

29 November 2018

Southern Acids (M) Berhad 1H19 Misses Expectations

1H19 Core Net Profit (CNP) of RM10.5m fell far below expectations, making up only 31% of consensus and 33% of our forecast on weaker margins from its oleochemical segment as well as the increase in minority interest (MI) due to higher plantation earnings contribution. No dividend was announced, as expected. We slash FY19-20E CNP by 19%-10% to RM26.5-29.7m to reflect weaker oleochemical segment. Maintain UNDERPERFORM with lower TP of RM2.60.

1H19 missed forecasts. Excluding one-off unrealised forex gain (RM4.6m) and inventory write-down (RM0.04m), 1H19 CNP came in at RM10.5m. This is far below expectations, making up only 31% of consensus' RM33.8m estimate and 33% of our RM31.7m full-year forecast. The lower-than-expected CNP was dragged by weaker margins from its oleochemical segment due to higher operating cost as well as increase in minority interest (MI) which we think is due to higher plantation earnings contribution arising from its 63% owned PT Mustika Agro Sari and PT Wanasari. FFB production at 44.4k metric tons (MT) was well above our estimate, making up 60% of full-year forecast. No dividend was announced, as expected.

Improved plantation but Oleochemical weakened. YoY, although all segments recorded improvements, 1H19 CNP dropped by 34% due to weakened oleochemical segment. Notably, Healthcare PBT improved 8% on higher average revenue per patient (ARPP) thanks to higher complex surgeries performed. Plantation upstream contribution surged 59% to RM10.7m on higher sales volume of CPO (+4%) and PK (+18%) as well as increase in FFB own production (+38%), positively affecting its cost structure that led to better margins. However, the oleochemical segment's PBT slumped 75% due to higher production costs. **QoQ,** CNP jumped more than four folds mainly on stronger contribution from plantation upstream, thanks to higher FFB production (+46%) which offset lower CPO prices (-9%). Healthcare division performed reasonably well with increased PBT (+5%) on steady PBT margins at 26%. These more than compensated for the following: (i) increase MI due to reasons above, and (ii) oleochemical segment registering LBT of RM0.5m from PBT RM0.9m in 1Q19 due to higher input costs.

Challenging prospects. We think its oleochemical segment will continue to be under pressure amidst high operating cost and stiff competition in the market. Given relatively smaller production size in the market, unit cost will potentially be higher as a result of lower economies of scale. YoY, 1H19 oleochemical capacity utilization rate decreased (-10.6ppt) to 84.1%. We think healthcare division will pick up for the rest of FY19 on the back of better average revenue per patient (ARPP) lifted by higher complex surgeries performed due to company's continuous effort in recruiting more specialists. We anticipate improvement in contribution from plantation upstream to be driven by higher FFB production despite softer CPO price outlook.

Reduced FY19-20E CNP by 16%-10% to RM26.5m-29.7m as we update our assumptions for oleochemical segment to reflect thinner margins on high operating costs and widened our MI assumptions.

Maintain UNDERPERFORM with a lower TP of RM2.60 (from RM2.70) post earnings adjustment on Sum-of-Parts valuation based on average of FY19-20E EPS of 20.6 sen (from 23.6 sen). In our Sum-of-Parts (SoP) valuation, we also update our valuations accordingly to reflect closer to small-mid cap planters average Fwd. PER of 18.0x, applying 25% discount to upstream segment to reflect the challenging near-term cost environment and depreciating CPO price trend. Meanwhile, we also peg oleochemical segment to 18.0x Fwd PER average of small-mid cap planters, ascribing 40% discount Fwd. PER of 18.0x with EBIT slashed to RM0.6m (from RM1.8m) to account for its challenging business prospect. For healthcare division, we maintain our assumptions with unchanged 18.0x PER as well as our conglomerate discount of 15% to arrive at our SoP TP of RM2.60. Our TP implies a Fwd. PER of 13.4x, which is below -0.5SD of 3-year average.

