

Singapore Company Guide

OSIM International

Version 5 | Bloomberg: OSIM SP | Reuters: OSIL.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

18 Mar 2016

HOLD

Last Traded Price: S\$1.39 (STI : 2,880.17)
Price Target : S\$1.46 (6% upside) (Prev S\$1.28)

Potential Catalyst: Earnings recovery
Where we differ: Slower earnings recovery than consensus

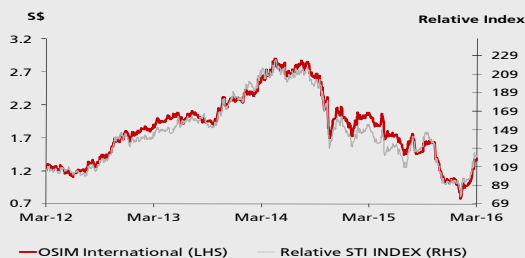
Analyst

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What's New

- **Mr Ron Sim would have to raise his offer if he really wants to privatise OSIM**
- **We believe an offer price of above S\$1.51 would enhance privatisation success**
- **Maintain HOLD, TP raised to S\$1.46**

Price Relative



Forecasts and Valuation

FY Dec (\$ m)	2014A	2015A	2016F	2017F
Revenue	691	620	640	664
EBITDA	158	109	118	122
Pre-tax Profit	132	71.3	94.8	99.3
Net Profit	102	51.5	67.9	71.0
Net Pft (Pre Ex.)	108	67.5	67.9	71.0
Net Pft Gth (Pre-ex) (%)	9.8	(37.4)	0.6	4.6
EPS (S cts)	13.4	6.79	9.16	9.58
EPS Pre Ex. (S cts)	14.2	8.91	9.16	9.58
EPS Gth Pre Ex (%)	4	(37)	3	5
Diluted EPS (S cts)	12.8	6.79	8.96	9.37
Net DPS (S cts)	6.00	6.00	6.00	6.00
BV Per Share (S cts)	56.7	53.5	56.7	60.3
PE (X)	10.3	20.4	15.1	14.5
PE Pre Ex. (X)	9.8	15.6	15.1	14.5
P/Cash Flow (X)	9.0	18.1	10.7	10.4
EV/EBITDA (X)	5.3	8.3	7.1	6.6
Net Div Yield (%)	4.3	4.3	4.3	4.3
P/Book Value (X)	2.4	2.6	2.4	2.3
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	28.8	12.3	16.6	16.4
Earnings Rev (%)			0	0
Consensus EPS (S cts):			7.60	8.20
Other Broker Recs:		B: 1	S: 1	H: 6

Source of all data: Company, DBS Bank, Bloomberg Finance L.P

Hold out for higher offer premium

Maintain HOLD; TP raised to S\$1.46. We raise our TP to S\$1.46 based on its 5-year historical average of 16x FY16F PE (from 14x previously) but continue to maintain our neutral stance on OSIM from a fundamental perspective. We believe share price should be supported by its founder, Mr Ron Sim's announcement to privatise OSIM at S\$1.32 per share. We had previously upgraded the stock on 29 Jan 2016, post its 4Q15 results, citing deep value; and the counter rallied c.45% thereafter, partly due to this development. At this juncture, the privatisation offer poses no fundamental changes to our earnings forecast but the offer price should lend support to share price.

Hold out for a higher premium if possible. We note that the offer price is below the annual period VWAPs from 2012 to 2015. The 2nd to 7th largest shareholders collectively own 13.79% of OSIM, each holding between 1% and 6% with entry periods from 1Q12 to 2Q14. We are taking a fundamental approach at this stage, and hence our HOLD recommendation given the limited upside to our new TP. While we note that the current traded price is above the offer, we would recommend current shareholders who might like to potentially benefit from a higher revised price to hold out, given the limited downside at S\$1.32. That said, we are not ready to advocate investors to initiate new positions in hope of a higher offer given the uncertainties.

