

29 October 2024

Consumer cyclical

Life Water (LWSABAH MK)

Nourishing Growth

- **MYR0.85 FV based on 13x FY25F (Jun) P/E.** At MYR0.65/share, Life Water is set to raise MYR63.4m (126m shares) from its IPO, mainly to fund working capital and expand its manufacturing capacity to capture new business opportunities in the beverage industry. Future earnings (3-year CAGR: 21.2%) are expected to be fuelled by aggressive expansion plans, new product launches, and entry into new markets, supporting sales growth and margin expansion. The IPO price implies 10x FY25F P/E.
- **Doubling capacity.** With the expected commencement of its Keningau plant by Dec 2024, coupled with the setting up of two new drinking water manufacturing lines in Sandakan, Life Water is set to double its total annual production capacity for drinking water from 389m litres currently to 804m litres by 2027. This expanded capacity will enable the group, in our view, to grow its customer base, enter new markets, achieve economies of scale, and increase its market share (11% currently).
- **Wide distribution network.** Life Water's key strength lies in its localised brand presence and extensive distribution network of >4,000 touchpoints across Sabah's retailers and wholesalers, ensuring exceptional convenience and accessibility for customers. Looking ahead, the group plans to leverage this robust network to penetrate new markets in Sarawak and Brunei by tapping into local distributors' established networks and local expertise, and facilitating efficient expansion without incurring significant capex.
- **Expansion of beverage products.** Life Water plans to expand its products line-up by introducing a new range of flavoured drinks and mineral water offerings. The group is currently developing recipes for its flavoured drinks and has conducted a trial production run for one batch of flavours. It aims to launch these flavoured drinks to existing customers – including retailers, wholesalers, and food service operators – in Sabah by 2H CY25. Simultaneously, Life Water is exploring suitable groundwater sources for its mineral water products, with the estimated timeline for commercialisation dependent on the progress of this exploration and development.
- **Capturing demand from the tourism rebound.** According to the Sabah Tourism Board, tourism arrivals in the state have increased by 24.3% YoY in 1H CY24, reaching 62% of pre-pandemic levels. As tourism continues to rebound, we expect demand for bottled water and beverages to rise, which will benefit Life Water, thanks to its robust distribution network across key tourist hotspots, and established relationships with hotels and retail outlets.
- **Valuation.** We derive a FV of MYR0.85 based on an ascribed 13x P/E on FY25F earnings – in line with its smaller-cap peers. We believe this is justifiable despite its lower market cap, given Life Water's higher ROE, stronger margins, and solid earnings growth trajectory vis-à-vis such peers. Key risks include fluctuations in raw material prices and expansion plan delays.

Fair Value (Return):	MYR0.85 (+30%)
IPO Price:	MYR0.65
Closing Application Date:	30 Oct 2024
Indicative Listing Date	13 Nov 2024

Analyst

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Company description

Life Water manufactures drinking water and carbonated beverages, including brands like K2 and 2more. It also offers contract manufacturing and packaging services, with facilities in Sandakan and Kota Kinabalu.

IPO details

Public Issue (%)	26.6
Shares outstanding (m)	126.0
Implied market cap	MYR307.6m

Major shareholders post IPO (%)

Scarecrow Holding	36.7
Tan Hwong Kuen	18.4
Lim Yong Piau	18.4

Utilisation of IPO proceeds

	MYRm
Set-up additional drinking water manufacturing line for Sandakan Sibuga Plant 1	19.0
Purchase of drinking water manufacturing line for Sandakan Sibuga Plant 2	12.0
Set-up second distribution centre on Sandakan	12.6
Expansion of existing plastic packaging facilities in Kota Kinabalu	9.6
Working capital	4.2
Estimated listing expenses	6.0
TOTAL	63.4

