Incubating growth

QL Resources is a diversified consumer play active in 3 segments: marine-product manufacturing (MPM), integrated-livestock farming (ILF) and palm-oil activities (POA). We see key rerating catalysts as an uptick in plantation earnings as the trees mature and growth from its recent foray into the convenience-store space benefiting its MPM segment. We initiate coverage on QL at BUY with a TP of RM5.56.

Maturity in plantation assets and better crude-palm-oil (CPO) pricing

QL owns plantation estates in Sabah and Indonesia, of which the latter is still at a relatively young age. Earnings should be boosted as the plantation matures, which would increase the fresh-fruit bunch (FFB) production. Coupled with the better CPO pricing compared to the previous year, we forecast this segment's PBT to grow by a 42% CAGR over FY16-19E.

Vertical integration through the convenience-store segment

In April 2016, QL Resources signed a franchise agreement with Family Mart to operate convenience stores (CVS) in Malaysia, expanding from its upstream food manufacturing business. While we estimate it to turn profitable only after six years, we believe the MPM segment will benefit as this could potentially lead to regional distribution of surimi-based products.

Growth in MPM segment fuelled by surimi and surimi-based products

Due to growing demand, QL is expanding its capacity in surimi (ie, fish paste)-based products and we believe that this can also gain better margin with higher automation efficiency and economies of scale. While we acknowledge that fish catch may be limited due to overfishing, QL has already started to invest in prawn aquaculture to overcome this limitation.

Volatility in ILF segment due to egg prices

Feedmill and the egg segment are the main earnings drivers for the ILF segment. While costs for feedmill had gone up due to the weakened RM, costs are likely to be passed on to customers and a reversal in the RM would be a boon, in our view. Egg prices remain volatile and fluctuate according to supply, but we gather that the industry is consolidating as smaller players exit which could potentially improve pricing in the long run.

Initiating coverage with a BUY rating and TP of RM5.56

We like QL as a diversified consumer play given its ability to weather through tough times, its foray into the attractive downstream segment and strong management team. Hence, we initiate coverage with a BUY rating and 10-year DCF-based 12-month TP of RM5.56. Key downside risks include the effects of El-Nino, downside to CPO pricing, downside to egg prices, delays in capacity expansion and competition in the CVS segment.

Earnings & Valuation Summary

FYE 31 March	2015A	2016A	2017E	2018E	2019E
Revenue (RMm)	2,707.8	2,853.9	3,035.6	3,489.1	3,887.1
EBITDA (RMm)	340.9	368.1	396.0	437.6	492.9
Pretax profit (RMm)	245.9	249.5	261.6	290.5	332.2
Net profit (RMm)	191.4	192.1	198.5	220.4	252.0
EPS (sen)	15.3	15.4	15.9	17.7	20.2
PER (x)	31.8	31.7	30.7	27.6	24.2
Core net profit (RMm)	191.4	192.1	198.5	220.4	252.0
Core EPS (sen)	15.3	15.4	15.9	17.7	20.2
Core EPS growth (%)	19.7	0.4	3.3	11.0	14.4
Core PER (x)	31.8	31.7	30.7	27.6	24.2
Net DPS (sen)	3.5	4.2	4.4	4.9	5.6
Dividend Yield (%)	0.7	0.9	0.9	1.0	1.1
EV/EBITDA	19.5	18.0	16.8	15.3	13.6
Affin/Consensus (x)			1.0	1.0	1.0

Source: Company, Affin Hwang forecasts, Bloomberg

Initiate coverage

QL Resources

QLG MK
Sector: Consumer

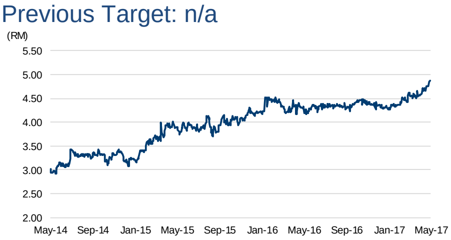
RM4.88 @ 8 May 2017

BUY

Upside: 14%

Target price: RM5.56

Previous Target: n/a



Price Performance

	1M	3M	12M
Absolute	+6.6%	+10.1%	+15.6%
Rel to KLCI	+5.0%	+5.2%	+7.8%

Stock Data

Issued shares (m)	1,248.0
Mkt cap (RMm)/(US$m)	6,090.4/1,404.4
Avg daily vol - 6mth (m)	0.5
52-wk range (RM)	4.14-4.92
Est free float	37.0%
BV per share (RM)	1.38
P/BV (x)	3.54
Net cash/(debt)(RMm)(9M17)	(579.1)
ROE (FY17E)	11%
Derivatives	Nil
Shariah Compliant	Yes

Key Shareholders

CBG Holdings Sdn Bhd	42.1%
Farsathy Holdings Sdn Bhd	12.1%
Skim Amanah Saham	4.5%

Source: Affin, Bloomberg

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Investment Thesis

In our view, the key investment themes for QL resources are:

1. Diversification enables stability through economic downturns.
2. Maturity in its plantation assets and better CPO pricing, which will fuel the palm-oil activities (POA) segment.
3. Foray into the downstream convenience store segment through Family Mart, which should bring synergies and growth:
    a. Convenience-store segment still underpenetrated and has room for growth;
    b. Potential to supply food products to Family Mart overseas.
4. Marine-product-manufacturing (MPM) segment will likely see growth in frozen and surimi products partly due to its integration with the downstream segment, higher efficiency due to automation and the start of prawn agriculture activities to mitigate fish-supply constraints.
5. Potential recovery of egg prices and cost pass through of raw material prices for the feedmill segment within the Integrated livestock farming (ILF) segment

Diversification enables stability through tough times

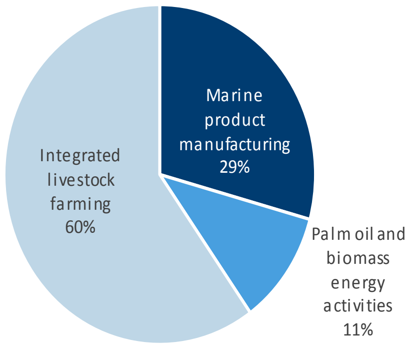
QL Resources operates in three segments:

- **Integrated-livestock farming (ILF)**
  (60% and 30% of revenue and earnings, respectively, in FY16 [March year end])
  QL partakes in four production divisions; a) eggs, b) day-old chicks (DOC), c) broilers, and d) animal-feed raw materials. Within the ILF segment, animal feed raw material contributed 65% of FY16 ILF revenue, followed by the egg segment at 26% of FY16 ILF revenue and we gather that these two divisions will still be the main earnings driver for the ILF segment moving forward.

- **Marine-product manufacturing (MPM)**
  (29% and 65% of FY16 revenue and earnings, respectively)
  QL is the largest surimi producer in Malaysia, as well as in Asia, and is also Malaysia's largest Halal fish-based product manufacturer and largest fishmeal manufacturer. QL's marine products include surimi (semi-processed fish paste typically used to make a variety of fish-paste products such as fish balls and crab meat), fishmeal and frozen fish/surimi-based products.

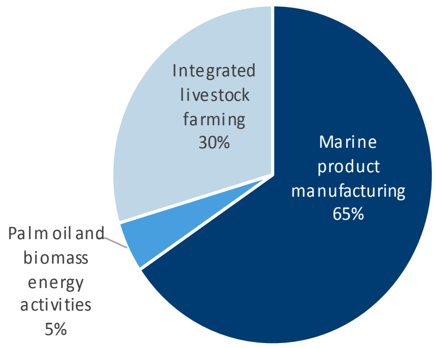
- **Palm-oil activities (POA)**
  (11% and 5% of FY16 revenue and earnings, respectively)
  QL currently has a 1,100Ha mature oil-palm estate in Tawau,Sabah with age between 8-20 years. On the Indonesia side, it has 15,000Ha of oil-palm plantation and 10,000Ha of it has been planted. In terms of age profile, it is relatively young. 20% of plantations are less than 3 years old, 40% are young (4-7 years) and 40% are prime at the age of 8-20 years. QL currently has 3 CPO mills, 2 in Tawau and 1 in Indonesia. The Group also has a 42% equity stake in Boilermech, ASEAN's largest biomass-boiler manufacturer.

