Issuer Profile:

Neutral (5)

BreadTalk Group Ltd ("BGL")

Ticker:

BREAD

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Recommendation

- **2Q2019 results revealed weaknesses in the Bakery segment. While y/y results are not comparable due to changes accounting rules, on a q/q basis EBITDA for the Bakery segment fell 11.8% q/q to SGD12.7mn which is not attributable to seasonality effects. We think underperformance may continue in 2019.**
- **Meanwhile, EBITDA growth continued in the Food Atrium (+13.4% q/q to SGD22.9mn) and Restaurant (+41.9% q/q to SGD14.9mn) segments.**
- **Net gearing rose q/q to 65% (1Q2019: 41%) due to capex (SGD13.6mn) and purchase of stakes in NPPG (SGD18.3mn). Net gearing may rise further and reach nearly 1x, based on capex guidance of SGD60mn-SGD80mn.**
- **While credit metrics will be pressured and Bakery segment has lost its shine, we remain comfortable with BGL's credit profile. Cash of SGD128.1mn sufficiently covers SGD53.9mn of current debt. Food Atrium and Restaurant segments are still anchoring the business which supported operating cashflows before working capital changes of SGD97.8mn in 1H2019. Reported EBITDA to interest expense is healthy at 8.5x.**
- **Despite some pressure on the credit profile, we stay Neutral on BREAD 4% '23s noting that it is a rare issuer in the F&B space and it trades wider than retail peers (e.g. REITs). That said, we prefer METRO 4.3% '24s, given that we rate Metro Holdings Ltd one notch higher at Neutral (4) Issuer Profile and we note that Metro is also a household name.**

Relative Value:

Bond	Maturity / Call date	Net gearing	Ask YTW	Spread
BREAD 4% 2023	17/01/2023	65%	3.75%	217bps
METRO 4.3% 2024	02/04/2024	19%	3.78%	220bps

Indicative prices as at 5 August 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter

Background

- Listed on the SGX in 2003 with a market cap of SGD383mn, BreadTalk Group Ltd ("BGL") is a household F&B brand owner. Prominent brands include BreadTalk, Toast Box and Food Republic. As a franchisee, BGL operates Din Tai Fung ("DTF"), Song Fa Bak Kut Teh ("Song Fa"), Wu Pao Chun Bakery, Nayuki and TaiGai.
- BGL has expanded beyond Singapore. As of end-June 2019 operates 386 outlets in China, Singapore, Thailand and other parts of Asia and Middle East. BGL is also the franchisor to 605 bakery stores (mainly through the BreadTalk brand).
- BGL is majority owned by founders George Quek (33.95%) and Katherine Lee (18.59%).

Key Considerations

- **Significant parts of the results are not comparable on a y/y basis:** Due to the effects of SFRS(I) 16 – Leases which has been applied since 1 Jan 2019, y/y results are not comparable as a significant portion of lease-related operating expenses are classified as depreciation and interest expense. As a result, expenses are also being front-loaded, as illustrated by BGL (4Q2018 Prezo, Pg 13). However, the precise impact on expenses and consequently profits cannot be dissected as BGL no longer disclose accounts based on the old standards. Mainly due to the accounting changes, in 2Q2019, EBITDA rose 174.8% y/y to SGD49.7mn. Revenue is still comparable y/y, which grew 9.8% y/y to SGD163.3mn due to growth in all segments including Bakery (+3.3% y/y to SGD70.8mn), Food Atrium (+2.0% y/y to SGD39.6mn), Restaurant (+18.2% y/y to SGD44.0mn) and 4orth (+157.8% y/y to SGD7.8mn).

