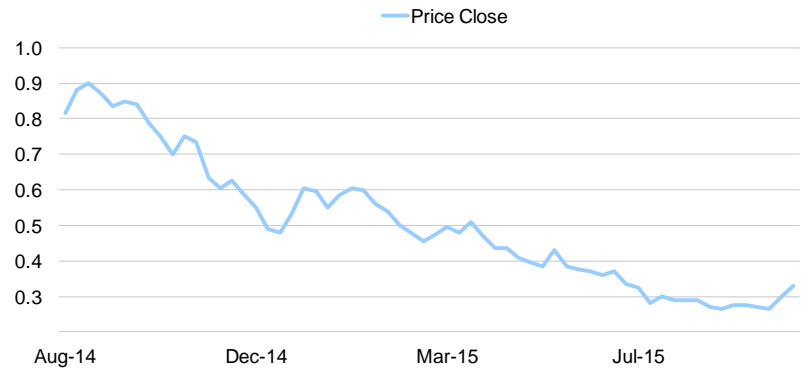


Source: Company data, RHB

Company Profile

Japfa is involved in the farming, processing and distribution of multiple classes of protein foods. Key products include milk, poultry and beef, which mainly cater to the middle- and lower-income consumer groups in the region.

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2015-10-19			

Source: RHB, Bloomberg

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Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

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Kuala Lumpur

RHB Research Institute Sdn Bhd
Level 11, Tower One, RHB Centre
Jalan Tun Razak
Kuala Lumpur
Malaysia
Tel : +(60) 3 9280 2185
Fax : +(60) 3 9284 8693

Hong Kong

RHB OSK Securities Hong Kong Ltd.
12th Floor
World-Wide House
19 Des Voeux Road
Central, Hong Kong
Tel : +(852) 2525 1118
Fax : +(852) 2810 0908

Singapore

**RHB Research Institute Singapore
Pte Ltd (formerly known as DMG & Partners Research
Pte Ltd)**
10 Collyer Quay
#09-08 Ocean Financial Centre
Singapore 049315
Tel : +(65) 6533 1818
Fax : +(65) 6532 6211

Jakarta

PT RHB OSK Securities Indonesia
Wisma Mulia, 20th Floor
Jl. Jend. Gatot Subroto No. 42
Jakarta 12710, Indonesia
Tel : +(6221) 2783 0888
Fax : +(6221) 2783 0777

Shanghai

RHB OSK (China) Investment Advisory Co. Ltd.
Suite 4005, CITIC Square
1168 Nanjing West Road
Shanghai 20041
China
Tel : +(8621) 6288 9611
Fax : +(8621) 6288 9633

Phnom Penh

RHB OSK Indochina Securities Limited
No. 1-3, Street 271
Sangkat Toeuk Thla, Khan Sen Sok
Phnom Penh
Cambodia
Tel: +(855) 23 969 161
Fax: +(855) 23 969 171

Bangkok

RHB OSK Securities (Thailand) PCL
10th Floor, Sathorn Square Office Tower
98, North Sathorn Road, Silom
Bangrak, Bangkok 10500
Thailand
Tel: +(66) 2 862 9999
Fax : +(66) 2 862 9799