SAC CAPITAL

ST Group Food Industries Holdings Ltd

29 November 2021

BUY (initiation)

BBG	SPST SP
Market cap	S$36.5m
Price (29 Nov 2021)	S$0.15
52-week range	S$0.082 – 0.15
Target Price	S$0.26
Shares Outstanding	243.1m
Free Float	23%
Major Shareholders	Saw Tatt Ghee 32% Saw Lee Ping 17%
P/BV (06/21)	1.7x
Net Debt to EBITDA (06/21)	net cash

Source: Company data, Bloomberg, SAC Capital

Analyst

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Re-opening to drive recovery

STG is a F&B operator with a strong brand portfolio. These include house brands PAFU and KURIMU and exclusive franchise and licence rights to popular Asian brands such as NeNe Chicken, PappaRich, Gong Cha, Hokkaido Baked Cheese Tarts and IPPUDO. It runs its owned outlets and sub-franchised to third party operators in Australia, NZ and the UK. Revenue split between self-run and sub-franchised is 67%/33%. Australia and NZ make up 72%/25%.

Some Australian cities lifted movement restrictions from Nov, after several lockdowns in Jun-Oct, which will drive a rebound in consumption and retail spending. More rapid re-opening should lift Australia's GDP in Q4 and 2022. New Zealand plans to allow business to resume from 3 Dec. Australia also announced border re-opening to visa holders and students from 1 Dec. Students are a significant customer base. About 10% of outlets are located at university campuses. Its price points appeal to young consumers.

Despite the COVID-induced lockdowns, it had a net add of 14 outlets (+12%) in FY21 (11 in Australia, 6 in NZ and 2 in the UK), with keen interests from sub-franchisees. The factors driving this are: 1) the food concepts are suitable for delivery and takeaway; 2) most of the outlets work on the quick service retail model, which overcome the constraints for dine-in. Safe distancing has reduced dine-in capacity by about 20-25%; and 3) food preparations are substantially handled at the central kitchen in Melbourne, thus cutting down on shop space and retail staff. It has 133 outlets (49 owned, 84 franchised) as at Sep 2021.

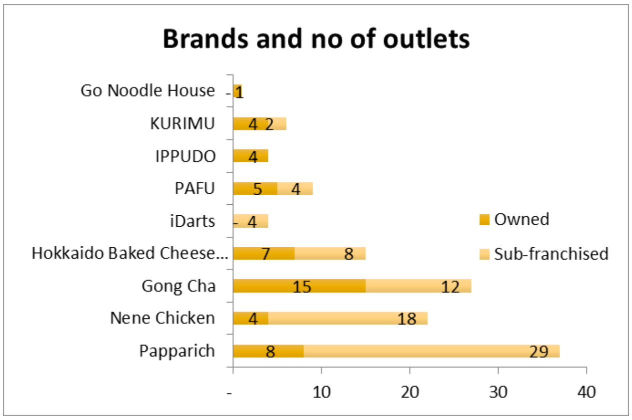
In our projections, we assume a net add of 15 outlets each year, of which two-thirds are sub-franchised. We have conservatively estimate sales per outlet in FY22E and FY23E at 70% and 80% of FY19's level. There is upside risk to our forecast if the recovery turns out stronger. Our DCF-derived TP is S$0.26 (WACC: 18.7%).

The downside risk to our forecast is a roll back of re-opening plans in the countries.

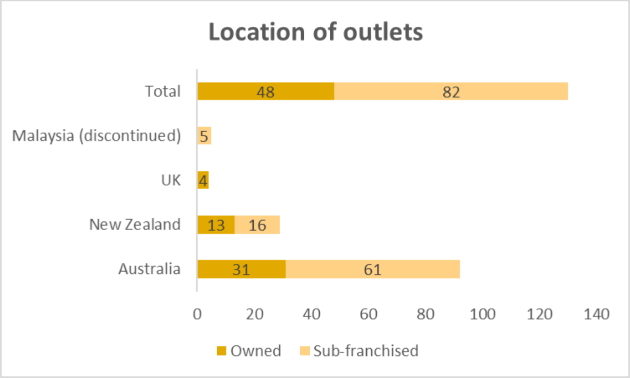
YE 30 Jun (A$m)	FY19A	FY20A	FY21A	FY22E	FY23E
Revenue	52.1	42.2	44.9	49.5	57.9
EBIT	4.5	3.4	3.9	3.5	4.9
Net profit	2.0	0.8	1.1	1.5	2.4
EPS (S cents)	0.8	0.6	0.7	0.6	1.0
DPS (S cents)	0.5	0.2	-	0.3	0.5
Net cash / (debt)	1.2	7.0	8.9	12.0	19.1
Valuation					
EBIT margin (%)	8.6	8.1	8.7	7.1	8.4
ROIC (%)	12.8	3.9	4.7	4.0	6.3
EV/EBITDA (x)	3.3	3.4	2.6	1.9	1.2
P/E (x)	19.3	43.8	32.9	25.5	15.6
Dividend yield (%)	2.9	1.0	-	2.0	3.2

