

Issuer: Hafary Holdings Limited

Security: Hafary Holdings Limited

Meeting details:

Date: 11 April 2017

Time: 11:00H

Venue: 8 Wilkie Road, #03-08 Wilkie Edge, Singapore 228095

Company Description

Hafary Holdings Limited, an investment holding company, imports, deals, distributes, and wholesales building materials in Singapore, the People's Republic of China, Vietnam, the Republic of the Union of Myanmar, Indonesia, and internationally. The company operates in two segments, General and Project. It offers ceramic and porcelain tiles; stone tiles, such as granite, limestone, marble, quartz, composite quartz, and marble tiles; wood flooring materials, including engineered timber, solid hardwood, laminates, vinyl, and outdoor decking products; and sanitary ware and fittings comprising accessories, basins, bathtubs, faucets, showers, water closets, pools, and sinks. The company serves architecture, interior design, and renovation firms, as well as property developers and construction companies. It also operates as a dealer of stones and wood for home furnishings. The company offers its products through three showrooms located in Singapore. Hafary Holdings Limited was founded in 1980 and is headquartered in Singapore. Hafary Holdings Limited is a subsidiary of Hap Seng Consolidated Berhad.

(Source: http://www.sgx.com/wps/portal/sgxweb/home/company_disclosure/stockfacts?code=)

Q1. In the CEO’s statement (page 11 of the annual report), it was disclosed that the group “will continue to explore expansion opportunities and synergistic partnerships, so as to grow our business, locally and in the region”.

- a) The group’s associate, Viet Ceramics International Joint Stock Company, has performed well in FY2016 and contributed profits amounting to S\$1.9 million to the group. **Now with a network of six showrooms in Vietnam, how much more can the associate grow in Vietnam? What is the potential of the Vietnamese market?**
- b) **Can shareholders understand how Gres Universal, a newly established subsidiary, is different from the current in-house Project team in Hafary?**
- c) **What are the other foreign markets that the group will explore and consider entering?**

Q2. Based on the Financial review (page 20), inventories amounted to \$50.9 million while revenue was \$109.6 million in FY2016. On page 21, it was also disclosed that inventory turnover was 285 days in 2016, up from 229 days in 2015. The table below shows the inventory turnover (in days) and the impairment of inventories (\$’000) over the past 5 years.

	FY2016	FY2015	FY2014*	FY2013*	FY2012*	FY2011*
Inventory turnover (days)	285	229	251	248	273	214
Impairment of inventories (\$’000)	472	1,171**	135	371	166	324

* denotes financial year end as at 30 June

** denotes 18 month period from 1 July 2014 to 31 December 2015

The impairment allowance on inventories was also a key audit matter raised in the Independent auditor’s report, to which the audit committee has discussed how they have addressed it (page 39 – Significant accounting matters).

- a) Inventory turnover (in days) has increased to 285 days, suggesting that inventory is held on average for 9 – 10 months. **Shareholders would like to understand if the group’s operational efficiency can be further improved so that lower inventory is held and the inventory turnover is improved.**

Q3. In the Financial highlights (page 17), the group’s net debt to equity ratio is shown. As seen from the table below, the net debt to equity ratio in FY2016 is at 2.6x.

Financial Ratios	FY2016	12M2015	18M2015	FY2014	FY2013	FY2012
Leverage						
Net debt to equity ratio (times) (Net debt/ Shareholders’ equity)	2.6	2.3	2.3	2.3	1.2	1.6
Interest cover (times) (EBITDA/ Finance cost)	5.4	6.8	7.8	8.0	26.8	7.6

(Source: Hafary Holdings Limited Annual Report 2016)

The net debt as at 31 December 2016 was S\$139.3 million, which was an increase from \$51.5 million in 2012.

For the Year	FY2016 S\$'000	FY2015 S\$'000	FY2014 S\$'000	FY2013 S\$'000	FY2012 S\$'000
Net debt	139,259	115,110	86,785	54,983	51,548
Shareholders' equity	54,175	50,787	37,649	44,676	31,304

(Source: Hafary Holdings Limited Annual Report 2016)

Over the same period, total revenue increased from S\$63.1 million to S\$109.6 million but the profitability measures (such as return on assets and return on equity) have dropped back to the FY2012 figures (page 17 – Financial highlights).

- a) **Can the group still grow profitably in its core market (i.e. Singapore)? Is the market saturated? What is the group's share of the market?**
- b) **Has the group been able to enjoy greater economies of scale as it has grown? How has that helped the group in its cost structure?**

In Note 28 (page 95 – Share capital), it was disclosed that “management does not set a target level of gearing but uses capital opportunistically to support its business and to add value for shareholders.

- c) **Can the board elaborate further on what guidance it gives to management in terms of capital structure, specifically any limits on leverage?**

The investment into 18 Sungei Kadut Street 2 (World Furnishing Hub) has been a major use of funds. As noted on page 20, “construction cost and capitalisation of land rents, property tax and borrowing costs during redevelopment to leasehold property at 18 Sungei Kadut Street 2” amounted to S\$18.6 million.

- d) **It would appear that the group has funded the redevelopment of World Furnishing Hub mainly by debt. Can the board further elaborate on the consideration to redevelop the site through increased leverage? Is this prudent given that the market conditions are muted? What are management's projected returns from the new World Furnishing Hub?**