

13 July 2018

Consumer Cyclical | Retailing

Sheng Siong

Buy (Maintained)

Defensive Staple Play

Target Price: SGD1.27
Price: SGD1.08
Market Cap: USD1,192m
Bloomberg Ticker: SSG SP

Reiterate BUY and new SGD1.27 TP from SGD1.18, with 18% upside, as we roll over our valuation to FY19F. Top Pick of the sector, we favour Sheng Siong for its defensive nature and steady earnings growth, as the economy moves to the late expansionary phase. We expect it to generate a steady EPS CAGR of 10% over FY17-20F, led by increase in store count and gross margin expansion. Strong cash flow generating capability should also allow it to support minimum dividend payout ratio of 70%.

Is the high gross margin sustainable? Not only do we think it is sustainable, we believe Sheng Siong's gross margin expansion will remain intact in the medium term. Key reasons:

- Sheng Siong is expanding distribution centre by 20% by the next Lunar New Year. The added capacity allows it to grow direct-sourcing and bulk handling capabilities, which translate to higher margins.
- Higher sales mix in fresh produce. Over the years, it has established itself as a household name known for quality fresh produce. The wet market industry continues to shrink, in line with changing consumer purchasing pattern, the lack of successors of stallholders and absence of land allocated to wet markets in new housing estates.

Hence, we believe it would be a key beneficiary as the go-to place for fresh foods. Fresh produce has much higher gross margin compared to dry goods. The displacement of wet markets would thus be positive for Sheng Siong's margin expansion in the medium term.

- Entrenched players in a small matured market. The Top 3 supermarket operators in Singapore – NTUC FairPrice Co-operative Ltd, Dairy Farm (DFI SP, BUY, TP:SGD9.66) and Sheng Siong – cornered close to 90% of market share. As such, they have strong bargaining power over suppliers and are able to command strong rebates for the suppliers to list their products on the shelf spaces.

Could it keep up with strong sales growth? We expect SSSG to track GDP growth in the long run. But this year, Sheng Siong's SSSG should hover above economic growth, as it is lifted by the expansion of the Tampines outlet, reopening of Loyang outlet, and migration of customers from the closure of The Verge and Woodlands 6A outlets to nearby Sheng Siong stores. YTD, it has also opened six new supermarkets. Given that a new supermarket takes three years to ramp up to matured revenue, we believe topline growth will be supported over the next three years.

Top Pick of the sector with SGD1.27 TP, based on blended DCF and P/E valuation. With Sheng Siong's strong cash flow generative ability, we expect it to accumulate a war chest of >SGD100m cash by end-FY19F. This could prompt management to pay out a special dividend to the investors.

Share Data

Avg Daily Turnover (SGD/USD) 5.19m/3.89m
52-wk Price low/high (SGD) 0.91 - 1.08
Free Float (%) 28
Shares outstanding (m) 1,384
Estimated Return 18%

Shareholders (%)

Sheng Siong Holdings 29.9
Lim Brothers 27.4
Mondrian Investment Partners 6.8

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	16.8	6.9	9.1	16.1	10.8
Relative	21.2	12.1	15.3	23.7	9.4

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (SGDm)	797	830	897	967	1,013
Reported net profit (SGDm)	62.7	69.8	75.1	83.0	88.8
Recurring net profit (SGDm)	62.7	67.6	75.1	83.0	88.8
Recurring net profit growth (%)	10.4	7.8	11.1	10.5	7.0
Recurring EPS (SGD)	0.04	0.04	0.05	0.06	0.06
DPS (SGD)	0.04	0.03	0.04	0.04	0.04
Recurring P/E (x)	25.9	24.0	21.6	19.6	18.3
P/B (x)	6.37	6.00	5.61	5.24	4.89
P/CF (x)	20.8	20.7	15.5	15.7	15.0
Dividend Yield (%)	3.5	3.1	3.5	3.8	4.1
EV/EBITDA (x)	17.2	16.2	14.6	12.9	11.9
Return on average equity (%)	25.1	26.6	26.8	27.7	27.6
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			1.9	8.2	7.4

