Singapore Company Guide

Sheng Siong Group

Version 15 | Bloomberg: SSG SP | Reuters: SHEN.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

30 Jul 2019

BUY

Last Traded Price (29 Jul 2019): S$1.11 (STI : 3,346.39)
Price Target 12-mth: S$1.32 (19% upside) (Prev S$1.25)

Analyst
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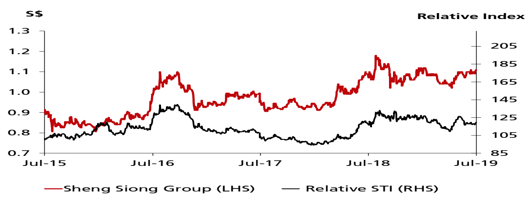
What's New

- 2Q19 earnings in line, growth led by new stores
- Core margins largely stable while decline in net margin was due to SFRS (I) 16 adoption
- Interim DPS of 1.75 Scts declared
- Maintain BUY, TP lifted to S$1.32

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2018A	2019F	2020F	2021F
Revenue	891	919	966	1,013
EBITDA	92.6	98.3	104	109
Pre-tax Profit	84.7	90.2	95.5	98.7
Net Profit	70.8	75.0	79.5	82.1
Net Pft (Pre Ex.)	70.8	75.0	79.5	82.1
Net Pft Gth (Pre-ex) (%)	1.8	6.0	5.9	3.3
EPS (S cts)	4.71	4.99	5.28	5.46
EPS Pre Ex. (S cts)	4.71	4.99	5.28	5.46
EPS Gth Pre Ex (%)	2	6	6	3
Diluted EPS (S cts)	4.71	4.99	5.28	5.46
Net DPS (S cts)	3.40	3.60	3.82	3.94
BV Per Share (S cts)	19.3	20.7	22.2	23.7
PE (X)	23.6	22.2	21.0	20.3
PE Pre Ex. (X)	23.6	22.2	21.0	20.3
P/Cash Flow (X)	18.1	19.9	18.1	16.2
EV/EBITDA (X)	17.1	15.9	14.8	13.8
Net Div Yield (%)	3.1	3.2	3.4	3.6
P/Book Value (X)	5.8	5.4	5.0	4.7
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	25.2	25.0	24.7	23.8
Earnings Rev (%):		0	0	N/A
Consensus EPS (S cts):		5.10	5.40	4.40
Other Broker Recs:		B: 6	S: 1	H: 2

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P

New stores driving growth

Maintain BUY and TP S$1.32, growth led by new stores. We maintain our BUY recommendation for Sheng Siong for its earnings resilience and stability. Growth continues to be led by new stores, with ten new stores opened in 2018 which will contribute for the full 12 months this year, and three new stores (Bukit Batok, Anchorvale and Sumang Lane) contributing from 2H19. A second store in Kunming, China has opened in June 2019. Dividend yield is decent at 3.5-3.6% with potential for a higher payout.

Where we differ. We do not think online grocery retail will pose a serious threat to Sheng Siong for now as: (i) Sheng Siong's target customers are less of the millennials who are open to online grocery shopping; (ii) warehouses of online grocery retailers are relatively small compared to Sheng Siong; (iii) the online market is small currently and will take time to gain share from brick-and-mortar stores rather than ramp up rapidly.

Potential catalysts. We believe that Sheng Siong with its decent store network and logistics chain could be a takeover target for online players eventually. Online players such as Alibaba's Hema (盒马鲜生) and Amazon (Wholefoods) are taking the online-to-offline route and are operating physical stores. We see scope for higher dividend payout if there is excess cash on its books.

Valuation:

Our target price for Sheng Siong is S$1.32, based on 25x FY20F PE. The valuation is pegged at +1SD of its historical mean valuation since listing and is below regional peers' average of 26x PE.

Key Risks to Our View:

Store openings, price competition. Revenue growth will be led by new store openings. Excessive discounts and promotions in the market by competitors will ultimately result in lower margins.

