Asia Credit Research

BreadTalk Group Ltd: Credit Update

Wednesday, 31 January 2018

Repositioning for growth?

- Following the completion of OCBC's engagement, we resume coverage on BreadTalk Group Ltd ("BGL") with an **Issuer Profile of Neutral (5)**.
- In an about-turn from the consolidation phase over 2015-17 when BGL controlled capex and trimmed underperforming stores, recent developments point to BGL deploying significant capital into property development and expanding its F&B business further. Pending further details to be shared, BGL has issued a SGD100mn 5-year bond, which may result in net debt/EBITDA deteriorating to 3.7x (from 0.7x).
- That said, we expect BGL's credit metrics to remain manageable with multiple performing brands generating healthy cashflows. We rate the recent **BREAD 4% '23s with a Neutral recommendation, seeing fair value around 3.75%**. We think BREAD '23s may appeal to investors seeking diversification into a rare F&B issuer.

S&P: Not rated

Moody's: Not rated

Fitch: Not rated

Ticker: BREAD

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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 957 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%).

Recent developments

Deployment of up to SGD96.2mn for property:

1. BGL will subscribe for a 5%-stake in a Perennial-led China JV to invest in, acquire and develop predominantly healthcare focused integrated mixed-use developments. While the initial required commitment is USD500mn, the JV targets an eventual USD1.2bn total committed capital. Given BGL's 5% stake, the cash commitment could amount to USD60mn (~SGD80mn).
2. BGL paid SGD16.2mn to purchase a freehold shop house located in Holland Village.

Both transactions should be met with SGD124.8mn cash on hand as of 3Q2017.

Expansion of F&B business:

1. BGL has entered into a 66%-34% JV with Shinmei Co Ltd ("Shinmei"). The JV will oversee the sourcing, procurement and supply of key raw materials and ingredients. According to Straits Times, BGL targets to reduce purchase value (est. SGD100mn p.a.) by 1% (~SGD1mn p.a. in recurring savings). We also see the potential for revenues to increase as the JV may potentially supply to third parties in the future and BGL will deliver new food concepts formed under the JV. BGL may also tap on Shinmei's presence to expand in the U.S and also to Japan (with talks to launch BreadTalk, Food Republic and Song Fa Bak Kut Teh). However, we understand that discussions on the details are still ongoing between BGL and Shinmei. Shinmei is based in Japan and procures and trades rice, flour, sugar and dairy products.
2. BGL looks to expand in India as Bakekneads LLP ("Bakekneads") has signed a master franchise to develop and operate BGL's bakery chain in Delhi and National Capital Region. The first bakery store is expected to open in 3Q2018. Bakekneads is a member of Som Datt Group, which has been involved in large-scale construction projects and the F&B industry.
3. Under the JV with Song Fa Holdings, the first Song Fa restaurant opened in Shanghai on 26 Jan 2018.

Issuance of bond: SGD100mn 4-year issue was priced on 10 Jan 2018.

Discussion on potential increase in leverage profile

While BGL has not stated the use of proceeds for the SGD100mn issue, we assume that the proceeds from the issuance will be consumed in subsequent needs. Together with the potential ~SGD80mn cash outlay for investment in the Perennial-led China JV, **we expect net debt/EBITDA to increase to 3.7x**, by conservatively assuming that EBITDA generation from the investment in China as well any other potential investments will be zero in the immediate-to-near term.

As BGL has raised SGD100mn, even while the F&B operations are cashflow generative, we surmise that BGL could be undertaking one or several of the following:

(1) **Likely significant increase in capex**. While BGL has been in a consolidation phase to slow down expansion and close the underperforming outlets, this has resulted in a stagnation of revenue (TTM revenue: SGD602.8mn) since 2015 (revenue: SGD624.1mn). As discussed above, we see signs that BGL is attempting to arrest the decline. Expansions include (a) entering into a 90-10 JV to partner Song Fa Bak Kut Teh in China and Thailand, (b) opening a Din Tai Fung restaurant in the UK, (c) partnering Shinmei (details as discussed above) and (d) development of new brands, for example the rebranding of RamenPlay to Sō. We also understand that BGL may be planning a central kitchen in China, which may incur ~SGD15mn-SGD20mn capex. As a comparison, capex during the 2012-2013 growth phase was ~SGD100mn p.a.