Valuation:

Our revised target price of S\$1.46 is based on 16x FY16F PE. OSIM has strong net cash, cheap PE valuation, and is showing narrowing y-o-y sales decline. Our target PE valuation of 16x is pegged to the stock's average 5-year historical mean valuation.

Key Risks to Our View:

Upside risks lies in a significantly better revised offer, and conversely, downside could come from the absence of revised price and a deterioration in business conditions post lapse of offer.

At A Glance

Issued Capital (m shrs)	742
Mkt. Cap (S\$m/US\$m)	1,027 / 761
Major Shareholders (%)	
Chye Hock Sim	69.2
Capital Group Companies Inc	5.2
Free Float (%)	29.6
3m Avg. Daily Val (US\$m)	1.9

ICB Industry : Consumer Goods / Leisure Goods

WHAT'S NEW**Hold out for higher offer premium**

Founder offers to privatise OSIM at S\$1.32 per share. On 7 March 2016, OSIM announced that Mr Ron Sim (with a majority stake of 69.25%) had made a voluntary unconditional cash offer for all the issued ordinary shares in the company. The offer price values OSIM at 14x FY16F PE.

Share price now trades higher than offer price. Trading sessions subsequent to the offer announcement saw share price trading at above the offer price. We have indicated that this signals the market is taking a stance that the offer price is too low. There has not been further announcement that the offeror has increased his stake at a higher offer price through the open market. According to the takeover code, if the offeror buys at above the offer price in the open market, it must increase its offer to the highest price paid for the shares for every shareholder. The offer price therefore remains at S\$1.32 for now.

The offeror may have to raise his offer IF he wants to ensure privatisation success. We reiterate that the 2nd to 7th largest shareholders collectively own 13.79% of OSIM and entered their initial positions from 1Q12 to 2Q14. The period's volume weighted average price (VWAP) is S\$1.88, much higher than the offer price and the current trading price. If all of them collectively decline the offer, there will be lower

possibility of privatisation success. The offeror would then have to increase his offer price IF he wants the privatisation to be successful.

A higher offer price of S\$1.51 or more may enhance acceptances. We believe past successful privatisation transactions suggest that an average premium of above 25-35% over the last transacted price and 1, 3, 6 months' VWAP would usually result in privatisation success. For this case, the premium over the 6-month VWAP stands at only 9%. A 25% premium over the 6-month VWAP would result in a higher offer price of at least S\$1.51. That may induce more shareholders to accept the offer.

Maintain HOLD, TP increased to S\$1.46. The takeover scenario has now prompted us to increase our TP. While there are no fundamental changes in earnings, the offer price of S\$1.32 presents a price floor to the share price, at least until the offer has lapsed. Conversely, the offeror may now need to increase his offer IF he desires to achieve privatisation success. That would present further upside catalyst should he decide to do so. Our higher TP continues to be based on fundamentals. We now peg our TP to the stock's 5-year historical mean of 16x FY16F PE.

Offer premium sensitivity

	S\$	S\$1.32 premium	25%	30%	35%
Last transacted price	1.22	8%	1.53	1.59	1.65
1 month VWAP	1.02	29%	1.28	1.33	1.38
3 month VWAP	0.99	33%	1.24	1.29	1.34
6 month VWAP	1.21	9%	1.51	1.57	1.63
Average	1.11		1.39	1.44	1.50

Source of all data: Bloomberg, DBS Bank

Offer premiums of 96 successful SGX delistings from 2008 to present (25-38%)

Offer premiums	Last transacted	1 month VWAP	3 month VWAP	6 month VWAP
Max	166.7	169.8	122.9	136.1
Median	32.8	34.7	36.6	37.5
Mean	24.9	29.3	31.0	31.7
Min	-	-3	1.0	-6.4

