

31 July 2018

Consumer Cyclical | Retailing

Sheng Siong

Buy (Maintained)

Highest Ever Gross Margin Achieved

Target Price: SGD1.27
 Price: SGD1.07
 Market Cap: USD1,181m
 Bloomberg Ticker: SSG SP

Maintain BUY and TP of SGD1.27, 18% upside. Sheng Siong is our Top Pick in the sector. 2Q18 results recorded the highest ever gross margin achieved in Sheng Siong's history, mainly on stronger fresh food sales. We believe gross margin expansion is sustainable given the continued drive to push fresh food sales and penetration, as well as cut wastage. YTD, Sheng Siong has secured six new stores, two of which were opened only in July, and are expected to underpin sales growth in 2H18.

Share Data

Avg Daily Turnover (SGD/USD) 4.58m/3.41m
 52-wk Price low/high (SGD) 0.91 - 1.10
 Free Float (%) 28
 Shares outstanding (m) 1,384
 Estimated Return 18%

2Q18 recorded healthy sales growth of 5.7%. This was mainly driven by new stores – three new stores in 2H17 and five in 1H18 – as well as high SSSG. Another two new stores opened in Jul 2018, which should contribute favourably to sales growth in 2H18.

Shareholders (%)

Sheng Siong Holdings 29.9
 Lim Brothers 27.4
 Mondrian Investment Partners 6.8

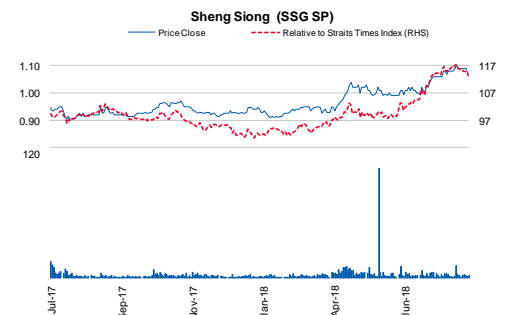
Gaining market share. We note that Sheng Siong outperformed the industry in 2Q18, with 2.3% recurring SSSG, probably at the expense of Dairy Farm (DFI SP, NEUTRAL, TP: USD9.60). Based on data released by the Department of Statistics, Singapore, retail sales at supermarkets showed slight contractions of 2.6% YoY and 0.8% YoY in April and May respectively.

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	15.7	0.9	4.9	15.1	11.5
Relative	18.5	(0.3)	13.4	21.9	12.2

Source: Bloomberg

We believe the contraction mainly reflected sales at premium range supermarkets (eg NTUC Finest, Cold Storage, Market Place), as well as the closure of smaller supermarket chains.



Source: Bloomberg

We remain confident of Sheng Siong's 2H18 performance as CFO, Mr Wong, indicated that the group has not seen any deterioration in consumer spending on the ground. In addition, with competitor Dairy Farm rationalising its stores, we believe Sheng Siong will continue to benefit from rising market share.

Continued gross margin expansion. In 2Q18, Sheng Siong recorded its highest ever gross margin of 27.3%. We note that the distribution centre is now operating at 100% utilisation rate and the gross margin expansion last quarter was predominantly driven by higher fresh food sales.

As a group, fresh food penetration has increased to slightly above 45% of sales and Sheng Siong is targeting to push the level to 50%. As at 2Q18, seven out of 48 stores already have fresh food penetration of above 50%. Since the group is expected to complete the distribution centre's expansion by end-2018 or early 2019, we believe there is potential for gross margins to improve further through increased bulk handling.

Maintain BUY with unchanged TP of SGD1.27. We expect Sheng Siong to chart EPS growth of 10% over the next three years. This year, most of the growth will be driven by new stores and gross margin expansion. As sales from the new stores normalise, operating cost will likely revert to the historical mean of 16.5% of sales, and in turn raise overall operating margin.

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)	25.7	23.8	21.4	19.4	18.1
P/B (x)	6.31	5.94	5.56	5.19	4.84
P/CF (x)	20.6	20.5	15.3	15.6	14.8
Dividend Yield (%)	3.5	3.1	3.5	3.9	4.1
EV/EBITDA (x)	17.1	16.0	14.4	12.8	11.8
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

Analyst

Juliana Cai CFA
 +65 6232 3871
juliana.cai@rhbgroup.com



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)	25.7	23.8	21.4	19.4	18.1
Key drivers	P/E (x)	25.7	23.1	21.4	19.4	18.1
New store openings, SSSG, gross margin expansion	P/B (x)	6.31	5.94	5.56	5.19	4.84
Key risks	FCF Yield (%)	(0.7)	3.8	4.3	5.9	6.3
i. High capex if Sheng Siong expands via the purchase of retail stores;	Dividend Yield (%)	3.5	3.1	3.5	3.9	4.1
ii. Inability to find affordable areas to lease;	EVEBITDA (x)	17.1	16.0	14.4	12.8	11.8
iii. Price war from competitors.	EVEBIT (x)	20.4	18.9	17.0	15.0	13.7
Company Profile	Income statement (SGDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
With 50 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

