**UPDATE REPORT** **17 February 2011**

# QL Resources Bhd

| | |
|---|---|
| **Price :** | **RM3.16** |
| **Market Capitalization :** | **RM2,629.1 mln** |
| **Board :** | **Main Market** |
| **Sector :** | **Consumer** |
| **Recommendation :** | **BUY** |

**Bursa / Bloomberg Code: 2084 / QLG MK**
**Stock is Shariah-compliant.**

### Key Stock Statistics

| FYE Mar | FY10 | FY11f |
|---|---|---|
| EPS (sen) | 13.7 | 15.4 |
| P/E (x) | 23.1 | 20.5 |
| Net Div/Share (sen) | 3.8 | 4.2 |
| NTA/Share (RM) | 0.63 | 0.74 |
| Book Value/Share (RM) | 0.64 | 0.74 |
| Issued Capital (mln shares) | 832.0 | |
| 52-week Hi-Low (RM) | 1.65 - 3.30 | |
| **Major Shareholders:** | **%** | |
| CBG Holdings Sdn. Bhd. | 47.7 | |
| Farsathy Holdings Sdn. Bhd. | 13.7 | |

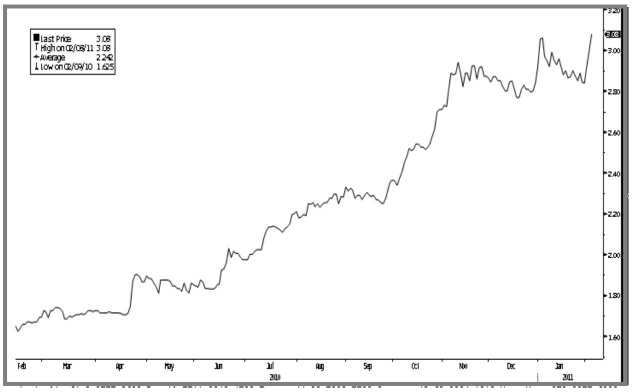
*Figures adjusted for 1-for-5 bonus issue in Feb 2010 & 2-for-1 share split in Feb 2011.*

### Per Share Data

| FYE Mar | FY09 | FY10 | FY11f |
|---|---|---|---|
| Book Value (RM) | 0.53 | 0.64 | 0.74 |
| Cash Flow (sen) | 15.7 | 18.7 | 20.7 |
| Earnings (sen) | 23.0 | 13.7 | 15.4 |
| Net Dividend (sen) | 2.9 | 3.8 | 4.2 |
| Payout Ratio (%) | 25.6% | 27.5% | 27.0% |
| PER (x) | 13.7 | 23.1 | 20.5 |
| P/Cash Flow (x) | 20.2 | 16.9 | 15.2 |
| P/Book Value (x) | 6.0 | 4.9 | 4.2 |
| Dividend Yield (%) | 0.9% | 1.2% | 1.3% |
| ROE (%) | 21.4% | 21.3% | 20.7% |
| Net gearing (x) | 0.7 | 0.6 | 0.5 |

*Figures adjusted for 1-for-5 bonus issue in Feb 2010 & 2-for-1 share split in Feb 2011.*

### Last 12-Month Share Price Chart



## Investment Highlights / Summary

- **Exposure to three agri-businesses** -- Marine-Products Manufacturing, Integrated Livestock Farming and Palm Oil Activities provides a diversified earnings streams. QL is the largest surimi producer in Asia and the largest fishmeal manufacturer in Malaysia.
- **Impressive financial track record** with 10-year revenue and net profit CAGR of 13.7% and 23.5% respectively over the last decade. PBT margin too, has been steadily rising from 4.9% in FY00 to 9.4% in FY10.
- **Exciting growth ahead.** QL is replicating its success in marine products manufacturing and livestock farming in Vietnam and Indonesia where demand for seafood and poultry products is high. These ventures are expected to provide major earnings booster from FY13 onwards. Meanwhile, its 20,000 hectares of oil palm plantations in Indonesia are also expected to start contributing to earnings in FY13.
- **Biotech ventures.** In line with the Group's objective to have zero-waste palm milling, it has successfully developed a proprietary technology to convert empty fruit bunch into palm pellets to be used to generate power. Should QL successfully commercialize this on a large scale, the potential is enormous.
- **Risks** include potential hiccups in its overseas ventures, bird-flu outbreak and lower-than-expected surimi and CPO prices.
- **Recommend to Buy with a fair value of RM3.60,** derived by pegging against peer's EV/EBITDA multiple of 14x. We like QL for its i) capable management who has led the Group's outstanding double-digit revenue and net profit growth over the last decade; ii) improving profitability margin; iii) healthy fundamentals; iv) clear growth prospects; and v) potential upside surprise from its biogas and palm pellet projects.