At A Glance

Issued Capital (m shrs)	1,504
Mkt. Cap (Sm/USm)	1,669 / 1,218
Major Shareholders (%)	
S & S Holdings	29.9
Lim Hock Chee	9.3
Lim Hock Eng	9.1
Free Float (%)	36.5
3m Avg. Daily Val (US$m)	1.4

ICB Industry : Consumer Services / Food & Drug Retailers

Live more, Bank less

ed: JS/ sa: DT, PY, CS

WHAT'S NEW

New stores driving growth

Earnings in line: 2Q19 revenue of S$238m (+11.8% y-o-y), operating profit of S$20.4m (+7.3% y-o-y), and earnings of S$18.4m (+7.4% y-o-y) were in line with our expectations. Revenue growth was driven by new stores as same store sales (SSSG) was -0.3% and annual sales per square foot was dipped 1.7% to S$1,921. China operations are now profitable, despite opening of a second store in Kunming in June. An interim dividend of 1.75 Scts was declared, equivalent to 70% payout rate.

Gross margins stable: Gross margins remained stable at 27.4% (+0.1 ppt y-o-y). This was sequentially higher than 1Q19's 26.1% due to the Chinese New Year sales period, where discounting and promotions lowered selling prices and margins. Sales mix of fresh products was higher, which led to the slightly higher margins.

Operating margins lower: Operating expenses increased by 14.6% y-o-y to S$44.8m, with operating margins falling by 0.3ppt to 8.6%. Distribution expense increased by 2.8% y-o-y to S$1.5m on higher headcount and fleet cost from higher sales volume. Admin expenses increased by 14.6% y-o-y to S$42.6m as staff costs and bonus provisions increased on a higher store count. Other expenses increased to S$0.7m (+50% y-o-y) due to higher finance charges relating to credit cards and other non-cash payments.

Outlook continues to be positive driven by new stores. Earnings are tracking our estimates despite a slightly negative SSSG and decline in annual sales psf, with new stores continuing to drive revenue growth. Three new stores that were opened in May 2019 (Bukit Batok, Anchorvale and Sumang Lane) will add to 2H19 revenue, while there will be a full 12 months of contribution from a total of 10 stores that were opened in 2018. Post adoption of SFRS (I) 16 in 2019, the accounting impact on 1H19 earnings was -S$1m. Net profit would have been 9.6% y-o-y higher in 1H19 at S$38.8m if the accounting impact was excluded. We estimate that net margin would have remained stable at about 8% as well.

Maintain BUY, TP S$1.32: We leave our forecast largely unchanged as 2Q19 results are in line. We maintain BUY but raise our TP higher to S$1.32 TP, based on 25x FY20F PE, rolling over from FY19F earnings previously. We continue to like the stock for its defensive qualities including stable earnings, net cash balance sheet, cash generating abilities, and decent dividend yield. Maintain BUY for 19% upside.

Quarterly / Interim Income Statement (S$m)

FY Dec	2Q2018	1Q2019	2Q2019	% chg yoy	% chg qoq
Revenue	213	251	238	11.8	(5.3)
Cost of Goods Sold	(155)	(186)	(173)	11.7	(7.0)
Gross Profit	**58.1**	**65.5**	**65.2**	**12.2**	**(0.5)**
Other Oper. (Exp)/Inc	(39.1)	(44.6)	(44.8)	14.6	0.5
Operating Profit	**19.0**	**21.0**	**20.4**	**7.3**	**(2.6)**
Other Non Opg (Exp)/Inc	1.64	2.39	1.89	15.4	(20.8)
Associates & JV Inc	0.0	0.0	0.0	-	-
Net Interest (Exp)/Inc	0.18	(0.1)	(0.2)	nm	(129.9)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Pre-tax Profit	**20.8**	**23.3**	**22.2**	**6.3**	**(4.8)**
Tax	(3.7)	(3.9)	(3.7)	0.5	(5.1)
Minority Interest	0.02	0.00	0.0	-	-
Net Profit	**17.2**	**19.4**	**18.4**	**7.4**	**(4.8)**
Net profit bef Except.	17.2	19.4	18.4	7.4	(4.8)
EBITDA	24.8	32.6	26.5	6.7	(18.8)
Margins (%)					
Gross Margins	27.3	26.1	27.4		
Opg Profit Margins	8.9	8.3	8.6		
Net Profit Margins	8.1	7.7	7.7		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

