

# Koda Limited

30 July 2021

**HOLD**  
**(Initiation)**

**Target Price: S\$1.00**

<b>BBG</b>	KODA SP								
<b>Market cap</b>	S\$75m								
<b>Price (26 July 2021)</b>	S\$0.90								
<b>52-week range</b>	S\$0.40 – S\$0.915								
<b>Target Price</b>	S\$1.002								
<b>Shares Outstanding</b>	82.8m								
<b>Free Float</b>	36.96%								
<b>Major Shareholders</b>	<table> <tr> <td>James Koh Jyh Gang</td><td>13.31%</td></tr> <tr> <td>Koh Teng Kwee</td><td>11.39%</td></tr> <tr> <td>Koh Jyh Eng</td><td>10.79%</td></tr> <tr> <td>Koh Shwu Lee</td><td>10.01%</td></tr> </table>	James Koh Jyh Gang	13.31%	Koh Teng Kwee	11.39%	Koh Jyh Eng	10.79%	Koh Shwu Lee	10.01%
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Koh Shwu Lee	10.01%								
<b>P/BV (12/20)</b>	1.4								
<b>Net Debt to EBITDA (12/20)</b>	Net cash								

Source: Company data, Bloomberg, SAC Capital

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## Furniture ODM manufacturer and brand owner

**Established in 1972, Koda is an ODM manufacturer for well-known retail brands.** ODM manufacturing accounts for 82% of revenue. The manufactured products are sold to North America (67.4%), Europe (10.4%) and Asia (22.2%). Koda also owns the brand Commune for mid- to high-end market. The products are sold in 85 stores across Asia Pacific, with 88% of these in China.

**Work-from-home and reduced mobility has driven higher demand for home renovation and improvements.** Fiscal stimulus handouts have raised household savings rate and propensity to spend on goods. In the US, sales at furniture stores surged 49.5% in the first five months of 2021. YT Apr 2021, Singapore's furniture and household equipment sales rose 22.7% yoy.

**Earnings growth catalysts in the next few years are:** 1) Higher home sales. Fueled by low interest rates and ample liquidity, home sales are hitting record volume in many countries. This will underpin for furniture and furnishing; 2) Raise capacity. Koda will raise production capacity in 2022 to cater to the higher demand. Production capacity is expected to increase by approximately 30% once operations are normalized in the new factory. 3) New product. The company plans to ramp up production of sofa sets as demand increase. Sofa sets are easier to produce because the process is relatively straightforward. 4) Greater penetration of Commune. It plans to grow the number of Commune stores to 100 by 2022, through rolling out more franchise stores in China. A larger store network will allow it to enjoy operating leverage.

Near term concerns include 1) tightened mobility restrictions in Malaysia and Vietnam to cope with a resurgence of COVID cases; and 2) increased adoption of e-commerce sales for furniture. Unlike in the past, furniture brands now face global competition. Those with weak online presence will face greater pressure.

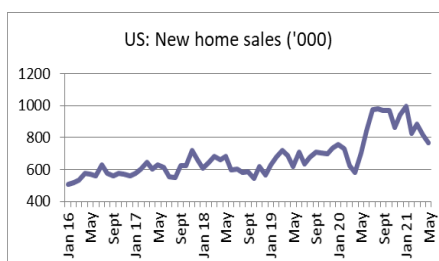
**HOLD. Price target of S\$1.00.** Our price target of S\$1.00 is derived from DCF based on WACC of 13.5%. The share is trading at 4.9x FY21E EV/EBITDA and net earnings are projected to grow at 56% and 29% in FY21E and FY22E.

