

11 July 2023

Consumer Cyclical | Retailing

Dairy Farm (DFI SP)

Neutral (Maintained)

Awaiting Firmer Signs Of Recovery

Target Price (Return): USD3.09 (8.7%)
 Price (Market Cap): USD2.84 (USD3,844m)
 ESG score: 3.0 (out of 4)
 Avg Daily Turnover (USD/USD) 0.86m/0.86m

- **Keep NEUTRAL and USD3.09 TP, 9% upside.** We maintain our rating on Dairy Farm as we await a better outlook (currently appears mixed) before turning positive on the stock. China tourists to Hong Kong are still lagging pre-COVID-19 levels, and grocery consumption in Singapore, China, and Hong Kong remains unexciting for DFI. We stay cautious on a more aggressive recovery until DFI's key markets' domestic supermarket consumption and China outbound tourist numbers pick up. This report marks the transfer of coverage to Alfie Yeo.

- **1Q23's mixed performance within expectations.** Better performance from the health & beauty (owing to the reopening of the Hong Kong-China border) and convenience store (from improved footfall and promotions) segments were offset by relatively poor grocery retail (due to last year's high base) and home furnishing divisions (on weaker demand for furniture in Hong Kong and Taiwan), leading to a modest hike in operating profit. Associate income rose significantly, driven by improvement from Maxim's (as COVID-19 restrictions eased). Grocery retail showed higher profitability vs 2019, while the profitability of the convenience stores and health & beauty segments remained below 2019's levels.

- **Gradual recovery going forward.** We anticipate a gradual rather than a firm earnings recovery towards 2019's levels. Hong Kong supermarket retail sales have been subdued so far this year, and the 2.8m Chinese visitors to Hong Kong in May remains far from pre-COVID-19 levels of 4-5m a month. There should also be a lag effect to China's recent rate cuts before consumption improves. Our economics desk does not see a 2023 V-shaped recovery for China either. Finally, we see risks of downtrading from higher-end grocery segments in Singapore, due to downside risks to the GDP growth outlook. We therefore believe that earnings recovery will be gradual. We have kept our earnings forecasts largely unchanged, given our stance of a gradual earnings recovery outlook.

- **Leadership transition.** DFI's current CEO since 2017, Ian Macleod will be stepping down from 1 Aug 2023, paving the way for Scott Price who was formerly Walmart Asia's CEO, and subsequently EVP, Global Leverage. He has also been Coles Group Australia's independent non-executive director since Sep 2022. We believe there will be tweaks to DFI's business focus and strategy after the new CEO's appointment, and the benefits of the new plans could take time to realise.

- **ESG.** As DFI's ESG score is 3.0 out of 4 – in line with our country median – we have a 0% ESG premium/discount to DFI's intrinsic value in deriving our final TP.

- **Risks to our recommendation include** slower-than-expected recovery in consumption spending, and higher-than-expected costs, which should ultimately lead to lower margins and earnings. There will be upside earnings risks should the opposite of the above scenario play out.

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (USDm)	9,188	9,174	9,429	9,692	9,962
Recurring net profit (USDm)	276	29	207	247	285
Recurring net profit growth (%)	(0.1)	(89.6)	618.7	19.6	15.2
Recurring P/E (x)	13.94	132.81	18.48	15.46	13.42
P/B (x)	3.0	4.0	3.5	3.2	3.0
P/CF (x)	3.45	4.07	3.74	3.45	3.28
Dividend Yield (%)	3.3	1.1	3.3	5.3	6.0
EV/EBITDA (x)	1.84	2.63	2.48	2.28	2.11
Return on average equity (%)	21.3	(10.4)	20.4	21.8	23.3
Net debt to equity (%)	66.6	91.9	77.7	69.8	65.2

Source: Company data, RHB

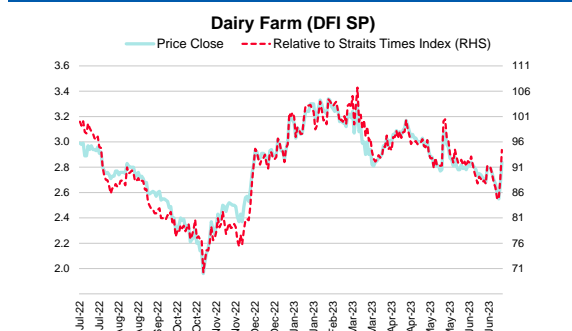
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(3.1)	1.1	(8.1)	(10.4)	(5.0)
Relative	0.0	2.3	(3.7)	(6.9)	(5.6)
52-wk Price low/high (USD)				1.96 – 3.34	



Source: Bloomberg

Overall ESG Score: 3.0 (out of 4)

E: GOOD

Worked closely with Humane Society International (HSI) to drive long-term change in the supply chain and source more sustainable choices for its customers. It has also taken several measures to reduce plastic usage and recycle rates.

