

Singapore Company Guide

Dairy Farm

Version 12 | Bloomberg: DFI SP | Reuters: DAIR.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

6 Mar 2020

HOLD

Last Traded Price (5 Mar 2020): US\$4.75 (STI : 3,018.27)

Price Target 12-mth: US\$5.20 (9% upside) (Prev US\$7.99)

Analyst

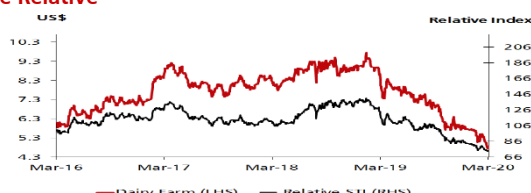
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What's New

- 2H19 earnings below as sales and margins disappoint
- Final DPS of 14.5 UScts declared
- Cut FY20-21F earnings by 10-12%
- Maintain HOLD with lower SOTP-based TP of US\$5.20

Price Relative



Forecasts and Valuation

FY Dec (US\$ m)	2018A	2019A	2020F	2021F
Revenue	11,749	11,192	11,530	11,879
EBITDA	1,720	1,554	1,603	1,686
Pre-tax Profit	452	392	407	457
Net Profit	358	326	338	380
Net Pft (Pre Ex.)	358	327	338	380
Net Pft Gth (Pre-ex) (%)	(24.7)	(8.8)	3.4	12.4
EPS (US cts.)	26.5	24.1	25.0	28.1
EPS Pre Ex. (US cts.)	26.5	24.1	25.0	28.1
EPS Gth Pre Ex (%)	(25)	(9)	3	12
Diluted EPS (US cts.)	26.5	24.1	24.9	28.0
Net DPS (US cts.)	21.0	21.0	21.0	21.0
BV Per Share (US cts.)	83.3	89.4	93.4	100
PE (X)	17.9	19.7	19.0	16.9
PE Pre Ex. (X)	17.9	19.7	19.0	16.9
P/Cash Flow (X)	4.4	5.0	4.8	4.7
EV/EBITDA (X)	4.2	4.7	4.6	4.4
Net Div Yield (%)	4.4	4.4	4.4	4.4
P/Book Value (X)	5.7	5.3	5.1	4.7
Net Debt/Equity (X)	0.6	0.7	0.7	0.7
ROAE (%)	25.4	27.9	27.3	29.0
Earnings Rev (%):			(12)	(10)
Consensus EPS (US cts.):			29.6	34.4
Other Broker Recs:		B: 2	S: 1	H: 4

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

Needs time for a successful transformation

Maintain HOLD, lower TP to US\$5.20. We remain neutral on Dairy Farm (DFI) as we believe that it needs time to execute its multi-year transformation plan. The COVID-19 outbreak in Asia has also dampened its growth outlook. Following the disappointing FY19 results, we have trimmed FY20-21F earnings by 10-12% to reflect a slower turnaround than before. We expect the reorganisation to continue in FY20F with muted earnings growth before efficiencies kick in from FY21F. Meanwhile, any upside to share price and earnings growth would be capped by the COVID-19 situation and subdued consumer sentiment.

Where we differ: We believe DFI's outlook will be muted as a result of COVID-19; continued investments, and more time needed to turnaround its supermarket/hypermarket business.

Potential catalyst: Faster turnaround from its food business will depend on the successful implementation of DFI's new multi-year transformation plan.

Valuation:

TP based on SOTP valuation. Our target price of US\$5.20 is derived from sum-of-parts valuation methodology. We value DFI's core business at US\$2.74 based on DCF, its 20% and 18% stakes in Yonghui and RRHI based on market values at US\$2.81 and US\$0.26 respectively, and net debt at US\$0.61 per share.

Key Risks to Our View:

Significant near-term earnings improvement. We believe share price upside will be driven by sustained earnings recovery. Upside risk on the stock is faster turnaround of its Southeast Asian food business. Earnings would have to improve significantly for us to reverse our neutral view on the stock.

