Dairy Farm International

Proxy to North Asian consumers boom

27 September 2017

SINGAPORE | CONSUMER | INITIATION

- Earnings back to growth track with sustainable high single-digit growth in FY17-18e
- Store rationalization enhanced profitability; Higher margin sales mix and economies of scale to lift margins further
- Associates' average earnings growth at 17% p.a. in FY17-18e
- Initiate coverage with **BUY** rating with a **SOTP-derived TP of US$9.89**; Attractive valuation after share price retracement

Company Overview

Dairy Farm International Holdings Limited ("Dairy Farm") is a leading Pan-Asian retailer. The Group, together with its associates and joint ventures, operated over 6,600 outlets across 12 markets, with FY2016 total sales* exceeding US$20bn.

** Total sales include 100% revenue of its associates and joint ventures*

Its four divisions include: **1) Food** (Supermarkets, Hypermarkets and Convenience Stores); **2) Health and Beauty**; **3) Home Furnishings** (IKEA businesses); and **4) Restaurants** (Maxim's, a leading Hong Kong restaurant chain).

Dairy Farm is incorporated in Bermuda and has a standard listing on the London Stock Exchange, with secondary listings in Bermuda and Singapore. It is a member of the Jardine Matheson Group.

Investment Thesis

1) **Multiple levers to drive up margins:** We expect Dairy Farm margins to expand in the next few years. This will arise from better sales mix of higher margin products. The four key product categories will be (i) higher Fresh food; (ii) more Corporate Brand (a.k.a. private label) items; (iii) expanding into the upscale market; and (iv) increase Ready-to-Eat products. These categories still lag competitors.

2) **More economies of scale:** (i) Establishing distribution centres in key countries to enhance efficiencies via bulk handling; (ii) Implementing Group-wide merchandising system to improve inventory management; and (iii) Streamlining supply chain and increase direct sourcing across countries and companies within its Group.

   Margin enhancement to materialize in three distribution centres – Singapore (opened in May-16), Philippines (opened in May-17) and Malaysia (target to open in 2H17).

3) **Expanding store network to lift sales**. 7-Eleven store count in Guangdong is on-track to grow by 10% p.a. to 1,000 by end-FY18. It has the potential to double Hong Kong's size given the vast population base in Guangdong. Meanwhile, a fourth IKEA store in Hong Kong is scheduled to open in Oct-17 and a site for a second store in Jakarta had been secured.

4) **Fast growing associates to boost earnings.** Yonghui and Maxim's are contributing over US$100mn or 20% to the Group's EBIT. We expect the profit contribution from its associates to grow 24%/8% in FY17/18e.

Key Investment Risks

- Prolonged macro headwinds in Hong Kong, Macau, Indonesia and Malaysia
- Intensifying competition and increasing operating costs could erode margins
- Regulatory risks in operating countries
- Unfavourable exchange rate movements will affect the Group's US dollar reported results and led to lower underlying earnings for the period
- Cancellation, termination, or unfavourable renegotiation terms and conditions of concessions, franchises and key contracts could have an adverse effect on the business operations

BUY (Initiate)

LAST CLOSE PRICE	USD 7.48
FORECAST DIV	USD 0.22
TARGET PRICE	USD 9.89
TOTAL RETURN	35.1%

COMPANY DATA

BLOOMBERG CODE	DFI SP
O/S SHARES (MN) :	1,352
MARKET CAP (USD mn / SGD mn) :	10116 / 13707
52 - WK HI/LO (USD) :	9.25 / 6.92
3M Average Daily T/O (mn) :	0.56

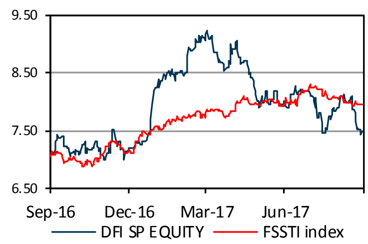
MAJOR SHAREHOLDERS (%)

JARDINE MATHESON HOLDINGS	77.61%
COMMONWEALTH BANK OF AUSTRALIA	5.17%
FRANKLIN RESOURCES	2.45%
MATTHEWS INTL CAPITAL MGMT	1.63%

PRICE PERFORMANCE (%)

	1MTH	3MTH	1YR
COMPANY	(4.7)	(5.0)	10.0
STI RETURN	(1.46)	1.38	16.50

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec	FY15	FY16	FY17e	FY18e
Revenue (USD bn)	11.1	11.2	11.4	11.7
Core EBITDA (USD bn)	0.65	0.67	0.68	0.75
Core EBIT (USD bn)	0.44	0.45	0.47	0.53
PATMI, adj. (USD bn)	0.43	0.46	0.50	0.56
EPS, adj. (USD)	0.32	0.34	0.37	0.41
PER, adj. (x)	19.2	22.2	20.2	18.1
P/BV, (x)	5.7	6.5	5.7	4.9
DPS (USD)	0.20	0.21	0.22	0.25
Div Yield (%)	2.7%	2.8%	2.9%	3.3%
ROE (%)	31.1%	30.6%	29.2%	28.4%

Source: Company Data, PSR est.

Valuation Method

Sum-of-parts

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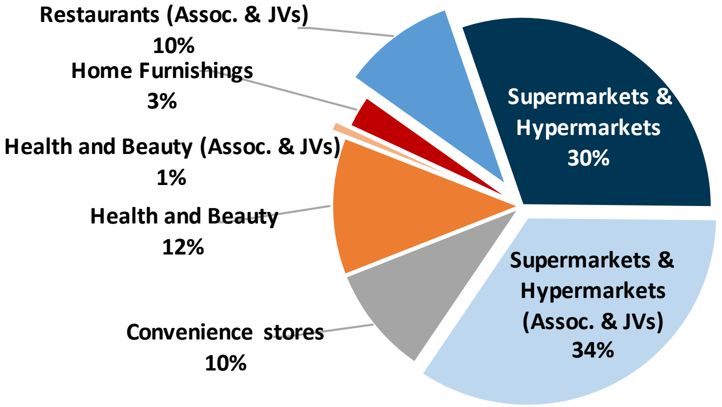
Ref. No.: SG2017_0220

Business Overview

At 30 Jun-17, Dairy Farm and its associates and joint ventures operated over 6,600 outlets across 12 markets, and employed over 180,000 people.

The Group operates under a number of well-known brands across four divisions, namely Food, Health and Beauty, Home Furnishings, and Restaurants.

Figure 1: FY2016 Revenue Mix (including 100% sales from Associates and Joint Ventures)

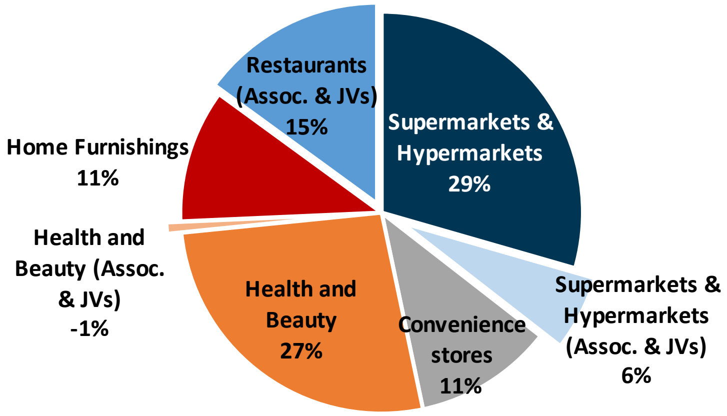


Size of its Associates and Joint Ventures grows to be comparable to its Core Business Units' (BUs).

Sales from Core BUs accounts for 55% of FY2016 Sales; remaining 45% was contributed by Assoc, & JVs.