S: GOOD

Invested heavily on PPE to ensure the safety of its employees amidst the pandemic. It also prioritised helping the communities and placed huge significance on access to education for all via numerous initiatives.

G: GOOD

The adopted system of governance allows DFI to benefit from Jardine Matheson's strategic guidance and professional expertise, while at the same time ensuring that the independence of the Board is respected.

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Financial Exhibits

Asia	Financial summary (USD)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Singapore	Recurring EPS	0.20	0.02	0.15	0.18	0.21
Consumer Cyclical	DPS	0.10	0.03	0.10	0.15	0.17
Dairy Farm	BVPS	0.94	0.70	0.81	0.88	0.94
DFI SP	Return on average equity (%)	21.3	(10.4)	20.4	21.8	23.3
Neutral						
	Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Recurring P/E (x)	13.94	132.81	18.48	15.46	13.42
	P/B (x)	3.0	4.0	3.5	3.2	3.0
	FCF Yield (%)	23.5	18.2	17.6	19.8	21.3
	Dividend Yield (%)	3.3	1.1	3.3	5.3	6.0
	EV/EBITDA (x)	1.84	2.63	2.48	2.28	2.11
	EV/EBIT (x)	5.21	11.88	10.60	8.96	7.72
Valuation basis						
SOTP						
Key drivers						
Revenue growth from:						
i. More convenience stores;						
ii. Returning Chinese tourists in Hong Kong.						
Margin expansion on:						
i. More direct sourcing, cutting out middleman;						
ii. Selling more fresh produce;						
iii. Increased penetration of corporate brands;						
iv. Elimination of non-performing stores.						
Key risks						
Downside risks:						
i. Slowdown in consumption spending and soft SSSG especially in ASEAN countries;						
ii. Labour costs and rental pressures.						
Upside risks:						
i. Faster than expected pick-up in consumption spending;						
ii. Labour costs and rental cost efficiency.						
Company Profile						
Dairy Farm is the largest retailer in Asia ex-Japan, with a strong market presence in China, Hong Kong, Taiwan, India and ASEAN. The company operates hypermarkets, supermarkets, convenience stores, pharmacies, home furnishing and restaurants- through its 50% associate Maxim's. Its brands, which are well-known, include Wellcome, Cold Storage, Giant, Hero, Mannings and Guardian. Dairy Farm is a member of the Jardine Matheson Group and is head-quartered in Hong Kong and listed on the London Stock Exchange, Bermuda and Singapore.						
	Income statement (USDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total turnover	9,188	9,174	9,429	9,692	9,962
	Gross profit	3,043	3,066	3,159	3,247	3,337
	EBITDA	1,369	1,105	1,136	1,196	1,256
	Depreciation and amortisation	(886)	(861)	(870)	(891)	(912)
	Operating profit	484	244	266	305	344
	Net interest	(119)	(122)	(122)	(121)	(121)
	Pre-tax profit	323	(89)	246	303	349
	Taxation	(59)	(31)	(45)	(55)	(64)
	Reported net profit	276	(115)	207	247	285
	Recurring net profit	276	29	207	247	285
	Cash flow (USDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Change in working capital	(10)	(7)	3	30	30
	Cash flow from operations	1,115	940	1,024	1,109	1,165
	Capex	(212)	(244)	(350)	(350)	(350)
	Cash flow from investing activities	(125)	(201)	(350)	(350)	(350)
	Dividends paid	(196)	(101)	(67)	(155)	(215)
	Cash flow from financing activities	(841)	(728)	(617)	(705)	(765)
	Cash at beginning of period	278	210	231	260	281
	Net change in cash	149	11	56	54	49
	Ending balance cash	210	231	260	281	289
	Balance sheet (USDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total cash and equivalents	210	231	260	281	289
	Tangible fixed assets	803	803	233	(359)	(971)
	Total investments	2,164	1,781	1,832	1,892	1,954
	Total assets	7,605	7,326	7,622	7,905	8,167
	Short-term debt	744	838	838	838	838
	Total long-term debt	311	259	259	259	259
	Total liabilities	6,338	6,385	6,547	6,737	6,929
	Total equity	1,267	941	1,075	1,168	1,237
	Total liabilities & equity	7,605	7,326	7,622	7,905	8,167
	Key metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Revenue growth (%)	(10.5)	(0.2)	2.8	2.8	2.8
	Recurrent EPS growth (%)	(0.1)	(89.5)	618.7	19.6	15.2
	Gross margin (%)	33.1	33.4	33.5	33.5	33.5
	Operating EBITDA margin (%)	14.9	12.0	12.0	12.3	12.6
	Net profit margin (%)	3.0	(1.2)	2.2	2.6	2.9
	Dividend payout ratio (%)	46.6	(35.3)	61.8	81.6	80.3
	Capex/sales (%)	2.3	2.7	3.7	3.6	3.5
	Interest cover (x)	4.07	2.01	2.18	2.52	2.85

