



GUAN CHONG

(GUAN MK EQUITY, GUAN.KL)

25 Aug 2021

*EBITDA yields to improve***BUY**

(Maintained)

AmInvestment Bank

www.amequities.com.my

03-2036 2290

Rationale for report: Company update

Price **RM2.83**
 Fair Value **RM3.12**
 52-week High/Low **RM3.79/RM2.44**

Key Changes

Fair value ⇕
 EPS ⇕

YE to Dec	FY20	FY21F	FY22F	FY23F
Revenue (RM mil)	3,685.0	3,589.2	4,200.2	4,425.2
Core net profit (RM mil)	211.9	123.9	259.6	292.1
FD Core EPS (sen)	17.0	9.9	20.8	23.4
FD Core EPS growth (%)	1.9	(41.5)	109.5	12.5
Consensus Net Profit (RM mil)	-	166.8	266.5	283.0
DPS (sen)	3.5	2.3	4.2	4.7
PE (x)	16.7	28.5	13.6	12.1
EV/EBITDA (x)	11.7	15.6	10.0	9.1
Div yield (%)	1.2	0.8	1.5	1.7
ROE (%)	20.8	10.0	20.1	22.2
Net Gearing (%)	87.9	62.9	83.8	83.8

Stock and Financial Data

Shares Outstanding (million) 1,079.0
 Market Cap (RM mil) 3,053.6
 Book Value (RM/share) 1.10
 P/BV (x) 2.6
 ROE (%) 20.8
 Net Gearing (%) 87.9

Major Shareholders
 Guan Chong Resources (50.5%)
 Misi Galakan (5.8%)
 Tay Hoe Lian (5.6%)

Free Float 227.9
 Avg Daily Value (RM mil) 0.8

Price performance	3mth	6mth	12mth
Absolute (%)	2.9	7.6	(23.5)
Relative (%)	5.6	10.6	(20.8)



— GUAN MK — FBMKLCI Index

Investment Highlights

- We maintain our BUY call on Guan Chong (GCB) with an unchanged fair value of RM3.12/share, using an unchanged PER of 15x FY22F EPS. There is no ESG-related price adjustment for our rating of 3 stars.

- We expect GCB to show better results in 2HFY21, underpinned by improved EBITDA yields and production tonnage as its combined ratio is boosted by recovering chocolate demand. In the long term, we are optimistic on the group's Ivory Coast, UK and Germany expansions capability to enter more lucrative western markets.

- Here are some key takeaways from the results briefing held yesterday:

1. For the second consecutive quarter, total sales tonnage continued falling, this time by 11.8% QoQ (though it rose +1.3% YoY). This is despite a 100% utilisation rate and the group reaching its highest ever production tonnage of 64K MT (Exhibit 1).

The group expects sales to improve by 2HFY21 contingent on demand recovery and an improvement in the freight situation, though we foresee the Delta variant slowing down the process.

2. Cocoa butter contributions fell by 12.2% QoQ in 2QFY21, as premium chocolate demand in western continents remains weak. While demand has already been slipping for quite some time, even the resilient cocoa solids sales fell by 13.7% QoQ in 2QFY21. GCB believes that heavy freight costs (a portion of which is usually borne by customers) push potential buyers to seek out regional alternatives that are more competitively priced.

Roughly 70% of cocoa butter volumes are shipped to Europe, the USA and Africa while 30% of cocoa solids are shipped to these regions.

3. On a more positive note, GCB's combined ratio (relative to cocoa bean price) has gradually improved over the course of the quarters. While the still-weak butter ratio saw improvements in 2QFY21, cocoa solid ratios have experienced a steady albeit slow growth over the last two years. A factor to this is that cocoa solids, being shipped primarily to Asian regions, are less affected by freight disruptions.

We expect EBITDA yields to improve in the coming quarters as combined ratio continues to rise, though unstable freight and input costs continue could offset potential gains in the near term (Exhibit 1). The current yield (excluding SHC contributions) stands at RM1,006.8/MT (+9% QoQ, -28%YoY).

- The group's Schokinag (SHC) facility's revenue contribution dipped by 6% QoQ in 2QFY21 (base effects make YoY comparisons more favourable). SHC is subject to cyclical earnings, with 1Q of the year experiencing better sales. It contributed to 24% of total revenue. EBITDA contribution is still lumpy due to fluctuating raw material costs not matching with production chocolate ASP, as SHC maintains a very low inventory stock.