Source of all data: Companies' announcement, Bloomberg, DBS Bank

CRITICAL DATA POINTS TO WATCH

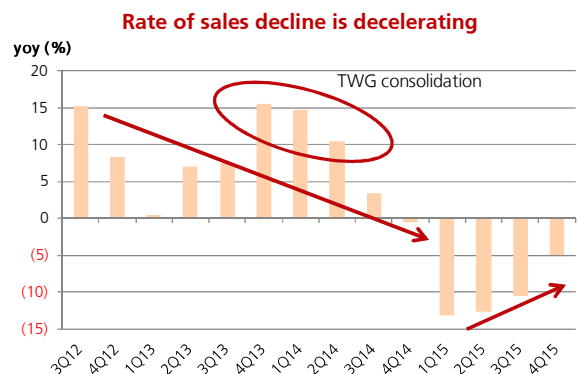
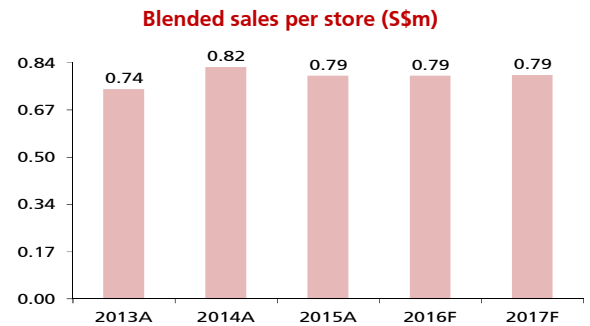
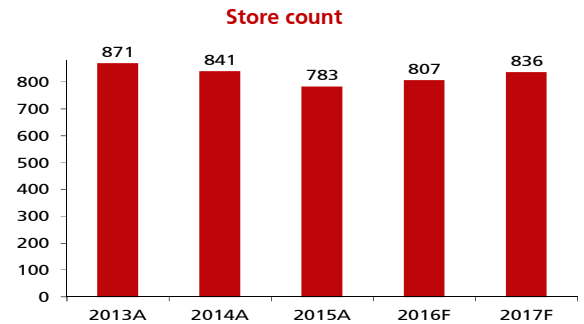
Earnings Drivers:

Five key markets. OSIM primarily operates in five key markets - Singapore, Malaysia, Taiwan, Hong Kong and China - with all other markets indirectly owned and operated. We estimate that OSIM's massage products contribute close to 60% of total revenue.

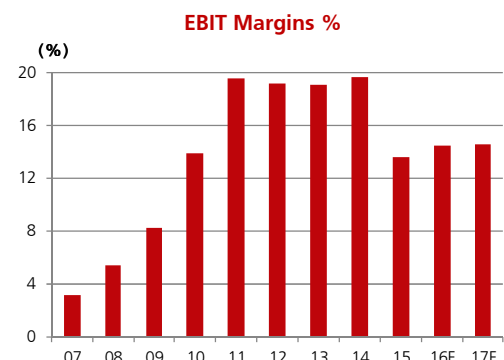
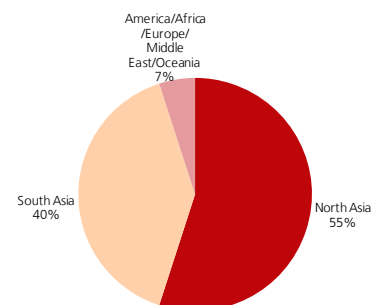
Earnings growth visibility likely to improve. We have turned more optimistic on earnings visibility as we can now see some positives from the OSIM, GNC and TWG brands for FY16F. As we had previously observed, sales growth rates (ex TWG consolidation) from 3Q12 to 1Q15 were declining. However from 2Q15, the rate of sales decline had consistently decelerated. We believe recovering chair sales could be driving this and the brighter outlook is validated by plans to focus more on marketing, introduce new products, and expand the OSIM franchise into new markets this year. In addition, costs for labour and rents in Singapore have eased compared to previous quarters, providing further relief to operating expenses. Apart from OSIM's massage products, GNC's earnings will also benefit from the closure of its Australian operations which has been loss making. TWG will continue to grow store count and will likely enjoy ramp-up of its newly opened North Asian outlets in FY16F. Besides, legal costs are likely to be much lower this year.

