OSIM International Ltd

Awaiting for the fruit to ripen

SINGAPORE | CONSUMER | UPDATE

3 March 2015

Highlights

- Invest while stock price is still attractive
- Building TWG store network to strengthen the third leg of growth
- Downgrade to “Accumulate” rating with unchanged TP$2.25, 15.5% upside

Why invest?

- **Stock price is still attractive -** The share price is currently about 30% cheaper than six months ago. The stock plunged in November because of compressed profit margins by the start-up costs from the TWG Tea business expansion and legal costs in 3Q14. On the whole, the business fundamentals remain strong with the company continuing to generate strong operating cash flows with its asset light business model while maintaining superior gross profit margins. We feel that this is a good opportunity for investors to reinvest into OSIM on the current price weakness.

- **TWG Tea, the third leg of profit growth** - OSIM is currently undergoing the expansion phase for its TWG Tea business. The company is trying to replicate the Starbuck’s proven model of premium products sold directly to the customers via a first-rate retail experience, bringing high quality tea to the mass affluent with the aggressive growth of its store units. While the expansion costs should pressure this year’s profitability, significant contribution is expected to materialise as expansion costs dwindle and operating costs normalise.

- **Premium branding with strong product pipeline to benefit from the rising affluence in China** – Even though there are concerns on the slowdown of China economy, one cannot deny that the Chinese are getting richer by the day. With the rise in the middle-to-high income consumers ready to spend with disposable income, the consumer spending in China should remain strong. We see OSIM’s premium branding and strong product pipeline to benefit from the changing trend in Chinese consumers’ behaviour tuning towards differentiated high quality products.

- **Strong net cash position provides the ammunition for future expansion –** The company is currently sitting on a net cash position of S$237mn. While there has not been any concrete plan on the capital deployment, we understand that OSIM is prudent when seeking suitable business investment opportunities.

Key Risks

- **Execution risks to the TWG business expansion plan –** Delays on the TWG expansion plan may lower our valuation on OSIM.

- **Reliance on new product innovation –** It is vital that OSIM stay innovative and nimble to the changing consumers’ needs to maintain its market leader position.

Investment Actions

With the recent uptick on the share price, we downgrade our rating to Accumulate with unchanged TP$2.25.

Accumulate (Downgrade)

CLOSING PRICE	SGD 2.00
FORECAST DIV	SGD 0.06
TARGET PRICE	SGD 2.25
TOTAL RETURN	15.5%

COMPANY DATA

O/S SHARES (MN) :	773
MARKET CAP (USD mn / SGD mn) :	1133 / 1545
52 - WK HI/LO (SGD) :	2.94 / 165
3M Average Daily T/O (mn) :	195

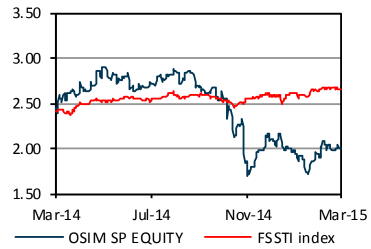
MAJOR SHAREHOLDERS (%)

CHYE HOCK SIM	62.6%
CAPITAL GROUP COMPANIES INC	9.6%
MORGAN STANLEY	2.5%

PRICE PERFORMANCE (%)

	1MTH	3MTH	1YR
COMPANY	3.6	(6.5)	(14.9)
STI RETURN	0.41	190	12.80

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

SGD MN	FY13	FY14	FY15E	FY16e
Revenue	648	691	728	757
EBITDA	140	152	158	170
NPAT (adj.)	102	102	106	112
EPS (adj.)	0.14	0.13	0.13	0.14
PER, x (adj.)	13.5	14.9	14.6	13.9
P/BV, x	4.9	3.5	3.1	2.8
DPS (SGD)	0.06	0.06	0.06	0.06
Div Yield, %	3%	3%	3%	3%
ROE, %	37%	24%	20%	19%

Source: Company Data, PSR est.