At A Glance

Issued Capital (m shrs)	1,353
Mkt. Cap (US\$m/US\$m)	6,425 / 6,425
Major Shareholders (%)	
Jardine Strategic Holdings Ltd	77.6
Free Float (%)	22.4
3m Avg. Daily Val (US\$m)	4.4
GIC Industry : Consumer Staples / Food & Staples Retailing	



DBS
Live more, Bank less

WHAT'S NEW

Earnings below as sales and margins disappoint

FY19 earnings below: Core FY19 earnings of US\$326m (-8.8% y-o-y) was below our estimates as both revenue and margins disappointed. Revenue came in at US\$11,192, (-4.7% y-o-y), with operating margins declining 0.4ppt to 3.9%. Pre-tax margins were also below expectations as Yonghui's contribution to associates/JV income was below our estimate. A final DPS of 14.5 UScts was declared, bringing full year DPS to 21 UScts, in line with expectations.

Sales slowdown led by supermarkets/hypermarkets: The decline in FY19 sales was led by a 10.7% drop in Supermarket/Hypermarket sales to US\$2,513m. While sales from Hong Kong and Macau rose, the decline was due to Rustan's divestment and store optimisation in Southeast Asia. Convenience stores grew 3.9% y-o-y to US\$2,185m, driven by new store growth and strong same store sales in China. Health and Beauty sales rose 0.5% y-o-y to US\$3,051m from stronger same store sales in Southeast Asia, China and Macau offset by Hong Kong contribution due to the social unrest. Sales at IKEA stores grew 6.2% y-o-y to US\$766m with strong sales growth from new stores, offset by slower same store sales in Hong Kong due to the social unrest in 2H19.

Lower operating margins: Operating margins declined to 3.9% (-0.4ppt), dragged by lower IKEA (-3.9ppt, 5.6%) and Health and Beauty stores (-1.2ppt, 9.7%). Food margins improved to 2.0% (+0.6ppt) with operating margins improving for supermarket/hypermarkets (+0.8ppt, 1.2%) compensated by lower convenience stores margin (-0.4ppt, 3.8%). Overall, the margin decline was due to continued investments into the various business segments.

2H19 remained weak: 2H19 sales and earnings performed weaker than both 1H19 and 2H18, affected by the social unrest in Hong Kong. There were some positives as overall gross margin improved to 32.4% in 2H19 while operating margins for supermarket/hypermarkets improved from the levels in 2H18 and 1H19. However, Health and Beauty, and IKEA stores recorded lower operating margins y-o-y in 2H19.

Cut FY20-21F earnings by 10-12%: With a slow 2H19, we believe the outlook for FY20F would be muted with the spread of the COVID-19 in 1Q19. We expect consumption to be dampened at least for 1Q19, thereby limiting FY20F earnings growth. Furthermore, travel restrictions regionally would cap growth for Health and Beauty business as well. We reduced our FY20F earnings by 12% with earnings growth now at 3.4%, having lowered our sales growth forecast from 5% to 3% and operating margins from 4% to 3.9%. We anticipate efficiencies like centralised procurement to bear fruit in FY21F, thus imputing better operating margins with a faster earnings growth rate of 12% y-o-y.

Maintain HOLD with a lower SOTP-based TP of US\$5.20: Our SOTP-based TP is lowered to US\$5.20 following the earnings cut, translating to 21.8x PE or -1SD of its mean. Our neutral view on the stock is based on muted earnings growth outlook dampened by the COVID-19 outbreak. Together with continued investments, we expect slower sales growth and lower margins in FY20F. We believe some of the operational efficiencies will start to bear fruit by FY21F. Overall, DFI needs more time to execute its transformation plan. We therefore remain neutral until there are firmer signs of earnings turning around. Maintain HOLD.

