

4 July 2022

Consumer Cyclical | Restaurants

Japan Foods (JFOOD SP)

Buy (Maintained)

Earnings Recovery Despite Cost Headwinds; BUY

Target Price (Return): SGD0.55 (27.9%)
 Price (Market Cap): SGD0.43 (USD53.1m)
 ESG score: 3.00 (out of 4)
 Avg Daily Turnover (SGD/USD) 0.01m/0.01m

• **Keep BUY and SGD0.55 TP, 28% upside and c.6% FY23F (Mar) yield.** Amidst a revival in discretionary consumer spending, as Singapore is now fully open for business, monthly revenue at Japan Foods' restaurants have returned to pre-pandemic levels. JFOOD has plans to capitalise on the economic revival and weak competition by looking to aggressively grow its number of outlets. We expect strong growth over FY23-25, with profit quickly reverting to pre-pandemic levels despite rising cost inflation.

• **We remain confident of JFOOD maintaining margins.** We estimate JFOOD to have 60 restaurants by end-Mar 2023 (currently 56). This rise in the number of outlets would mean YoY higher operating costs, especially from increased labour. In addition, rising cost inflation would imply higher input expenses across its entire operations. However, JFOOD's standardised food inputs across all its operations, an efficient central kitchen operations, and improved labour productivity should enable it to maintain its margins. To manage the rise in input costs, the group is focusing on diversifying its raw materials sourcing. We note that it was able to keep its gross margins above 84% throughout the pandemic (FY22: 84.6%). We estimate FY23 gross margins at 84.4%.

• **Net cash balance sheet offers growth potential.** As at March, JFOOD had no borrowings and a cash balance of SGD23m (c.43% of market cap). While it believes this large cash balance gives it a buffer to survive any unexpected decline in economic activity, we assess that, once we get past the near-term economic weakness, this large cash balance will provide it with sufficient firepower to aggressively expand the number of outlets in Singapore or regionally, if needed.

• **High dividend yield.** During FY18-20, its dividend payout ratio stood at 68-214%. JFOOD announced 100% of net profit to be paid as dividends in FY22, which it expects to sustain in the future. We estimate the group's dividend yield at >5% for FY22-23.

• **Compelling valuation.** We believe JFOOD's FY24F P/E of 17x does not do justice to our expectations of its strong return to pre-pandemic profitability. On an ex-cash basis, the stock is trading at 12x FY23F P/E, which we believe is quite compelling. Our TP is derived by using an average of forward P/E, P/BV, EV/EBITDA, and DCF of adjusted free cash flow. JFOOD's ESG score, based on our proprietary methodology, is 3.0. As this is in line with the country median score, we ascribe a 0% premium/discount to its fair value to arrive at our TP.

Analyst

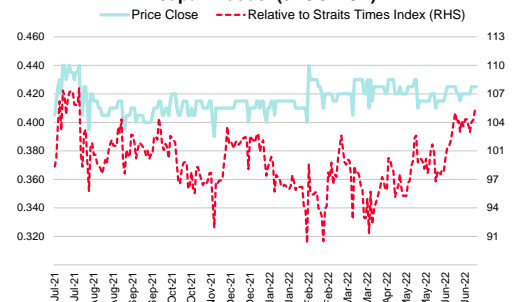
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Share Performance (%)

| | YTD | 1m | 3m | 6m | 12m |
|----------------------------|-----|-----|-------|-------------|-----|
| Absolute | 4.9 | 2.4 | (1.2) | 4.9 | 1.2 |
| Relative | 5.8 | 7.0 | 8.3 | 5.8 | 2.1 |
| 52-wk Price low/high (SGD) | | | | 0.39 – 0.44 | |

Japan Foods (JFOOD SP)



Source: Bloomberg

Overall ESG Score: 3.00 (out of 4)

E: GOOD

JFOOD has identified its gas, electricity and water consumption rates as the key environmental factors to focus on. For FY21 (Mar), while the absolute consumption of gas, electricity and water was lower YoY, the rate of consumption measured as a ratio to revenue increased as revenue declined at faster rate amidst the pandemic.