Figure 1:Segmental revenue breakdown in FY16



Source: Company

Figure 2: Segmental PBT breakdown in FY16

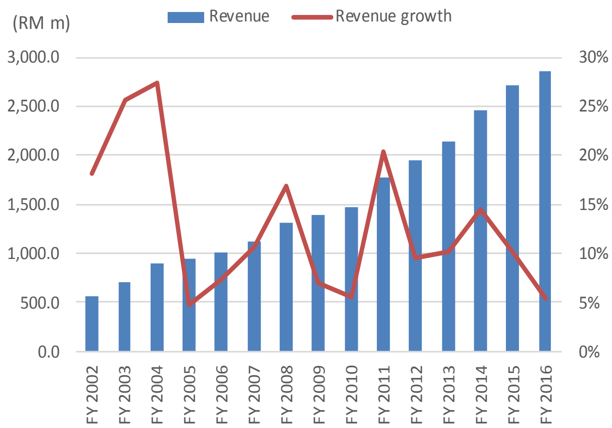


Source: Company

Consistently growing since IPO

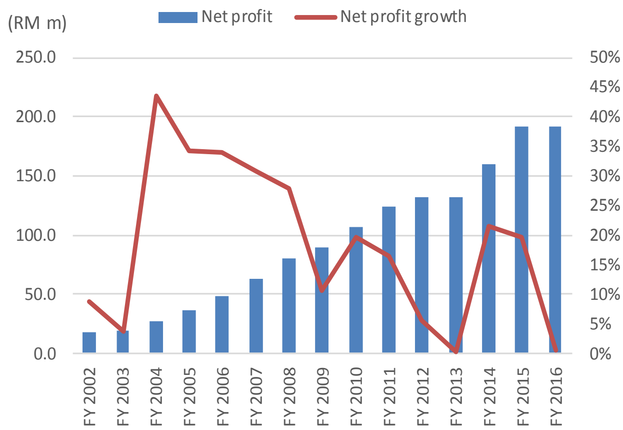
QL has seen solid earnings growth since its IPO in 2000, weathering through the global financial crisis in 2008-2009. Revenue and earnings grew at CAGRs of 13% and 18%, respectively, over FY02-16.

Figure 3: Consistently positive revenue growth



Source: Company

Figure 4: No negative earnings growth between FY02-16



Source: Company

Palm-oil activities (POA) fueled by asset maturity and better CPO pricing

Weak in FY16

In FY16, the POA, which accounted for 10% and 5%, respectively, of the group's total revenue and PBT in FY16, suffered a 10% yoy and 18% yoy decline in revenue and PBT due to a low FFB yield rate and lower CPO milling utilization rate resulting from a drop in FFB processed due to El Nino. To make matters worse, its associate Boilermech's net profit declined by 20% to RM31m because of weak demand for oil-palm boilers.

POA segment PBT to grow at a 42% CAGR over FY16-19, on our forecasts

Nonetheless, we forecast the PBT for the POA segment to grow at a CAGR of 42% over FY16-19E, as we expect the POA segment's profitability to improve in the next few years. This will be driven by margin expansion and volume growth due to the:

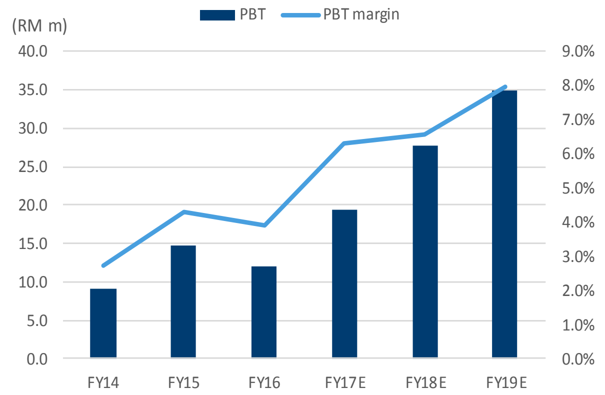
i) ***Increasing age profile of its Indonesia oil-palm plantation***, which is expected to boost FFB production. The Indonesia oil-palm plantation's age profile is relatively young compared to QL Resources' oil-palm plantation in Tawau, Sabah, and we believe that its FFB yield should improve from the current 15-20 MT/Ha level. As a result, we expect higher earnings to come from FFB production as this segment enjoys better margins than CPO milling.

ii) ***Increasing utilization rate of CPO milling plant in Indonesia***. According to management, the palm-oil mill has capacity of 500,000MT per year, but we estimate the utilization rate was only 30-40%. As a result, the milling plant in Indonesia has been loss making due to its low utilization rate. However, we expect that to improve as management guided for maturing oil-palm trees to contribute more FFB. Hence, we believe the milling plant could turn profitable this year.

iii) ***Better CPO pricing***. The average CPO price was RM2,300 and RM2,100 in FY15 and FY16 respectively. Our in-house forecast of CPO price is RM2500-RM2600 for FY17-FY18.

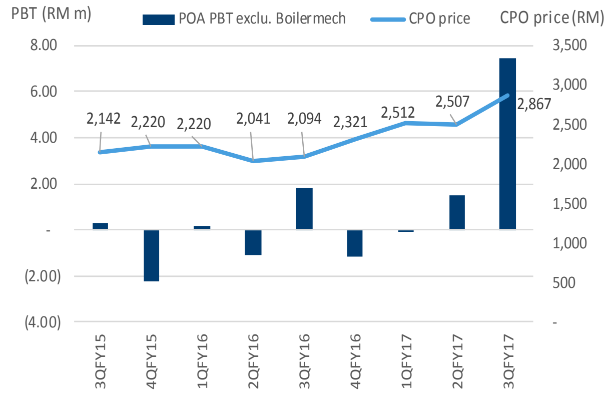
iv) ***Potential recovery on Boilermech's profit contribution***. The crop-damaging El Nino had reduced FFB production last year, resulting in lower demand in boilers, which impacted Boilermech's earnings. As we expect a recovery in crop yields, we believe that this will translate into better earnings in FY18E.

Figure 5: POA forecasted PBT and PBT margins



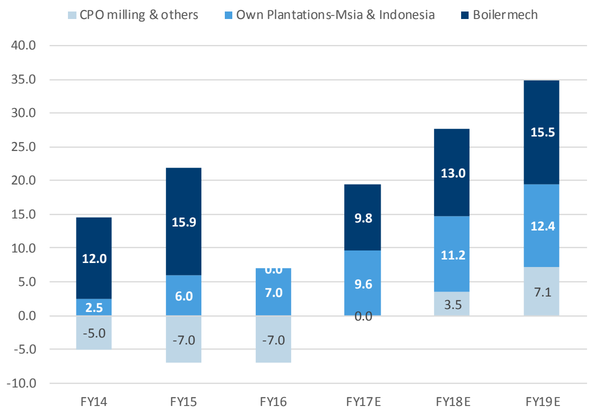
Source: Company, Affin Hwang forecasts

Figure 6: POA PBT exclu. Boilermech vs. CPO price



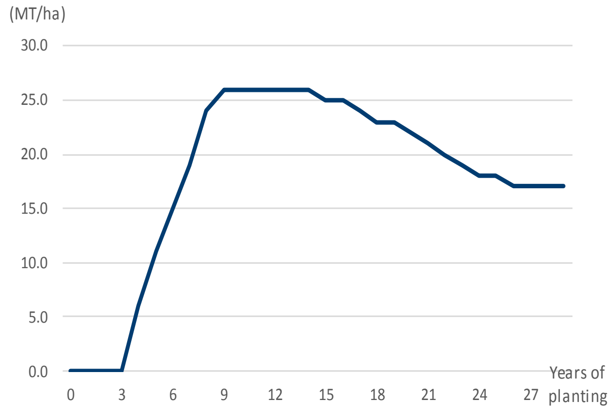
Source: Company

Figure 7: POA PBT including Boilermech



Source: Company, Affin Hwang forecasts

Figure 8: FFB yield over age profile



Source: Affin Hwang estimates

Expanding into attractive downstream consumer space

Operating Family Mart convenience stores

In April 2016, QL Resources signed a franchise agreement with Family Mart to develop and operate convenience stores (CVS) in Malaysia for 20 years. This is part of QL Resources' growth strategy to expand from existing upsteam food manufacturing business into the downstream consumer sector. We view the strategy positively as we believe Family Mart is a well-known name that is poised to benefit from the rising penetration of convenience stores in Malaysia.

Founded in 1973, Family Mart is a chain of convenience stores that originated in Japan. It is the 2^{nd} largest convenience store chain in Japan, behind 7-Eleven and has market presence in Japan, South Korea, Taiwan, China, the Philippines, Vietnam, Indonesia, Thailand and now in Malaysia. QL targets to open 300 stores in 5 years and expects to achieve profitability by year 5 or year 6. To date, it has opened 8 stores.

Figure 9: Family Mart Openings

No.	Location	Opening date
1	Wisma Lim Foo Yong	11/11/2016
2	Mid Valley	2/12/2016
3	KLIA	26/12/2016
4	MRT-TTDI	12/1/2017
5	SS15 Subang Jaya	13/3/2017
6	MyTown, IKEA	16/3/2017
7	Taylors Lakeside Campus	1/4/2017
8	Jalan Sultan	17/4/2017

Source: Company

More concentrated on fresh foods and beverage compared to competitors

The convenience-store segment has garnered more interest these past two years with the listing of 7-Eleven Malaysia (SEM) and Bison (myNews outlets). However, the distinguishing point for Family Mart is that it differs in the basket of goods being offered in that it has a higher portion of its sales coming from the high-margin fresh-food and beverage segment such as ice cream, bread, oden, hot foods and takeaway meals/snacks, which we estimate at 60% of sales (approximately 10% for SEM's fresh food and beverage segment and 40% for Bison's food and beverage sales). Further, Family Mart's brand name is a boon as it is known overseas for its offerings in this segment.

