

28 February 2019

Southern Acids (M) Berhad Challenging Prospects

Southern Acids (M) Berhad (SAB) 9M19 Core Net Profit (CNP) of RM16.2m came in below our expectation at 61% of forecast but in line with consensus' RM21.6m at 75%. The lower-than-expected 9M19 CNP was dragged by oleochemical division margins due to unfavourable operating costs. No dividend was declared as expected. We cut FY19-20E CNPs by 19-12% to RM21.5-26.1m to reflect thinner oleochemical margins. Maintain UNDERPERFORM with a lower TP of RM2.50 (from RM2.60).

Below expectations. 9M19 CNP of RM16.2m after excluding one-off unrealised forex loss (RM4.2m), bad debt written-off (RM0.12m), came in below expectations, making up 61% of our RM26.5m estimate but in line with consensus' RM21.6m at 75%. The lower-than-expected 9M19 CNP was dragged by oleochemical division margins due to unfavourable operating costs, as its FFB production at 67.4k metric tons (MT) was well above our estimate, making up 91% of our full-year estimate. No dividend was declared as expected.

Improved plantation weaker Oleochemical. YoY, 9M19 CNP dropped (-41%) largely dragged by losses before tax (LBT) from Oleochemical segment on lower production capacity utilization and lower ASP of fatty acids that led to margin erosion. However, healthcare saw improvement in its pre-tax profit (+14%) underpinned by margin expansion to 27% (vs. 24% in 9M18) that was boosted by higher complex surgeries performed; but bed occupancy rate remains flattish, which was marginally down by 0.7% from 56.9% in 9M18. Similarly, its plantation upstream registered higher pre-tax profit (+9%) on higher FFB own production (+26.2%) positively affecting its cost structure that led to better margins. QoQ, 3Q19 CNP decreased (-34%) largely owing to Oleochemical division, which saw LBT widening to RM2.7m (from RM0.5m in 2Q19) mainly due to lower ASPs of fatty acids and exacerbated by drop in sales volume. Healthcare business remains resilient as it recorded better PBT margins of 28% (vs. 26% in 2Q19) likely on the better number of complex surgeries, while bed occupancy rate improves by (+7ppt).

Headwinds ahead. 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. We note that the segment's top-line performance is weakening due to lower sales volume. Improvement in CPO production output should improve unit costs through economies of scale. Meanwhile, its healthcare division will continue to register robust growth driven by improvement in average revenue per patient (ARPP). This is lifted by higher complex surgeries performed as a result of the company continuous effort in recruiting more specialists.

Reduce FY19-20E CNPs by 19-12% to RM21.5-26.1m as we update our assumptions for oleochemical segment to reflect thinner margins on higher operating costs.

Maintain UNDERPERFORM with a lower TP of RM2.50 (from RM2.60) post earnings adjustment on Sum-of-Parts valuation based on average of FY19-20E EPS of 17.4 sen (from 20.6 sen). In our Sum-of-Parts (SoP) valuation, we maintain our average Fwd. PER of 14.5x, applying a 25% discount to upstream segment to reflect the challenging near-term cost environment. Meanwhile, we maintain oleochemical segment at 11.0x Fwd. PER (average of small-mid cap planters), ascribing 40% discount to the Fwd. PER 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 RM2.50. Our TP implies a Fwd. PER of 15.9x, which is -0.5SD of 3-year average.

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.

UNDERPERFORM ↔

Price: RM3.87
Target Price: RM2.50 ↓

Expected Capital Gain: -RM1.37 -35.4%
Expected Divd. Yield: RM0.02 +0.5%
Expected Total Return: -RM1.35 -34.9%

KLCI Index 1,713.45

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)	529.9
Par value per share (RM)	1.00
52-week range (H)	4.12
52-week range (L)	3.58
Free Float	47%
Beta	0.8
3-mth avg daily vol:	6,587

