

7 February 2020

Consumer Non-cyclical | Food & Beverage Products

Delfi (DELFI SP)

Buy (Maintained)

Recapturing The Value Segment; Keep BUY

Target Price (Return): SGD1.68 (75%)
 Price: SGD0.96
 Market Cap: USD419m
 Avg Daily Turnover (SGD/USD) 0.99m/0.73m

- **BUY, SGD1.68 TP implies 75% upside with c.4% FY20F yield.** Delfi is the market leader in Indonesia's chocolate confectionery space, with a c.45-50% market share. Despite the softer outlook for Indonesia's domestic consumption in 2020, we expect Delfi's earnings to grow by a solid 13% YoY this year, underpinned by its premiumisation strategy as well as the introduction of new products to recapture the value segment. Recent paring down of shares by substantial shareholders could also bring about improved liquidity.
- **Recapturing the market for value products.** Delfi has done well in the last two years following the premiumisation strategy, which has helped to drive margin expansion. Moving into 2020, it plans to introduce new products in the value segment to recapture this market. These products are expected to have a better margin profile than those that were previously culled. We believe the launch of these new products would partially offset the slower consumption outlook for Indonesia in 2020.
- **Impact on profitability.** We expect to see slight gross margin erosion in FY20-21, as new products are targeted at the value segment and have lower price points. Raw material costs have been trending up in the last six months. However, we note that the group does forward purchasing of raw materials to manage gross margins. As a result, we may not see an immediate and significant impact from the rise in material costs. The appreciation of the IDR could also help to boost its gross margins. On the other hand, we expect operating margins to remain steady on higher sales volumes and operating leverage.
- **Better free float.** We believe the lack of liquidity in the stock has led to a disconnect between its share price and financial performance in the last two years. In addition, the sell-down by substantial shareholders has resulted in an overhang on the stock. That said, this could be positive for the market in the long term, as free-float and liquidity should improve after they cease to be major shareholders.
- **Undervalued counter.** We think Delfi's valuation is still very compelling, given that it is trading at 14x FY20F P/E, at a discount to its Indonesian peers (average: 20x FY20F PE) despite the similar growth profiles. Delfi's dividend yield of close to 4% is also attractive relative to its peers. Key risks: further sell-down from substantial shareholders, IDR and/or PHP depreciation, slower-than-expected domestic consumption.

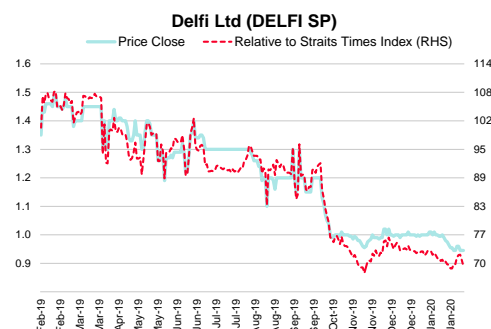
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(5.5)	(5.5)	(4.6)	(27.3)	(30.0)
Relative	(4.8)	(4.3)	(3.1)	(27.5)	(30.5)
52-wk Price low/high (SGD)				0.95 – 1.49	



Source: Bloomberg

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (USDm)	381	427	484	529	578
Recurring net profit (USDm)	17	23	27	31	35
Recurring net profit growth (%)	(34.7)	34.6	18.6	13.8	11.5
Recurring P/E (x)	24.49	18.20	15.34	13.48	12.09
P/B (x)	2.0	2.0	1.9	1.8	1.7
P/CF (x)	17.33	31.96	13.21	11.45	10.34
Dividend Yield (%)	2.6	2.7	3.3	3.7	4.1
EV/EBITDA (x)	9.17	8.26	7.11	6.31	5.66
Return on average equity (%)	10.8	10.0	12.8	13.6	14.2
Net debt to equity (%)	(7.2)	2.1	0.3	(3.5)	(7.6)
Interest cover (x)	10.95	13.02	16.31	18.33	20.16