(2) **Possible large scale acquisitions**. BGL does not have a history of large scale acquisition of other F&B brands, so this may be unlikely. However, we would not rule out further partnerships that require significant capital (e.g. with Perennial in China).

(3) **Refinance, though unlikely to be the reason to issue the new bond**. While BGL has sizeable SGD159.2mn debt, we do not think there is a hurry to refinance given that only SGD45.2mn of loans will be due within the next 12 months, which may be met by the cash on hand and healthy free cashflow (9M2017: SGD25.7mn).

Key credit considerations

- **Mixed bag of results:** Revenue continued to trend down in 3Q2017 (-2.0% y/y to SGD154.3mn) due to Bakery (-1.7% y/y to SGD77.2mn) and Food Atrium (-4.5% y/y to SGD38.8mn) though Restaurant remains flattish (+0.9% y/y to SGD35.3mn). Bakery revenue remains under pressure, likely due to lower revenue from directly operated stores at Shanghai and Beijing and from the termination of underperforming franchisees which still contributed revenues in 3Q2016. Food Atrium's underperformance is likely due to the decrease in the number of outlets by 3 y/y to 54. Reported EBITDA declined 4.6% y/y to SGD20.1mn, mainly weighed down by declines in Bakery (-22.3% y/y to SGD7.4mn) due to weaker revenues, higher raw material costs and closure of underperforming franchisees (which had formally contributed to results despite underperformance). However, Food Atrium turned around (+52.7% y/y to SGD5.9mn) as impairments and underperforming outlets were largely cleared out.

- **Unlocking capital via property divestments:** The Perennial-led consortium intends to enbloc sell AXA Tower (BGL's stake: 5.3%) at no less than SGD1.65bn. If sold at the minimum asking price, after paying down the debt at the AXA JV, we estimate net proceeds to BGL at ~SGD40mn with ~SGD18mn in gains recognized. The potential remains for BGL to unlock more value. Other property investments include 29% stake in CHIJMES (Book value: SGD18.0mn), 5.7% stake in Perennial Tongzhou Development (Book value: SGD20.1mn) and 5.9% stake in Perennial Tongzhou Holdings (Book value: SGD14mn).

- **Expanding and diversifying the F&B business:** A DTF outlet will open in the UK in 2018. In addition, BGL has entered into a 90-10 JV to partner Song Fa Bak Kut Teh ("Song Fa") in China and Thailand, with the first Song Fa outlet to be opened in Shanghai in 2018. Another 2 Song Fa restaurants in Thailand and 3 in China will open in 2018. Meanwhile, BGL has rebranded RamenPlay to Sō, with double digit percentage improvement in revenue. In Malaysia, BGL has sold ML Breadworks Sdn Bhd to a JV Co for SGD0.3mn gain on disposal with a 25% stake retained though impact may be minimal as BGL only has 9 Bakery outlets (out of 862) in Malaysia in 2016.

- **Strong operating cashflows:** 9M2017 cashflow from operations of SGD49.0mn well covers the capex and acquisitions of SGD26.6mn. However, we expect capex to be ramped up given the announced plans for expansion.

- **Multiple performing brands:** DTF is the top performer, contributing 34.3% of 9M2017's reported EBITDA. Although the DTF franchise agreement will expire on July 2021, management has expressed confidence in the renewal of the agreement given BGL's track record in running DTF and interest alignment with the franchisor owning 20% stake in the DTF JV. Bakery (28.8%) and Food Atrium (27.3%) are also significant contributors. A risk though is the continuation of the DTF franchise agreement, which will expire on July 2021. Nevertheless, we are not overly worried as management has expressed confidence in the renewal of the agreement given its track record. The franchisor's interest is also aligned with 20% stake in the DTF JV.