Source: Company data, RHB

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Financial Exhibits

Financial model updated on : 2018-07-12

Asia	Financial summary	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Singapore	Recurring EPS (SGD)	0.04	0.04	0.05	0.06	0.06
Consumer Cyclical	EPS (SGD)	0.04	0.05	0.05	0.06	0.06
Sheng Siong	DPS (SGD)	0.04	0.03	0.04	0.04	0.04
Bloomberg SSG SP	BVPS (SGD)	0.17	0.18	0.19	0.21	0.22
Buy	Weighted avg adjusted shares (m)	1,504	1,504	1,504	1,504	1,504
Valuation basis	Valuation metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Blended DCF and P/E	Recurring P/E (x)	25.9	24.0	21.6	19.6	18.3
Key drivers	P/E (x)	25.9	23.3	21.6	19.6	18.3
New store openings and SSSG	P/B (x)	6.37	6.00	5.61	5.24	4.89
Key risks	FCF Yield (%)	(0.7)	3.8	4.3	5.8	6.2
i. High capex if Sheng Siong expands via purchase of retail stores;	Dividend Yield (%)	3.5	3.1	3.5	3.8	4.1
ii. Inability to find affordable areas to lease;	EV/EBITDA (x)	17.2	16.2	14.6	12.9	11.9
iii. Price war from competitors.	EV/EBIT (x)	20.6	19.1	17.2	15.2	13.8
Company Profile	Income statement (SGDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
With 48 stores located in suburban areas, Sheng Siong operates the third-largest supermarket chain in Singapore that caters to the country's mass market.	Total turnover	797	830	897	967	1,013
	Gross profit	205	217	238	259	274
	EBITDA	91	97	106	117	125
	Depreciation and amortisation	(15)	(15)	(16)	(18)	(18)
	Operating profit	76	82	90	100	107
	Net interest	1	0	0	0	1
	Pre-tax profit	76	82	91	100	107
	Taxation	(13)	(13)	(16)	(18)	(19)
	Minority interests	0	0	0	0	0
	Recurring net profit	63	68	75	83	89
	Cash flow (SGDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Change in working capital	1	(9)	22	3	2
	Cash flow from operations	78	79	105	103	108
	Capex	(89)	(18)	(36)	(8)	(8)
	Cash flow from investing activities	(89)	(17)	(36)	(8)	(8)
	Dividends paid	(55)	(51)	(56)	(62)	(67)
	Cash flow from financing activities	(52)	(51)	(56)	(62)	(67)
	Cash at beginning of period	126	64	61	78	111
	Net change in cash	(63)	10	13	33	34
	Ending balance cash	63	74	74	111	145
	Balance sheet (SGDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Total cash and equivalents	64	61	78	111	145
	Tangible fixed assets	252	255	270	261	251
	Total assets	388	404	429	459	487
	Other liabilities	2	3	3	3	3
	Total liabilities	133	130	138	147	153
	Shareholders' equity	255	271	289	310	332
	Minority interests	0	2	2	2	2
	Total equity	255	273	292	312	334
	Net debt	(64)	(61)	(78)	(111)	(145)
	Total liabilities & equity	388	404	429	459	487
	Key metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Revenue growth (%)	4.2	4.2	8.1	7.7	4.8
	Recurrent EPS growth (%)	4.5	7.8	11.1	10.5	7.0
	Gross margin (%)	25.7	26.2	26.5	26.8	27.0
	Operating EBITDA margin (%)	11.4	11.6	11.8	12.1	12.3
	Net profit margin (%)	7.9	8.4	8.4	8.6	8.8
	Dividend payout ratio (%)	89.9	71.1	74.7	74.8	74.9
	Capex/sales (%)	11.2	2.1	4.0	0.9	0.8