Additional data

Listing Market	Main
Bursa Code	5328

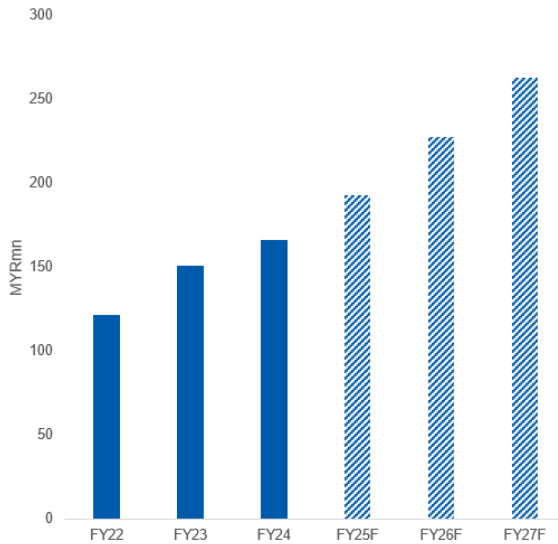
Forecasts and Key Data	Jun-23	Jun-24	Jun-25F	Jun-26F	Jun-27F
Total turnover (MYRm)	151.0	166.5	193.1	227.6	263.0
Recurring net profit (MYRm)	20.6	28.1	30.8	37.7	44.5
Recurring net profit growth (%)	31.1	36.4	9.6	22.4	18.0
Recurring EPS (MYR)	0.04	0.06	0.07	0.08	0.09
Recurring P/E (x)	14.9	10.9	10.0	8.2	6.9
P/BV (x)	3.3	2.5	1.5	1.3	1.1
P/CF (x)	9.0	6.8	7.5	6.4	5.4
Dividend yield (%)	0.3	1.3	2.0	2.5	2.9
EV/EBITDA (x)	3.2	2.7	1.2	0.9	0.5
ROE (%)	24.5	26.0	18.6	16.8	17.2
Net debt to equity (%)	0.4	0.4	Net Cash	Net Cash	Net Cash

Source: Company data, RHB

Financial Overview And Valuation

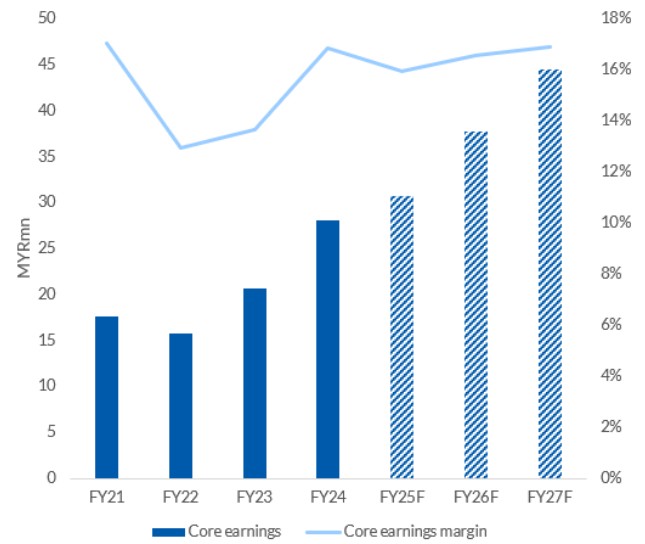
FY24 results review. YoY, FY24 sales grew 15.5% to MYR18.7m, driven by higher volumes of drinking water and carbonated drinks from main customers, supported by increased marketing and promotional efforts. FY24 GPM improved by 4.9ppts to 48%, benefiting from reduced plastic costs while ASPs remained stable. Consequently, FY24 core earnings rose 36.4% to MYR28.1m.

