

28 February 2018

Southern Acids (M) Berhad Challenging Prospects

Southern Acids (M) Berhad (SAB) 9M18 Core Net Profit (CNP) of RM27.6m came in below expectations at 68% of consensus and 63% of our forecast, dragged by lower contribution from upstream plantation and oleochemical segments. No dividend was declared as expected. We cut FY18-19E CNP by 13-6% to RM38.1-45.1m to reflect softer plantation margins. Downgrade to MARKET PERFORM with a lower TP of RM4.40 (from RM4.95) reflecting challenging Plantation businesses.

Below expectations. Excluding one-off unrealised forex loss (RM3.3m), inventory write-down (RM0.05m), bad debt written-off and other provision (RM0.01m), 9M18 CNP came in at RM27.6m. This is below expectations, making up 68% of consensus' RM43.6m and 63% of our RM40.3m estimate. The lower-than-expected 9M18 CNP was dragged by weaker upstream plantation and oleochemical division margins due to unfavourable operating costs. FFB production at 56.0k metric tons (MT) was in line, making up 71% of our full-year estimate. No dividend was declared as expected.

Oleochemical returned to black but lacklustre upstream business. YoY, 9M18 CNP was stronger (+12%) largely buoyed by larger contribution from its resilient healthcare segment at RM14.8m (+13%). This was on the back of strong PBT margins of 24% (vs. 22% in 9M17) boosted by higher complex surgeries performed although bed occupancy rate remains flattish, only inching up by 0.5% from 56.4% in 9M17. However, PBT was weaker at both plantation upstream (-24%) and oleochemical (-61%) businesses due to lower FFB volumes (-6%) leading to poorer margins. QoQ, CNP doubled (+108%) as FFB production improved 14%, while Oleochemical division saw a reversal into PBT of RM4.6m (from RM0.5m losses previously) on thanks to lower hedging and raw material costs. Healthcare business saw flat performance (-1%) despite softer revenue (-4%) likely on the better number of complex surgeries, despite slightly weaker occupancy.

Headwinds ahead. Despite the encouraging recovery in 3Q18, the weaker-than-expected plantation segment profit caused management to be cautious amidst uncertainty over the European Union palm oil ban as well as potential for further duty hike in India. We note that the segment's top-line performance is still encouraging despite softer operating margins, thanks to higher sales volume. Improvement in CPO production output should improve unit costs through economies of scale. Likewise, Oleochemical performance is expected to remain challenging due to the current high production costs and thin margins. Meanwhile, healthcare 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 FY18-19E CNP by 13-6% to RM38.1-45.1m as we update our upstream and oleochemical assumptions to reflect higher costs.

Downgrade to MARKET PERFORM with lower TP of RM4.40 (from RM4.95) based on Sum-of-Parts as we apply valuation discounts to the small-cap plantation benchmarks on our Upstream applied PER of 10% to 14.5x (from 16x) and to our Oleochemical segment of 20% to 13x (from 14x) the reflect the challenging near-term cost environment. Our Healthcare Fwd. PER is unchanged at 18x, as well as our conglomerate discount of 15%. Thus, our adjusted Sum-of-Parts valuation of RM603m implies a TP of RM4.40. While its solid net cash position of RM157m (RM1.15/share) should sustain its 4.0 sen dividend, we expect earnings outlook to remain challenging and thus downgrade our call to MARKET PERFORM.

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

MARKET PERFORM ↓

Price: RM4.10
Target Price: RM4.40 ↓

Expected Capital Gain: RM0.32 +7.3%
Expected Divd. Yield: RM0.04 +1.0%
Expected Total Return: RM0.36 +8.3%

KLCI Index 1,871.46

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)	561.4
Par value per share (RM)	1.00
52-week range (H)	5.25
52-week range (L)	4.08
Free Float	47%
Beta	0.4
3-mth avg daily vol:	5,738

