Singapore Company Guide

Sheng Siong Group

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

Refer to important disclosures at the end of this report

DBS Group Research . Equity

28 Apr 2016

BUY

Last Traded Price: S$0.89 (**STI :** 2,874.72)
Price Target : S$1.04 (16% upside) (Prev S$1.01)

Potential Catalyst: New stores
Where we differ: Below consensus on conservative growth

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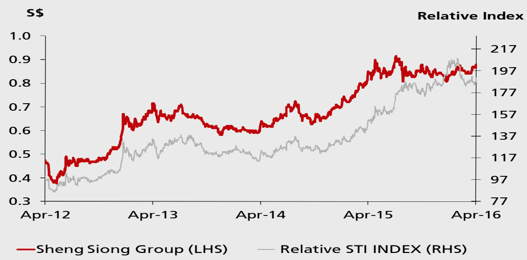
What's New

- **1Q16 earnings in line with expectations, supported by wage credits**
- **Growth to be driven by new stores**
- **Raise FY17F earnings by 5%**
- **Maintain BUY, with higher TP of S$1.04**

Price Relative



Forecasts and Valuation

FY Dec (S$ m)	2014A	2015A	2016F	2017F
Revenue	726	764	836	806
EBITDA	63.0	70.6	74.5	78.7
Pre-tax Profit	57.1	67.7	73.3	77.1
Net Profit	47.0	56.8	60.8	64.0
Net Pft (Pre Ex.)	47.0	56.8	60.8	64.0
Net Pft Gth (Pre-ex) (%)	20.8	20.8	7.0	5.3
EPS (S cts)	3.13	3.78	4.04	4.25
EPS Pre Ex. (S cts)	3.13	3.78	4.04	4.25
EPS Gth Pre Ex (%)	11	21	7	5
Diluted EPS (S cts)	3.13	3.78	4.04	4.25
Net DPS (S cts)	2.88	3.50	3.74	3.94
BV Per Share (S cts)	15.7	16.2	16.5	16.8
PE (X)	28.5	23.6	22.0	20.9
PE Pre Ex. (X)	28.5	23.6	22.0	20.9
P/Cash Flow (X)	18.7	18.2	17.0	17.3
EV/EBITDA (X)	19.2	17.2	16.9	15.9
Net Div Yield (%)	3.2	3.9	4.2	4.4
P/Book Value (X)	5.7	5.5	5.4	5.3
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	24.3	23.6	24.7	25.5
Earnings Rev (%):			-	5
Consensus EPS (S cts):			4.00	4.30
Other Broker Recs:		B: 9	S: 0	H: 0

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

Continues growing

Maintain BUY; margins, store expansion, revenue and earnings growth remain on track. We continue to like SSG as the company continues to meet growth expectations. SSG is on track towards attaining its 50-store target, while long term margin is expected to track to our expectations. The company is one of the most well-run grocery retailers in ASEAN, leading regional peers in profitability, cash flow generation and working capital management. Dividend continues to be attractive at 4.2% based on FY16F DPS of 3.74 Scts.

1Q16 earnings in line. While revenue met our numbers, we were slightly aggressive in our gross margin assumptions which meant operating margins disappointed. But earnings were eventually offset by higher-than-expected government grants in the form of wage credits. SSSG was -0.5% affected by weak Chinese New Year demand, Loyang, Geylang and Woodlands stores. Higher wage credit has led us to raise our FY17F's earnings by 5% as a result.

New stores, margins to support growth. Sheng Siong is expected to add another four stores in 2Q16 (15,000 sqft at Yishun Junction 9, 3,500 sqft at Circuit Road, 3,000 sqft at Upper Boon Keng, and 3,300 sqft at Sengkang Fernvale). We expect margin outlook to sustain this year, and improve further in FY17F from more bulk purchasing and fresh sales mix. These, along with government grants, should support growth.