Shares of results from Assoc. & JVs are also gaining more significant. The percentage contribution to EBIT grew from 20% in FY2016 to 24% in 1H17. (See Figure 22)

Figure 2: FY2016 EBIT Mix (Operating Profit and Share of results from Associates and Joint Ventures)

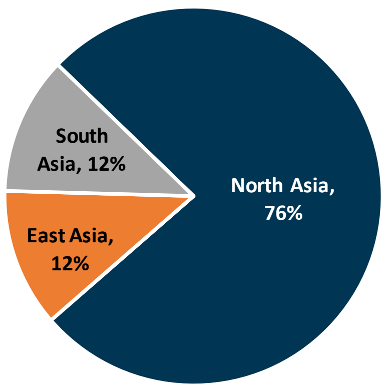


Source: Company, PSR

Food is the largest revenue and earnings generator.

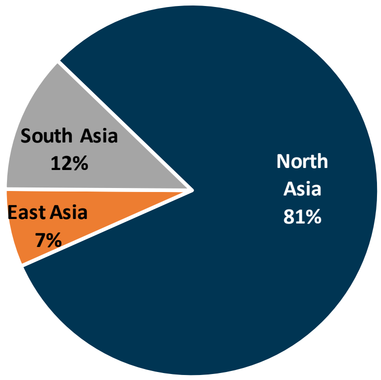
Supermarkets & Hypermarkets combined with Convenience stores contributed 74% of its turnover and 47% of profitability.

Figure 3: FY2016 Sales by Geographical Locations (including assoc. and JVs)



Source: Company, PSR

Figure 4: FY2016 Operating Profit from Core Business Units by Geographical Locations



Source: Company, PSR

Figure 5: Regional Footprint and Principal Brands

	Supermarkets and Hypermarkets	Convenience Stores	Health and Beauty	Home Furnishings	Restaurants
Mature Markets					
Hong Kong	▪ Wellcome ▪ Market Place by Jasons ▪ Jason Food & Living	▪ 7-Eleven	▪ Mannings ▪ GNC	▪ IKEA	▪ Maxim's (Also licensee of brands such as Starbucks Coffee, The Cheesecake Factory, Genki Sushi, IPPUDO Ramen, and Shake Shack)
Macau	▪ San Miu	▪ 7-Eleven	▪ Mannings	▪ IKEA	▪ Maxim's
Singapore	▪ Giant ▪ Cold Storage ▪ Market Place ▪ Jasons The Gourmet Grocer	▪ 7-Eleven	▪ Guardian		
Malaysia	▪ Giant ▪ Cold Storage ▪ Jasons Food Hall		▪ Guardian		
Brunei	▪ Giant		▪ Guardian		
New Markets					
Mainland China	▪ Yonghui	▪ 7-Eleven	▪ Mannings		▪ Maxim's
Indonesia	▪ Hero ▪ Giant		▪ Guardian	▪ IKEA	
Taiwan	▪ Wellcome ▪ Jasons Market Place			▪ IKEA	
The Philippines	▪ Shopwise ▪ Wellcome ▪ Rustan's		▪ Rose Pharmacy		
Vietnam	▪ Giant		▪ Guardian		▪ Maxim's
Cambodia	▪ Lucky Supermarkets ▪ Giant		▪ Guardian		▪ Maxim's
Thailand					▪ Maxim's

Source: Company, PSR

Investment Thesis
– Margin gains and store expansion plan to fuel medium-term growth

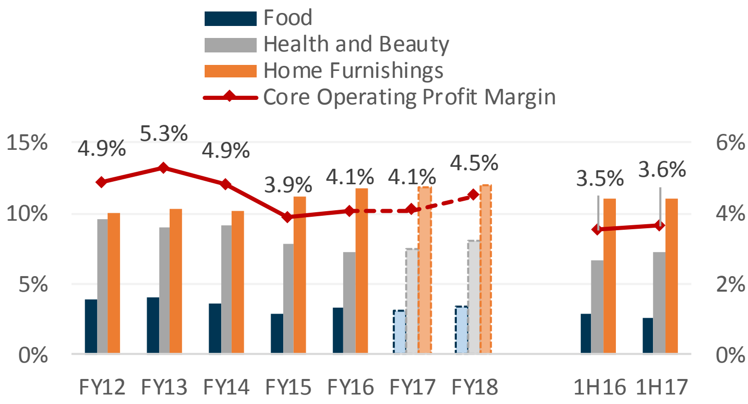
Dairy Farm is constantly investing to enhance its competitive position, increase customer convenience and adapt to emerging consumer trends. We think that the Group is poised to ride the macro tailwind in Asia's developing markets.

1. Margin enhancement on the back of (a) better sales mix of higher margin products, and (b) improving economies of scale

(a) Increase Fresh participation and moving into upscale market

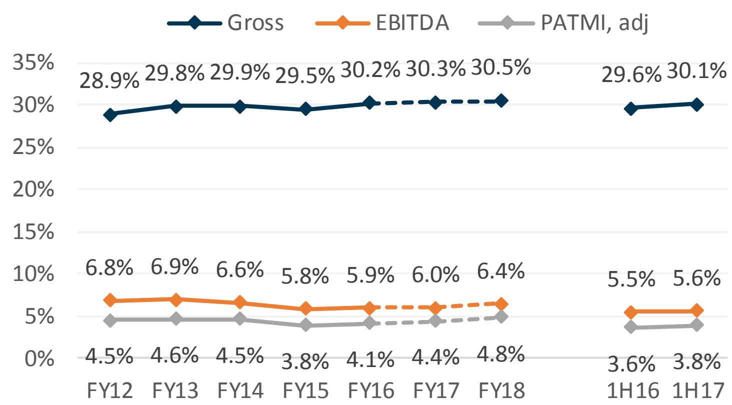
- Food is the Group's key revenue and earnings generator; but fetches low single-digit operating margins.
- In view of the competitive pressure from not only brick-and-mortar rivals, but also the rising e-commerce players, the Group continuously expands its fresh products offerings and product innovations to drive up profitability.

Figure 6: The better gross margins will lift Core EBIT margin to 4.5% by end-FY18e



Source: Company, PSR

Figure 7: Stronger contribution from its Associates and Joint Ventures will prop up another 20bps p.a. at net margin level in FY17-18e



Source: Company, PSR

- **Fresh from the farm –** Quality Fresh products translate into better margins.

  Over the past three years, the Group has integrated Fresh Production Centre and the Dry Distribution Centre in Taiwan (2014); opened three distribution centre hubs in Indonesia (2014); and commenced a new Fresh Food Distribution Centre in Singapore (May-16). These translate to a higher Fresh penetration, which increased by over 20 bps in the FY2013-16.

Management shared that its Fresh participation rate is still lagging behind NTUC Fairprice and Sheng Siong, despite being the second largest retailer in Singapore. Nonetheless, the new 75k sqft fresh food distribution centre in Singapore should level its playing field with NTUC Fairprice and Sheng Siong, and bode well with its plan to increase fresh participation. Management shared that lead time from farm to shelf in Singapore has shorten by 50%. The additional capacity also enables higher value food production – such as processing of fresh products.

We expect the two additional new fresh distribution centres that will commence operations this year – Philippines (opened in May-17) and Malaysia (target to open in 2H17), to further improve Food margins.

Figure 8: Increase Fresh participation

Source: Company

- **Taking shopping to a higher level –** Capture upscale consumers by including more imported and exclusive brands which demand higher margins.

  We also expect the Group to benefit from its plan to increase its ownership in Rustan's to 100% with the acquisition of the remaining 34% interest from its joint venture partner.

Rustan Supercenters Inc. is the pioneer and best performing brand in Philippines' modern grocery retailing.

(b) Capitalizing on convenience via Ready-to-Eat products and enhanced service offerings in Convenience Stores

Ready-to-Eat (RTE) food offerings continue to gained traction. Sales of RTE products grew over 10% YoY in FY16, double the rate of overall growth in Convenience Store. It has also revamped store format to incorporate a small dining in or seating area.