Store expansion. Sheng Siong currently operates 57 stores. Compared to the other local operators, it has scope to expand its store network, particularly in areas such as Serangoon and Hougang, where it has a smaller presence. In the past six years, up to 10 stores were opened annually, largely a function of supply of HDB shop space available for tender and Sheng Siong's ability to win the tenders. Sheng Siong mainly operates in HDB estates.

Gross margin expansion through better sales mix. The gross margin for fresh products is estimated to be 30%, and close to 20% for non-fresh grocery items. Sheng Siong's product mix stands at approximately 40% fresh vs 60% non-fresh. We see headroom for its sales mix to improve to 50% for each as it skews its store offerings towards fresh products.

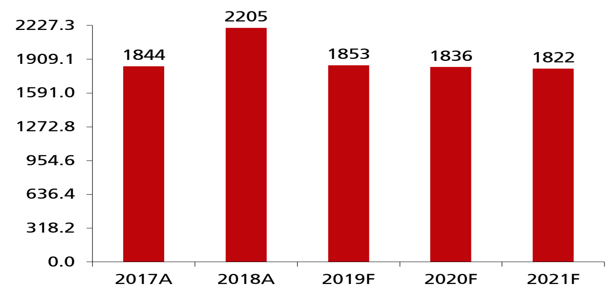
Mandai Distribution Centre to expand. The Mandai Distribution Centre allows Sheng Siong to perform direct sourcing and bulk handling. This effectively drives down input costs, resulting in cost savings and better margins. We estimate that the facility is currently running at only 90% of capacity. Expansion of the warehouse going forward will help support more new stores. It will be able to secure more suppliers and products to trade through the distribution centre to effectively enjoy more bulk handling and higher supplier rebates. Margins are expected to trend up as utilisation increases towards full capacity.

Margin expansion through direct sourcing. Sheng Siong is increasingly sourcing directly from suppliers such as farms instead of from middlemen. The company has the resources to place large orders, which is welcomed by producers.

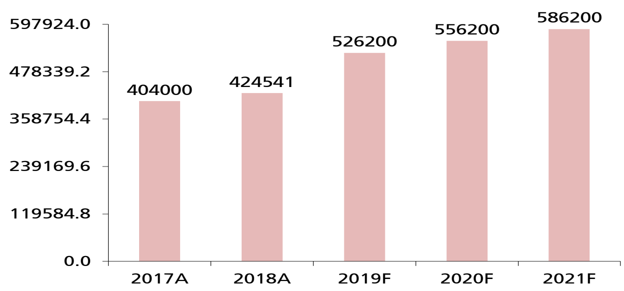
Generating more same-store-sales growth (SSSG) to increase revenue. Sheng Siong has been able to maintain positive SSSG since 4Q13 (excluding 4Q15, 1Q16) through longer operating hours and renovation of older stores, offering products in demand, and effective marketing. SSSG was affected partly by the renovation of the Loyang store from 3Q16 to 1Q17. The SSSG would have been positive had the Loyang store performed similarly to the previous year and was not shut down for renovation. SSSG was positive in 1Q-3Q18, but 4Q18 to 2Q19 was slightly negative between -0.3% and -1%. Positive SSSG will support earnings growth as well.

Kunming store in China. Its first store in Kunming (40,000 sqft) commenced operations in 2017, broke even in 1Q19 and is now profitable. Downside for the JV is limited to its US$6m paid-up capital, which is sufficient to open 2-3 new stores. We expect more positive contribution going forward. It opened a second store in June 2019.

