China / Hong Kong Company Guide

Pico Far East

Version 6 | Bloomberg: 752 HK EQUITY | Reuters: 0752.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

21 Jun 2019

BUY

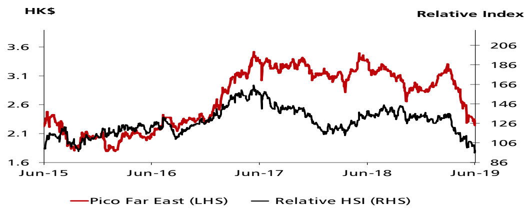
Last Traded Price (20 Jun 2019):HK$2.32(**HSI :** 28,550)
Price Target 12-mth:HK$3.40 (46.6% upside) (Prev HK$3.50)

Analyst
Chris KO CFA,+852 36684172, chriskof@dbs.com
Tsz-Wang TAM, CFA+852 36684195, tszwangtam@dbs.com

What's New

- **1HFY10/19 core earnings in line**
- **More mega projects such as Tokyo Olympics 2020 secured to set an eventful year ahead**
- **Revised down earnings estimates by 3% and 5% for FY10/19 and FY10/20 respectively due to higher acquisition-related costs**
- **Recent sell-off due to concerns on trade war overdone; maintain BUY for its stronger growth in the medium term despite a lower TP of HK$3.4**

Price Relative



Forecasts and Valuation

FY Oct (HK$m)	2018A	2019F	2020F	2021F
Turnover	4,631	4,966	5,636	5,946
EBITDA	387	399	477	533
Pre-tax Profit	337	348	424	477
Net Profit	272	280	342	385
Net Profit Gth (Pre-ex) (%)	(3.5)	3.3	21.8	12.7
EPS (HK$)	0.22	0.23	0.28	0.31
EPS Gth (%)	(3.9)	3.3	21.8	12.7
Diluted EPS (HK$)	0.22	0.23	0.28	0.31
DPS (HK$)	0.14	0.14	0.17	0.19
BV Per Share (HK$)	1.55	1.64	1.78	1.92
PE (X)	10.6	10.2	8.4	7.4
P/Cash Flow (X)	19.6	10.8	9.1	8.0
P/Free CF (X)	40.2	15.1	11.9	10.1
EV/EBITDA (X)	5.6	5.4	4.4	3.7
Net Div Yield (%)	5.8	6.0	7.3	8.2
P/Book Value (X)	1.5	1.4	1.3	1.2
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE(%)	14.2	14.2	16.2	16.8
Earnings Rev (%):		(3)	(5)	New

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

An eventful future

Leading exhibition service provider with improving growth outlook. Pico Far East (Pico) is a leading exhibition and event marketing service provider in Asia. Despite near-term headwinds from the Sino-US trade dispute, we have a BUY rating on Pico as we are optimistic on the company's medium-term growth outlook. Trading at c.10x FY10/19F PE, the valuation of the stock looks attractive with a decent dividend yield of c.6% and an earnings CAGR of c.12% from FY10/18-FY10/21.

Where we differ: More optimistic on the growth outlook in the medium term. Pico has secured a museum project in Oman and a theme park project in China with total contract value of c.HK$900m (vs total revenue of HK$359m for museum, themed environment, interior and retail business segment in FY10/18). The company also targets to increase the US market's revenue contribution from the current 6% to 15% by FY10/20. These will support business growth in the medium term.

Potential catalyst: Raising dividend payout ratio. Pico lowered its dividend payout ratio from 80% in FY10/17 to 60% in FY10/18 as it plans to reserve more cash for future acquisitions to expand in the US market. Supported by strong free cash flows and a net cash position of c.HK$800m (which accounts for c.20% of its market capitalisation), we believe it has the capability to resume an 80% dividend payout in the medium term.

Valuation:

Our TP of HK$3.4 is based on 15x FY10/19 PE, which is higher than its historical average. The higher target multiple is justified by its stronger earnings outlook in the medium term.