To draw higher footfall, it has also introduced enhanced service offers, such as establishing pick-up points and e-lockers services to complement the booming e-commerce industry, as well as cash withdrawal services, bill payment facilities, courier services, and prepaid card top-ups services over the counter.

Figure 9: RTE products for the bustling city

Source: Company

(c) Higher penetration of Corporate Brand in both Food and Health& Beauty segments

Corporate Brand (a.k.a. private labels) not only provide customers alternatives, but also enhance business profitability. The Group has over 10,000 SKUs (stock keeping units) under its Corporate Brands across Food and Health and Beauty segments. However, the penetration rate lags at mid-single digit percentage for Dairy Farm, as compared to mainstream retailers' 25% to 50%.

This also implies that there is more scope for growth and margin expansion. In particular, its Health and Beauty division in New Markets. In 2016, over 900 new products were launched. More than 450 of these Corporate Brand products were introduced into the developing markets of Vietnam, Cambodia, Indonesia and the Philippines, which recording an impressive 117% sales growth in 2016.

Figure 10: More SKUs and new Corporate brands launched under its grocery segment

Source: Company

(d) Strengthening and streamlining supply chain and boosting stock management capability

- **Establishing advanced infrastructure across the region.** These centralized distribution centres could:
  - (i) Enhance efficiencies driven by higher bulk handling. The Group could lower cost of goods and shorten the time from field to shelf, thus improving the quality and freshness of its fresh product offerings, and stock availability levels.
  - (ii) Provide capacity to create higher value food production and bringing wider range of products to its consumers.
- **Efficient inventory management via technology.** Its Group-wide newly implemented SAP merchandising system will reduce handling costs, strengthen key processes in the supply chain and enhance business analytics.
- **Shortening supply chain via direct sourcing**. Leveraging on each other's operating scale and sharing of know-how, would propel greater synergies and collaboration across the Group as well as with partners.
  - (i) Improve local and international sourcing – Diversify its range of product offerings while keeping costs low. E.g. collaboration with 7-Eleven Japan to source exclusive and unique Japanese products for its Singapore and Hong Kong markets.
  - (ii) Manages common sourcing in general merchandise – Consolidate common range across business units and better coordination of seasonal promotions.

Figure 11 & 12: New Fresh DC in Singapore enables bulk handling

Source: Company

2. Organic and inorganic growth to ride tailwinds in Asia

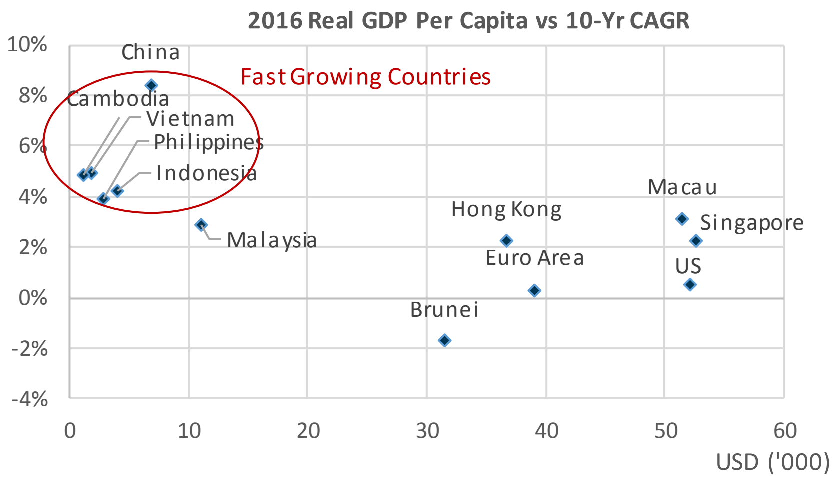
(a) Tapping onto fast growing markets; Diversifying concentration risk in Hong Kong

New Markets: *China, Taiwan, Vietnam, Cambodia, Philippines, Indonesia*

Mature Markets: *Hong Kong, Macau, Singapore, Malaysia, Brunei*

- These underlying factors will underpin the long-term growth trajectory of New Markets, which also helps to mitigate the slowdown in Mature Markets.
  - (i) Rising consumer affluence spurs demand for quality goods and services. Imported goods are preferred over local products.
  - (ii) Consumers are willing to pay a premium for convenience-enhanced services.
  - (iii) Rising foreign direct investments into modern retail formats and government's push to redevelop traditional markets into a modern retail distribution system would promote higher market penetration of modern trade.
  - (iv) Urbanization underpins demand for affordable quality home furnishings.
  - (v) Improving infrastructure and distribution systems increases market accessibility.

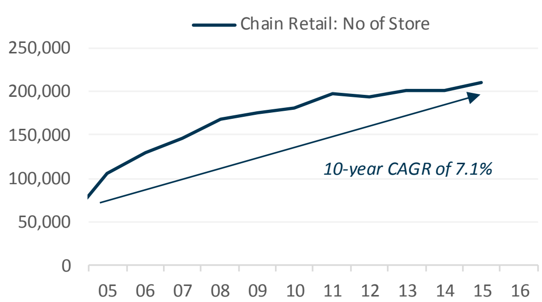
Figure 13: Emerging markets' growing disposable income and buoyant economies



Source: World Bank, PSR
** Taiwan data unavailable*

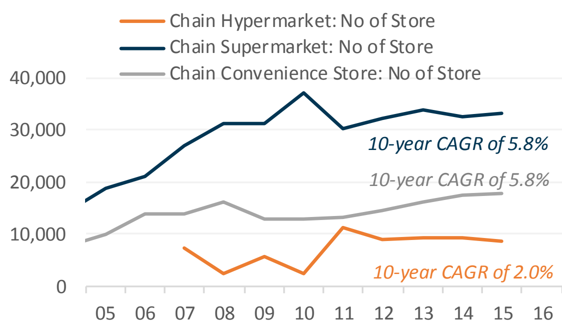
- **Evolving retail landscape.** The rapid globalization, commercialization and urbanization after opening up their markets, coupled with favourable demographics, are supportive of structural growth in these countries.
- **Example #1: China**
  - (i) China is the world's second largest retail market after the United States.
  - (ii) Its rebalancing towards a consumption-driven economy will encourage domestic demand and further reshape the industry to modern retail.

Figure 14: Retail industry boom



Source: CEIC, PSR

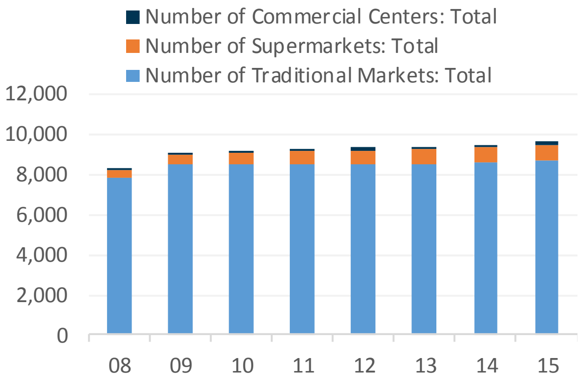
Figure 15: Trend of favouring smaller format store



Source: CEIC, PSR

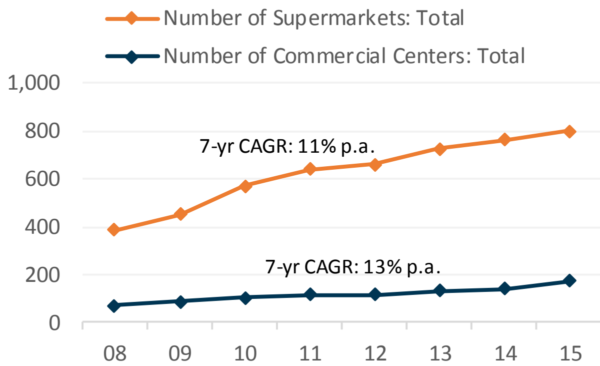
- **Example #2: Vietnam**
  (i) Vietnam aims to grow modern retail contribution from 20% in 2011 to 43% of the total retail trade by 2020.
  (ii) Since Vietnam officially joined the World Trade Organisation in 2007, the number of supermarkets and commercial centres grew 107% and 141.7%, respectively, between 2008-15.
  (iii) Dairy Farm opened its first five Guardian stores in 2011. Management shared that competition within the Health and Beauty segment remains scarce – there are few branded or chain affiliated pharmacy retailers in Vietnam.