Valuation:

Our target price for Sheng Siong is S$1.04 based on 25x blended FY16F/FY17F PE. Valuation is pegged to below +1SD of its historical mean and below regional peers' average of 27x 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)	1,338 / 992
Major Shareholders (%)	
SS Holdings	29.85
Lim Family	33.99
Free Float (%)	36.16
3m Avg. Daily Val (US$m)	0.86

ICB Industry : Consumer Services / Food & Drug Retailers

WHAT'S NEW

Decent set of results

1Q16 earnings were within expectations. Net profit of S$16.4m (+17% y-o-y) was in line with expectations. Revenue met our expectations. But operating margins were a tad below because we were expecting slightly faster margin expansion. Nonetheless, gross margins of 24.5% were still decent. Lower-than-expected margins were compensated by higher wage credits in the form of government grants, which helped to align our net profit forecast to the reported 1Q16 earnings.

Revenue driven by new stores; SSSG falls. Revenue of S$209m (+11.5% y-o-y) was boosted by new stores. Otherwise, SSSG fell by 0.5% due to 1) weak Chinese New Year demand; 2) ongoing renovation around Loyang store; 3) liquor sales decline in Geylang store; and 4) slower sales at the Woodlands store due to the weak ringgit.

Gross margins lower sequentially but improved slightly y-o-y. Gross margins were comparable to 1Q15 but declined slightly from 4Q15. This was due to the effect of Chinese New Year sales where promotions and discounting were more intense compared to 4Q15.

Opex slightly lower. Operating expenses amounted to S$35.4m (+8.8% y-o-y, +4.2% q-o-q), growing slower than revenue on both a sequential and y-o-y basis. 1Q16 saw lower staff costs, distribution expenses and other expenses as a percentage of sales compared to both 4Q15 and 1Q15.

Benefitted from higher wage credit. Other operating income was S$3.8m, the highest ever. S$2.2m of it comprised government grants in the form of wage credit and special employment credit schemes. This was above our expectations.

Slight rental savings on Bedok property purchase. Sheng Siong had, on 8 April, announced that it will acquire the property for its Bedok store for S$53m. The Bedok store is one of SSG's key stores and acquiring the property will minimise risks of store closure in the event the landlord sells the property. We expect slight rental savings at the Bedok store going forward and have accounted for the property purchase in our cash flow and balance sheet projections.

Revise FY17F earnings by 5%. There is no change to our FY16F net profit forecast. However, we have lowered operating margin on slower-than-expected gross margin expansion, compensated by higher government grants. Our core numbers for FY17F are unchanged, except for higher government grants going forward. We see wage credits increasing in line with a higher store count, which lifts our earnings by 5%.

Maintain BUY, TP raised to S$1.04. We continue to value Sheng Siong based on 25x earnings. Our TP is now raised to S$1.04 as we roll over our earnings base from FY16F to blended FY16F/FY17F. Maintain BUY for 17% upside.

Quarterly / Interim Income Statement (S$m)

FY Dec	1Q2015	4Q2015	1Q2016	% chg yoy	% chg qoq
Revenue	198	187	209	5.1	11.5
Cost of Goods Sold	(150)	(140)	(158)	5.1	12.2
Gross Profit	**48.5**	**46.7**	**51.0**	**5.2**	**9.2**
Other Oper. (Exp)/Inc	(33.9)	(32.5)	(35.4)	4.2	8.8
Operating Profit	**14.6**	**14.2**	**15.6**	**7.4**	**9.9**
Other Non Opg (Exp)/Inc	2.24	1.95	3.82	70.8	95.8
Associates & JV Inc	0.0	0.0	0.0	nm	nm
Net Interest (Exp)/Inc	0.27	0.31	0.34	27.9	11.0
Exceptional Gain/(Loss)	0.0	0.0	0.0	nm	nm
Pre-tax Profit	**17.1**	**16.5**	**19.8**	**16.1**	**20.1**
Tax	(3.0)	(1.9)	(3.4)	12.6	79.6
Minority Interest	0.0	0.0	0.0	nm	nm
Net Profit	**14.1**	**14.6**	**16.4**	**16.8**	**12.4**
Net profit bef Except.	14.1	14.6	16.4	16.8	12.4
EBITDA	20.0	19.8	23.0	15.2	16.6
Margins (%)					
Gross Margins	24.4	25.0	24.5		
Opg Profit Margins	7.3	7.6	7.5		
Net Profit Margins	7.1	7.8	7.9		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Earnings Drivers:

Store expansion. Sheng Siong currently operates only 39 stores. Compared to the other local operators, it has scope to expand its store network, particularly in areas such as Bukit Batok, Serangoon, Hougang and Seng Kang where it has a low presence. Management targets to ultimately operate 50 stores islandwide. In the past six years, 0-8 stores were opened annually, largely a function of the 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 sales mix to improve to 50% as it skews its store offering more towards fresh products.

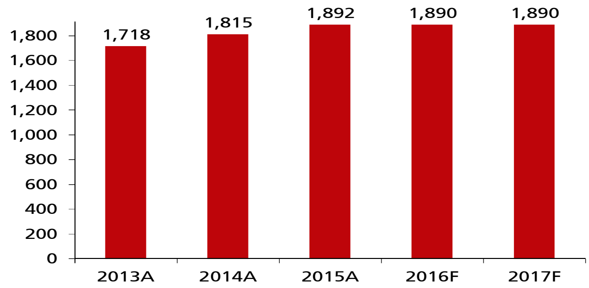
Margin expansion through bulk purchasing at its Mandai Distribution Centre. The Mandai Distribution Centre allows Sheng Siong to perform direct sourcing and bulk handling. This effectively drives down input costs, resulting in cost savings and better margins. We estimate that the facility is currently running at only 60% of capacity and expects it to achieve >80% ultimately as it secures more suppliers and products to trade through the distribution centre. Margins are expected to trend up as utilisation increases towards optimal capacity.

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

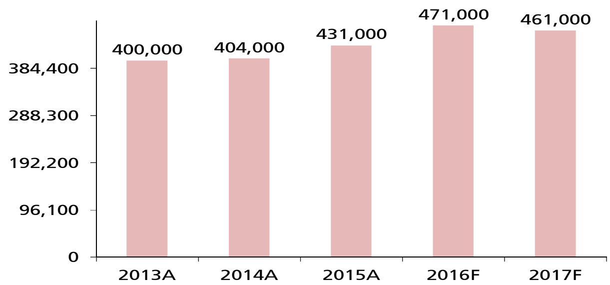
Generating more same-store-sales growth to increase revenue. Sheng Siong has been able to maintain a positive SSSG since 4Q13 (bar 4Q15, 1Q16) through longer operating hours and renovation of older stores, offering the correct products and effective marketing. Maintaining a positive SSSG will support earnings growth.

Future earnings drivers, e-commerce and China JV (in Kunming). Both developments are at their initial stages. The market for e-commerce remains small and the business model in Kunming is still under trial. This is even though Sheng Siong already has 1) an up-and-running e-commerce operation which services selected areas in Singapore; and 2) the JV in Kunming has already secured the relevant licences to operate there. It targets to open its first Kunming store in 2H15. Downside for the JV is limited to US$6m paid-up capital which is sufficient to open 2-3 new stores.