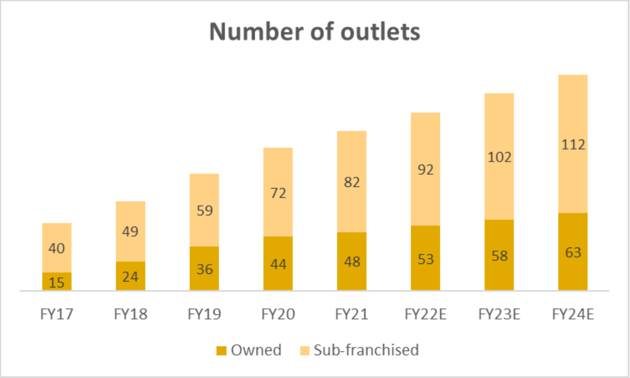
Background

Founded in 2011 and headquartered in Australia, ST Group Food Industries holds the exclusive franchise and licence rights to six F&B brands in Australia, New Zealand and the UK – PappaRich, NeNe Chicken, Gong Cha, Hokkaido Baked Cheese Tart, IPPUDO and iDarts. It also develops house brands, PAFU and KURIMU for pastries. The group is also a franchisee of the "Go Noodle House" brand.



The F&B outlets are located in Australia, New Zealand and the UK. It disposed of all 5 sub-franchised outlets for NeNe Chicken in Malaysia in October 2021 due to lack of economies of scale and weak consumer spending in the country.





When STG secures an exclusive master franchise for a new brand, it will set up and run some owned outlets. Over time when these brands have proven to be successful and gained market acceptance, STG will sign on sub-franchisees to operate new outlets in other locations. The ratio of owned to franchised stores is about 1 is to 4. It earns a royalty fee on sales from the sub-franchisees. On the other hand, it pays annual master franchise fees based on sales generated.

The central kitchen in Melbourne handles the substantial part of food preparation and these are supplied to all outlets, and the warehouse in New Zealand which will then distribute in that region. STG believes the central kitchen can support up to 200 outlets (currently 133). It books supply chain revenue from supplies delivered to the sub-franchisees, project income from helping the sub-franchisees to set up new outlets, and earns bulk rebates from key suppliers.

Competitive strengths

Focus on QSR concept. STG adopts a combination of dine-in and quick service retail concept, but the latter is expanding at a faster pace. Its brand portfolio comprises easy-to-prepare and takeaway food is suitable for the QSR concept. QSR helps to lower labour costs for food preparation, cuts down space for kitchen and seating. The semi-processed food are supplied from the central kitchen, hence reduce preparation time and enable quick turnaround. The QSR concept has helped to mitigate the constraints on seating capacity and dine-in, and is suitable for the food delivery model.

Proactive in sourcing for popular brands. STG has been actively adding new brands to its portfolio. PAFU and KURIMU are developed in house.

2012	PappaRich
2013	iDarts
2015	NeNe Chicken
2015	Gong Cha
2016	Hokkaido Baked Cheese Tart
2017	PAFU (in-house developed)
2018	IPPUDO
2019	KURIMU (in-house developed)
2021	Go Noodle House

Central kitchen offers operating leverage. STG runs a 3,000 sqm central kitchen in Melbourne, which supplies semi-finished food to all the outlets and the warehouse in New Zealand. This reduces food preparation work at the outlets, ensure consistency and quality and reduce labour and rents. Sub-franchisees are attracted by the twin draws of ease in operations and lower overheads. The management believes the central kitchen can support up to 200 outlets. Unit operating cost will improve with a bigger network.