Figure 16: Still dominated by traditional markets



Source: CEIC, PSR

Figure 17: Rapid modernization



Source: CEIC, PSR

- **Example #3: The Philippines**
  (i) Philippines is set to be Asia's fifth largest retail grocery market, behind China, India, Japan, and Indonesia, according to the 24th National Retail Conference in the Philippines. The market is expected to grow by an average of 9.3% p.a. from 2016 to about PHP7tn (or c.US$140bn) in 2021.
  (ii) Modern trade currently accounts for c.20% of total grocery retail sales and is expected to grow rapidly in both the number of outlets and sales for modern grocery retailers.
  (iii) The consolidation of Rustan's to 100% ownership and its successful integration of Rose Pharmacy should continue to boost Philippine's contribution to its Food and Health and Beauty segments in FY17-18.

(b) Expanding its brick-and-mortar store network which offers convenience and accessibility

- After an intensive store rationalization exercise in 2015-16, the Group has changed its gear to focus on expanding its presence. The Group added a net 114 stores in 2016 bringing a total 6,548 stores as at end Dec-2016, including its interest in 487 Yonghui stores in Mainland China.
- **Expanding 7-Eleven footprint in Guangdong, China.** While Hong Kong remained the main profit driver for Convenience Store division, Management has been very optimistic on China's growth.

  7-Eleven is one of the leading convenience stores in China. Its store count in Guangdong was at 828 as at end-Dec 16. It is on-track to its expansion plan of 900 stores this year, and 1,000 stores in the subsequent year. As compared to Hong Kong's c.930 stores serving population of 7.4mn, Guangdong has much room to expand on the back of 110mn consumer pool. Based on the latest data available in 2015, Guangdong has only 1,877 convenience stores.
- On the other hand, **a fourth IKEA store in Hong Kong** is scheduled to open later this year (Oct-17) and a site for a **second store in Jakarta** had been secured.

Figure 18: 7-Eleven in Guangdong

Source: Company

Figure 19: Pop-up Store in Tsuen Wan

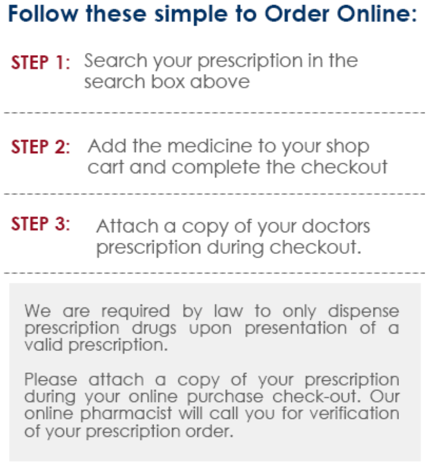
Source: Company

(c) Creating a seamless consumer experience and extending reach via e-commerce

- Development in technology, logistics and infrastructure in the region has revolutionized spending pattern and business operation. Alongside governments' initiatives to promote e-commerce, momentum of online transactions growth in Asia should continue.
- Dairy Farm's online platform complements in-store sales, while pick-up points and delivery services enable efficient customer services.
- **Health and Beauty**
  E-prescription and Online Pharmacist services in Rose Pharmacy (Philippines) and collaboration with MyDoc in Guardian (Singapore).
- **IKEA**
  Online shopping service was first rolled out in Hong Kong and Indonesia in 2016, followed by Taiwan in 2017. It has four pick-up points – which are located at Macau (1), Hong Kong (2), and Taiwan (1). The Group also plans to rollout parcel pick-up services at selected 7-Eleven stores in Hong Kong.

** In parenthesis are the number of pick-up points in the respective country*

Figure 20: E-prescription



Source: Rose Pharmacy Website

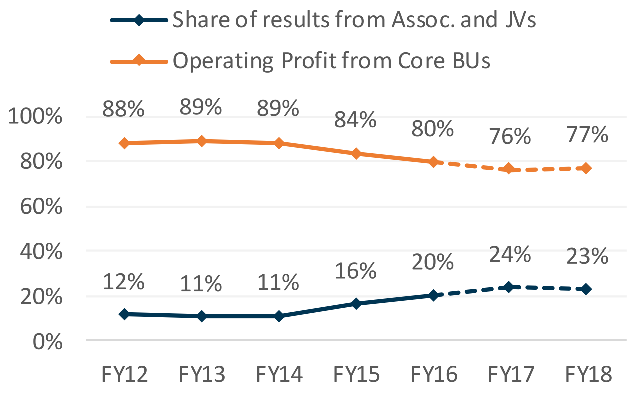
Figure 21: Pick-up Point in Hsinchu County, Taiwan, provides the locals a convenient alternative instead of travelling to IKEA Taoyuan

Source: IKEA Taiwan website

3. Fruition from its investment in Associates and JVs: Yonghui and Maxim's driving earnings

- Contribution from Associates and JVs to Group's EBIT increased over the past two years since the acquisition of Yonghui. We expect its contribution to stay above 20% of EBIT going forward.

Figure 22: Strategic investment in Yonghui and Maxim's are bolstering EBIT growth



Source: Company, PSR

- **Strong growth in Yonghui due to both stores expansion and margin gains from more effective merchandising**

(i) It has consistently contributed to the bottom line, despite the challenging trading environment in China. Its size, in terms of turnover, has already outpaced the Group's Supermarket and Hypermarket businesses.

Currently, Yonghui has nearly 500 stores. It targets to reach 700 stores by FY19/20e, i.e. to toll out another 100 outlets per year in the next two years.

(ii) Its major shareholders include Dairy Farm (19.99%) and JD.com (10%). Its strategic partnerships with Dairy Farm will expand its product scope; and JD.com will expand scale up its e-commerce and O2O (online-to-offline) capabilities.

On the other hand, Dairy Farm could enhance margins from increase direct sourcing in mainland China via Yonghui. Yonghui could also potentially provide a distribution platform for Dairy Farm's private labels.

Figure 23: Yonghui is the 4th largest hypermarket operator in China

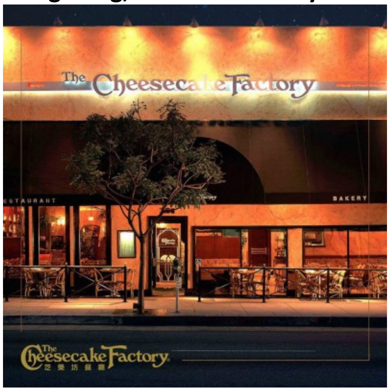
- **Maxim's continues to expand organically and via acquisition to become one of Asia's leading food and beverage companies**

  Maxim's is a leading restaurant and catering company in Hong Kong. It operates over 1,000 outlets across Greater China and Southeast Asia, with a diverse portfolio of over 70 brands comprising Chinese, Asian and European restaurants, quick service restaurants, bakery shops and institutional catering. It is also the licensee of renowned brands including Starbucks Coffee, Genki Sushi and IPPUDO ramen and The Cheesecake Factory in various territories.

  Hong Kong Caterers and Dairy Farm each holds 50% of Maxim's stakes.

