

Koda Limited

1 September 2021

BUY (previously hold)
Target Price: S\$1.00

BBG	KODA SP
Market cap	S\$66m
Price (31 August 2021)	S\$0.80
52-week range	S\$0.40 – S\$0.915
Target Price	S\$1.00
Shares Outstanding	82.7m
Free Float	36.96%
Major Shareholders	James Koh Jyh Gang 16.3% Koh Teng Kwee 11.4% Koh Jyh Eng 10.8% Koh Shwu Lee 10.3%
P/BV (06/21)	1.0
Net Debt to EBITDA (06/21)	Net cash

Source: Company data, Bloomberg, SAC Capital

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Strongest year for Koda

The results were ahead of our projections of revenue (+13%) and net profit (+36%). Revenue rose 36.9% yoy to US\$82.6m, and net profit more than doubled to US\$9.1m, led by export sales to OEM customers (+34.8%) and retail sales (+46.7%) under house brand Commune.

Retail operations turned around with operating profit of US\$1.2m, bolstered by strong sales in Singapore fuelled by WFH home refurbishment needs. Commune are still on track with its plan to expand the number of stores in China to 100 by 2022. Its own flagship store is also expected to be open in Shanghai by end 2021. A higher store count will allow Commune to enjoy operating leverage in the long run.

US furniture demand growth intact. OEM manufacturing makes up 80.7% of revenue, with US its biggest market accounting for 60% of total sales and ~74.2% of its customers for its manufacturing segment. U.S. July retail sales excluding auto and gasoline grew 10.9% yoy. Furniture and furnishing sector exceeded pre-pandemic level by 26.8%. Market sentiments are in favor of uptrend in furniture demand. Gross margin inched up 1.2ppt to 32.8%.

COVID curbs in Vietnam and Malaysia could hurt output in 1H22. Virus resurgence has led to temporary suspension of Koda's factory operations in both countries. Koda has been drawing down inventories to meet delivery requirements. However, as inventories run thin, fulfillment of orders will depend on how fast Koda can restart production when the curbs are lifted. The authorities stipulate that companies can resume operations only when the workforce achieves a certain vaccination rate.

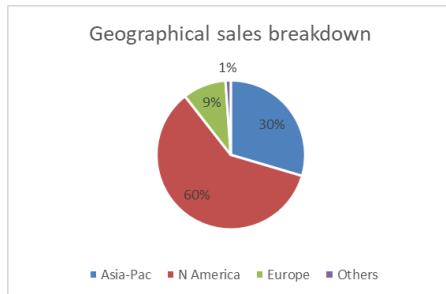
Sales at Commune's stores could be impacted by 1) property curbs imposed by China government and strict lockdown measures in China due to spread of Delta cases. 2) Singapore now allow up to 50% of employees to return to their workplace, potentially lowering demand for home furniture.

BUY at price target of S\$1.00 (Unchanged). Our price target of S\$1.00 is derived from DCF based on WACC of 9.6% and translates into FY22E PE of 11.7x and P/B of 1.1x. We adjusted our FY22E & FY23E topline estimates downward by 16%, taking into account the possible impact of limited production in 1H22. Likewise, net profit estimate is adjusted downward by 40% and 42% respectively for both years.

FY ended 30 Jun (in US\$m)	FY2019	FY2020	FY2021	FY2022E	FY2023E
Revenue	57.9	60.4	82.6	72.0	81.8
EBIT	5.8	4.8	11.3	6.4	6.8
Net profit	5.3	4.3	9.1	5.2	5.5
EPS (US cents)	6.4	5.3	11.0	6.3	6.7
Dividend per share (S cents)	2.5	1.3	3.0	1.3	1.3
Net cash / (debt)	13.0	13.7	11.8	11.8	13.3
Valuation					
EBIT margin (%)	9.9	7.9	13.7	8.9	8.3
ROIC (%)	21.1	15.4	24.0	12.4	12.3
EV/EBITDA (x)	6.4	7.5	3.3	5.9	5.4
P/E (x)	9.3	11.5	5.4	9.8	9.2
Dividend yield (%)	3.1	1.6	2.5	1.6	1.6

Investment Summary

US furniture demand growth intact



Source: Company Data

	1H21	2H21
Revenue (US\$ m)	39.6	43.1
Gross profit (US\$ m)	12.8	14.4
Gross profit margin (%)	32.3	33.4
EBITDA margin (%)	19.1	14.8*

Source: Company Data

*Lower EBITDA margin for 2H21 due to higher distribution and administrative expenses in line with higher Commune sales

North America market represents 74.2% of Koda's manufacturing segment. U.S. retail sales excluding auto and gasoline for July grew 10.9% yoy. Furniture and furnishing sector posted a 3.2% yoy increase and outgrew pre-pandemic sales level in July 2019 by 26.8% as consumers are still eager to turn their houses into homes. (*Mastercard Spendingpulse*) Additionally, several companies including Facebook, Amazon and Alphabet have delayed their back to office arrangement until 2022 due to surge in Delta variant cases. Spending on homes are likely to sustain given the extended period to work remotely. WFH trend bodes well for Koda as this would imply higher orders coming from their customers which translates to higher sales.