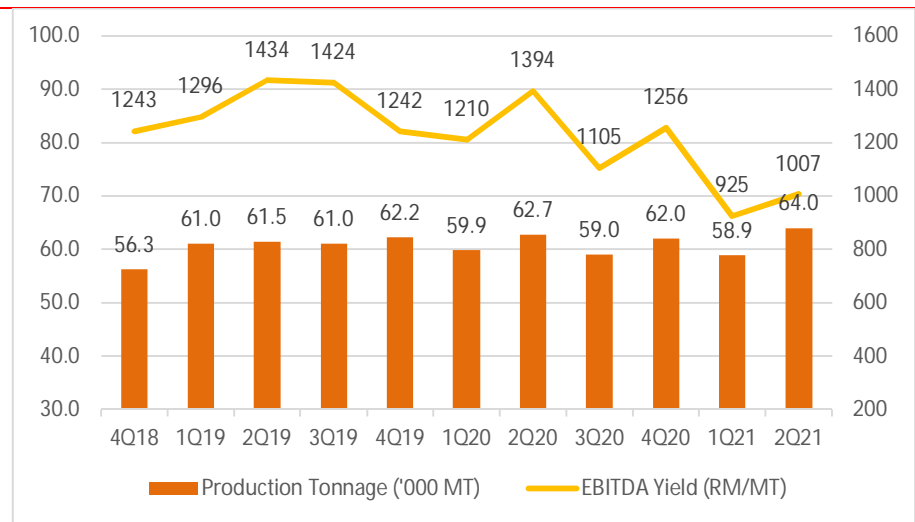
We can look forward to more consistent earnings as global demand in raw materials begin to stabilise and as the group improves operational and profitability efficiency with pandemic restrictions are gradually relaxed.

- About 75% of GCB's workers in Malaysia have been administered with the first dose of the Covid-19 vaccine, with 95% expected to be fully vaccinated by the end of September. About 95% of factory workers in Indonesia have been fully vaccinated. While production shutdowns and workforce restrictions will cut into utilisation rate in the next quarter, we believe that no major hiccups will occur following a 95% vaccination rate.
- We remain extremely optimistic on the group's UK, Germany and Ivory Coast expansion plans despite continual delays plaguing development (Exhibit 3). Chocolate with a +30% EBITDA yield premium over operations in Asia can be generated in these facilities. Aside from selling directly to confectionary manufacturers, the Ivory Coast facility has the additional benefit of internal production for SHC and future UK and Germany facilities

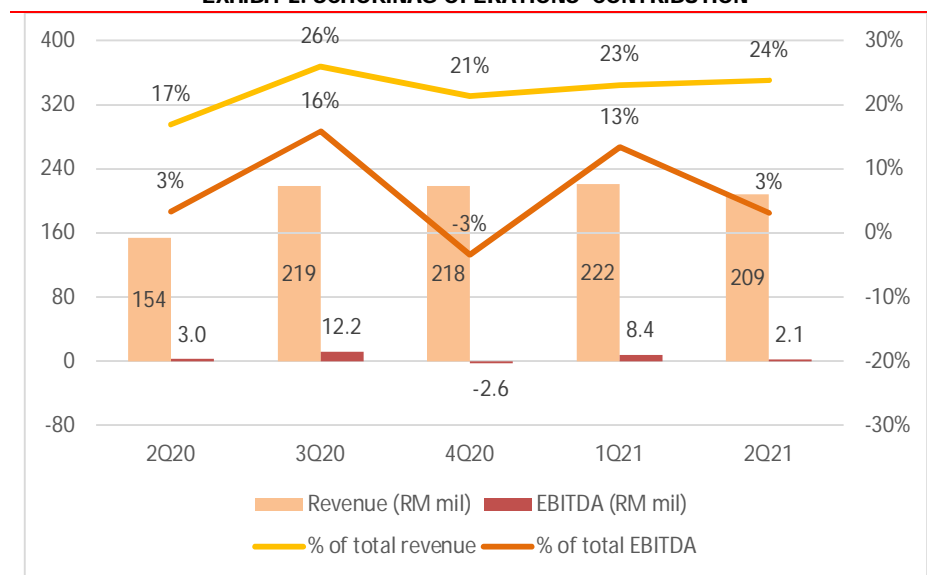
This provides a crucial opportunity for the group to penetrate the lucrative European and US markets, which have higher premium chocolate consumption than in Asia. The primary concern is commissioning date as there is risk that the pandemic would delay the commissioning date.