  New and gestating brand names which will contribute in FY17-18e
  (i) Its 20 Starbucks cafes in Vietnam and Cambodia
  (ii) Opened its first Treats food hall in Hong Kong in 2016, and looking to open Jade Garden and Café Landmark in Beijing, China in 2017.
  (iii) Launched MX Cakes and Bakery, its first Thai franchise via a joint venture with ThaiBev in Sep-16, with three outlets opened in Bangkok
  (iv) The Cheesecake Factory has started with two outlets in China (one each in Shanghai Disney Town and Beijing), and one outlet in Hong Kong. Under the terms of its licensing agreement with The Cheesecake Factory, Maxim's will open a minimum of 14 restaurants over 10 years in Hong Kong, Macau, Taiwan, and China, with the possibility of also entering Japan, South Korea, Malaysia, Singapore, and Thailand.
  (v) Acquired COVA, a premium chain of cake shops and restaurants, in Apr-16. COVA has ten outlets across Hong Kong.
  (vi) Acquired franchise to operate Shake Shack, an American burger-and-fries restaurant format, in Hong Kong and Macau with the first store opening in 2018.

Figure 24: The Cheesecake Factory in Hong Kong, launched in May-17



Source: Company

Forecast Assumptions

1. Revenue bottomed out in FY17e with expansion driving sales; Associates continue to boost earnings growth

We expect earnings to grow c.10% p.a. in FY17-18e, driven by:

(a) Higher turnover driven by store openings, together with the introduction of enhanced e-commerce offers in many of its businesses.

We also expect FY17-18e revenue to pick up in its key markets, following

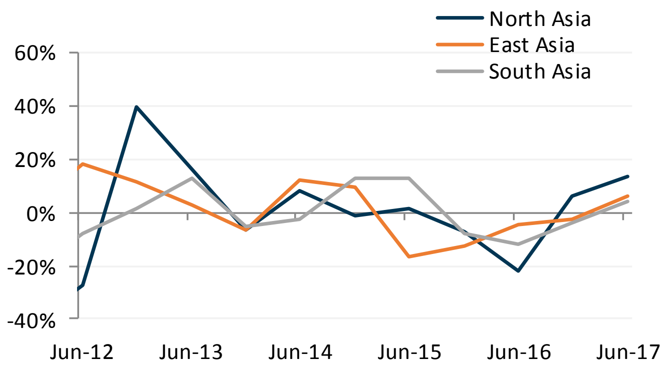
- Modest increase in mainland Chinese tourist arrivals in Hong Kong and Macau
- Singapore with stronger consumer sentiment

(b) Improved same-store-sales, benefitting from store rationalization exercise

(c) Margin enhancement initiatives, including expansion of the range of fresh produce and corporate brands, as well as investments in technology and supply chain infrastructure

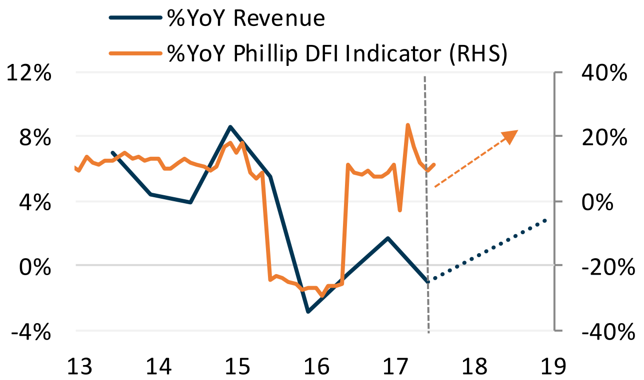
(d) Higher contributions from associates

Figure 25: Consumer confidence recoveries in 1H17



Source: Bloomberg, PSR

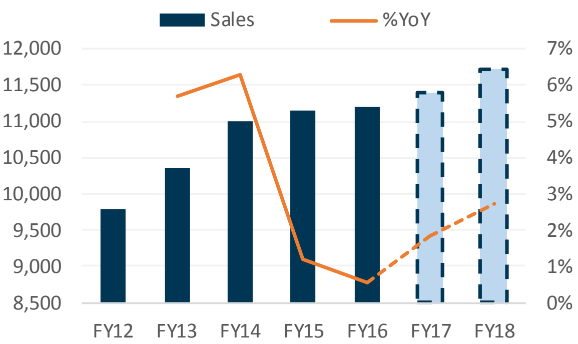
Figure 26: Positive momentum to continue in FY17-18e



Source: CEIC, PSR

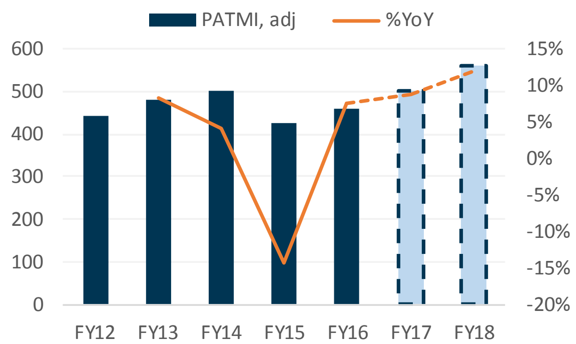
** Phillip DFI Indicator is an index of retail sales from the countries which the Group operates in. It is weighted based on contribution of respective regions.*

Figure 27: Group revenue to grow c.2% p.a. in FY17-18e



Source: Company, PSR

Figure 28: But earnings to grow c.10% p.a. in FY17-18e



Source: Company, PSR

Figure 29: Supermarkets & Hypermarkets
Driven by its associate, Yonghui

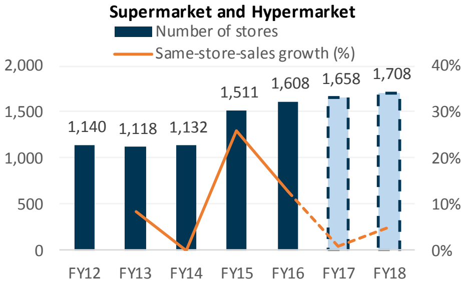


Figure 30: Convenience Stores
Expansion drive in Guangdong

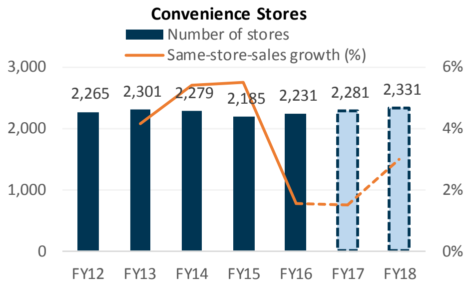


Figure 31: Health & Beauty
Store rationalization improves profitability

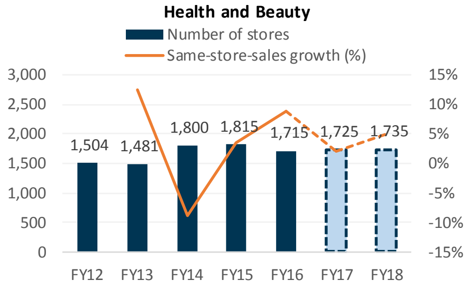


Figure 32: Home Furnishings
New store in Hong Kong in Oct-17

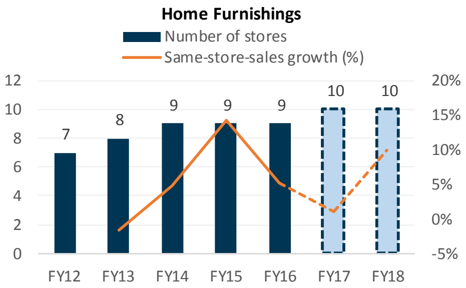
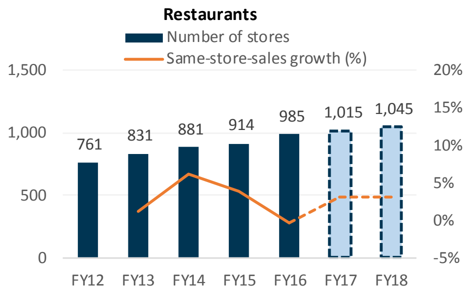


