Guan Chong Berhad

Unboxing Sweet Gains

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	Rating	Fair Value
Last Price	-	RM4.05
Kenanga	Trading Buy	RM4.85
Consensus	Buy	RM6.00

We call GCB a "Trading Buy" with a fair value of RM4.85 sweetened by favourable input prices, as global cocoa production outpaces demand. Coupled with GCB's strong clientele this warrant us to believe the stock is due for a PER re-rating. This backs our targeted PER of 10x based on its FY20E EPS of 48.5 sen, which is above its 3-year average as well as current trailing level of 9x. In the longer term, the new plant in Ivory Coast is to lift production capacity to 310kMT/year(+24%).

Tailwind from favourable cocoa prices – global cocoa supply volume has finally normalised post 2014 Ebola-inflicted shortages. In FY14, cocoa commodity prices rose to an all-time high of USD3.1k/MT due to global supply shortages triggered by an Ebola outbreak in Africa (where 70% of global cocoa producers are based), impacting its Indonesia plant (c.60% of FY14 capacity) negatively with supply shortage of cocoa beans. Making matters worse, grinding activity surged in the region, upon the implementation of export tax on the country's cocoa beans in 2010. As a cocoa refiner, this greatly inflated GCB's production costs and led to FY14 EBITDA margins declining sharply to just c.1% leading to LATAMI of RM17.3m (-300% YoY). With the supply progressively normalising prices have been reverting towards FY18 level of USD2.3k/MT, boosting EBITDA margin to 11.6% and PATAMI of RM190.1m. We believe this long-term average could be sustainable as we gathered from International Cocoa Organisation's forecast that global cocoa production still outpaces demand and is expected to persist.

Strong clientele. GCB's business is highly exposed to global demand through supplying to some of the largest global bluechip MNCs such as. Nestle, Mars and Hershey's in supporting their downstream businesses (distribution and manufacturing of finished goods). With global MNC customers making up over 50% of revenue, we see GCB as a beneficiary of a stable, diversified and growing international consumer market. In dealing with these MNCs, not only is risk lessened through diversification that a global market brings, it enjoys a long order visibility with duration of 6-12 months forward at a pre-determined price. With this, management is able to project that FY19/FY20 orders are 100%/60% filled based on its existing 250k MT/year capacity.

24%-Capacity expansion to propel growth. The group announced its plans to build a new facility in Ivory Coast which is earmarked to be commissioned by 1QFY21 for an additional 60k MT/year capacity. The estimated capex of EUR50-60m/RM230-276m will be funded from a mix of internally-generated funds, bank borrowings, and proceeds from private placement. We are in favour of this initiative which could; (i) ease access to materials, (ii) provide cheaper logistics cost for its export, and (iii) enjoy savings as tariffs are waived between Ivory Cost and the European Union.

Earnings estimates. Our revenue estimates are RM2.85b(+26%)/ RM2.92b(+2%) with EBITDA at RM312.7m(+19%)/RM315.4m(+1%) as production inches closer to its maximum levels. This led to our net income forecast of RM226.8m(+19%)/RM231.6m(+2%).Dividend prospects are expected to remain low at 2.0sen/2.4sen on a 5% payout ratio (from a 3-year average of 11%) on the management's emphasis to reinvest its earnings to support operations and the abovementioned expansion for the time being. This translates to dividend yields of 0.5%/0.6% in FY19/FY20.

We call a "Trading Buy" on the stock with a TP of RM4.85 based on a 10x FY20E PER valuation. Our targeted Fwd. PER is above the stock's 3-year average as well as current trailing level of 9x. We anticipate an expansion in valuations, warranted by: (i) the enlarged grinding capacity of the group to cater to the defensive international consumer market, and (ii) the more stable operating environment (post-FY14 supply shortage debacle) which is seen maintaining. Additionally, our PER expansion could be viewed as conservative when compared to its indirect peers' (COCOLND, APOLLO, OFI) 16x Fwd. PER, GCB looks to provide a stronger 3-year net profit CAGR of 9% (vs. -2%) and better 3-year ROE of >c.20% (vs. 9%). Further, GCB could see brighter prospects in the longer term as its Ivory Coast plant contributes from FY21E onwards. The added liquidity from the pending bonus issue could also be seen as a positive.

Stock Information

Shariah Compliant	No
Stock Name	GUAN CHONG BHD
CAT Code	5102
Industry	Food
Industry Sub-sector	Food-Confectionery
YTD stock price chg	48.05%
Market Cap (RM'm)	1,935.08
Shares Outstanding (m)	477.80
52-week range (Hi)	4.24
52-week range (Low)	2.019
3-mth avg daily vol	679,850
Free Float	18.4%
Beta	0.86
Altman's Z-score	3.55

Major Shareholders

Guan Chong Res Sdn Bhd	53.3%
Misi Galakan Sdn Bhd	6.1%
Syarikat Pj Enterprise	3.2%

