

23 May 2019

Consumer Cyclical | Restaurants

Japan Foods (JFOOD SP)

Neutral (Maintained)

Slow Earnings Growth, Keep NEUTRAL

Target Price (Return) SGD0.40 (-9%)
 Price: SGD0.44
 Market Cap: USD55m
 Avg Daily Turnover (SGD/USD) 4,580/3,320

- **Keep NEUTRAL, with a lower SGD0.40 TP** from SGD0.45, 9% downside with 4.3% FY20F (Mar) yield as we lower FY20F-21F earnings by 25-30%. While there exists pressure from moderating consumer discretionary spending, contributions from new *Konjiki Hototogisu* stores and Japan Foods' growing regional presence should help it deliver 4% profit growth in FY20 vs 42% profit decline in FY19. A net cash position, strong FCF generation and +4% yield should provide support to its share price.
- **Lower DPS should remain unchanged in FY20.** 4QFY19 profit of SGD0.5m (down 44% YoY) was the lowest in the past 12 quarters. Decline in profit came in on the back of higher operating costs relating to higher number of stores, launch of new franchise brands and losses reported by the associates. Final dividends were cut to SGD0.011 (down from SGD0.013). Full year dividends of SGD0.019 represented a payout ratio of 99%. We expect Japan Foods to be able to maintain similar DPS in FY20 and pay out more than 90% of its earnings as dividend during the forecast period.
- **Weak revenue for key brands offset by contribution from new brands.** Japan Foods' key brands, namely *Ajisen Ramen*, *Menya Musashi* and *Osaka Ohsho*, which account for more than 70% of its revenue, have witnessed YoY decline in average revenue per store. *Ajisen Ramen's* revenue contribution fell to 34% in FY19 from 39% in FY18. However, some of the weakness from key brands was partially offset by higher revenue contribution from new stores, namely *Konjiki Hototogisu* and *Shitamachi Tendon Akimitsu*, which have seen their revenue contribution increase to 24% in FY19 from 16% in FY18.
- **Losses from overseas associates should narrow.** High initial set-up costs for three new restaurants in China and initial start-up losses for the associate company in Indonesia led to QoQ widening of associate losses. However, these elevated costs should moderate and we expect profit contributions from these stores in FY20. Japan Foods' continuing geographical expansion through its recently announced JV with Minor Group could further help in growing earnings from associates and JVs.
- **Low ex-cash valuation and +4% yield should provide price support.** With its net cash balance accounting for 29% of its market cap, Japan Foods' ex-cash P/E is at a 30% discount to its listed restaurant peers in Singapore. In addition, an average annual FCF generation of c.SGD3m should support more than 4% yield during FY20F-22F. Higher-than-estimated profit contribution from its new brands and from its JV with Minor could re-rate the stock.
- **Key risks are** rising operating costs and rental expenses and weakening consumer discretionary spending amidst a weakening economic outlook.

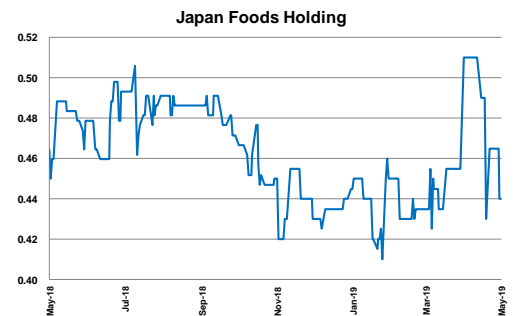
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	1.1	(13.7)	(2.2)	(2.2)	(9.3)
Relative	(2.6)	(8.5)	0.4	(6.9)	0.9
52-wk Price low/high (SGD)	0.40 - 0.53				



Source: Bloomberg

Forecasts and Valuations	Mar-18	Mar-19	Mar-20F	Mar-21F	Mar-22F
Total turnover (SGDm)	68	68	70	70	71
Recurring net profit (SGDm)	5.8	3.3	3.5	3.8	4.6
Recurring net profit growth (%)	24.0	(42.3)	4.4	10.4	19.0
Recurring P/E (x)	13.2	22.9	21.8	19.8	16.6
P/BV (x)	2.2	2.3	2.2	2.2	2.2
P/CF (x)	8.2	9.0	10.6	8.5	7.5
Dividend Yield (%)	4.8	4.3	4.3	4.8	5.2
EV/EBITDA (x)	9.1	12.2	11.2	10.3	9.3
ROE (%)	17.6	9.8	10.3	11.2	13.1
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash
Interest coverage (x)	nm	nm	nm	nm	nm

Source: Company data, RHB

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