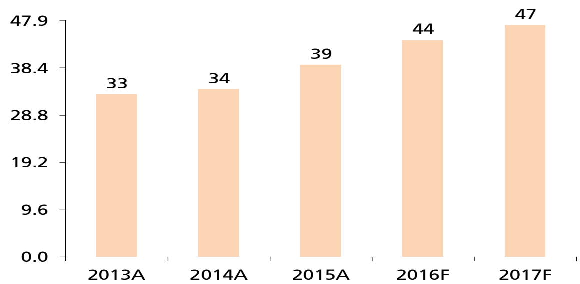
Rev per sqft



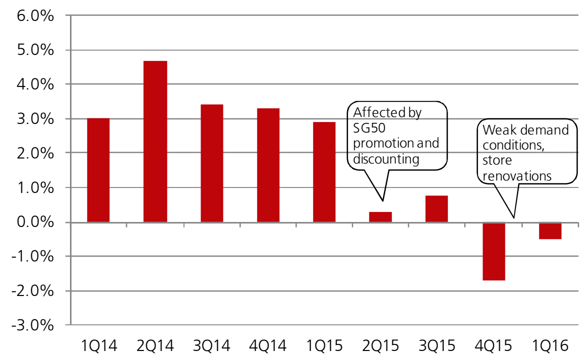
Operation Area (sqft)



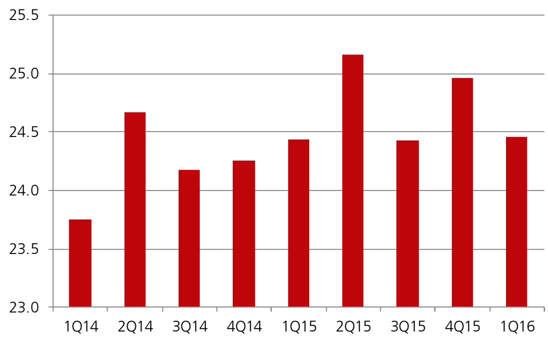
Number of stores



Same store sales growth



Gross margin (%)



Source: Company, DBS Bank

Balance Sheet:

Net cash of over S$100m or >7 Scts per share. The excess cash allows for strategic store acquisitions if suitable real estate arises for it to expand its store presence in the future. The business generates positive working capital. Inventory is purchased on credit, turned quickly and sold for cash. Over the past seven years, the business has generated between S$20-75m of operating cash flow each year. Dividend payout is attractive at 90%. We expect this to be maintained as long as there is no significant requirement for cash funding.

Share Price Drivers:

Strong earnings growth performance. Sheng Siong's financial performance has consistently met our expectations, delivering earnings growth (CAGR of 20.4% since FY11) through a combination of margin expansion, store growth and SSSG. It is this consistency, together with strong dividend payout of 90% and yield of 4%, that has led to the stock's re-rating from 20x to 22x FY15F PE currently. We believe continued delivery of consistent performance and profit growth will support a strong share price.

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

Key Risks:

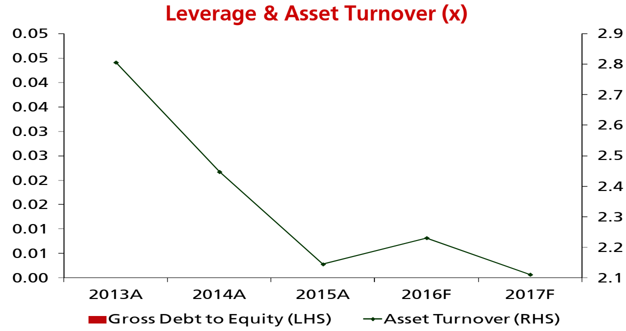
Revenue growth limited by store openings. Store expansion in Singapore is largely dependent on the supply of new supermarket retail space released by HDB and its ability to secure the tenders.

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.