Key Risks to Our View:

Trade war. Exhibitions and trade shows are Pico's major growth drivers. A trade war will reduce the number of exhibitions and trade shows, which will be negative to Pico.

Decrease in dividend payout ratio. A lower dividend payout ratio decreases the attractiveness of the dividend yield and is therefore negative for its share price.

At A Glance

Issued Capital (m shrs)	1,238
Mkt Cap (HK$m/US$m)	2,872 / 368
Major Shareholders (%)	
Pine Asset Management Ltd.	37.3
APG Asset Management N.V.	6.0
Free Float (%)	56.7
3m Avg. Daily Val. (US$m)	0.24
ICB Industry: Consumer Services / Media	

WHAT'S NEW

1HFY10/19 core earnings in line; secured project pipeline for an eventful future

1HFY10/19 result highlights

Total revenue increased by 8% y-o-y to HK$2,474m, mainly driven by (1) museum, themed environment, interior and retail, and (2) conference and show management segments. Segmental revenue from (1) exhibition and event marketing services, (2) brand signage and visual identity, (3) museum, themed environment, interior and retail, and (4) conference and show management business changed by +5%, +2%, +21% and +251% y-o-y respectively.

Gross profit increased by 10% y-o-y to HK$739m with margin expanding by 0.6ppt to 29.9% in 1HFY10/19. Operating profit decreased by 4% y-o-y in 1HFY/19 due to a 68% (or HK$16m) increase in (1) changes of fair value of contingent consideration, and (2) amortisation of intangible assets relating to recent acquisitions.

Net profit decreased by 4% to HK$123m in 1HFY10/19. However, excluding acquisition-related costs, the adjusted net profit would have increased by 5% y-o-y to HK$143m in 1HFY10/19. An interim dividend of HK$0.045 per share has been declared, (the same as in 1HFY10/18).

More mega projects secured for an eventful FY10/20

Despite uncertainties due to trade disputes between China and the US, we believe Pico's medium-term growth will be partly supported by mega projects already secured. The company has clinched a museum project in Oman and a Hollywood movie theme park project in China with contract values of HK$780m and HK$151m respectively (vs total revenue of HK$359m for the museum, themed environment, interior and retail business segment in FY10/18). It has also secured some projects for the Tokyo 2020 Olympics and Expo 2020 Dubai. FY10/20 will be an eventful year for the company.

Major projects in pipeline

Project	Location	Contract Value (HK$m)	Completion
Museum in Oman	Nizwa, Oman	780	FY10/20
Tokyo 2020 Olympics - Archery Field	Tokyo, Japan	254	FY10/20
Lexus: exhibitions, events and visual branding	Various cities in China; Singapore	156	FY10/19
Hollywood movie theme parks	Beijing, China; Osaka, Japan	151	FY10/20
Expo 2020 Dubai	Dubai, the UAE	143	FY10/21
Huawei: exhibitions, events and showrooms	Worldwide	92	FY10/19
Sunac theme parks (formerly known as Wanda parks)	Chongqing, Kunming and Wuxi, China	90	FY10/19
Bird Park and West Node at the Mandai precinct	Singapore	58	FY10/20
Audi: exhibitions and events	Various cities in China	41	FY10/19
Pan American Games Lima	Lima, Peru	23	FY10/19
ITMA international textile and garment technology exhibition	Barcelona, Spain	23	FY10/19
Singapore National Day Parade	Singapore	18	FY10/19
Formula 1 Singapore Airlines Singapore Grand Prix	Singapore	17	FY10/19

Source: Company, DBS HK

Expansion into the US through acquisition

In 1HFY10/19, revenue from the US and UK jumped by 78% y-o-y to HK$285m, and accounted for 9% of total revenue, mainly led by the strong growth from Not Ordinary Media LLC (NOM), Sub Rosa and Camron which were acquired in September 2017, December 2017 and July 2018 respectively. In March 2019, it acquired another company in the US, Local Projects, which engages in design and production services that integrate physical design with digital media. Pico targets to increase the revenue contribution from the US market to 15% by FY10/20.