## Background

**Corporate profile.**

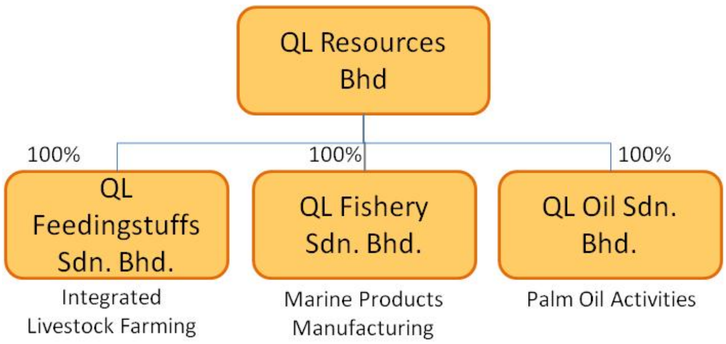
**Three core divisions:- Marine-Products, Integrated Livestock and Palm Oil Activities**

QL Resources (QL) is a diversified resource and agricultural-based group with three core business divisions:- Marine Products Manufacturing, Integrated Livestock Activities and Palm Oil Activities. QL was first listed on the then Second Board of Bursa Malaysia in March 2000, before being transferred to the Main Board (now known as the Main Market) in January 2002.

QL's history dates back to the early 1980's when its founder, Mr. Chia Song Kun, started a small-scale animal feed raw materials distribution business along with his family members. Under Mr. Chia's stewardship, the Group has successfully ventured into manufacturing of fishmeal and surimi products, livestock farming, crude palm oil milling (CPO) and oil palm plantation.

Today, Mr. Chia continues to helm the QL Group as the Group Managing Director. Meanwhile, QL's nine-member board of directors is led by YM Tengku Dato' Zainal Rashid bin Tengku Mahmood as the Chairman and Independent Director. Apart from YM Tengku Dato' Zainal Rashid and Mr. Chia, the other board members include five Executive Directors and two Independent Directors.

**Corporate structure.**




*Note: Only direct subsidiaries are shown.*

**Business.** A brief description of QL's three core businesses:-

**Marine Products Manufacturing Activities (MPM)**

QL operates both upstream and downstream marine activities, from deep sea fishing to manufacturing of fishmeal, surimi (fish paste) and surimi-based products such as fish balls and fishcakes.

**Largest surimi producer in Asia and largest fishmeal manufacturer in Malaysia**

With the Group's current production output, it is now:-

- the largest surimi producer in Asia (25,000 mt output per year);
- the largest surimi-based products manufacturer in Malaysia (30,000 mt per year); and
- the largest fishmeal manufacturer in Malaysia (25,000 mt per year).

Between 40%-50% of its marine products are exported overseas to countries such as Japan, Korea, China and Singapore, to name just a few. The balance is for domestic consumption, where QL estimates its local market share of marine products at circa 25%. The Group operates nine MPM plants located in Perak, Johor and Sabah, Malaysia.

**Expanding into Indonesia by building a surimi and fishmeal plant**

Leveraging on its success and experience in Malaysia, QL is now replicating its business model overseas in Indonesia. It is constructing a surimi and fishmeal processing plant on a 10-hectare land in Surabaya. Under Phase 1 that involved a capex of USD 10 mln, the initial capacity would be 5,000 mt of surimi and 5,000 mt of fishmeal per annum. The plant is currently on track for completion in March 2011 with earnings contribution expected to commence in FY12.