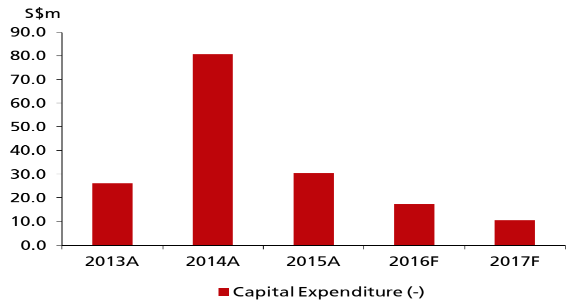
Company Background

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

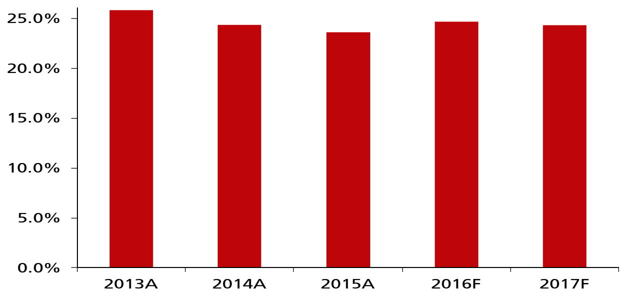
Leverage & Asset Turnover (x)



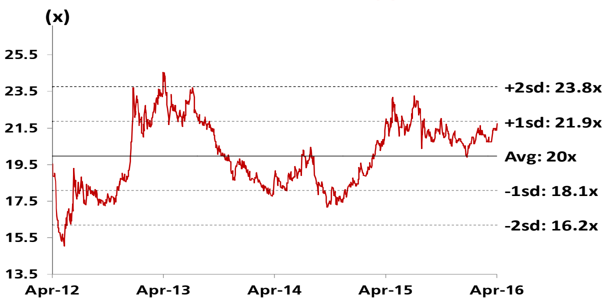
Capital Expenditure



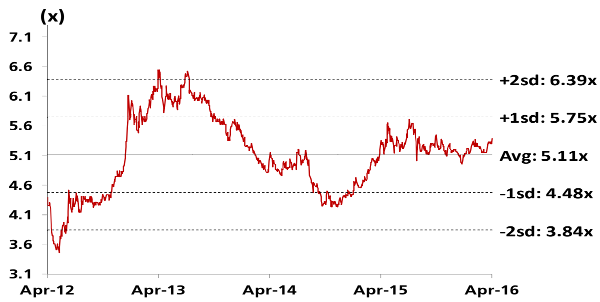
ROE (%)



Forward PE Band (x)



PB Band (x)



Source: Company, DBS Bank

Key Assumptions

FY Dec	2013A	2014A	2015A	2016F	2017F
Rev per sqft	1,718	1,815	1,892	1,890	1,890
Operation Area (sqft)	400,000	404,000	431,000	471,000	461,000
Number of stores	33.0	34.0	39.0	44.0	47.0

40,000-sqft Woodlands store to close

Segmental Breakdown

FY Dec	2013A	2014A	2015A	2016F	2017F
Revenues (S$m)					
Singapore	687	726	764	836	806
Total	**687**	**726**	**764**	**836**	**806**
Operating profit (S$m)					
Singapore	41.6	52.2	57.2	60.2	64.9
Total	**41.6**	**52.2**	**57.2**	**60.2**	**64.9**
Operating profit Margins					
Singapore	6.1	7.2	7.5	7.2	8.0
Total	**6.1**	**7.2**	**7.5**	**7.2**	**8.0**

Income Statement (S$m)

FY Dec	2013A	2014A	2015A	2016F	2017F
Revenue	687	726	764	836	806
Cost of Goods Sold	(529)	(550)	(576)	(632)	(605)
Gross Profit	**158**	**176**	**189**	**204**	**202**
Other Opng (Exp)/Inc	(117)	(124)	(132)	(144)	(137)
Operating Profit	**41.6**	**52.2**	**57.2**	**60.2**	**64.9**
Other Non Opg (Exp)/Inc	4.89	3.80	9.26	11.7	11.4
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	1.05	1.19	1.22	1.38	0.78
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**47.6**	**57.1**	**67.7**	**73.3**	**77.1**
Tax	(8.7)	(10.2)	(10.9)	(12.5)	(13.2)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	**38.9**	**47.0**	**56.8**	**60.8**	**64.0**
Net Profit before Except.	38.9	47.0	56.8	60.8	64.0
EBITDA	51.7	63.0	70.6	74.5	78.7
Growth					
Revenue Gth (%)	7.9	5.6	5.3	9.4	(3.5)
EBITDA Gth (%)	19.8	21.9	12.1	5.5	5.6
Opg Profit Gth (%)	19.8	25.3	9.7	5.2	7.8
Net Profit Gth (Pre-ex) (%)	24.7	20.8	20.8	7.0	5.3
Margins & Ratio					
Gross Margins (%)	23.0	24.2	24.7	24.5	25.0
Opg Profit Margin (%)	6.1	7.2	7.5	7.2	8.0
Net Profit Margin (%)	5.7	6.5	7.4	7.3	7.9
ROAE (%)	25.8	24.3	23.6	24.7	25.5
ROA (%)	15.9	15.8	15.9	16.2	16.7
ROCE (%)	22.3	22.0	19.8	20.1	21.3
Div Payout Ratio (%)	92.5	92.1	92.7	92.7	92.7
Net Interest Cover (x)	NM	NM	NM	NM	NM