Koda had registered a 34.8% yoy growth in its manufacturing segment and the segment makes up 80.7% of its total revenue. Gross margin measured at 32.8% for FY21. Comparing 1H21 and 2H21, the gross margin increased by 1.2 ppt due to improved factory efficiency thereby resulting in lower unit production cost per output.

COVID curbs in Vietnam and Malaysia could hurt output in 1H22

High COVID-19 cases had led to temporary suspension of Koda's factory operations in both countries. Factory in Malaysia is closed for approximately 3 months since June while operations in Vietnam are temporarily suspended since late July.

In the meantime order shipments are fulfilled by drawing down on available inventories. However with production strictly limited and inventories may have been substantially consumed (USD7.3m of finished goods in inventories as of 30 June 2021 which represents 13% of FY21 COGS), the time to complete the orders will be dragged out and thus, negatively impacting delivery timeline.

Further delay on reopening of production lines in Vietnam and Malaysia could potentially cause a further dip in 1H22 sales. Both authorities have provided guidance on the conditions to resume operations. For Malaysia, operating capacity will depend on workers full vaccination rates ranging from 60-100% while for Vietnam, factories may be allowed to operate at 70% capacity if all workers have received first dose of vaccination and at full capacity if workers registered full vaccination rates. Given the higher full vaccination rate in Malaysia, Koda is expecting to resume its operations in September and gradually resume full production given increasing higher full vaccination rate. As for its Vietnam operations, Koda will follow up on implementation dates guided by the authority before progressively resuming their operations.

Investment Summary

COVID curbs in Vietnam and Malaysia could hurt output in 1H22 (cont')

Given the depleted inventories, uncertainty brought about by virus resurgence and slow reopening of production lines, we expect sales in 1H22 to take a hit. Gp margin is also expected to fall, holding at about 32.2% due to increase unit production cost with higher fixed costs distributed across lower sales volume.

Factors impacting sales at Commune's stores

Property curbs: China is determined to curb property speculations and cool property prices to make homes affordable. The authorities imposed more restrictive measures such as raising mortgage rates, temporarily halting land auctions in some major cities, and increased scrutiny of financing to developers, etc. Home sales in first tier cities and investment have since dropped. Thus, this is expected to reduce demand for home furniture. Currently, Commune has 75 stores in China.

Lockdown: In early August, China has instructed lockdown of various cities such as Nanjing, Zhangjiajie and Zhuzhou as COVID-19 cases spike due to Delta variant. Commercial activities are disrupted. While Commune stores in China are not directly affected as the stores are still open, retail sales took an indirect hit due to lower foot traffic as more employees work from home. Nevertheless, one mitigating factor is that the government has sped up its vaccination drives with mobile vaccination sites, free transportation, door-to-door visits etc. As of mid-August, China had administered more than 1.975 billion doses of COVID-19 vaccines. Hence, China's quick and strict response to COVID-19 cases is likely to mitigate the spread faster and restart its activities earlier like how it did before in 2020.

Back to office arrangement: Singapore has also allowed up to 50% of employees to return to their workplace. There will be less of a need to renovate the homes anymore. This is expected to slow down retail sales for furniture in Singapore. Commune has enjoyed a boost in sales for its 4 stores in Singapore during the pandemic.

Income Statement

YE 30 Jun					
US\$m	FY19A	FY20A	FY21A	FY22E	FY23E
Revenue	57.9	60.4	82.6	72.0	81.8
Cost of sales	(39.6)	(42.3)	(55.5)	(48.8)	(55.3)
Gross profit	18.2	18.1	27.1	23.2	26.5
Other income	0.8	1.2	1.9	1.0	1.0
Distribution costs	(5.0)	(5.3)	(6.8)	(7.8)	(9.2)
Admin expenses	(8.1)	(9.1)	(10.6)	(9.5)	(11.0)
Other income/ (expenses)	(0.2)	(0.1)	(0.3)	(0.5)	(0.5)
Operating profits	5.8	4.8	11.3	6.4	6.8
Share of results of associates	0	0	0	0	0
Government grant	0	0.4	0	0	0
EBIT	5.8	4.8	11.3	6.4	6.8
Interest income	0	0	0	0	0
Interest expense	0	(0.2)	(0.2)	(0.2)	(0.2)
Profit before tax	5.7	4.6	11.1	6.1	6.5
Tax expense	(0.4)	(0.5)	(2.0)	(1.0)	(1.1)
Minority interests	0	0.2	0	0	0
Net profit	5.3	4.3	9.1	5.1	5.4