Valuation Method

DCF

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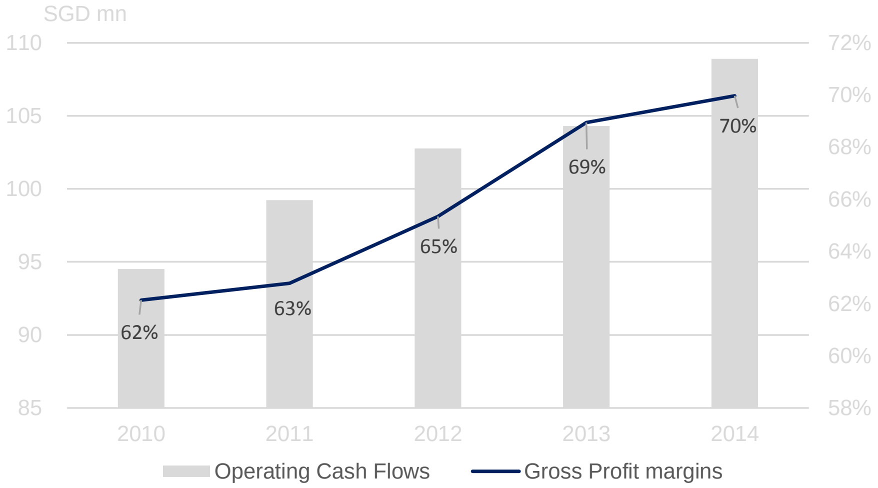
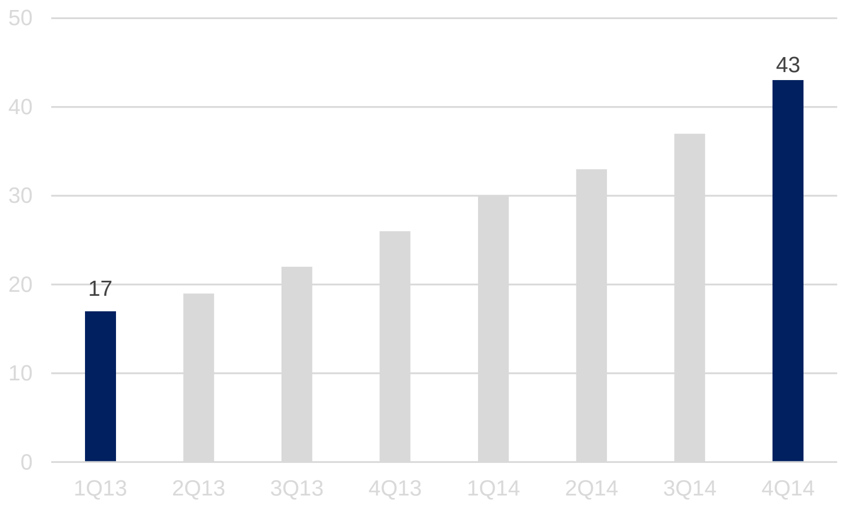
Figure 1: Strong operating cash flows and healthy gross profit margins for the past 5 years