Affected by Woodlands store closure

Includes government grants and wage credits

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	1Q2015	2Q2015	3Q2015	4Q2015	1Q2016
Revenue	198	179	200	187	209
Cost of Goods Sold	(150)	(134)	(151)	(140)	(158)
Gross Profit	**48.5**	**45.1**	**48.8**	**46.7**	**51.0**
Other Oper. (Exp)/Inc	(33.9)	(31.5)	(33.8)	(32.5)	(35.4)
Operating Profit	**14.6**	**13.6**	**15.0**	**14.2**	**15.6**
Other Non Opg (Exp)/Inc	2.24	2.30	2.78	1.95	3.82
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	0.27	0.30	0.34	0.31	0.34
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**17.1**	**16.2**	**18.1**	**16.5**	**19.8**
Tax	(3.0)	(2.6)	(3.5)	(1.9)	(3.4)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	**14.1**	**13.6**	**14.7**	**14.6**	**16.4**
Net profit bef Except.	14.1	13.6	14.7	14.6	16.4
EBITDA	20.0	19.2	21.2	19.8	23.0
Growth					
Revenue Gth (%)	11.2	(9.8)	11.7	(6.4)	11.5
EBITDA Gth (%)	21.5	(4.2)	10.4	(6.6)	16.6
Opg Profit Gth (%)	6.6	(6.6)	10.5	(5.3)	9.9
Net Profit Gth (Pre-ex) (%)	19.2	(3.0)	7.5	(0.4)	12.4
Margins					
Gross Margins (%)	24.4	25.2	24.4	25.0	24.5
Opg Profit Margins (%)	7.3	7.6	7.5	7.6	7.5
Net Profit Margins (%)	7.1	7.6	7.3	7.8	7.9

Balance Sheet (S$m)

FY Dec	2013A	2014A	2015A	2016F	2017F
Net Fixed Assets	90.8	161	178	234	231
Invts in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	0.0	0.0	0.0	0.0	0.0
Cash & ST Invts	99.7	130	126	77.9	85.4
Inventory	45.6	43.1	52.5	57.6	55.2
Debtors	12.3	10.8	11.8	12.9	12.4
Other Current Assets	0.0	0.0	0.0	0.0	0.0
Total Assets	**248**	**345**	**368**	**382**	**383**
ST Debt	0.0	0.0	0.0	0.0	0.0
Creditor	88.2	95.9	109	119	115
Other Current Liab	7.94	10.7	12.7	12.5	13.2
LT Debt	0.0	0.0	0.0	0.0	0.0
Other LT Liabilities	2.29	2.20	2.24	2.24	2.24
Shareholder's Equity	150	236	244	249	253
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Cap. & Liab.	**248**	**345**	**368**	**382**	**383**
Non-Cash Wkg. Capital	(38.4)	(52.7)	(57.1)	(60.9)	(60.3)
Net Cash/(Debt)	99.7	130	126	77.9	85.4
Debtors Turn (avg days)	5.0	5.8	5.4	5.4	5.7
Creditors Turn (avg days)	59.0	62.3	66.4	67.3	72.1
Inventory Turn (avg days)	30.1	30.0	31.0	32.5	34.8
Asset Turnover (x)	2.8	2.4	2.1	2.2	2.1
Current Ratio (x)	1.6	1.7	1.6	1.1	1.2
Quick Ratio (x)	1.2	1.3	1.1	0.7	0.8
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)	10.9	10.1	9.2	8.9	9.1