S: GOOD

Customer satisfaction, food quality and inclusive workplace are key social factors being monitored. For FY21, 98% of its restaurants were graded A by Singapore Food Agency. It had zero food safety incidents and zero workplace fatalities. The number of non-fatal workplace injuries also declined YoY.

G: EXCELLENT

JFOOD has a proven track record of receiving awards that recognise our good corporate governance and transparency practices. The company assesses its corporate governance framework through the Singapore Governance and Transparency Index score measured by the National University of Singapore Business School. In FY21, the score fell by 8pts.

Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

| Forecasts and Valuation | Mar-21 | Mar-22 | Mar-23F | Mar-24F | Mar-25F |
|---------------------------------|---------|--------|---------|---------|---------|
| Total turnover (SGDm) | 51 | 55 | 69 | 73 | 75 |
| Recurring net profit (SGDm) | (5) | (0) | 4 | 4 | 5 |
| Recurring net profit growth (%) | (634.8) | (95.0) | - | 24.9 | 4.9 |
| Recurring P/E (x) | na | na | 20.82 | 16.68 | 15.90 |
| P/B (x) | 2.2 | 2.3 | 2.3 | 2.2 | 2.2 |
| P/CF (x) | 10.06 | 9.54 | 12.95 | 9.36 | 8.61 |
| Dividend Yield (%) | 2.3 | 5.3 | 5.5 | 4.8 | 6.0 |
| EV/EBITDA (x) | 6.53 | 8.45 | 7.30 | 6.17 | 5.85 |
| Return on average equity (%) | 11.2 | 9.8 | 11.0 | 13.6 | 14.1 |

