



CHINA
DEVELOPMENT
FINANCIAL

Halcyon Agri Corporation Limited

(HALC SP/HALC.SI)

Not Rated

Price as of 24 Jan 2018	0.67
12M target price (SGD)	na
Previous target price (SGD)	na
Upside (%)	na

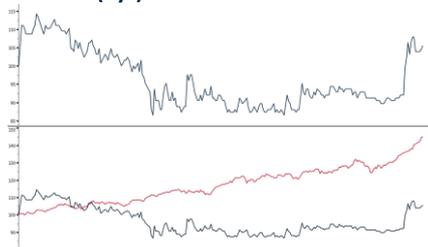
Trading data

Market Cap (SGDm)	1,060.7
Issued Shares (m)	1,595.0
Ave Daily Traded (3-Month) Vol / Val	0.3m / \$0.2m
52 week lo / hi (SGD)	\$0.54 / \$0.73
Free Float	35.4%

Major Shareholders

Sinochem International	55.0%
China Africa Development	10.2%

HALC SP (1yr) VS STI



Source: Bloomberg

Proxy for growth in natural rubber demand

Event

We recently visited 2 of the 19 Standard Indonesian Rubber (SIR) processing facilities of Halcyon Agri (Halcyon) in Palembang, South Sumatra, Indonesia, to understand Halcyon's role in the rubber supply chain and what drives its value.

Impact

From midstream Natural Rubber (NR) player to supply chain manager. Since its IPO listing in 2013, Halcyon's production capacity has grown from 110,000 metric tonnes (mT) per annum to about 1.63 million mT today, covering major rubber producing regions across 6 countries. From being a processor of rubber, Halcyon has moved both up and down the supply chain by acquiring 3 rubber plantations with a total land area of 122,000 ha (current planted area: 39%) as well as an extensive network of distribution centres across the globe.

Rubber prices showing signs of recovery. TSR20 and RSS3 futures prices have risen 6.4% and 7.7% respectively, since 29 November 2017, when Thailand, Malaysia and Indonesia agreed to cut rubber exports by 350,000 mT between December 2017 and March 2018. This agreement is the fifth Agreed Export Tonnage Scheme (AETS) which aims to address declining NR prices, which have a direct impact on smallholders, by restricting exports. Rising oil prices and the increased rainfall in rubber producing regions (affects rubber production and reduces supply) during the year end have also contributed to positive rubber price movements.

High exposure to defensive tyre market. The demand for natural rubber is expected to grow at an annual rate of 2.5% until 2020, before settling at an average of 2.6% thereafter, according to the International Rubber Study Group (IRSG). This will be largely driven by the growing tyre industry, accounting for 70% of global rubber consumption. As this demand is dominated by motor vehicles, the demand from the global automotive industry (tyres for new vehicles: 30% and replacement tyres for existing vehicles: 70%) remains a key driver for Halcyon's growth. Because of the finite useful lives of tyres, the replacement market provides support for long term demand.

Valuation & Action

Halcyon currently trades at a historical P/E of 5.0x, well below its peers in both categories – 417.4x for rubber players and 17.5x for supply chain managers. Being the youngest of the lot, Halcyon has a relatively short track record in the industry and also has a significantly sizeable proportion of unplanted capacity. While we think that Halcyon should trade at a lower P/E to its peers, we believe that it is currently undervalued in view of its growth potential. Its ability to achieve cost efficiencies by eliminating key transactions through its pursuit of a cost productive structure may also be overlooked, due to the lack of understanding of its seemingly complex operating structure. Special dividends may provide a short-term upside catalysts when it reports full-year earnings in the last week of February.

Risks

Key risks include volatility of rubber prices which could affect average selling price and unfavourable weather conditions affecting tree yields.