FY ended 30 Jun (in US\$m)	FY2018	FY2019	FY2020	FY2021E	FY2022E
Revenue	52.4	57.9	60.4	73.0	85.7
EBIT	6.0	5.8	4.8	8.1	10.5
Net profit	5.4	5.3	4.3	7.3	9.4
EPS (US cents)	6.6	6.4	5.3	8.8	11.4
Dividend per share (S cents)	1.8	2.5	1.3	1.3	1.3
Net cash / (debt)	9.9	13.0	13.7	17.1	20.7
<b>Valuation</b>					
EBIT margin (%)	11.5	9.9	7.9	11.1	12.2
ROIC (%)	22.2	21.1	15.4	21.5	24.3
EV/EBITDA (x)	5.9	5.7	6.7	4.9	3.8
P/E (x)	8.4	8.6	10.5	9.1	7.0
Dividend yield (%)	2.4	3.4	1.7	1.7	1.7

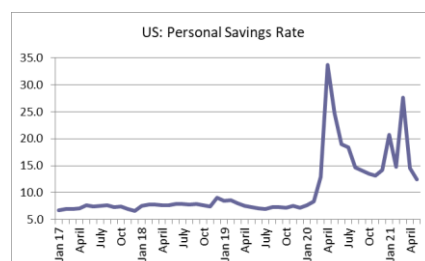
## Investment Summary

### Robust demand for homes and home renovation

COVID had altered consumer behavior. Remote working from home and need for more space and comfort in the living environment have raised demand for home improvements and renovation. Demand for new homes have also risen, as employees have more options to move to a remote region and enjoy lower-cost and bigger living space.



Source: US Census Bureau



Source: Federal Reserve Economic Data

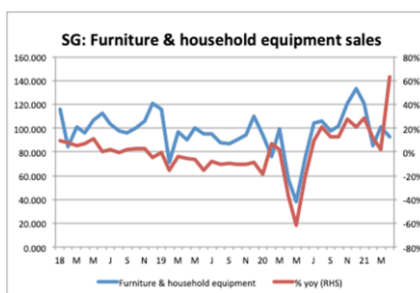
Another key underlying factor is the generous fiscal handouts given to help workers tide over the job losses and reduced income during the lockdowns. The additional liquidity boosts spending on goods in particular as non-essential consumer services were prohibited to operate.

Fiscal stimulus bills have also lifted personal savings rate. Although this has slowed to 12.4% in May, from 27.6% in Mar, the level is still 60% higher than the average 7% before COVID hit. North America accounts for 55% of Koda Group sales.

### Leading to higher demand for furniture

In the US, furniture stores recorded 49.5% increase in sales in the first five months of 2021. Singapore's Apr 21 sales of furniture and household equipment was 3.2% higher than Apr 19. YTD Apr 2021, total furniture and household equipment sales rose 22.7% yoy. Similar trends are reported by the US major retail stores as well. Crate & Barrel saw an increase of 11.6% (FY2020: EUR 12,087m, FY2019: EUR 10,828m).

Similarly Williams Sonoma and Pottery Barn saw an increase of 20.3% (FY2020: US\$1,242.3m FY2019: US\$1,032.4m). and 14.1% in sales (FY2020: US\$ 2,526.2m, FY2019: US\$ 2,214.4m) respectively.



Source: Singapore Department of Statistics

## Investment Summary

### Adding capacity

Koda has newly acquired 1 piece of land with a factory in Vietnam in March 2021. The factory will help to raise its production capacity to better cope with increasing demand from its ODM customers. Currently, the factory is being fitted with equipments and is building the 2<sup>nd</sup> floor. The factory is slated to start production in Jan 2022 and will contribute approximately an additional 30% production capacity as operations normalized.

Additionally, Koda has also acquired 2 pieces of industrial plots in Vietnam in Nov 2019. It plans to commence in-house production of sofa. As the production processes are relatively straight forward, Koda can easily take on the production with its manufacturing capabilities. Current demand comes from its current ODM customers which are manufactured in rented factory. Koda expects demand for sofa to climb and as demand builds to a scalable level, it can start its sofa production in these purchased plots and take on more sofa orders.

### Greater penetration of Commune

It plans to grow the number of Commune stores to 100 by 2022, through rolling out more franchisee stores in China. A larger store network will allow it to enjoy operating leverage. Its own flagship store will also be open in Shanghai by Dec 2021 to further establish their brand name in the market. Commune could also work with property developers in China to supply customized furniture for new property projects to lock in corporate customers.

Additionally, It has signed a dealership arrangement in Denmark to bring its concept to EU market. Sales is expected to start at end of FY2021. While Commune also plans to enter the Indian market, its efforts are hampered by the pandemic.