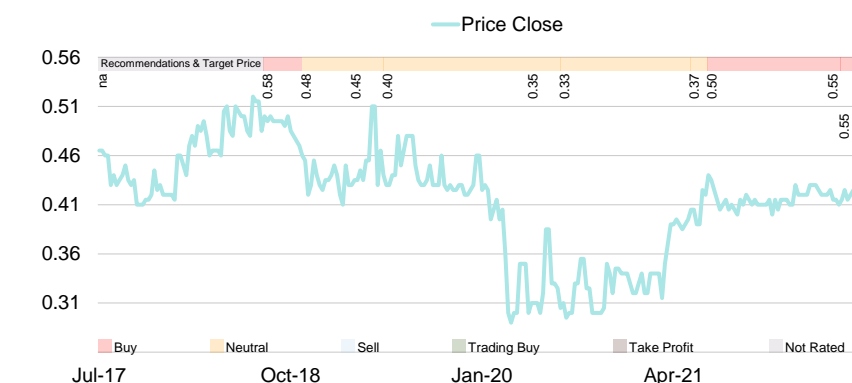
Source: Company data, RHB

Financial Exhibits

| | | | | | | |
|---|-------------------------------------|---------------|---------------|----------------|----------------|----------------|
| Asia | Financial summary (SGD) | Mar-21 | Mar-22 | Mar-23F | Mar-24F | Mar-25F |
| Singapore | Recurring EPS | (0.03) | (0.00) | 0.02 | 0.03 | 0.03 |
| Consumer Cyclical | DPS | 0.01 | 0.02 | 0.02 | 0.02 | 0.03 |
| Japan Foods | BVPS | 0.19 | 0.19 | 0.18 | 0.19 | 0.19 |
| JFOOD SP | Return on average equity (%) | 11.2 | 9.8 | 11.0 | 13.6 | 14.1 |
| Buy | | | | | | |
| | Valuation metrics | Mar-21 | Mar-22 | Mar-23F | Mar-24F | Mar-25F |
| Valuation basis | Recurring P/E (x) | na | na | 20.82 | 16.68 | 15.90 |
| Our TP is derived by using an average of forward P/E, P/BV, EV/EBITDA, and DCF of adjusted free cash flow. | P/B (x) | 2.2 | 2.3 | 2.3 | 2.2 | 2.2 |
| | FCF Yield (%) | 8.9 | 5.1 | 1.7 | 4.6 | 5.5 |
| | Dividend Yield (%) | 2.3 | 5.3 | 5.5 | 4.8 | 6.0 |
| | EV/EBITDA (x) | 6.53 | 8.45 | 7.30 | 6.17 | 5.85 |
| | EV/EBIT (x) | 12.11 | 16.63 | 13.15 | 10.56 | 10.24 |
| Key drivers | Income statement (SGDm) | Mar-21 | Mar-22 | Mar-23F | Mar-24F | Mar-25F |
| i. Continuing revenue growth from addition of new restaurant and brands; | Total turnover | 51.0 | 54.6 | 68.7 | 72.9 | 75.4 |
| ii. Positive contributions from its JV with Minor Singapore and recent expansion into Hong Kong. | Gross profit | 43.2 | 46.2 | 58.0 | 61.6 | 63.6 |
| | EBITDA | 7.8 | 6.0 | 7.4 | 8.8 | 9.3 |
| | Depreciation and amortisation | (3.6) | (3.0) | (3.3) | (3.6) | (4.0) |
| | Operating profit | 4.2 | 3.1 | 4.1 | 5.1 | 5.3 |
| | Net interest | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| | Pre-tax profit | 4.2 | 3.2 | 4.3 | 5.4 | 5.7 |
| | Taxation | (0.6) | 0.0 | (0.8) | (1.0) | (1.0) |
| | Reported net profit | 3.6 | 3.2 | 3.6 | 4.4 | 4.7 |
| | Recurring net profit | (5.4) | (0.3) | 3.6 | 4.4 | 4.7 |
| Key risks | Cash flow (SGDm) | Mar-21 | Mar-22 | Mar-23F | Mar-24F | Mar-25F |
| i. Rising operating costs and rental expenses; | Change in working capital | (1.7) | 2.3 | (1.1) | (0.2) | (0.0) |
| ii. Weakening consumer discretionary spending amidst a weakening economic outlook. | Cash flow from operations | 7.4 | 7.8 | 5.7 | 7.9 | 8.6 |
| | Capex | (0.8) | (4.0) | (4.5) | (4.5) | (4.5) |
| | Cash flow from investing activities | (2.2) | (3.5) | (4.6) | (4.6) | (4.6) |
| | Dividends paid | (1.7) | (3.9) | (4.1) | (3.6) | (4.4) |
| | Cash flow from financing activities | (2.5) | (5.7) | (4.1) | (3.6) | (4.4) |
| | Cash at beginning of period | 20.4 | 23.1 | 23.2 | 20.3 | 20.0 |
| | Net change in cash | 2.6 | (1.4) | (2.9) | (0.2) | (0.4) |
| | Ending balance cash | 23.1 | 21.7 | 20.3 | 20.0 | 19.6 |
| Company Profile | Balance sheet (SGDm) | Mar-21 | Mar-22 | Mar-23F | Mar-24F | Mar-25F |
| Japan Foods operates Japanese restaurants in Singapore, Malaysia, and Indonesia. The group franchises some of its restaurants in Malaysia and Indonesia, and serves fried rice and pan-fried noodles. | Total cash and equivalents | 23.1 | 23.2 | 20.3 | 20.0 | 19.6 |
| | Tangible fixed assets | 6.1 | 7.2 | 8.5 | 9.4 | 10.0 |
| | Total investments | 2.1 | 1.9 | 1.9 | 1.9 | 1.9 |
| | Total assets | 68.1 | 77.8 | 77.0 | 78.3 | 78.8 |
| | Total liabilities | 34.8 | 45.1 | 44.8 | 45.2 | 45.5 |
| | Total equity | 33.4 | 32.7 | 32.2 | 33.1 | 33.3 |
| | Total liabilities & equity | 68.1 | 77.8 | 77.0 | 78.3 | 78.8 |
| | Key metrics | Mar-21 | Mar-22 | Mar-23F | Mar-24F | Mar-25F |
| | Revenue growth (%) | (25.4) | 7.1 | 25.9 | 6.1 | 3.4 |
| | Recurrent EPS growth (%) | (634.7) | (95.0) | 0.0 | 24.9 | 4.9 |
| | Gross margin (%) | 84.7 | 84.6 | 84.4 | 84.4 | 84.4 |
| | Operating EBITDA margin (%) | 15.3 | 11.0 | 10.7 | 12.0 | 12.4 |
| | Net profit margin (%) | 7.1 | 5.9 | 5.2 | 6.1 | 6.2 |
| | Dividend payout ratio (%) | 48.0 | 121.4 | 115.1 | 80.1 | 95.4 |
| | Capex/sales (%) | 1.5 | 7.3 | 6.5 | 6.2 | 6.0 |