In the short run, there could be higher acquisition-related costs such as a change in remeasurement of contingent consideration. We forecast the change in remeasurement of contingent consideration to peak in FY10/19 and gradually decrease thereafter as most earn-out considerations for the acquisition of NOM will be realised in FY10/19. In the long run, we believe the acquisitions were better uses of the company's net cash on hand of c.HK$660m and are accretive to the earnings.

Major acquisitions in the US

	Not Ordinary Media	Sub Rosa	Camron	Local Projects
Description	A media and technology company	An online marketing and PR company	A brand-focused PR agency in the design, lifestyle and communications space	A marketing agency company engaging in the design and production services
Transaction date	29-Sep-17	1-Dec-17	12-Jul-18	4-Mar-19
Initial consideration	HK$73.9m	HK$7.8m	HK$43.2m	HK$136.9m
Maximum holdback consideration	HK$27.2m (based on FY17 EBITDA)	NA	NA	HK$46.7m (based on FY20 EBITDA)
Maximum new business line consideration	NA	NA	NA	HK$7.8m
Maximum earn-out consideration	HK$311.2m (based on average of FY18 EBITDA and FY19 projected EBITDA)	HK$116.1m (based on FY21 EBIT)	HK$52.8m (based on FY19-22 EBITDA)	HK$49.8m (based on average of FY19-21 EBITDA)
Contingent consideration as at FY10/18	HK$150m	HK$27.5m	HK$33.1m	NA
Discount rate	28%	19%	19%	NA

Source: Company, DBS HK

Sell-off due to concerns on trade war overdone; maintain BUY

We have revised down our earnings estimates for FY10/19-FY10/20 by 3% and 5% respectively to reflect bigger changes in remeasurement of contingent consideration for the previous acquisitions. We forecast net profit to grow by 3%/22%/13% in FY10/19-FY10/21 respectively. We believe the recent share price correction due to the concern on Sino-US trade dispute is overdone, given the mega projects secured. The company now offers an attractive dividend yield of c.6% with an earnings CAGR of c.12% from FY10/18-FY10/21. We maintain our BUY rating on Pico due to stronger growth outlook in the medium term, despite a lower TP of HK$3.4 which is pegged to 15x FY10/19 PE.

CRITICAL FACTORS TO WATCH

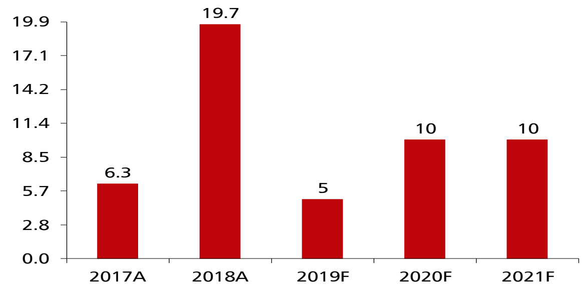
Critical factors

Economic growth. Historically, Pico's business performance has been highly correlated with economic growth, especially in Asia. In recent years, the company has diversified its customer base to different industries to reduce the impact from economic cycles. However, a positive economic growth outlook allows enterprises to spend more on advertising including marketing events and exhibitions which will benefit Pico.

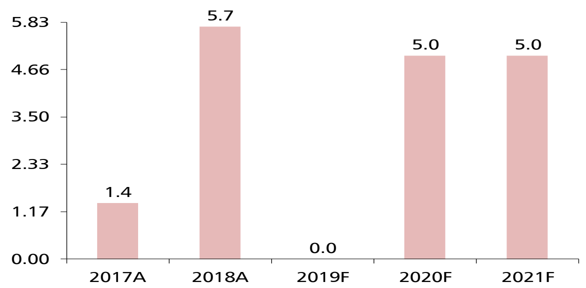
Expect mid-teen business growth in China. China is the most important market for Pico, with more than 50% revenue contribution in FY10/18. We expect the exhibition market in China to maintain an annual mid-teen growth rate in the next 3-5 years, supported by (1) increasing area of exhibition halls, and (2) increasing scale of exhibitions. The exhibition market's growth in turn drives demand for exhibition and event services.

