

Earnings Review: BreadTalk Group Ltd (“BGL”)

Recommendation

- While the weaker profits in 1Q2018 were largely a result of one-off factors (e.g. absence of divestment gains), contribution from the bakery division has fallen significantly. Nevertheless, BGL remains a highly cash flow generative business, with Food Atrium and Restaurant segments continuing to deliver.
- While credit metrics remain healthy, with reported net debt/EBITDA at 0.28x and net gearing at 0.27x, we expect this to increase to ~3.0x and ~1.0x respectively. We think BREAD will likely deploy the proceeds from the SGD100mn BREAD '23s to focus on expansion and capex to arrest the decline in revenue since 2015.
- We continue to hold BGL with a Neutral (5) Issuer Profile. We think BREAD '19s look fully valued with a spread of 70bps and recommend investors to switch into VITSP '18s (spread: 140bps) or LMRTSP 4.5% '18s (209bps). We think BREAD '23s looks fair, though investors looking for higher carry may consider LMRTSP 4.1% '20s and/or HTONSP 6.08% '21s.

Relative Value:

Bond	Maturity/Call date	Net gearing	Ask Yield	Spread
BREAD 4.6% '19s	01/04/2019	0.24x	3.07%	70bps
BREAD 4% '23s	17/01/2023	0.24x	3.94%	161bps
VITSP 4.15% '18s	19/09/2018	0.68x	3.01%	140bps
LMRTSP 4.5% '18s	23/11/2018	0.53x	3.74%	209bps
LMRTSP 4.1% '20s	22/06/2020	0.53x	4.60%	256bps
HTONSP 6.08% '21s	19/07/2021	0.64x	5.73%	354bps

Indicative prices as at 07 May 2018 Source: Bloomberg, OCBC, Company
Net gearing based on latest available quarter

Issuer Profile: Neutral (5)

Ticker: **BREAD**

Background

Listed on the SGX in 2003, BreadTalk Group Ltd (“BGL”) is a household F&B brand owner. BGL has expanded beyond Singapore and currently operates 943 outlets in China, Singapore, Thailand and other parts of Asia and Middle East. BGL classifies its businesses into Bakery, Food Atrium and Restaurants, with prominent brands including BreadTalk, Toast Box and Food Republic. BGL also operates Din Tai Fung (“DTF”) as a franchisee. The company is majority owned by founders George Quek (34.01%) and Katherine Lee (18.62%).

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Key Considerations

- Flattish 1Q2018 results running on 2 out of 3 engines:** BGL reported 1Q2018 results for the quarter ending 31 March. While revenue was flattish (+0.5% y/y to SGD148.5mn), the results showed a disparity between BGL's main business segments. Bakery's revenue fell 4.5% y/y to SGD70.4mn, mainly due to lower revenue from direct operated stores at Shanghai, Beijing and Hong Kong while lower franchise revenue was received from China (24 fewer outlets y/y to 254 outlets). Food Atrium's revenue increased 3.3% y/y to SGD37.5mn with strong same store growth though this was partially offset with 4 fewer outlets. Restaurant was the outperformer, growing 6.4% y/y to SGD36.9mn with 1 outlet added in Singapore and 2 outlets added in Thailand. While revenue was flattish, EBITDA for the 3 core segments fell 2.2% y/y to SGD17.8mn, with Bakery segment as the largest drag (-31.0% y/y to SGD3.8mn) due to lower revenue (which likely depresses margins). Food Atrium EBITDA (-3.7% y/y to SGD5.3mn) was dragged down by an outlet closure at Hangzhou while Restaurant reported stronger EBITDA (+24.4% y/y to SGD8.7mn) on the back of stronger revenue.
- Credit metrics intact, for now:** Net gearing inched down to 0.24x (2017: 0.26x), mainly due to an increase in equity with investment securities increasing by SGD51.9mn q/q due to the adoption of SFRS (9) on 1 Jan 2018. Reported net debt/EBITDA also improved to 0.28x (2017: 0.49x). However, with [BGL repositioning for growth](#), we expect BGL to consume a substantial portion of its cash balance (1Q2018: SGD210.6mn). As such, net debt/EBITDA may increase to ~3.0x, with net gearing likely to rise closer to 1.0x.
- Potential utilisation of cash:** BGL surprised us with the issuance of SGD100mn BREAD 4% '23s in Jan 2018 given its highly cash flow generative business and healthy credit metrics. As such, we surmise that BGL may undertake a significant increase in capex and large scale partnerships/acquisitions. We note that BGL's revenue has stagnated since 2015 as it has been slowing down on expansion and closed underperforming outlets. With impairments and consolidation largely done,

we see BGL attempting to arrest the revenue decline. BGL has committed to deploy significant capital (~SGD80mn) to subscribe for a 5%-stake in a Perennial-led China JV for property development in China. Recent partnerships include a 66%-34% JV with Shinmei Co Ltd, partnership with Bakeneads LLP to expand into India, JV with Song Fa Holdings to bring the Song Fa brand to China, JV with Wu Pao Chun Food Ltd to operate Wu Pao Chun bakeries in China and JV with PUT Pura Indah Berkat to operate Toast Box chain of outlets in Indonesia.

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Explanation of Issuer Profile Rating / Issuer Profile Score

Positive (“Pos”) – The issuer’s credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral (“N”) – The issuer’s credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative (“Neg”) – The issuer’s credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight (“OW”) – The performance of the issuer’s specific bond is expected to outperform the issuer’s other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral (“N”) – The performance of the issuer’s specific bond is expected to perform in line with the issuer’s other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight (“UW”) – The performance of the issuer’s specific bond is expected to underperform the issuer’s other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

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Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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