View on the recent BREAD 4% '23s

The recent SGD100mn 5-year issue was priced at 4.0% on 10th Jan, tightening from an initial price guidance of 4.25% on the back of SGD385mn orderbook with investors split between Fund Managers (56%), Private Banks (41%) and Banks/Corp (3%).

We see the fair value around 3.75%, if we assume 20bps yield spread increase p.a. against BREAD '19s (I-spread: 97.8). We think our fair value estimate is reasonable compared to retail REITs and Fraser and Neave Ltd ("FNN"). That said, we think there is potential for BREAD '23s to re-rate tighter with further clarity on the use of proceeds and performance of the expansion of the F&B business (which can diversify BGL's source of income).

While not closely comparable, FCTSP '24s and SGREIT '23s should set the lower bound (60-70bps yield spread) where BGL should trade as the retail REITs have bigger scale, diversity and a larger proportion of tangible assets. We find similarities between BGL and retail REITs as they are dependent on retail sales and the biggest trade sector by revenue of retail REITs is typically from the F&B sector. In addition, BGL generates some rental income from its stake in CHIJMES and AXA Tower.

We also compare to FNNSP 3.09% '22s. We think it is reasonable for BREAD '23s to trade wider given FNN's healthier net debt/EBITDA, larger scale and net gearing.

Despite having a small operating scale, we see diversification benefits to hold BREAD '23s, given that it is a rare issuer in the F&B space (aside from FNN). Being a household name with visible retail presence, we think demand for the issue may remain supported.

Relative Value:

Issue	Maturity	Net debt/ EBITDA	Net gearing	Ask YTW	I-Spread
BREAD 4% 2023	17-Jan-23	0.7x (Forecast: 3.7x)	0.22x (Forecast: 1.3x)	3.78%	174.1
BREAD 4.6% 2019	01-Apr-19	0.7x (Forecast: 3.7x)	0.22x (Forecast: 1.3x)	2.34%	97.8
FCTSP 2.77% 2024	11-Aug-24	6.5x	0.42x	2.80%	59.4
SGREIT 3.4% 2023	26-May-23	7.4x	0.53x	2.74%	66.7
FNNSP 3.09% 2022	23-Mar-22	1.2x	0.05x	2.61%	69.0