Interim Income Statement (US\$m)

FY Dec	2H2018	1H2019	2H2019	% chg yoy	% chg hoh
Revenue	5,821	5,761	5,432	(6.7)	(5.7)
Cost of Goods Sold	(3,974)	(3,989)	(3,670)	(7.7)	(8.0)
Gross Profit	1,846	1,772	1,762	(4.6)	(0.6)
Other Oper. (Exp)/Inc	(1,588)	(1,538)	(1,560)	(1.8)	1.4
Operating Profit	258	234	202	(21.8)	(13.8)
Other Non Opg (Exp)/Inc	0	0	0	-	-
Associates & JV Inc	60	74	41	(31.7)	(44.3)
Net Interest (Exp)/Inc	(81)	(84)	(74)	8.5	12.3
Exceptional Gain/(Loss)	(9)	(1)	0	nm	nm
Pre-tax Profit	229	223	169	(25.9)	(24.2)
Tax	(44)	(44)	(26)	(41.8)	(41.0)
Minority Interest	(4)	(2)	5	nm	nm
Net Profit	181	178	148	(18.1)	(16.9)
Net profit bef Except.	190	179	148	(22.0)	(17.1)
EBITDA	319	308	243	(23.6)	(21.1)
Margins (%)					
Gross Margins	31.7	30.8	32.4		
Opg Profit Margins	4.4	4.1	3.7		
Net Profit Margins	3.1	3.1	2.7		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

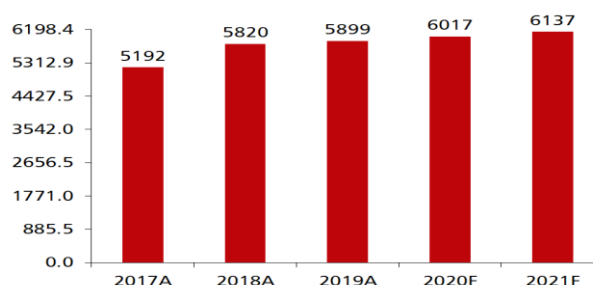
Building an integrated high performing business. Following the appointment of new CEO Ian McLeod in 2H17, DFI's management strategy includes building up its management capability, growth in China, maintaining a strong position in Hong Kong, revitalising Southeast Asia, and driving digital innovation. The new CEO has already closed several underperforming and loss-making Supermarket and Hypermarket stores, mainly in Malaysia, Singapore and Indonesia, whose performance he believes will not improve. He has appointed CEOs for 7-eleven and Mannings to drive growth in China. He will also invest to strengthen its brands in Hong Kong. Plans to revitalise Southeast Asia include a multi-year transformation plan post strategic review and management recruitment. Back-end IT development will continue.

Expect store performance to strengthen eventually. We expect store performance to be better especially in Southeast Asia, as the new CEO implements plans including product range expansion, space management, pricing strategy, consolidated sourcing, etc. However, we recognise that these strategies will take time to implement and reap benefits and are hence neutral on this development for now. Plans are now being put into action following a strategic review. Longer term, we believe the Supermarket/Hypermarket segment's profitability and growth will improve, through an expanded product range, pricing, procurement, space management etc. For now, we believe high operating costs and lower contribution from Yonghui at associate/JV income level will be a drag on earnings in the near term.

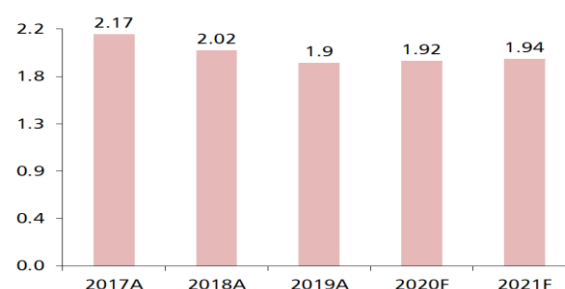
More efficient store and back-end operations. We see DFI strengthening its back-end operations regionally for the long term, with much of the focus geared towards improving operating efficiencies especially at both store and back-end levels. The areas include e-commerce, IT infrastructure, supply chain, and food and product safety. Growth will be supported by efficiencies in backend supply chain, presentation, pricing, variety, food and service quality, store presentation, customer retention, etc. However, we envisage the multi-year transformation plan will take time to bear fruit. For now, lower margins, down to the cost of new key management personnel appointed across various roles, and weak Southeast Asia's food profitability will be felt in the immediate term. We await results of this transformation plan to kick in.