## Investment Summary

### Risks

#### **Suspension of operations in Malaysia & Vietnam**

On 13 July, its Vietnam plant has been directed to halt operations temporarily in a bid to contain high COVID-19 infections. Koda is working on getting authority's approval to resume manufacturing operations as soon as possible.

The impact will not be reflected in Koda's FY2021 financials as their year ended June. Going forward, it is expected that July's production output will reduce accordingly with the decrease in labor numbers. In the meantime, Koda will draw down on its inventory to fulfil orders. Malaysia operation remains closed due to extension of MCO. Malaysia accounts for approximately 20% of total capacity, and the impact is likely not material.

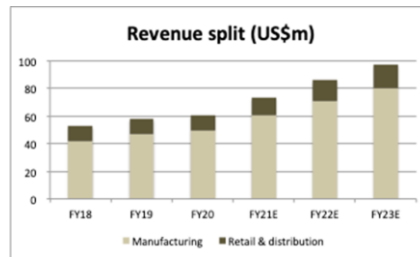
#### **Rising trend of e-commerce for furniture sales**

Online sales in China takes up 58% of total furniture sales with an estimated value of over US\$68.6bn in 2019. (Mordor Intelligence), from 53% in 2017 and 54% in 2018. The trend is expected to continue as e-commerce gains further traction. Rising e-commerce sales poses a threat to physical stores.

Nevertheless, for higher-priced products, customers still prefer to visit a physical store to view the items before making purchase decisions. Therefore physical stores are still relevant for sales conversion. Currently, Online to Offline (O2O) marketing is the "new retail" which combines both online and offline experience to provide consumers with a seamless and enjoyable retail journey. With only 12% of purchasing decisions happened entirely online (McKinsey), new retail will generate more revenue than either online or offline presence on its own. Koda has its own website in Singapore showcasing its product catalogue. It is also present on e-commerce platforms such as Lazada, Shopee and Taobao.

## Background

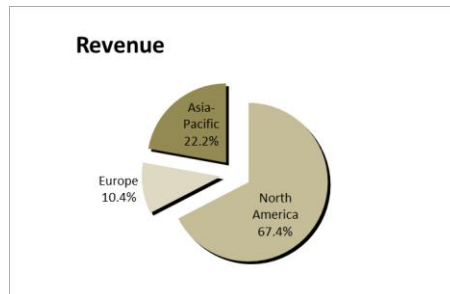
Established in 1972 and listed on SGX in 2002, Koda is an Original Design Manufacturer for furniture production. It started from a small workshop in Singapore, and has expanded its production operations to Malaysia and Vietnam.



Source: Company data

### Furniture manufacturing for ODM customers

Pertaining to its ODM business, Koda manufactures a diverse range of furniture for major well-known brands such as Crate and Barrel (under listed Otto Group) and Pottery Barn under listed Williams Sonoma in the US, Canada and Europe. This segment accounts for 82% of sales. The products are produced at its plants in Vietnam and Malaysia. The customers are mainly in North America (67.4%), Europe (10.4%) and Asia (22.2%).



Source: Company data

### Retailing and distribution under house brand Commune

Koda launched its house brand Commune in 2011. Commune purchases its products from inhouse from Koda and other manufacturers as well.

Commune targets high-end customers with its trendy and contemporary lifestyle furniture and home accessories. Its products include furniture for the living, dining, bedroom and home office. Commune also offer home decor, soft furnishings, tableware and lightings.

Commune's products are sold on its website as well as retail outlets. The products are sold in 85 Commune stores, of which 4 in Singapore and the remaining 81 are set up and run by distributors. 75 of these stores are in China and it plans to expand its store franchise network to 100 by 2022. The opening of a flagship store in Shanghai to exhibit its catalogue of furniture is also in the pipeline.

## Background

Commune also has presence in Hong Kong, Malaysia and Philippines. It has plans to open more outlets in China to further establish its brand presence in the country. Its target customers are first-time homeowner and homeowners who want to refurnish their house. With the shift to work from home arrangement, there is also an increase in demand from office workers who want to build a conducive workspace in their home.