**Integrated Livestock Activities (ILF)**

**A key poultry player in Peninsular Malaysia with 12% market share in eggs**

A leading poultry player in Malaysia, QL distributes animal feed raw materials such as soybean meal and corn, as well as operates broiler and layer farms. The group's current annual output are:-

- 500,000 mt of animal feed raw materials;
- 1 billion eggs;
- 7 million broilers; and
- 16 million 'day old chicks' (DOC).

Based on QL's egg production, it has a market share of approximately 12% in the Peninsular Malaysia and 55% in the East Malaysia. Presently, it operates six poultry farms located in Kedah, Selangor, Negeri Sembilan, Sabah and Sarawak.

**Expanding into Vietnam and Indonesia**

The ILF division is similarly on an expansion mode, with management now replicating its operating model in Tay Ninh, Vietnam and Ciajur, Indonesia. With an investment of USD10 mln, QL is building a layer farm on a 20-hectare land in Vietnam with the initial production target of 500,000 eggs per day by 1QFY13. The production is meant for local consumption in Vietnam, which is currently importing mostly from China. Local poultry farming industry is fragmented, comprising various small-scale operators.

Meanwhile, in Indonesia, QL is starting both breeder and layer farms with an investment of USD20 mln. Management expects to produce 1 mln DOC per month by 2QFY12 and 500,000 eggs per day by 1QFY13.

**Palm Oil Activities (POA)**

**Small CPO milling and plantation operations in Tawau…**

QL operates two independent CPO milling plants in Tawau and Kunak, Sabah, with an annual production capacity of 500,000 mt. It also has a small oil palm plantation in Tawau with 3,000 acres of mature oil palms planted.

**…but going big in Indonesia with 20,000 hectares of plantation**

In 2006, QL ventured into oil palm plantation in Eastern Kalimantan, Indonesia via a joint venture to jointly develop two parcels of plantation land measuring 20,000 hectares. Planting commenced in 2007, and approximately 8,200 hectares have been planted as at December 2010. Management plans to complete planting by FY14. Contribution is expected to start trickling in by FY13, with major earnings boost from FY14 onwards. In anticipation of the upcoming Fresh Fruit Bunch (FFB), the Group is building its third CPO milling plant at its Indonesia plantation site, slated for completion end of 2011 with an annual production capacity of 500,000 mt.

**Venturing into biogas and palm pelletizing projects**

In line with the Group's initiatives for sustainable zero-waste palm oil milling, QL has also embarked on renewable energy projects by building a biogas plant and a palm pelletizing plant in Tawau, Sabah. The biogas plant, which is slated for commencement by early February 2011, will convert palm oil mill effluent into energy that can be used to power its milling plants and the pelletizing plant.

**First in the world to produce palm pellets**

As for the palm pelletizing plant, QL believes it is the first company in the world to have developed the proprietary technology of converting Empty Fruit Bunch (EFB) into palm pellets that can be used as feedstock to generate power. EFB, in its bulky state, is difficult to be transported, plus the high humidity content makes them inefficient to be used for burning. QL solved these problems by converting EFB into small-sized pellets where they are easily transportable, and with the humidity content reduced substantially, the pellets can be burned with high combustion efficiency. The plant is targeted for completion in February 2011 as well, with a capacity of 40,000 mt palm oil pellets.

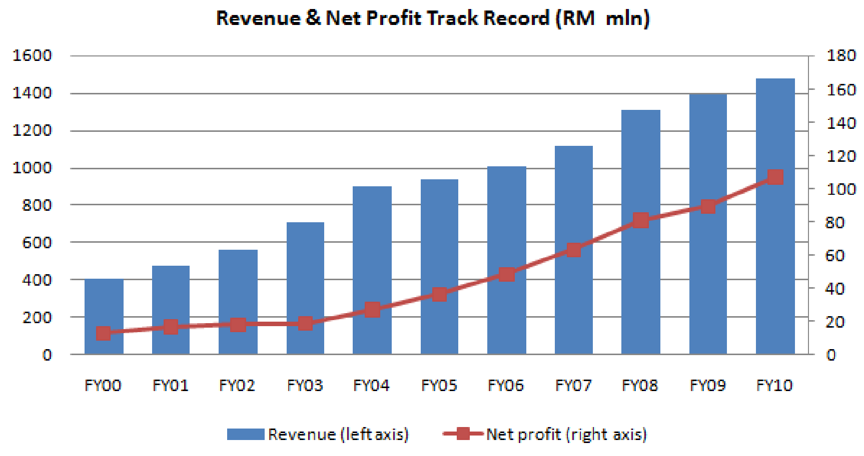
**Acquired 40.51% in Boilermech for exposure in biomass boilers**