GNC, more positive post closure of GNC Australia. OSIM is the sole franchisee for GNC in Singapore, Malaysia and Taiwan. This business generally generates stable earnings and delivers positive cashflows. We estimate that GNC contributes about 25% of total sales. Store count has decreased from the peak of 270 in 4Q11 to 197 in 4Q15 partly due to closure of the GNC business in Australia. Following the provision of S\$5.6m in 4Q15 for the closure, we are now more optimistic on the GNC business given that GNC Australia was making losses of S\$3.5m a year for the past three years. Taiwan now has the most headroom for GNC to scale up.

TWG is growing, legal expenses should be lower in FY16F barring court's ruling. TWG's development has been exciting, growing from 26 stores in FY13 to 52 stores by 4Q15. It now has presence in new markets including Korea, Taiwan, Macau and China. 4Q15 saw more store openings including Four Seasons Macau and Tea WG at Elements in Hong Kong. Going forward, there are plans to open another 15-20 stores in 2016. Besides store presence, it is also increasing its market share in supplying to the luxury hotel segments in Hong Kong, China and Taiwan. We estimate TWG's contribution to group net profit (70% stake and after minority interest) to be small at 8-10%. Following S\$3.4m recognition for legal expenses in 4Q15, 2016's legal fees are expected to be much lower, barring potential damages it has to pay should the court order compensation to its plaintiffs.



Sales mix by geography FY15



Source: Company, DBS Bank

Balance Sheet:

Net cash of S\$200m. The business is generally cashflow positive, generating average operating cashflow of S\$100m over the past five years. OSIM's 4Q15 balance sheet has S\$358m of cash, well equipped to make acquisitions. We believe the company is able to serve out the call option for its convertible bonds in 2017, provided it does not make a significant acquisition. Net cash of S\$200m is equal to over 4x annual dividend payments at 6 Scts/share. Therefore, there is no stress on its balance sheet in this respect.

Share Price Drivers:

Revision in offer price. We see upside catalyst for the stock if any will come from a revision in offer price. The current offer price of S\$1.32 is below the market price, suggesting that the offer is not attractive enough. The offer price is only 9% above the 6-month VWAP. We believe the offeror would have to raise the offer price IF he desires to achieve privatisation success.

Key Risks:

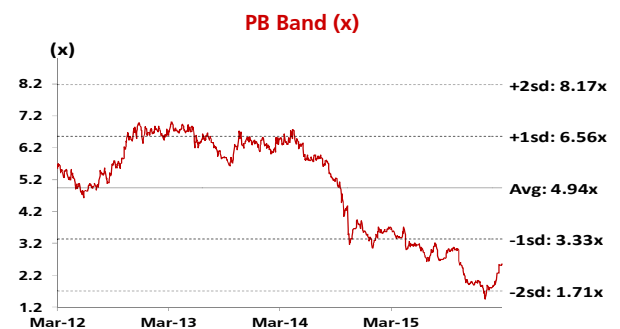
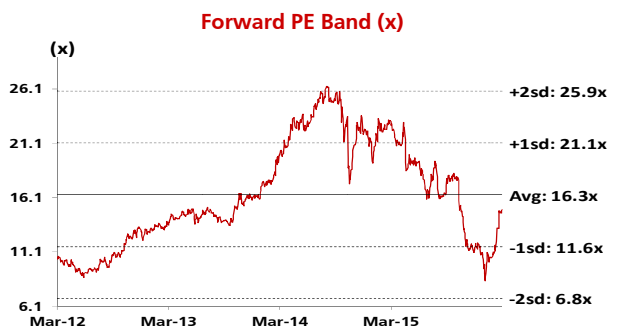
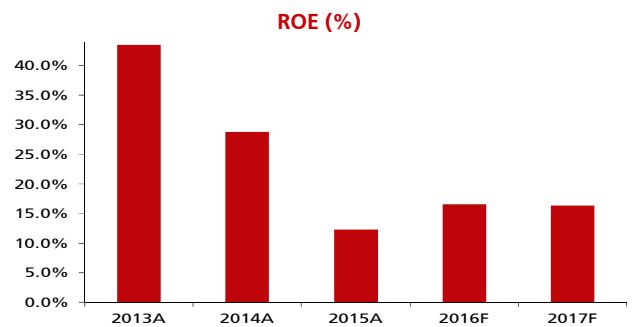
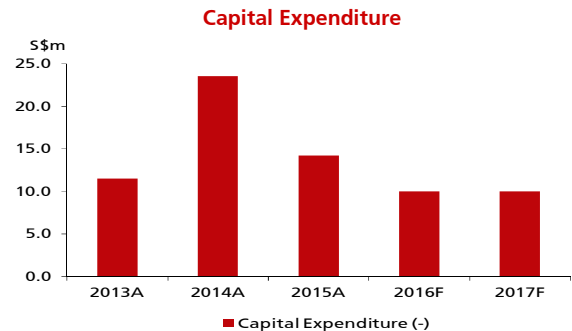
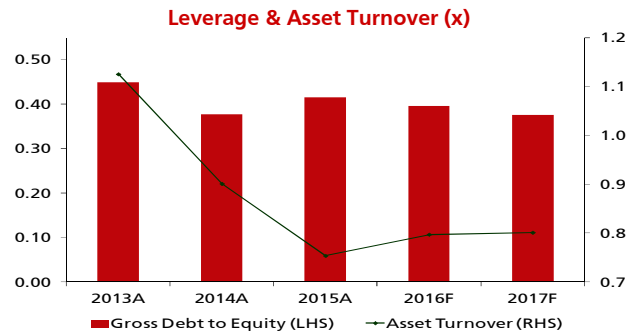
Strong reliance on new chair sales to drive turnaround. Due to the significant contribution of OSIM massage products to revenue, new OSIM massage products are expected to lead a sustainable turnaround and drive growth. New products such as uMagic, uGallop 2, and limited edit uDiva will be launched soon. uJoy should be leading growth going forward, if earnings turnaround is to be sustainable. Any potential slowdown in market demand for OSIM massage products would hamper earnings recovery.

Litigation cases pose unknown earnings risks. The two ongoing litigation cases in Singapore and Hong Kong, where costs remain relatively uncertain, are two unknowns that could spring negative surprises which could yet dampen earnings. Apart from legal fees, there are also potential expenses on damages which OSIM may or may not have to pay, depending on the court's ruling.

Consumer sentiment. OSIM is ultimately a retailer of lifestyle products, and its fortune depends on discretionary consumption. Poor consumption sentiment will be a drag on demand while strong consumption cycle will fuel demand for its products.

Company Background

OSIM is a retailer and brand owner of healthy lifestyle products. The company is the brand owner, manufacturer and retailer for the OSIM line of massage chairs and related products worldwide; a sole franchisee for the GNC chain of nutritional supplement retail stores in Singapore, Malaysia and Taiwan; and a majority owner of the TWG brand of high-end luxury tea cafes and saloons.



Source: Company, DBS Bank

Key Assumptions

FY Dec	2013A	2014A	2015A	2016F	2017F
Store count	871	841	783	807	836
Blended sales per store	0.74	0.82	0.79	0.79	0.79

Segmental Breakdown

FY Dec	2013A	2014A	2015A	2016F	2017F
Revenues (\$\$m)					
North Asia	353	366	341	355	377
South Asia	250	279	248	252	255
America / Africa / Europe /	45.0	46.0	31.0	31.8	32.5
Total	648	691	620	640	664

Income Statement (\$\$m)