Commune has a sister brand, Alto, which targets a different demographic from Commune. Alto creates bigger and more luxurious furniture pieces such as larger sofa sets and longer dining tables that fit into bigger houses. China, India and Europe are key markets as they do not face the problem of land constraint as seen in Singapore and they generally have bigger houses. There are currently 8 retail outlets, 7 in China and 1 in Singapore.

Retailing and distribution account for 18% of sales. Unlike a typical franchise model, Commune does not collect franchise fees from the franchise stores. Instead, their products are sold directly to the franchisees, taking in the wholesale margin while their franchisees earn the retail margin when they sold the products to the customers. Sales are recorded in the books only when their products are sold at the retail side. Inventories are also controlled by Commune. After selling and distribution costs, net margin for the two business segments are fairly similar. With a high operating leverage, a bigger retail network and higher revenue is positive for margins.

## Production plants

Koda manufactures white label furniture for major retail brands out of its factories in Malaysia and Vietnam. Main production comes from Vietnam with Malaysia production contributing only approximately 20% of output. Lot D14 industrial land and factory in Vietnam are newly added in 2021 to help increase its current production capacity by approximately 30% once the factory starts operating and production is stabilized.

	Space (sq ft)	Location
Malaysia Industrial Land and Factory Building	572,963	Lot 9, Lot 15, Title No GM 10, Mukim Senai-Kulai, 81400 Senai, Johor, Malaysia
Vietnam Industrial Land and Factory Building	665,684	Lot A1, A4, A5 & A6, Thuan Dao Industrial Zone, Ben Luc District, Long An Province, Vietnam
Vietnam Industrial Land	322,920	Lot C11 & C12, Road 14, Thuan Dao IP's Expansion Phase, Long Dinh Commune, Can Duoc District, Long An Province, Vietnam
Vietnam Industrial Land and Factory Building	239,400	Lot D14, Road No. 09, Thuan Dao IP's Expansion Phase, Long Dinh Commune, Can Duoc District, Long An Province, Vietnam
<b>Total area</b>	<b>1,800,967</b>	

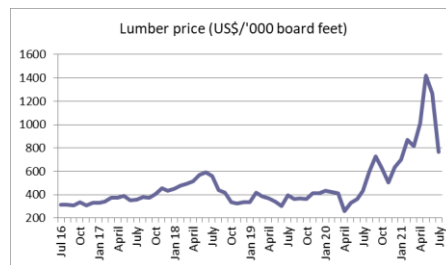
Source: Company Data

## Financial projections

### Production cost

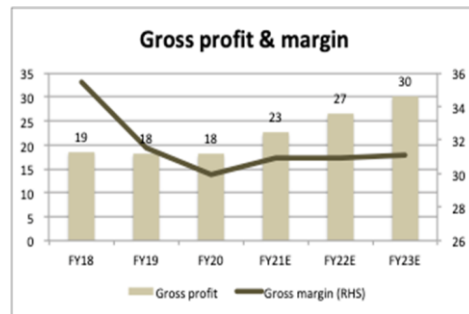
The furniture making industry is highly fragmented, and they cater to big retail brands which dominate the retail scene. Effective cost management is critical to ensure profitability.

We estimate that the cost of production comprises 65-75% raw materials, 20-25% labour and subcontractor costs and 10-15% production overheads. We believe wood accounts for bulk of raw materials among metal, leather, foam and fabrics. The price of lumber spiked in early May 2021, but have since eased to about US\$750-800 per thousand board feet. Koda has passed on some of the price increase to its customers.