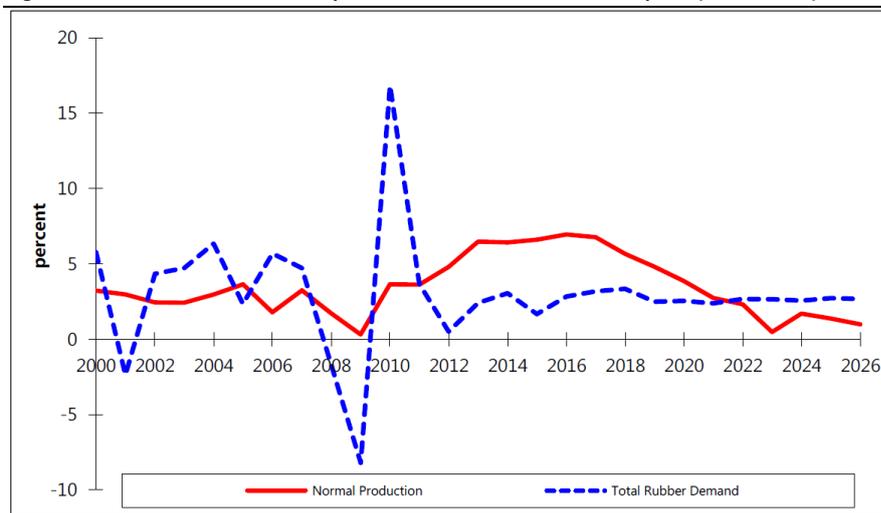
Nicholas Siew
65 6202 1193
nicholas.siew@kgi.com

See the last page for important disclosures.

Rubber consumption expansion, following subdued growth in 2015

According to the IRSG, the global total rubber consumption is expected to have grown 3.2% in 2017, compared to 2.9% in 2016, below the long-term average of 3.6% (1961 – 2013). The growth in 2017 came in above expectations and is attributed to improving manufacturing activities and growth in output of tyres, in both emerging and developed markets. It is also expected that supply will taper off and grow at a slower pace than NR consumption after 2021.

Figure 1: Growth rates in NR normal production and total tuber consumption (2000 – 2026)

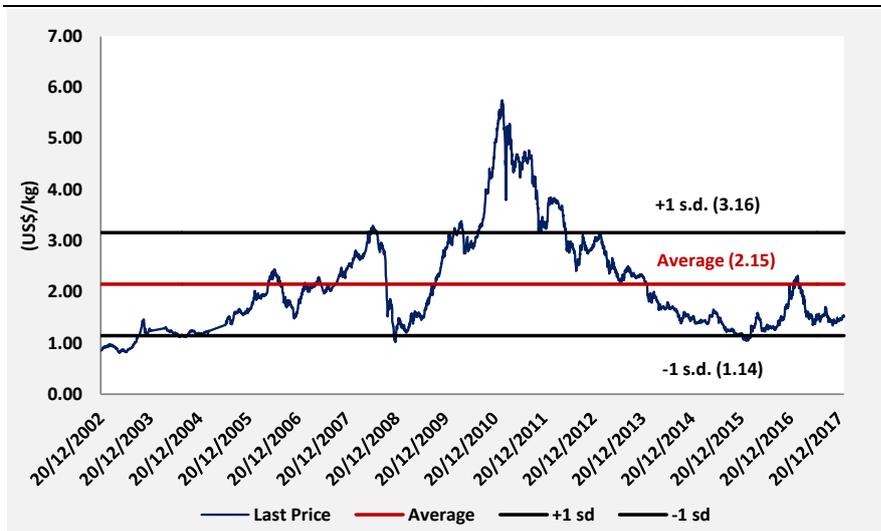


Source: IRSG

Natural rubber prices suppressed by the supply glut

Rubber prices have historically experienced high volatility due to the changing supply and demand dynamics. However, in the past 7 years, rubber prices have declined 74% from its peak of US\$5.75/kg to current levels of about US\$1.52/kg, as a result of the oversupply of NR. The demand for automotive tyres, and therefore the demand for NR, is commonly linked to global GDP growth. While demand for NR is expected to grow steadily in the long term, it is still not sufficient to absorb the current oversupply of NR. To address this, the International Tripartite Rubber Council (ITRC) has stepped in to restrict rubber exports. The three ITRC members are Thailand, Indonesia and Malaysia – the three largest producers of NR globally.