Synergies with Yonghui. We expect more synergies from increased collaboration in the sharing of knowledge in procurement and management of food supplies post Ben Keswick's appointment to the Yonghui board as Chairman.

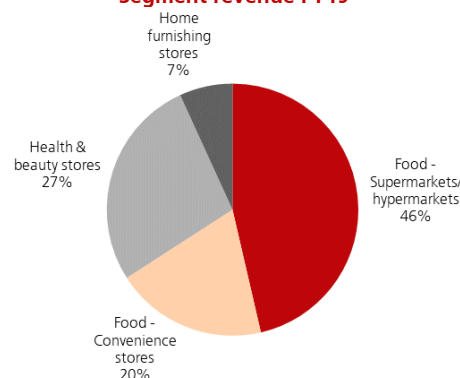
Number of outlets



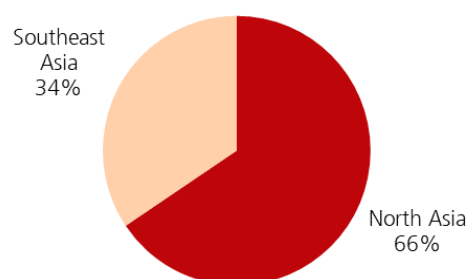
Sales per store blended



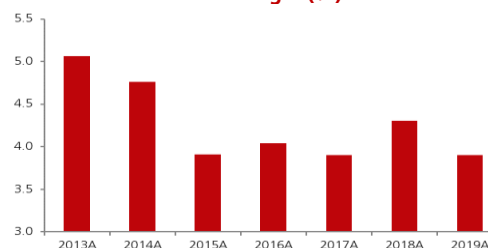
Segment revenue FY19



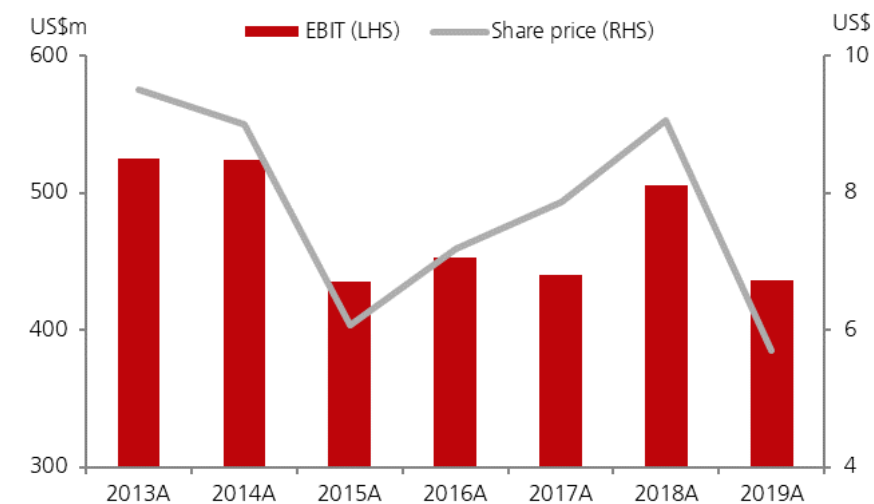
Geographical segment FY19



EBIT margin (%)



Source: Company, DBS Bank

Dairy Farm**Appendix 1: A look at Company's listed history – what drives its share price?****Correlation between share price and absolute operating profit (EBIT) is strong at 0.8x**

Source: DBS Bank

Dairy Farm

Balance Sheet:

Higher net debt. DFI's net debt-to-equity is at c.0.68x with net debt at US\$821m as at end-Dec19, on the back of continued investment in the Philippines. The net debt initially resulted from the purchase of Yonghui in FY16 before full acquisition of Rose Pharmacy in FY18 led to higher net debt. DFI has generated strong operational cash flows of US\$1.3bn a year on average over the past five years, which we believe is strong enough to support the current debt level.

