

CHINA
DEVELOPMENT
FINANCIAL

Japan Foods Holding Ltd

(JFOOD SP/JPFD.SP)

Venturing beyond Singapore; Indonesia a promising market

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- 1Q19 net profit declined 7.6% YoY to S\$0.97mn due mainly to lower contribution from associates and slight decline of gross profit margins to 84.8%.
- We expect an improvement in the next few quarters as the weakness in 1Q was also partly due to lower performance in June, which coincided with the FIFA World Cup 2018.
- We re-iterate our BUY recommendation and maintain our fair value of S\$0.64 based on DCF valuation. JFOOD offers an attractive 4.4% dividend yield while net cash of S\$24.5mn makes up 28% of its market cap.

Financials & Key Operating Statistics

YE Mar SGD mn	2017	2018	2019F	2020F	2021F
Revenue	62.8	67.8	69.6	71.6	74.4
Gross Profit	52.9	57.7	59.0	60.7	63.1
PATMI	3.8	5.8	5.9	6.3	6.7
Core PATMI	3.2	5.3	5.3	5.7	6.0
Core EPS (SG cents)	1.8	3.0	3.1	3.3	3.5
Core EPS grth (%)	-24.1	66.5	0.5	6.3	6.1
Core P/E (x)	18.5	13.1	14.6	13.8	13.1
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	84.8	84.8	84.8
Net Margin (%)	6.0	8.5	8.5	8.8	8.9
ROE (%)	12.3	17.8	16.8	16.6	16.3

Source: Company Data, KGI Research

Weak quarter mainly from HK and China. Contribution from associated companies decreased 62.5% YoY to S\$57,000 in 1Q19 due to weak performance of its Menya Musashi restaurants in Hong Kong and in second tier cities in China such as Hangzhou and Wuhan. On a positive note, we expect performance from associates to have bottomed in 1Q19 and to start picking up going forward due to new store openings.

Superb execution. The stabilisation of JFOOD's gross profit margins at around the 85% level is very impressive amid ever increasing costs in Singapore; management has been able to increase its gross margins from 77.5% in FY2011 to 80.1% in FY2013, then to 83.4% in FY2015 and finally to 85.0% in FY2018. We think that FY2018 may already represent peak margins and to be able to maintain it at 85% going forward would be commendable. Furthermore, the introduction of JFOOD's first Michelin-award ramen restaurant also proves management's quality control capabilities.

Figure 1: Gross profit margins



Source: Company data, KGI Research

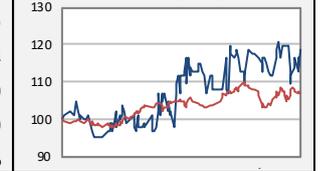
BUY - Maintain

Price as of 16 Aug 18 (SGI)	0.51	Performance (Absolute)	
12M TP (\$)	0.64	1 Month (%)	0.6
Previous TP (\$)	0.64	3 Month (%)	0.5
Upside, inc div (%)	30.0	12 Month (%)	22.4

Trading data

Mkt Cap (\$mn)	89
Issued Shares (mn)	174
Vol - 3M Daily avg (mn)	0.0
Val - 3M Daily avg (\$mn)	0.0
Free Float (%)	23.3%

Perf. vs STI Index (Red)



Major Shareholders

Takahashi Kenichi	70.6%	Previous Recommendations	
Eugene Wong	5.5%	21-May-18	BUY \$0.64
		13-Feb-18	BUY \$0.54
		15-Nov-18	BUY \$0.53

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

Overseas expansion as key driver. JFOOD increased its overseas network to 22 as at end June 2018 - an increase from 20 in the prior year period - mainly from its overseas associates adding 3 new Menya Musashi restaurants in China and 1 in Indonesia, offset by 2 store closures in Malaysia.

First step into Southeast Asia's largest economy. The group acquired a 30% stake in PT Menya Musashi Indonesia (MMI), which opened the first Menya Musashi restaurant in Jakarta in April 2018. The group expects to open another 4 restaurants over the next 3 years. We are optimistic on its entry into Indonesia but will not factor it into our forecasts until we obtain more clarity on the performance of its first restaurant in the country.

Valuation & Action: We maintain our BUY recommendation with a fair value of S\$0.640 (DCF valuation). Japan Foods' business model remains resilient and adaptable even in the face of higher costs. We see several upside catalysts in FY2019, driven by organic growth amid an improving macro environment and through JVs with overseas partners. The group maintains a sizeable cash balance of S\$24.5mn (28% of market cap), supported by strong free cash flows averaging S\$1m/quarter.

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

KGI's Ratings

Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

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