MACRO HEADWINDS REMAIN

- Retail scene remains tough
- Macro environment not helping
- No change to preferred picks

Not picking up yet
There has been a lack of signs towards a sustained pickup in growth for relevant key markets to our coverage (i.e. Singapore, China, Indonesia, Thailand). In addition, the US Fed rate hike decision, China’s slowdown and recent Renminbi devaluation have added to market volatility on a broad level. Within our coverage of consumer stocks, the outperformer was our top pick Sheng Siong whose share price had gained 22% YTD. Our other preferred pick, Thai Beverage (Thai Bev) has also done reasonably decent with a 1.4% rise in share price as compared to the benchmark STI (-14.5%).

2Q results within expectations, albeit some unspectacular
Results from our coverage were mostly within our expectations, although OSIM and Petra Foods were unspectacular. Sheng Siong displayed another strong quarter with improved margins, proving stability as a consumer staples stock. We also like that Thai Bev’s beer business continued to see more profits.

Soft retail scene in China persists but not all are experiencing this
The soft retail scene in China seems to persist as sales for OSIM and BreadTalk remain slow there. BreadTalk had to close two underperforming Food Atrium outlets in China. But we note that not everyone is seeing the slowdown in consumption. For instance, CapitaLand Retail China Trust’s (CRCT) shopper traffic was up 1.8% YoY this quarter and they do not see a visible impact from the recent stock market volatility. The latter is supported by OCBC Treasury Research and Strategy’s view that the impact of negative wealth effect is perhaps limited as equity investments only account for 15-20% of household financial assets. The rather mixed accounts on consumption in China suggest that there are still growth opportunities given good management execution.

Maintain NEUTRAL
We are keeping our NEUTRAL call for the consumer sector amid challenging times while government reforms support a better outlook in the longer term. On the macro front, we saw a cabinet reshuffle for both Indonesia and Thailand in a bid to improve their economy. But domestic consumption for Indonesia could remain soft for 2H, thus we kept our call on Petra Foods [SELL, S$2.74]. While the recent bomb blast in Thailand is expected to adversely impact tourism and consumption for the short term, Thai Bev’s [BUY, S$0.83] defensive alcoholic portfolio underpins our long term positive view on the stock. Sheng Siong Group [BUY, S$0.95] remains as our top pick within the sector, backed by strong management, productivity initiatives such as their new self-check-out counters to sustain good margins, refurbishments of old stores, as well as a dividend payout of ~90%.
i. Sector Recap

Not picking up yet

There has been a lack of signs towards a sustained pickup in growth for relevant key markets to our coverage (i.e. Singapore, China, Indonesia, Thailand). In addition, the US Fed rate hike decision, China’s slowdown and recent Renminbi devaluation have added to market volatility on a broad level. The consumer indices FTSE Consumer Goods (FSTCG) and FTSE Consumer Services (FSTCS) have suffered similarly to the benchmark STI, with YTD returns of -14.4% from FSTCS and -15.0% from FSTCG vs. the FSSTI of -14.5%. Referring to FSTCS and FSTCG indices’ forward PER levels (Exhibit 3 and 4), both are now trading lower than their two-year historical averages. We continue to recommend Sheng Siong Group and Thai Beverage (Thai Bev) for the long term. More details on our recommendations can be found under section ii.

Preferred picks outperformed broader market

Within our coverage of consumer stocks, the outperformer was our top pick Sheng Siong whose share price had gained 22% YTD. Our other preferred pick, Thai Bev, has also done reasonably decent with a 1.4% rise in share price as compared to the broader market. In contrast, the share price of OSIM [HOLD, S$1.52], Petra Foods [SELL, S$2.74] and BreadTalk [SELL, S$1.14] have all declined ~20%. On the latter, further allegations on its business practices in China drove an 11.5% dip in share price on 18 Aug.
Exhibit 3: FSTCS Index forward PER levels (based on 2-year historical average)

Exhibit 4: FSTCG Index forward PER levels (based on 2-year historical average)