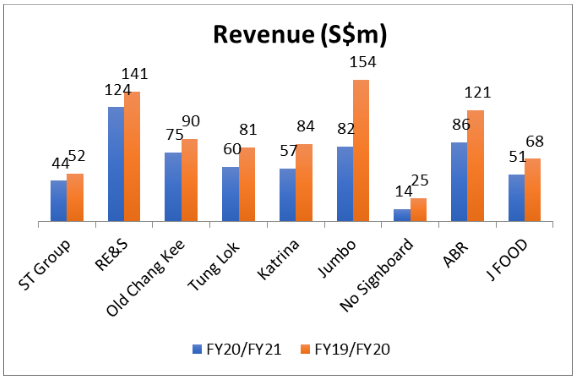
COVID ravaged the F&B sector

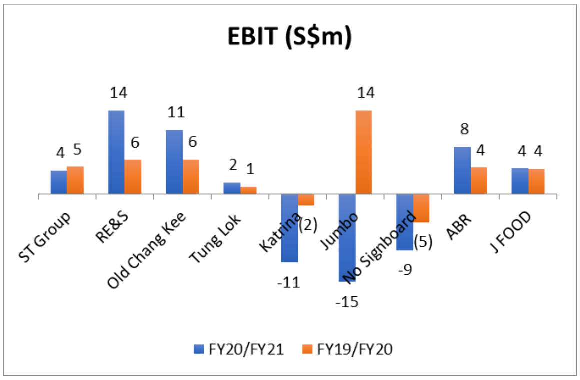
The pandemic has dealt a heavy blow on F&B operators. Movement restrictions and border closure curbed mall traffic and dine-out activities. The impact is hardest on countries that have a larger share of tourists and migrant population, such as Australia and New Zealand.

Average revenue of Singapore-listed F&B companies fell 26.4% in 2021 compared with pre-pandemic level in 2019. The ones most impacted are those that cater to dine-in customers, require more manpower on site for food preparation, or are reliant on tourists and corporate customers. We estimate seating capacity has reduced by 25% to allow safe distancing, and this rule is unlikely to be rolled back.

The sector's performance was masked by several factors, making it difficult to assess the underlying challenges each player faced. These include government's Job Support Scheme, rental and property tax rebates and cuts in foreign workers levies. The support received for Singapore operations have been more generous compared with other countries. Some operators, such as Old Chang Kee, also benefitted from government's food catering for people serving quarantine notices and workers living at the dormitories. These support will fade in the current year. Margins and returns for some F&B players might not hold.

Many companies took the opportunity to consolidate and down-size, resulting in one-off impairment charge. Some booked non-cash gains from reduction in lease liabilities as they gave up retail space.





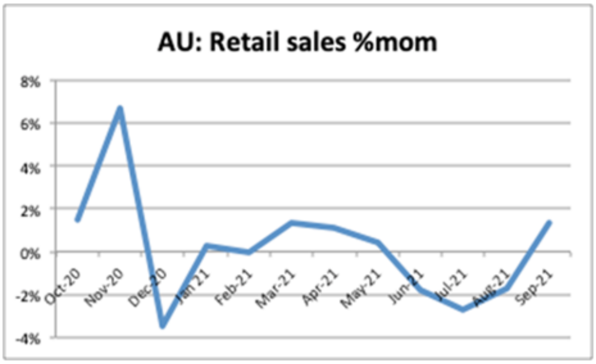
In S$m	YE	Mkt cap	Revenue	EBIT	PER (x)	PBR (x)	ROE	ROIC	EV/EBIT (x)	FCF yield	EBIT margin
ST Group	06/21	34.0	44.4	3.9	30.4	1.6	5.1%	6.1%	6.5	17.9%	8.7%
RE&S	06/21	77.9	123.9	13.9	8.2	2.1	26.1%	17.3%	4.4	45.3%	11.2%
Old Chang Kee	03/21	85.0	75.3	10.7	9.7	2.5	25.9%	39.5%	6.0	32.4%	14.2%
Tung Lok	03/21	39.0	59.7	1.8	38.8	2.9	7.4%	10.1%	16.8	13.8%	3.1%
Katrina	12/20	17.4	57.4	(11.5)	(1.1)	(2.0)	188.8%	-54.5%	(1.6)	181.5%	-20.0%
Jumbo	09/21	195.3	81.8	(14.7)	(16.6)	4.4	-26.4%	-27.0%	(12.3)	-5.1%	-18.0%
No Signboard	09/20	19.4	13.6	(9.4)	(2.0)	2.9	-144.5%	2809.8%	(1.1)	-14.8%	-69.2%
ABR Holdings	03/21	93.5	86.0	7.8	15.6	1.0	6.1%	9.8%	5.8	22.3%	9.1%
J FOOD	03/21	73.0	51.0	4.2	20.1	2.2	10.9%	16.3%	11.8	23.6%	8.3%

