2 July 2019

Consumer | Retail

Retail

Neutral (Maintained)

Labour Reforms In Singapore's Retail Industry

Stocks Covered	4
Ratings (Buy/Neutral/Sell):	2 / 2 / 0
Last 12m Earnings Revision	Neutral

- **Maintain NEUTRAL on the Singapore retail sub-sector; preferred pick: Sheng Siong.** The tightening of the foreign workers quota for the services sector takes effect on 1 Jan 2020. We think this is likely to cause near-term cost pressure on the retail and food & beverage (F&B) industries. Firms like Sheng Siong and Koufu, which have made good use of government grants to invest in automation over the past years, should be less impacted by the labour crunch.
- **Negative for retail and F&B service industry in the short run.** During the announcement of Budget 2019, Finance Minister Mr Heng Swee Keat announced that the cut in the foreign labour dependency ratio ceiling (DRC) will take effect in 2020-2021. This is negative for the retail and F&B service companies operating in Singapore, as they would need to find ways to attract more Singaporean workers or resort to automation – which involves more upfront capex and depreciation costs in the near term.
- **Full-service restaurants would be the most impacted** as their business is often labour-intensive. Automation solutions could also be limited without affecting the quality of service provided to customers.
- **Short-term pain, long-term gain.** While investing in technology and automation solutions could result in higher upfront capex and higher depreciation costs in the near term, we believe this will benefit the retail and F&B industry in the longer run. With slower population growth, these firms are likely to find it harder to attract labour in the future. The increase in the number of citizens with tertiary education also implies that there would be less people willing to take on unpopular frontline jobs in the service sector. Meanwhile, companies choosing to invest in automation solutions now can access government funding of up to 70% of the project and training costs.
- **Prefer companies with a head start in automation.** Sheng Siong is our preferred pick amongst our retail sector coverage, as we believe it will be the least impacted by the tightening of DRC. The company has rolled out hybrid check-out counters in two-thirds of its outlets. We believe it will also be able to reduce manpower needs, as it implements the check-out system in the remaining outlets. We are also upbeat on Koufu's (Koufu SP, NR) prospects, as it has invested in tray-return robots, and has an integrated facility under construction to improve labour productivity.

Company Name	Rating	TP (SGD)	% Upside (Downside)	P/E (x) Dec-19F	P/BV (x) Dec-19F	Yield (%) Dec-19F
Jumbo	BUY	0.47	22.1	19.0	3.4	3.7
Sheng Siong	BUY	1.23	11.8	21.3	5.3	3.4
BreadTalk	NEUTRAL	0.81	8.0	29.5	3.1	2.7
Dairy Farm*	NEUTRAL	8.25	13.4	19.7	5.8	3.1

*Note: * in USD*
Source: Company data, RHB

Top Picks	Target Price
Sheng Siong (SSG SP) – BUY	SGD1.23

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Labour reforms in retail and F&B

Labour structure reforms in the retail and F&B sector. There are more than 26,000 retail establishments in Singapore and they account for 4.4% of total employment here. In February, Finance Minister Mr Heng Swee Keat announced Singapore's Budget 2019, and said there will be a cut in the foreign workers quota for the services sector – with F&B and retail being the key targets. Mr Heng added that this was due to the higher growth in S-Pass (for mid-level skilled foreigners earning at least SGD2,300 per month) and work permit holders, and that the F&B and retail sectors are still very labour-intensive.

This comes six years after the last cut in the foreign workers quota, in 2013. Following this year, the foreign labour DRC is expected to tighten from 40% to 38% in 2020, and to 35% in 2021. The S-Pass sub-DRC is expected to drop from 15% to 13% in 2020, and to 10% in 2021. This is negative for all F&B service and retail companies operating in Singapore as they would need to find ways to employ more Singaporeans or resort to automation, which would mean more upfront capex and depreciation costs in the near term.

