

OTS Holdings Ltd

2 September 2021

BUY (initiation)

BBG	OTS SP
Market cap	S\$63.1m
Price (1 Sep 2021)	S\$0.295
52-week range	S\$0.28 – S\$0.40
Target Price	S\$0.40
Shares Outstanding	214m
Free Float	19%
Major Shareholder	Ong Family 80%

P/BV (06/21)	2.1x
Net Debt to EBITDA (06/21)	net cash

Source: Company data, Bloomberg, SAC Capital

Analyst

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Home-grown branded food vying for the region

An established local brand for processed meat products.

Established in 1994, OTS produces and sells ready-to-eat and ready-to-cook meat products under house brands such as “Golden Bridge” and “Kelly’s” in SE Asia. The products are available in four formats: chilled, frozen, dried and shelf-stable, and sold in supermarkets and convenience stores, through wholesalers and e-commerce platforms, and to the foodservice sector.

COVID drag on FY21 (Jun) (revenue +11.5%, EBITDA +8.9%).

The headwinds were: 1) Singapore’s stockpiling drive resulted in orders being front-loaded to 2H20 and 1H21; 2) production disruption from labour shortage. OTS is accelerating automation to cut labour content; 3) higher costs to retain workers; 4) restrictions on dine-in lowered demand from foodservice operators; 5) supply chain bottleneck held back marketing push into the overseas markets. NPAT grew 9.6% if we stripped out wage grant and IPO expenses.

The growth drivers are: 1) Greater market penetration into Malaysia, the Philippines and Indonesia as pandemic subsidies and these economies rebound. OTS made inroads into Malaysian foodservice sector in early 2020 before COVID hit. It plans to commence sales in the Philippines in Nov 2021 to take on competitor brand SPAM. In Indonesia, it has a 50:50 JV with Salim Group to produce and sell processed meat products. 2) Distribution of third-party food products through its regional distribution network; 3) Launch of in-house developed plant-based protein alternative products in Apr 2022, to tap on the trend towards healthier lifestyle.

Heading off competition. Despite its smaller size, latest ROIC of 20.1% is comparable with peers (Hormel 18.3%, Shanghai Maling 23.3%, Danish Crown 7.1%). EBIT margin of 10.8% is slightly lower than Hormel’s 11.5%, but above Maling’s 4.4% and Crown’s 4.5%.

BUY at TP of S\$0.40. Branded food companies command a premium taking into account: 1) brand recognition and customer stickiness; 2) food being a resilient sector; and 3) increased emphasis on food security. The DCF-derived TP is S\$0.40 (COE 10.9%).

YE 30 Jun (S\$m)	FY19A	FY20A	FY21A	FY22E	FY23E
Revenue	26.3	34.5	38.5	50.9	53.8
EBIT	1.3	4.7	4.2	6.6	7.0
Net profit	1.6	3.6	3.0	5.3	5.6
EPS (S cents)	0.9	2.0	1.4	2.5	2.6
DPS (S cents)	-	-	0.7	1.2	0.5
Net cash / (debt)	(0.7)	(0.2)	11.5	9.2	13.5
Valuation					
EBIT margin (%)	4.8	13.5	10.8	13.0	13.0
ROIC (%)	9.5	16.3	20.1	20.8	21.9
EV/EBITDA (x)	6.9	4.6	4.8	3.7	3.5
P/E (x)	33.2	14.8	21.1	12.0	11.3
Dividend yield (%)	-	-	2.4	4.1	1.8

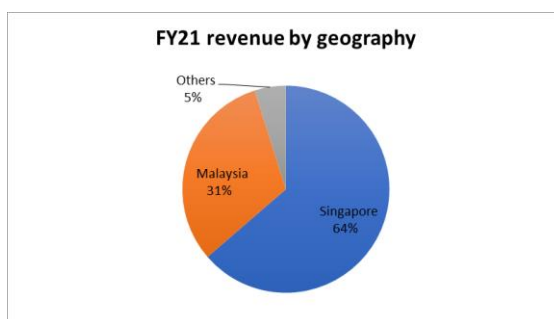
Background

OTS is a meat product manufacturing company. Its products are ready-to-eat (RTE) and ready-to-cook (RTC) and grouped into four types: chilled, frozen, dried and shelf-stable. The RTE and RTC food categories are gaining popularity with smaller household size and pursuit of convenience and ease of preparation. The shelf-stable products are also preferred for easy storage and longer shelf life.