- As the group continues to widen its reach in western markets, rising ESG concerns by large customers prompt the group to shift toward more sustainable methods of sourcing. Via its Ivory Coast plant, GCB will be partnering with the Rainforest Alliance, focusing on traceability, lifting the living conditions of farmers and stamping out child labour issues. While these procedures may require resources, customers are happy to bear the brunt of costs.

EXHIBIT 1: PRODUCTION METRICS



Source: Guan Chong, AmInvestment Bank Bhd

EXHIBIT 2: SCHOKINAG OPERATIONS' CONTRIBUTION

Source: Guan Chong, AmInvestment Bank Bhd

EXHIBIT 3: FUTURE EXPANSION PLANS

Facility	Est. Capex	Commission date	Details
Ivory Coast	€50–60mil	2H22	60,000 MT grinding facility in first phase
UK	£1 mil	2H22	Liquid industrial chocolate line Value-added capacity line
Germany	€8mil confirmed so far	Line upgrade: 1H22	Bean and cake grinding Liquor and butter-melting Deodorising facilities

Source: Guan Chong, AmInvestment Bank Bhd

EXHIBIT 4: PB BAND CHART

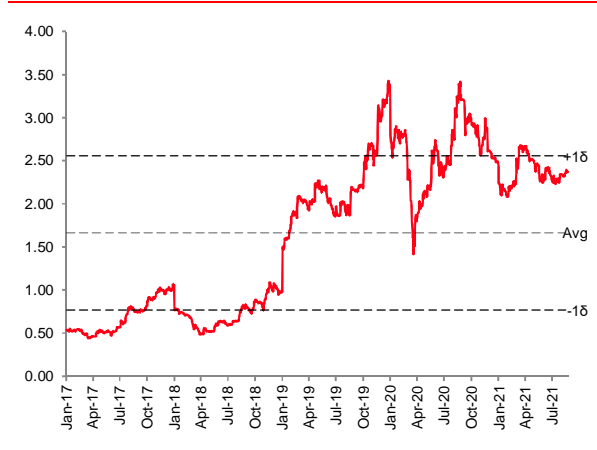


EXHIBIT 5: PE BAND CHART

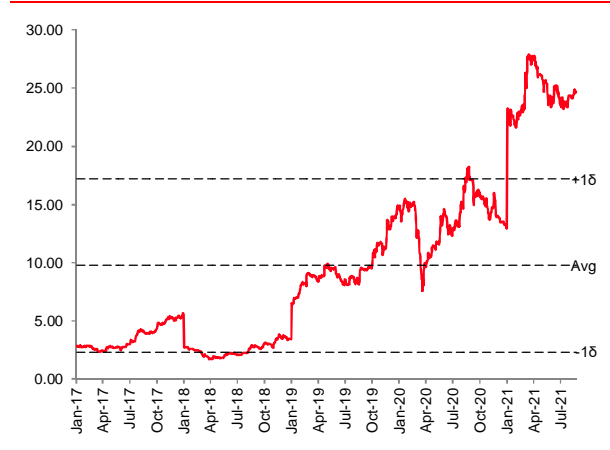


EXHIBIT 6: ESG MATRIX

Overall	★	★	★		
Biological preservation	★	★			
Water + energy conservation	★	★	★		
Pollution + waste regulation	★	★	★		
Sustainable sourcing	★				
Occupational safety + health	★	★	★		
Workplace diversity	★	★	★	★	
Employee training + wellbeing	★	★			
Volunteering + charitable giving	★	★	★		
Corruption-free pledge	★	★	★		
Accessibility & transparency	★	★	★	★	

We accord a discount/premium of -6%, -3%, 0%, +3% and +6% on fundamental fair value based on the overall ESG rating as appraised by us, from 1-star to 5-stars