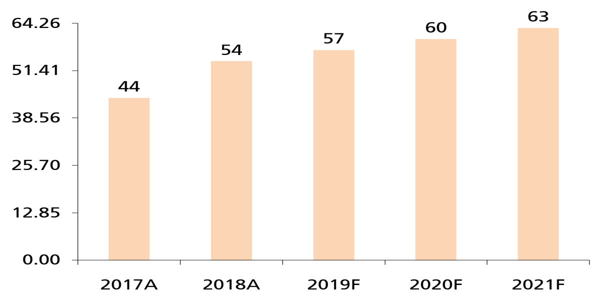
Rev per sqft



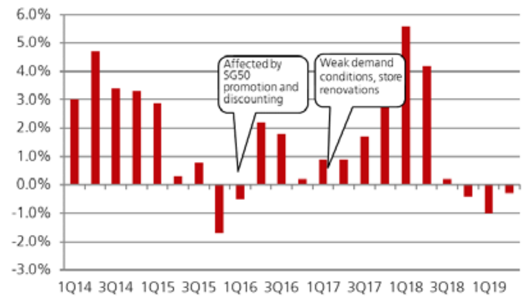
Operation Area (sqft)



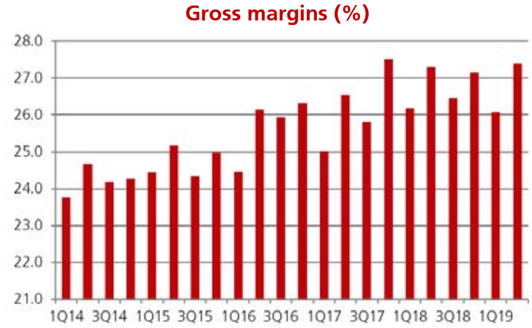
Number of stores



Same store sales growth (%)



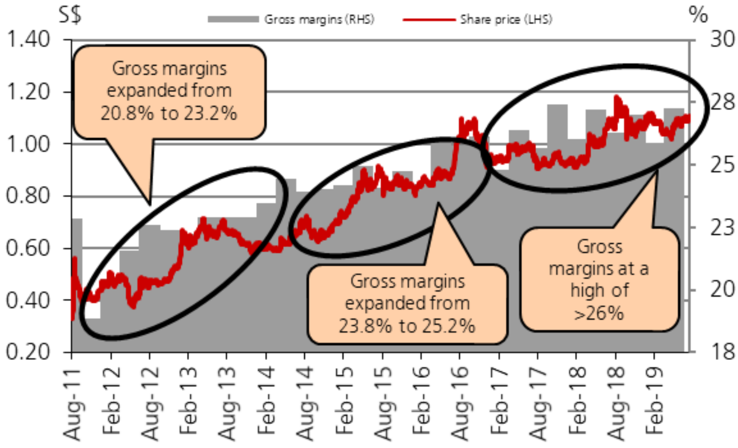
Gross margins (%)



Source: Company, DBS Bank

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

Correlation of stock price to gross margin improvement is strong at 0.9



Source: DBS Bank

Balance Sheet:

Net cash of c.S$83m or c.5.5 Scts per share. The excess cash allows for strategic store acquisitions to expand its store presence in the future. The business generates positive working capital. Inventory is purchased on credit, and quickly turned into cash. Over the past eight years, the business has generated between S$28-92m of operating cashflow each year. Dividend payout is attractive at over 70%. We expect this to be maintained as long as there is no significant requirement for cash funding. Hence, there is scope for higher dividend payout.

Share Price Drivers:

Strong earnings growth performance. Sheng Siong's financial performance has consistently met our expectations, delivering earnings growth (5-year CAGR of 18.1% since FY11) through a combination of margin expansion, store growth, and SSSG. We believe continued delivery of consistent performance and profit growth will support a strong share price.

China is a wildcard. We believe Sheng Siong's JV in China is a wildcard. If operations prove to be successful, in time to come, China can provide an alternate source of growth. There is scope for the number of stores to increase should Sheng Siong's business model work. Downside remains limited to US$6m should the JV fail.