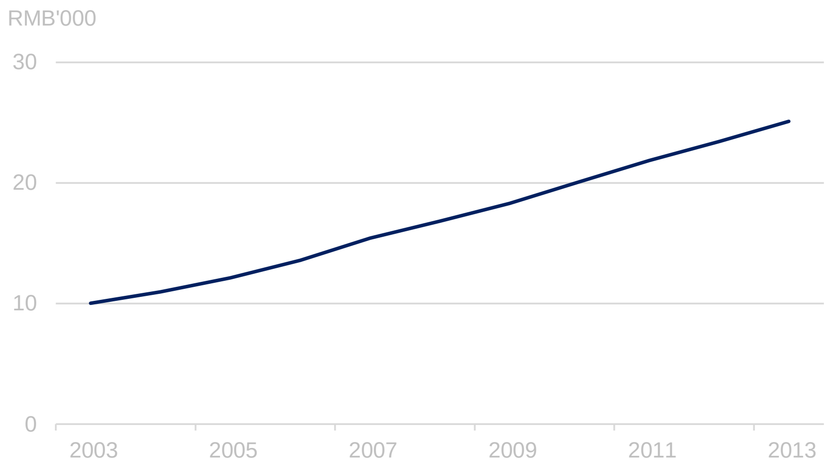
Source: Company, PSR Est

Figure 2: TWG outlets more than doubled over the past 8 quarters



Source: Company, PSR Est

Figure 3: China Real GDP per capita grew at a CAGR of 10% over the past ten years



Source: CEIC, PSR Est

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Financials

Income Statement

Y/E Dec, SGD mn	FY12	FY13	FY14	FY15e	FY16e
Revenue	**602**	**648**	**691**	**728**	**757**
EBITDA	**127**	**140**	**152**	**158**	**170**
Depreciation & Amortisation	(11)	(14)	(22)	(24)	(28)
EBIT	**115**	**127**	**130**	**135**	**142**
Net Finance (Expense)/Inc	(6)	(6)	(3)	(4)	(4)
Other items	3	5	5	4	5
Associates & JVs	2	3	1	1	1
Profit Before Tax	**115**	**129**	**132**	**135**	**143**
Taxation	(28)	(28)	(30)	(30)	(31)
Profit After Tax	**87**	**102**	**102**	**106**	**112**
Non-Controlling Interest	0	0	0	1	2
Net Income, reported	**87**	**102**	**102**	**106**	**112**
Net Income, adj.	**87**	**102**	**102**	**106**	**112**

Per share data (SGD)

Y/E Dec, SGD	FY12	FY13	FY14	FY15e	FY16e
EPS, reported	0.12	0.14	0.13	0.14	0.14
EPS, adj.	0.12	0.14	0.13	0.13	0.14
DPS	0.06	0.06	0.06	0.06	0.06
BVPS	0.24	0.27	0.37	0.58	0.65

Balance Sheet

Y/E Dec, SGD mn	FY12	FY13	FY14	FY15e	FY16e
ASSETS					
PPE	21	25	36	51	62
Intangibles	20	190	181	172	164
Associates & JVs	47	18	18	19	20
Long-term investments	28	15	15	15	15
Others	11	14	15	15	15
Total non-current assets	**126**	**262**	**266**	**273**	**277**
Stocks	54	73	72	73	76
Accounts Receivables	56	54	59	61	63
Cash balance	202	267	428	462	519
Others	33	24	29	29	29
Total current assets	**344**	**418**	**587**	**624**	**687**
Total Assets	**471**	**680**	**852**	**897**	**964**
LIABILITIES					
Short term loans	25	155	17	17	17
Accounts Payables	103	118	107	92	95
Others	19	24	32	32	32
Total current liabilities	**147**	**297**	**157**	**142**	**145**
Long term loans	117	0	168	172	176
Others	7	39	36	36	36
Total non-current liabilities	**124**	**39**	**204**	**207**	**211**
EQUITY					
Shareholder Equity	196	271	438	494	552
Non-controlling interest	4	73	54	54	56
Total Equity	**200**	**344**	**492**	**548**	**608**

Cash Flows

Y/E Dec, SGD mn	FY12	FY13	FY14	FY15e	FY16e
CFO					
Profit before tax	115	129	132	135	143
Adjustments	14	2	19	23	27
WC changes	0	2	(16)	(18)	(3)
Cash generated from ops	129	133	135	141	167
Taxes paid, others	(27)	(29)	(26)	(30)	(31)
Cashflow from ops	**103**	**104**	**109**	**111**	**136**
CFI					
CAPEX, net	(13)	(11)	(24)	(31)	(31)
Purchase/sale of investments	(26)	(7)	(5)	(0)	0
Others	3	14	7	4	5
Cashflow from investments	**(36)**	**(3)**	**(23)**	**(26)**	**(26)**
CFF					
Purchase of treasury shares	(15)	(8)	(12)	0	0
Loans, net of repayments	(0)	4	150	(0)	(0)
Dividends paid	(36)	(36)	(45)	(46)	(47)
Others	(3)	(2)	(19)	(4)	(5)
Cashflow from financing	**(54)**	**(41)**	**73**	**(51)**	**(52)**
Net change in cash	**13**	**60**	**159**	**34**	**57**
Effects of exchange rates	(5)	6	1	0	0
CCE, end	**202**	**267**	**428**	**462**	**519**