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (USD)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Singapore	Recurring EPS	0.03	0.04	0.04	0.05	0.06
Consumer Non-cyclical	DPS	0.02	0.02	0.02	0.03	0.03
Delfi	BVPS	0.34	0.34	0.36	0.38	0.41
DELFI SP	Return on average equity (%)	10.8	10.0	12.8	13.6	14.2
Buy						
Valuation basis	Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
DCF	Recurring P/E (x)	24.49	18.20	15.34	13.48	12.09
	P/B (x)	2.0	2.0	1.9	1.8	1.7
	FCF Yield (%)	3.0	(1.5)	4.7	5.8	6.8
	Dividend Yield (%)	2.6	2.7	3.3	3.7	4.1
Key drivers	EV/EBITDA (x)	9.17	8.26	7.11	6.31	5.66
Improvement in consumer confidence and private consumption.	EV/EBIT (x)	12.35	11.20	9.35	8.14	7.20
Key risks	Income statement (USDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
i. Slow recovery in consumer spending;	Total turnover	381	427	484	529	578
ii. Increased competition from foreign brands;	Gross profit	130	148	168	184	200
iii. Depreciation of IDR against USD;	EBITDA	44	51	59	65	71
iv. Sell-down from substantial shareholders	Depreciation and amortisation	(11)	(13)	(14)	(15)	(15)
	Operating profit	33	38	45	50	55
	Net interest	(1)	0	0	0	1
	Pre-tax profit	35	36	45	52	58
	Taxation	(13)	(15)	(18)	(21)	(23)
	Reported net profit	22	21	27	31	35
	Recurring net profit	17	23	27	31	35
Company Profile	Cash flow (USDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Delfi is a chocolate confectionery company headquartered in Singapore. It is an integrated player involved in segments ranging from chocolate production to distribution. Other than distributing its own chocolate confectionary brands, it also distributes agency brands. Delfi's core markets are Indonesia – where it has a more than 50% market share – and the Philippines, where it is a top 5 player with an estimated 10% market share.	Change in working capital	(9.3)	(22.8)	(8.6)	(8.2)	(8.1)
	Cash flow from operations	24.1	13.1	31.7	36.6	40.5
	Capex	(11.8)	(19.5)	(12.2)	(12.2)	(12.2)
	Cash flow from investing activities	(8.0)	(19.3)	(14.3)	(12.2)	(12.2)
	Dividends paid	(13.3)	(10.1)	(13.6)	(15.5)	(17.3)
	Cash flow from financing activities	(9.3)	(1.4)	(22.6)	(15.5)	(17.3)
	Cash at beginning of period	67.7	67.4	54.7	49.4	58.3
	Net change in cash	6.9	(7.6)	(5.3)	8.8	11.0
	Ending balance cash	74.8	60.5	49.4	58.3	69.2
	Balance sheet (USDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Total cash and equivalents	67	55	49	58	69
	Tangible fixed assets	123	109	108	106	103
	Total investments	5	5	7	8	9
	Total assets	351	361	377	400	426
	Short-term debt	47	59	50	50	50
	Total long-term debt	5	0	0	0	0
	Total liabilities	141	155	157	164	173
	Total equity	210	206	220	235	253
	Total liabilities & equity	351	361	377	400	426
	Key metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Revenue growth (%)	(5.3)	12.1	13.4	9.2	9.2
	Recurrent EPS growth (%)	(34.7)	34.6	18.6	13.8	11.5
	Gross margin (%)	34.1	34.6	34.7	34.7	34.7
	Operating EBITDA margin (%)	11.5	12.0	12.2	12.3	12.2
	Net profit margin (%)	5.8	4.9	5.6	5.9	6.0
	Dividend payout ratio (%)	49.8	55.0	50.0	50.0	50.0
	Capex/sales (%)	3.1	4.6	2.5	2.3	2.1
	Interest cover (x)	10.9	13.0	16.3	18.3	20.2

Source: Company data, RHB

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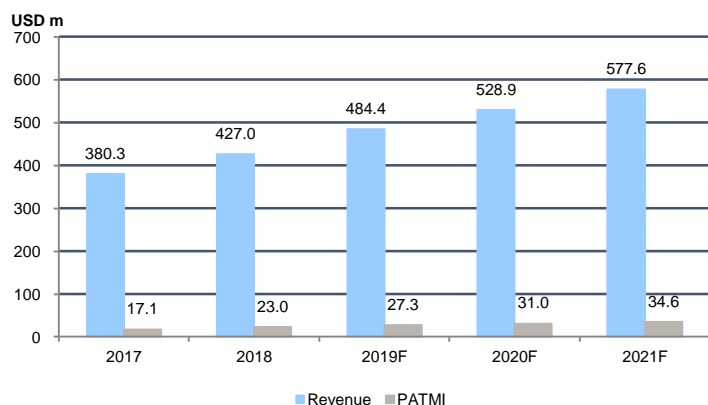
Refocus on the value segment

