Halcyon Agri Corporation Limited

31 December 2021

Non rated
(Initiation)

Price: S$0.23 (as at 30 Dec 2021)

BBG	HACL SP
Market cap	S$383m
Price (30 Dec 2021)	S$0.23
52-week range	S$0.179 – S$0.355
Target Price	Non-rated
Shares Outstanding	1595m
Free Float	28.8%
Major Shareholder	Sinochem International (Overseas) Pte Ltd (54.99%)
P/BV (06/21)	0.4x
Net Debt to EBITDA (12/20)	n.m

Source: Company data, Bloomberg, SAC Capital

Riding on rubber demand

Halcyon Agri Corporation Limited is involved in the production, processing and distribution of various natural rubber grades. Through its wholly-owned subsidiaries HRC and CMC, the Group owns a total of 4 plantations, 38 processing plants, and distribution centers across key geographical areas. Sales to tyre makers makes up around 70% of total revenue.

Rubber consumption is on the rise. Recovery in global mobility of people and goods, economic development, and rise of sharing economy are putting more cars on the road. About 70% of world rubber consumption goes into the tyre industry of which ~75% are for tyre replacement.

Future supplies are curtailed as low rubber prices in the past few years dissuade planting investment and maintenance. Other factors such as fungal disease and extreme weather conditions pose immediate threat to current and future rubber yield. Increased consumption and tighter supply will underpin rubber price.

Adoption of HeveaConnect platform among industry players (i.e rubber producers, tyre makers) to gain ground as they seek for more transparent and sustainability-focused rubber trades. SGX holds a 9.1% stake in HC. HC charges a fee for every mT of rubber traded on the digital platform.

ASP and raw material cost trends in line with rubber prices. The Group sourced a substantial majority (c.95%) of its feedstock from independent smallholders, therefore cost of raw materials follows rubber prices closely. Extreme weather conditions which affect supplies could further erode purchasers' margin. In the near term, resurgence of Omicron variant could see rubber prices falling. In the long term, rubber prices could be supported by a tightening supply.

Key risks: Variant resurgence, volatility in rubber prices and foreign currency risk as purchases from smallholders are paid in their local currencies while sale proceeds are mainly received in USD.

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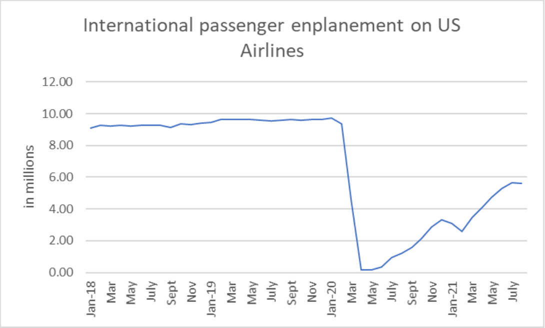
Key Financials

FY ended 31 Dec (US$m)	FY2016	FY2017	FY2018	FY2019	FY2020
Revenue	970	2,158	2,141	1,908	1,709
EBIT	78.0	62.2	9.4	44.4	(25.4)
Net profit	49.5	31.0	(8.5)	(1.6)	(53.8)
EPS (US cents)	3.1	1.9	(0.5)	(0.1)	(3.4)
Dividend per share (S cents)	-	2.0	-	-	-
Net cash / (debt)	(638)	(458)	(787)	(1,066)	(966)
Valuation					
EBIT margin (%)	8.0	2.9	0.4	2.3	-1.5
ROIC (%)	-0.1	3.1	0.4	-2.3	-2.8
EV/EBITDA (x)	49.6	11.5	33.3	18.0	132.6
P/E (x)	5.7	9.1	n.m.	n.m.	n.m.
Dividend yield (%)	-	8.3	-	-	-

