

CHINA
DEVELOPMENT
FINANCIAL

Japan Foods Holding Ltd

(JFOOD SP/JPFD.SP)

Rising competition; downgrade to HOLD

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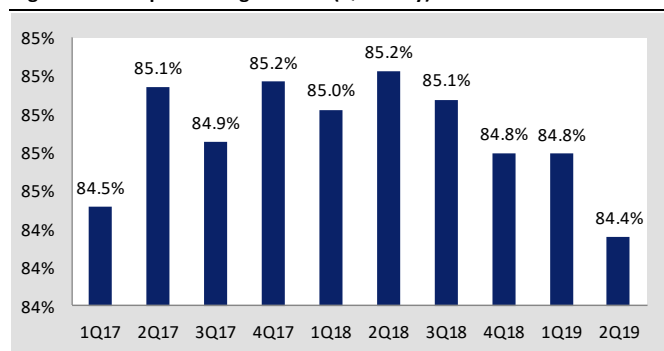
- 2Q19 net profit declined 57% YoY to S\$0.6mn mainly due to S\$0.5mn of costs related to opening of new outlets. Adjusted PATMI if excluding the one-off expenses would have still declined 19% YoY. Sequential improvement QoQ did not materialise as expected after a weak 1Q19.
- We downgrade to HOLD as outlook over the next 3-4 quarters is expected to remain challenging on the back of heightened competition and on slower-than-expected expansion of overseas associates.
- JFOOD's balance sheet remains strong and will be able to tide through the current market weakness. Its S\$22mn net cash position makes up 28% of its market cap, while offering a 4.4% dividend yield.

Financials & Key Operating Statistics					
YE Mar SGD mn	2017	2018	2019F	2020F	2021F
Revenue	62.8	67.8	68.9	70.9	73.6
Gross Profit	52.9	57.7	58.0	59.6	61.8
PATMI	3.8	5.8	4.6	5.3	5.7
Core PATMI	3.2	5.3	4.0	4.7	5.0
Core EPS (SG cents)	1.8	3.0	2.3	2.7	2.9
Core EPS grth (%)	-24.1	66.5	-24.2	17.3	6.6
Core P/E (x)	18.5	13.1	18.8	16.3	15.3
DPS (SG cents)	2.0	2.1	2.2	2.2	2.3
Div Yield (%)	5.0	4.8	4.4	4.4	4.6
Gross Margin (%)	84.2	85.0	84.2	84.0	84.0
Net Margin (%)	6.0	8.5	6.7	7.5	7.7
ROE (%)	12.3	17.8	13.3	14.8	14.9

Source: Company Data, KGI Research

2Q19 earnings drop. JFOOD had S\$0.5mn of expenses related to new store openings, leading to a net change of +5 outlets YoY (53 total outlets as at end Sep 2018 compared to 48 as at end Sep 2017). 2Q19 gross margins declined 80bps YoY to 84.4%, contributing further to the weak quarter.

Figure 1: Gross profit margins trend (Quarterly)



Source: Company data, KGI Research

Local and overseas businesses facing increased competition.

Although performance from overseas associates bottomed out in 1Q19, recovery remains tepid. The weakness in JFOOD's home market of Singapore also caught up by surprise as its key brand Ajisen Ramen recorded a 13% YoY decline in 1H19 revenues, which points to increasing competition and pressure on margins. On a positive note, the four new Shitamachi Tendon Akimitsu and new restaurant brand Kagurazaka Saryo saw positive momentum.

HOLD - Downgrade

Price as of 9 Nov 18 (SGD)	0.46	Performance (Absolute)	
12M TP (\$)	0.56	1 Month (%)	-5.2
Previous TP (\$)	0.64	3 Month (%)	-8.0
Upside, inc div (%)	21.7	12 Month (%)	14.3
Trading data		Perf. vs STI Index (Red)	
Mkt Cap (\$mn)	80		
Issued Shares (mn)	174		
Vol - 3M Daily avg (mn)	0.0		
Val - 3M Daily avg (\$mn)	0.0		
Free Float (%)	23.1%		
Major Shareholders		Previous Recommendations	
Takahashi Kenichi	70.6%	16-Aug-18	BUY \$0.64
Eugene Wong	5.5%	21-May-18	BUY \$0.64
		13-Feb-18	BUY \$0.54

Singapore upside limited. Based on our analysis of peers in Singapore (BreadTalk, ABR, Sakae, Soup Rest., Tung Lok, RE&S, Kimly), all face the same challenge of high rents and limited manpower. Thus, upside from its Singapore market is expected to be limited and we reiterate our view that growth will have to come from overseas expansion.

Overseas expansion slower-than-expected. JFOOD maintained the number of outlets overseas on a YoY basis at 21. Even as it opened 3 new outlets in China, it was offset by closures of 2 in Malaysia and 1 in HK. Overseas expansion is coming in slower than our expectations and adds to our cautious outlook in the near term.

Valuation & Action: While our DCF-backed fair value of S\$0.56 offers a 22% upside potential, we downgrade our recommendation on JFOOD to HOLD on the lack of near term upside catalysts and on a weak outlook over the next 3-4 quarters, as competitive forces dampen margins and as the group re-positions its various brands in the market.

