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Singapore Consumer

Reuters BEST.SI
Bloomberg BEST SP

Priced on 12 January 2017
STI @ 2,993.0

12M hi/lo S\$1.64/0.22

12M price target S\$2.50
±% potential +78%

Shares in issue 275.2m
Free float (est.) 45.0%

Market cap US\$272m

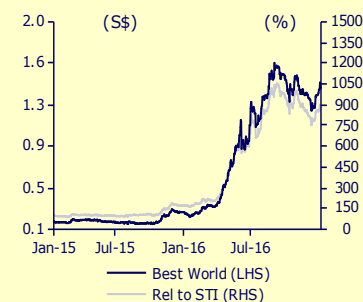
3M average daily volume
S\$2.2m (US\$1.5m)

Major shareholders

D2 Investments Pte Ltd 35.0%

Stock performance (%)

	1M	3M	12M
Absolute	7.7	2.2	466.5
Relative	6.2	(3.9)	409.5
Abs (US\$)	7.4	(0.9)	470.9



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Poised for the big leap

Well-established track record not fully appreciated

Best World (BW) is a direct-selling company that has built a credible track record. Focusing on the premium skin care, it is well established outside of Singapore, and thus, the investment merits are not fully appreciated. BW's ability to succeed in highly competitive markets like Taiwan and China is a testimony of management capabilities. Despite the share-price rally (480% over the past one year), the stock remains undervalued vs regional peers. Fundamentals are underpinned by 27% EPS Cagr over FY16-18CL and strong free cashflow and backed by ~40% net cash equity. We initiate coverage with BUY and S\$2.50 target price.

Track record not fully appreciated

Unlike many direct-selling firms, BW does not require members to make bulk purchase, thus revenue is not inflated. This minimises risks of inventory buildup. Importantly, BW has successfully built its product positioning in the premium skincare segment. The success is evident through the strong revenue growth, as the product, coupled with successful marketing strategies, helps penetrate markets in Taiwan and China. The business model is scalable, enjoys high operating margins, and is consistently free cashflow positive.

Exponential growth in Taiwan but will be eclipsed by China

BW's ability to succeed in Taiwan, a highly competitive market, is a litmus test of management capabilities. We project sales to grow sevenfold over five years to reach S\$107m in 2016. Growth looks set to continue, as we expect 20-30% YoY sales growth in 2017-18. However, China will be the game changer. In Nov-16, BW was awarded a direct-selling licence by the Chinese government. This endorsement can significantly propel China sales (33% of sales) and overtake Taiwan (54% of sales) in five years.

Delivering on China

BW has already built certain scale with a network of beauty salons as distributors. The licence enables BW to gain credibility and differentiate its products. BW can succeed in China, as the market has similar dynamics as Taiwan - a receptive consumer base, utilising online marketing platform and product positioning catering to a discerning group. Marketing events held in China have seen turnouts increasing twofold post the licence award.

Strong earnings growth in 2017-18CL

BW trades at a large discount to comparables despite enjoying superior earnings, dividend yield and ROE. Our target at S\$2.50 is based on ~18x 2017CL PE is based on a 30% discount to peer group PEG.

Financials

Year to 31 December	14A	15A	16CL	17CL	18CL
Revenue (S\$m)	75	102	198	256	312
Net profit (S\$m)	4	8	31	39	49
Core EPS (S¢)	1.9	3.9	11.2	14.1	18.0
Core EPS growth (% YoY)	388.0	105.7	189.0	26.8	27.0
DPS (S¢)	0.0	2.0	4.7	6.0	7.5
EV/Ebitda (x)	26.8	13.6	7.6	5.8	4.3
PE (x)	74.9	36.4	12.6	9.9	7.8
PB (x)	5.4	4.9	4.7	3.7	2.9
ROE (%)	7.7	14.2	42.3	42.0	41.8
Dividend yield (%)	0.0	1.4	3.3	4.3	5.3
Net cash/equity (%)	63.4	76.2	40.0	34.1	44.6

Source: CLSA

Investment merits of Best World are not fully appreciated

Members are not required to make bulk purchase to join its network, thus revenue is not grossly inflated

Obtaining the coveted direct-selling licence in China is a testimony to the firm's credibility

Established track record

Best World (BW) is a good quality and well-managed direct-selling company. Focusing on premium skin care, it first established itself outside of Singapore, and thus, the investment merits are not fully appreciated.