Key Risks:

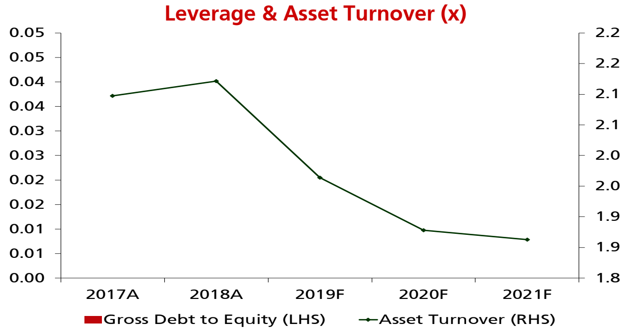
Revenue growth limited by store openings. Store expansion in Singapore is largely dependent on the supply of new supermarket retail space released by HDB and its ability to secure the tenders.

Excessive discounts and promotions may erode margins. Heavier discounts and promotions vis-a-vis competitors would drive sales revenue, but this could be gained at the expense of margins.

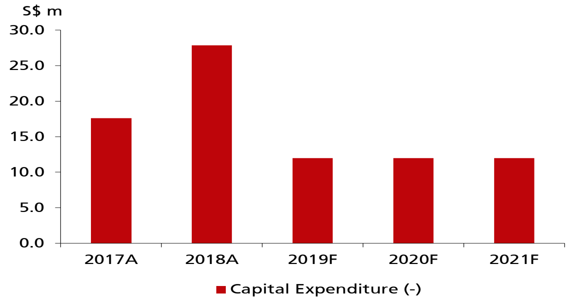
Company Background

Sheng Siong is the third-largest supermarket operator in Singapore, behind NTUC Fairprice and Dairy Farm International.

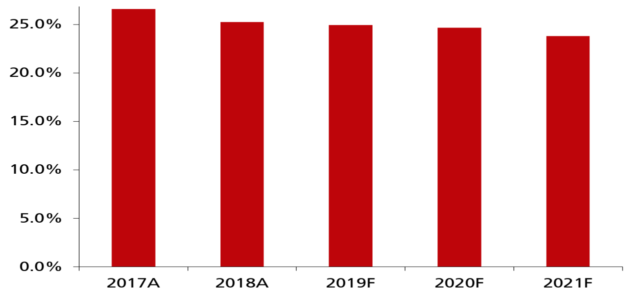
Leverage & Asset Turnover (x)



Capital Expenditure



ROE (%)



Forward PE Band (x)

PB Band (x)

Source: Company, DBS Bank

Key Assumptions

FY Dec	2017A	2018A	2019F	2020F	2021F
Rev per sqft	1,844	2,205	1,853	1,836	1,822
Operation Area (sqft)	404,000	424,541	526,200	556,200	586,200
Number of stores	44.0	54.0	57.0	60.0	63.0

Segmental Breakdown

FY Dec	2017A	2018A	2019F	2020F	2021F
Revenues (S$m)					
Singapore	830	891	919	966	1,013
Total	830	891	919	966	1,013
Operating profit (S$m)					
Singapore	71.5	76.2	81.3	86.5	90.7
Total	71.5	76.2	81.3	86.5	90.7
Operating profit Margins					
Singapore	8.6	8.6	8.8	8.9	8.9
Total	8.6	8.6	8.8	8.9	8.9