In October 2010, QL announced the proposed acquisition of 40.51%-stake in Boilermech Sdn. Bhd. (Boilermech) for a cash consideration of RM29.2 mln, which translated into a PER of 5.85x based on Boilermech's latest financial year results ended April 2010. Boilermech is one of the leading biomass boiler manufacturers in Malaysia that also has presence in neighbouring countries such as Indonesia, Thailand, Myanmar, Ivory Coast and Cambodia. The acquisition complements QL's focus to expand into renewable energy business. Management plans to list Boilermech on the ACE Market in the near future. The Group announced on 14 February 2011 that it has obtained approval from Bursa Malaysia for the listing of Boilermech on the ACE Market.

## Financial Highlights

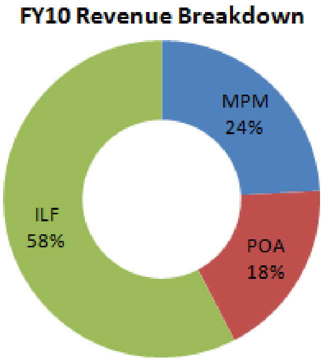
**Impressive 10-year double-digit revenue and net profit CAGR**

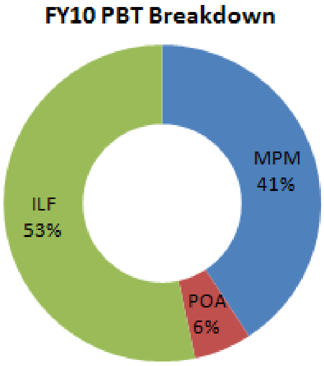
QL's financial track record since its listing in 2000 has been remarkable. During the decade, the Group chalked up a 10-year revenue CAGR of 13.7% and a 10-year net profit CAGR of 23.5%. It is noteworthy to mention that QL posted consecutive growth in both revenue and net profit during the 10-year period, a testament to the quality of leadership, business acumen and execution skills of the Group's management in weathering through different economic cycles.




**ILF is the largest earnings contributor**

In FY10, ILF is the anchor revenue and PBT contributor to QL Group at 58% and 53% respectively, followed by MPM and POA divisions. The MPM division enjoys the highest segmental PBT margin amongst the three, contributing 41% of Group PBT despite making up only 24% of Group revenue.

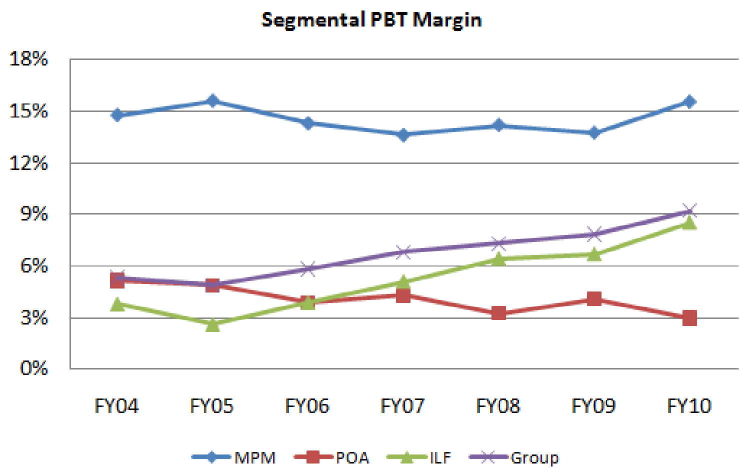



*Source: Company*

**Improving Group PBT margins over the years**

In terms of PBT margin, the Group PBT margin has steadily been inching up from 4.5% in FY04 to 9.2% in FY10, largely due to the improving profitability at the ILF division, which saw PBT margin more than doubled to 8.5% in FY10 from a mere 3.8% in FY04. Management attributed the success in ILF to effective cost-control initiatives especially since it imports its own animal feed raw materials, as well as tight biosecurity measures to ensure healthy and productive broilers and layers.