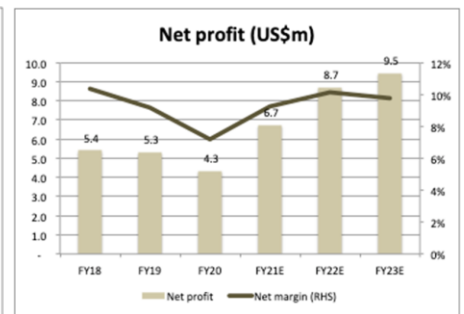


Source: Nasdaq

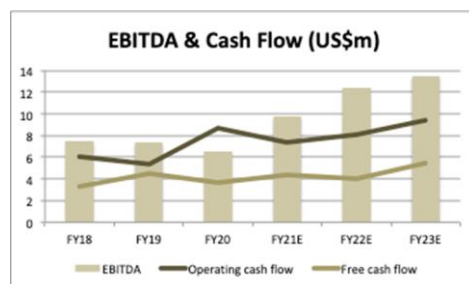
The gross margin trend has reflected the higher share of manufacturing revenue (~82%). Going forward, even with more Commune stores, we expect manufacturing revenue to rise at a higher rate, holding gross margin at about 31.5%. Their operations has been generating good cash flows. ROE was 11% in FY20 in spite of US\$14m net cash in its books.



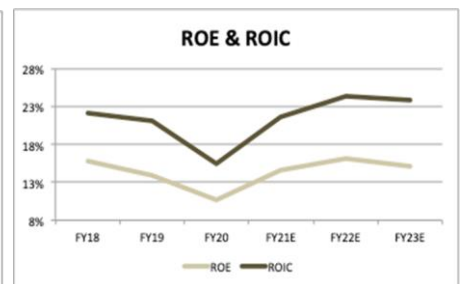
Source: Company data



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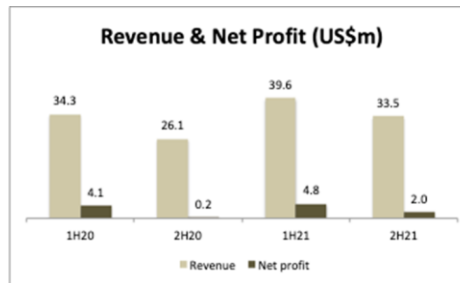
Source: Company data

## Financials projection

### 1H21 (ended Dec 20) earnings performance

1H21 revenue rose 15.5% to US\$39.6m, spectacular when considering 1H20 was before COVID. Some of this could have been spilled over from 2H20 when mobility restrictions affected output and consumer spending. Net profit was 15.7% higher yoy to US\$4.8m, exceeding FY20A net profit, as 2H20 profit was negligible.

Our projections have taken into consideration the recent tightened mobility restrictions in Malaysia and Vietnam amidst the resurgence of COVID cases.



Source: Company data



## Income Statement

YE 30 Jun					
US\$m	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Revenue</b>	<b>52.4</b>	<b>57.9</b>	<b>60.4</b>	<b>73.4</b>	<b>85.8</b>
Cost of sales	(33.8)	(39.6)	(42.3)	(50.6)	(59.3)
<b>Gross profit</b>	<b>18.6</b>	<b>18.2</b>	<b>18.1</b>	<b>22.8</b>	<b>26.6</b>
Other income	0.7	0.8	1.2	1.0	1.0
Distribution costs	(5.4)	(5.0)	(5.3)	(6.2)	(7.1)
Admin expenses	(7.3)	(8.1)	(9.1)	(9.0)	(9.5)
Other income/ (expenses)	(0.5)	(0.2)	(0.1)	(0.5)	(0.5)
<b>Operating profits</b>	<b>6.0</b>	<b>5.8</b>	<b>4.8</b>	<b>8.1</b>	<b>10.5</b>
Share of results of associates	0	0	0	0	0
Government grant	0	0	0.4	0.4	0
<b>EBIT</b>	<b>6.0</b>	<b>5.8</b>	<b>4.8</b>	<b>8.1</b>	<b>10.5</b>
Interest income	0	0	0	0	0
Interest expense	0	0	(0.2)	(0.1)	(0.1)
<b>Profit before tax</b>	<b>6.0</b>	<b>5.7</b>	<b>4.6</b>	<b>8.0</b>	<b>10.4</b>
Tax expense	(0.6)	(0.4)	(0.5)	(1.4)	(1.8)
Minority interests	0	0	0.2	0.1	0.1
<b>Net profit</b>	<b>5.4</b>	<b>5.3</b>	<b>4.3</b>	<b>6.7</b>	<b>8.7</b>