Figure 10: Food offerings at Family Mart

Source: Google

Source: Google

Source: Google

Source: Google

Malaysia's convenience-store segment still in its infancy

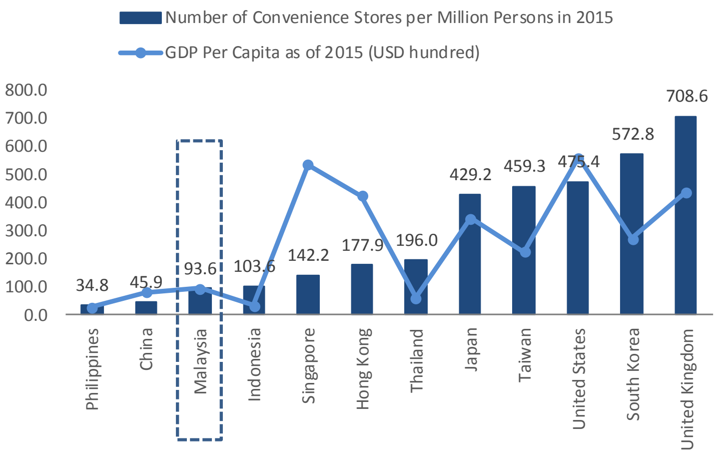
While the two other listed competitors Bison and 7-Eleven are also expanding their store count aggressively, we believe that the current number of convenience stores per million people is still underpenetrated compared to other developing countries and still at its infancy stage with more room to grow. As shown in the figure below, the number of convenience stores per million persons for Malaysia in 2015 is at an estimated 94 stores/million people, behind that of countries such as Indonesia, Singapore, Thailand, Japan and Taiwan.

Figure 11: Current expansion plans of competitors

Convenience store players	Expansion plans	Current no. of stores
Family Mart	300 stores in 5 years	8
myNews.com (Bison)	70 stores per year for FY16-18	309 as of Jan 2017
7-Eleven	200 in 2017	2122 as of Dec 2016

Source: Companies

Figure 12: Convenience store penetration still low in Malaysia

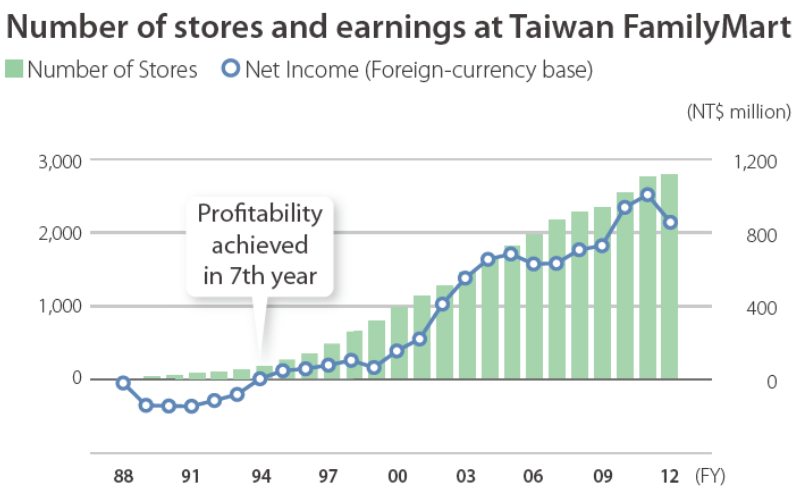


Source: USDA, CEIC, Affin Hwang estimates

Case study: Family Mart in Taiwan

Family Mart was introduced in Taiwan in 1988 and listed as Taiwan Family Mart Co Ltd in 2002. The company broke even in 1994 after 6 years, with 192 stores in total. Since then, the number of stores grew at a CAGR of 14% until 2015.

Figure 13: Family Mart Taiwan achieved profitability in 7th year

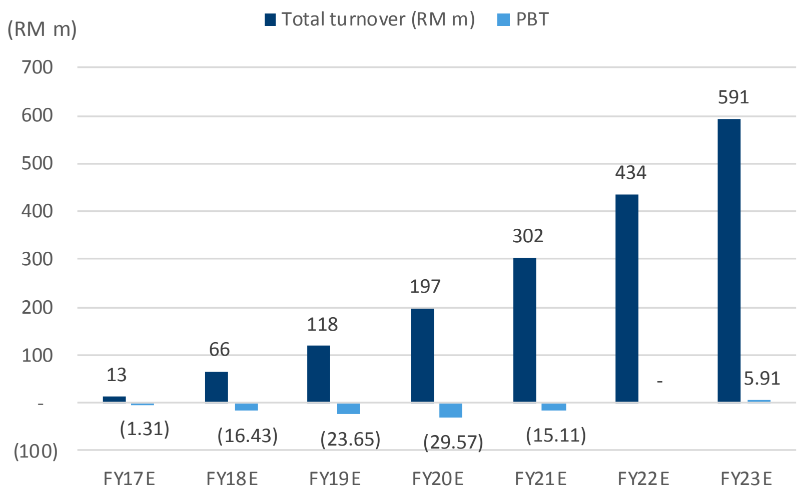


Source: Company

Earnings for the convenience store segment expected to come in FY23E

We have factored in some assumptions for the convenience store segment into our model and believe that this segment will break even in FY22E and turn profit-making in FY23E. We estimate a conservative growth of 2 new stores/month, an average turnover of RM6,000/store/day and a gross-profit margin of 30%, which is in line with Taiwan's Family Mart.

Figure 14: Estimating QL's CVS segment to breakeven by FY22E



Source: Affin Hwang estimates and forecasts

Manageable capex

In terms of capex, we believe the cost of new store openings should be manageable. The capex for a new convenience store is around RM400k. Assuming 2 store openings/month, we estimate annual investment at RM10-15m. Besides, with its existing distribution centers and central kitchen which has the capacity to provide fresh food for up to 150 outlets, we do not foresee significant cash outlays on capex in the near term.

Opportunities to supply surimi-based products to Family Mart overseas

More importantly, Family Mart is to be an extension of QL's food business such as surimi-based products that are supplied as Family Mart's selection of hot food. We believe that the partnership with Family Mart creates more opportunities for QL going forward. For example, there were 24,000 Family Mart stores located in Japan, South Korea, China, Thailand, Vietnam, the Philippines and Indonesia as of end of February 2016. Assuming that QL is able to capture certain market share of surimi-based products supplied to these stores, it would provide an additional boost to its MPM segment's top-line growth.

MPM segment to benefit from downstream segment, coupled with higher efficiency and start of prawn-aquaculture activities

Capacity expansion mainly focused on frozen surimi-based products which benefit the MPM segment

In line with QL's strategy to tap the downstream consumer segment, it is now focusing on the frozen-food section within its MPM segment. The Group plans to construct a new chilled surimi-based product plant with an estimated 25k mt capacity at its Hutan Melintang unit, which is double its current capacity of 12k mt. This is targeted to be complete by 4Q18 and with an estimated cost of RM40m. QL is also planning to construct a frozen products factory in 4Q18 at its Hutan Melintang unit with an additional cost of RM40m.

Figure 15: Expansion plans for the MPM segment

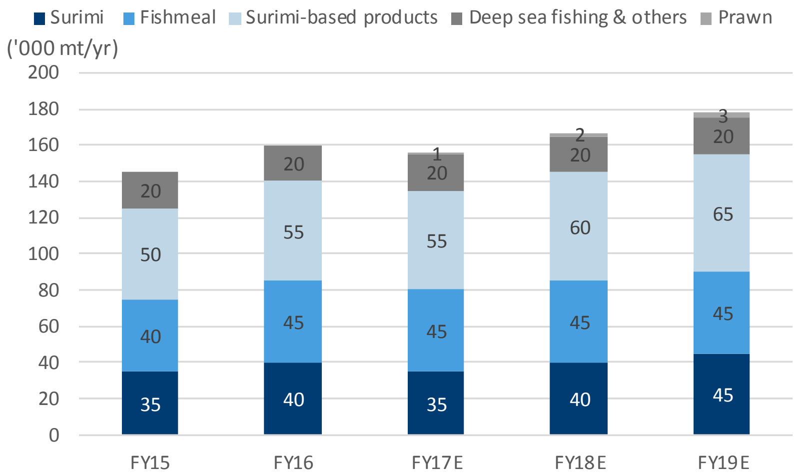
Location	Factory	Capacity	Completion	Capex (RM m)
Hutan Melintang, Perak	Chilled surimi-based products	25k mt	4Q18	40
	Frozen products	15k mt	4Q18	40

Source: Company

Growth from MPM segment from surimi and surimi-based products

The MPM segment can be further divided into surimi, fishmeal, surimi-based products and deep-sea fishing divisions. Due to the growing demand of surimi-based products and its higher value add, we look for top-line growth to come from the surimi and surimi-based products. We believe the production for surimi and surimi-based products will increase from FY18 onwards as capacity utilization increases and capacity from the new factories comes online. We also estimate PBT margins for these two segments to increase with better machinery efficiency and economies of scale.