Financials

FY Dec (RM m)	2018A	2019E	2020E
Revenue	2,273.4	2,856.1	2,925.0
EBITDA	262.6	312.7	315.4
Profit Before Tax	208.7	254.9	254.5
PATAMI	**190.1**	**226.8**	**231.6**
EPS (sen)	39.8	47.5	48.5
BV/Share (RM)	1.4	1.8	2.3
PER (x)	10.2	8.5	8.4
Price/BV (x)	2.2	2.2	1.8
Net Gearing (x)	0.8	0.6	0.5
DPS (sen)	2.5	2.0	2.4
Div Yield (%)	0.6%	0.5%	0.6%

Quarterly Financial Data (RM'm)

Quarterly Financial Data (RM'm)	4Q18	1Q19	2Q19
Revenue	**663.4**	**648.1**	**753.1**
PBT/(LBT)	54.6	63.8	72.0
PATAMI	**64.0**	**53.1**	**61.0**
Basic EPS (sen)	0.13	0.11	0.13
Revenue Growth (QoQ)	10.8%	-2.3%	16.2%
EPS growth (QoQ)	45.6%	-16.8%	14.8%
PATAMI Margin	9.6%	8.2%	8.1%

Peers Comparisons

Peers Comparisons	PER (1y-fwd)	Div. Yld (%)	Mkt Cap (RM'm)
COCOLND	13.5	3.9%	443.9
APOLLO	18.1	7.7%	308.0
OFI	15.1	3.2%	156.0
Average	**15.6**	**5.0%**	**-**

Daily Charting – Guan Chong Berhad

Comment: GCB has been consolidating since the formation of a long bullish candlestick that broke above all key-SMAs in mid-August 2019. However, we note the potential formation of a "Golden Cross" as its 50-Day SMA gradually approaches its 100-Day SMA, indicating that buying momentum has resumed. Thus, should the share find support at its 20-Day SMA, we expect the uptrend to continue and test its immediate resistance at RM4.30 (S1) and RM4.50 (S2). Conversely, downside support can be found at RM3.80 (S1) and RM3.50 (S2).

About the stock:

Name	:	Guan Chong Berhad
Bursa Code	:	GCB
CAT Code	:	5102

Key Support & Resistance level

Resistance	:	RM4.30 (R1)	RM4.50 (R2)
Support	:	RM3.80 (S1)	RM3.50 (S2)
Outlook	:	Bullish	

Source: Kenanga Research

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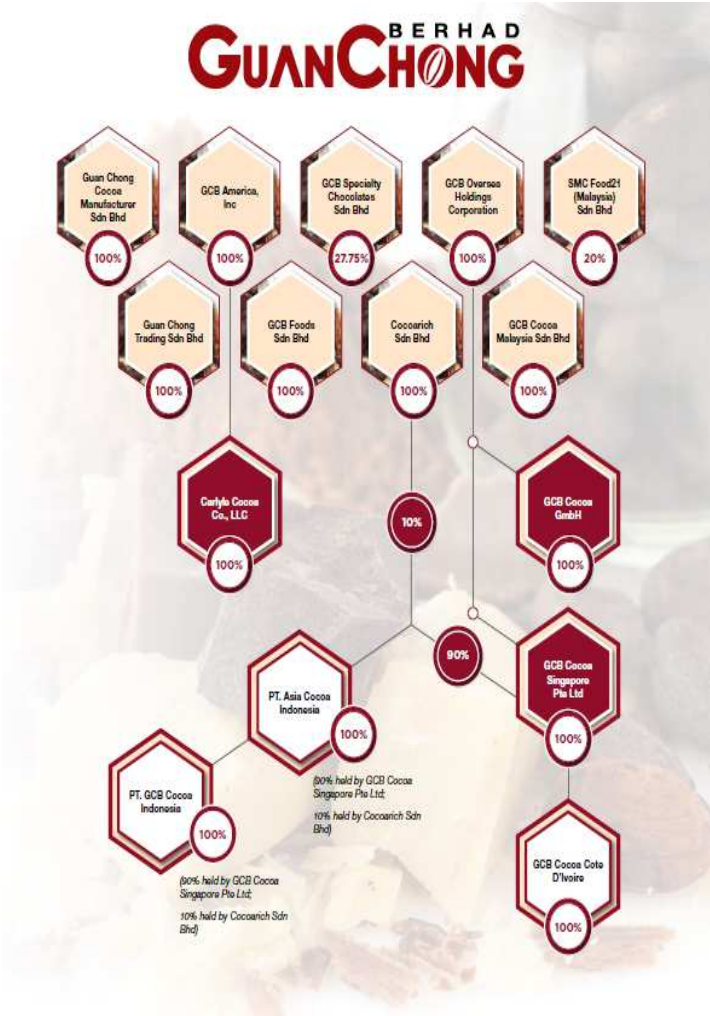
CORPORATE STRUCTURE



Source: Company

BUSINESS OVERVIEW

GCB is the largest cocoa processor in the region, with annual grinding capacity of 250k MT/year. Established in 1990, the group has production facilities in Pasir Gudang, Johor and Batam, Indonesia as well as a cocoa cake and butter grinding capacity in Delaware, USA. GCB's cocoa ingredients are marketed under the " Favorich Brand"

BUSINESS SEGMENTS

The group business segment is mainly focused on cocoa processing where cocoa beans are grinded into semi-finished products such as powder, cake, butter and liquor.

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