Figure 1: Revenue trends



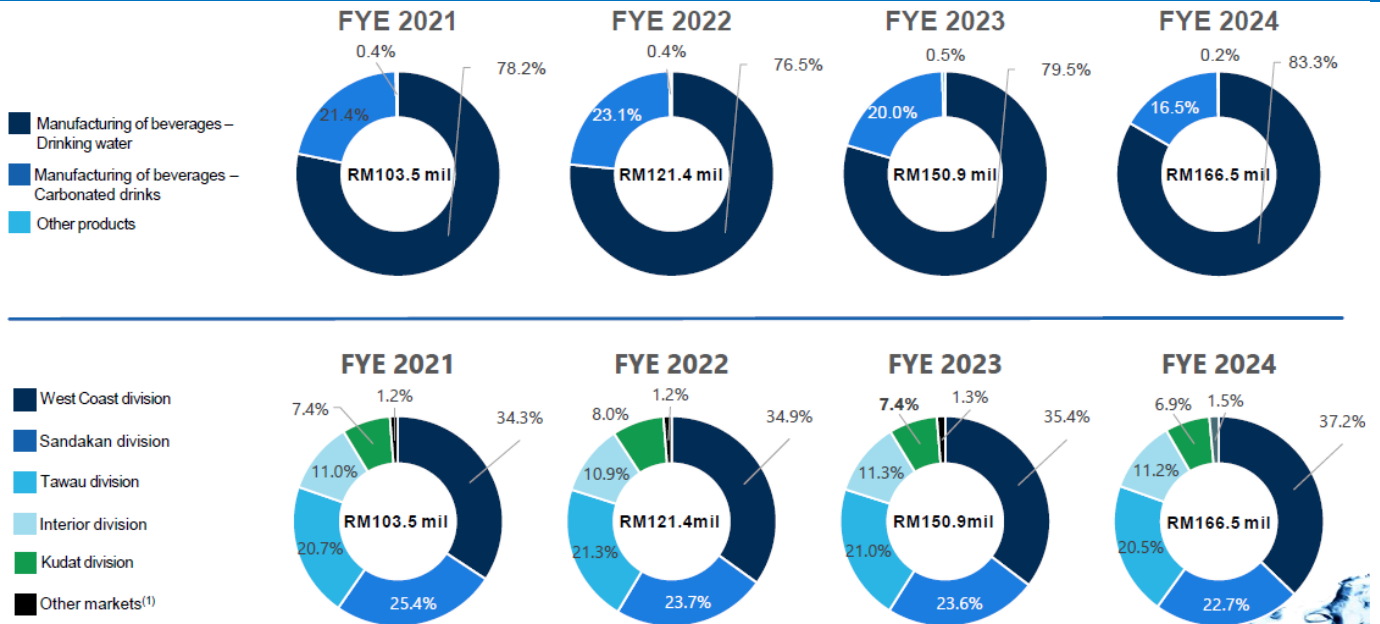
Source: Company data

Figure 2: Core profit trends



Source: Company data

Figure 3: Life Water's revenue by business segments and geography



Note(s): (1) Includes Federal Territory of Labuan, Sarawak and Brunei

Source: Company data

29 October 2024

Consumer Non-cyclical

Earnings forecast. We are projecting a 3-year earnings CAGR of 16.5% for Life Water, driven primarily by its expanded production capacity from the new Keningau plant and two Sandakan manufacturing lines, which will double total capacity to 804m litres by 2027 to support revenue growth and margins expansion via economies of scale. Additionally, Life Water's launch of new products, such as flavoured drinks and mineral water, alongside its strategic entry into new markets in Sarawak and Brunei, is expected to further boost market penetration – this is facilitated by its robust distribution network and established relationships with local distributors.

Valuation. We derive a FV of MYR0.85 based on an ascribed P/E of 13x on FY25F earnings, which is below the peer average of 18x (skewed by Fraser & Neave's much larger market cap). Our 13x P/E valuation is in line with its smaller-cap peers, which we believe is justifiable despite the lower market cap, given Life Water's higher ROE, stronger margins, and solid earnings growth trajectory supported by expansion into new markets, new product launches, and increased production capacity.

Figure 4: Peer tables

Company	Country	FYE	Mkt cap (USDm)	Price		P/E (x)		Div. yld (%)	ROE (%)	EV/ EBITDA	NP growth (%)		PEG
				28-Oct-24 (Local currency)	Actual	1 yr fwd	2 yr fwd				1 yr fwd	1 yr fwd	
Life Water	MA	Jun	71.0	0.65	10.9	10.0	8.2	2.0	18.6	1.2	9.6	22.4	1.0
Peers													
Spritzer	MA	Dec	200.0	2.74	18.4	13.4	12.8	2.3	12.4	9.4	37.3	5.1	2.5
Power Root	MA	Mar	141.4	1.42	15.8	14.3	12.6	5.1	12.3	8.4	10.7	13.7	0.9
Fraser & Neave	MA	Sep	2625.3	31.22	22.1	18.1	17.0	2.7	17.9	12.2	22.2	6.5	2.6
Mkt. cap weighted avg.			2343.4		21.6	17.6	16.5	2.8	17.2	11.9	22.7	6.7	2.5
Simple average			988.9		18.8	15.3	14.1	3.4	14.2	10.0	23.4	8.4	2.0

