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Food for thought at 7-Eleven

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Target price:

CONVENIENCE store chain 7-Eleven Malaysia may benefit from collaborating with a sizeable food supplier and have its food supply chain enhanced.

"In the longer term, earnings enhancement would depend on the demand for its potential food offerings," said Maybank IB Research, maintaining its earnings forecasts, "hold" call and target price of RM1.38 with a financial year 2017 price earnings rate of 25x.

To recap, 7-Eleven had on April 12 entered into a memorandum of understanding (MoU) with Brahim's SATS Food Services Sdn Bhd (BSFS) to collaborate and cooperate in the food chain supply.

Under the MoU, BSFS would supply menu specifications and products to be marketed through 7-Eleven's convenience stores domestically. Meanwhile, 7-Eleven will provide a centralised distribution centre (CDC) to BSFS to handle products delivery.

The terms of the agreement were not disclosed but 7-Eleven's net cash position of RM120mil (end-December 2015) provides it with an opportunity to invest in a new CDC should the project really require a new one.

"Recall that 7-Eleven had in November 2015 re-allocated its unutilised balance of RM41mil proceeds earmarked for its new CDC working capital, given the availability of third party capacity around. The new CDC had a planned usable warehouse space of 124,000 sq ft (+38% in capacity)," the research house said.

"We understand that some con- venience store players domestically has been facing some supply chain issues such as product quality, consistency and choices mainly due to dependence on multiple fresh food suppliers and scale and reach of the existing food suppliers," it said, concluding that collaboration with a sizeable party could benefit 7-Eleven in the longer term in terms of cost efficiencies and consistency of product quality/choices while not having to move away from its core competence of managing convenience stores.

The research house noted that fresh food and services as a percentage of merchandise sales had been fairly stable, at an estimated 10%. HARTALEGA HOLDINGS BHD Target price:

HARTALEGA is set to announce its fourth quarter results for the financial year 2016 (4QFY16) early next month. UOBKayHian Research projected flat to modestly stronger quarterly net profit of RM74milRM80mil on the back of three new production lines and possible forex gains from outstanding forward contracts.

"Margins could, however, see quarter-on-quarter (qoq) contraction due to the partial absorption of the industrial gas price hike and recovery in nitrile input costs. "We expected higher sales volume arising from the commissioning of the remaining three new lines in plant 1 and 2 during the quarter, and possible foreign exchange gains on its outstanding forward contracts, given the sequentially lower 4QFY16 reference rate of RM3.88/ US dollar (3QFY16: RM4.29).

"However, we expect the impact from the above factors to be partially offset by weaker qoq nitrile glove prices and softer 4QFY16 forex rate of RM4.12/US dollar (3QFY16: RM4.28)," the research house said.

UOBKayHian said while it projected a 5%-7% increase in sequential sales volume (arising from the three new lines coming on stream during the quarter), 4QFY16 topline could remain flat qoq due to further 2-3% quarter-on-quarter drop in nitrile glove selling prices amid an increasingly competitive operating landscape as well as a 4% quarter-on-quarter depreciation of the US dollar against the ringgit.

Margin-wise, UOBKayHian Research projected a qoq contraction arising from the partial absorption of the 17% hike in industrial gas prices (effective Jan 16), qoq recovery in nitrile raw material costs, weakening US dollar (-3.8% qoq), and lower glove average selling prices.

"This would be partially offset by a higher operating leverage at its NGC plants, which had been ramped up to full capacity by March (+5.8% qoq). Coupled with forex gains from its hedging transactions, we expect 4QFY16 net profit at RM74-80mil," the research house said.

BUMI ARMADA BHD By Affin Hwang Capital Research Sell (maintained) Target price: RM0.65

AFFIN Hwang Capital Research removed the Armada Claire FPSO contract from its earnings forecast valuation for Bumi Armada.

The research house also revised foreign exchange assumption to RM4.00/US dollar, which has the effect of reducing Bumi Armada's profits and valuation in ringgit terms.

Together, these adjustments led to Affin Hwang Capital Research cutting its financial year 2016-2018 estimated earnings by 25-32%, and target price to RM0.65.

Significant contract wins could re-rate the stock, but this remains a distant affair. The decision was made following the unilateral termination of the contract by its client Woodside Energy Julimar Pty Ltd in March 2016.

Bumi Armada had initiated legal proceedings in the Supreme Court of Western Australia seeking for compensation for the unilateral termination of contract.

"But we are not factoring in any potential compensation in our forecasts for now, as it could not be quantified at this juncture, while the legal proceedings will undoubtedly be a long and tedious affair," the research house said.

It was revising its forex assumption to RM4.00/US dollar in 20152017 estimates from a previous RM4.20 per US dollar to reflect the recent gains in ringgit.

This has the effect of lowering the oil and gas player's profits in tinggit terms. Together, these adjustments led it to shave its earnings forecasts for Bumi Armada by 25% in its 2016 estimates, 32% in 2017s and 28% in 2018s.

The seemingly large earnings revision is due to the fact that Bumi Armada will cease to book any revenue from Armada Claire, but it still has to incur finance costs on borrowings raised for the Armada Claire FPSO project," the research house said, maintaining its "sell" rating on Bumi Armada after reducing its target price to 65 sen from 81 sen previously to reflect the termination of Armada Claire and the revised forex assumption of RM4.00 per US dollar.

Further downside risk to the stock could come from the potential repudiation of other FPSO contracts, and the negative impact of a stronger ringgit.

"However, key upside risk to the stock would be new significant FPSO contract wins, but we think this is unlikely to take place within the near term given the slowdown in greenfield developments," it said.


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