Over the last two years, sales have grown strongly, led by growth in its premium products. This is after the group embarked on a stock-keeping unit (SKU) rationalisation programme in 2015, to phase out unprofitable products in the lower-priced value segment. The acquisition of the *Van Houten* license for key markets in the Asia-Pacific in 2018 further boosted revenue growth in 2019. Currently, c.70% of Delfi's sales are derived from the premium segment. As the sales mix is tilted more towards premium products, its 9M19 gross margin reached a high of 35.6%, from 29.8% in 2015.

Moving ahead, the group will focus on growing revenue. The group plans to roll out more lower-priced SKUs to recapture the value segment market. The lower-priced SKUs are typically sold in the general trade channel, which is c.3-4x bigger than modern trade retail channels (where most of the premium products are sold). The refocus on value segment products will allow the group to tap on a wider market.

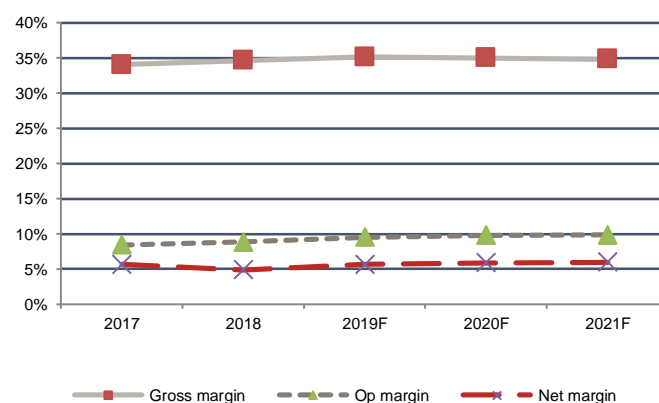
While these value-segment products are expected to have lower gross margins, we think the near-term impact on gross margins is small. The group just phased out its unprofitable IDR500 product in 2019. The new value segment products are expected to have better margin profiles, and be profitable.

Figure 1: Revenue and earnings forecast



Source: Company, RHB

Figure 2: Margins forecast



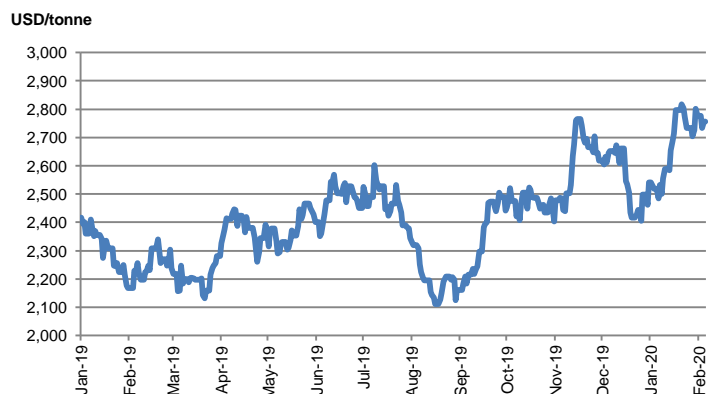
Source: Company, RHB

Changes in raw material prices

Raw material prices – cocoa, sugar and milk have been on a rise. This is not a key concern in the short term as the group typically make forward purchase of the raw materials to lock in the margins. However, prolonged uptrend of raw material prices would be negative to the group.

As most of the raw materials prices are denominated in USD, appreciation of IDR against USD would also help to buffer the increase in prices.