Figure 33: Restaurants
Continue to seek and build leading brands



Source: Company, PSR

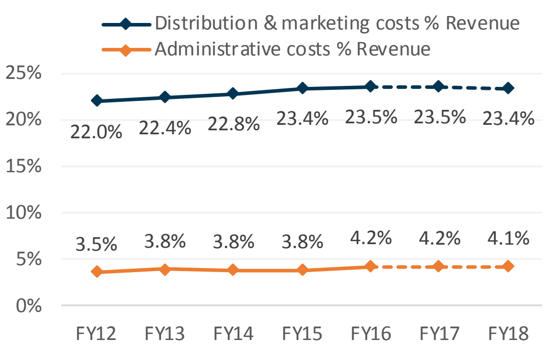
2. Margins expansion from:

(a) Higher margin sales mix: increase fresh penetration, corporate brands participation

(b) Improved economies of scale, better stock management, and consolidation of supply chain across the Group

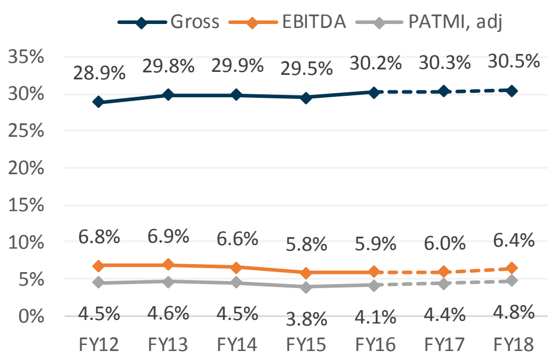
(c) Steady operating costs pressure, particularly rental and labour costs in Hong Kong and Singapore.

Figure 34: Steady Operating Costs as a percentage of Revenue



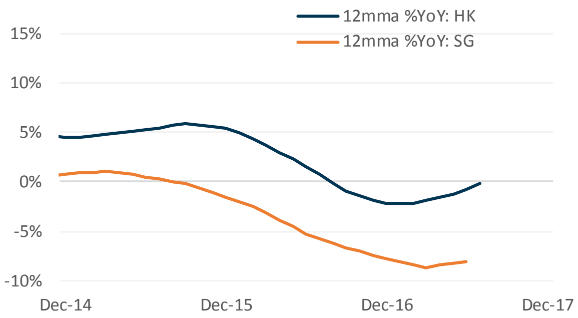
Source: Company, PSR

Figure 35: Realization of margin improvements



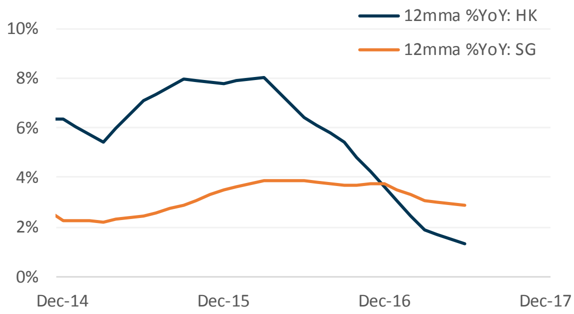
Source: Company, PSR

Figure 36: Property Rental Index: Retail



Source: CEIC, PSR

Figure 37: Average Monthly Wage



3. Strong financial position enabled the Group to grow organically and inorganically, while sustaining dividend payout

The Group's free cash flow stood at US$259mn in FY16 and we expect it to improve over years with higher earnings. The strong operating cash flows enable the Group to:

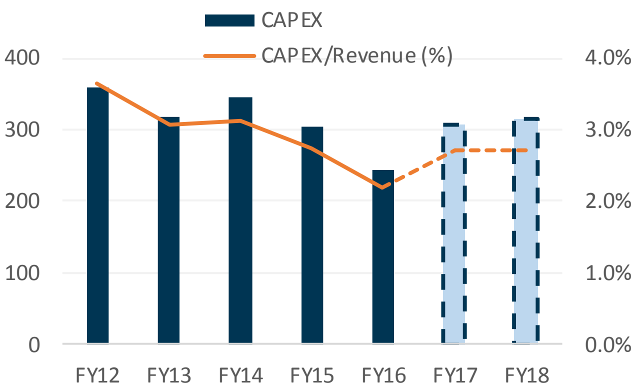
(a) **Par down debt.** The Group is in a net debt position of US$684.9mn with gearing ratio at 0.42x as at 30 Jun-17. We expect gearing ratio to improve to 0.18x by end-FY18e.

(b) **Capital expenditure (CAPEX).** Scalability and replicability enable fast expansion.

(c) **Secure further development opportunities or M&A deals.** Consolidation of Rustan's to 100% ownership will be the next milestone. No details on the transaction has been disclosed yet. However, we could expect an acquisition consideration of c.US$50mn based on the 2014 acquisition deal (16% interest of Rustan's at US$23.4mn).

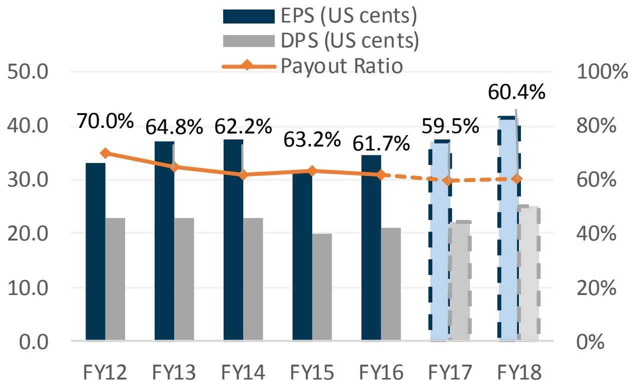
(d) **Higher dividend per share.** Historical 5-year average dividend payout ratio was 64.4%. We expect the Group to payout 22.0 and 25.0 Cents per share in FY17e and FY18e respectively, which represent 4.8% and 13.6% increase YoY.

Figure 38: Ramping up store count



Source: Company, PSR

Figure 39: Sustainable dividend payout backed by strong cash flow



Source: Company, PSR

Valuation

Sum-of-the-parts (SOTP) target price of S$9.89. We value the respective core businesses and its unlisted associate, Maxim's, at respective peers' average. Meanwhile, its affiliated company, Yonghui, is valued based on its latest market value.

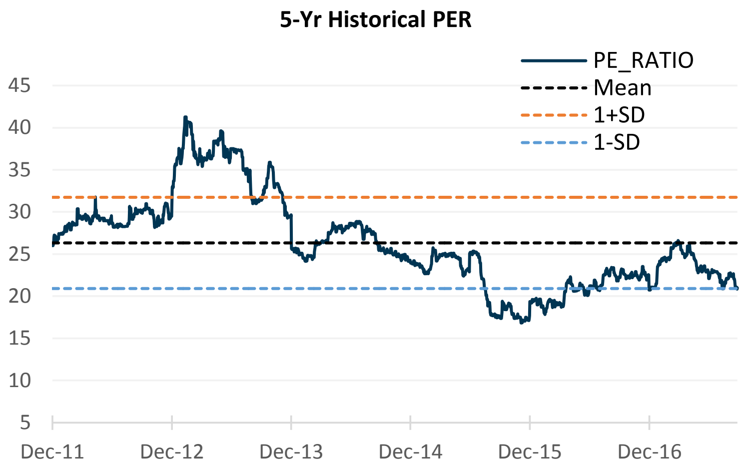
Figure 40: A US$9.89 target price

Sum-of-parts Valuation					
Equity affiliate		**Mkt Cap (USD mn)**	**EV (USD mn)**	**Stake (%)**	**EV to DFI (USD mn)**
Yonghui Superstores Co., Ltd		11,108	10,498	19.99	2,099
Unlisted Associate	**FY18e Sales (USD mn)**	**Peer's Fwd EV/Sales (x)**	**EV (USD mn)**	**Stake (%)**	**EV to DFI (USD mn)**
Restaurants	2,273	0.5	1,136	50.0	568
Core Businesses		**FY18e EBITDA (USD mn)**	**Peer's Fwd EV/EBITDA (x)**		**EV to DFI (USD mn)**
Food		367	9.5		3,482
Health and Beauty		270	20.0		5,396
Home Furnishings		113	20.0		2,264
		750			11,142
Total EV (US$ mn)		13,809			
Less: Debt		733			
Less: Minority Interest		74			
Plus: Cash		372			
Total Market Value (US$ mn)		**13,373**			
Total Sum-of-parts					
No. of shares (mn)		1,352			
NAV/Share (TP US$)		9.89			
Current share price (US$)		7.48			
% upside/downside		*32.2%*			
FY18e EPS (US$)		0.41			
Implied FY18e P/E (x)		*23.9*			

Source: Bloomberg, PSR

Dairy Farm is currently trading at trailing PER of 21x, which is near one standard deviation below its 5-year average. It is trading at a discount to its peers' average of 25x for retailers. Our SOTP TP of US$9.89 implied 26.7x/23.9x FY17/18e PER.