Source: Bloomberg, RHB

Figure 5: Operating metrics

Company	Revenue 3-year CAGR [^]	Net profit 3-year CAGR [^]	Gross profit margin [*]	EBITDA margin [*]	Net profit margin [*]	Net gearing (latest)
Life Water	17.2%	16.8%	48.0%	30.2%	16.9%	0.44
Peers						
Spritzer	9.4%	11.5%	N/A	18.1%	10.1%	1.18
Power Root	7.4%	-6.9%	N/A	13.2%	9.9%	Net Cash
Fraser & Neave	7.0%	9.4%	28.7%	15.8%	10.7%	Net Cash
Market cap weighted average	7.2%	8.7%	28.7%	15.8%	10.7%	
Simple average	8.0%	4.7%	28.7%	15.7%	10.2%	

Note: [^]Based on the latest three financial yearsNote 2: ^{*}Based on the latest financial year

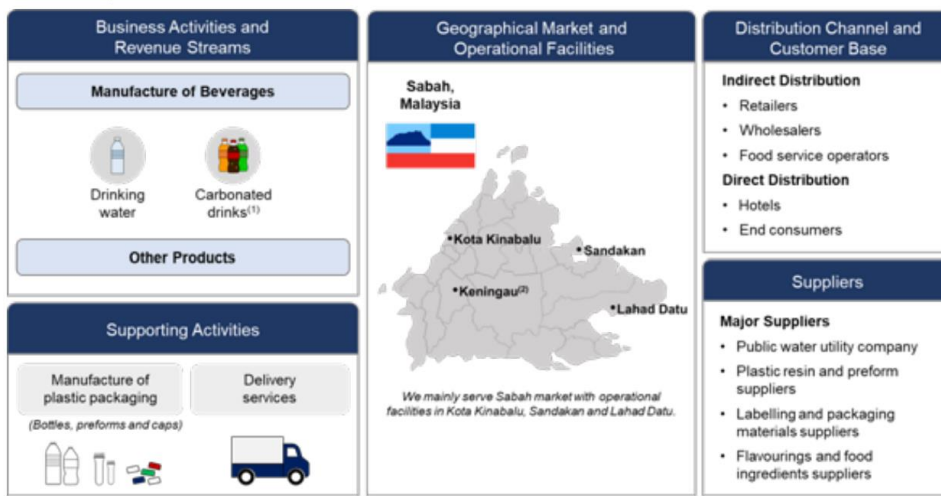
Source: Bloomberg, RHB

Company Overview

Life Water is an investment holding group with its primary business in beverage manufacturing, specifically producing drinking water and carbonated drinks. Its operations are further supported by complementary activities, including plastic packaging manufacturing, as well as delivery and distribution services. The group's headquarters and main production facilities are in Sandakan, with additional manufacturing capabilities at Kota Kinabalu.

Life Water markets its beverages under established brands such as K2, Sasa, and Sabah Water for drinking water, and 2more and TRITONiC for carbonated drinks. Additionally, the group offers contract manufacturing services, producing private-label drinking water for petrol stations, hypermarkets, wholesalers, and hotels, including brands like Mesra, Hiap Lee, Water2go, Ikame, Seafest Hotel, and Sabah Hotel.