Income Statement (S$m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Revenue	830	891	919	966	1,013
Cost of Goods Sold	(612)	(653)	(673)	(706)	(741)
Gross Profit	217	238	246	260	273
Other Opng (Exp)/Inc	(146)	(162)	(165)	(173)	(182)
Operating Profit	71.5	76.2	81.3	86.5	90.7
Other Non Opg (Exp)/Inc	10.3	7.61	8.00	8.00	8.00
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	0.24	0.89	0.87	1.05	0.0
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	82.1	84.7	90.2	95.5	98.7
Tax	(12.6)	(14.1)	(15.1)	(16.0)	(16.5)
Minority Interest	0.0	0.27	(0.1)	(0.1)	(0.1)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	69.5	70.8	75.0	79.5	82.1
Net Profit before Except.	69.5	70.8	75.0	79.5	82.1
EBITDA	86.3	92.6	98.3	104	109
Growth					
Revenue Gth (%)	4.2	7.4	3.2	5.1	4.9
EBITDA Gth (%)	7.9	7.3	6.1	6.1	4.9
Opg Profit Gth (%)	9.9	6.5	6.8	6.3	4.9
Net Profit Gth (Pre-ex) (%)	10.9	1.8	6.0	5.9	3.3
Margins & Ratio					
Gross Margins (%)	26.2	26.8	26.8	26.9	26.9
Opg Profit Margin (%)	8.6	8.6	8.8	8.9	8.9
Net Profit Margin (%)	8.4	7.9	8.2	8.2	8.1
ROAE (%)	26.6	25.2	25.0	24.7	23.8
ROA (%)	17.6	16.9	16.0	15.4	15.1
ROCE (%)	22.7	22.2	21.2	20.4	20.1
Div Payout Ratio (%)	71.4	72.2	72.2	72.2	72.2
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	2Q2018	3Q2018	4Q2018	1Q2019	2Q2019
Revenue	213	228	222	251	238
Cost of Goods Sold	(155)	(168)	(162)	(186)	(173)
Gross Profit	**58.1**	**60.3**	**60.2**	**65.5**	**65.2**
Other Oper. (Exp)/Inc	(39.1)	(41.3)	(41.4)	(44.6)	(44.8)
Operating Profit	**19.0**	**19.0**	**18.7**	**21.0**	**20.4**
Other Non Opg (Exp)/Inc	1.64	1.82	1.77	2.39	1.89
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	0.18	0.23	0.29	(0.1)	(0.2)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**20.8**	**21.0**	**20.8**	**23.3**	**22.2**
Tax	(3.7)	(3.3)	(3.4)	(3.9)	(3.7)
Minority Interest	0.02	0.16	0.08	0.00	0.0
Net Profit	**17.2**	**17.8**	**17.5**	**19.4**	**18.4**
Net profit bef Except.	17.2	17.8	17.5	19.4	18.4
EBITDA	24.8	24.9	24.7	32.6	26.5
Growth					
Revenue Gth (%)	(6.7)	7.0	(2.7)	13.4	(5.3)
EBITDA Gth (%)	(3.9)	0.4	(0.9)	32.2	(18.8)
Opg Profit Gth (%)	(2.1)	(0.3)	(1.2)	11.8	(2.6)
Net Profit Gth (Pre-ex) (%)	(6.1)	4.0	(1.8)	10.5	(4.8)
Margins					
Gross Margins (%)	27.3	26.5	27.1	26.1	27.4
Opg Profit Margins (%)	8.9	8.3	8.5	8.3	8.6
Net Profit Margins (%)	8.1	7.8	7.9	7.7	7.7

Balance Sheet (S$m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Net Fixed Assets	255	266	261	255	249
Invts in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	0.0	0.0	52.0	52.0	52.0
Cash & ST Invts	73.4	87.2	105	128	160
Inventory	60.8	69.9	65.6	81.0	84.9
Debtors	14.7	13.0	16.0	12.8	13.4
Other Current Assets	0.0	0.0	0.0	0.0	0.0
Total Assets	**404**	**436**	**500**	**529**	**559**
ST Debt	0.0	0.0	0.0	0.0	0.0
Creditor	111	126	123	129	135
Other Current Liab	16.5	15.4	34.9	35.7	36.3
LT Debt	0.0	0.0	0.0	0.0	0.0
Other LT Liabilities	2.56	2.92	29.0	29.0	29.0
Shareholder's Equity	271	290	311	333	356
Minority Interests	2.50	2.14	2.24	2.34	2.44
Total Cap. & Liab.	**404**	**436**	**500**	**529**	**559**
Non-Cash Wkg. Capital	(52.4)	(58.2)	(75.8)	(70.8)	(73.1)
Net Cash/(Debt)	73.4	87.2	105	128	160
Debtors Turn (avg days)	5.5	5.7	5.8	5.4	4.7
Creditors Turn (avg days)	69.9	68.0	69.1	66.6	66.7
Inventory Turn (avg days)	37.5	37.5	37.7	38.9	41.9
Asset Turnover (x)	2.1	2.1	2.0	1.9	1.9
Current Ratio (x)	1.2	1.2	1.2	1.3	1.5
Quick Ratio (x)	0.7	0.7	0.8	0.9	1.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	N/A	N/A	N/A	N/A	N/A
Z-Score (X)	9.5	9.5	9.7	9.5	9.5

