

## Earnings Review: BreadTalk Group Ltd (“BGL”)

### Recommendation

- With the Bakery division continuing to perform poorly, 2Q2018 results look lacklustre with flattish revenue (+0.8% y/y to SGD148.8mn) and slight declines in reported EBITDA (-1.9% y/y to SGD18.1mn).
- That said, we remain comfortable with BGL given that it holds SGD206.6mn of cash, which is sufficient to cover its near term maturing debt and capital commitments. Operating cashflows are also likely to cover capex requirements.
- We continue to hold BGL with a Neutral (5) Issuer Profile, despite the good credit metrics for now, as we expect BGL to consume a significant part of its cash balance (e.g. invest in new business, acquisitions) to fuel growth.
- We think BREAD 4.6% '19s look fully valued with a spread of 80bps and recommend investors to switch into HFCSP 4.75% '19s which yields 158bps higher. We think BREAD 4% '23s look fair though it provides some yield pickup over FCTSP 2.77% '24s and CAPITA 3.2115% '23s for exposure to the retail sector. However, we prefer OUESP 3.55% '23s, which yields higher than BREAD 4% '23s with a stronger Issuer Profile of Neutral (4).

### Relative Value:

Bond	Maturity/Call date	Net gearing	Ask Yield	Spread
BREAD 4.6% '19s	01/04/2019	0.24x	2.49%	80bps
BREAD 4% '23s	17/01/2023	0.24x	4.00%	177bps
CAPITA 3.2115% '23s	09/11/2023	0.35x	2.98%	69bps
FCTSP 2.77% '24s	08/11/2024	0.42x	3.24%	87bps
HFCSP 4.75% '19s	22/03/2019	0.34x	3.84%	218bps
OUESP 3.55% '23s	10/05/2023	0.60x	4.19%	194bps

Indicative prices as at 02 Aug 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 930 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

- Lacklustre 2Q2018 results with Bakery continuing to drag...:** BGL reported 2Q2018 results for the quarter ending 30 June. Continuing the trend from 1Q2018, revenue remained flattish in 2Q2018 (+0.8% y/y to SGD148.8mn) with mixed results from various divisions. Bakery continued its poor performance with 2Q2018 revenue declining 5.2% y/y to SGD68.8mn, largely due to lower revenue from direct operated stores (13.5% y/y fall in the number of direct operated stores) and lower franchise revenue from China. However, Food Atrium (+4.0% y/y to SGD38.8mn) and Restaurant (+7.1% y/y to SGD37.3mn) performed well, with the former reporting strong same store growth and the latter adding 3 more outlets in Singapore (1) and Thailand (2).
- ... with weaker EBITDA contribution:** Reported EBITDA fell 1.9% y/y to SGD18.1mn dragged mainly by a significant 40.0% y/y fall in Bakery, which we think is due to the high operating leverage. Management also attributed the fall in EBITDA margin due to the closure of several franchise stores, which were performing below targets but generated higher EBITDA margin than direct operated stores. Meanwhile, restaurant division reported EBITDA also came in lower (-2.2% y/y to SGD7.1mn) which we think is due to expenses incurred by the newly opened restaurants. Food Atrium has become the highest reported EBITDA contributor (+44.3% y/y to SGD7.7mn) with EBITDA margin surging to 19.8% (1Q2018: 14.1%) as vacancy rates fell to a record low (1.5%). While net profit increased 7.7% y/y to SGD4.4mn despite the fall in reported EBITDA, we do not think that this is a cause for celebration as it is largely driven by 11.5% y/y decline in depreciation to SGD9.3mn. Meanwhile, we were surprised that SGD1.9mn of loss on divestment of investment securities was recorded. Noting that this corresponded with q/q declines in current investment securities while interest income surged 297% y/y to SGD1.2mn, we believe this may relate to structured financial products held by BGL.

- **Not worried about refinancing with ample liquidity:** SGD75mn BREAD 4.6% '19s and SGD35.4mn of short-term loans will come due within 12 months, which is covered by SGD206.6mn of cash. This should also be sufficient to cover ~SGD80mn capital that BGL has committed to subscribe for a 5%-stake in a Perennial-led China JV for property development in China. We understand that BGL may undertake SGD40mn-SGD50mn capex p.a. for 2018 and 2019, which should be sufficiently met by operating cash flow before working capital changes (1H2018: SGD37.0mn) – we believe this may be deployed towards the numerous recent JVs that BGL entered. Meanwhile, BGL is not ruling out opportunities for M&A and further JVs. As a recap, the JVs that BGL entered include:
  - i) 5%-stake in a Perennial-led China JV for property development in China
  - ii) 90-10 JV with Song Fa Holdings Pte Ltd to open Song Fa Bak Kut Teh outlets in China and Thailand
    - Subsequently, a 90-10 JV was formed with Shenzhen Pindao Food & Beverage which in turn formed a 90-10 JV (BGL has 81% effective interest) with Song Fa Holdings Pte Ltd to manage the Song Fa brand of restaurants in Shenzhen and Guangzhou
  - iii) 66-34 JV with Shinmei Co Ltd which will oversee the sourcing, procurement and supply of key raw materials and ingredients
  - iv) Partnership with Bakneads LLP, which will be the master franchise to develop and operate BGL's bakery chain in certain parts of India.
  - v) 80-20 JV with Wu Pao Chun Food Ltd to operate Wu Pao Chun bakeries in certain cities in China
  - vi) 70-30 JV with PT. Pura Indah Berkas to bring Toast Box to Indonesia
  - vii) 90-10 JV with Shenzhen Pindao Food & Beverage Management Co Ltd to bring Nayuki and Tai Gai brands into Singapore and Thailand
  - viii) 30-70 JV with BreadTalk franchisee, Ge Ying, to re-enter the Chongqing market
  
- **Credit metrics intact, for now:** Net gearing looks manageable, largely unchanged q/q at 0.24x despite SGD10.1mn net operating cash inflow due to SGD8.4mn payment in dividends. Our estimated net debt/EBITDA at ~0.7x looks healthy still though this has increased from 1Q2018's reported net debt/EBITDA of 0.28x. We expect BREAD's credit metrics to continue weakening and net debt/EBITDA may reach ~3x as BGL consumes its cash balance for growth.

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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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