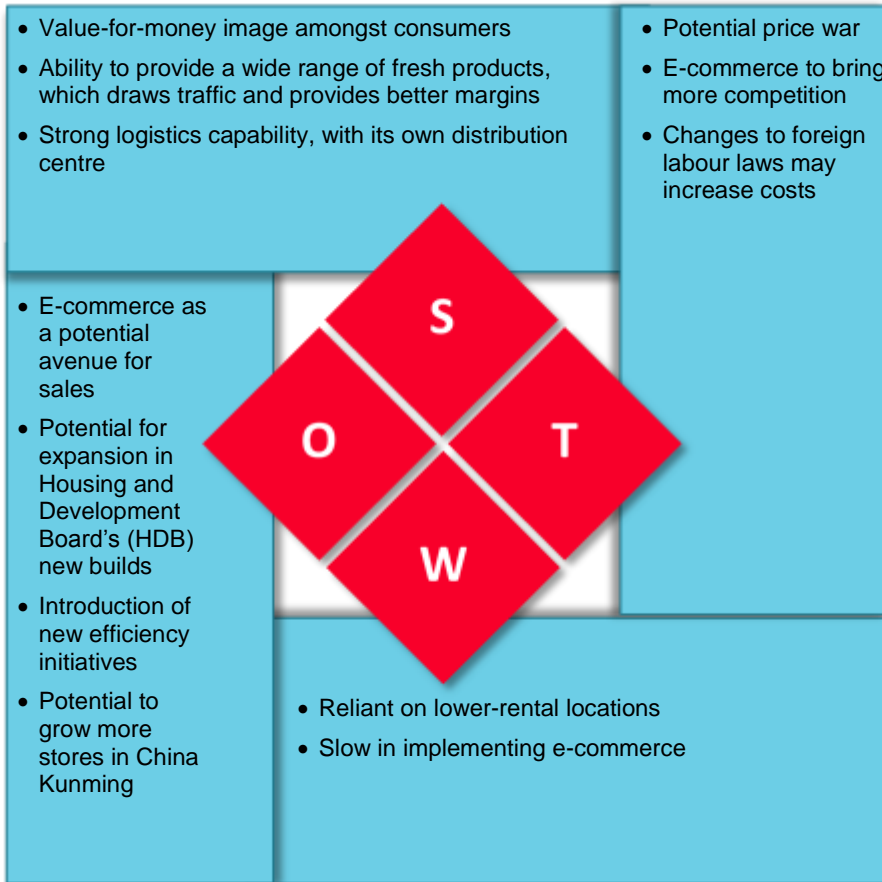
Source: Company data, RHB

Figure 1: 2Q18's result summary

(SGDm)	2Q18	1Q18	2Q17	QoQ (%)	YoY (%)	Comments
Revenue	213.0	228.3	201.5	(6.7)	5.7	Driven by SSSG of 2.3%, with 1.9% growth from the expansion at the Tampines outlet, and new store sales growth of 7.8%, but offset by closure of two outlets, which resulted in a decline of 7.2%.
Gross profit	58.1	59.8	53.5	(2.7)	8.7	
Gross margin (%)	27.3%	26.2%	26.6%			Higher sales mix of fresh food products.
EBITDA	24.8	25.8	23.4	(3.9)	5.9	Slower growth in EBITDA due to increased headcount to operate the seven new stores.
EBITDA margin (%)	11.7%	11.3%	11.6%			
Core net profit	17.2	18.3	16.1	(6.1)	6.3	Driven by higher sales growth and gross margin expansion.
Net margin (%)	8.1%	8.0%	8.0%			

Source: RHB, Company data

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2018-07-12	Buy	1.27	1.08
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

Source: RHB, Bloomberg

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Kuala Lumpur	Hong Kong	Singapore
RHB Research Institute Sdn Bhd Level 3A, Tower One, RHB Centre Jalan Tun Razak Kuala Lumpur 50400 Malaysia Tel : +(60) 3 9280 8888 Fax : +(60) 3 9200 2216	RHB Securities Hong Kong Ltd. 12 th Floor World-Wide House 19 Des Voeux Road Central, Hong Kong Tel : +(852) 2525 1118 Fax : +(852) 2810 0908	RHB Research Institute Singapore Pte Ltd. 10 Collyer Quay #09-08 Ocean Financial Centre Singapore 049315 Tel : +(65) 6533 1818 Fax : +(65) 6532 6211
Jakarta	Shanghai	Bangkok
PT RHB Sekuritas Indonesia Wisma Mulia, 20th Floor Jl. Jenderal Gatot Subroto No. 42 Jakarta 12710, Indonesia Tel : +(6221) 2783 0888 Fax : +(6221) 2783 0777	RHB (China) Investment Advisory Co. Ltd. Suite 4005, CITIC Square 1168 Nanjing West Road Shanghai 20041 China Tel : +(8621) 6288 9611 Fax : +(8621) 6288 9633	RHB Securities (Thailand) PCL 10th Floor, Sathorn Square Office Tower 98, North Sathorn Road, Silom Bangrak, Bangkok 10500 Thailand Tel: +(66) 2 088 9999 Fax : +(66) 2 088 9799