Figure 16: Production breakdown



Source: Company, Affin Hwang estimates

Expect fish processing to grow slower due to fish-supply constraints, but QL can import surimi regionally

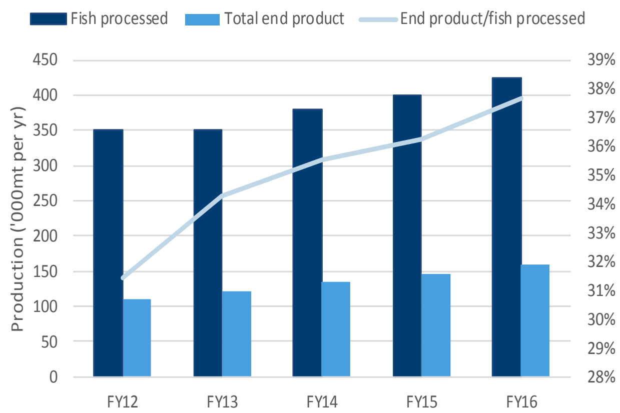
Currently QL processes around 450k MT of fish per year (vs. 350k MT/year in 2012) into different products such as surimi, fishmeal, and surimi-based products. According to management, the amount of fish processed is expected to grow at slower pace because the fish supply constraint is a major bottleneck.

Therefore, we assume QL's fish processed volume to grow at a 1% CAGR over the next 3 years compared to a 5% CAGR over FY12-16. However, we opine that fish supply constraints should not cap QL's top-line growth at least in the near term. Surimi products' volume that can be produced mainly depends on the fish catch and how efficient it can be processed into surimi products. However, QL Resources faces less raw-material supply constraints in surimi-based products as the company can import surimi from Vietnam, Thailand or China to process them into surimi-based products.

Efficiency to drive MPM segment's profitability

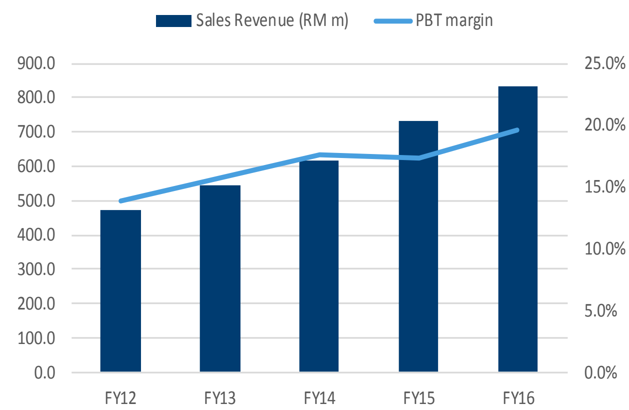
QL allocates around RM100m/year of capex to the MPM segment to expand capacity and to increase the level of automation in its factories. This not only helps to manage labour costs, it also improves production efficiency. Based on our estimates, the volume of end products as a percentage of fish processed has improved from 31% in FY12 to 38% in FY16 and MPM's PBT margin has increased from 13.8% to 19.6% over the same period. We assume QL's scale and efficiency will continue to improve, boosting its PBT margin to 21% in FY20, along with serving as a high entry barrier for new entrants.

Figure 17: Efficiency reduces fish wastage



Source: Company

Figure 18: Automation improves PBT margin



Source: Company

Prawn rearing is progressing well

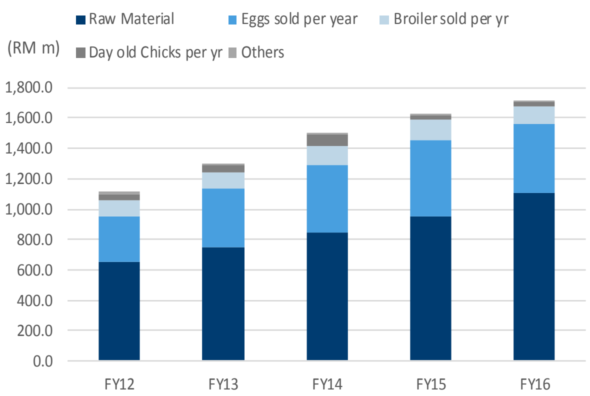
In light of fish-supply constraints, the company decided to start prawn aquaculture activities at Tuaran, Sabah, and export frozen peeled prawns to countries like Australia, Japan, and China. The contribution is minimal at the moment (less than 1% of MPM total PBT) but we believe this is a scalable and profitable business that is expected to contribute 5% of MPM PBT in the next 3 years. From our understanding, the current production is less than 1k MT and we forecast it will reach 3k MT in 2 years time. The average selling price of prawns that the management is looking at is around RM2,000-2,500/MT, which is 4-6 times higher than that for its other MPM products.

Potential recovery of egg prices, cost pass through for feedmill segment and capacity growth within ILF segment

ILF earnings driven by animal-feed raw materials and eggs

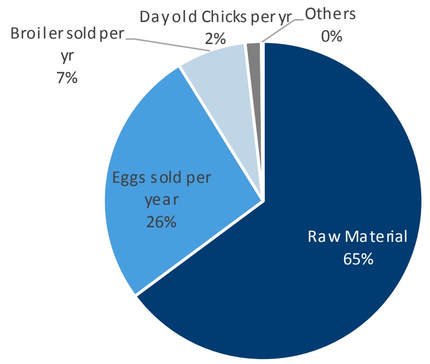
QL's ILF segment contributed approximately 60% of total group revenue in FY16. It is divided into 4 production divisions; a) eggs, b) day-old chicks (DOC), c) broilers and d) animal-feed raw materials. Within the ILF segment, animal-feed raw material contributed 65% of FY16 ILF revenue, followed by the egg segment at 26% of FY16 ILF revenue and we gather that these two divisions will still be the main earnings driver for the ILF segment moving forward.

Figure 19: Revenue breakdown in ILF segment



Source: Company

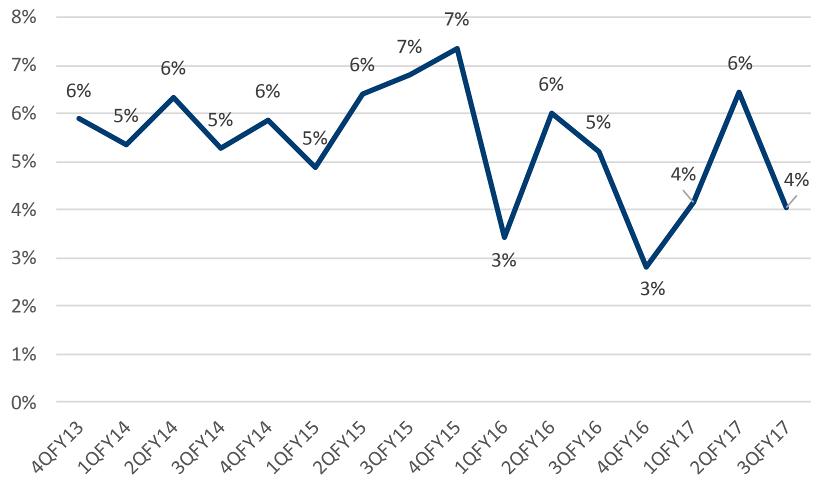
Figure 20: Raw materials: biggest driver to ILF revenue



Source: Company

While this segment contributes to 60% of revenue, it accounts for 30% of PBT, as margins for this segment are relatively lower compared to the MPM segment, which mostly range from 3-10%; raw materials have a PBT margin of 3-5% whereas eggs have a PBT margin of 5-8%.

Figure 21: ILF quarterly PBT margins have been volatile

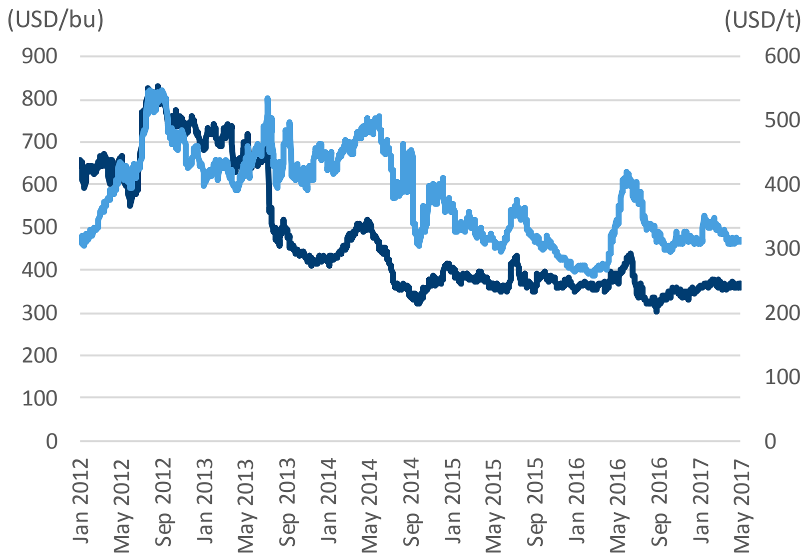


Source: Company

Raw material costs will likely be passed on; RM strengthening is positive

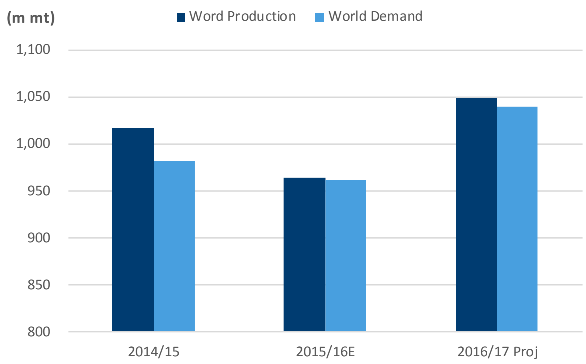
About 85% of feed raw material is mainly made up of corn and soymeal and is mainly sourced from Argentina and Brazil. We gather that prices of corn and soymeal were trending downwards in 2016, from 2015. According to the USDA, world supply currently outweights demand and this scenario should persist in the near term, meaning that prices should stay relatively stable. Nonetheless, the cost of these raw materials are in USD and the drop in the value of the Ringgit against the USD affected margins for this segment in FY16 as only some costs were passed through to the consumer. We believe any increase in costs will eventually able to be passed on to customers. Our house view of the Ringgit stabilizing to an average of RM 4.20/US$ in 2017 should also help boost the PBT margin in this segment. As such, we have forecasted in an improvement in margins for feed raw material from 3.6% in FY16 to 4.0% from FY17E onwards.