Source: Company data, RHB

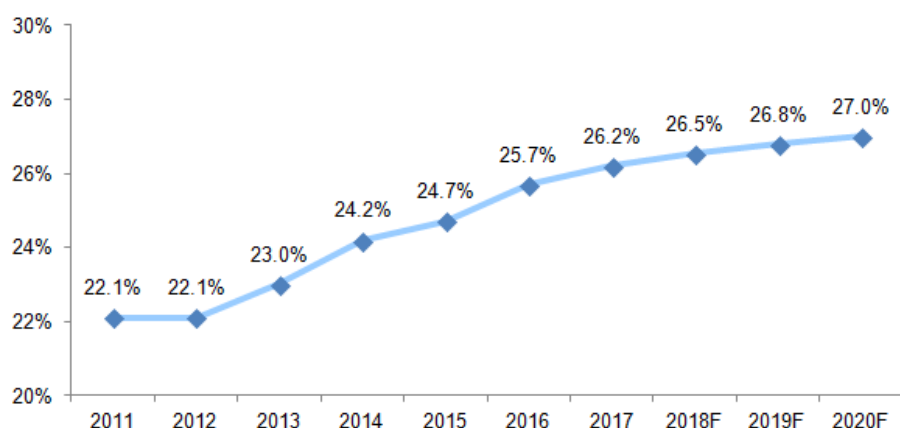
The gross margin expansion story continues...

Prowess of bulk handling and direct sourcing in distribution centre. Sheng Siong completed the construction of distribution centre at Mandai Link in 2011. The warehouse gave it a centralised facility to manage inventory holdings and individual outlets' requirements more efficiently. With a centralised procurement system, it is able to increase purchases directly from the suppliers, thereby cutting out middle-men and reducing costs. By handling stores logistical demands from the distribution centre, it also gets rebates from the suppliers.

This resulted in gross margin growing from 22.1% in 2011 to 26.2% in 2017. As the distribution centre approached full utilisation rate in the recent year, Sheng Siong is now constructing an extension, which would add another 20% capacity. We believe this would allow it to cope with the store expansion plan and continue growing margins over the next 3-5 years.

- ◆ We expect gross margin to reach 27% by FY20F.

Figure 1: Track record in gross margin expansion



Source: Company data, RHB

Household name for quality fresh produce. Over the years, Sheng Siong has established itself as a household name known for quality fresh produce. We believe it would be a key player in displacing wet markets as the go-to place for fresh produce.

We believe wet market is a sunset industry in Singapore. With increase female workforce participation, wet markets – which typically only open from morning till noon – are not able to reach the consumers. Comparatively, most supermarkets in Singapore are now open 24 hours a day. In addition, the lack of autonomy and price transparency in the wet market environment is likely to discourage the younger generation. Moreover, stallholders have difficulty finding successors. As a result, we also note that the Housing Board of Development (HDB) has not allocated any sites for wet markets in new housing estates.

Fresh produce like meat, seafood, fruits and vegetables have much higher gross margins (36-38%) compared to dry goods (16-18%). Sheng Siong currently boasts the highest sales mix in fresh produce (over 44%) amongst the regional supermarket players. Its best store has 50% of sales deriving from fresh produce. Assuming this as the optimal sales mix, Sheng Siong would be able to achieve over 27% gross margin, as it displaces wet markets as the preferred choice for buying fresh foods over the medium term. This comes notwithstanding cost efficiencies from the distribution centres.

- ◆ Sheng Siong is the go-to place for fresh produce and is the key candidate to displace wet markets.

- ◆ With higher sales mix from fresh produce, Sheng Siong would be able to raise margins in the medium term.

Figure 2: Room for gross margin expansion through improved sales mix

	Fresh produce	Dry merchandise	Blended gross margin
Average gross margin	38%	17%	
Current sales mix	44%	56%	26.2%
Optimal sales mix	50%	50%	27.5%

Source: Company data, RHB

Extra boosters in sales growth...

Strong SSSG. We believe Sheng Siong is a clear beneficiary of the recovering consumer sentiment in Singapore. But this year, we believe sales would receive an extra boost. We expect normal SSSG to track GDP growth of about 3%.

But we note that Sheng Siong expanded the Tampines outlet and renovated the Loyang outlet in 2017. This should give extra support to SSSG in 2018. Furthermore, the closure of the Verge and Woodlands 6A outlets in 2017 resulted in customer migration to nearby Sheng Siong stores.

New stores openings. YTD, Sheng Siong has opened six new outlets. We understand it is currently in one private negotiation and HDB has another eight new sites up for supermarket bidding till year-end. We thus expect Sheng Siong to secure another two new sites in 2H. Revenue should grow by 8.1% YoY in FY18F (Figure 3).