Source: Company data, RHB

Recommendation Chart

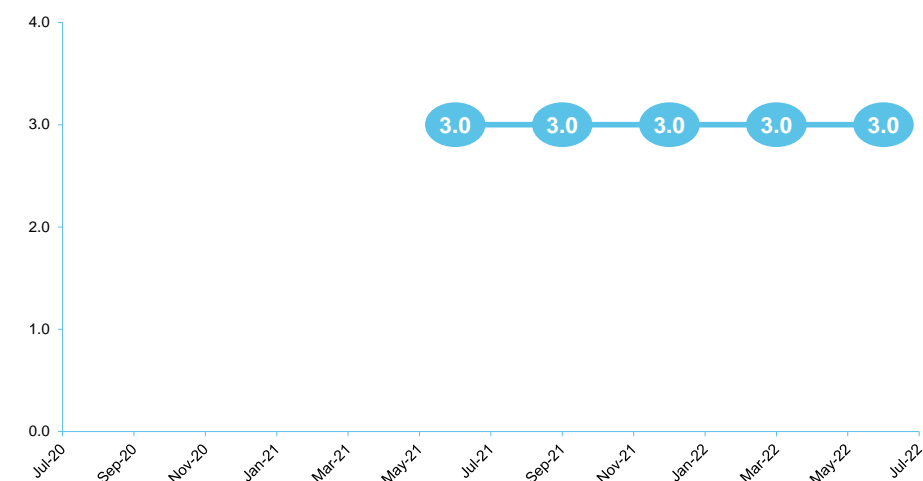


Source: RHB, Bloomberg

| Date | Recommendation | Target Price | Price |
|------------|----------------|--------------|-------|
| 2022-04-29 | Buy | 0.55 | 0.42 |
| 2021-07-11 | Buy | 0.50 | 0.42 |
| 2021-05-30 | Neutral | 0.37 | 0.40 |
| 2020-07-22 | Neutral | 0.33 | 0.33 |
| 2020-05-06 | Neutral | 0.35 | 0.30 |
| 2019-05-23 | Neutral | 0.40 | 0.44 |
| 2019-03-08 | Neutral | 0.45 | 0.43 |
| 2018-11-09 | Neutral | 0.48 | 0.46 |
| 2018-08-29 | Buy | 0.58 | 0.49 |
| 2018-08-08 | Buy | na | 0.50 |

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

RHB Guide to Investment Ratings

| | |
|---------------------|--|
| Buy: | Share price may exceed 10% over the next 12 months |
| Trading Buy: | Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain |
| Neutral: | Share price may fall within the range of +/- 10% over the next 12 months |
| Take Profit: | Target price has been attained. Look to accumulate at lower levels |
| Sell: | Share price may fall by more than 10% over the next 12 months |
| Not Rated: | Stock is not within regular research coverage |

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