Share Price Drivers:

Earnings turnaround. We believe any share price upside will be driven by earnings recovery over the longer term. Upside risk on the stock is based on DFI's ability to turn in more efficient operations to drive earnings growth. Key indicators are higher contribution by Yonghui and margin expansion at its core business through better cost management and margin enhancement initiatives (i.e. distribution centres). IT and backend enhancement initiatives should also support a better cost structure in terms of centralised procurement, logistics and other operations, etc.

Key Risks:

Profitability susceptible to rental and labour costs. As a retailer, labour and rental costs are key operating cost components. Significant changes in these components will affect earnings growth. Higher rental and labour costs were seen in Hong Kong, Singapore and Indonesia in FY15-16 and FY18, which resulted in lower margins and dampened earnings.

Competitive pressure. Grocery retail customers can be price sensitive and may switch to retailers offering more promotions. This can be a risk to market share, sales and earnings growth. In times of weaker consumer sentiment, customers may trade down from high-end supermarkets to the mass-market segment. DFI has plans to strengthen its marketing to the mass-market segment and target specifically local consumers.

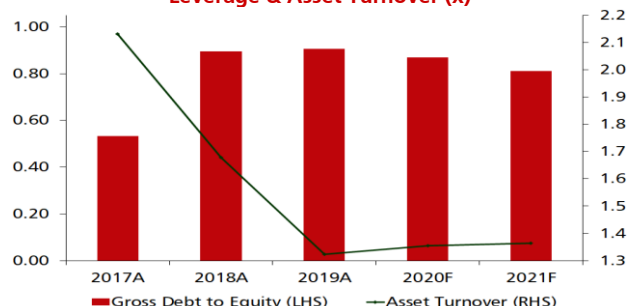
Environment, Social, Governance:

DFI's corporate social responsibilities include waste reduction, supporting a sustainable environment, community work. It is focused on reduction and recycling single use packaging, with IKEA phasing out single use plastic by 2020 and Maxim's reducing food and plastic straw usage. Community work includes interacting and volunteering at social organisations.

Company Background

Dairy Farm is a Pan Asian retailer, operating over 6,400 supermarkets, hypermarkets, health and beauty stores, convenience stores, home furnishing stores and restaurants under well-known brand names in Hong Kong, Taiwan, China, Macau, Singapore, the Philippines, Cambodia, Brunei, Malaysia, Indonesia and Vietnam.

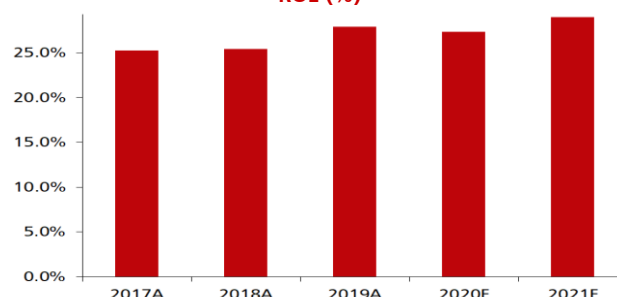
Leverage & Asset Turnover (x)



Capital Expenditure



ROE (%)



Forward PE Band (x)



PB Band (x)



Source: Company, DBS Bank

Dairy Farm

Key Assumptions

FY Dec	2017A	2018A	2019A	2020F	2021F
Number of outlets	5,192	5,820	5,899	6,017	6,137
Sales per store blended	2.17	2.02	1.90	1.92	1.94

Segmental Breakdown

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenues (US\$m)					
Food	8,038	7,992	7,376	7,598	7,828
Health & beauty stores	2,597	3,036	3,051	3,143	3,238
Home furnishing stores	653	721	766	789	813
Total	11,289	11,749	11,192	11,530	11,879
Operating profit (US\$m)					
Food	220	110	145	178	198
Health & beauty stores	210	330	296	277	304
Home furnishing stores	68.0	68.4	42.7	46.5	49.6
Support office/others	(57.7)	(3.2)	(46.8)	(51.3)	(55.8)
Total	440	506	437	450	496
Operating profit Margins					
Food	2.7	1.4	2.0	2.3	2.5
Health & beauty stores	8.1	10.9	9.7	8.8	9.4
Home furnishing stores	10.4	9.5	5.6	5.9	6.1
Support office/others	N/A	N/A	N/A	N/A	N/A
Total	3.9	4.3	3.9	3.9	4.2