Figure 22: Corn and soybean-meal price trend



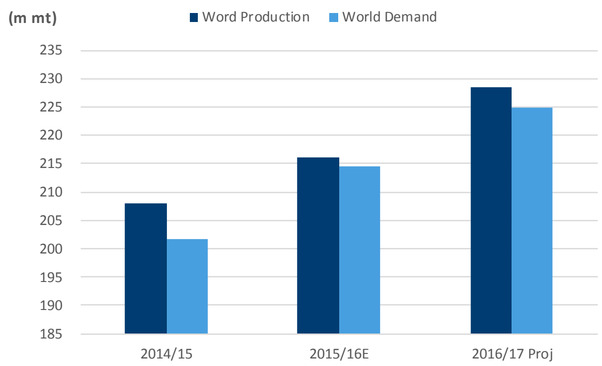
Source: Bloomberg, Affin Hwang

Figure 23: World corn production vs. demand



Source: USDA

Figure 24: World soybean-meal production vs. demand



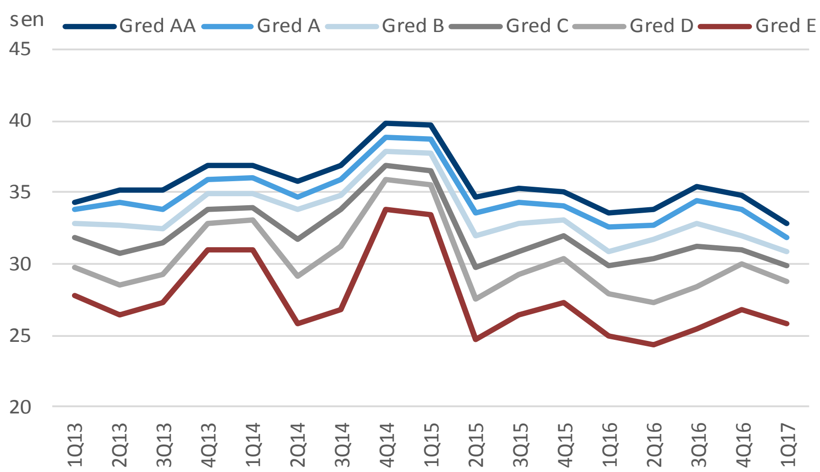
Source: USDA

Expect volatile egg price caused by supply

QL is one of the leading poultry-farming companies in ASEAN and the 2nd largest in Malaysia, with an estimated 12% market share according to the company. In terms of egg-production capacity, the company produces approximately 4.6m eggs per day, with 1.9m eggs produced in Peninsular, 1.4m in East Malaysia, and 0.65m each in Indonesia and Vietnam. Contrary to other poultry players that export eggs to nearby countries like Singapore, QL's eggs are produced and consumed within the region.

However, we caution that the ILF segment's PBT margin is volatile. While the demand for eggs is stable, the risk is always the oversupply of eggs due to over expansion of poultry players that causes egg prices to plummet as seen through historical quarterly egg prices trending downwards since 4Q14/1Q15. Note that the self-sufficiency ratio (SSR) for chicken/duck eggs was at 112.3% in 2015 according to the Department of Statistics Malaysia, still above 100% which indicates that production is more than sufficient to meet domestic needs. According to management, Peninsular Malaysia's egg oversupply dragged the egg price to 24 sen recently, compared to East Malaysia's average of 32 sen. To provide some perspective, management stated that its recent production breakeven cost is around 25 sen. Nonetheless, we understand that the market is undergoing some consolidation as smaller poultry players exit the market, which would provide some relief to the oversupply of eggs and lead to better egg pricing, in our view.

Figure 25: Historical quarterly egg prices trending downwards



Source: Department of Veterinary Services, MOA

Growth will mainly be from egg production and Indo's feedmill

With regards to expansion plans, the Group will be ramping up its commercial feedmill in Bekasi, Indonesia, which has an estimated production capacity of 20k mt/mth, doubling current production of 10k mt/mth. The Group has also received an investment incentive of 10 years Pioneer Status under the East Coast Economic Region scheme to start an integrated-layer farming project in Pahang. A capacity of 500,000 eggs/day has been targeted for Phase 1, which is estimated to take 2-3 years for completion and will require a capex of RM50m. Vietnam's poultry layer unit will also be increasing its egg production from the current 650k eggs/day, to 850k eggs/day by 4Q18.

Figure 26: Capacity expansion

Location	Factory	Capacity	Completion	Capex (RMm)
Bekasi, Indonesia	Feedmill	20k mt/mth	-	-
Raub, Pahang	Eggs	500k/day	2019/20	50
Vietnam	Eggs	850k/day (from 650k/day)	4Q18	

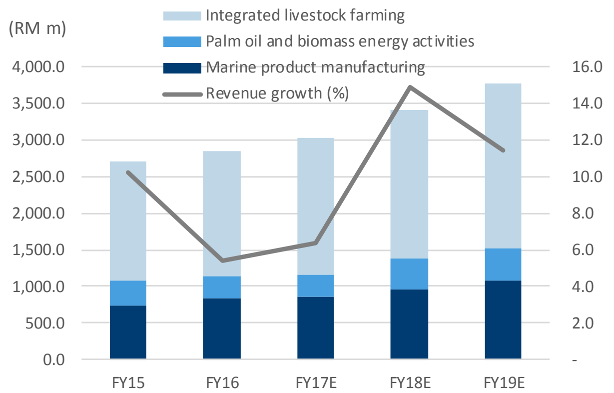
Source: Company

Financials

FY18E earnings growth expected to be better than in FY17E

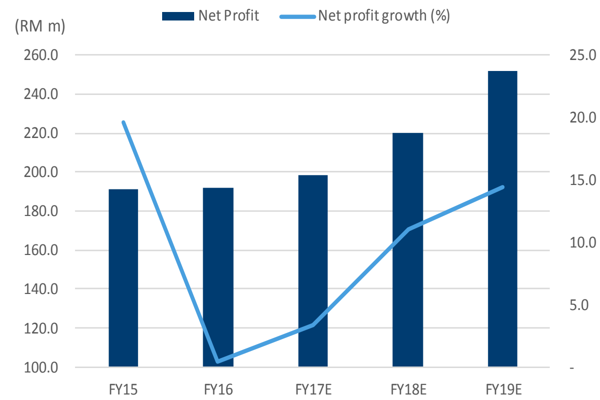
We estimate an earnings CAGR of 13% over FY17-19E. We expect FY18E PBT to grow by 10.5% yoy (vs. 5.4% yoy in FY17E) due to the largest growth of 42% yoy from the palm-oil segment, followed by the MPM segment (+18% yoy) and ILF segment (+9% yoy).

Figure 27: Revenue growth forecast



Source: Company, Affin Hwang forecasts

Figure 28: Net profit growth forecast

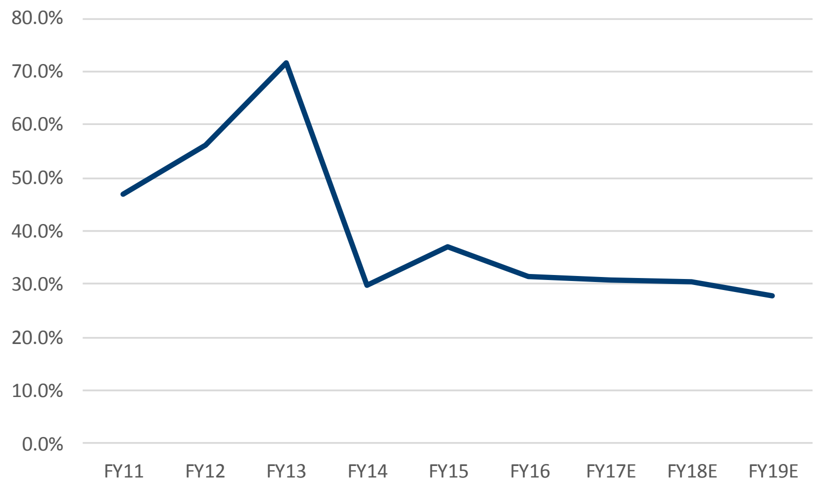


Source: Company, Affin Hwang forecasts

Gearing trending down

The Group's gearing has trended down since its high of 72% in FY13, and reached a gearing of 31% in FY16. Capex is normally about an average of RM220m/year with capex at almost RM240m in FY16; we forecast a capex of RM280m/year over FY17-19E as the Group undertakes capacity expansion for both the MPM and ILF segments, as well as store openings for the CVS segment. Nonetheless, this should not have much impact on net gearing and we believe it would stay at low levels.