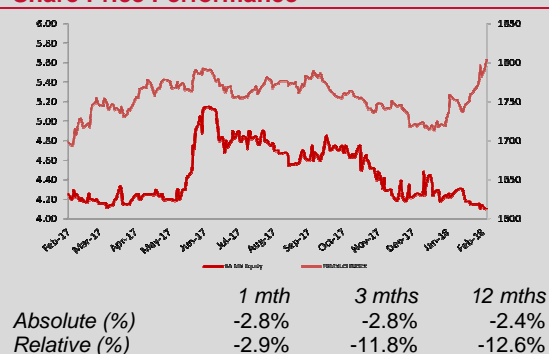
Major Shareholders

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

Summary Earnings Table

FY Mar (RM m)	2017A	2018E	2019E
Turnover	740.1	723.2	755.3
EBIT	69.5	57.5	65.5
PBT	73.8	61.5	70.8
Net Profit (NP)	48.7	38.1	45.1
Core NP	43.4	38.1	45.1
Consensus (NP)	N.A	40.3	45.55
Earnings Revision	N.A	-13%	-6%
Core EPS (sen)	31.7	27.8	33.0
Core EPS growth (%)	50.9	-12.3	18.5
NDPS (sen)	5.0	4.0	5.0
NTA per Share (RM)	4.16	4.40	4.68
Price to NTA (x)	1.1	0.9	0.9
PER (x)	13.9	14.7	12.4
Debt-to-Equity ratio(x)	Cash	Cash	Cash
Return on Asset (%)	6.1	5.1	5.8
Return on Equity (%)	7.6	6.3	7.0
Net Div. Yield (%)	1.1	1.0	1.2

Share Price Performance



Voon Yee Ping, CFA / Nor Nazirah
voonyyp@kenanga.com.my / nornazirah@kenanga.com.my
+603-2172 2647 / +603-2172 2652

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Results Highlights								
FY Mar	3Q18	2Q18	QoQ %	3Q17	YoY%	9M18	9M17	YoY%
Revenue	198.8	189.0	5%	191.9	4%	566.5	520.0	9%
Op Profit	17.8	9.3	92%	24.2	-26%	37.7	49.4	-24%
Pretax Profit	17.8	9.4	88%	23.0	-23%	37.9	48.3	-22%
Tax	(4.0)	(2.3)	75%	(5.2)	-23%	(8.3)	(11.7)	-29%
MI	(2.9)	(1.4)	109%	(3.7)	-20%	(5.3)	(4.8)	10%
Net Profit	10.8	5.7	88%	14.1	-24%	24.3	31.8	-24%
Core Net Profit	11.7	5.6	108%	11.2	5%	27.6	24.7	12%
EPS (sen)	7.9	4.2	88%	10.3	-24%	17.7	23.3	-24%
Net DPS (sen)	0.0	0.0	N.M.	0.0	N.M.	5.0	5.0	0%
EBIT %	9.0%	4.9%		12.6%		6.7%	9.5%	
PBT%	8.9%	5.0%		12.0%		6.7%	9.3%	
Tax %	22.6%	24.3%		22.7%		22.0%	24.2%	
MPOB CPO Avg. (RM)	2,547	2,612	-2%	2,724	-6%	2,606	2,575	1%
FFB Prod ('000 mt)	21,612	18,877	14%	25,594	-16%	56,016	59,316	-6%

Source: Company, Kenanga Research

Segmental Breakdown								
FY Mar	3Q18	2Q18	QoQ %	3Q17	YoY%	9M18	9M17	YoY%
Segmental Revenue								
- Oleochemical	95.9	95.2	1%	96.7	-1%	288.3	252.8	14%
- Upstream Plantation	78.7	68.6	15%	72.5	9%	203.2	199.4	2%
- Healthcare	19.9	20.9	-4%	19.3	3%	62.0	58.2	7%
- Others	4.2	4.3	-4%	3.5	20%	12.9	9.6	35%
Total Group	198.8	189.0	5%	191.9	4%	566.5	520.0	9%
						24%	22%	
Segmental Profit	3Q18	2Q18	QoQ %	3Q17	YoY%	9M18	9M17	YoY%
- Oleochemical	4.6	(0.5)	-1057%	6.2	-26%	6.2	15.8	-61%
- Upstream Plantation	8.5	4.2	104%	13.7	-38%	15.2	20.0	-24%
- Healthcare	4.9	4.9	-1%	4.5	8%	14.8	13.0	13%
- Others	(0.2)	0.6	-129%	(0.3)	-38%	1.5	0.5	200%
- Share of associate profit	(0.0)	0.2	-128%	(1.1)	-96%	0.3	(1.0)	-124%
Total PBT	17.8	9.4	88%	23.0	-23%	37.9	48.3	-22%

