7-Eleven to weave web of networks

BY LIEW JIA TENG

7-Eleven may be an icon of 24-hour convenience stores of over 30 years in Malaysia, but many may not be aware that the profit made by each store is still arguably thin.

And if you are wishing for a 7-Eleven store in your neighbourhood or one within a five-minute walk, it may just come true soon.

7-Eleven Malaysia Holdings Bhd has been on an aggressive expansion mode. In the next 10 years, the country's largest convenience store chain plans to open 200 stores a year or 50 outlets every three months.

Already, it owns 1,840 stores, commanding more than 80% of the stand-alone store market.

CEO and executive director Gary Thomas Brown believes that opening more outlets will help maximise the potential of 7-Eleven in Malaysia. The company has no intention of slowing down its expansion programme despite current weaker consumer sentiment.

"There is a lot of upside in this industry, and 7-Eleven will continue to open 200 new stores per annum, for at least the next 10 years. They will be in the Klang Valley, Sabah, Sarawak, Johor, Penang and the east coast," Brown tells *The Edge*.

"The 2,000 stores is just an estimate and it's not a number we have budgeted for. Whether we do exactly 200 stores a year, we [shall] wait and see. But I've got a feeling that we can keep going at that pace."

With a cash-rich balance sheet, 7-Eleven Malaysia has the financial muscle to build its web of networks. It had net cash position of RM169 million with borrowings of only RM5.62 million as at March 31, 2015.

HARIS HASSAN/THE EDGE

Brown: There is a lot of upside in this industry

Brown dismisses concerns about market saturation and possible overexpansion, citing the low penetration rate in Malaysia relative to elsewhere in the region.

"No, I don't think so," says Brown when asked about overexpansion. "We are lower than Thailand, Japan, Taiwan and South Korea in terms of store penetration. Just on pure number basis, I would say there is plenty of room for expansion. On actual basis, you can feel it and see it. That also gives us great optimism to open more stores," says Brown, an Australian who joined the company as deputy CEO in December 2013. Before that, he was with the Dairy Farm group in Australia.

In Malaysia, there are 131 stores per one million people, compared with 192 outlets per one million people in Thailand, 340 in Japan, 429 in Taiwan and 490 in South Korea.

According to 7-Eleven Inc's website, there are 17,569 stores in Japan, 8,334 in Thailand, 7,327 in South Korea and 5,037 in Taiwan.

Brown opines that many areas in Malaysia, including the central business district, are still underpenetrated. Thus, he says, it is up to 7-Eleven Malaysia to be flexible and creative to find the locations where customers want the stores to be.

"We haven't even touched the office buildings yet. There are also plenty of opportunities in educational and transport facilities. Who's to say there can't be kiosk-type of 7-Eleven outlets on the streets?" he says.

Brown also highlights that store expansion, even within a vicinity, is the way 7-Eleven's business model works.

For instance, he says, 7-Eleven operates six stores in Berjaya Times Square and four in Publika, all of which are performing well.

"You may ask, 'why don't you just have one [in a certain location], and everyone will come to that one [store]?' But, maybe they won't, maybe they don't want to walk from one end to the other. So, our job is to provide convenience to the customer, because it's all about impulse purchase," says Brown.

While the aggressive opening of new stores has helped bump up the company's earnings, the profit per store is considerably low.

For the first quarter ended March 31, 2015 (1QFY2015), the company posted a 23% increase in net profit to RM14.38 million from RM11.63 million a year ago. Based on 1,802 outlets nationwide, the net profit per store, on average, was only RM7,980, which translates into RM2,660 a month — lower than the profits of some mom-and-pop shops.

But Brown insists he has no problem with that as he deems the numbers healthy, but admits that he would like them to be higher.

"We wouldn't call it (net profit per store) thin. Based on the way you do your calculations, our profit per store grew nearly 10% last year. I don't agree that it is thin, but even if it was, we still managed to achieve substantial growth on profitability per store," he says.

7-Eleven Malaysia's financial highlights

FINANCIAL YEAR ENDED DEC 31	2011	2012	2013	2014	1Q 2015
Revenue (RM bil)	1.46	1.58	1.67	1.89	0.50
Net profit (RM mil)	30.1	40.5	44.1	63.1	14.4
Net margin (%)	2.1	2.6	2.6	3.3	2.8
Store count	1,328	1,407	1,557	1,745	1,802
Corporate store	1,149	1,235	1,389	1,587	1,644
Franchise store	179	172	168	158	158

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He adds that in spite of the expansion, the selling and distribution costs per store remain flat. This means that any additional sales would give a bigger boost to the stores' bottom line.

"There is no incremental cost because it is fixed. If I service 200 more customers a day, I don't pay more rent and electricity and labour costs. Our focus is to make every store more profitable than what it is now ... whether the profit is thin or not, it can always be better," he says.

According to him, even if there was an overexpansion, the risk would be very limited as most of the stores are tenanted. "In a worst-case scenario, if a store doesn't work, we can close it and then move the equipment to another location."

Based on the earnings per share of 5.44 sen in FY2014, 7-Eleven Malaysia's shares are trading at a historical price-to-earnings ratio (PER) of 31.4 times. Year to date, the stock has climbed 16%, to RM1.71 last Thursday, valuing the convenient store chain at RM2.1 billion.

However, the company's expansion mode doesn't seem to convince analysts with exciting growth.

An analyst who tracks the company advises his clients to hold on to their shares but not to buy at the present price level.

"Most positive factors have been priced in and there is no immediate catalyst at the moment. For me, the biggest challenge for 7-Eleven Malaysia is to change the local culture because people don't usually hang out at convenience stores," he says.

At the moment, RHB Research is the only research house that sees further upside in 7-Eleven shares. It has a "buy" call on the stock and a target price of RM1.98. The other three research houses — CIMB, Maybank IB and UBS — have a "hold" recommendation with a target price of RM1.70.

Nonetheless, Brown says 7-Eleven Malaysia deserves better valuation as the company offers regular dividend payouts and has low risks.

The company has a dividend policy of returning 30% to 50% of its net profit to shareholders, but it paid close to 100% last year.

Apart from new stores and refurbishment, which are expected to cost RM85 million to RM90 million a year, there is no major capital expenditure in the near term.

"That's good news for the shareholders because we will be generating a lot of profit from this growing business, which will enable us to keep paying good dividends to them," says Brown.

"If you look at the 7-Eleven operator in the Philippines (Philippine Seven Corp), with a growth trajectory like ours, it is trading at a PER of 40 to 50 times. Traditionally, 7-Eleven attracts higher PER, it is not out of line."

Will 7-Eleven Malaysia be valued as much as its peer in the Philippines? To Malaysian investors, this will be much dependent on how much the expansion plan can accelerate its earnings growth, including profit per store. E