OTS carries more than 1,100 SKUs across 13 main product types under 6 house brands, catering to both halal and non-halal consumer segments. OTS also produces seasonal food products such as roast meats, hams and pork knuckles during festive periods such as Chinese New Year and Christmas.

The retail brands are “Golden Bridge”, “Kelly’s” for non-halal products, and “El-Dina” for halal products. For the foodservice sector, the products are sold under house brands “GoldenLion” and “Orcid” for non-halal, and “Kizmiq” for halal items.

The products are sold in major supermarkets, convenience stores, provision shops, hotels and restaurants in Singapore and Malaysia. Through wholesalers, the products are also available in more than 25 countries, such as Brunei, Hong Kong, Myanmar, India and the EU.



Products sold in Malaysia are produced by a Malaysian-based contract manufacturer, and sold under OTS' house brands “El-Dina”, “Kizmiq” and “Orchid”.

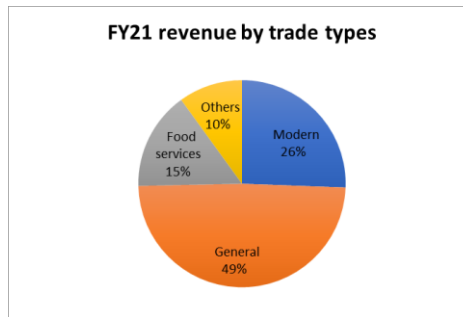
OTS is also the sole agent and distributor in Singapore for the brand “Heng’s”. This is a third party brand originating from Malaysia. OTS market and sell Heng’s brand of products such as sauces, condiments, herbs and spices, capitalizing on its established distribution network. OTS plans to add more brands to its portfolio for complementary shelf-stable food items in FY22. We expect distribution to contribute 5% of sales in FY22E.

Demand for their products are seasonally higher during festive periods such as Christmas and Chinese New Year. Orders from merchandisers and distributors are received one to 2 months ahead. Depending on the month in which CNY falls in, fiscal Q2, and to a lesser extent, Q3 are the two high seasons for sales.

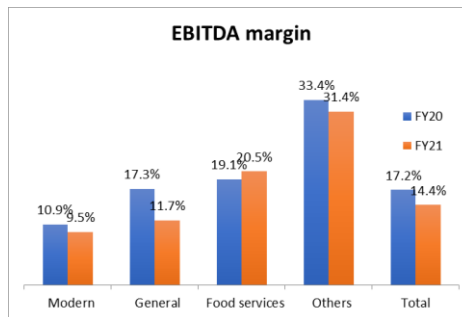
OTS has embarked on R&D of plant-based protein alternative products. The first product, canned plant-based luncheon meat, is expected to be launched in April 2022. While it is too early to ascertain the level of market acceptance and price points, this gives them the first-mover advantage in the canned plant-based ready-to-eat and ready-to-cook segment with a longer shelf life.

Sales channels

OTS sells through all channels, broadly classified as modern trade, general trade, foodservices and others.



Modern trade consists of supermarkets and hypermarkets, such as NTUC and Sheng Siong. Modern trade is important for creating brand awareness, but profitability is lower as OTS has to incur listing fee and higher advertising spend through participation in the store promotional activities.



General trade comprises minimarts, convenience stores and provision shops, which are located nearer to housing estates and residential areas. During COVID lockdowns and more working from home, consumers avoided the malls and shopped nearer their homes.