Source: Company, Kenanga Research

Sum-of-Parts Valuation					
Segment	Valuation	Note	Fair Value (RM'm)	PE/RNAV discount	Net Income (RM'm)
Oleochemicals	13x PER on CY18E earnings	20% discount to Plantation small caps valuation	129	13.0	9.9
Hospital	18x PER on CY18E earnings	Small cap healthcare average valuation	301	18.0	16.7
Plantation	14.5x PER on CY18E earnings	10% discount to Plantation small caps valuation	280	14.5	19.3
Sum-Of-Parts (RM m)			710		
Conglomerate discount			15%		
Adj. Sum-Of-Parts (RM m)			603		
No of shares (m)			137		
TP (RM)			4.40		

Source: Company, Kenanga Research

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Peer Comparison

NAME	Price (27- Feb- 2018)	Mkt Cap	Core PER (x)			Est. Net Div. Yld.	Historical ROE	P/BV	Core Net Profit (RMm)			FY17/18 NP Growth	FY18/19 NP Growth	Target Price	Rating
	(RM)	(RMm)	FY16/17A	FY17/18F	FY18/19F	(%)	(%)	(x)	FY16/17A	FY17/18F	FY18/19F	(%)	(%)	(RM)	
Core Coverage															
SIMEPLT	5.53	3,318	30.7	27.0	24.0	2.4%	9.8%	3.0	1,221.0	1,395.7	1,567.0	14%	12%	5.90	MARKET PERFORM
IOICORP	4.79	30,105	27.4	25.6	24.0	2.2%	14.7%	4.0	1,099.0	1,174.0	1,257.0	7%	7%	5.15	MARKET PERFORM
KLK	25.52	27,178	25.4	23.7	22.3	2.3%	9.2%	2.3	1,069.0	1,145.0	1,217.0	7%	6%	25.75	MARKET PERFORM
PPB	18.18	21,552	20.8	18.4	18.3	1.6%	4.9%	1.0	1,038.0	1,172.0	1,175.0	13%	0%	19.25	OUTPERFORM
GENP	10.10	8,112	24.1	23.1	19.4	2.4%	7.0%	1.7	336.0	358.0	434.0	7%	21%	10.75	OUTPERFORM
FGV	1.98	7,223	N.M.	62.5	53.1	1.5%	1.9%	1.2	108.0	116.0	136.0	N.M.	17%	2.00	MARKET PERFORM
IJMLNT	2.29	2,017	17.8	28.3	24.9	1.8%	6.4%	1.1	113.3	71.5	81.3	-37%	14%	2.00	UNDERPERFORM
TSH	1.57	2,168	21.2	20.5	19.8	1.2%	6.5%	1.4	101.1	106.6	110.2	5%	3%	1.60	MARKET PERFORM
HSPLANT	2.49	1,991	14.9	16.8	16.6	4.4%	6.4%	1.0	125.0	130.0	134.0	4%	3%	2.30	UNDERPERFORM
TAANN	3.40	1,512	12.2	11.3	12.2	4.7%	9.4%	1.2	123.6	134.0	124.0	8%	-7%	3.60	MARKET PERFORM
UMCCA	6.32	1,322	17.4	20.0	18.5	3.2%	4.3%	0.8	76.0	66.2	71.5	-13%	8%	6.80	MARKET PERFORM
CBIP	1.70	889	9.9	9.3	8.7	4.3%	12.5%	1.2	90.0	95.3	102.1	6%	7%	2.10	OUTPERFORM
SAB	4.10	561	12.9	14.7	12.4	1.0%	7.6%	1.0	43.4	38.1	45.1	-12%	18%	4.40	MARKET PERFORM

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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KENANGA INVESTMENT BANK BERHAD (15678-H)

Level 12, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my

This report is accessible at www.bursamids.com too.



Chan Ken Yew
Head of Research