Source: Company data

Investment Summary

Rubber consumption is on the rise

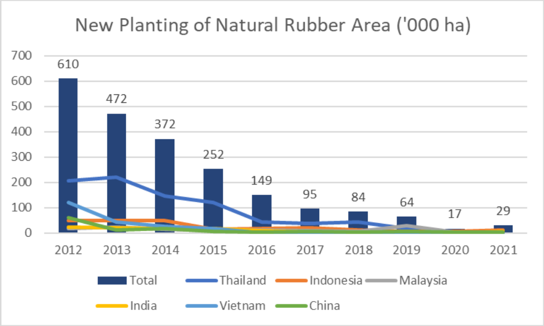


Source: Bureau of Transportation Statistics

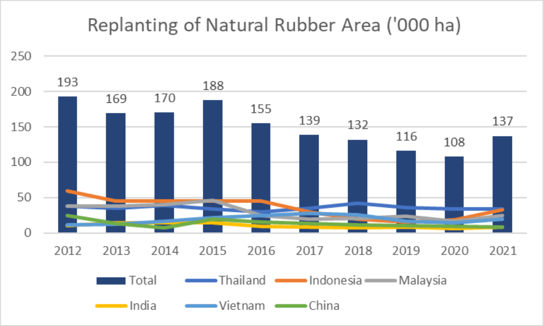
About 70% of world rubber consumption goes into the tyre industry of which replacement tyres represents ~75% of total tyres sold while the remaining is fitted into new cars. Global mobility has progressively returned and will climb higher as travel restrictions relaxed in more countries. Economic development, increased mobility of people and goods and rise of sharing economy are reducing car idle time and putting more of them on the road. Michelin, the second-largest global tyre manufacturer, has estimated km traveled per year to grow by 34% from 2020 to 2030. This translates to greater tyre servicing requirements down the road. Additionally, according to IHS Markit, global light vehicle production is expected to grow 10.6% yoy and 11.2% yoy for 2022 and 2023 respectively.

Rubber is also used in other products such as gloves, hoses, protective personal equipment and shoe soles.

Future rubber supply curtailed



Source: International Rubber Study Group



Source: International Rubber Study Group

Over the years there has been a decline in planting investment due to low rubber prices. Thailand, the world top producer of NR accounting up to 40% of global supply, has planned to slash local rubber plantations by 21% by 2036. As rubber trees need ~7 years to mature and yield the first drop of latex, the impact of reduced supply are felt down the years. Immediate threat to current (and future) crop yield include factors such as fungal disease, shift to higher yield crops (i.e. oil palm) and extreme weather conditions.

Investment Summary

Industry adoption of HeveaConnect platform

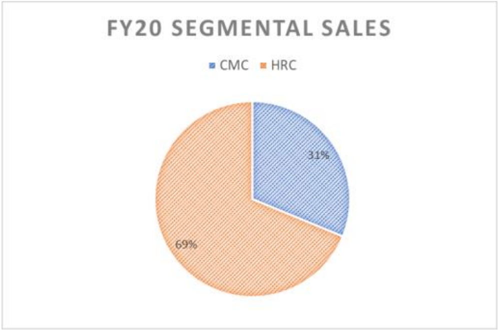
HeveaConnect (HC) platform is a digital marketplace which provides supply chain data for the trading of sustainably processed NR. Its targeted users are stakeholders involved in rubber trade such as rubber producers and tyre makers. Apart from digitalization of paper trades, HC offers greater transparency and traceability along the supply chain to users among other benefits.

In Mar 2021, SGX took up a 9.09% stake in HC via its wholly owned subsidiary while Halcyon reduced stake to 49.91%. SGX's investment also supports further development and promotion of the platform's functionalities.

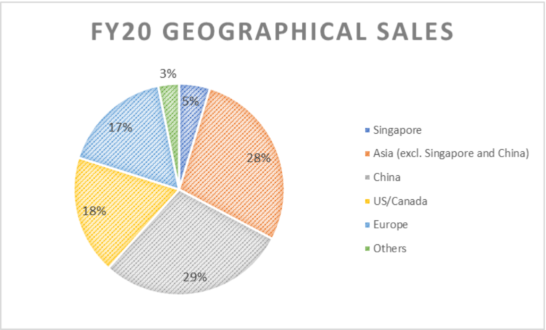
HC earns transaction fees for successful trades on the platform. Increased industry adoption would translate to higher transaction volumes. FY20's transaction volume on HC was 169,000 metric ton with a total gross sales value of US$185m.