Operating margins. The operating profit margins of (1) exhibition and event marketing services, and (2) brand signage and visual identity segments were stable at around 10%. However, operating profit margins for (3) museum, themed environment, interior & retail and conference, and (4) show management segments are dependent on the projects completed in the year. We expect the overall core operating margins, excluding the non-operating expenses related to acquisitions, to be stable at around 7.8%.

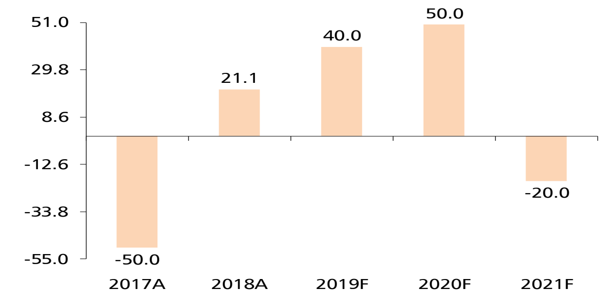
Exhibition and event marketing services growth %



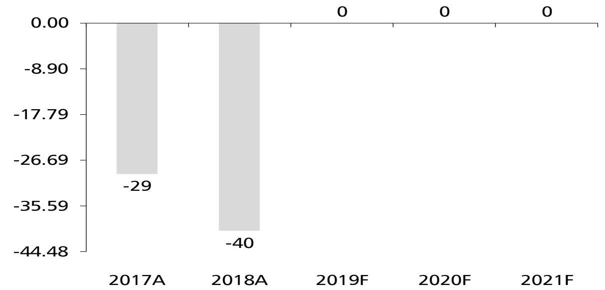
Brand signage and visual identity growth %