◆ Expect another two new stores in 2H18

Figure 3: Revenue growth assumptions**Growth categories**

Normal SSSG	3.0%
Special factors from Tampines outlet expansion, Loyang outlet reopen and migration of customers	2.3%
Closure of the Verge and Woodlands 6A	-5.0%
New stores* growth	7.8%
FY18F YoY growth	8.1%

Note: *Based on Sheng Siong's categorisation, stores opened in FY17 and FY18F are considered new stores

Source: RHB

Potential upside to our revenue growth assumptions. Currently, we forecast 12 new stores* across FY17-18F. Of which, four were opened in FY17 and six opened in 1H18. We believe our growth assumptions of 7.8% is conservative, given Sheng Siong was able to derive 6.2-9.9% revenue growth with 8-10 stores opened across two years.

◆ Potential upside in revenue growth assumptions.

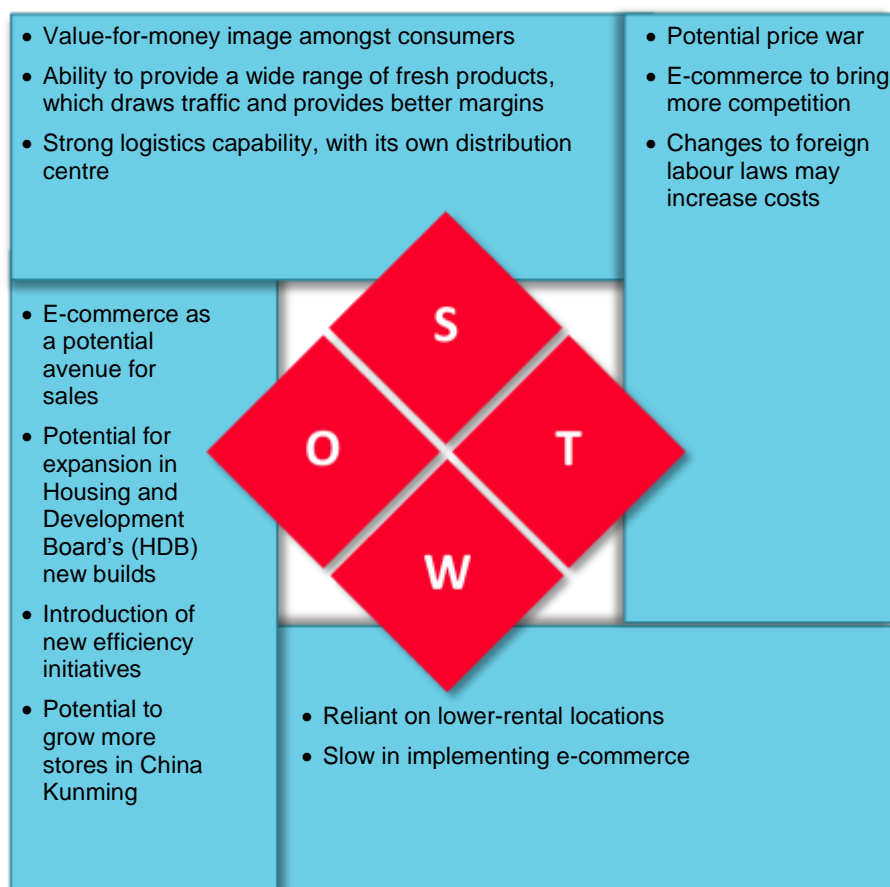
Figure 4: Revenue growth from new stores

	FY12	FY13	FY14	FY15	FY16	FY17	FY18F
New stores opened over past 24 months	10	8	1	6	8	5	12
Growth from new stores	7.3	9.9	2.3	4.6	6.2	4.5	7.8

Note: *Based on Sheng Siong's categorisation, stores opened in FY17 and FY18F are considered new stores

Source: Company data, RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2018-05-21	Buy	1.18	0.99
2018-04-29	Buy	1.18	1.02
2018-04-11	Buy	1.11	0.98
2018-02-25	Neutral	0.98	0.93
2018-02-18	Neutral	0.99	0.92
2017-10-26	Neutral	0.98	0.93
2017-07-28	Neutral	1.05	0.96
2017-03-07	Buy	1.21	0.94
2016-10-27	Buy	1.21	1.07
2016-07-27	Buy	1.12	0.99

Source: RHB, Bloomberg

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