Background

Halcyon Agri Corporation Limited is an integrated natural rubber (NR) supply chain manager, engaged in the production, processing & distribution of NR products. The Group's presence is entrenched across the entire value chain of natural rubber through its wholly owned subsidiaries, Halcyon Rubber Company (HRC) and Corrie MacColl (CMC). The Group commanded 9% of global market share of NR in 2020.



Source: Company data



Source: Company data

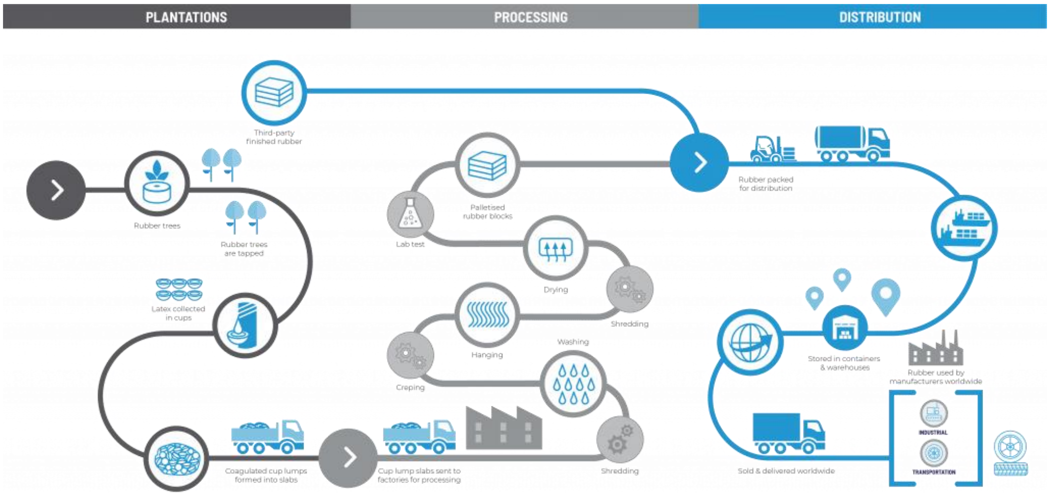
Halcyon Rubber Company

HRC is involved in upstream and midstream of NR value chain. HRC collects latex/cup lumps from rubber tree tapping and processes those to tyre-grade NR products before marketing them to global tyre makers under HeveaPro brand. HRC's customers includes Bridgestone, Michelin and Goodyear. HRC's market share of tyre–grade NR is 11% in 2020.

NR is produced mainly in the Asia region with Thailand, Vietnam and Indonesia being the top 3 producers. Raw material supply in NR industry is fragmented with ~85% of global NR production coming from individual smallholder farmers. As such, HRC sourced almost all of their raw materials from smallholder farmers scattered across key rubber origins. Contribution from its own plantation in Ivory Coast is insignificant.

The raw materials ("cuplumps") collected are processed in HRC's operated factories into Technically Specified Rubber (TSR), which is commonly used by tyre makers. HRC owns 36 factories with a combined production capacity of 1.537m metric ton. Utilization rate is typically at 64-65%.

HRC supplied 881,467 metric ton of HeveaPro tyre grade NR to the tyre industry in FY20.

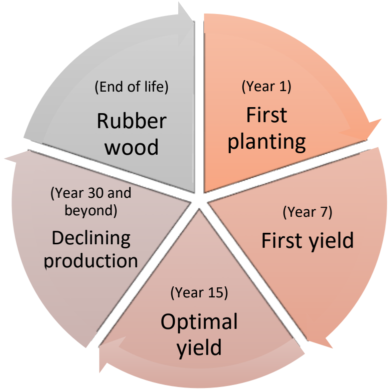


Source: Company data

Background

Corrie MacColl

CMC is made of 2 units: CMC Plantations (CMCP) and CMC International (CMCI). CMCP owns plantations for rubber production. Output from CMCP together with NR products procured from 3rd party sources will be distributed by CMCI. CMC's NR products are used in industrial and non-tyre applications such as gloves and apparels.