Figure 2: SICOM TSR20 currently trades at US\$1.51/kg, way below the average (2002 – 2017)

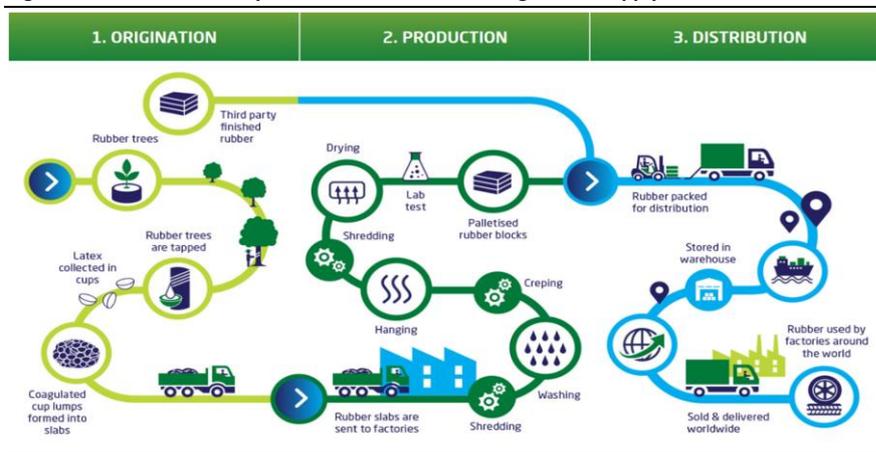


Source: Bloomberg, KGI Research

Seeking cost synergies through inorganic expansion

Since its IPO, Halcyon has acquired several rubber processing facilities to expand its production capacity. It has also acquired rubber plantations and distribution facilities to span the full rubber supply chain from origination to distribution. According to the management, this strategic direction would allow them to streamline the rubber supply chain into a cost productive structure.

Figure 3: Illustration of Halcyon's involvement in each stage of the supply chain



Source: Bloomberg, KGI Research

Supplier to major tyre manufacturers around the globe

Halcyon's customer base includes international tyre manufacturers as well as international trading houses. Historically, Cooper Tire has been the largest customer of Halcyon. The rubber blocks sold to each customer is not fungible due to the different specifications each customer requires. Major customers include: Bridgestone, Ceat India, Continental, Cooper Tire, Goodyear, JK Tyre India, Kumho, Sumitomo Tyre and Toyo Tires.

Valuations seem undemanding, well below its peers

Halcyon currently trades at a historical P/E of 5.0x, well below its peers in both categories – 417.4x for rubber players and 17.5x for supply chain managers. Being the youngest of the lot, Halcyon has a relatively short track record in the industry and also has a significantly sizeable proportion of unplanted capacity, accounting for 61% of its total plantable land area of 122,000ha. While we think that Halcyon should trade at a lower P/E to its peers, we think that it deserves a higher valuation from its current level as it is still in its early stages of growth. Its ability to achieve cost efficiencies by eliminating key transactions through its pursuit of a cost productive structure may also be overlooked, due to the lack of understanding of its seemingly complex operating structure.