## Ratios

YE 30 Jun					
	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Profitability (%)</b>					
Gross margin	35.5	31.5	29.9	31.0	31.0
Pretax margin	11.4	9.9	7.7	10.9	12.1
<b>Liquidity (x)</b>					
Current ratio	3.0	3.9	2.8	2.9	3.2
Quick ratio	1.9	2.5	1.9	1.9	2.1
Interest coverage ratio	188.3	192.0	30.5	81.1	104.7
Net Debt to Equity (%)	29	34	34	37	37
<b>Valuation (x)</b>					
P/E	8.4	8.6	10.5	9.1	7.0
P/B	1.3	1.2	1.1	1.3	1.1
EV/EBITDA	5.9	5.7	6.7	4.9	3.8
<b>Cash Conversion Cycle</b>					
Trade receivable days	27	22	22	20	20
Inventory days	103	97	98	98	98
Trade payable days	30	21	23	23	23
CCC days	100	98	97	95	95

## Balance Sheet

YE 30 Jun					
US\$m	FY18A	FY19A	FY20A	FY21E	FY22E
PPE	17.1	16.1	13.6	15.3	17.4
ROU assets	0	0	5.9	5.9	5.9
Club membership	0.2	0.2	0.2	0.2	0.2
Deferred tax	0.1	0.1	0.2	0.2	0.2
Prepayment, deposits & other receivables	0	0	3.7	3.7	3.7
<b>Total non-current assets</b>	<b>17.3</b>	<b>16.4</b>	<b>23.6</b>	<b>25.3</b>	<b>27.4</b>
Cash	10.5	13.4	16.4	19.7	22.8
Inventories	9.6	10.6	11.3	13.6	15.9
Trade receivables	3.9	3.4	3.6	4.0	4.7
Prepayment, deposits & other receivables	2.5	2.7	2.6	2.6	2.6
<b>Current assets</b>	<b>26.4</b>	<b>30.1</b>	<b>34.0</b>	<b>40.0</b>	<b>46.0</b>
<b>Total assets</b>	<b>43.8</b>	<b>46.5</b>	<b>57.7</b>	<b>65.3</b>	<b>73.4</b>
Bank overdrafts	(0.2)	(0.2)	(1.0)	(1.0)	(1.0)
Accounts payable	(2.8)	(2.3)	(2.7)	(3.2)	(3.7)
Accruals & other payables	(5.3)	(5.0)	(6.6)	(7.0)	(6.6)
Bill payables	(0.1)	0	0	0	0
Finance lease	0	0	(1.2)	(1.2)	(1.2)
Income tax payable	(0.4)	(0.3)	(0.6)	(1.4)	(1.8)
<b>Total current liabilities</b>	<b>(8.7)</b>	<b>(7.8)</b>	<b>(12.2)</b>	<b>(13.8)</b>	<b>(14.4)</b>
Borrowings	(0.4)	(0.2)	(1.7)	(1.7)	(1.7)
Deferred tax	(0.3)	(0.2)	(0.3)	(0.3)	(0.3)
Finance lease	0	0	(3.0)	(3.0)	(3.0)
<b>Total non-current liabilities</b>	<b>(0.7)</b>	<b>(0.4)</b>	<b>(5.0)</b>	<b>(5.0)</b>	<b>(5.0)</b>
<b>Net assets</b>	<b>34.3</b>	<b>38.2</b>	<b>40.5</b>	<b>46.5</b>	<b>54.1</b>
Share capital	4.5	4.7	4.8	4.8	4.8
Treasury shares	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Reserves	0.9	0.6	0.1	0.1	0.1
Retained earnings	28.9	33.0	35.9	41.6	49.3
Minority interests	0	0	(0.1)	(0.1)	(0.1)
<b>Total equity</b>	<b>34.3</b>	<b>38.2</b>	<b>40.5</b>	<b>46.2</b>	<b>53.9</b>