Australia economic outlook

More rapid re-opening should lift Australia's GDP outlook in 4Q and 2022. The country had prolonged lockdowns in most cities from June to October. The vaccination rate has reached about 70%, and the Government has moved to end lockdowns gradually from November.

The labour market has tightened considerably. Unemployment rate, at 4.6%, is expected to decline further in 2022. This should lift wages and consumption.

From Dec 1, visa holders and visitors from Singapore, South Korea and Japan are allowed to enter the country. According to Universities Australia, about 130,000 international students remain outside the country. The return of international students is significant for STG, as about 10% of its outlets are located in universities campuses. Its brands and price points appeal to the younger crowd.

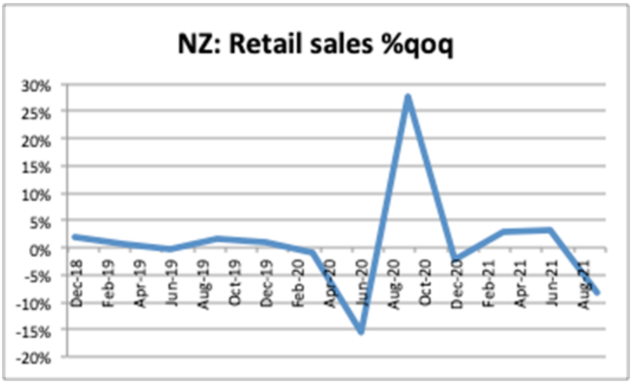


New Zealand economic outlook

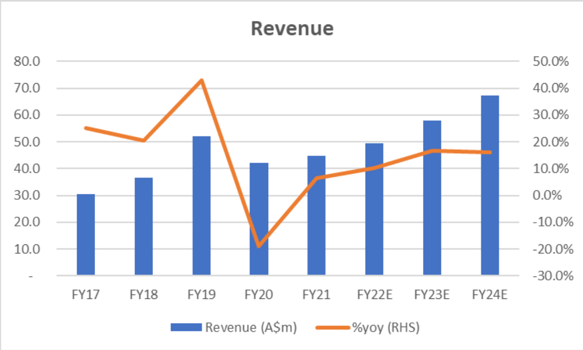
New Zealand also had a hard lockdown in Q3, driving retail sales down by 8.1% qoq (-5.1% yoy), compared with 3.3% qoq rise in Q2. Food & beverage services had the largest fall, down 19% qoq.

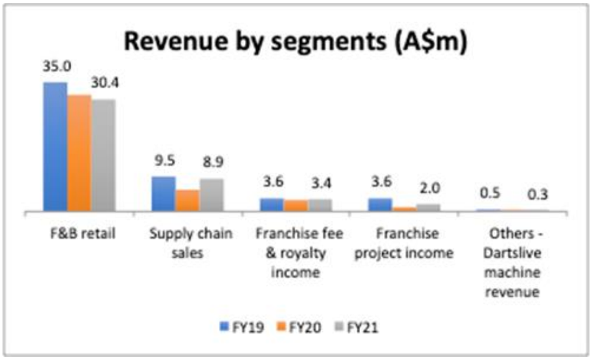
Similar to Australia, New Zealand announced that it would, from Dec 3, adopt a new system of living with the virus, which will end tough restrictions and allow businesses to operate in its biggest city.

The Government has indicated its intention to gradually reopen the borders from early 2022. This will lift GDP growth if tourists and migrant population return.