Since listing in 2004, the firm has built a credible track record. Unlike the practice of many direct-selling firms, distributors of BW are not required to commit large purchases – as membership fees – to join its network or distribute its products. At the same time, it has successfully expanded in Taiwan and China, markets that offer significant growth potential.

BW primarily targets users of its products, hoping to convert them as sales agents eventually. The practice of not requiring to purchase huge inventory is important, as it implies there is no “inventory stuffing” in the distribution channel where revenue can be grossly inflated as a result. This enables investors to keep track of inventory build-up, which could suggest potential slowdown in sales.

However, the exception to this practice is in China, where distributors need to purchase RMB20,000 worth of products. This is equivalent to five sets of skincare products. This is practised only in China to facilitate logistical efficiency given the geographical expanse of the country.

Obtaining the coveted direct-selling licence in China

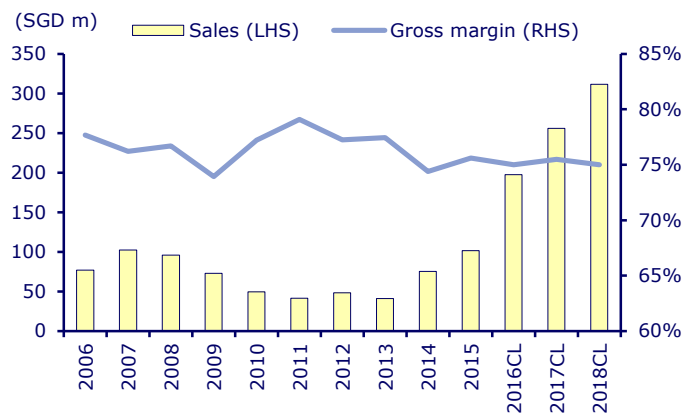
BW was awarded the much-coveted direct-selling licence by the Chinese government in Nov-16, due to its track record and quality products. This is a testimony of the firm’s credibility and product efficacy, in our view. Since 2006, approximately 80 licences have been awarded in China. The reputable Beijing-based medical hall Tong Ren Tang was awarded about the same time as BW.

BW is the only Singapore name to receive the award. This can enable the firm to capitalise on rapid industry growth. Despite economic headwinds, skin-care products is one of the fastest-growing segments in China today. According to McKinsey, sales of premium skincare products, for instance, rose by more than 20% a year in the past decade while the industry average was 10%.