Figure 4: Peer comparison

Company	Last Price	Market Cap (\$\$ m)	P / E (x)			P / B (x)			Div Yield (%)		Gearing (%) Current
			Last FY	FY+1	FY+2	Last FY	FY+1	FY+2	Last FY	FY+1	
Rubber Players											
Halcyon Agri Corp Ltd	SGD 0.67	1,061	5.0	-	-	1.1	-	-	0.0	-	45.8
China Hainan Rubber Indust-A	CNY 6.08	4,924	446.2	152.0	76.0	3.4	2.9	2.8	0.0	-	32.4
Sinochem Intl Corp-A	CNY 8.60	3,690	388.7	23.9	18.7	2.2	1.5	1.4	0.8	2.2	48.5
Sri Trang Agro-Industry Pcl	THB 12.30	808	-	-	26.3	1.5	0.9	0.8	1.7	1.3	64.8
Thai Rubber Latex Corp	THB 2.04	142	-	-	-	0.7	-	-	0.0	-	66.7
Rubber Players Average			417.4	87.9	40.3	1.9	1.8	1.7	0.6	1.8	53.1
Supply Chain Managers											
Glencore Plc	GBP 402.40	106,708	-	14.5	13.5	1.1	1.7	1.6	2.0	2.0	42.7
Archer-Daniels-Midland Co	USD 42.75	31,558	21.4	18.5	15.7	1.5	1.4	1.4	2.6	3.0	29.4
Wilmar International Ltd	SGD 3.21	20,306	16.1	14.4	12.7	1.1	1.0	1.0	1.9	2.2	53.3
Bunge Ltd	USD 82.11	15,242	15.6	29.9	17.5	1.6	1.5	1.5	2.2	2.1	43.1
Olam International Ltd	SGD 2.22	7,003	17.1	15.9	15.9	1.2	-	-	3.0	1.6	67.6
Noble Group Ltd	SGD 0.26	345	-	9.8	1.3	0.4	0.1	0.1	0.0	0.0	77.5
Supply Chain Managers Average			17.5	17.2	12.8	1.2	1.1	1.1	2.0	1.8	52.3
Overall average			217.5	52.6	26.6	1.5	1.5	1.4	1.3	1.8	52.7

Source: Bloomberg, KGI Research

Figure 5: It takes 3 days to collect 1 cup. This is sold to Halcyon based on the percentage of dry rubber content (DRC) in the collected rubber.



Source: KGI Research

Figure 6: Coagulated raw rubber, referred to as cup lumps, are gathered at the base of the tree.



Source: KGI Research

Figure 7: Cup lumps are collected, pressed into pillow like blocks, and sent to Halcyon's factories for processing.



Source: KGI Research

Figure 8: Cup lump pillows are delivered to the processing facilities and kept under shelter, away from rain and direct sunlight.



Source: KGI Research

Figure 9: The processing of rubber starts with cup lump pillows being loaded onto a conveyor which leads to a shredder.



Source: KGI Research

Figure 10: Cup lump pillows are shredded and washed. This process also helps to remove foreign objects stuck in the rubber.



Source: KGI Research

Figure 11: Cup lump pillows come out from the shredder looking like popcorn.



Source: KGI Research

Figure 12: Workers manually check for any metal objects and large foreign objects.



Source: KGI Research

Figure 13: Shredded cup lumps are sent through a heating machine that presses them into sheets.



Source: KGI Research

Figure 14: Rubber sheets are visually inspected for foreign objects that failed to be removed in the earlier stages of the process.



Source: KGI Research

Figure 15: Rubber sheets are further rinsed with water to remove dirt and particles.



Source: KGI Research

Figure 16: Rubber sheets are collected and folded into stacks to facilitate hanging and drying.



Source: KGI Research

Figure 17: Rubber sheets at this point have most of the impurities and particles removed.



Source: KGI Research

Figure 18: Rubber sheets are brought to the hanging sheds to be hung and dried for 14 days. The sheets turn brown as they oxidize.



Source: KGI Research

Figure 19: After the rubber sheets are hung and dried, they are further shredded and dried in a massive heating machine.



Source: KGI Research

Figure 20: The dried shredded pieces of rubber are pressed and shaped into blocks.



Source: KGI Research

Figure 21: Rubber blocks enter the final stages of processing; sent for further inspection.



Source: KGI Research

Figure 22: Rubber blocks are weighed. Samples of rubber are taken from the blocks and sent for testing to ensure consistency in the blocks.



Source: KGI Research

Figure 23: Rubber blocks are compressed in blue heating machines to facilitate packaging.



Source: KGI Research

Figure 24: Pressed rubber blocks, referred to as bails, are packed into boxes; 36 bails are packed into one box and weigh a total of 1250kg.