Source: Company data

CMCP and CMCI

CMCP has 3 plantations in total, located in Malaysia and Cameroon. CMCP produced 15,015 metric ton and 19,597 metric ton of predominantly concentrated latex in FY20 and FY19 respectively, the decrease is mainly due to suspension of tapping activities amid COVID-19 lockdown restriction. Currently, the average tree age is 12.2 years, and as the trees turn mature, the yields will improve. CMCP has also planted oil palm trees within its Malaysia plantation, producing 8,356 metric ton of fresh fruit bunches in FY20.

CMCI markets its in-house production output as well as 3rd party sourced NR products through its broad distribution network covering 9 countries. CMCI seeks to add value to its customers by providing value-added logistic services, and as a merchandiser at destination, its volumes are lower but it is compensated by higher unit margins. CMCI distributed a total of 349,820 metric ton of products in FY20, including plantation outputs.

For FY20, CMCI fulfilled a total of 349,820 metric ton of NR products.

There is high barrier of entry into upstream and midstream of the industry due to its capital intensive nature required for new planting and maintenance of plantations, setting up of processing facilities as well as building an extensive distribution network. Proven track record of quality assured products gives established players an upper hand.

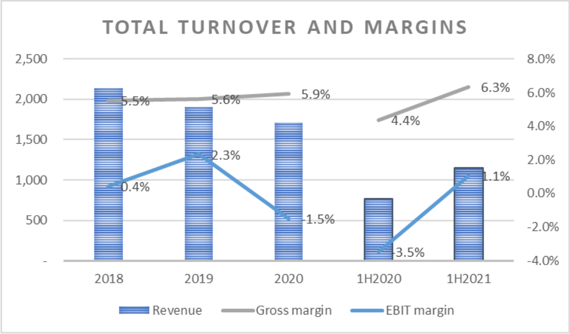
Synthetic rubber not a complete substitute

Certain qualities of NR are better (e.g. higher tensile strength and tear resistance) which makes it irreplaceable for certain uses. (i.e. aircraft tyres) Additionally, as synthetic rubber is a polymer made up of petroleum-based by-products it does not provide a sustainable solution as compared to NR which is produced naturally. High synthetic rubber price due to rising oil price benefits NR producers as customers will switch to a lower cost alternative. As NR cannot be fully replaced by synthetic rubber, the opposite scenario would only play out to a limited extent.

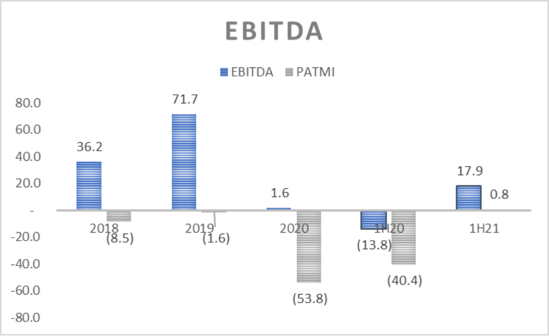
Financial performance

FY20 results

FY20 gross margin improve marginally due to lower cost of raw materials procured in line with weakening rubber prices and volume. FY20 EBIT margin fell 3.8% pt due to 1) an one-off fair value gain of US$52.7m recognized in FY19 from reclassification of CMC's Cameroon plantation from bearer plant to non-bearer plant; 2) US$7.2m reversal of impairment on doubtful debt was recorded in FY19; and 3) higher pandemic-led operating expenses, one-off business rationalization costs and professional fees. FY20 operating loss of US$31.3m was a reversal from US$38.3m profit in FY19.