Figure 1: Change in DRC or foreign worker quotas for Singapore's service sector

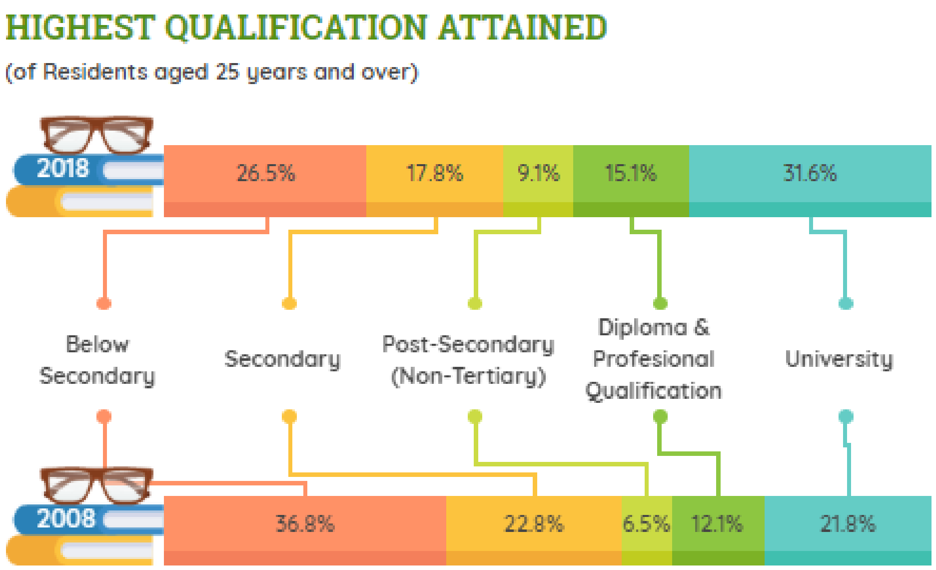
	DRC	S Pass Sub-DRC
Pre 1 Jul 2012	50%	25%
Effective 1 Jul 2012	45%	20%
Effective 1 Jul 2013 (current)	**40%**	**15%**
Effective 1 Jan 2020	38%	13%
Effective 1 Jan 2021	35%	10%

Source: Singapore Ministry of Finance, RHB

Change in demographics makes it none the better. While Mr Heng highlighted that the ultimate goal is to enable Singapore residents to continue to have good jobs and opportunities, we note that the non-professionals, managers, executives and technicians (PMET) jobs are not where Singaporeans want to work. The structure of F&B and retail service jobs – which imply long hours and weekend shifts – have not made such positions popular amongst the locals. As such, these sectors typically find it hard to attract local staff.

Moreover, over the last 10 years, the proportion of university graduates in Singapore has risen from 21.8% to 31.6%, leaving less people being interested in taking these frontline jobs. The salary levels of jobs in these industries do not attract retrenched PMETs, who might be better off financially if they reskill and change career options to something other than being on the frontline for F&B or retail services. Last, with the slow growth in the population and workforce, retail and F&B players will only find it harder to cope with a tighter labour crunch in the longer run, if productivity does not improve.

Figure 2: Proportion of university graduates in Singapore has risen



Source: Singapore Department of Statistics (SingStats)

Short term pain, long term gain (hopefully)

Best case scenario: Investing in technology and automation. To avoid paying higher costs to attract labour, the Government hopes that the services industry will invest in technology and automation. Companies moving in this direction are likely to incur higher capex in the short run.

To support this change, the Government will provide enhanced funding support (Figure 3) through the Enterprise Development Grant (EDG) and Productivity Solutions Grant (PSG). EDGs provide firms with up to 70% government funding to undertake projects which strengthen their business capabilities, improve operational efficiencies and internationalise. Meanwhile, PSGs provide firms with up to 70% funding to adopt pre-scoped, off-the-shelf productivity solutions and technologies. Eligible firms will be able to receive a subsidy for up to 70% of their out-of-pocket training expenses, capped at SGD10,000 per enterprise.

Figure 3: Government support to push for increased productivity

Enterprise Development Grant		
Areas of support	**Support for SMEs**	**Support for non-SMEs**
Eligible expenses	Up to 70%	Up to 50%
Exception: Hardware/software	Up to 50%	Up to 30%
Productivity Solutions Grant		
Area of support	**Date**	**Max funding**
Pre-scoped, off-the-shelf productivity solutions and technologies	Up to 31 Mar 2023	70%
Out-of-pocket training expenses	Up to 31 Mar 2023	SGD10,000 per enterprise

Source: Ministry of Finance

Interim solution: tapping senior workers. Finding suitable automation solutions and implementing them within one year would be key challenges for firms in the affected industries. We believe tapping senior workers would be one of the interim solutions. Singapore has an ageing population and a limited social safety net. With rising life expectancy and cost of living, elderly citizens without adequate savings for retirement would have to continue working. To support the reemployment of older workers, the Government also has schemes to help offset senior employees' pay since 2011. These schemes would be extended until 31 Dec 2020. However, if not for the limited workforce available, we believe the subsidies (Figure 4) would not be compelling enough for firms to specifically hire more senior workers.