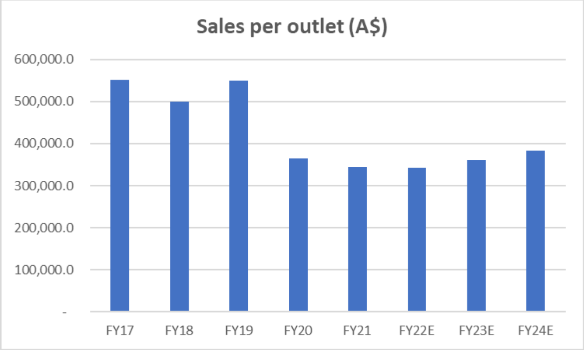
Financial Performance

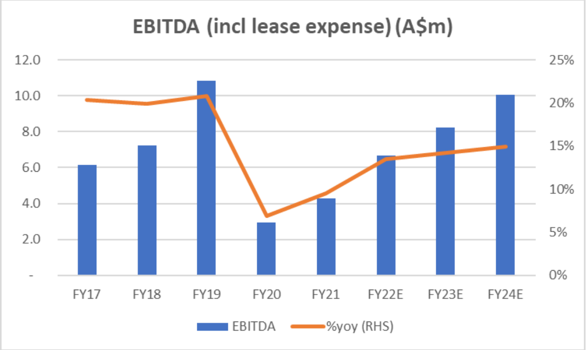


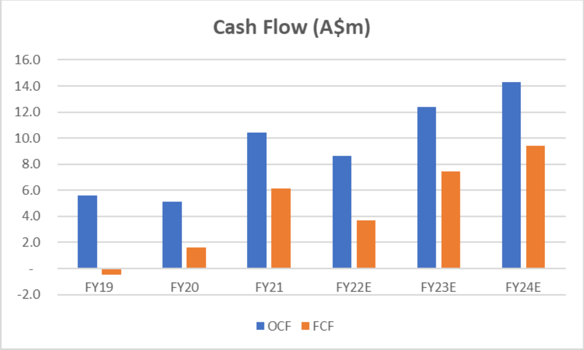


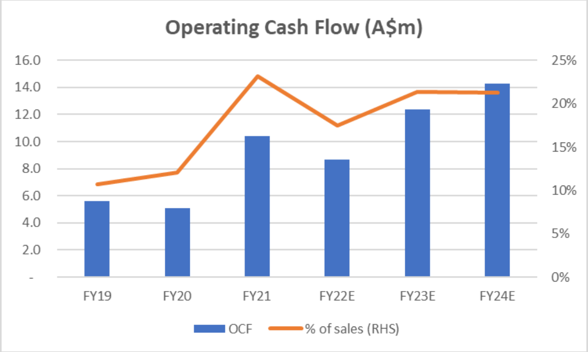
Revenue per outlet in FY21 fell by 35% when compared with FY19. We project this to fall by 1.1% in FY22E, factoring in a 4-month lockdown till October. But we expect an improvement by 5.8% and 6.2% in FY23E and FY24E respectively. These estimates assume sales per outlet in FY23E and FY24E would still be 30% and 20% below that of FY19's. There is therefore upside risks to our forecasts.

More outlets will drive revenue growth going forward. We estimate a net add of 15 outlets each year, of which two-thirds are sub-franchised outlets. EBITDA growth is expected to grow at a faster pace due to operating leverage from a larger network. The business generates good operating cash flow, and positive free cash flow. Operating cash flow doubled in FY21. As at end Jun 2021, it has net cash of A$8.9m.









Income Statement

FYE 30 Jun (A$m)	FY20A	FY21A	FY22E	FY23E
Revenue	**42.2**	**44.9**	**49.5**	**57.9**
Cost of sales	(12.1)	(13.9)	(15.2)	(18.0)
Gross profit	**30.2**	**30.9**	**34.3**	**39.9**
Other income	1.1	1.0	1.0	1.0
Employee benefits	(16.6)	(15.7)	(15.9)	(18.5)
Operating expenses	(5.7)	(5.5)	(6.2)	(7.2)
EBITDA	**8.9**	**10.7**	**13.2**	**15.2**
Depreciation & amortisation	(7.5)	(8.3)	(8.7)	(9.5)
Associates & JV	0.0	0.0	0.0	0.0
Government grants	3.2	2.6	-	-
Exceptional items	(1.2)	(1.2)	(1.0)	(0.8)
EBIT	**3.4**	**3.9**	**3.5**	**4.9**
Finance costs	(1.5)	(1.5)	(1.5)	(1.5)
Pretax profit	1.9	2.4	2.1	3.4
Tax expense	(0.6)	(0.8)	(0.6)	(1.0)
Minority interests	0.1	-	-	-
Net profit	**1.4**	**1.6**	**1.5**	**2.4**