Figure 29: Net gearing on a downward trend since its high in FY13

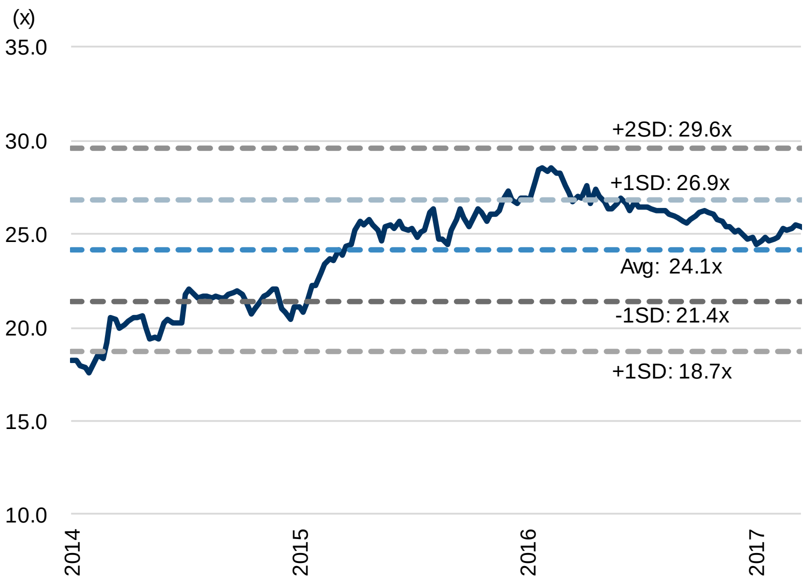


Source: Company, Affin Hwang forecasts

Valuation and Recommendation

Currently trading at FY18E PER of 27.6x (vs. past-3-year average of 24.1x)
Given QL's diversified business model there are no direct comparisons available. Based on our forecasts, QL shares are currently trading at a FY18E PER of 27.6x (which is above its past-3-year-average PER of 24.1x), which we believe is due to the defensive nature of its business in the food segment and its consistent earnings delivery since its IPO.

Figure 30: QL's past-3-year PER



Source: Bloomberg, Affin Hwang estimates

Initiating with a BUY call and DCF-based TP of RM5.56
To capture its potential growth in its plantation and CVS segment, we have carried out a 10-year DCF valuation with assumptions as per the table below. Hence, we initiate coverage with a BUY rating and 10-year DCF-based 12-month TP of RM5.56. While this translates to a FY18E PER of 31.5x, we believe this is justified as the Group has yet to see gains from its new convenience store segment which we believe has been ventured into at the right time when it is still at its infancy, as well as its plantation segment where its plantation estates need time to mature.

Figure 31: DCF Valuation

DCF Assumptions	
LT growth	4.0%
Risk-free rate (Rf)	4.0%
Market Return (Rm)	10.0%
Equity risk premium	6.0%
Beta	0.8
Cost of Equity (Ke)	8.8%
Proportion of debt financing	39.0%
After-tax cost of debt (Kd)	3.8%
Weighted Avg Cost of Capital (WACC)	6.9%

DCF Valuation (RM m)	FY18E	FY19E	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E
EBITDA	437.6	492.9	549.6	586.3	637.2	669.0	703.2	732.6	759.3	780.8
Less:Tax expense	(55.6)	(63.5)	(72.0)	(76.5)	(83.9)	(87.6)	(91.8)	(95.3)	(98.4)	(100.6)
Less:Working capital	(71.2)	(61.4)	(65.6)	(43.1)	(59.8)	(57.4)	(31.9)	(29.0)	(23.6)	(28.1)
Less:Capex	(280.0)	(280.0)	(288.4)	(297.1)	(306.0)	(312.1)	(318.3)	(324.7)	(331.2)	(334.5)
Free Cash Flow	**30.8**	**88.0**	**123.6**	**169.6**	**187.6**	**212.0**	**261.2**	**283.5**	**306.1**	**317.7**

PV of terminal value	6,377.60
Enterprise Value	7,655.44
minus net debt	611.71
Less: Minority Interest	106.84
Equity value	6,936.88
No. of shares	1,248.03
Target price (RM)	**5.56**

Source: Affin Hwang estimates and forecasts

Figure 32: Peer Comparison (based on 8 May 2017 closing prices)

	Bloomberg Code	Rating	Price (RM)	TP (RM)	Mkt Cap (RMm)	Year end	PE (x) CY17E	PE (x) CY18E	EPS growth (%) CY17E	EPS growth (%) CY18E	P/B (x)	ROE (%) CY17E	ROE (%) CY18E	Div. Yield (%) CY17E	Div. Yield (%) CY18E
Ppb Group Berhad	PPB MK	N/R	17.18	N/R	20,367	Dec	17.6	16.6	2.1	6.1	0.9	5.2	5.3	1.6	1.8
Dutch Lady Milk Inds Bhd	DLM MK	N/R	59.00	N/R	3,776	Dec	22.6	21.0	3.5	7.7	22.7	98.9	103.2	4.6	4.8
Nestle	NESZ MK	HOLD	82.30	79.08	19,299	Dec	27.8	26.1	14.8	6.5	18.3	65.8	65.7	3.5	3.8
QL Resources	QLG MK	BUY	4.88	5.56	6,090	Mar	28.3	24.9	9.2	13.6	3.3	12.1	12.6	1.0	1.1
Average					**49,812**		**23.2**	**21.6**	**10.5**	**9.7**	**9.6**	**38.2**	**39.3**	**2.7**	**2.9**

Source: Bloomberg

Proposed bonus issue of 3 for every 10 shares

Note that the company had announced in February 2017 that they are proposing to undertake a bonus issue on the basis of 3 bonus shares for every 10 existing ordinary shares at a date to be determined and announced later. We view this positively as it should improve the trading liquidity of QL's shares.

Key Risks

Downside risks to our call include:

MPM division

- Effects of El Nino are twofold where fish catch will probably improve if the temperature for the waters are a conducive environment for fish, but will reduce if temperatures are too high
- Decreased fish landing due to overfishing
- Delays in capacity expansion and prawn aquaculture activities

ILF division

- El Nino would have an adverse impact on farm productivity which may reduce production
- Volatile egg prices- earnings would be affected negatively should there be an egg oversupply, putting downward pressure on prices and vice versa
- Viruses that might affect livestock and farm production

POA division

- El Nino would have an adverse impact on the FFB production
- Dependent on CPO price

CVS division

- If convenience-store segment were to take a longer time to breakeven
- Aggressive store expansion from other competitors which would increase competition and decrease availability of attractive locations to open stores