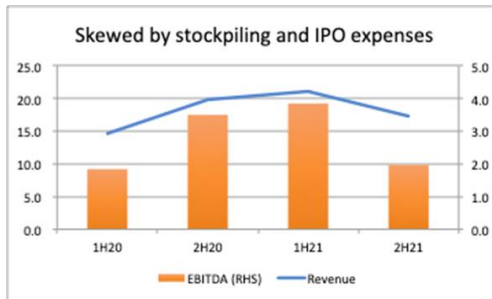
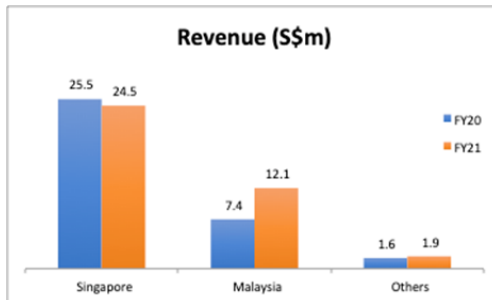
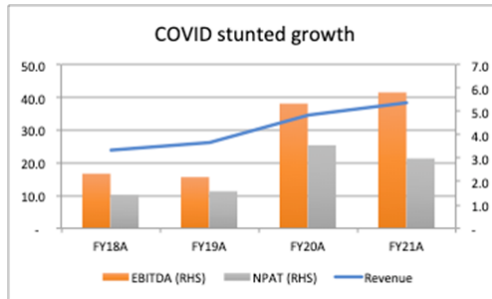
Their products are sold as food ingredients to food service operators that include hotels, restaurants, airlines, caterers, quick service restaurants, bakeries, clubs, cafes and pubs. Sales to these customers are expected to rebound with gradual relaxation of mobility restrictions and dine-in at F&B outlets. The foodservice sector have grown during COVID with the sprouting of cloud kitchens that support budding cooks without physical retail presence. The Malaysian food service market, which OTS made its first foray before COVID movement control orders hit, is likely pick up when the lockdowns are lifted.

The remaining sales are derived from e-commerce platforms and export markets. Besides selling on its own websites. OTS also sells via B2C arrangements with third party sites such as Qoo10 and Shopee. It also has B2B arrangements with e-commerce players Amazon and Redmart who buy direct from OTS..

The export markets are promising as OTS gears up to commence sales in the Philippines (from Nov 2021), Indonesia and the EU. The EU-Singapore free trade agreement, effective Nov 2019, removes tariffs on certain Singapore products exported to EU over 3 to 5 years (by Nov 2024). The UK has a similar agreement effective 1 Jan 2021. OTS' plants are 2 out of 3 meat processing plants in Singapore that have obtained approval to export meat products to the EU.

Financial performance

COVID-fuelled pantry stocking and Singapore Government's stockpiling initiative resulted in order front-loading of orders from the Singapore supermarkets in 2H20 and spilled over to 1H21. As Singapore progressively lift mobility restrictions from Jan 2021, the channel inventories were run-down in 2H21, negatively impacting OTS' sales in 2H21. Malaysia sales could be higher if not for MCO.



OTS faced manpower shortage as some foreign workers left for home and its plants were operating at sub-optimal capacity. It also incurred higher costs to house the foreign workers. Border controls also resulted in supply chain bottlenecks, and hampered marketing efforts in the Philippines and Indonesia. Excluding one-off IPO expenses and government grant, NPAT would be 9.6% higher.

Cash flow generated from operations was S\$7.1m, or S\$0.033/share. With S\$7.7m raised from the IPO in Jun 2021, net cash at Jun 21 amounted to S\$11.5m (or S\$0.054/share). ROIC was 20.1%, well ahead of the Singapore listed branded food producers.

We expect sales to grow by 32% in FY2022 (Jun) as channel inventory at the modern and general trade in Singapore normalizes and re-stocking resumes, and demand from food service operators grow with greater relaxation of dine-in and tourism. A higher vaccination rates in the regional markets could see a rebound in economic activities. With high operating leverage, we expect EBITDA margin to rise by 0.6ppt to 15.7% and net margin to recover to 10.3% (FY21: 7.8%).

Manufacturing base

OTS owns and operates three plants, 2 in Singapore (1 each for halal and non-halal meat products), and 1 in Bulan Island, Indonesia (via a 45% JV with the Salim Group).

Production location	Capacity	Products
Singapore	2,500 tonnes	Ready-to-eat and ready-to-cook meat products
Indonesia	140 tonnes	Chinese sausages

In Malaysia, the manufacturing is outsourced to a halal-certified contract manufacturer. OTS supplies all raw materials, premix ingredients and packaging, and provides production equipment to the contract manufacturer. The outsourced products include chicken meat loaves, corned beef and corned chicken products that are marketed under OTS' house brands "El-Dina", "Kizmiq" and "Orchid" in Malaysia.

Joint Venture with the Salim Group

In March 2019, OTS set up a 50:50 joint venture with Hogsworld Pte Ltd (part of Salim's KMP Group) to process pork related product in Bulan Island, Indonesia. The Salim group runs pig and chicken farming in Bulan Island, Indonesia and is the largest exporter to Singapore.