- **Significant weakening in the Bakery segment due to underperformance overseas:** EBITDA for the bakery segment has fallen 11.8% q/q to SGD12.7mn in 2Q2019. This is not due to seasonality as we observed q/q growth in the previous years for the segment in 2Q2018 (+7.9% q/q), 2Q2017 (+17.0% q/q) and 2Q2016 (+4.4% q/q). Profit before taxes sank into losses of SGD1.9mn (1Q2019 PBT: SGD0.5mn). According to management, this is primarily attributed to the China direct operated stores business, which saw declines in revenues from the stores in Beijing and Shanghai, where there are signs of new brand fatigue. While the franchise business is profitable, profitability for this sub-segment also declined due to the exit from 8 cities in 2018. While the acquisition of the remaining 50% interest in BTM (Thailand) Ltd from Minor Food Group supported the revenue growth, Thailand is loss-making, which may not breakeven in 2019 still. That said, we understand that the takeover costs for 50 BreadTalk stores in Thailand is significantly lower than the initial set up costs of 19 stores. Meanwhile, same store growth for BreadTalk in Singapore is around 2%-3%.

- **Food Atrium as the largest EBITDA contributor:** EBITDA for Food Atrium grew 13.4% q/q to SGD22.9mn, with strong same store growth across North China, East China and Hong Kong while stall vacancy remains low (thereby pushing EBITDA margin higher by 5.6 ppts q/q to 57.9%). The growth in revenue is due to opening of two stores in Hong Kong and Bangkok in 2Q2019. This follows the opening of one store in Hong Kong in 1Q2019.

- **Din Tai Fung still a key contributor though the UK expansion may not bear fruit:** EBITDA for restaurants grew 41.9% q/q to SGD14.9mn contributed by same store growth of 4% in Singapore. Following the addition of two outlets in 1Q2019 (one in Thailand, one in Singapore), another two outlets were added in Singapore in 2Q2019. However, management highlighted that DTF in London is still unprofitable without economies of scale given only 1 store and BGL will not go ahead yet with the planned 2nd outlet in UK due to issues with store space. Meanwhile, losses at UK are not expected to widen.

- **Expansion in the horizon still, especially in the 4orth segment:** Following a series of large scale partnerships/acquisitions laid out in 2018, management guided SGD60mn-SGD80mn capex for 2019 – we note SGD23.9mn capex has been undertaken as of end-1H2019. 4orth segment added 7 more stores q/q. This is from the opening of Song Fa (4 stores), Wu Pao Chun (2 stores) and Nayuki (1 store). As Song Fa is doing well and is the fastest breakeven brand in the 4orth segment, another 5 stores are targeted by end-2019. Wu Pao Chun, however, is not expected to breakeven due to cost structure despite making SGD400k-SGD500k/mth in Singapore. Meanwhile, Wu Pao Chun in Shanghai is underperforming. Management expects 4orth segment to stabilise by end FY2020. Sō (which has 5 stores) is profitable though Tai Gai (1 store) and Nayuki (2 stores) may likely remain unprofitable. Meanwhile, management expects the partnership with NPPG (Thailand) to be profitable by end-2019 with strategic synergies, noting that NPPG supply ready to eat meals and frozen meals in Thailand and plastic packaging.

- **Pushing gearing higher though credit metrics still manageable given healthy cashflow:** Net gearing rose q/q to 65% (1Q2019: 41%). This is in part due to the capex and SGD18.3mn purchase of investment securities for the first-tranche purchase of NPPG for THB427.5mn, and in part due to SGD4.8mn fall in equity to SGD145.8mn due to total comprehensive loss of SGD0.2mn (weighed by SGD1.2mn foreign currency translation loss) and SGD5.6mn dividends paid to shareholders. We think net gearing may reach nearly 1x based on the capex guidance. We also do not rule out further significant acquisitions/capex given the renewed focus on growth in recent quarters. That said, we remain comfortable with the credit metrics of BGL. Cash of SGD128.1mn sufficiently covers SGD53.9mn of current debt. 1H2019 operating cashflows before working capital changes is SGD97.8mn, which compares favourably to the net debt of SGD94.2mn. Meanwhile, reported EBITDA to interest expense is healthy at 8.5x (1Q2019: 8.0x) and we calculate 1H2019 net debt to reported EBITDA at a very manageable 0.95x.

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

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

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.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

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