Source: Company data



Source: Company data

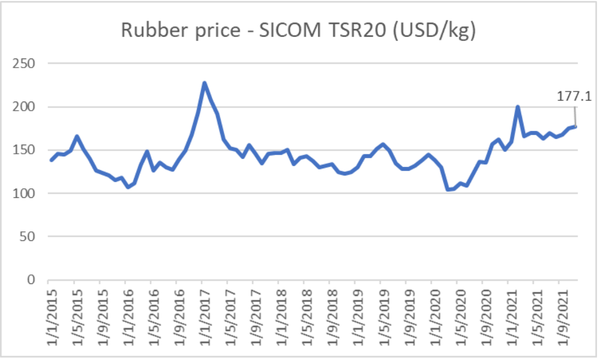
1H 2021 performance

Revenue is up by 50% yoy and gross margin improved to 6.3% on the back of stronger downstream demand which resulted in higher sales volume (+24%) and ASP (+21%). Higher gross profits and gain on disposal of subsidiary of US$7.6m resulted in the Group's turnaround to operating profit. HAC posted PATMI of US$0.8m for first half of 2021.

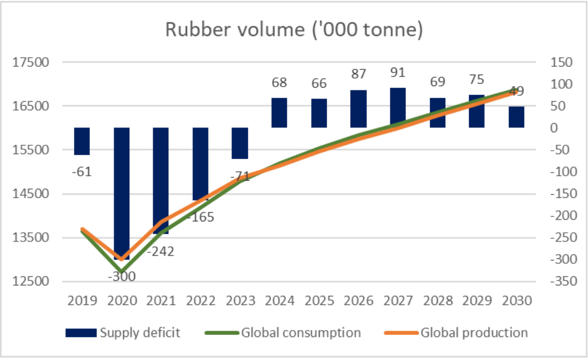
As at 30 Jun 21, HACL has a net debt of US$1,004.5m and net gearing ratio of 1.3x. HAC issued a US$200m 3.8% perpetual securities in Nov 2020 which are unconditionally guaranteed by Sinochem.

Financial performance

Rubber price



Source: Bloomberg



Source: International Rubber Study Group

The Group's revenue is highly sensitive to fluctuations in rubber price. SICOM TSR rubber prices has risen 18% YTD. ASP and cost of raw material trends in line with rubber prices. With at least 95% of the Group's raw material obtained from external smallholders, cost of raw materials follows rubber prices closely. Extreme weather conditions which affect supplies could raise its input costs.

In the near term, resurgence of Omicron variant could see rubber prices falling. In the long term, rubber prices could benefit from tighter supply.

In 9M21, Halcyon has reached sales volume of 988,107 mT rubber products at an average selling price of ~USD1775/metric ton.

Income Statement

YE 31 Dec US$m	FY16A	FY17A	FY18A	FY19A	FY20A	1H21
Revenue	**970**	**2,158**	**2,141**	**1,908**	**1,709**	**1,152**
Cost of sales	(919)	(2,008)	(2,023)	(1,800)	(1,607)	(1,079)
Gross profit	**51**	**151**	**118**	**107**	**102**	**73**
Other income	97	28	12	68	13	12
Other expenses	(70)	(116)	(121)	(131)	(140)	(73)
EBIT	**78**	**62**	**9**	**44**	**(25)**	**8.8**
Interest expense	(28)	(26)	(26)	(41)	(31)	(12)
Share of results of associates	2	10	(0)	(0)	0	0
Profit before tax	**52**	**47**	**(17)**	**3**	**(56)**	**0.2**
Tax expense	(3)	(12)	4	(7)	(4)	0
Minority interests	(1)	4	(5)	(2)	(7)	(1)
PATMI	**49**	**31**	**(8)**	**(2)**	**(54)**	**1**