We note that QL's effective tax rate between FY05 and FY10 has been hovering below 15%. We understand from management that the lower-than-statutory rate is due to the various tax incentives that the Group enjoys for its three divisions, such as Pioneer Status, Reinvestment Allowance, Investment Tax Allowance, Double-Deduction for imports etc.

On balance sheet strength, QL's net gearing stood at 0.6x as at FY10, down from 1.5x in FY04. Interest cover ratio too, has been rising from 6x in FY04 to a comfortable 11x in FY10. Moreover, we estimate that following its recent private placement exercise that raised approximately RM116 mln for capex and working capital needs, its net gearing would further reduce to circa 0.5x.

## Earnings Outlook

**Existing operations to support earnings growth in FY11 and FY12; expects booster in FY13**

QL's earnings in FY11 and FY12 will largely continue to be supported by the growth from its existing businesses in Malaysia. While its MPM expansion and breeder farming in Indonesia should be operational by FY12 according to management's plans, we have not factored in any contribution yet to reflect a more prudent stand in case of teething issues in the initial period or any unforeseen delays. We anticipate the big earnings booster to kick in by FY13 when its MPM, ILF and POA expansions in Vietnam and Indonesia all come to fruition.

Based on its historical growth trend, we estimate QL's net profit to register 15% and 19% yoy growth in FY11 and FY12 to RM122.6 mln and RM145.8 mln respectively.

## Investment Risks

**Hiccups in overseas expansions.** QL had budgeted a total capex of approximately RM500 mln for both FY11 and FY12 for its expansions in three core divisions. The bulk of the capex is for the expansions in Vietnam and Indonesia. Any delays or potential operational issues faced in these two countries may have a drag on future earnings.

**Outbreak of bird-related flu.** Any outbreak of bird-flu in the region would likely have an impact on the demand for eggs and poultry products in Malaysia. However, the mitigation factors include its strict biosecurity measures as well as earnings diversification from MPM and POA divisions.

**Lower-than-expected prices of surimi and CPO.** Given the commodity nature of the products, fluctuations in prices are expected. However, any unexpected major decline in surimi and CPO prices may have an adverse impact on earnings.

## Valuation

**Peer comparison**

Given QL's exposure to three different agri-businesses, there is no direct peer to the Group in the region. Nonetheless, we have listed in the table below several players in Malaysia and Thailand that are involved in poultry farming and frozen seafood businesses to provide a perspective on the size and profitability of their operations. From the table, it is evident that QL's profitability is superior by comparison to its peers in the respective industry.

| Company | Curr | Share price | PER (x) | P/BV (x) | Mkt Cap (mln) | Revenue (mln) | Net inc (mln) | Net margin (%) |
|---|---|---|---|---|---|---|---|---|
| QL | RM | 3.09 | 19.5 | 4.5 | 2,595.8 | 1,476.4 | 106.9 | 7.2% |
| **Poultry** | | | | | | | | |
| Huat Lai | RM | 1.43 | 5.6 | 0.9 | 121.7 | 501.2 | 10.3 | 2.1% |
| Emivest Bhd | RM | 0.84 | 5.1 | 0.8 | 100.2 | 635.8 | 16.5 | 2.6% |
| Leong Hup Holdings | RM | 1.66 | 7.7 | 0.8 | 293.9 | 1,142.9 | 34.1 | 3.0% |
| **Frozen Seafood** | | | | | | | | |
| Surapon Foods Public Cc | THB | 6.10 | 14.0 | 1.1 | 1,647.0 | 5,373.3 | 271.3 | 5.0% |
| Kiang Huat Sea Gull | THB | 180.00 | 8.0 | 1.0 | 1,350.0 | 3,568.5 | 164.8 | 4.6% |
| Asian Seafoods | THB | 3.36 | 8.0 | 0.7 | 1,215.7 | 9,979.8 | 113.3 | 1.1% |
| Thai Union Frozen Prod. | THB | 44.75 | 12.3 | 2.3 | 42,795.7 | 68,994.5 | 3,343.8 | 4.8% |

*Source: Bloomberg, Company data*

In terms of market capitalization and size of revenue, Thai Union Frozen Products PCL (TUF) from Thailand appears to be the closest comparable peer to QL. TUF is currently trading at an EV/EBITDA multiple of 14.5x.