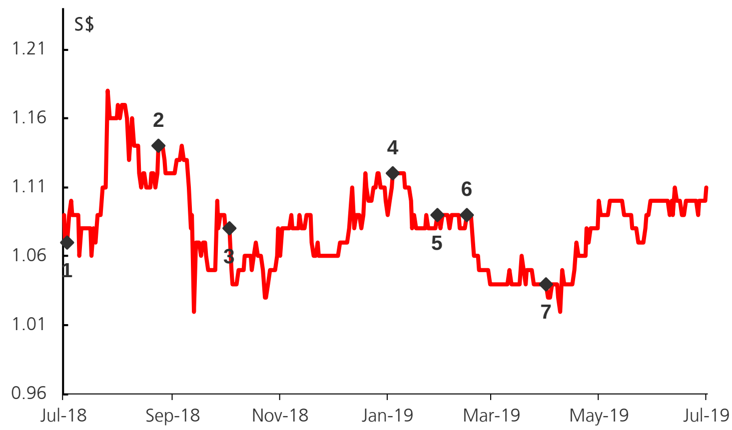
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Pre-Tax Profit	82.1	84.7	90.2	95.5	98.7
Dep. & Amort.	14.8	16.5	17.0	17.9	18.7
Tax Paid	(8.9)	(14.9)	(15.4)	(15.1)	(16.0)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(9.4)	6.88	18.0	(5.9)	1.71
Other Operating CF	(0.1)	(0.9)	(25.9)	0.0	0.0
Net Operating CF	**78.5**	**92.2**	**83.9**	**92.4**	**103**
Capital Exp.(net)	(17.6)	(27.9)	(12.0)	(12.0)	(12.0)
Other Invts.(net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.24	0.89	0.0	0.0	0.0
Net Investing CF	**(17.3)**	**(27.0)**	**(12.0)**	**(12.0)**	**(12.0)**
Div Paid	(51.1)	(51.1)	(54.2)	(57.4)	(59.3)
Chg in Gross Debt	0.0	0.0	0.0	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	0.0	0.0	0.0	0.0	0.0
Net Financing CF	**(51.1)**	**(51.1)**	**(54.2)**	**(57.4)**	**(59.3)**
Currency Adjustments	(0.1)	(0.3)	0.0	0.0	0.0
Chg in Cash	9.93	13.8	17.8	23.0	31.9
Opg CFPS (S cts)	5.85	5.68	4.39	6.54	6.75
Free CFPS (S cts)	4.05	4.28	4.78	5.35	6.06

Source: Company, DBS Bank

Target Price & Ratings History



***Note** : Share price and Target price are adjusted for corporate actions.*

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	31 Jul 18	1.07	1.26	BUY
2:	21 Sep 18	1.14	1.26	BUY
3:	31 Oct 18	1.08	1.24	BUY
4:	01 Feb 19	1.12	1.24	BUY
5:	26 Feb 19	1.09	1.25	BUY
6:	15 Mar 19	1.09	1.25	BUY
7:	29 Apr 19	1.04	1.25	BUY

Source: DBS Bank

Analyst: Alfie YEO

Andy SIM, CFA

DBS Bank 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*

Completed Date: 30 Jul 2019 08:59:48 (SGT)
Dissemination Date: 30 Jul 2019 09:00:59 (SGT)

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

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