Figure 6: Business model



Source: Company data

Figure 7: Examples of Life Water's products portfolio

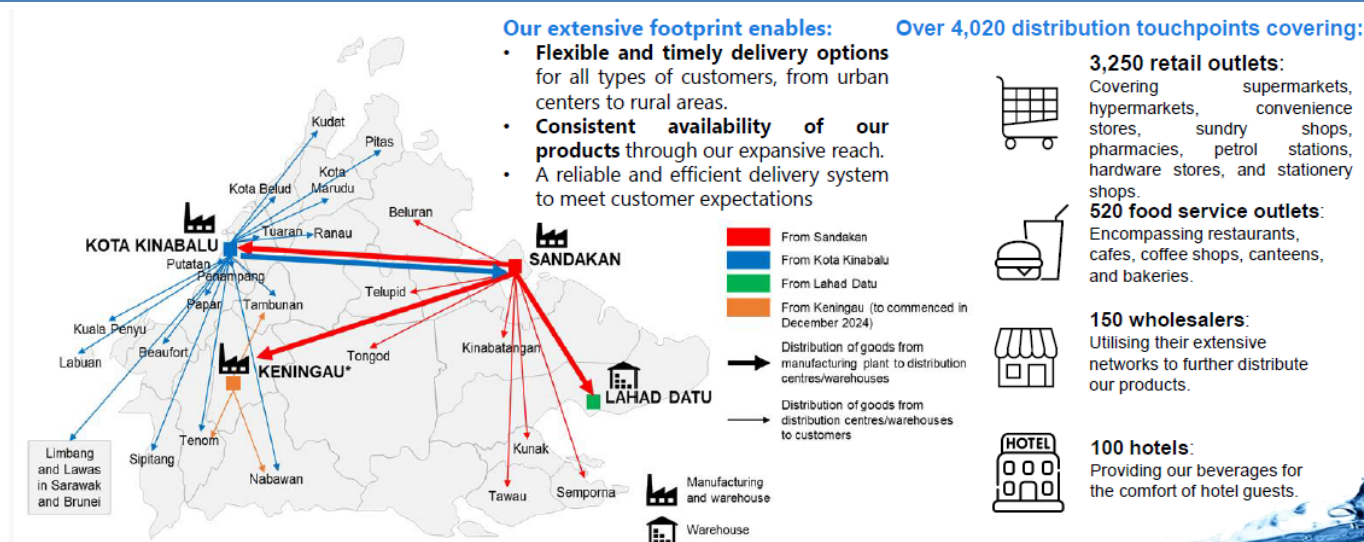


Source: Company data

Life Water utilises a predominantly indirect distribution strategy, focusing on a wide network of retailers and wholesalers to ensure product accessibility and being able to cater to the mass market. As of the listing date, the group serves over 3,250 retail outlets, including supermarkets, hypermarkets, and convenience stores.

Life Water supplements its own fleet of 75 delivery trucks by partnering with external logistics providers to ensure that products reach across Sabah, Labuan, and parts of Sarawak. This wide distribution network is key to the group’s success, as it allows it to reach a large number of consumers and generate significant revenue. In FY24, 68.46% of Life Water's revenue came from retailers, demonstrating the effectiveness of this approach.

Figure 8: Distribution model



Source: Company data

Figure 9: Life Water’s top five customers (FY24)

Major Customers	Main type of products	Length of relationship ⁽¹⁾ (year)	Revenue contribution	
			RM'000	%
Bataras Group ⁽⁴⁾	Drinking water and carbonated drinks	11	8,308	4.99
Eco Water	Drinking water and carbonated drinks	8	4,701	2.82
Mu Group ⁽⁵⁾	Drinking water and carbonated drinks	8	3,760	2.26
Sabanah Group ⁽²⁾	Drinking water and carbonated drinks	19	2,947	1.77
Servay Group ⁽⁶⁾	Drinking water and carbonated drinks	19	2,751	1.65
Sub-total			22,467	13.49
Total Group revenue			166,532	

Source: Company data

Figure 10: Life Water’s top five suppliers (FY24)

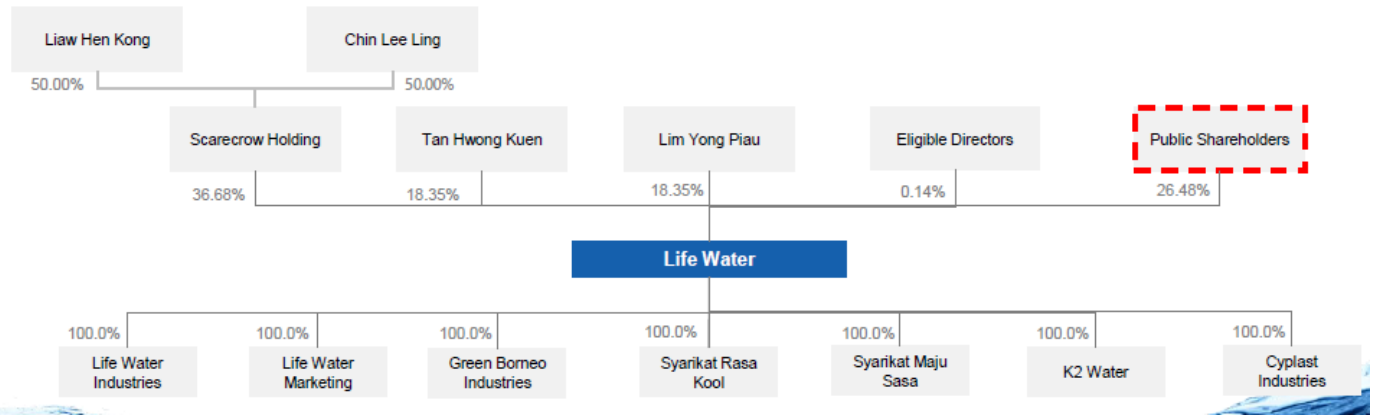
Major Suppliers	Country of Origin	Product supplied	Length of relationship ⁽¹⁾ (years)	Purchases contribution	
				RM'000	%
Hainan Yisheng Petrochemical Co., Ltd	China	PET resins	3	15,430	29.35
Far Eastern Group ⁽²⁾	China	PET resins and preforms	11	11,171	21.25
Hwa Khooon Plastic Industries Sdn Bhd	Malaysia	Shrink films	7	6,778	12.89
Hon Chuan Malaysia Sdn Bhd	Malaysia	PET preform and plastic caps	5	2,986	5.68
Win Smith Packaging Sdn Bhd	Malaysia	Label	22	2,308	4.39
Sub-total				38,673	73.56
Total Group purchases				52,581	