Figure 3: Cocoa prices have been on the uptrend



Source: Bloomberg

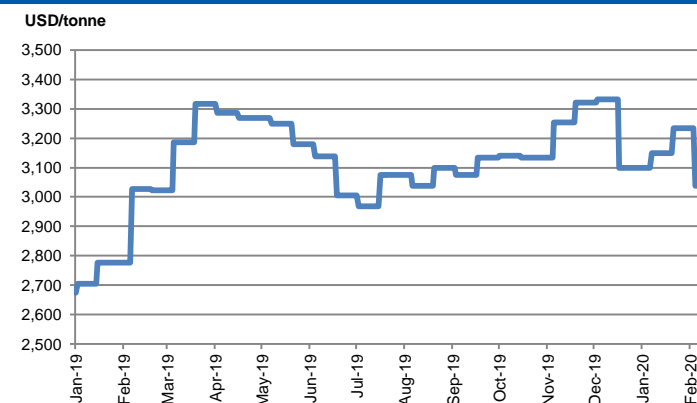
Figure 4: Sugar prices have also been going up



Source: Bloomberg

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Figure 5: Whole milk powder average price has been fairly stable

Source: Bloomberg

Figure 6: Appreciating IDR could help to cushion the increase in raw material prices

Source: Bloomberg

Valuation still compelling when compared to Indonesian peers

In terms of P/E and EV/EBITDA, Delfi is still trading at a discount to its peer average, despite the similar growth profiles. We think this is unjustified, given Delfi's strong brand equity and distribution network. With improved liquidity, the gap between its valuation and that of its peers should narrow ahead.

Figure 7: Peer comparison

Company	BB Code	Share	Target	Market	P/E			3-yr	EV/	ROE			Div
		price	price	cap	FY19F	FY20F	FY21F	EPS	EBITDA	FY19F	FY20F	FY21F	Yield
		(lcl ccy)	(lcl ccy)	(USDm)	(x)	(x)	(x)	CAGR	FY20F	(%)	(%)	(%)	FY20F
Delfi	DELFI SP	0.95	1.68	419	15.3	13.5	12.1	14.5	6.3	12.8	13.6	14.2	3.7
Nippon Indosari	ROTI IJ	1,300	1,600	589	28.5	23.2	20.5	31.7	12.9	9.3	10.7	11.1	1.2
Mayora Indah	MYOR IJ	1,905	2,600	3,118	23.2	20.8	18.0	11.5	11.9	19.7	19.7	19.7	1.6
Indofood	INDF IJ	7,750	8,900	4,982	13.0	10.7	9.7	19.1	7.2	14.6	15.7	15.7	3.0
Indofood CBP	ICBP IJ	11,500	11,700	9,818	26.7	24.5	22.3	11.0	14.8	21.3	20.8	20.4	2.1
Unilever Indo	UNVR IJ	8,100	8,600	22,622	41.5	40.8	38.4	-2.6	27.4	103.3	121.3	125.6	2.4
Average					21.4	20.0	18.1	14.1	11.3	33.6	34.4	33.8	3.0

Source: Bloomberg, RHB

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Figure 8: DCF valuation

USDm	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F
Net income	31.0	34.6	37.3	39.9	42.3	44.4	46.2	47.6
D&A costs	14.5	15.0	10.0	10.0	10.0	10.0	10.0	10.0
Net capex	(12.0)	(12.0)	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)
Change in net working capital	(8.0)	(8.0)	0.0	0.0	0.0	0.0	0.0	0.0
Change in debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Free cash flow to equity (FCFE)	25.5	29.5	37.3	39.9	42.3	44.4	46.2	47.6
Terminal value								914.7
Present Value	25.5	27.2	31.8	31.4	30.7	29.7	28.5	548.6
Total discounted FCFE	753.5							
Value/ share (USD)	1.23							
Exchange rate: USDSGD	1.36							
Value/ share (SGD)	1.68							
Cost of equity	8.4%							
Risk-free rate	7.0%							
Beta	0.7							
Market expected return	9.0%							
Terminal growth	3.0%							

Source: Bloomberg, RHB

Recommendation Chart



Date	Recommendation	Target Price	Price
2019-11-13	Buy	1.68	0.96
2019-08-14	Buy	1.68	1.24
2019-05-16	Buy	1.68	1.35
2019-03-01	Buy	1.68	1.45
2018-11-13	Buy	1.59	1.19
2018-08-03	Buy	1.47	1.18

Source: RHB, Bloomberg

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