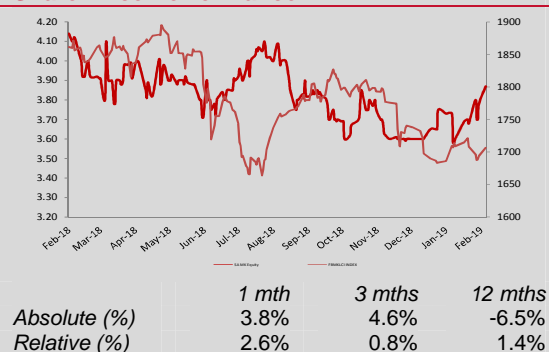
Major Shareholders

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	663.5	691.6
EBIT	49.1	36.9	38.8
PBT	49.4	41.5	43.6
Net Profit (NP)	30.7	21.5	26.1
Core NP	36.8	21.5	26.1
Consensus (NP)	N.A	21.7	29.2
Earnings Revision	N.A	-19%	-12%
Core EPS (sen)	26.9	15.7	19.0
Core EPS growth (%)	-15%	-42%	21%
NDPS (sen)	5.0	2.0	2.0
NTA per Share (RM)	4.28	4.42	4.59
Price to NTA (x)	0.9	0.9	0.8
PER (x)	14.4	24.7	20.3
Debt-to-Equity ratio(x)	N.Cash	N.Cash	N.Cash
Return on Asset (%)	5.1	2.9	3.4
Return on Equity (%)	6.3	3.6	4.1
Net Div. Yield (%)	1.3	0.5	0.5

Share Price Performance



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Results Highlights								
FY Mar	3Q19	2Q19	QoQ %	3Q18	YoY%	9M19	9M18	YoY%
Revenue	146.6	153.0	-4%	198.8	-26%	457.6	566.5	-19%
Op Profit	9.7	13.3	-27%	17.8	-46%	32.7	37.7	-13%
Pretax Profit	9.9	13.3	-26%	17.8	-44%	33.2	37.9	-12%
Tax	(2.6)	(2.7)	-5%	(4.0)	-36%	(7.4)	(8.3)	-12%
MI	(2.1)	(2.3)	-9%	(2.9)	-28%	(5.6)	(5.3)	7%
Net Profit	5.2	8.3	-37%	10.8	-52%	20.3	24.3	-16%
Core Net Profit	5.7	8.6	-34%	11.7	-51%	16.2	27.6	-41%
EPS (sen)	3.8	6.1	-37%	7.9	-52%	6.1	7.9	-23%
Net DPS (sen)	0.0	0.0	N.M.	0.0	N.M.	0.0	5.0	-100%
EBIT %	6.6%	8.7%		9.0%		7.2%	6.7%	
PBT%	6.7%	8.7%		8.9%		7.3%	6.7%	
Tax %	25.8%	20.2%		22.6%		22.1%	22.0%	
MPOB CPO Avg. (RM)	2,002	2,192	-9%	2,547	-21%	2,002	2,547	-21%
FFB Prod ('000 mt)	24,226	27,667	-12%	21,612	12%	70,852	56,016	26%

Source: Company, Kenanga Research

Segmental Breakdown								
FY Mar	3Q19	2Q19	QoQ %	3Q18	YoY%	9M19	9M18	YoY%
Segmental Revenue								
- Oleochemical	72.8	75.3	-3.3%	95.9	-24%	224.3	288.3	-22%
- Upstream Plantation	47.5	50.7	-6%	78.7	-40%	155.3	203.2	-24%
- Healthcare	21.9	20.9	5%	19.9	10%	63.0	62.0	2%
- Others	4.5	6.2	-27%	4.2	7%	15.1	12.9	17%
Total Group	146.6	153.0	-4%	198.8	-26%	457.6	566.5	-19%
Segmental Profit								
- Oleochemical	(2.7)	(0.5)	467%	4.6	n.m	(2.3)	6.2	n.m.
- Upstream Plantation	6.0	7.2	-17%	8.5	-30%	16.6	15.2	9%
- Healthcare	6.2	5.5	13%	4.9	26%	16.8	14.8	14%
- Others	0.2	1.1	-81%	(0.2)	-218%	1.5	1.5	4%
- Share of associate profit	0.2	0.0	541%	(0.0)	-518%	0.5	0.3	115%
Total PBT	9.9	13.3	-26%	17.8	-44%	33.2	37.9	-12%