Company Background

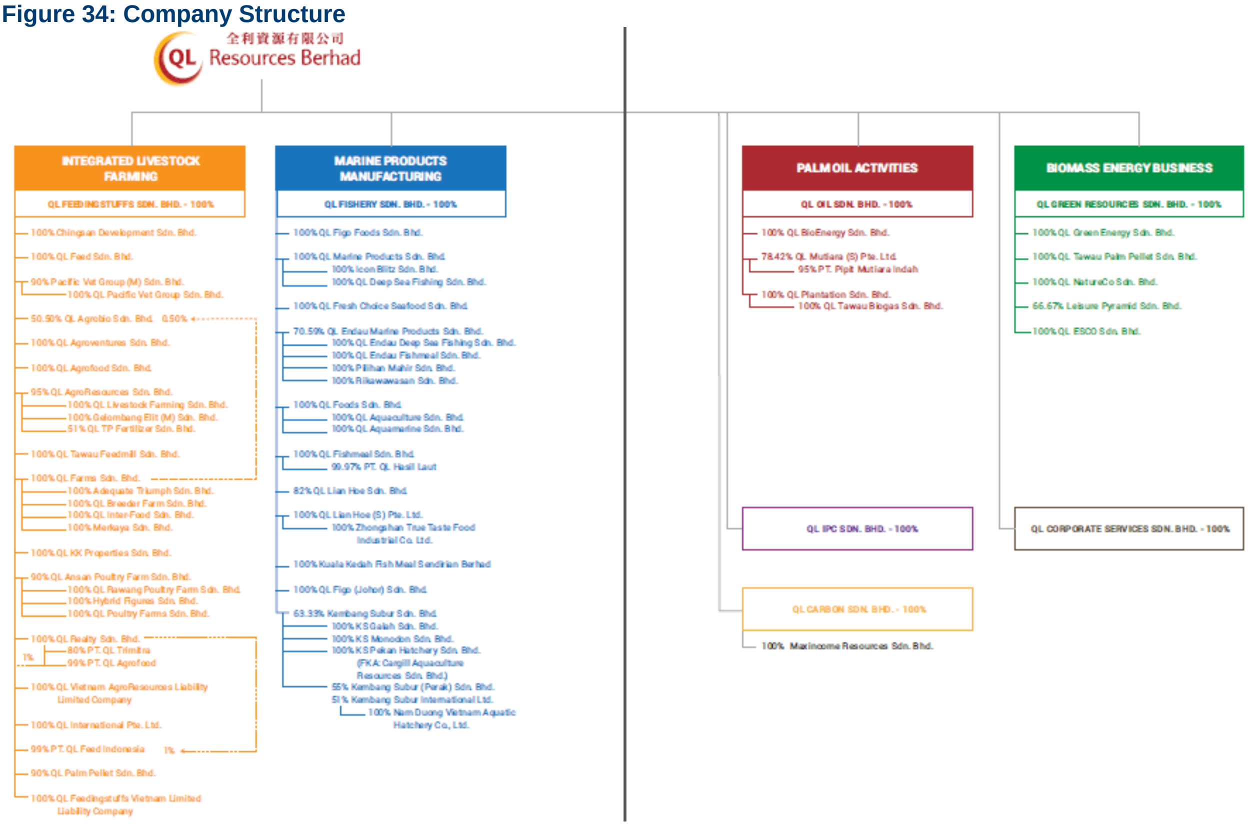
QL was founded in 1987 by Dr. Chia Song Kun who, along with his brothers and brothers-in-law, managed to build the company from a local feedstuff trader to a multinational agro-food corporation. Today, QL operates in three distinct segments: Integrated Livestock Farming, Marine Products Manufacturing, Palm-Oil Activities and has, in the past year, dived into the downstream Convenience Store Segment. Major shareholders include CBG Holdings (42% stake) and Farsathy Holdings (12% stake), which are held mainly by Dr Chia Song Kun and his family members.

Figure 33: Major shareholders and designations

Company	Major Shareholders	Designation	Relationship
CBG Holdings Sdn Bhd	Dr Chia Song Kun	Managing Director	
	Chia Song Kooi	Executive Director	Brother to MD
	Chia Song Swa	Executive Director	Brother to MD
	Chia Mak Hooi	Executive Director	Nephew to MD
Farsathy Holdings Sdn Bhd	Chia Seong Pow	Non-independent executive director	Brother-in-law to MD
	Chia Seong Fatt	Non-independent executive director	Brother-in-law to MD

Source: Company

Figure 34: Company Structure



Source: Company

Appendix

A) Marine Product Manufacturing (MPM)

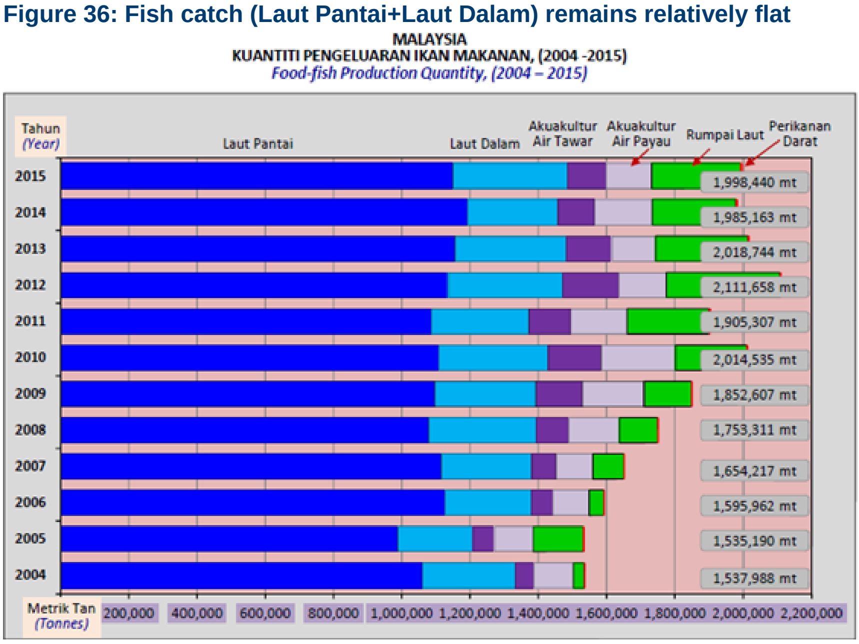
QL's marine products include surimi (semi-processed fish paste typically used to make a variety of fish paste products such as fish balls and crab meat), fishmeal and frozen fish/surimi-based products. The Group dominates the surimi market by being the largest surimi producer in Malaysia, as well as in Asia, and is also Malaysia's largest Halal fish-based product manufacturer and largest fishmeal manufacturer. The products are exported nationwide and internationally under both private label and QL brands such as Mushroom, Ocean Ria and Figo. The MPM segment is by far the most profitable segment, which contributed 30% of total revenue (FY16), but 60% of PBT. PBT margins for MPM are the highest among the three segments, at around 17-20%.

Figure 35: MPM production and export market

Products	Annual Production (mt)	Export Market
Surimi	40,000	Japan, Korea, Taiwan, China, Singapore, Indonesia
Fishmeal	45,000	China, Indonesia, Taiwan, Japan
Surimi-based products	50,000	Australia, HK, USA, North America, China, Brunei, Singapore, Philippines

Source: Company

Figure 36: Fish catch (Laut Pantai+Laut Dalam) remains relatively flat



Source: Department of Fisheries

Figure 37: Location of MPM operations

Source: Company

B) Integrated Livestock Farming (ILF)

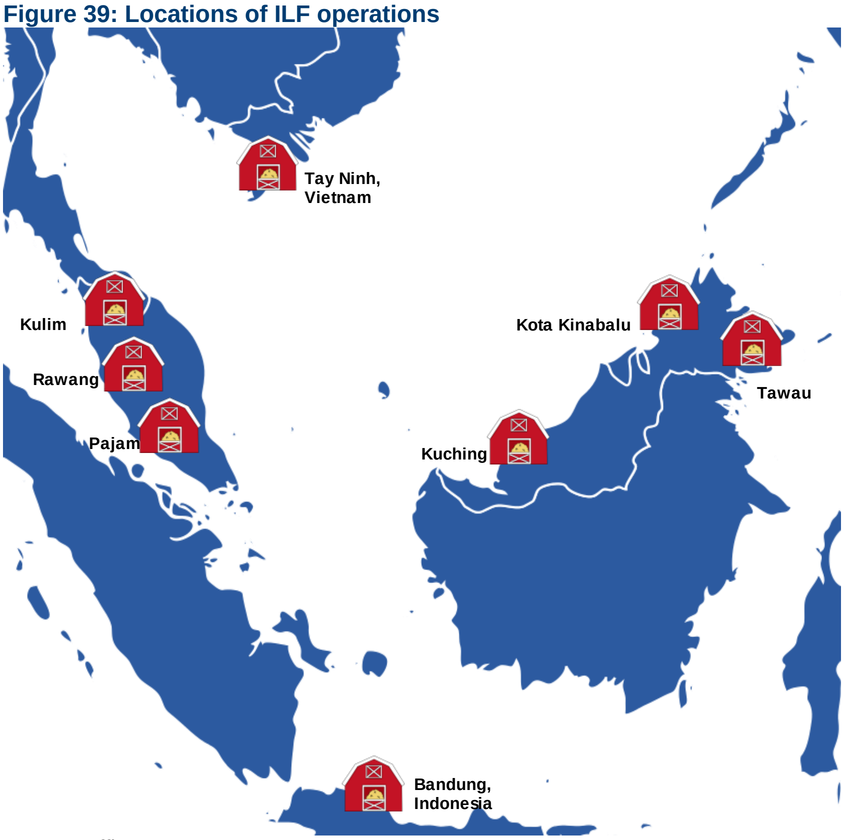
Curently, the Group has 8 poultry farms: 3 in East Malaysia, 3 in Peninsular (Pajam-2000, Rawang-2005, Kulim-2008), 1 in Vietnam-2009, and 1 in Indonesia-2011.

Figure 38: Current ILF Production

	Egg production per day (m)	DOC per year (m)	Broiler per year (m)	Animal feed raw materials (mt per year) (k MTs)	Feedmilling (mt per year) (k MTs)
Peninsular	1.9	NA	NA	900	120
East Malaysia	1.4	20	12	NA	15
Indonesia	0.65	15	8	30	90
Vietnam	0.65	NA	NA	20	40
Total	**4.7**	**35**	**20**	**1,000**	**400 (90% own use)**

Source: Company

Figure 39: Locations of ILF operations



Source: Affin Hwang, Company

C) Palm-Oil Activities (POA)

The POA segment contributed 10% and 5%, respectively, to the group's total revenue and PBT in FY16. QL Resources currently has a 1,100Ha mature oil-palm estate in Tawau,Sabah, with an age between 8-20 years. On the Indonesia side, it has 15,000Ha of oil-palm plantation and 10,000Ha of this has been planted. In terms of age profile, it is relatively young: 20% of plantations are less than 3 years old, 40% are young (4-7 years) and 40% are prime at the age of 8-20 years.

