

6 March 2020

Consumer Cyclical | Retailing

Dairy Farm (DFI SP)

Neutral (Maintained)

Headwinds From High Exposure To North Asia

Target Price (Return): USD5.05 (+6%)
 Price: USD4.75
 Market Cap: USD6,425m
 Avg Daily Turnover (USD/USD) 4.29m/4.29m

- **Stay NEUTRAL with a new USD5.05 TP from USD6.63, 6% upside plus 4% yield.** FY19 results were below expectations while full-year PATMI of USD326m met 92% of our estimate. Social unrest in Hong Kong during 2H19 impacted sales growth and profitability for the health & beauty unit, as well as Dairy Farm's associate – Maxim's. Looking ahead, we think the headwinds remain, as the outbreak of COVID-19 should continue to put downward pressure on these two businesses' sales.
- **Headwinds on health & beauty and Maxim's.** Management expects the ongoing COVID-19 outbreak to impact FY20F results materially. In particular, we expect the health & beauty division to likely see most of the negative impact. We believe a substantial proportion of Hong Kong sales is dependent on Mainland Chinese tourist spending. The outbreak should affect tourism activities till 1H20. Additionally, its Maxim's associate is in the foodservice retail business and is also likely to be negatively impacted, as consumers avoid gatherings and dining out during this outbreak.
- **Improvements in grocery retail underway.** The group saw operating profit for the supermarket division surge >100% YoY to USD63m (2018: USD22m) on improved profitability of its South-East Asian business. However, we note this was partially due to a shift of costs from this unit to headquarters, as Dairy Farm centralised its procurement and integrated its supply chain. Centralised SG&A expenditure rose to USD143m from USD103m. Nonetheless, we see this as a positive move, as we expect the SG&A increase to decelerate on increased centralisation. Sales for this segment should remain resilient against the virus outbreak.
- **Expect IKEA to still see gestation costs in FY20.** Sales from IKEA grew 6% YoY on two new store openings in Taiwan and Indonesia. However, operating profits declined, as the new stores are in their gestation phase. Dairy Farm expects more stores to open in Taiwan and Macau in 2020. As such, we do not expect operating profit to recover significantly due to these new start-up costs.
- **Change in TP and earnings.** The challenging operating environment is likely to slow down the turnaround process for Dairy Farm. We cut our FY20F-21F earnings by 25% and 20% amidst declining profitability in key segments. This lowers our DCF-derived TP to USD5.05.
- **Key downside risk:** A prolonged COVID-19 outbreak or epidemic escalation in South-East Asian countries may lead to further declines in consumer sentiment and earnings. Upside risk: Faster-than-expected recovery in consumer spending.

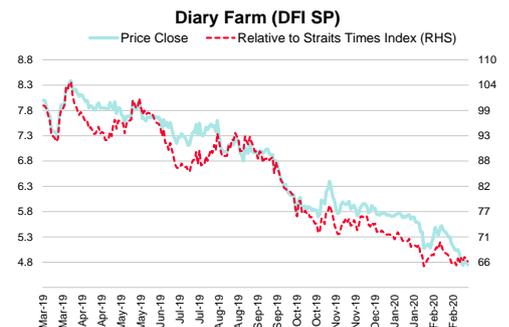
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(16.8)	(10.6)	(19.9)	(32.2)	(43.0)
Relative	(10.4)	(4.9)	(15.0)	(28.1)	(36.3)
52-wk Price low/high (USD)	4.74 – 8.39				



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (USDm)	11,749	11,192	11,181	11,605	12,220
Recurring net profit (USDm)	92	326	275	337	410
Recurring net profit growth (%)	(77.1)	254.6	(15.7)	22.5	21.8
Recurring P/E (x)	69.84	19.70	23.38	19.08	15.67
P/B (x)	4.4	5.3	5.4	5.1	4.6
P/CF (x)	10.58	4.62	13.26	9.50	8.32
Dividend Yield (%)	4.4	4.4	4.2	4.2	4.4
EV/EBITDA (x)	16.71	3.62	8.85	7.84	6.85
Return on average equity (%)	5.9	24.6	22.8	27.3	30.7
Net debt to equity (%)	49.9	66.2	92.3	88.4	73.8