Cash paid out for Bedok property purchase

Source: Company, DBS Bank

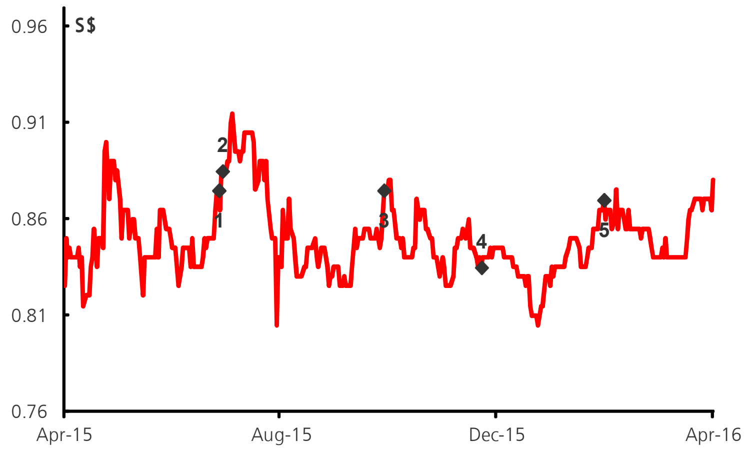
Cash Flow Statement (S$m)

FY Dec	2013A	2014A	2015A	2016F	2017F
Pre-Tax Profit	47.6	57.1	67.7	73.3	77.1
Dep. & Amort.	10.1	10.9	13.4	14.3	13.8
Tax Paid	(8.7)	(7.5)	(10.7)	(12.7)	(12.5)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(2.6)	11.5	2.54	3.88	(1.2)
Other Operating CF	(1.2)	(0.3)	0.52	0.0	0.0
Net Operating CF	**45.1**	**71.7**	**73.5**	**78.8**	**77.2**
Capital Exp.(net)	(26.1)	(80.8)	(30.4)	(70.5)	(10.5)
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	1.05	0.92	1.22	0.0	0.0
Net Investing CF	**(25.0)**	**(79.9)**	**(29.2)**	**(70.5)**	**(10.5)**
Div Paid	(40.8)	(40.1)	(48.9)	(56.3)	(59.3)
Chg in Gross Debt	0.0	0.0	0.0	0.0	0.0
Capital Issues	0.0	79.0	0.0	0.0	0.0
Other Financing CF	0.0	0.0	0.0	0.0	0.0
Net Financing CF	**(40.8)**	**38.9**	**(48.9)**	**(56.3)**	**(59.3)**
Currency Adjustments	0.0	0.0	0.04	0.0	0.0
Chg in Cash	(20.7)	30.8	(4.5)	(48.0)	7.43
Opg CFPS (S cts)	3.45	4.00	4.72	4.98	5.21
Free CFPS (S cts)	1.38	(0.6)	2.86	0.55	4.44

Includes S$53m Bedok property purchase

Source: Company, DBS Bank

Target Price & Ratings History



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

S.No.	Date	Closing Price	Target Price	Rating
1:	22 Jul 15	0.88	0.98	BUY
2:	24 Jul 15	0.89	1.00	BUY
3:	23 Oct 15	0.88	1.01	BUY
4:	17 Dec 15	0.84	1.01	BUY
5:	24 Feb 16	0.87	1.01	BUY

Source: DBS Bank

DBS Bank recommendations are based 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 catalysts within this time frame)

Share price appreciation + dividends

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