Museum, themed environment, interior and retail growth %



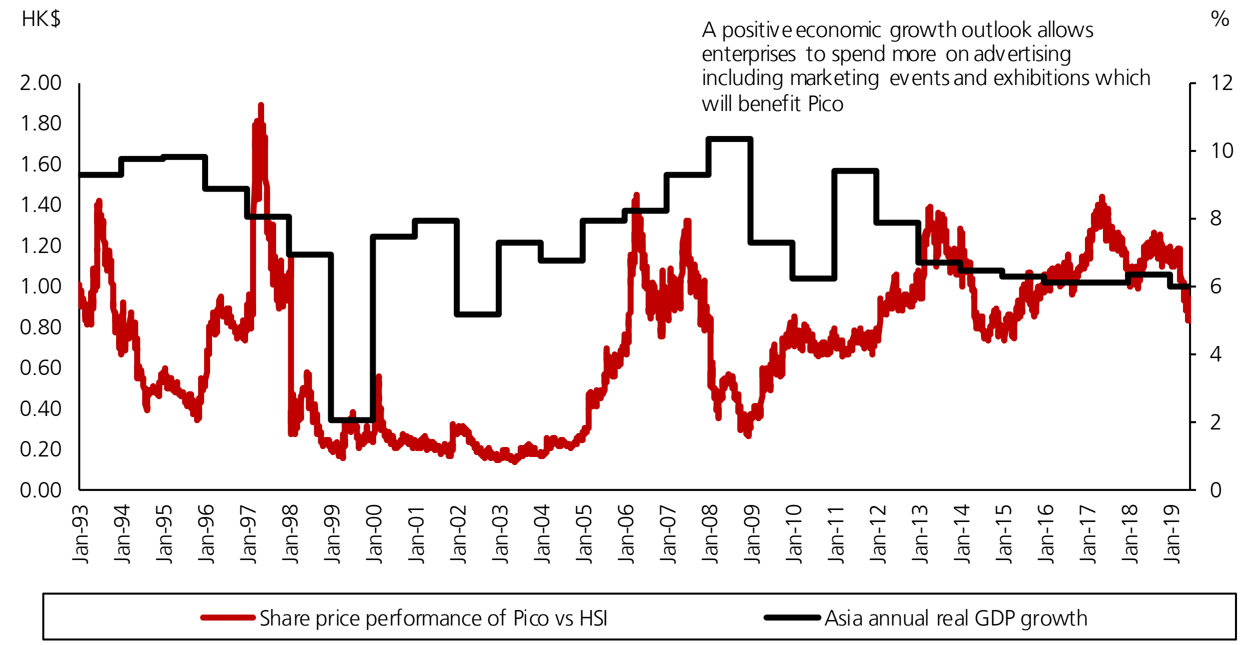
Conference and show management growth %



Source: Company, DBS HK

Appendix 1: A look at Company's listed history – what drives its share price?

Share price performance of Pico vs HSI and Asia annual real GDP growth



Source: Bloomberg Finance L.P., DBS HK

Balance Sheet:

Strong net cash position. Pico had a strong balance sheet with c.HK$660bn net cash as at the end of 1HFY10/19. We expect the company to maintain a high dividend payout ratio of 50%+ supported by positive free cash inflow and net cash position.

Share Price Drivers:

More mega projects or events. Obtaining larger projects or events will be positive to Pico's share price. Hong Kong Disneyland is expanding its park facilities in 2018-2023 with a total budget of HK$10bn. Pico was a service provider for Hong Kong and Shanghai Disneyland interior decoration projects which commanded higher margins. Securing Disneyland projects will be positive to the company's share price.

Increase in dividend payout ratio. We believe Pico has the capability to raise its dividend payout ratio, supported by strong free cash flows and a net cash position of c.HK$660m (which accounts for c.20% of its market capitalisation).

Key Risks:

Trade war. Trade shows are Pico's major growth drivers. A trade war will reduce the number of trade shows which will be negative to Pico's exhibition and event service business.

Decrease in dividend payout ratio. A lower dividend payout ratio decreases the attractiveness of the dividend yield and is therefore negative for its share price.

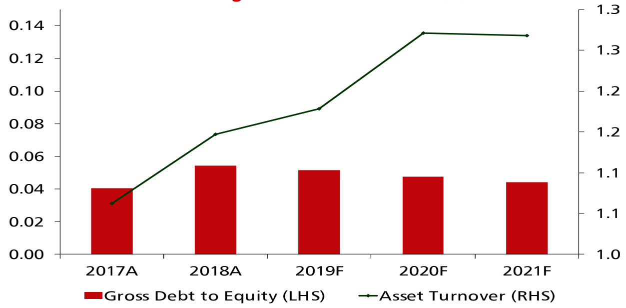
Environment, Social, Governance:

Events and exhibitions are a labour-intensive business while much of Pico's renovation work for exhibition booths and pavilions is outsourced. Though Pico has been aiming to ensure that its suppliers adopt good and ethical business practices, there is social risk that employees of Pico's subcontractors are mistreated. If this happens, it could adversely impact Pico and its customers' brand images.

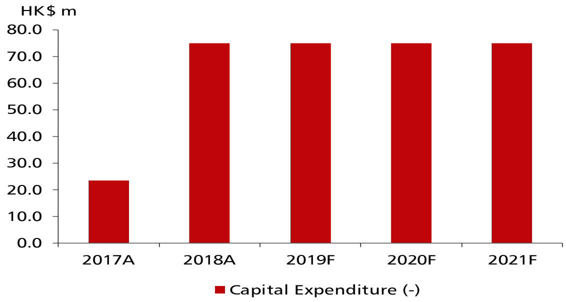
Company Background

Pico Far East (Pico) is one of the leading exhibition and event marketing service providers in Asia. It also has a proven and long track record in this arena.