Exhibit 5: YTD prices of OIR coverage

Sources: Bloomberg, OIR
2QFY15 earnings review

Exhibit 6: Summary of 2QFY15 corporate earnings

<table>
<thead>
<tr>
<th></th>
<th>Reporting Currency</th>
<th>Revenue ($m)</th>
<th>YoY</th>
<th>PATMI ($m)</th>
<th>YoY</th>
<th>Gross Profit Margin</th>
<th>YoY (ppt)</th>
<th>Op Profit Margin</th>
<th>YoY (ppt)</th>
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<tbody>
<tr>
<td>BreadTalk Group</td>
<td>SGD</td>
<td>154.9</td>
<td>10.7%</td>
<td>2.9</td>
<td>10.0%</td>
<td>52.7%</td>
<td>-0.2</td>
<td>3.4%</td>
<td>0.2</td>
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<tr>
<td>OSIM International</td>
<td>SGD</td>
<td>159.5</td>
<td>-12.7%</td>
<td>22.5</td>
<td>-24.0%</td>
<td>72.6%</td>
<td>2.2</td>
<td>17.4%</td>
<td>-3.3</td>
</tr>
<tr>
<td>Petra Foods</td>
<td>USD</td>
<td>115.1</td>
<td>-12.7%</td>
<td>7.4</td>
<td>-39.9%</td>
<td>29.3%</td>
<td>-2.6</td>
<td>10.6%</td>
<td>-4.4</td>
</tr>
<tr>
<td>Sheng Siong Group</td>
<td>SGD</td>
<td>179.0</td>
<td>4.3%</td>
<td>13.6</td>
<td>27.0%</td>
<td>25.2%</td>
<td>0.5</td>
<td>8.9%</td>
<td>1.1</td>
</tr>
<tr>
<td>Thai Beverage PLC</td>
<td>THB</td>
<td>38992.4</td>
<td>-2.6%</td>
<td>5862.2</td>
<td>6.2%</td>
<td>30.4%</td>
<td>-1.1</td>
<td>13.2%</td>
<td>-0.9</td>
</tr>
</tbody>
</table>

Sources: Company, OIR

2Q results within expectations, albeit some unspectacular
Results from our coverage were mostly within our expectations, although results from OSIM and Petra Foods were unspectacular. Sheng Siong displayed another strong quarter with improved margins, proving stability as a consumer staples stock. We also like that Thai Bev’s beer business continued to see more profits. OSIM saw a drag from poor performance in its smaller products, while a lackluster macro environment in Indonesia has continued to impact Petra Foods.

Agents de-stocking in 2Q
Sales for both Thai Bev and Petra Foods were down partially due to de-stocking by trade agents this quarter. The former’s spirits’ revenue fell 4.7% to THB24.1b due to agents de-stocking post implementation of the new tax from 27 Mar-15. As seen in weaker economic times, demand has also shifted to the cheaper white spirits. Beer’s revenue was steady albeit volume was 4% lower. For Petra Foods, given the subdued economic environment, trade customers have also reduced their inventory levels, resulting in lower sales.

Soft retail scene in China persists but not all are experiencing this
Following the stock market rout, OCBC Treasury Research and Strategy believes the impact of negative wealth effect is perhaps limited as equity investments only account for 15-20% of household financial assets. Factors affecting sales of retail companies (E.g. OSIM, BreadTalk) include the structural changes and inherent economy slowdown in China. Lower demand for luxury goods has also led to weaker footfall in malls, thus weighing on the other tenants as well. EIU’s retail sales forecasts (Exhibit 7) also show a slowing trend due to rising operating costs and strong competition. During the quarter, BreadTalk had closed two underperforming Food Atrium outlets in China.

However, we note that not everyone is seeing the slowdown in consumption or footfall, such as Capitaland Retail China Trust (CRCT). CRCT’s shopper traffic was up 1.8% YoY this quarter and they do not see a visible impact from the stock market volatility. In addition, the Westpac MNI China Consumer Sentiment Indicator also rose for a third consecutive month in Aug. The rather mixed accounts on consumption in China suggest that there are still growth opportunities given good management execution.
ii. Outlook and Recommendations

We are keeping our NEUTRAL call for the consumer sector amid challenging times while government reforms support a better outlook in the longer term. On the macro front, we saw a cabinet reshuffle for both Indonesia and Thailand in a bid to improve their economy. On Indonesia, OCBC Treasury Research and Strategy sees a risk of domestic consumption staying soft in 2H, thus due to a subdued outlook, we kept our call for **Petra Foods [SELL, S$2.74]**. The bomb blast in Thailand had inevitably drove concerns on tourism levels again. For **Thai Bev [BUY, S$0.83]**, as the group’s sales are positively correlated to tourism levels (Exhibit 8), they will be similarly impacted in the short term but we remain positive for the long run due to the group’s defensive alcoholic portfolio. Keep in mind that 3Q is also the group’s seasonally weakest quarter.

To alleviate some pressure from current headwinds, we see continued closure of under-performing stores in the companies’ core markets (OSIM, BreadTalk), introduction of productivity initiatives (Sheng Siong) as well as prudent cost management to at least maintain margins. To improve growth, new products are being launched (OSIM, Thai Bev, Petra Foods) while OSIM and **Eu Yan Sang [non-rated]** are leveraging on e-commerce platforms to market and drive sales for their products, but note that e-commerce sales typically contribute 1-5% of overall revenue.

**Sheng Siong Group [BUY, S$0.95]** remains as our top pick within the sector, backed by strong management, productivity initiatives including their new self-check-out counters to sustain good margins, refurbishments of old stores, as well as their dividend payout of ~90%. Keep in mind that the environment has turned more competitive due to “SG50” promotions, thus 3Q may reflect some impact from this, but earnings would be cushioned by additional rental income from its Tampines store.
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For shareholding disclosure on individual companies, please refer to the latest reports of these companies.

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- OIR’s fundamental views and ratings (Buy, Hold, Sell) are medium-term calls within a 12-month investment horizon.
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