Source: AmInvestment Bank Bhd

EXHIBIT 7: FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	FY19	FY20	FY21F	FY22F	FY23F
Revenue	2,941.6	3,685.0	3,589.2	4,200.2	4,425.2
EBITDA	332.1	349.1	248.2	412.7	459.1
Depreciation/Amortisation	(33.1)	(56.5)	(58.2)	(63.0)	(67.7)
Operating income (EBIT)	299.0	292.6	190.0	349.8	391.4
Other income & associates	1.4	0.3	-	-	-
Net interest	(33.5)	(25.6)	(40.7)	(40.7)	(43.7)
Exceptional items	(10.0)	(10.8)	-	-	-
Pretax profit	266.8	267.3	149.3	309.0	347.7
Taxation	(48.9)	(44.6)	(25.4)	(49.4)	(55.6)
Minorities/pref dividends	-	-	-	-	-
Net profit	217.9	222.7	123.9	259.6	292.1
Core net profit	207.9	211.9	123.9	259.6	292.1
Balance Sheet (RMmil, YE 31 Dec)	FY19	FY20	FY21F	FY22F	FY23F
Fixed assets	481.7	834.8	879.2	942.4	980.9
Intangible assets	12.0	93.2	93.2	93.2	93.2
Other long-term assets	41.1	37.0	21.1	21.1	21.1
Total non-current assets	534.7	964.9	993.5	1,056.7	1,095.2
Cash & equivalent	46.8	78.2	239.0	212.8	277.8
Stock	1,035.1	1,302.1	1,286.7	1,485.4	1,554.3
Trade debtors	412.3	509.1	495.8	580.3	611.3
Other current assets	12.8	60.8	60.8	60.8	60.8
Total current assets	1,507.1	1,950.2	2,082.4	2,339.4	2,504.3
Trade creditors	325.2	364.2	359.9	415.5	434.7
Short-term borrowings	637.2	694.8	619.8	569.8	669.8
Other current liabilities	35.8	111.0	251.9	245.6	288.2
Total current liabilities	998.2	1,169.9	1,231.6	1,230.9	1,392.7
Long-term borrowings	45.5	428.9	428.9	728.9	728.9
Other long-term liabilities	48.4	127.3	127.3	127.3	127.3
Total long-term liabilities	93.9	556.3	556.3	856.3	856.3
Shareholders' funds	949.6	1,188.9	1,288.0	1,296.1	1,337.7
Minority interests	-	-	-	-	-
BV/share (RM)	0.91	1.10	1.19	1.04	1.07
Cash Flow (RMmil, YE 31 Dec)	FY19	FY20	FY21F	FY22F	FY23F
Pretax profit	266.8	267.3	149.3	309.0	347.7
Depreciation/Amortisation	33.1	56.5	58.2	63.0	67.7
Net change in working capital	(362.7)	(251.9)	24.3	(227.5)	(80.7)
Others	(30.9)	(69.6)	(135.7)	(169.2)	(384.8)
Cash flow from operations	(93.7)	2.3	96.1	(24.7)	(50.1)
Capital expenditure	(64.4)	(212.5)	(100.0)	(120.0)	(100.0)
Net investments & sale of fixed assets	-	-	-	-	-
Others	2.3	(108.8)	-	-	-
Cash flow from investing	(62.1)	(321.2)	(100.0)	(120.0)	(100.0)
Debt raised/(repaid)	90.5	331.3	175.0	150.0	250.0
Equity raised/(repaid)	92.5	42.8	-	-	-
Dividends paid	(34.0)	(20.4)	(24.8)	(51.9)	(58.4)
Others	8.6	(10.1)	18.3	18.5	21.5
Cash flow from financing	157.6	343.5	168.5	116.6	213.1
Net cash flow	1.9	24.6	164.6	(28.1)	63.0
Net cash/(debt) b/f	31.4	33.1	58.3	225.0	198.8
Net cash/(debt) c/f	33.1	58.3	225.0	198.8	263.8
Key Ratios (YE 31 Dec)	FY19	FY20	FY21F	FY22F	FY23F
Revenue growth (%)	29.4	25.3	(2.6)	17.0	5.4
EBITDA growth (%)	27.0	5.1	(28.9)	66.3	11.2
Pretax margin (%)	9.1	7.3	4.2	7.4	7.9
Net profit margin (%)	7.4	6.0	3.5	6.2	6.6
Interest cover (x)	8.9	11.4	4.7	8.6	9.0
Effective tax rate (%)	18.3	16.7	17.0	16.0	16.0
Dividend payout (%)	15.6	9.2	20.0	20.0	20.0
Debtors turnover (days)	46	46	51	47	49
Stock turnover (days)	118	116	132	120	125
Creditors turnover (days)	47	34	37	34	35

Source: Company, AmInvestment Bank Bhd estimates

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