The JV manufactures under OTS' house brand "Orchid" for sale in Indonesia. The plant currently produces Chinese sausages with an annual production capacity of ~140 tonnes. The expansion plan was put on hold when COVID hit. When the border re-opens, the plant will manufacture canned meat products by early 2022. OTS could tap on Salim Group's distribution network to penetrate the Indonesian markets.

Competition

The canned meat product market is highly competitive. Its closest competitive brands for core canned luncheon meat products are SPAM by Hormels, Tulip by Danish Crown, and Maling by Shanghai Maling. These companies are global players with a wide range of products and service offerings including restaurants and catering. Canned meat products account for an insignificant percentage of sales. The world's largest meat processor WH Group produces sausages that differ in tastes and do not compete directly with OTS.

Despite its smaller scale, OTS' EBIT margin of 10.8% and ROIC of 20.1% are comparable and even ahead of some of the bigger peers.

In S\$m	BBG	YE	Mkt cap	Revenue	EBIT	EBIT margin	ROIC	ROE
OTS	OTS SP	06/21	63	39	4	10.8%	20.1%	10.1%
WH Group	288 HK	12/20	14,734	34,545	1,958	5.7%	8.8%	8.3%
Hormel	HRL US	12/20	538	12,971	1,485	11.5%	18.6%	14.1%
Shanghai Maling	600073 CH	12/20	938	7,637	336	4.4%	23.3%	12.3%
Danish Crown	unlisted	09/20	-	13,375	598	4.5%	7.1%	26.8%

Valuation

OTS' historical valuation is in line with the other food and ingredients producers. However, owing to its smaller size, it has the potential to grow at a faster rate compared with peers.

Due to thin trading volume and a diverse range of products, there is a wide variance in valuation among the Singapore listed branded consumer companies.

We arrived at an equity value of S\$86m or S\$0.401/share on DCF at cost of equity of 10.9% and a terminal growth rate of 3%. At this valuation, the forward PER is 16.3x and 15.3x for FY22E and FY23E, respectively. EV/EBITDA is 9.6x and 8.6x for the two years.

(in S\$m)	BBG	YE	Mkt cap	Revenue	EBIT	EBIT margin	ROE	ROIC	EV/EBITDA (x)	EBIT/EV	PER (x)	PBR (x)
OTS	OTS SP	6/21	63	39	4	10.8%	10.1%	20.1%	8.87	8.1%	21.12	2.13
<i>Food ingredients - pork</i>												
WH Group	288 HK	12/20	15,732	34,545	1,958	5.7%	8.3%	8.8%	6.12	11.4%	14.07	1.16
Hormel	HRL US	10/20	32,626	12,971	1,485	11.5%	14.1%	18.6%	18.69	4.6%	26.61	3.76
Shanghai Maling	600073 SH	12/20	2,254	7,637	336	4.4%	12.3%	23.3%	5.85	15.2%	17.40	2.14
Danish Crown	unlisted	09/20	-	13,375	598	4.5%	26.8%	7.1%	-	-	-	-
<i>Branded consumer</i>												
Del Monte Pacific	DELM SP	04/21	680	2,920	284	9.7%	10.9%	7.9%	4.41	11.9%	7.97	0.87
Delfi	DELFI SP	12/20	501	520	41	7.8%	7.7%	11.2%	7.88	8.5%	21.24	1.65
Hosen	HOSEN SP	12/20	21	71	4	5.7%	9.3%	11.7%	4.84	15.8%	7.12	0.66
QAF	QAF SP	12/20	535	562	57	10.1%	5.4%	0.0%	5.84	11.4%	19.29	1.04
Khong Guan	KGL SP	07/20	41	61	1	0.9%	0.1%	0.1%	(59.05)	1.7%	804.06	0.67

Income Statement

FYE 30 Jun (\$m)	FY20A	FY21A	FY22E	FY23E
Revenue	34.5	38.5	50.9	53.8
Cost of sales	(23.1)	(25.4)	(33.6)	(35.5)
Gross profit	11.5	13.1	17.3	18.3
Other income	0.2	0.1	0.1	0.1
Selling & distribution	(2.1)	(2.1)	(2.8)	(3.0)
Operating expenses	(4.3)	(5.3)	(6.6)	(7.0)
EBITDA	5.3	5.8	8.0	8.4
Depreciation	(1.2)	(1.3)	(1.4)	(1.4)
Associates & JV	(0.1)	(0.1)	-	-
Exceptional items	0.6	(0.3)	-	-
EBIT	4.7	4.2	6.6	7.0
Finance costs	(0.3)	(0.3)	(0.3)	(0.3)
Pretax profit	4.4	3.9	5.3	5.6
Tax expense	(0.8)	(0.9)	(1.1)	(1.1)
Minority interests	-	-	-	-
Net profit	3.6	3.0	5.3	5.6