UNDERPERFORM ↔

Price: RM3.68
Target Price: RM2.60 ↓

Expected Capital Gain: -RM1.080 -29.3%
Expected Divd. Yield: RM0.030 +0.8%
Expected Total Return: -RM1.050 -28.5%

KLCI Index 1,686.55

Stock Information

Bloomberg Ticker	SA MK Equity
Bursa Code	5134
Listing Market	Main Market
Shariah Compliant	Yes
Issued shares	136.9
Market Cap (RM m)	503.9
Par value per share (RM)	1.00
52-week range (H)	4.48
52-week range (L)	3.60
Free Float	47%
Beta	0.7
3-mth avg daily vol:	7,446

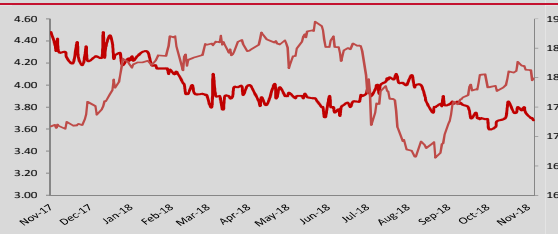
Major Shareholders

Southern Palm Industry	31.3%
Lembaga Tabung Haji	13.1%
Southern Realty (Malaya)	8.4%

Summary Earnings Table

FY Mar (RM m)	2018A	2019E	2020E
Turnover	763.2	677.1	704.9
EBIT	49.1	39.1	40.8
PBT	49.4	43.7	45.7
Net Profit (NP)	30.7	26.5	29.7
Core NP	36.8	26.5	29.7
Consensus (NP)	N.A.	33.8	36.7
Earnings Revision	N.A.	-16%	-10%
Core EPS (sen)	26.9	19.4	21.7
Core EPS growth (%)	-15%	-28%	12%
NDPS (sen)	5.0	3.0	3.0
NTA per Share (RM)	4.28	4.44	4.63
Price to NTA (x)	0.9	0.8	0.8
PER (x)	13.7	19.0	17.0
Debt-to-Equity ratio(x)	N.C	N.C	N.C
Return on Asset (%)	5.1	3.6	3.9
Return on Equity (%)	6.3	4.4	4.7
Net Div. Yield (%)	1.4	0.8	0.8

Share Price Performance



	1 mth	3 mths	12 mths
Absolute (%)	4.9%	4.9%	-13.0%
Relative (%)	1.6%	2.0%	-16.2%

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Other Points

Upside risks to our call include: (i) higher-than-expected CPO prices, (ii) lower-than-expected cost of production, and (iii) higher-than-expected CPO output.

Results Highlights								
FY Mar	2Q19	1Q19	QoQ %	2Q18	YoY%	1H19	1H18	YoY%
Revenue	153.0	158.0	-3%	189.0	-19%	311.0	367.7	-15%
Op Profit	13.3	9.7	36%	9.3	43%	23.0	19.8	16%
Pretax Profit	13.3	10.0	33%	9.4	41%	23.4	20.1	16%
Tax	(2.7)	(2.1)	27%	(2.3)	17%	(4.8)	(4.3)	11%
MI	(2.3)	(1.1)	104%	(1.4)	67%	(3.5)	(2.3)	50%
Net Profit	8.3	6.8	22%	5.7	45%	15.1	13.5	12%
Core Net Profit	8.6	1.9	348%	5.6	52%	10.5	15.8	-34%
EPS (sen)	6.1	5.0	22%	4.2	45%	5.0	5.7	-13%
Net DPS (sen)	0.0	0.0	N.M.	0.0	N.M.	0.0	5.0	-100%
EBIT %	8.7%	6.2%		4.9%		7.4%	5.4%	
PBT%	8.7%	6.4%		5.0%		7.5%	5.5%	
Tax %	20.2%	21.1%		24.3%		20.6%	21.5%	
CPO Avg	2,192	2,416	-9%	2,612	-16%	2,192	2,612	-16%
FFB Prod ('000 mt)	27,667	18,959	46%	18,877	47%	46,626	34,404	36%

Source: Company, Kenanga Research

Segmental Breakdown								
FY Mar	2Q19	1Q19	QoQ %	2Q18	YoY%	1H19	1H18	YoY%
Segmental Revenue								
- Oleochemical	75.3	76.2	-1.3%	95.2	-21%	151.5	192.4	-21%
- Upstream Plantation	50.7	57.1	-11%	68.6	-26%	107.8	124.5	-13%
- Healthcare	20.9	20.2	3%	20.9	0%	41.1	42.1	-2%
- Others	6.2	4.4	39%	4.3	42%	10.6	8.7	21%
Total Group	153.0	158.0	-3%	189.0	-19%	311.0	367.7	-15%
Segmental Profit	2Q19	1Q19	QoQ %	2Q18	YoY%	1H19	1H18	YoY%
- Oleochemical	(0.5)	0.9	-155%	(0.5)	-1%	0.4	1.6	-75%
- Upstream Plantation	7.2	3.5	106%	4.2	72%	10.7	6.7	59%
- Healthcare	5.5	5.2	5%	4.9	11%	10.7	9.9	8%
- Others	1.1	0.2	504%	0.6	79%	1.3	1.7	-21%
- Share of associate profit	0.0	0.3	-90%	0.2	-82%	0.3	0.3	12%
Total PBT	13.3	10.0	33%	9.4	41%	23.4	20.1	16%
	26%	26%		24%		26%	24%	
Segmental PBT Margins								
- Oleochemical	-1%	1%		-1%		0%	1%	
- Upstream Plantation	14%	6%		6%		10%	5%	
- Healthcare	26%	26%		24%		26%	24%	