## Cash Flow Statement

YE 30 Jun					
US\$m	FY18A	FY19A	FY20A	FY21E	FY22E
PBT	6.0	5.7	4.6	8.0	10.4
Depreciation & amortization	1.4	1.6	1.7	1.7	1.9
Net interest expense	0	(0.1)	(0.1)	0.1	0.1
Non-fund items	0.5	0.4	1.8	0	0
<b>Working capital</b>					
Receivables	0.4	0.5	(0.2)	(0.4)	(0.7)
Other receivables	0.5	(0.2)	0.0	0.0	0.0
Inventories	(2.8)	(1.3)	(1.0)	(2.2)	(2.3)
Payables	0.9	(0.5)	0.4	0.5	0.5
Other payables	0	(0.3)	1.6	0.4	(0.4)
<b>Operating cashflow</b>	<b>6.7</b>	<b>5.8</b>	<b>8.9</b>	<b>8.1</b>	<b>9.6</b>
Net interest expense	0	0.1	0.1	(0.1)	(0.1)
Tax paid	(0.7)	(0.6)	(0.3)	(0.6)	(1.4)
<b>Cash flow from operations</b>	<b>6.0</b>	<b>5.4</b>	<b>8.7</b>	<b>7.3</b>	<b>8.1</b>
CAPEX	(2.9)	(0.9)	(5.0)	(3.0)	(4.0)
Net fixed assets disposal	0.1	0.1	0.0	0.0	0.0
<b>Free cashflow</b>	<b>3.3</b>	<b>4.5</b>	<b>3.7</b>	<b>4.3</b>	<b>4.1</b>
Dividends paid	(1.1)	(1.2)	(1.5)	(1.0)	(1.0)
Borrowings	(0.2)	(0.3)	1.1	0	0
Equity issue	(0.1)	0	0	0	0
<b>Net cash flow</b>	<b>2.0</b>	<b>3.0</b>	<b>3.2</b>	<b>3.3</b>	<b>3.1</b>
Exch diff on consolidation	0.2	(0.1)	(0.2)	0.0	0.0
<b>Opening cash balance</b>	<b>8.4</b>	<b>10.5</b>	<b>13.4</b>	<b>16.4</b>	<b>19.7</b>
<b>Ending cash balance</b>	<b>10.5</b>	<b>13.4</b>	<b>16.4</b>	<b>19.7</b>	<b>22.8</b>

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

## Comparables

Singapore-listed (in S\$m)

Name	YE	Mkt Cap	Revenue	EBITDA	EBIT	Net profit	EBIT margin %	Net margin %	ROE %	ROIC %	EV/EBITDA (x)	EBIT/EV %	PER (x)	PBR (x)
Koda (BBG: KODA SP)	6/20	75	80.3	6.4	6.4	5.8	7.9	7.2	10.7	15.4	8.85	11.3	12.92	1.38
LY Corporation (BBG: LCL SP)	12/20	78.3	76.4	5.6	2.1	1.5	2.8	2.0	2.1	2.3	14.20	2.7	50.67	1.09
Versalink Holdings (BBG: 02/21 VERSA SP)	10.7	10.7	0.4	1.3	1.3	-11.1	-11.9	-8.6	-10.3	-20.05	-14.0	-7.93	0.68	
Average:												-5.7	21.37	0.89

Overseas-listed (in S\$mil)

Name	YE	Mkt Cap	Revenue	EBITDA	EBIT	Net profit	EBIT margin %	Net margin %	ROE %	ROIC %	EV/EBITDA (x)	EBIT/EV %	PER (x)	PBR (x)
Lii Hen Industries Bhd (BBG: LHI MK)	12/20	184.3	298.1	38.4	33.0	24.5	11.1	8.2	18.3	26.8	3.67	23.4	7.53	1.38
Latitude Tree (BBG: LATI MK)	06/20	51.7	219.1	13.1	7.7	5.4	3.5	2.5	2.9	4.2	3.44	17.1	9.63	0.28
Poh Huat Resources (BBG: PHR MK)	10/20	103.6	211.0	25.1	21.3	16.6	10.1	7.9	12.2	20.7	1.80	47.2	6.23	0.76
Homeritz Corp (BBG: HMCB MK)	08/20	52.8	49.7	10.5	9.1	7.5	18.3	15.2	13.4	23.3	2.66	32.5	7.00	0.94
Man Wah Holdings (BBG: 03/21 1999 HK)	12,423 .4	2,803.2	502.2	419.0	328.3	14.9		11.7	17.9	24.2	24.84	3.4	37.85	6.78
Average:												0.25	13.65	2.03

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