Source: Company data, RHB

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Figure 1: SOP valuation

	Value (USD/share)	Basis
Core business	1.58	DCF (WACC:6.6%, TG:0.5%)
Yonghui	0.65	Fair value (current share price)
Robinsons		
Holdings (RRHI)	0.24	Fair value (current share price)
Maxim's	0.61	15x P/E
SOP TP	3.09	
ESG		
premium/(discount)	0%	
Final TP	3.09	

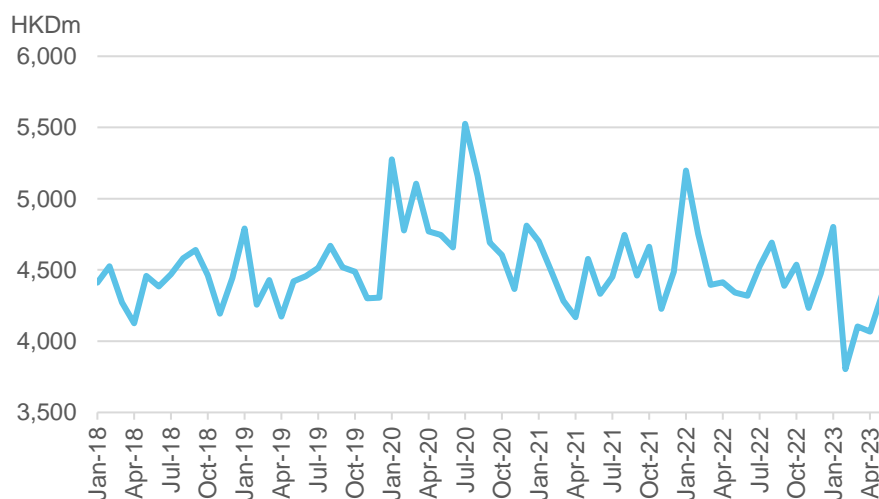
Source: RHB

Figure 2: China's monthly tourist numbers to Hong Kong have yet to normalise



Source: Bloomberg

Figure 3: Monthly supermarket sales in Hong Kong have been weak YTD



Source: Bloomberg

Recommendation Chart

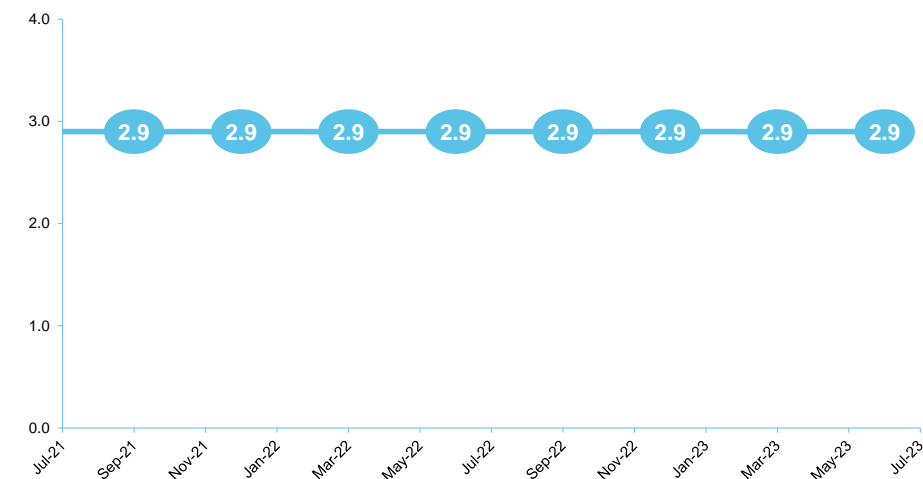


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-03-03	Neutral	3.09	3.07
2022-08-01	Neutral	2.71	2.77
2022-03-07	Neutral	2.88	2.46
2021-07-30	Buy	4.42	3.76
2021-07-18	Buy	4.78	4.09
2021-03-12	Neutral	4.78	4.51
2020-09-22	Buy	4.47	3.91
2020-07-30	Neutral	4.47	4.28
2020-04-08	Neutral	4.95	4.89
2020-03-06	Neutral	5.05	4.64
2019-09-23	Neutral	6.63	6.81
2019-08-05	Neutral	7.38	7.31
2019-05-29	Neutral	8.25	7.83
2019-03-20	Buy	8.25	7.74
2019-03-04	Neutral	8.64	8.65

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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