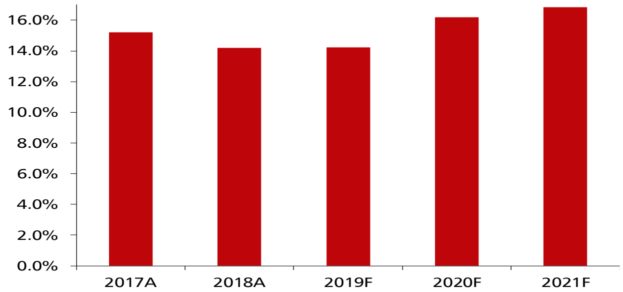
Leverage & Asset Turnover (x)



Capital Expenditure



ROE



Forward PE Band

PB Band

Source: Company, DBS HK

Key Assumptions

FY Oct	2017A	2018A	2019F	2020F	2021F
Exhibition and event marketing services growth %	6.3	19.7	5.0	10.0	10.0
Brand signage and visual identity growth %	1.4	5.7	0.0	5.0	5.0
Museum, themed environment, interior and retail growth %	(50.0)	21.1	40.0	50.0	(20.0)
Conference and show management growth %	(29.4)	(40.4)	0.0	0.0	0.0

Source: Company, DBS HK

Income Statement (HK$ m)

FY Oct	2017A	2018A	2019F	2020F	2021F
Revenue	3,979	4,631	4,966	5,636	5,946
Cost of Goods Sold	(2,734)	(3,215)	(3,446)	(3,906)	(4,115)
Gross Profit	**1,245**	**1,416**	**1,520**	**1,730**	**1,831**
Other Opng (Exp)/Inc	(895)	(1,107)	(1,197)	(1,332)	(1,380)
Operating Profit	**350**	**309**	**323**	**398**	**451**
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	17	26	25	25	25
Net Interest (Exp)/Inc	1	2	0	1	1
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	**368**	**337**	**348**	**424**	**477**
Tax	(72)	(63)	(66)	(81)	(91)
Minority Interest	(15)	(2)	(2)	(2)	(2)
Preference Dividend	0	0	0	0	0
Net Profit	**281**	**272**	**280**	**342**	**385**
Net Profit before Except.	281	272	280	342	385
EBITDA	415	387	399	477	533
Growth					
Revenue Gth (%)	(4.0)	16.4	7.2	13.5	5.5
EBITDA Gth (%)	(3.3)	(6.9)	3.3	19.4	11.9
Opg Profit Gth (%)	(4.7)	(11.7)	4.4	23.4	13.3
Net Profit Gth (%)	(6.3)	(3.5)	3.3	21.8	12.7
Margins & Ratio					
Gross Margins (%)	31.3	30.6	30.6	30.7	30.8
Opg Profit Margin (%)	8.8	6.7	6.5	7.1	7.6
Net Profit Margin (%)	7.1	5.9	5.6	6.1	6.5
ROAE (%)	15.2	14.2	14.2	16.2	16.8
ROA (%)	7.5	6.7	6.7	7.7	8.2
ROCE (%)	13.6	11.1	11.1	12.9	13.7
Div Payout Ratio (%)	80.9	61.4	61.0	61.0	61.0
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS HK

Interim Income Statement (HK$ m)