Figure 41: PER range



Source: Bloomberg, PSR

Figure 42: Dairy Farm PER below Food industry peers

Comparables

Company	FYE	Mkt Cap (USD mn)	EV (USD mn)	EV/EBITDA FY1	P/S FY1	EV/S FY1	P/E	P/B	Div Yield (%)	Net D/E (%)	ROE (%)
DAIRY FARM INTL HLDGS LTD	12/2016	10,116	10,873	15.2	0.9	1.0	21.0	6.4	2.8	40.6	32.5
Yonghui Superstores Co Ltd	12/2016	11,108	10,498	25.0	1.3	1.2	43.4	3.8	1.6	Net Cash	10.4
Food											
Sun Art Retail Group Ltd	12/2016	8,610	7,491	6.5	0.5	0.5	20.0	2.7	3.3	Net Cash	13.8
Sheng Siong Group Ltd	12/2016	1,021	972	14.0	1.7	1.6	21.5	5.4	3.7	Net Cash	25.4
Zhongbai Holdings Group Co Ltd	12/2016	967	947	18.4	0.4	0.4	30.5	2.1	0.9	21.4	6.9
Jiajiayue Group Co Ltd	12/2016	1,134	740	8.7	0.6	0.4	22.4	3.2	2.2	Net Cash	15.1
Chengdu Hongqi Chain Co Ltd	12/2016	1,234	1,185	23.8	1.2	1.1	59.8	3.6	0.3	Net Cash	6.4
Sumber Alfaria Trijaya Tbk PT	12/2016	2,157	2,672	10.4	0.4	0.6	40.6	5.7	0.6	109.5	12.1
Matahari Putra Prima Tbk PT	12/2016	255	279	11.8	0.2	0.3	N/A	1.5	N/A	20.6	-4.5
Aeon Co M Bhd	12/2016	676	867	7.5	0.7	0.9	35.7	1.5	1.5	46.3	4.2
Robinsons Retail Holdings Inc	12/2016	2,719	2,692	15.8	1.2	1.2	27.2	2.8	0.7	Net Cash	10.8
Metro Retail Stores Group Inc	12/2016	290	235	6.2	0.4	0.3	15.4	2.0	1.2	Net Cash	13.3
Cosco Capital Inc	12/2016	1,229	1,783	6.4	0.4	0.6	12.3	1.2	0.9	Net Cash	9.7
Puregold Price Club Inc	12/2016	2,725	2,820	13.5	1.1	1.2	24.1	3.0	0.6	2.5	13.3
Lawson Inc	02/2017	6,593	7,473	6.6	1.1	1.3	19.8	2.7	3.4	51.9	14.1
FamilyMart UNY Holdings Co Ltd	02/2017	6,453	8,451	9.0	0.6	0.8	27.6	1.4	2.0	58.4	5.9
Market Cap Weighted Average (Food)				9.7	0.8	0.8	25.0	2.7	2.2	28.3	11.5
Health & Beauty											
Sa Sa International Holdings Ltd	03/2017	1,131	1,006	12.5	1.1	1.0	26.6	4.0	5.8	Net Cash	14.5
It's Hanbul Co Ltd	12/2016	501	531	8.8	2.2	2.4	N/A	1.1	2.7	Net Cash	9.4
Beauty Community PCL	12/2016	1,326	1,294	32.8	12.5	12.1	50.5	31.6	2.0	Net Cash	67.4
Market Cap Weighted Average (Health & Beauty)				21.0	6.4	6.2	32.8	15.9	3.5	0.0	37.3
Home Furnishing											
Test Rite International Co Ltd	12/2016	380	563	9.7	0.3	0.5	16.5	1.6	4.8	68.3	9.5
Siam Global House PCL	12/2016	1,805	2,050	22.2	2.9	3.3	38.6	4.7	1.0	47.1	10.9
Market Cap Weighted Average (Home Furnishing)				20.1	2.4	2.8	34.8	4.2	1.7	50.8	10.7
Restaurant											
Tsui Wah Holdings Ltd	03/2017	199	144	5.5	0.8	0.6	17.2	1.3	5.0	Net Cash	N/A
BreadTalk Group Ltd	12/2016	324	366	5.3	0.7	0.8	21.4	3.3	3.2	29.1	15.8
Market Cap Weighted Average (Restaurant)				5.3	0.7	0.7	19.8	2.6	3.9	18.1	9.8

Source: Bloomberg

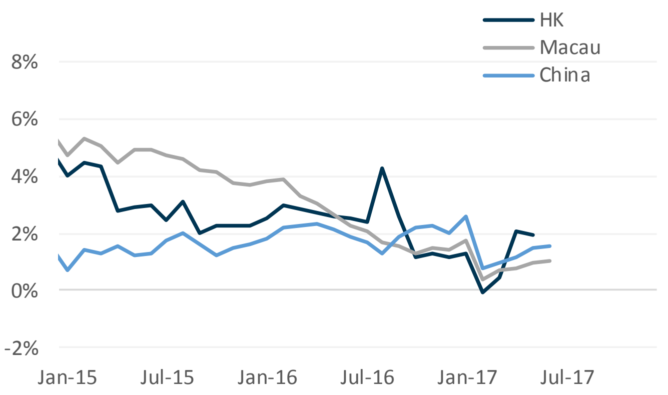
Investment Risks

1. Prolonged macro headwinds in Hong Kong, Macau, Indonesia and Malaysia could dampen consumer confidence and weigh on performance.
   - Hong Kong and Macau were impacted by lacklustre mainland Chinese tourist arrivals
   - Singapore, Malaysia and Indonesia suffered from soft consumer sentiment and currency weakness
   - Higher inflation could also erode consumers' spending power

2. Intensifying competition and increasing operating costs, especially labour and rental costs could crimp profit growth.

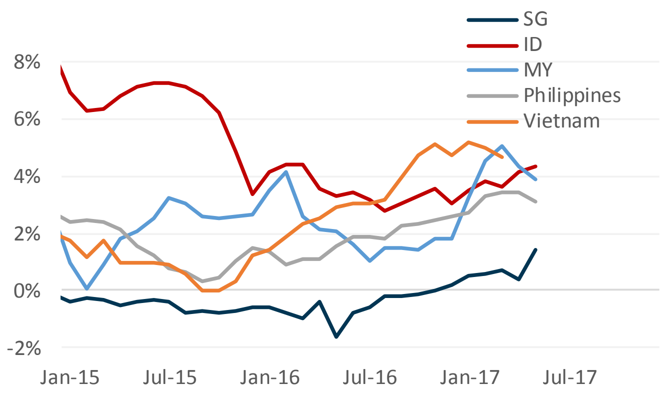
3. Regulatory risk in operating countries, such as:
   - New regulations curtailing late night alcohol sales in Singapore
   - The introduction of GST (Apr-15) and Anti-Profiteering Act (early-17) in Malaysia
   - A substantial cigarette tax hike (Jul-15) in Macau

Figure 43: Moderate inflation in Greater China



Source: CEIC, IMF, PSR

Figure 44: Contained inflation in Emerging Markets; while Singapore is seeing an uptick



Source: CEIC, IMF, PSR

4. Unfavourable exchange rate movements will affect the Group's US dollar reported results and led to lower underlying earnings for the period.