Balance Sheet

YE 31 Dec US$m	FY16A	FY17A	FY18A	FY19A	FY20A	1H21
Intangible assets	200	200	301	301	300	300
Investment in associate	190	-	1	1	1	10
PPE	245	245	295	312	304	287
Biological assets	289	337	380	466	525	526
Others	43	31	52	50	109	105
Deferred tax assets	13	14	15	21	17	20
Total non-current assets	**980**	**828**	**1,045**	**1,151**	**1,257**	**1,249**
Inventories	320	305	298	375	389	393
Trade receivables	98	122	147	134	157	183
Derivatives	31	23	44	21	16	24
Income tax recoverable	2	2	9	12	6	5
Other assets	52	200	146	165	93	97
Cash	67	152	125	58	46	35
Current assets	**569**	**805**	**770**	**764**	**707**	**737**
Total assets	**1,550**	**1,633**	**1,815**	**1,915**	**1,964**	**1,986**
Finance lease payables	0	0	0	3	3	3
Trade payables	46	39	35	38	33	31
Other liabilities	101	77	58	66	68	89
Bank borrowings	245	208	520	612	837	567
Income tax payable	20	21	12	6	7	6
Total current liabilities	**413**	**345**	**625**	**725**	**948**	**696**
Deferred tax liabilities	35	31	39	48	45	46
Finance lease payables	1	0	0	10	9	9
Other liabilities	19	21	23	31	38	35
Bank borrowings	460	403	392	512	175	472
Total non-current liabilities	**515**	**455**	**454**	**601**	**267**	**562**
Total liabilities	**927**	**800**	**1,079**	**1,326**	**1,215**	**1,258**
Share capital	604	604	604	604	604	604
Perpetual securities	-	149	149	-	193	193
Retained earnings	48	(6)	(52)	(56)	(115)	(118)
Other reserves	(77)	43	6	14	46	29
Minority interests	47	43	29	28	21	20
Total equity	**622**	**833**	**736**	**589**	**749**	**708**

Ratios

YE 31 Dec	FY16A	FY17A	FY18A	FY19A	FY20A	1H21
Profitability (%)						
Gross margin	5.3	7.0	5.5	5.6	5.9	6.3
Pretax margin	5.1	1.4	-0.4	-0.1	-3.1	0.02
Liquidity (x)						
Current ratio	1.4	2.3	1.2	1.1	0.7	1.1
Quick ratio	0.6	1.4	0.7	0.5	0.3	0.5
Interest coverage ratio	2.8	2.4	0.4	1.1	-0.8	1.0
Net Debt to Equity	1.03	0.55	1.07	1.81	1.29	1.38
Valuation (x)						
P/E	5.7	9.1	-33.4	-173.6	-5.3	-
P/B	0.5	0.3	0.4	0.5	0.4	-
EV/EBITDA	(619.6)	11.4	29.6	18.8	804.5	-
Cash Conversion Cycle						
Trade receivable days	20	14	22	29	34	-
Inventory days	127	57	54	68	87	-
Trade payable days	18	8	7	7	8	-
CCC days	128	63	70	90	113	-

Cash Flow Statement

YE 31 Dec US$m	FY16A	FY17A	FY18A	FY19A	FY20A	1H21
PBT	49	47	(17)	3	(56)	0.2
Depreciation & amortization	12	27	29	33	33	17
Other adjustments	(66)	(15)	21	(21)	52	4.3
Working capital						
Receivables	44	(45)	(50)	8	(16)	(36)
Inventories	(82)	(50)	22	(35)	(21)	(11)
Payables	0	10	(30)	(4)	1	17
Other WC changes	-	-	-	-	-	-
Operating cashflow	(42)	(26)	(24)	(15)	(8)	(9)
Others	(8)	(16)	(29)	(27)	(13)	(8)
Cash flow from operations	**(50)**	**(43)**	**(53)**	**(42)**	**(22)**	**(17)**
CAPEX	(16)	(54)	(79)	(68)	(44)	(18)
Other adjustments	54	168	(123)	3	(4)	1.1
Cash flow from investments	**38**	**113**	**(201)**	**(66)**	**(49)**	**(17)**
FCF	**(12)**	**71**	**(254)**	**(107)**	**(70)**	**(34)**
Dividends paid to SH	-	-	(24)	-	-	-
Proceeds from perpetual	-	149	-	(150)	199	-
Proceeds from borrowings	30	(113)	281	210	(125)	51
Other adjustments	(22)	(24)	(28)	(21)	(17)	(28)
Cash flow from financing	**7**	**11**	**228**	**39**	**57**	**24**
Net cash flow	**(4)**	**82**	**(26)**	**(68)**	**(14)**	**(10)**
Exch diff on consolidation	1	5	(5)	1	2	0
Opening cash balance	71	67	153	123	56	44
Ending cash balance	**67**	**153**	**123**	**56**	**44**	**35**

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