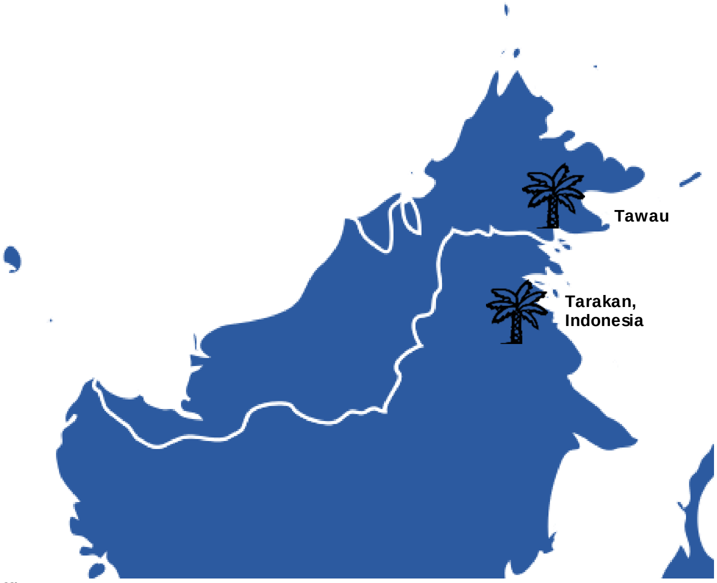
QL currently has 3 CPO mills: 2 in Tawau and 1 in Indonesia. The Group also has a 42% equity stake in Boilermech, ASEAN's largest biomass boiler manufacturer.

Figure 40: Current palm oil activities

Palm oil activities	Location	Notes
Oil palm estate	Tawau, Sabah Eastern Kalimantan,Indo	1,100 Ha mature plantation (8-20 years old) 15,000 Ha plantation with 10,000 Ha planted (40% mature)
CPO milling	2 in Tawau 1 in Indonesia	
Boilermech (42% equity)		ASEAN's largest biomass boiler manufacturer

Source: Company

Figure 41: Location of POA operations



Source: Affin Hwang, Company

QL Resources - FINANCIAL SUMMARY

Profit & Loss Statement

FYE 31 Mar (RM m)	FY15	FY16	FY17E	FY18E	FY19E
Revenue	**2,707.8**	**2,853.9**	**3,035.6**	**3,489.1**	**3,887.1**
Operating expenses	(2,366.8)	(2,485.9)	(2,751.8)	(3,178.7)	(3,536.4)
EBITDA	**340.9**	**368.1**	**283.8**	**310.3**	**350.7**
Depreciation	(88.5)	(98.8)	-	-	-
EBIT	252.4	269.2	283.8	310.3	350.7
Net interest income/(expense	(29.7)	(32.7)	(32.0)	(32.9)	(34.0)
Associates' contribution	23.3	12.9	9.8	13.0	15.5
EI	-	-	-	-	-
Pretax profit	**245.9**	**249.5**	**261.6**	**290.5**	**332.2**
Tax	(50.0)	(47.7)	(50.0)	(55.6)	(63.5)
Minority interest	(4.5)	(9.7)	(13.1)	(14.5)	(16.6)
Net profit	**191.4**	**192.1**	**198.5**	**220.4**	**252.0**

Balance Sheet Statement

FYE 31 Mar (RM m)	FY15	FY16	FY17E	FY18E	FY19E
PPE	1,239.4	1,372.7	1,540.4	1,693.2	1,831.0
Other non-current assets	372.4	344.1	344.1	344.1	344.1
Total non-current assets	**1,611.8**	**1,716.8**	**1,884.5**	**2,037.3**	**2,175.1**
Cash and equivalents	200.7	249.9	211.7	161.8	161.7
Inventory	334.6	375.3	398.0	460.4	512.0
Trade receivables	306.8	338.8	332.6	382.3	425.9
Other current assets	131.3	129.3	129.3	129.3	129.3
Total current assets	**973.4**	**1,093.3**	**1,071.7**	**1,133.9**	**1,229.0**
Trade payables	238.3	271.6	261.0	301.9	335.8
Short term borrowings	431.0	469.8	469.8	469.8	469.8
Other current liabilities	16.8	14.7	14.7	14.7	14.7
Total current liabilities	**686.1**	**756.1**	**745.5**	**786.5**	**820.3**
Long term borrowings	326.0	303.7	303.7	303.7	303.7
Other long term liabilities	73.7	79.3	79.3	79.3	79.3
Total long term liabilities	**399.8**	**383.0**	**383.0**	**383.0**	**383.0**
Shareholders' Funds	**1,426.6**	**1,591.7**	**1,735.3**	**1,894.8**	**2,077.3**

Cash Flow Statement

FYE 31 Mar (RM m)	FY15	FY16	FY17E	FY18E	FY19E
PAT	195.9	201.8	211.6	234.9	268.7
Depreciation & amortisation	88.5	98.8	112.2	127.2	142.2
Working capital changes	(67.3)	(56.3)	(27.1)	(71.2)	(61.4)
Others	8.0	7.1	-	-	-
Cashflow from operations	**225.1**	**251.4**	**296.7**	**290.9**	**349.5**
Capex	(261.9)	(238.1)	(280.0)	(280.0)	(280.0)
Others	(15.5)	67.1	-	-	-
Cash flow from investing	**(277.4)**	**(171.0)**	**(280.0)**	**(280.0)**	**(280.0)**
Debt raised/(repaid)	69.4	59.7	-	-	-
Equity raised/(repaid)	-	-	-	-	-
Dividends paid	(43.7)	(53.0)	(54.8)	(60.9)	(69.6)
Others	#VALUE!	31.9	-	-	-
Cash flow from financing	**(5.2)**	**(25.2)**	**(54.8)**	**(60.9)**	**(69.6)**
Free Cash Flow	**(19.6)**	**23.3**	**16.7**	**10.9**	**69.5**

Source: Company, Affin Hwang forecasts

Key Financial Ratios and Margins

FYE 31 Mar (RM m)	FY15	FY16	FY17E	FY18E	FY19E
Growth					
Revenue (%)	10.2	5.4	6.4	14.9	11.4
EBITDA (%)	13.7	8.0	7.6	10.5	12.7
Core net profit (%)	19.7	0.4	3.3	11.0	14.4
Profitability					
EBITDA margin (%)	12.6	12.9	13.0	12.5	12.7
PBT margin (%)	9.1	8.7	8.6	8.3	8.5
Net profit margin (%)	7.1	6.7	6.5	6.3	6.5
Effective tax rate (%)	20.3	19.1	19.1	19.1	19.1
ROA (%)	7.4	6.8	6.7	6.9	7.4
Core ROE (%)	12.8	11.5	10.9	11.0	11.5
ROCE (%)	8.2	7.6	7.4	7.7	8.3
Dividend payout ratio (%)	22.8	27.6	27.6	27.6	27.6
Liquidity					
Current ratio (x)	1.4	1.4	1.4	1.4	1.5
Op. cash flow (RMm)	225.1	251.4	296.7	290.9	349.5
Free cashflow (RMm)	(19.6)	23.3	16.7	10.9	69.5
FCF/share (sen)	(1.6)	1.9	1.3	0.9	5.6
Asset management					
Inventory turnover (days)	56.8	61.3	61.0	61.0	61.0
Receivables turnover (days)	41.4	43.3	43.0	43.0	43.0
Payables turnover (days)	40.4	44.4	40.0	40.0	40.0
Capital structure					
Net Gearing (%)	0.4	0.3	0.3	0.3	0.3
Interest Cover (x)	8.5	8.2	8.9	9.4	10.3

Quarterly Profit & Loss

FYE 31 Mar (RM m)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17
Revenue	738.0	768.9	669.5	729.7	799.1
Op costs	-631.9	-683.4	-584.0	-622.5	-692.3
EBITDA	106.1	85.5	85.5	107.2	106.7
Depn and amort	-23.0	-29.0	-27.5	-31.2	-27.9
EBIT	83.1	56.5	58.0	76.0	78.9
Net int income/(exp)	-8.7	-8.6	-8.8	-7.4	-5.7
EI	0.0	0.0	0.0	0.0	0.0
Inc/(loss) from affiliates	2.1	1.5	3.6	2.1	2.3
Pretax profit	76.5	49.4	52.8	70.7	75.4
Tax	-12.4	-8.4	-11.5	-14.8	-14.3
MI	-6.3	-3.0	0.8	-5.4	-5.1
Net profit	57.9	38.1	42.1	50.5	56.0
Core net profit	57.9	38.1	42.1	50.5	56.0
Margins (%)					
EBITDA	14.4	11.1	12.8	14.7	13.4
PBT	10.4	6.4	7.9	9.7	9.4
PAT	7.8	5.0	6.3	6.9	7.0

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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