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (USD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	Recurring EPS	0.07	0.24	0.20	0.25	0.30
Consumer Cyclical	DPS	0.21	0.21	0.20	0.20	0.21
Dairy Farm	BVPS	1.07	0.89	0.89	0.94	1.04
DFI SP	Return on average equity (%)	5.9	24.6	22.8	27.3	30.7
Neutral						
	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Valuation basis	Recurring P/E (x)	69.84	19.70	23.38	19.08	15.67
DCF.	P/B (x)	4.4	5.3	5.4	5.1	4.6
	FCF Yield (%)	5.5	17.2	3.0	6.0	7.5
	Dividend Yield (%)	4.4	4.4	4.2	4.2	4.4
Key drivers	EV/EBITDA (x)	16.71	3.62	8.85	7.84	6.85
Revenue growth from:	EV/EBIT (x)	65.22	12.16	13.71	11.93	10.25
i. More convenience stores;						
ii. Returning Chinese tourists in Hong Kong.						
Margins expansion on:	Income statement (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
i. More direct sourcing, cutting out middlemen;	Total turnover	11,749	11,192	11,181	11,605	12,220
ii. Selling more fresh produce;	Gross profit	3,649	3,534	3,533	3,667	3,862
iii. Increased penetration of corporate brands;	EBITDA	308	1,428	613	685	759
iv. Elimination of non-performing stores.	Depreciation and amortisation	(229)	(1,002)	(218)	(235)	(252)
	Operating profit	79	426	396	450	507
	Net interest	(33)	(158)	(43)	(45)	(45)
Key risks	Pre-tax profit	179	394	344	416	501
Downside risks:	Taxation	(101)	(69)	(71)	(81)	(92)
i. Slowdown in consumption spending and soft SSSG, especially in ASEAN;	Reported net profit	92	326	275	337	410
ii. Labour costs and rental pressures.	Recurring net profit	92	326	275	337	410
Upside risk: Faster-than-expected recovery in consumer spending.						
	Cash flow (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Change in working capital	(55)	25	(40)	56	75
	Cash flow from operations	607	1,389	485	676	772
	Capex	(256)	(287)	(290)	(290)	(290)
	Cash flow from investing activities	(501)	(265)	(300)	(300)	(300)
	Dividends paid	(284)	(284)	(284)	(271)	(271)
	Cash flow from financing activities	(186)	(217)	(111)	(271)	(271)
	Cash at beginning of period	332	296	301	165	156
	Net change in cash	(80)	907	74	106	202
	Ending balance cash	253	1,204	375	271	358
	Balance sheet (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	296	301	165	156	243
	Tangible fixed assets	848	820	876	916	940
	Total investments	2,067	2,102	2,160	2,228	2,310
	Total assets	5,390	8,370	8,581	8,756	9,065
	Short-term debt	1,026	938	200	200	200
	Total long-term debt	15	184	1,100	1,100	1,100
	Total liabilities	3,899	7,130	7,352	7,462	7,633
	Total equity	1,491	1,240	1,229	1,294	1,432
	Total liabilities & equity	5,390	8,370	8,581	8,756	9,065
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	4.1	(4.7)	(0.1)	3.8	5.3
	Recurrent EPS growth (%)	(77.1)	254.5	(15.7)	22.5	21.8
	Gross margin (%)	31.1	31.6	31.6	31.6	31.6
	Operating EBITDA margin (%)	2.6	12.8	5.5	5.9	6.2
	Net profit margin (%)	0.8	2.9	2.5	2.9	3.4
	Dividend payout ratio (%)	308.7	87.1	98.4	80.3	69.3
	Capex/sales (%)	2.2	2.6	2.6	2.5	2.4
	Interest cover (x)	2.41	2.69	9.20	9.97	11.36

Source: Company data, RHB

Figure 1: FY19 Results Summary

FYE Dec (USDm)	FY19	FY18	YoY (%)	Comments
Revenue	11,192.3	11,749.3	(4.7)	Due to divestment of Rustan and store rationalisation in South-East Asia.
Gross profit	3,533.8	3,648.8	(3.2)	
<i>Gross margin (%)</i>	31.6	31.1		
Operating profit	425.6	78.9	439.4	Sharp decline in business restructuring costs and absence of major impairments.
<i>Operating margin (%)</i>	3.8	0.7		
Net profit	326.2	92.0	254.6	
<i>Net margin (%)</i>	2.9	0.8		
Core PATMI	326.2	424.0	(23.1)	Decline was due to weaker contributions from health & beauty, IKEA, and Maxim's.
<i>Core margin (%)</i>	2.9	3.6		

Source: Company data, RHB

Figure 2: DCF assumptions

USD m	FY20F	FY21F	FY22F	FY23F	FY24F	FY24F
Net income	274.8	336.7	410.1	442.9	473.9	502.4
D&A costs	217.5	234.7	251.8	254.3	260.0	260.0
Net capex	(290.0)	(290.0)	(290.0)	(280.0)	(270.0)	(260.0)
Change in net working capital	(40.4)	56.1	75.4	0.0	0.0	0.0
Change in debt	177.8	0.0	0.0	0.0	0.0	0.0
Free cash flow to equity (FCFE)	340	337	447	417	464	502
Terminal value						7,099.3
Present value	339.8	312.1	382.4	329.9	339.1	5138.5
Total discounted FCFE	6841.8					
Value/ share (USD)	5.05					
Cost of equity	8.2%					
Risk-free rate	2.0%					
Beta	0.8					
Country risk premium	0.2%					
Market expected return	9.5%					
Market risk premium	7.5%					
Terminal growth	1.0%					

Source: RHB

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