Indicative prices as at 31 January 2018
Source: Bloomberg

BreadTalk Group Ltd

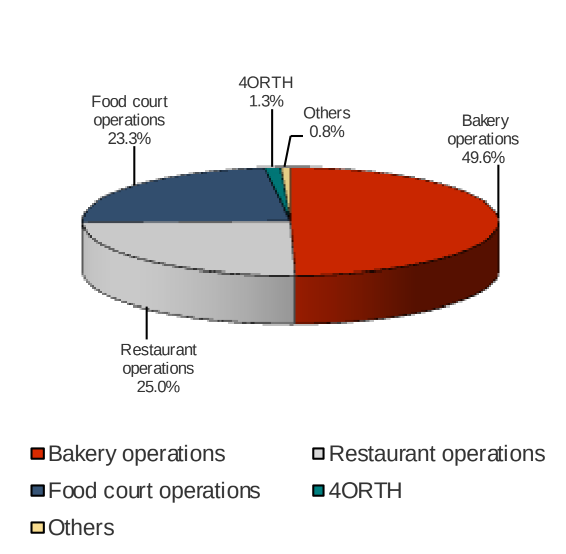
Table 1: Summary Financials

Year End 31st Dec	FY2015	FY2016	9M2017
Income Statement (SGD'mn)			
Revenue	624.1	615.0	449.5
EBITDA	61.3	58.0	38.7
EBIT	11.7	5.8	7.0
Gross interest expense	5.3	5.9	3.6
Profit Before Tax	25.4	29.7	30.8
Net profit	7.6	11.4	16.8
Balance Sheet (SGD'mn)			
Cash and bank deposits	94.9	120.6	124.8
Total assets	545.1	533.9	516.2
Gross debt	202.2	181.3	159.2
Net debt	107.3	60.7	34.5
Shareholders' equity	146.4	151.9	159.6
Total capitalization	348.6	333.3	318.8
Net capitalization	253.8	212.7	194.0
Cash Flow (SGD'mn)			
Funds from operations (FFO)	57.2	63.6	48.4
CFO	66.5	85.2	49.1
Capex	37.6	31.9	23.4
Acquisitions	22.9	2.8	3.2
Disposals	0.1	16.4	29.9
Dividend	7.8	9.7	14.1
Free Cash Flow (FCF)	28.9	53.3	25.7
* FCF adjusted	-1.7	57.2	38.3
Key Ratios			
EBITDA margin (%)	9.8	9.4	8.6
Net margin (%)	1.2	1.9	3.7
Gross debt to EBITDA (x)	3.3	3.1	3.1
Net debt to EBITDA (x)	1.8	1.0	0.7
Gross Debt to Equity (x)	1.38	1.19	1.00
Net Debt to Equity (x)	0.73	0.40	0.22
Gross debt/total capitalisation (%)	58.0	54.4	49.9
Net debt/net capitalisation (%)	42.3	28.6	17.8
Cash/current borrowings (x)	1.2	3.8	2.8
EBITDA/Total Interest (x)	11.5	9.8	10.7

Source: Company, OCBC estimates

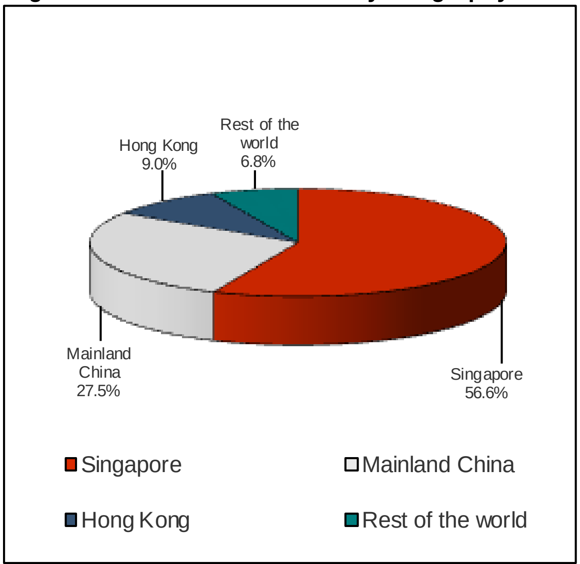
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals*

Figure 1: Revenue breakdown by Segment - 9M2017



Source: Company

Figure 2: Revenue breakdown by Geography - 9M2017



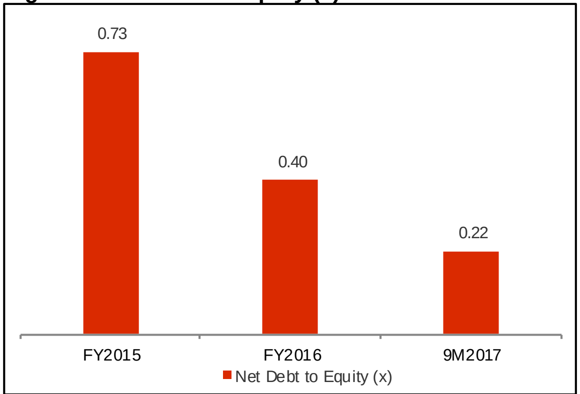
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 30/09/2017	% of debt
Amount repayable in one year or less, or on demand		
Secured	35.3	22.1%
Unsecured	10.1	6.4%
	45.4	**28.4%**
Amount repayable after a year		
Secured	37.5	23.5%
Unsecured	76.8	48.1%
	114.3	**71.6%**
Total	**159.8**	**100.0%**

Source: Company, OCBC estimates

Figure 4: Net Debt to Equity (x)



Source: Company

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.

Co.Reg.no.:193200032W