



Source: Bloomberg

Ticker	5ML
Exchange	Singapore Stock Exchange
Industry & Sector	Consumer, Non-cyclical
Market Capitalization	S\$ 35,925,975
52-wk Price Range	S\$ 0.22 – S\$0.39
Recent Price	S\$ 0.375 (14/09/2012)
Net Asset Value	S\$ 0.26 (31/03/2012)
Current P/E	11.07x
Projected 2014 P/E	7.74x
Dividend Yield	4%
Benchmark	MSCI Singapore Small Cap

Recommendation

HOLD

Pros

- Prominent household brand
- International expansion at Perth
- Product range may be priced higher
- Defensive company with net Cash Balance Sheet
- Improving internal efficiency
- Stable dividend payout of \$0.015

Cons

- Food range not ideal for health-conscious consumers
- Low profit margin business model
- Only 16.8% outstanding shares in public float
- Not actively traded: Illiquid

Intrinsic Value

S\$ 0.39

Based on Discounted Cash Flow (DCF)
Upside potential: 4%

1. Business Summary

Over 56 years, Old Chang Kee Limited has grown in depth and strength, from a small stall in a coffee shop to a listed company on SGX Catalist Board with market capitalization of about \$36 million. The company specializes in hot finger-food takeaways and is a household brand among Singaporeans and foreigners alike, sprawling 82 outlets island-wide. Identifiable 3 main operations which contribute to revenue are Old Chang Kee finger-food, ready-made meals and delivery service. After its failed venture in China, the company expands down south at Perth, catering to an increasing South and South East Asian taste buds.

2. Financial Analysis

Profitability metrics, compiled in Table 1, show resilience with gross margin relatively stable and net margin return modestly. The business model seems to focus more on generating higher revenue instead of streamlining cost, which in Old Chang Kee's case, is appropriate in order to gain market share.

Increasingly, the company has automated production facilities. However, this insufficient as earnings growth is significantly volatile compared to revenue growth. In this respect, should Old Chang Kee be able to meaningfully control expenses (bulk of which labor hours), stable earnings growth could likely be in the range of between 15% and 20%.

Table 1: Profitability

	FY07	FY08	FY09	FY10	FY11	2012E	2013E	2014E
Revenue growth	---	19.5%	6.5%	8.0%	9.3%	11.1%	10.7%	10.7%
Earnings growth	---	-15.5%	92.4%	-33.7%	33.9%	8.6%	14.9%	14.6%
Gross Margin	58.6%	59.6%	61.3%	59.9%	60.1%	60.0%	60.0%	60.0%
Net Margin	6.5%	4.6%	8.3%	5.1%	6.3%	6.1%	6.4%	6.6%
ROA	14.9%	10.5%	16.5%	10.0%	12.1%	12.0%	13.0%	14.2%
ROE	27.9%	17.5%	24.0%	13.9%	16.8%	16.2%	16.8%	17.8%

Source: Annual Reports, VPM estimates

Internal efficiencies as measured by turnover ratios are encouraging. Inventory turnover is decreasing, possibly showing weakening demand for its products. However, according to the AR2011, the company is simply taking advantage of bulk purchase credits by suppliers. Asset turnover, sales per asset, is stable at around 2X. This is evident of good management planning.

Table 2: Efficiency

Turnovers	FY07	FY08	FY09	FY10	FY11	2012E	2013E	2014E
Inventory	31.5	30.5	28.6	35.0	29.8	25.7	24.8	21.3
Receivables	67.4	87.6	115.4	129.6	143.4	145.0	145.0	145.0
Payables	---	4.6	4.5	4.6	4.6	5.4	6.7	7.7
Asset	2.3	2.3	2.0	2.0	1.9	2.0	2.0	2.1

Source: Annual Reports, VPM estimates

3. Valuations

My estimate of discount rate is mathematical usage of 10-yr SGS yield at 1.6% as risk-free rate, Beta of 0.48 according to Google Finance, market return of 11% before adding 4% liquidity premium. $Re = 1.6 + 0.48(11 - 1.6) + 4 = 14.06\%$

Since Old Chang Kee gives out annual dividend, my dividend discount model assumes the payout to increase 0.5cent per year from the current 15cents till 2014. After which, on a rate basis, dividend is projected to increase at GST rate 7%.

Table 3: Dividend Discount Model

	2013E	2014E	Terminal Value
Dividend	\$0.02	\$0.025	\$0.379
PV	0.01873	0.02052	0.31104
Intrinsic Value	\$0.35		

Table 4: Discounted Free Cash Flow to Equity (FCFE)

	2012E	2013E	2014E	Terminal Value
FCFE	\$1,908	\$2,736	\$3,457	\$52,393
PV	1,787	2,246	2,488	37,708
Intrinsic Value	\$0.39			

Table 5: Residual Income Model

	2012E	2013E	2014E	Terminal Value
Residual Value	\$755	\$967	\$1,294	\$19,618
PV	707	794	932	14,119
Intrinsic Value	\$0.43			

The various valuation methods presented in Tables 3, 4 and 5 yield different intrinsic values in the range of \$0.35 to \$0.43. As dividend discount model entails significant uncertainty on whether management will increase dividend payout in line with my estimation, it is better to rely more on discounted FCFE model and Residual Income model. Between RI and FCFE models, RI model may not be the most relevant because the bulk of assets held is cash and equivalents. Hence, discounted FCFE is the most relevant valuation method for Old Chang Kee.

The company is trading at 4% discount to its calculated intrinsic value. The current market price does not make the company a strong value buy.

4. Key Assumptions and Risks

I grew revenue at 10.7% annually using the stable CAGR between 2007 and 2011. All the other income items are observed to be constant with respect to revenue. Hence, SG&A assumed to be at 38% of core Revenue and other Operating expenses at \$1.2m annually for the next 3 forecasted periods. Depreciation is assumed to be 27% of the non-current assets.

The main investment risk is the illiquidity of the company listed on SGX. Daily turnover is low to non-existent. Public float accounted for only 16.8%, as of 15 June 2012, which effectively means significant majority 83.2% is held privately. Unless insider interests buy on stronger fundamentals, it is less likely to see significant price upside.

As a food manufacturing company, Old Chang Kee is regulated with National Environmental Agency (NEA) and Agri-Food and Veterinary Authority of Singapore (AVA), any shock findings in its fillings would trigger thorough inspection of its facilities. For example, an insect found in a Curry O'Puff on March 3, 2012 caused public concern and alerted NEA to inspect its production facilities. Such negative news will inadvertently hurt revenue and dent its reputation.

5. Disclosures

I do not have any position in Old Chang Kee but intend to go long for investment portfolio when Price < \$0.34.