By ascribing an EV/EBITDA multiple of 14x (benchmarked against TUF), we arrive at a fair value of RM3.60 for QL. We note that this implies a relatively high FY12 PER of 20x, but we believe the premium is justified after factoring in the Group's major expansion plans overseas and the expected earnings booster from FY13 onwards upon commencement of contributions from the overseas operations. The implied PER of 20x is also within QL's 3-year historical PER range of 10x – 21x.

## Recommendation

**BUY recommendation with fair value of RM3.60**

We recommend a **Buy** call on QL with a fair value of **RM3.60** (ex-price following 2-for-1 share split which went ex on 8 February 2011).

We continue to QL for its i) highly capable management who has led the Group's outstanding double-digit revenue and net profit growth over the last decade; ii) improving profitability margin; iii) healthy fundamentals; iv) clear growth prospects; and v) potential upside surprise from its biogas and palm pellet projects.

## Recent Developments

**14 Feb 2011:** QL obtained approval from Bursa Malaysia for the listing of Boilermech on ACE Market.

**26 Jan 2011:** QL completed its private placement exercise of 20.8 mln shares at RM5.60 (cum price) each, raising gross proceeds of approximately RM116 mln.

**11 January 2011:** QL proposed to acquire a 51%-stake in Pilihan Mahir Sdn. Bhd. via its 70.6% subsidiary, QL Endau Marine Products Sdn. Bhd., for RM500,000.

**3 November 2010:** QL proposed to undertake corporate proposals involving i) a private placement; ii) 2-for-1 share split; iii) 1-for-20 free warrants after the private placement and share split; and iv) increase in the authorized share capital and amendments to QL's Memorandum and Articles of Association. The ex-date for the share split and free warrants was on 8 February 2011.

**24 August 2010:** QL acquired 23.29%-stake in Lay Hong Bhd. As Lay Hong is in similar poultry farming business, the objective of the acquisition is to achieve synergies from feed raw material sourcing arrangements, supply chain networks and operations efficiency.

## P&L Summary

| FYE Mar (RM mln) | FY09 | FY10 | FY11f | FY12f |
|---|---|---|---|---|
| Revenue | 1,397.9 | 1,476.4 | 1,630.8 | 1,836.9 |
| EBITDA | 159.6 | 187.9 | 213.0 | 251.9 |
| Depreciation | (34.2) | (39.4) | (42.4) | (51.4) |
| Net Int Exp | (16.0) | (12.9) | (15.8) | (16.4) |
| Pre-tax Profit | 109.9 | 136.0 | 155.3 | 184.6 |
| Eff. Tax Rate | 12.0% | 15.4% | 15.0% | 15.0% |
| Net Profit | 89.3 | 106.9 | 122.6 | 145.8 |
| EBITDA Margin (%) | 11.4% | 12.7% | 13.1% | 13.7% |
| Pre-tax Margin (%) | 7.9% | 9.2% | 9.5% | 10.0% |
| Net Margin (%) | 6.4% | 7.2% | 7.5% | 7.9% |

*Source: Company, ZJ Research*

## Balance Sheet Summary

| FYE Mar (RM mln) | FY09 | FY10 |
|---|---|---|
| Total Assets | 953.5 | 1,106.1 |
| Non-Current Assets | 568.8 | 654.0 |
| Current Assets | 384.7 | 452.1 |
| Current Liabilities | 295.8 | 292.5 |
| Long Term Liabilities | 192.4 | 255.0 |
| Share Capital | 165.0 | 197.6 |
| Shareholders' Equity | 417.9 | 502.8 |

*Source: Company, ZJ Research*

**Analyst: Nicole Tan Yoke Ping (nicole@zj.com.my)**

## RATING GUIDE

| | |
|---|---|
| BUY | Price appreciation expected to exceed 10% within the next 12 months |
| SELL | Price depreciation expected to exceed 10% within the next 12 months |
| HOLD | Price movement expected to be between -10% and +10% over the next 12 months from current level |

## DISCLAIMER



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