Balance Sheet

FYE 30 Jun (\$m)	FY20A	FY21A	FY22E	FY23E
Assets				
Fixed assets	11.1	10.9	11.5	11.1
ROU assets	3.4	3.3	3.3	3.3
Associates & JV	0.4	0.8	0.8	0.8
Others	0.1	4.5	4.5	4.5
Non-current assets	15.0	15.0	15.6	15.1
Inventories	10.0	7.8	9.2	9.7
Trade receivables	6.0	6.0	9.1	9.6
Other non-financial assets	0.3	0.5	0.5	0.5
Cash	5.0	15.9	13.5	17.8
Current assets	21.3	30.2	32.3	37.6
Total assets	36.3	45.2	47.9	52.8
Liabilities				
Bank loans	1.4	1.1	1.1	1.1
Trade payables	6.0	6.0	5.5	5.8
Lease liabilities	0.3	0.3	0.3	0.3
Other non-financial liabilities	0.4	0.1	0.1	0.1
Tax provisions	0.1	0.5	1.1	1.1
Current liabilities	8.1	8.0	8.1	8.5
Bank loans	3.9	3.2	3.2	3.2
Provisions	0.6	0.6	0.6	0.6
Deferred tax	0.2	0.4	0.4	0.4
Lease liabilities	3.3	3.2	3.2	3.2
Other non-financial liabilities	0.2	0.1	0.1	0.1
Non-current liabilities	8.2	7.5	7.5	7.5
Net assets	20.0	29.6	32.3	36.7
Equity				
Share capital	14.8	22.5	22.5	22.5
Other reserves	(0.0)	(0.0)	(0.0)	(0.0)
Retained earnings	5.2	7.2	9.8	14.3
	20.0	29.6	32.3	36.7
Minority interests	-	-	-	-
Total equity	20.0	29.6	32.3	36.7

Cash Flow

FYE 30 Jun (\$m)	FY20A	FY21A	FY22E	FY23E
Pretax profit	4.4	3.9	6.3	6.7
Depreciation & amortisation	1.2	1.3	1.4	1.4
Associates & JV	0.1	0.1	-	-
Net finance expense	0.3	0.3	0.3	0.3
Non-fund items	(0.1)	0.0	-	-
Working capital changes	(4.1)	1.9	(4.9)	(0.7)
Interest paid	(0.1)	(0.1)	(0.3)	(0.3)
Dividend from associates	-	-	-	-
Tax paid	0.0	(0.3)	(0.5)	(1.1)
Operating cash flow	1.7	7.1	2.3	6.4
Capex	(0.5)	(1.0)	(2.0)	(1.0)
Net investments	(0.5)	(0.5)	-	-
Fixed assets disposal	0.1	-	-	-
Others	(0.1)	0.1	-	-
Investing cash flow	(0.9)	(1.3)	(2.0)	(1.0)
Free cash flow	0.8	5.8	0.3	5.4
Dividend paid	-	(1.5)	(2.6)	(1.1)
Borrowings	1.8	(1.1)	-	-
Equity	-	7.7	-	-
Financing cash flow	1.8	5.1	(2.6)	(1.1)
Net change	2.6	10.8	(2.3)	4.2

Ratios

FYE 30 Jun (\$m)	FY20A	FY21A	FY22E	FY23E
Profitability (%)				
Gross margin	29.7	30.6	31.3	31.3
EBIT margin	13.5	10.8	13.0	13.0
Liquidity (x)				
Current ratio	2.6	3.8	4.0	4.4
Net Debt/EBITDA	3.9	3.0	4.7	
Interest coverage ratio	7.0	9.8	8.7	9.9
Net Debt to Equity (%)	4.0	Net cash	Net cash	Net cash
Valuation (x)				
P/E	14.8	21.2	12.0	11.3
P/B	2.6	2.1	2.0	1.7
EV/EBITDA	4.6	4.8	3.7	3.5
Cash Conversion Cycle				
Trade receivable days	64	57	65	65
Inventory days	157	112	100	100
Trade payable days	94	86	60	60

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