FY Dec	2013A	2014A	2015A	2016F	2017F
Revenue	648	691	620	640	664
Cost of Goods Sold	(193)	(205)	(175)	(179)	(186)
Gross Profit	455	486	445	460	478
Other Opng (Exp)/Inc	(332)	(351)	(360)	(368)	(381)
Operating Profit	123	135	84.4	92.5	96.4
Other Non Opng (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	2.92	0.98	1.47	1.47	1.47
Net Interest (Exp)/Inc	(0.4)	1.54	1.41	0.85	1.39
Exceptional Gain/(Loss)	3.35	(5.7)	(16.0)	0.0	0.0
Pre-tax Profit	129	132	71.3	94.8	99.3
Tax	(27.6)	(30.1)	(21.5)	(28.6)	(30.0)
Minority Interest	0.0	0.0	1.70	1.70	1.70
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	102	102	51.5	67.9	71.0
Net Profit before Except.	98.2	108	67.5	67.9	71.0
EBITDA	140	158	109	118	122
Growth					
Revenue Gth (%)	7.6	6.7	(10.4)	3.2	3.8
EBITDA Gth (%)	8.6	13.0	(31.1)	8.6	3.3
Opg Profit Gth (%)	6.9	9.8	(37.7)	9.6	4.2
Net Profit Gth (Pre-ex) (%)	13.0	9.8	(37.4)	0.6	4.6
Margins & Ratio					
Gross Margins (%)	70.3	70.4	71.8	72.0	72.0
Opg Profit Margin (%)	19.0	19.6	13.6	14.5	14.5
Net Profit Margin (%)	15.7	14.8	8.3	10.6	10.7
ROAE (%)	43.5	28.8	12.3	16.6	16.4
ROA (%)	17.7	13.3	6.3	8.5	8.6
ROCE (%)	21.9	16.7	8.6	9.6	9.7
Div Payout Ratio (%)	44.5	45.4	86.4	65.5	62.7
Net Interest Cover (x)	278.4	NM	NM	NM	NM

Source: Company, DBS Bank

Quarterly / Interim Income Statement (\$\$m)

FY Dec	4Q2014	1Q2015	2Q2015	3Q2015	4Q2015
Revenue	178	150	159	142	169
Cost of Goods Sold	(54.1)	(44.1)	(43.7)	(40.1)	(47.0)
Gross Profit	124	106	116	101	122
Other Oper. (Exp)/Inc	(89.4)	(87.2)	(86.0)	(88.4)	(98.7)
Operating Profit	34.2	18.6	29.8	13.1	23.0
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	(0.1)	0.43	0.49	0.30	0.25
Net Interest (Exp)/Inc	0.54	0.0	0.54	0.69	0.22
Exceptional Gain/(Loss)	(0.7)	(1.0)	(2.0)	(4.0)	(9.0)
Pre-tax Profit	34.0	18.0	28.8	10.0	14.5
Tax	(6.3)	(4.9)	(6.9)	(4.3)	(5.3)
Minority Interest	(0.3)	0.49	0.49	0.45	0.28
Net Profit	27.4	13.5	22.4	6.17	9.40
Net profit bef Except.	28.1	14.5	24.4	10.2	18.4
EBITDA	39.6	24.5	36.0	19.2	29.4

Growth

Revenue Gth (%)	12.3	(15.7)	6.4	(11.2)	19.2
EBITDA Gth (%)	20.1	(38.0)	46.9	(46.8)	53.2
Opg Profit Gth (%)	26.9	(45.6)	60.4	(56.2)	76.1
Net Profit Gth (Pre-ex) (%)	31.1	(48.3)	68.0	(58.3)	80.9

Margins

Gross Margins (%)	69.5	70.6	72.6	71.7	72.2
Opg Profit Margins (%)	19.2	12.4	18.7	9.2	13.6
Net Profit Margins (%)	15.4	9.0	14.0	4.4	5.6

Balance Sheet (\$\$m)