Balance Sheet

YE 30 Jun					
US\$m	FY19A	FY20A	FY21A	FY22E	FY23E
PPE	16.1	13.6	15.5	24.0	25.2
ROU assets	0	5.9	7.7	7.7	7.7
Club membership	0.2	0.2	0	0	0
Deferred tax	0.1	0.2	0.2	0.2	0.2
Prepayment, deposits & other receivables	0	3.7	5.1	5.1	5.1
Total non- current assets	16.4	23.6	28.6	37.2	38.4
Cash	13.4	16.4	14.7	14.8	16.2
Inventories	10.6	11.3	19.6	13.1	14.8
Trade receivables	3.4	3.6	4.5	3.9	4.5
Prepayment, deposits & other receivables	2.7	2.6	7.1	7.1	7.1
Current assets	30.1	34.0	45.9	38.9	42.6
Total assets	46.5	57.7	74.5	76.1	80.9
Bank overdrafts	(0.2)	(1.0)	(1.2)	(1.2)	(1.2)
Accounts payable	(2.3)	(2.7)	(5.0)	(3.1)	(3.5)
Accruals & other payables	(5.0)	(6.6)	(11.8)	(11.8)	(11.8)
Bill payables	0	0	0	0	0
Finance lease	0	(1.2)	(1.5)	(1.5)	(1.5)
Income tax payable	(0.3)	(0.6)	(1.6)	(1.0)	(1.1)
Total current liabilities	(7.8)	(12.2)	(21.1)	(18.6)	(19.1)
Borrowings	(0.2)	(1.7)	(1.7)	(1.7)	(1.7)
Deferred tax	(0.2)	(0.3)	(0.3)	(0.3)	(0.3)
Finance lease	0	(3.0)	(2.1)	(2.1)	(2.1)
Total non- current liabilities	(0.4)	(5.0)	(4.1)	(4.1)	(4.1)
Net assets	38.2	40.5	49.2	53.3	57.7
Share capital	4.7	4.8	4.8	4.8	4.8
Treasury shares	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Reserves	0.6	0.1	0.7	0.7	0.7
Retained earnings	33.0	35.9	43.9	47.9	52.3
Minority interests	0	(0.1)	(0.1)	(0.1)	(0.1)
Total equity	38.2	40.5	49.2	53.3	57.6

Cash and short-term deposits include cash at bank and other short-term deposits.

Ratios

YE 30 Jun					
	FY19A	FY20A	FY21A	FY22E	FY23E
Profitability (%)					
Gross margin	31.5	29.9	32.8	32.2	32.4
Pretax margin	9.9	7.7	13.4	8.5	8.0
Liquidity (x)					
Current ratio	3.9	2.8	2.2	2.1	2.2
Quick ratio	2.5	1.9	1.2	1.4	1.5
Interest coverage ratio	192.0	30.5	56.5	45.5	48
Net Debt to Equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Valuation (x)					
P/E	8.6	11.5	5.4	9.8	9.2
P/B	1.2	1.2	1.0	0.9	0.9
EV/EBITDA	5.7	7.5	3.3	5.9	5.4
Cash Conversion Cycle					
Trade receivable days	22	22	20	20	20
Inventory days	97	98	129	98	98
Trade payable days	21	23	33	23	23
CCC days	98	97	116	95	95

Cash Flow Statement

YE 30 Jun					
US\$m	FY19A	FY20A	FY21A	FY22E	FY23E
PBT	5.7	4.6	11.1	6.1	6.5
Depreciation & amortization	1.6	1.7	1.8	2.7	2.8
Net interest expense	(0.1)	(0.1)	0.1	0.2	0.2
Non-fund items	0.4	1.8	0	0	0
Working capital					
Receivables	0.5	(0.2)	(0.8)	0.6	(0.5)
Other receivables	(0.2)	0	(4.4)	0	0
Inventories	(1.3)	(1.0)	(8.2)	6.5	(1.7)
Payables	(0.5)	0.4	2.1	(1.9)	0.4
Other payables	(0.3)	1.6	5.3	0	0
Operating cashflow	5.8	8.9	8.8	14.2	7.7
Net interest expense	0.1	0.1	(0.1)	(0.2)	(0.2)
Tax paid	(0.6)	(0.3)	(1.1)	(1.6)	(1.0)
Cash flow from operations	5.4	8.7	7.6	12.4	6.4
CAPEX	(0.9)	(5.0)	(4.8)	(11.2)	(4.0)
Net fixed assets disposal	0.1	0.0	0.1	0	0
Other flows	0	0	(2.3)	0	0
Free cashflow	4.5	3.7	0.6	1.1	2.4
Dividends paid	(1.2)	(1.5)	(1.1)	(1.0)	(1.0)
Borrowings	(0.3)	1.1	(1.4)	0	0
Equity issue	0	0	0	0	0
Net cash flow	3.0	3.2	(1.9)	0.1	1.4
Exch diff on consolidation	(0.1)	(0.2)	0.2	0	0
Opening cash balance	10.5	13.4	16.4	14.7	14.8
Ending cash balance	13.4	16.4	14.7	14.8	16.2

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