Despite the challenging short-term outlook, JFOOD's business model remains resilient and adaptable even in the face of higher costs. The group maintains a sizeable cash balance of S\$22mn (28% of market cap), supported by strong free cash flows averaging S\$1m per quarter.

Risks: Rising labour costs and rental expenses, lower consumer spending amid slower wage growth; non-renewal of franchise agreements.

This report is prepared by KGI Securities (Singapore) under the SGX StockFacts Research Programme. See the last page for important disclosures.

Results update – Building brands

Four pillars of growth. The group aims to have four main brands that will serve as key pillars of growth in the future. “Menya Musashi” is showing potential to be the group’s second pillar – FY2018 sales from this brand grew 20% YoY compared to the 4% YoY growth of its most established brand, “Ajisen Ramen”. Another rising star is “Osaka Ohsho” which had flat revenue growth as it closed 2 stores in FY2018 (1 in Eastpoint Mall), but which we think may be temporary as management decides on other more suitable locations.

“Shitamachi Tendon Akimitsu” is still in its early phase but we would be watching whether this could become Japan Foods’ fourth pillar in view of the positive reception since opening its first branch six months ago. JFOODs now has seven restaurants under this brand, contributing around S\$4mn to revenues in FY2018.

JFOOD’s first Michelin brand! We commend management’s ability in bringing “Konjiki Hototogisu” to Singapore, where it opened the first restaurant at CHIJMES in June 2018. This ramen restaurant is an award winning ramen featured in Michelin Guide Tokyo’s Bib Gourmand for four consecutive years from 2015 to 2018. Additionally, the chicken and pork broth has been named by Tokyo Walker Magazine as the “#1 Ramen in Tokyo in 2016, 2017” and the “#1 ramen in Japan 2016”.

Figure 4: Konjiki Hototogisu-Award winning ramen restaurant at CHIJMES



Source: Company data, KGI Research

Figure 2: Number of outlets in Japan Food's Singapore network

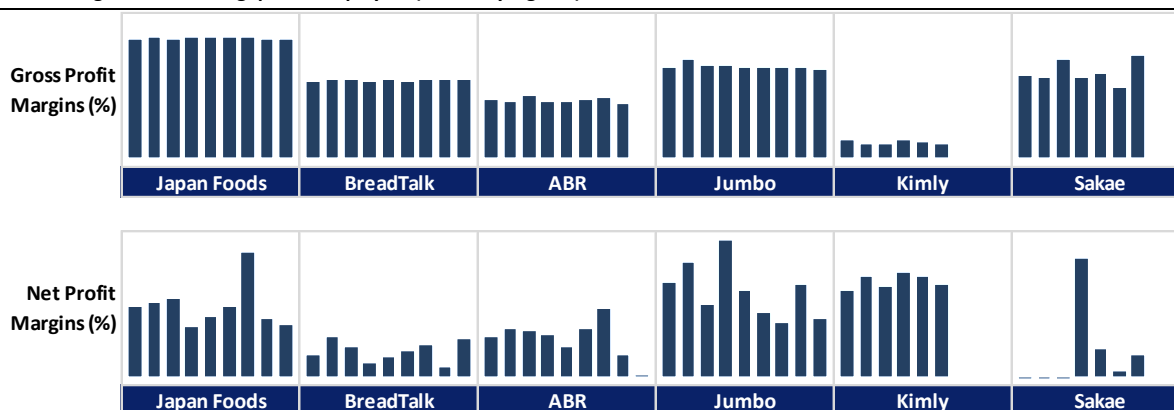
Number of restaurants										
Restaurants	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19
Ajisen Ramen + Keika Ramer	18	19	19	19	19	19	18	18	18	17
Menya Musashi	8	8	8	7	8	9	10	10	10	11
Osaka Ohsho	6	6	6	7	6	6	5	5	5	5
Fruit Paradise	4	4	4	4	3	3	3	2	2	1
Kazokutei	3	3	3	2	1	1	1	1	1	1
Japanese Gourmet Town	1	1	1	1	1	1	1	1	1	1
Others	9	9	9	9	6	9	10	12	14	17
Food court outlets										
Ajisen Ramen*	1	1	1	1	1	1	1	1	0	0
Total	50	51	51	50	45	49	49	50	51	53

Source: Company data, KGI Research

Industry analysis. A key trend among Singapore F&B companies is the cost pressure from rising rents and the tight labour market. The table below highlights the margins of SGX-listed F&B companies on a quarterly basis. As a result, F&B players have been venturing overseas for growth e.g., BreadTalk in China and UK, Jumbo in China, and Japan Foods in China and Indonesia.

JFOOD’s business model of taking associate stakes – typically 30% - offers relatively lower risk while providing enough incentive for its overseas partners to drive growth in their respective countries. As at end September 2018, JFOOD’s associated companies operated 7 restaurants in Hong Kong and 10 restaurants in China under the “Menya Musashi” brand.

Figure 3: Profit margin trends of Singapore F&B players (Quarterly Figures)



Source: Bloomberg, KGI Research

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HOLD	-10% to +10% total return over the next 12 months
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