FY Oct	2H2017	1H2018	2H2018	1H2019	2H2019
Revenue	2,269	2,291	2,340	2,474	2,492
Cost of Goods Sold	(1,559)	(1,619)	(1,597)	(1,735)	(1,711)
Gross Profit	**710**	**673**	**743**	**739**	**780**
Other Oper. (Exp)/Inc	(501)	(516)	(591)	(588)	(608)
Operating Profit	**209**	**156**	**153**	**151**	**172**
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	2	11	14	2	23
Net Interest (Exp)/Inc	0	1	1	(1)	1
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	**211**	**169**	**168**	**153**	**196**
Tax	(42)	(37)	(26)	(33)	(33)
Minority Interest	(12)	(4)	2	4	(5)
Net Profit	**158**	**128**	**144**	**123**	**157**
Net profit bef Except.	158	128	144	123	157
Growth					
Revenue Gth (%)	7.1	34.0	3.2	8.0	6.5
Opg Profit Gth (%)	(1.2)	10.6	(26.8)	(3.5)	12.5
Net Profit Gth (%)	(8.2)	3.4	(8.9)	(3.8)	9.6
Margins					
Gross Margins (%)	31.3	29.4	31.8	29.9	31.3
Opg Profit Margins (%)	9.2	6.8	6.5	6.1	6.9
Net Profit Margins (%)	7.0	5.6	6.1	5.0	6.3

Source: Company, DBS HK

Balance Sheet (HK$ m)

FY Oct	2017A	2018A	2019F	2020F	2021F
Net Fixed Assets	647	711	736	759	778
Invts in Associates & JVs	152	160	160	160	160
Other LT Assets	448	536	533	529	526
Cash & ST Invts	1,105	884	912	987	1,070
Inventory	72	64	69	78	82
Debtors	1,456	1,688	1,823	1,969	2,127
Other Current Assets	75	76	76	76	76
Total Assets	**3,955**	**4,119**	**4,308**	**4,558**	**4,818**
ST Debt	5	93	93	93	93
Creditors	1,412	1,481	1,555	1,632	1,714
Other Current Liab	308	339	339	339	339
LT Debt	76	16	16	16	16
Other LT Liabilities	155	193	193	193	193
Shareholder's Equity	1,916	1,912	2,026	2,197	2,373
Minority Interests	84	85	87	88	90
Total Cap. & Liab.	**3,955**	**4,119**	**4,308**	**4,558**	**4,818**
Non-Cash Wkg. Capital	(116)	8	74	151	231
Net Cash/(Debt)	1,024	775	803	878	961
Debtors Turn (avg days)	125.4	123.9	129.1	122.8	125.7
Creditors Turn (avg days)	189.6	166.9	163.2	151.0	150.5
Inventory Turn (avg days)	7.8	7.9	7.1	6.9	7.2
Asset Turnover (x)	1.1	1.1	1.2	1.3	1.3
Current Ratio (x)	1.6	1.4	1.4	1.5	1.6
Quick Ratio (x)	1.5	1.3	1.4	1.4	1.5
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	29.1	68.9	68.9	68.9	68.9
Z-Score (X)	3.2	3.3	3.3	3.3	NA

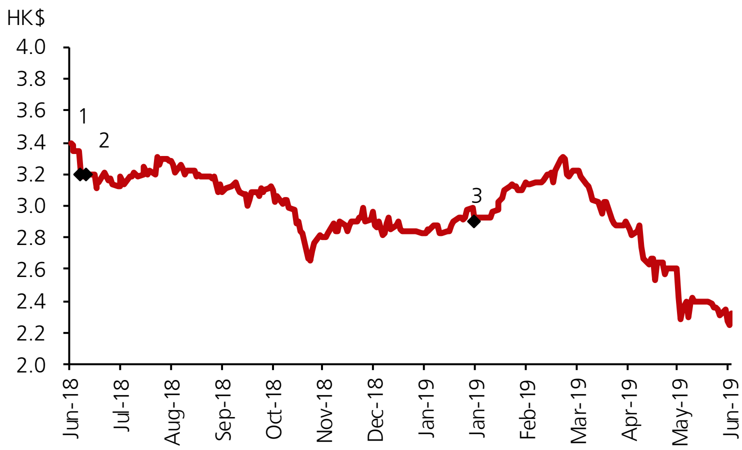
Source: Company, DBS HK

Cash Flow Statement (HK$ m)