Source: Company data

Life Water has an experienced management team with extensive experience in the beverage industry. It is led by Liaw Hen Kong and Chin Lee Ling, both of whom have been with the group for over 22 years. Managing Director Liaw steers Life Water’s overall strategic direction and business growth. Executive Director Chin oversees various key functions, including human resources, product development, branding, marketing, and IT. The financial aspects of the group are managed by Financial Controller Christina Yap Chui Fui. She brings her expertise as a chartered accountant, and member of both the Association of Chartered Certified Accountants and Malaysian Institute of Accountants to the role.

Overseeing the production lines in both Sandakan and Kota Kinabalu is Operations Manager Chin Lee Yung @ Rina Chin who has over 17 years of experience in the drinking water industry. Completing the team is Technical Manager Chin Chun Ming who is responsible for all machinery-related matters at Kota Kinabalu, including installation, maintenance, and upgrades. His 14 years of experience in the beverage manufacturing industry makes him valuable to Life Water.

Figure 11: Post-IPO shareholding structure



Source: Company data,

Future Plans And Strategies

Expansion of warehousing facilities. Life Water has outlined an ambitious expansion strategy focused on enhancing its manufacturing capabilities to meet growing demand. The group currently operates one manufacturing facility in Sandakan and two in Kota Kinabalu, with a new facility in Keningau set to begin operations by December. As part of its future plans, Life Water intends to construct a new factory, KK IZ8 Plant 2, in Kota Kinabalu on a recently acquired 8.16-acre parcel of land. This facility, expected to go operational by 2H CY27, will accommodate the relocation of one drinking water manufacturing line, with a total setup cost estimated at MYR38.48m. Additionally, the group plans to convert KK IZ8 Plant 1 into a dedicated plastic packaging facility by 2027, investing in new machinery such as an automated warehouse system and a polyethylene terephthalate or PET preform injection moulding machine.

Further expansion is planned for Sandakan, where Life Water will add a new drinking water manufacturing line to its Sandakan Sibuga Plant 1 by 2025, and construct a new factory, Sandakan Sibuga Plant 2, which will go operational by 2027. These initiatives – collectively funded through internally generated funds, bank borrowings, and proceeds from the IPO – are designed to support the group's long-term growth and production efficiency.

Expansion of warehousing facilities. Life Water plans to expand its warehousing facilities to meet growing demand, with two new distribution centres in Tawau and Sandakan. The Tawau distribution centre – set to go operational by 1H CY26 – will cater to the growing market in Tawau Division, leveraging on a newly purchased 1.98-acre site. Renovations will begin in 2025, including floor reinforcement and fire protection system installation, with the total setup cost estimated at MYR6.34m. This is being funded through internally generated funds and bank borrowings. In Sandakan, Life Water plans to construct Sandakan Sibuga Distribution Centre 2 by 2027, adjacent to its existing facilities. This new centre will include a 70,000sq ft warehouse and 10,000sq ft depot for delivery trucks, with a total cost of MYR12.60m – all funded through IPO proceeds. These expansions will significantly enhance Life Water's distribution capacity and operational efficiency, in our view.

Geographical market expansion. Life Water aims to expand its geographical reach beyond its Sabah core market, which accounted for 98.55% of its total revenue in FY24. While the group already generates some revenue from Sarawak, Labuan, and Brunei, it plans to further penetrate these markets, particularly focusing on Sarawak and Brunei. To achieve this, Life Water is in the process of appointing distributors there with distribution agreements expected to cover aspects such as contract duration, territorial reach, and product offerings. The group aims to finalise these distributor appointments by end 2025, marking a strategic move to diversify its revenue streams and increase its market presence in East Malaysia and Brunei.