Partially affected by Rustan's divestment and store optimisation in Southeast Asia

Includes IFRS 16 lease adoption impact

Expect operating margin improvement

Income Statement (US\$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenue	11,289	11,749	11,192	11,530	11,879
Cost of Goods Sold	(7,856)	(8,101)	(7,659)	(7,841)	(8,018)
Gross Profit	3,433	3,649	3,534	3,690	3,861
Other Opng (Exp)/Inc	(2,992)	(3,143)	(3,097)	(3,240)	(3,365)
Operating Profit	440	506	437	450	496
Other Non Opng (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	144	113	115	121	128
Net Interest (Exp)/Inc	(26.3)	(167)	(158)	(164)	(166)
Exceptional Gain/(Loss)	(72.3)	0.0	(1.0)	0.0	0.0
Pre-tax Profit	486	452	392	407	457
Tax	(92.9)	(93.8)	(69.5)	(72.1)	(81.1)
Minority Interest	10.6	0.20	2.80	2.90	3.27
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	404	358	326	338	380
Net Profit before Except.	476	358	327	338	380
EBITDA	805	1,720	1,554	1,603	1,686
Growth					
Revenue Gth (%)	0.8	4.1	(4.7)	3.0	3.0
EBITDA Gth (%)	2.8	113.5	(9.7)	3.2	5.2
Opg Profit Gth (%)	(2.7)	14.9	(13.7)	3.1	10.1
Net Profit Gth (Pre-ex) (%)	2.8	(24.7)	(8.8)	3.4	12.4
Margins & Ratio					
Gross Margins (%)	30.4	31.1	31.6	32.0	32.5
Opg Profit Margin (%)	3.9	4.3	3.9	3.9	4.2
Net Profit Margin (%)	3.6	3.0	2.9	2.9	3.2
ROAE (%)	25.3	25.4	27.9	27.3	29.0
ROA (%)	7.6	5.1	3.9	4.0	4.4
ROCE (%)	12.7	9.9	6.9	7.2	7.8
Div Payout Ratio (%)	70.4	79.3	87.2	84.1	74.8
Net Interest Cover (x)	16.7	3.0	2.8	2.7	3.0

11 months from RRHI (18% stake)

9 months contribution from Yonghui (20% stake)

Unadjusted for IFRS 16 lease accounting

Source: Company, DBS Bank

Quarterly / Interim Income Statement (US\$m)

FY Dec	2H2017	1H2018	2H2018	1H2019	2H2019
Revenue	5,783	5,929	5,821	5,761	5,432
Cost of Goods Sold	(4,007)	(4,126)	(3,974)	(3,989)	(3,670)
Gross Profit	1,777	1,803	1,846	1,772	1,762
Other Oper. (Exp)/Inc	(1,537)	(1,555)	(1,588)	(1,538)	(1,560)
Operating Profit	240	247	258	234	202
Other Non Opq (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	82.9	52.6	60.2	73.8	41.1
Net Interest (Exp)/Inc	(13.9)	(85.8)	(80.8)	(84.3)	(73.9)
Exceptional Gain/(Loss)	(72.3)	9.10	(9.1)	(0.5)	0.0
Pre-tax Profit	237	223	229	223	169
Tax	(52.9)	(49.5)	(44.3)	(43.7)	(25.8)
Minority Interest	8.20	3.90	(3.7)	(1.7)	4.50
Net Profit	192	178	181	178	148
Net profit bef Except.	264	169	190	179	148
EBITDA	323	300	319	308	243

Growth

Revenue Gth (%)	5.1	2.5	(1.8)	(1.0)	(5.7)
EBITDA Gth (%)	23.6	(7.2)	6.2	(3.2)	(21.1)
Opq Profit Gth (%)	20.0	3.0	4.4	(9.3)	(13.8)
Net Profit Gth (%)	(9.1)	(7.5)	1.7	(1.4)	(16.9)