FY Oct	2017A	2018A	2019F	2020F	2021F
Pre-Tax Profit	368	337	348	424	477
Dep. & Amort.	50	54	53	55	59
Tax Paid	(64)	(63)	(66)	(81)	(91)
Assoc. & JV Inc/(loss)	(17)	0	0	0	0
(Pft)/ Loss on disposal of FAs	(4)	0	0	0	0
Chg in Wkg.Cap.	(29)	(175)	(66)	(77)	(80)
Other Operating CF	375	331	343	418	471
Net Operating CF	**312**	**146**	**265**	**316**	**360**
Capital Exp.(net)	(24)	(75)	(75)	(75)	(75)
Other Invts.(net)	0	0	0	0	0
Invts in Assoc. & JV	(45)	(78)	0	0	0
Div from Assoc & JV	12	0	0	0	0
Other Investing CF	13	6	5	5	6
Net Investing CF	**(44)**	**(147)**	**(70)**	**(70)**	**(69)**
Div Paid	(209)	(228)	(167)	(171)	(208)
Chg in Gross Debt	(1)	0	0	0	0
Capital Issues	9	0	0	0	0
Other Financing CF	(11)	0	0	0	0
Net Financing CF	**(212)**	**(228)**	**(167)**	**(171)**	**(208)**
Currency Adjustments	17	0	0	0	0
Chg in Cash	73	(229)	28	75	82
Opg CFPS (HK$)	0.28	0.26	0.27	0.32	0.36
Free CFPS (HK$)	0.23	0.06	0.15	0.20	0.23

Source: Company, DBS HK

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	26-Jun-18	HK$3.34	HK$3.90	Buy
2:	29-Jun-18	HK$3.20	HK$3.90	Buy
3:	29-Jan-19	HK$2.99	HK$3.50	Buy

Source: DBS HK

Analyst: Chris KO CFA,
Tsz-Wang TAM, CFA

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

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Dissemination Date: 21 Jun 2019 15:26:09 (HKT)

Sources for all charts and tables are DBS HK unless otherwise specified.

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DBS Bank (Hong Kong) Limited

13th Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong

Tel: (852) 3668-4181, Fax: (852) 2521-1812

DBS Regional Research Offices

HONG KONG
DBS Bank (Hong Kong) Ltd
Contact: Carol Wu
13th Floor One Island East,
18 Westlands Road,
Quarry Bay, Hong Kong
Tel: 852 3668 4181
Fax: 852 2521 1812
e-mail: dbsvhk@dbs.com

MALAYSIA
AllianceDBS Research Sdn Bhd
Contact: Wong Ming Tek (128540 U)
19th Floor, Menara Multi-Purpose,
Capital Square,
8 Jalan Munshi Abdullah 50100
Kuala Lumpur, Malaysia.
Tel.: 603 2604 3333
Fax: 603 2604 3921
e-mail: general@alliancedbs.com

SINGAPORE
DBS Bank Ltd
Contact: Janice Chua
12 Marina Boulevard,
Marina Bay Financial Centre Tower 3
Singapore 018982
Tel: 65 6878 8888
Fax: 65 65353 418
e-mail: equityresearch@dbs.com
Company Regn. No. 196800306E

INDONESIA
PT DBS Vickers Sekuritas (Indonesia)
Contact: Maynard Priajaya Arif
DBS Bank Tower
Ciputra World 1, 32/F
Jl. Prof. Dr. Satrio Kav. 3-5
Jakarta 12940, Indonesia
Tel: 62 21 3003 4900
Fax: 6221 3003 4943
e-mail: research@id.dbsvickers.com

THAILAND
DBS Vickers Securities (Thailand) Co Ltd
Contact: Chanpen Sirithanarattanakul
989 Siam Piwat Tower Building,
9th, 14th-15th Floor
Rama 1 Road, Pathumwan,
Bangkok Thailand 10330
Tel. 66 2 857 7831
Fax: 66 2 658 1269
e-mail: research@th.dbs.com
Company Regn. No 0105539127012
Securities and Exchange Commission, Thailand