Expansion of beverage products. Life Water plans to diversify its beverage offerings by introducing a new range of flavoured drinks under the Mandak brand – the trademark registration has already been secured. Currently in the R&D phase, the group has already conducted a trial production run and aims to launch these flavoured drinks by 2H CY25. The new products will be marketed to existing customers, including retailers, wholesalers, and food service operators, in Sabah – utilising Life Water's existing carbonated drinks production line at Sandakan Sibuga Plant 1.

Additionally, the group is exploring a venture into mineral water production, though this plan is in its early stages. Life Water is still in search of a suitable groundwater source, and the project's timeline will depend on the success of this exploration, with the risk that it may not materialise if no viable source is found.

Key Risks

Disruption in water supply at manufacturing plants. The potential disruption of public water supply, which is critical for Life Water's manufacturing operations. Currently, all its plants rely on a single source of potable water from the Sabah State Water Department. Past disruptions, caused by water rationing, burst pipes, contamination, and maintenance work, have ranged from a few minutes to five days. While these disruptions have not simultaneously affected all plants – allowing production to continue at unaffected locations – a prolonged or widespread disruption could severely impact operations. If Life Water is unable to secure alternative water sources in a timely manner, it could face significant operational challenges, which may adversely affect its business and financial prospects.

Fluctuations in raw material prices and shortages of such materials. Life Water's operations are heavily dependent on plastic packaging materials and ingredients like sugar, which are susceptible to price volatility due to factors such as global market conditions and geopolitical events. For instance, the price of plastic resin surged by 52.78% in 2022 due to the Russia-Ukraine conflict, while the cost of sugar and certain flavourings also rose in 2023 and 2024. Although Life Water has adjusted its product prices in response to rising costs, it has not always been able to pass on the full cost to customers, leading to a decline in gross profit margins and profitability in some years. While there was some relief in 2024 with the decrease in plastic resin and artificial sweetener prices, sugar prices have continued to rise. The group's ability to manage future price increases or supply shortages will be crucial for maintaining profitability, but there is no guarantee that cost increases can always be passed on to customers, which could negatively impact its financial performance.

Changes in consumer demands. There is a potential impact from changes in consumer demand, which can be influenced by shifting tastes, preferences, and values. If the popularity of Life Water's products declines or it fails to adapt to significant changes in consumer habits – eg preferences for healthier or more environmentally friendly options – the group's sales volumes and profitability could be negatively affected. Timely responses to these evolving trends are crucial for maintaining market share and ensuring sustained business growth.

IPO Details

Figure 12: Indicative IPO timeline

Opening of Application	22 Oct 2024
Closing of Application	30 Oct 2024
Balloting of applications	4 Nov 2024
Allotment of the IPO Shares to successful applicants	11 Nov 2024
Listing	13 Nov 2024

Source: Company data, RHB

Figure 13: Utilisation of IPO proceeds

	Estimated timeframe	MYRm	% of proceeds
a) Set-up additional drinking water manufacturing line for Sandakan Sibuga Plant 1	Within 9 months	19.0	29.9
b) Purchase of drinking water manufacturing line for Sandakan Sibuga Plant 2	Within 32 months	12.0	18.9
c) Set-up second distribution centre on Sandakan	Within 39 months	12.6	9.9
d) Expansion of existing plastic packaging facilities in Kota Kinabalu	Within 14 months	9.6	15.2
e) Working capital	Within 3 months	4.2	6.6
f) Estimated listing expenses	Within 3 months	6.0	9.5
Total		63.4	100.0

Source: Company data, RHB

Figure 14: Offering structure

	No. of IPO shares	% of enlarged share base ⁽¹⁾
Public Issue of new shares:		
Malaysia Public	23,660,000	5.0
Bumiputera public investors	59,148,000	12.5
Eligible Persons under pink form allocations	14,195,000	3.0
Private placement to selected investors	560,000	0.12
Offer for sale:		
Private placement to selected investors	28,390,000	6.0
Total	125,953,000	26.62

Note: Based on our enlarged share capital of 125,953,000 shares after the IPO

Source: Company data, RHB

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