Source: Company, Kenanga Research

Sum-of-Parts Valuation					
Segment	Valuation	Note	Fair Value (RM'm)	PE (x)	Net Income (RM'm)
Oleochemicals	11x PER on CY18E earnings	40% discount to Plantation small - mid caps valuation	5	11.0	0.480
Hospital	18x PER on CY18E earnings				
Plantation	13.5x PER on CY18E earnings	25% discount to Plantation small caps valuation	317	18.0	17.6
Sum-Of-Parts (RM m)			97	13.5	7.2
Conglomerate discount			419		
Adj. Sum-Of-Parts (RM m)			15%		
No of shares (m)			356		
TP (RM)			137		
			2.60		

Source: Kenanga Research

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Peer Comparison

Name	Last Price	Market Cap	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div. Yld. (%)	Target Price (RM)	Rating
	(RM)	(RM'm)			1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.		
STOCKS UNDER COVERAGE																	
CB INDUSTRIAL PRODUCT HLDG	1.00	517.1	Y	12/2018	-26.2%	-8.7%	-19.9%	0.5%	6.2	7.8	7.7	0.7	0.7	8.9%	4.0%	1.10	OP
FGV HOLDINGS BHD	0.915	3,338.1	Y	12/2018	-2.0%	5.7%	-275.0%	314.9%	31.2	N.A.	56.1	0.6	0.6	-3.4%	0.0%	0.965	MP
GENTING PLANTATIONS BHD	9.63	7,756.4	Y	12/2018	9.5%	15.2%	-7.4%	35.9%	23.0	25.3	19.0	1.6	1.6	6.4%	2.2%	10.80	OP
HAP SENG PLANTATIONS HLDGS	1.66	1,327.5	Y	12/2018	-19.5%	10.9%	-70.9%	73.3%	9.9	34.2	19.7	0.6	0.6	1.9%	1.8%	1.95	OP
IJM PLANTATIONS BHD	1.51	1,329.7	Y	03/2019	-20.1%	20.0%	-82.0%	483.4%	18.9	105.3	18.1	0.8	0.8	0.7%	2.0%	1.85	MP
IOI CORP BHD	4.24	25,891.6	Y	06/2019	-1.8%	5.5%	14.3%	9.8%	28.5	24.9	22.7	2.9	2.8	11.4%	2.2%	4.50	MP
KUALA LUMPUR KEPONG BHD	24.44	26,027.8	Y	09/2019	2.6%	3.6%	28.8%	4.9%	29.2	22.7	21.6	2.3	2.2	9.8%	2.3%	25.70	MP
PPB GROUP BERHAD	17.00	24,184.2	Y	12/2018	12.6%	6.3%	-17.7%	18.2%	19.9	24.1	20.4	1.2	1.1	4.7%	1.5%	18.35	OP
SIME DARBY PLANTATION BHD	4.90	33,324.1	Y	12/2018	-59.0%	122.9%	-83.4%	525.3%	26.3	158.0	25.3	2.4	2.4	1.5%	0.4%	5.00	MP
SOUTHERN ACIDS MALAYSIA BHD	3.68	503.9	Y	03/2019	-11.3%	4.1%	-28.0%	12.0%	13.7	19.0	17.0	0.9	0.8	4.4%	0.8%	2.60	UP
TA ANN HOLDINGS BERHAD	2.09	929.3	Y	12/2018	-25.5%	3.1%	-33.0%	1.5%	7.4	11.0	10.8	0.7	0.7	6.2%	4.8%	2.35	OP
TSH RESOURCES BHD	1.00	1,380.7	Y	12/2018	7.3%	4.8%	-51.7%	49.0%	13.5	28.4	19.1	0.9	0.9	3.3%	0.9%	1.05	MP
UNITED MALACCA BHD	5.50	1,153.2	Y	04/2019	-11.1%	9.8%	6.2%	64.3%	30.0	28.2	17.2	0.7	0.6	2.3%	2.2%	5.25	UP
Simple Average					-11.1%	15.6%	-47.7%	122.5%	19.8	40.7	21.1	1.2	1.2	4.5%	1.9%		

Source: Bloomberg, Kenanga Research

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Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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