Margins

Gross Margins (%)	30.7	30.4	31.7	30.8	32.4
Opq Profit Margins (%)	4.2	4.2	4.4	4.1	3.7
Net Profit Margins (%)	3.3	3.0	3.1	3.1	2.7

Balance Sheet (US\$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Net Fixed Assets	1,184	757	820	884	954
Invt in Associates & JVs	1,601	2,031	2,102	2,223	2,351
Other LT Assets	1,011	4,175	3,943	3,969	3,959
Cash & ST Invt	332	296	301	228	192
Inventory	950	913	896	967	989
Debtors	351	326	281	347	293
Other Current Assets	38.3	35.2	26.1	26.1	26.1
Total Assets	5,467	8,533	8,370	8,644	8,763
ST Debt	413	1,026	938	938	938
Creditor	2,470	2,364	2,315	2,470	2,372
Other Current Liab	130	905	911	979	1,104
LT Debt	522	14.5	184	184	184
Other LT Liabilities	177	3,062	2,782	2,782	2,782
Shareholder's Equity	1,690	1,126	1,209	1,263	1,358
Minority Interests	65.7	35.5	30.3	27.4	24.1
Total Cap. & Liab.	5,467	8,533	8,370	8,644	8,763
Non-Cash Wkg. Capital	(1,261)	(1,995)	(2,023)	(2,109)	(2,169)
Net Cash/(Debt)	(602)	(744)	(821)	(894)	(930)
Debtors Turn (avg days)	10.4	10.5	9.9	10.0	9.8
Creditors Turn (avg days)	114.7	126.0	128.3	128.3	127.1
Inventory Turn (avg days)	46.2	48.6	49.6	49.9	51.3
Asset Turnover (x)	2.1	1.7	1.3	1.4	1.4
Current Ratio (x)	0.6	0.4	0.4	0.4	0.3
Quick Ratio (x)	0.2	0.1	0.1	0.1	0.1
Net Debt/Equity (X)	0.3	0.6	0.7	0.7	0.7
Net Debt/Equity ex MI (X)	0.4	0.7	0.7	0.7	0.7
Capex to Debt (%)	23.4	21.4	20.8	23.5	24.1
Z-Score (X)	2.2	2.1	2.2	2.2	2.3

Source: Company, DBS Bank

Cash Flow Statement (US\$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Pre-Tax Profit	486	452	392	407	457
Dep. & Amort.	221	1,101	1,002	1,032	1,062
Tax Paid	(84.3)	(96.0)	(25.1)	(127)	(72.1)
Assoc. & JV Inc/(loss)	(144)	(113)	(115)	(121)	(128)
Chg in Wkg.Cap.	140	(20.5)	(76.7)	18.2	(65.2)
Other Operating CF	53.5	134	110	122	116
Net Operating CF	671	1,458	1,288	1,331	1,371
Capital Exp.(net)	(218)	(223)	(233)	(263)	(270)
Other Invt.(net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	(5.8)	(223)	(3.8)	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	(56.4)	(55.2)	(45.9)	(50.0)	(50.0)
Net Investing CF	(281)	(501)	(283)	(313)	(320)
Div Paid	(284)	(284)	(284)	(284)	(284)
Chg in Gross Debt	(40.9)	102	73.4	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(63.0)	(818)	(797)	(808)	(802)
Net Financing CF	(388)	(1,001)	(1,008)	(1,092)	(1,086)
Currency Adjustments	9.10	(6.5)	6.30	0.0	0.0
Chg in Cash	11.9	(50.0)	3.80	(73.6)	(35.8)
Opg CFPS (US cts.)	39.3	109	101	97.1	106
Free CFPS (US cts.)	33.5	91.3	78.0	79.0	81.4

Include lease payments

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	15 Mar 19	7.37	8.44	HOLD
2:	02 Aug 19	7.60	7.99	HOLD

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

Source: DBS Bank

Analyst: Alfie YEO

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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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