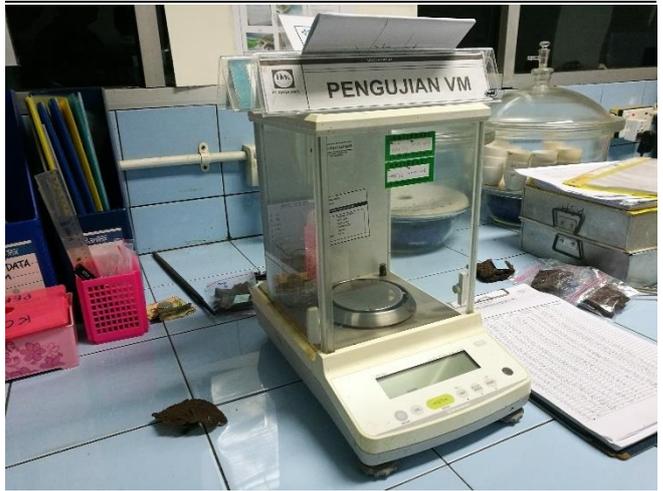
Source: KGI Research

Figure 25: Samples taken from the rubber blocks are sent to the laboratories for testing of characteristics such as, plasticity and viscosity.



Source: KGI Research

Figure 26: One of the few machines used to test the various characteristics of the samples.



Source: KGI Research

Figure 27: Company profile

Halcyon Agri (SGX: 5VJ) is a leading supply chain manager of natural rubber with a production capacity of 1.63 million mT per annum. The Group owns 38 processing factories in most major rubber producing origins and produces sustainable natural rubber under its proprietary HEVEAPRO brand. The Group leverages its extensive network of warehouses, terminals laboratories and sales offices across the world to distribute a range of natural rubber grades, latex and specialised rubber for the tyre and non-tyre industries. The Group is headquartered in Singapore and has more than 15,000 employees located in 54 locations. Halcyon Agri is listed on the Mainboard of the Singapore Exchange with a market capitalisation of more than US\$700 million.

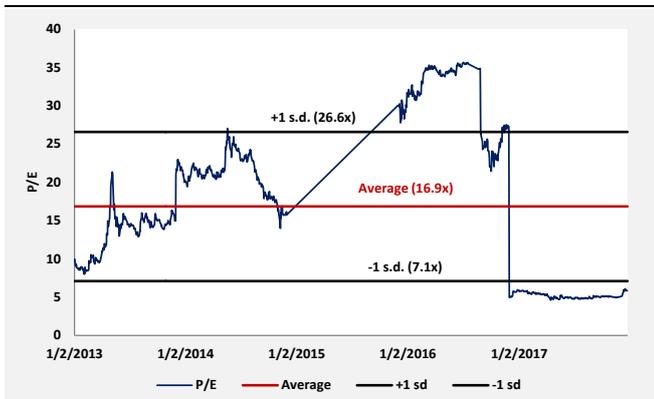
Source: Company

Figure 28: Halcyon's share price performance since IPO



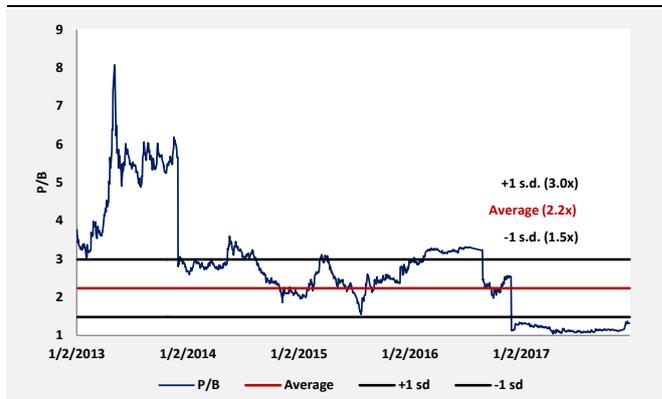
Source: Bloomberg, KGI Research

Figure 29: Halcyon's Price to Earnings (x) since IPO



Source: Bloomberg, KGI Research

Figure 30: Halcyon's Price to Book (x) since IPO



Source: Bloomberg, KGI Research

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Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

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