* Excludes discontinued operations

Balance Sheet

FYE 30 Jun (A$m)	FY20A	FY21A	FY22E	FY23E
Assets				
Fixed assets	12.5	13.2	12.3	11.3
ROU assets	22.8	23.0	25.5	27.9
Intangible assets	3.2	3.0	2.6	2.3
Others	6.9	6.9	7.0	6.9
Non-current assets	**45.4**	**46.1**	**47.4**	**48.4**
Inventories	2.6	2.5	2.7	3.2
Trade receivables	4.7	3.9	4.3	5.0
Other non-financial assets	0.1	0.7	0.2	0.1
Cash	8.5	9.8	12.8	19.9
Current assets	**15.9**	**16.9**	**20.0**	**28.2**
Total assets	**61.2**	**63.0**	**67.3**	**76.6**
Liabilities				
Bank loans	1.1	0.5	0.5	0.5
Trade payables	5.9	6.9	7.6	8.9
Lease liabilities	6.4	7.2	7.2	7.2
Other non-financial liabilities	0.5	1.2	0.4	0.5
Tax provisions	2.1	2.0	0.6	1.0
Current liabilities	**16.0**	**17.8**	**16.3**	**18.1**
Bank loans	0.3	0.3	0.3	0.3
Lease liabilities	22.3	22.1	27.2	32.8
Other non-financial liabilities	0.9	0.8	0.7	0.7
Non-current liabilities	**23.5**	**23.2**	**28.2**	**33.8**
Net assets	**21.8**	**22.1**	**22.8**	**24.7**
Equity				
Share capital	57.2	57.2	57.2	57.2
Other reserves	(40.9)	(40.9)	(40.9)	(40.9)
Retained earnings	3.1	3.9	4.6	6.6
	19.9	**20.2**	**20.9**	**22.9**
Minority interests	1.9	1.9	1.9	1.9
Total equity	**21.8**	**22.1**	**22.8**	**24.7**

Cash Flow

FYE 30 Jun (A$m)	FY20A	FY21A	FY22E	FY23E
Pretax profit	1.9	2.4	2.1	3.4
Depreciation & amortisation	7.5	8.3	8.7	9.5
Associates & JV	-	(0.0)	0	-
Net finance expense	1.5	1.5	1.5	1.5
Non-fund items	0.7	(0.1)	-	-
Working capital changes	(3.9)	0.3	(0.1)	0.2
Interest paid	(1.4)	(1.2)	(1.5)	(1.5)
Dividend from associates	-	-	-	-
Tax paid	(1.3)	(0.8)	(2.0)	(0.6)
Operating cash flow	**5.1**	**10.4**	**8.7**	**12.4**
Capex	(3.6)	(4.1)	(2.5)	(2.5)
Net investments	-	-	-	-
Fixed assets disposal	0	-	-	-
Others	-	(0.2)	(2.5)	(2.4)
Investing cash flow	**(3.6)**	**(4.3)**	**(5.0)**	**(4.9)**
Free cash flow	**1.6**	**6.2**	**3.7**	**7.5**
Dividend paid	(1.5)	(0.4)	(0.7)	(0.4)
Borrowings	(4.1)	(4.6)	-	-
Equity	8.8	-	-	-
Financing cash flow	**3.2**	**(5.0)**	**(0.7)**	**(0.4)**
Net change	**4.8**	**1.1**	**3.0**	**7.1**

Ratios

FYE 30 Jun (A$m)	FY20A	FY21A	FY22E	FY23E
Profitability (%)				
Gross margin	71.4	68.9	69.3	68.9
EBIT margin	8.1	8.7	7.1	8.4
Liquidity (x)				
Current ratio	1.0	1.0	1.2	1.6
Net Debt/EBITDA	Net cash	Net cash	Net cash	Net cash
Interest coverage ratio	103	135	165	191
Net Debt to Equity (%)	4.0	Net cash	Net cash	Net cash
Valuation (x)				
P/E	43.8	32.9	25.5	15.6
P/B	1.9	1.8	1.8	1.6
EV/EBITDA	3.4	2.6	1.9	1.2
Cash Conversion Cycle				
Trade receivable days	41	32	32	32
Inventory days	80	66	66	66
Trade payable days	179	182	182	182

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(ii) The report was produced independently by him/her;

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