Figure 4: Government support to push for increased productivity

Income of employee in a given month ($)	SEC/ASEC for the month ($) for employers who hire Singaporeans				
	Aged between 55 and 59 (i.e. >=55yrs 0mths and <=59yrs 11mths)	Aged between 60 and 64 (i.e. >=60yrs 0mths and <=64yrs 11mths)	Aged between 65 and 67 (i.e. >=65yrs 0mths and <67yrs 0mths)		Aged 67 and above (i.e. >=67yrs 0mths)
			Born on or after 1 July 1952	Born before 1 July 1952	
Up to 3,000	3% of wage	5% of wage	8% of wage	11% of wage	11% of wage
> 3,000 to 4,000	360 – (0.09*wage)	600 – (0.15*wage)	960 – (0.24*wage)	1,320 – (0.33*wage)	1,320 – (0.33*wage)

Source: Ministry of Manpower

Retail and F&B players are key losers of the labour reforms as they will likely incur higher capex or manpower cost after the DRC tightens. For companies with operations in Singapore, we like firms that have already invested in automation procedures, and are less likely to be affected by the manpower supply crunch come 2020.

Retail stocks on our radar

Sheng Siong (SSG SP, BUY, TP: SGD1.23) – least impacted by DRC tightening. Management believes that the group will be able to cope with the tightening of DRC in 2020-2021, as it has begun investing in hybrid check-out counters and automation in its distribution centre. Currently, two-thirds of its outlets have implemented the hybrid check-out counters. Management believes that the group will be able to free up some manpower needs by 2020, once it rolls out the hybrid check-out counters in the remaining one-third of its stores. In addition, the extension of its distribution centre (20% of current capacity) – expected to be completed by year-end – also features more automation to reduce the reliance on manpower.

Sheng Siong is one of our Top Picks in the consumer sector, and the preferred pick for the retail sub-sector. Since it has begun embarking on automation since 2015, we believe it would be less affected by the anticipated labour crunch in 2020. We project a 9% earnings CAGR over FY18-21F, led by the increase in store count and improved operating leverage, as new stores mature.

Jumbo (JUMBO SP, BUY, TP: SGD0.47) – expansion of higher-margin brand helps. According to the group, its cost of hiring local and foreign workers is similar after factoring in foreign worker levies and benefits. It will look to hiring more local workers post-2020, once the tighter DRC kicks in. On a per store basis, we expect labour cost to go up.

However, the group has opened more *Jumbo Seafood* restaurants in Singapore in FY19, as they represent the profitable brand in its portfolio. Labour cost as a percentage of sales for *Jumbo Seafood* Singapore is also lower than other brands. Hence, on a group basis, we do not expect significant margin deterioration when the DRC tightens. We expect earnings to grow at 15% CAGR over FY18-21F, with margins staying relatively stable.

BreadTalk (BREAD SP, NEUTRAL, TP: SGD0.81) – more could be done in the central kitchen. BreadTalk should not be severely impacted by changes in the DRC ratio as it has a diversified geographical market. Only c.54% of BreadTalk's revenue is attributed to its Singapore business. Moreover, the group built its central kitchen in 2013 to automate some of the manual cooking/baking procedures, thereby reducing manpower reliance – especially in the bakery segment.

We believe the restaurant segment (25% of group's revenue) would be the one taking the biggest hit, given that its *Din Tai Fung* brand focuses on good service and is the most labour-intensive. Currently, *Din Tai Fung* customers put their orders on a piece of paper, and hand it over to a server. We believe the group can reduce manpower requirements by adopting self-ordering kiosks or electronic tablets, which are already prevalent in other food service retailers in Singapore.

We estimate a 14% earnings CAGR for the next three years, but remain NEUTRAL on the stock for now, on its higher-than-average P/E, and higher capex required for its store expansion plan in the near term.

Dairy Farm (DFI SP, NEUTRAL, TP: USD8.25) – the going gets tougher. We estimate only c.15-20% of Dairy Farm revenue is attributed to Singapore. Hence, DRC tightening may not have a huge impact on Dairy Farm's overall cost structure. However, we note that its ASEAN supermarket operations have not been profitable. The increase in labour costs or higher capex required for automation in Singapore could therefore slow down the turnaround of ASEAN operations.

We remain NEUTRAL on Dairy Farm, as slower growth in Hong Kong's health & beauty industry could eventually taper its growth in that segment. Ongoing protests are also likely to hamper consumer sentiment and tourist arrivals into the city.

Koufu (KOUFU SP, NR), automation in place and more to come. Currently, we do not have a recommendation for Koufu. That said, we like the stock for its valuation as well as the company's growth prospects. We believe Koufu will not be impacted by changes in the DRC ratio. Over the years, the group has improved productivity through the use of roaming tray-return robots and adoption payment systems that accept both cash and cashless options. Moving into 2H20, the group's integrated facility will allow the group to have centralised dishwashing to reduce its reliance on manpower. It will also be renting out unutilised space in its integrated facility to stall tenants as having a mini-central kitchen would help them improve labour productivity.

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