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Will revamp bear fruit for SunMoon?

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SUNMOON Food Company's latest debt restructuring has finally removed the proverbial sword of Damocles hanging over its head and given it a fresh impetus for growth.

Those familiar with its corporate history will remember SunMoon as the doomed FHTK Holdings, or Fook Huat Tong Kee, a major fruit distributor and investor in China. It listed on Singapore Exchange's mainboard in 1997 to great excitement, boasting sales the year before of $225 million and pre-tax profits of $10.7 million. That same excitement saw the stock hitting a high of 88 cents in the course of its trading, against its initial public offering price of 60 cents.

But signs of wilting began to set in after that. FHTK found itself chalking up big losses in a 10-year loss spell, with red ink spilling into the hundreds of millions. Debt restructurings took place, and fresh money poured in, but each time, the company sank deeper into the red.

Its business model, which leased massive tracts of farmland to local farmers, was not set up to generate cash. For one thing, fruit plantation yields were poor. Worse still, its old business model of storing apples in a massive cold storage facility became irrelevant as competitors built similar facilities of their own.   In 2007, the company was saved from liquidation by a $60 million convertible loan from investors. Old management resigned, including founder Ee Tai Ting, who had built up the company from his days in the 1950s of selling over-ripe fruits in a pushcart.

Since then, new management, led by ex-Singapore Food Industries director Neo Wei Ming, has been restructuring the company and its operations in China. But its debt overhang remained, with accrued interest causing accounting losses. And even as the company pulled off positive pre-tax profits of several million dollars, auditors warned that without a loan restructuring, its ability to remain as a going concern was in doubt. All this changed on Sept 10, when the company announced that it had settled its remaining $24.4 million of legacy debt by paying creditors $12.4 million in cash and issuing them six billion new settlement shares at 0.1 of a cent each. The rescuer, First Alverstone Capital (FACL), will pay them the remaining $6 million a year later in a separate share or cash deal. This could well turn out to be a win-win situation as the shares are now trading at 0.2 of a cent.

Good deal

FACL also got a good deal. It had entered into an $18 million convertible loan arrangement with SunMoon and converted all that to 18 billion shares at 0.1 of a cent each. FACL only had to cough up $12 million of cash for the convertible loan. For the remaining $6 million that was converted to shares, FACL has the option of paying the creditors a year later in cash or shares, as mentioned earlier.   SunMoon's share capital rose from 7.9 billion shares to 31.9 billion shares, with FACL's stake increasing from 6.3 per cent to 58 per cent.

The move has also improved the company's balance sheet. As part of the deal, $13.2 million of accrued interest was written off, which will result in a one-off profit boost in Q3. Together with the $24.4 million debt settlement, SunMoon's net asset value thus increased by about $38 million, lifting it up from a negative net asset value to a positive $16.5 million.

FACL, meanwhile, has been selling some of its stake to other stakeholders "to get them to participate in the growth of the company", FACL executive chairman Gary Loh told BT. FACL held 12.5 billion shares at end-September, or 39.1 per cent. The shares have been hovering around 0.2 to 0.3 of a cent, giving the company a market value of between $64 million to $96 million. Assuming a price-to-earnings ratio of 10, the market is perhaps expecting long-run profits to be in the zone of roughly $6 million to $10 million every year.

This is not an impossible target. The company's earnings before interest, tax, depreciation and amortisation (Ebitda) had been $10 million in 2009, around $5 million in 2010 and 2011, and $2 million last year. The poorer 2012 performance was due to higher production costs and higher taxes on exports of dehydrated products from China, as well as lower fresh fruit sales margins.

But business could improve in the years ahead now that the threat of bankruptcy hanging over the company is not there. Suppliers and customers will be more confident to deal with it without worrying about payments and product delivery. More significantly, the company's business had been transformed since 2009 into an asset-light distribution and trading model that focuses on building a strong brand through quality control. Today, SunMoon's revenues are split into two roughly equal streams: fresh fruits, and food ingredients. For fresh fruits, SunMoon mainly exports Fuji apples grown in China to the world, mainly to Indonesia. This segment had struggled to break $1 million of profit in the past few years but with the debt overhang gone and more working capital in place, it can perhaps break $2 million to $3 million.

Under food ingredients (also known as agricultural products), the company produces dehydrated garlic and onions in China for export. The China factory has a carrying value of about $6 million and is the biggest asset on SunMoon's books. In good years, such as 2010 and 2011, the segment made $4 million to $6 million.

Higher potential earnings

So in its current situation, the company is capable of making $8 million to $10 million a year, justifying a valuation of 0.3 of a cent. And this does not include the value of the shell company and the intangible value of the SunMoon brand. The company has the potential to make more.

Management is diversifying into other fruits. The company is also exploring a new line of business in consumer products. This includes fruit crisps and existing fruit cups supplied to budget airlines. If that segment takes off, another boost to earnings would be on the way.

Ultimately, SunMoon has to focus on its brand-building efforts, relying on quality products and letting the numbers do the talking. While its brand might be known in Indonesian mini-marts, it is relatively less known in Singapore. A focus on selling premium fruits could help on this front. For example, premium SunMoon fruits - seen in NTUC and Sheng Siong - could boost the profile of the company more.

SunMoon appears to have cleaned up its rot and has done all the right things so far. Its task is now to ensure that all the restructuring efforts will bear fruit.