Source: Company, Kenanga Research

Sum-of-Parts Valuation					
Segment	Valuation	Note	Fair Value (RM'm)	PE/RNAV discount	Net Income (RM'm)
Oleochemicals	11x PER on CY19E earnings	40% discount to Plantation small mid-caps valuation	(16)	11.0	-1.5
Hospital	18x PER on CY19E earnings	Small cap healthcare average valuation	326	18.0	18.1
Plantation	14.5x PER on CY19E earnings	10% discount to Plantation small caps valuation	97	13.5	7.2
Sum-Of-Parts (RM m)			406		
Conglomerate discount			15%		
Adj. Sum-Of-Parts (RM m)			345		
No of shares (m)			137		
TP (RM)			2.50		

Source: Company, Kenanga Research

28 February 2019

Peer Comparison

Name	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div. Yld. (%)	Target Price (RM)	Rating
					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	1.05	536.3	Y	12/2019	-30.8%	-10.0%	0.8%	-7.5%	10.6	10.5	11.4	0.7	0.6	7.4%	3.8%	0.850	UP
FGV HOLDINGS BHD	1.18	4,304.8	Y	12/2018	-2.0%	5.7%	-275.0%	314.9%	40.2	N.A.	72.3	0.8	0.9	-18.7%	0.0%	0.800	MP
GENTING PLANTATIONS BHD	10.52	8,496.7	Y	12/2019	19.3%	12.5%	168.6%	17.7%	59.3	24.1	22.2	2.1	2.2	9.1%	2.3%	9.80	UP
HAP SENG PLANTATIONS HLDGS	1.94	1,551.4	Y	12/2019	-29.6%	12.1%	-78.2%	51.0%	11.6	53.4	35.4	0.7	0.9	1.6%	1.3%	1.95	MP
IJM PLANTATIONS BHD	1.74	1,532.2	Y	03/2019	-24.0%	26.1%	-128.1%	32.1%	21.8	N.A.	24.9	0.9	0.9	-1.1%	0.0%	1.50	UP
IOI CORP BHD	4.49	27,418.7	Y	06/2019	-1.9%	5.6%	10.7%	13.6%	30.2	27.3	24.0	3.1	2.9	10.9%	1.6%	4.45	MP
KUALA LUMPUR KEPONG BHD	24.80	26,411.1	Y	09/2019	2.6%	3.6%	28.8%	4.9%	29.6	23.0	21.9	2.3	2.2	9.8%	2.2%	25.70	MP
PPB GROUP BERHAD	18.50	26,318.1	Y	12/2018	8.0%	4.7%	-11.4%	27.0%	24.6	27.8	21.9	1.3	1.2	5.1%	1.4%	16.60	UP
SIME DARBY PLANTATION BHD	5.09	35,042.5	Y	12/2018	-59.0%	122.9%	-83.4%	525.3%	27.3	164.1	26.2	2.5	2.5	1.5%	0.4%	5.00	MP
SOUTHERN ACIDS MALAYSIA BHD	3.87	529.9	Y	03/2019	-12.9%	4.0%	-41.1%	20.2%	14.4	24.7	20.3	0.9	0.9	3.6%	0.5%	2.50	UP
TA ANN HOLDINGS BERHAD	2.50	1,103.3	Y	12/2018	-25.5%	3.1%	-33.0%	1.5%	8.8	13.2	13.0	0.8	0.8	6.2%	4.0%	2.35	MP
TSH RESOURCES BHD	1.12	1,546.4	Y	12/2019	35.7%	4.7%	76.7%	5.3%	31.3	17.6	16.7	1.1	1.0	5.9%	1.4%	1.30	OP
UNITED MALACCA BHD	5.56	1,165.9	Y	04/2019	-27.3%	28.9%	-130.0%	43.1%	30.3	N.A.	855.4	0.7	0.7	4.5%	0.7%	5.10	UP
Simple Average					-11.3%	17.2%	-38.0%	80.7%	26.2	38.5	89.7	1.4	1.4	3.5%	1.5%		

Source: Bloomberg, Kenanga Research

28 February 2019

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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