5. Cancellation, termination, or unfavourable renegotiation terms and conditions of concessions, franchises and key contracts could have an adverse effect on the business operations.

Financials

Income Statement

Y/E Dec, USD mn	FY14	FY15	FY16	FY17e	FY18e
Revenue	**11,008**	**11,137**	**11,201**	**11,407**	**11,719**
Gross profit	3,291	3,285	3,386	3,456	3,574
Core EBITDA	**727**	**647**	**665**	**684**	**750**
Depreciation & Amortisation	203	212	213	217	223
Core EBIT	**524**	**435**	**453**	**467**	**527**
Associates & JVs	69	85	115	146	158
Other items	10	(4)	10	0	0
Net Finance Inc/(Exp)	(2)	(14)	(22)	(21)	(22)
Profit Before Tax	**601**	**502**	**555**	**592**	**663**
Taxation	(93)	(84)	(85)	(92)	(103)
Profit After Tax	**508**	**418**	**470**	**500**	**560**
- Non-controlling interest	(2)	(6)	0	0	0
PATMI, reported	**509**	**424**	**469**	**500**	**560**
PATMI, adj.	**500**	**428**	**460**	**500**	**560**

Per share data (USD)

Y/E Dec	FY14	FY15	FY16	FY17e	FY18e
EPS, reported	0.38	0.31	0.35	0.37	0.41
EPS, adj.	0.37	0.32	0.34	0.37	0.41
DPS	0.23	0.20	0.21	0.22	0.25
BVPS	1.13	1.08	1.17	1.32	1.51

Cash Flow

Y/E Dec, USD mn	FY14	FY15	FY16	FY17e	FY18e
CFO					
Operating Profit	534	431	459	467	527
Adjustments	207	237	221	217	223
WC changes	(17)	73	(97)	99	24
Net finance expense	(1)	(13)	(21)	(21)	(22)
Tax paid	(94)	(90)	(85)	(92)	(103)
Dividends from Assoc/JV	48	62	66	86	94
Others	0	0	0	0	0
Cashflow from ops	**676**	**700**	**543**	**755**	**743**
CFI					
CAPEX, net	(367)	(449)	(243)	(308)	(316)
Others	(65)	(917)	(185)	0	0
Cashflow from investments	**(433)**	**(1,365)**	**(428)**	**(308)**	**(316)**
CFF					
Loans, net of repayments	21	573	238	(114)	(117)
Dividends	(311)	(311)	(270)	(284)	(298)
Others	(2)	16	(10)	0	0
Cashflow from financing	**(293)**	**278**	**(42)**	**(398)**	**(415)**
Net change in cash	(50)	(388)	72	49	12
Effects of exchange rates	(5)	(12)	(7)	(7)	(7)
CCE, end	**657**	**257**	**323**	**365**	**371**

Balance Sheet

Y/E Dec, USD mn	FY14	FY15	FY16	FY17e	FY18e
ASSETS					
PPE	1,219	1,141	1,100	1,134	1,169
Intangibles	566	744	765	822	881
Investments in Assoc/JV	388	1,292	1,462	1,522	1,586
Others	213	203	186	186	186
Total non-current assets	**2,386**	**3,381**	**3,512**	**3,664**	**3,822**
Accounts receivables	252	234	291	250	257
Cash	662	259	324	366	372
Inventories	(1,011)	(937)	(983)	(1,002)	(1,026)
Others	2,027	1,885	1,986	2,023	2,072
Total current assets	**1,930**	**1,440**	**1,617**	**1,638**	**1,674**
Total Assets	**4,316**	**4,821**	**5,129**	**5,302**	**5,496**
LIABILITIES					
Accounts payables	2,413	2,355	2,328	2,405	2,460
Short term loans	93	730	370	425	220
Others	59	67	73	73	73
Total current liabilities	**2,566**	**3,151**	**2,771**	**2,903**	**2,754**
Long term loans	94	11	595	425	513
Others	135	204	184	184	184
Total non-current liabilities	**228**	**215**	**779**	**609**	**697**
Total Liabilities	**2,794**	**3,366**	**3,550**	**3,512**	**3,451**
EQUITY					
Non-controlling interests	94	79	74	74	74
Shareholder Equity	**1,429**	**1,376**	**1,505**	**1,715**	**1,971**

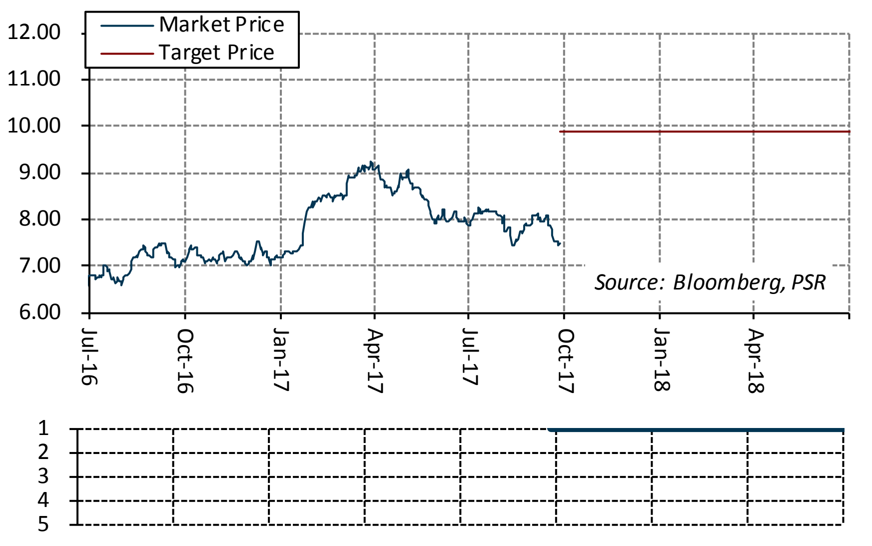
Valuation Ratios

Y/E Dec	FY14	FY15	FY16	FY17e	FY18e
P/E (X), adj.	24.3	19.2	22.2	20.2	18.1
P/B (X)	8.0	5.7	6.5	5.7	4.9
EV/EBITDA (X), adj.	16.2	13.6	16.4	15.6	14.1
Dividend Yield (%)	3.1%	2.7%	2.8%	2.9%	3.3%
Growth & Margins (%)					
Growth					
Revenue	6.3%	1.2%	0.6%	1.8%	2.7%
EBITDA	1.2%	-11.0%	2.8%	2.8%	9.6%
EBIT	0.4%	-17.0%	4.0%	3.2%	12.8%
Net profit, adj.	4.2%	-14.4%	7.5%	8.7%	11.9%
Margins					
Gross margin	29.9%	29.5%	30.2%	30.3%	30.5%
EBITDA margin	6.6%	5.8%	5.9%	6.0%	6.4%
EBIT margin	4.8%	3.9%	4.0%	4.1%	4.5%
Net profit margin	4.5%	3.8%	4.1%	4.4%	4.8%
Key Ratios					
ROE (%)	35.0%	31.1%	30.6%	29.2%	28.4%
ROA (%)	11.6%	8.9%	9.0%	9.4%	10.2%
Net Debt/(Cash)	(475)	482	641	484	362
Net Gearing (X)	Net Cash	33.1%	40.6%	27.1%	17.7%

Source: Company, Phillip Securities Research (Singapore) Estimates

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
<-20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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