Valuation Ratios

Y/E Dec, SGD mn	FY12	FY13	FY14	FY15e	FY16e
P/E (X), adj.	10.9	13.5	14.9	14.6	13.9
P/B (X)	4.7	4.9	3.5	3.1	2.8
EV/EBITDA (X)	6.9	9.2	8.8	8.2	7.4
Dividend Yield (%)	4.8%	3.3%	3.0%	3.1%	3.2%
Growth & Margins (%)					
Growth					
Revenue	8.7%	7.6%	6.7%	5.3%	4.1%
EBITDA	13.2%	10.9%	8.0%	4.5%	7.1%
EBIT	14.9%	9.8%	2.5%	3.7%	5.5%
Net Income, adj.	24.8%	16.4%	0.6%	3.4%	5.7%
Margins					
EBITDA margin	21.0%	21.7%	21.9%	21.8%	22.4%
EBIT margin	19.2%	19.6%	18.8%	18.5%	18.8%
Net Profit Margin	14.5%	15.7%	14.8%	14.5%	14.7%
Key Ratios					
ROE (%)	47.3%	37.3%	24.5%	20.3%	19.3%
ROA (%)	19.4%	17.7%	13.3%	12.1%	12.0%
Net Debt/(Cash)	(60)	(113)	(242)	(273)	(326)
Net Gearing (X)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Source: Company, Phillip Securities Research (Singapore) Estimates

**Forward multiples and yields are based on current market price; historical multiples and yields are based on historical market price.*

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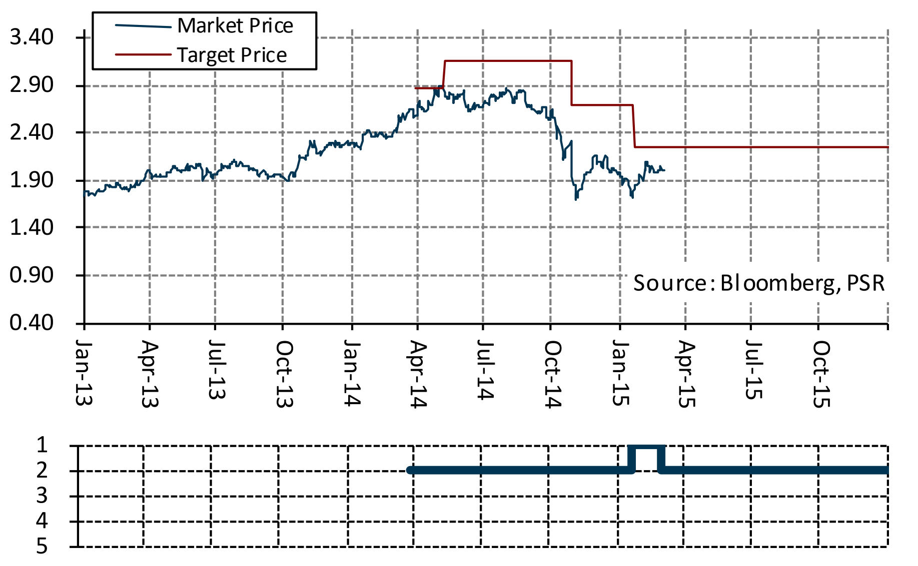
Ratings History



PSR Rating System

Total Returns	**Recommendation**	**Rating**
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
<-20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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