FY Dec	2013A	2014A	2015A	2016F	2017F
Net Fixed Assets	25.2	36.4	33.5	28.5	23.5
Invt in Associates & JVs	18.5	18.4	21.7	23.2	24.6
Other LT Assets	219	211	217	207	198
Cash & ST Invt	291	456	385	418	455
Inventory	72.5	71.6	78.2	80.7	83.7
Debtors	42.0	42.6	37.6	38.8	40.3
Other Current Assets	12.5	17.8	17.9	17.9	17.9
Total Assets	680	854	790	814	842
ST Debt	155	17.2	13.2	13.2	13.2
Creditor	107	77.0	76.6	79.0	82.0
Other Current Liab	35.2	64.0	50.4	50.4	50.4
LT Debt	0.06	168	173	173	173
Other LT Liabilities	39.1	35.7	29.4	29.4	29.4
Shareholder's Equity	271	438	397	420	447
Minority Interests	72.7	53.6	50.9	49.2	47.5
Total Cap. & Liab.	680	854	790	814	842
Non-Cash Wkg. Capital	(15.4)	(8.9)	6.71	7.98	9.50
Net Cash/(Debt)	136	271	199	232	269
Debtors Turn (avg days)	22.6	22.3	23.6	21.8	21.7
Creditors Turn (avg days)	201.2	183.5	184.8	183.7	182.2
Inventory Turn (avg days)	128.9	143.7	180.3	187.6	186.0
Asset Turnover (x)	1.1	0.9	0.8	0.8	0.8
Current Ratio (x)	1.4	3.7	3.7	3.9	4.1
Quick Ratio (x)	1.1	3.2	3.0	3.2	3.4
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	7.4	12.7	7.7	5.4	5.4
Z-Score (X)	0.0	0.0	0.0	0.0	0.0

Source: Company, DBS Bank

Cash Flow Statement (\$m)

FY Dec	2013A	2014A	2015A	2016F	2017F
Pre-Tax Profit	129	132	71.3	94.8	99.3
Dep. & Amort.	21.7	29.8	31.2	32.5	32.5
Tax Paid	(29.2)	(26.0)	(38.8)	(28.6)	(30.0)
Assoc. & JV Inc/(loss)	(2.9)	(1.0)	(1.5)	(1.5)	(1.5)
Chg in Wkg.Cap.	3.87	(16.0)	(5.8)	(1.3)	(1.5)
Other Operating CF	(9.5)	(2.3)	1.58	0.0	0.0
Net Operating CF	113	117	58.0	96.0	98.9
Capital Exp.(net)	(11.5)	(23.6)	(14.2)	(10.0)	(10.0)
Other Invts.(net)	(3.8)	(3.8)	(9.7)	0.0	0.0
Invts in Assoc. & JV	(7.0)	0.0	(2.6)	0.0	0.0
Div from Assoc & JV	1.36	1.21	0.69	0.0	0.0
Other Investing CF	16.5	3.19	5.29	0.0	0.0
Net Investing CF	(4.4)	(23.0)	(20.5)	(10.0)	(10.0)
Div Paid	(36.2)	(45.5)	(45.9)	(44.5)	(44.5)
Chg in Gross Debt	4.57	134	(4.0)	0.0	0.0
Capital Issues	(7.5)	0.0	0.0	0.0	0.0
Other Financing CF	(2.3)	(15.1)	(52.2)	0.0	0.0
Net Financing CF	(41.4)	73.4	(102)	(44.5)	(44.5)
Currency Adjustments	6.19	0.85	2.93	0.0	0.0
Chg in Cash	73.6	168	(61.5)	41.5	44.4
Opg CFPS (\$ cts)	15.1	17.4	8.42	13.1	13.5
Free CFPS (\$ cts)	14.1	12.3	5.77	11.6	12.0

Source: Company, DBS Bank

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date	Closing Price	Target Price	Rating
1:	06 May 15	1.74	1.82	HOLD
2:	24 Jul 15	1.54	1.61	HOLD
3:	02 Sep 15	1.47	1.61	HOLD
4:	28 Oct 15	1.44	1.22	FULLY VALUED
5:	29 Jan 16	1.02	1.28	BUY
6:	17 Feb 16	1.00	1.28	BUY

Source: DBS Bank

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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