Effective and low-cost distribution model

Figure 1

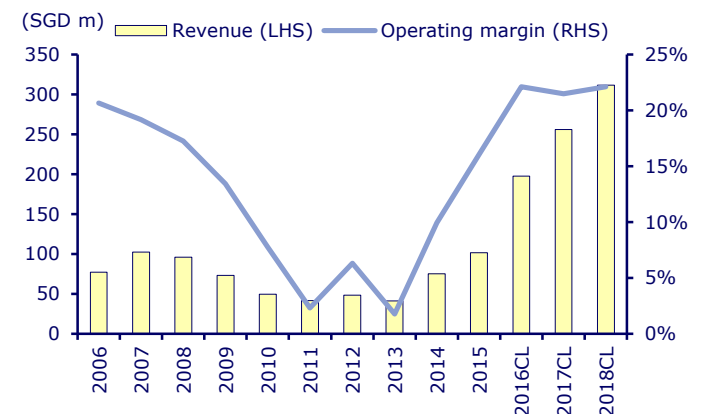
Best World – Sales and gross margin



Source: CLSA, Company

Figure 2

Best World – Operating margin vs net profit



Source: CLSA, Company

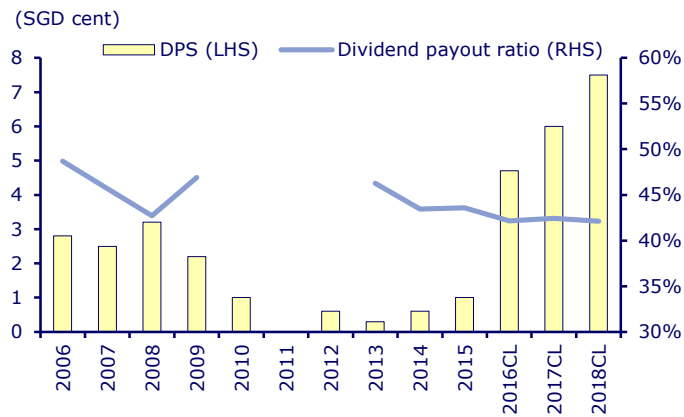
Scalable business model and less subjected to business overhead

Enjoys consistently high gross margin but operating margin can be volatile due to effects of operating leverage

As a direct-selling company, the business model is scalable, particularly as the company increases the distributorship network. Compared with traditional retailers, BW has no retail outlets and therefore is not subjected to volatility in rental costs, marketing expenses or high overheads. BW outsources manufacturing to third parties, removing capex needs. At the same time, distributors are not paid salaries but work on commissions. This enables it to deliver consistently high gross margin in excess of 70%. Operating margin, however, is much more volatile due to effects of operating leverage.

Figure 3

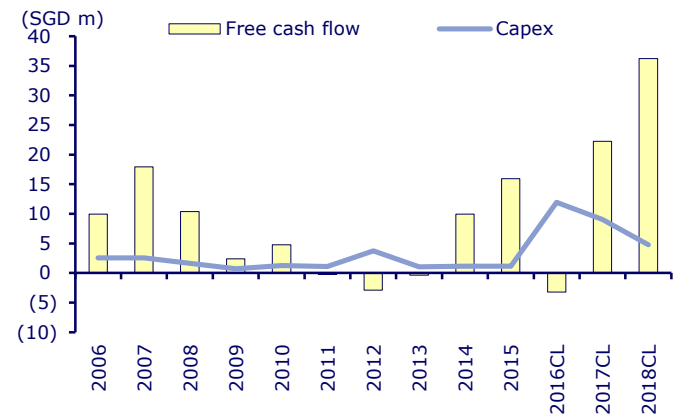
Best World – DPS and Dividend Payout ratio



Source: CLSA, Company; Note: * Payout ratio was 184% in 2010, 0% in 2011 and 136% in 2013 due to low net profit registered in these three years

Figure 4

Best World – FCF vs Capex



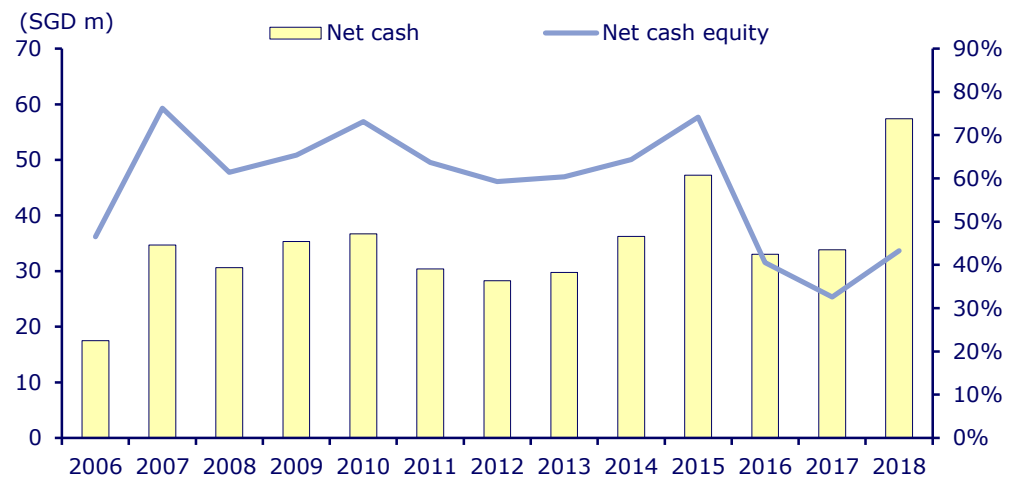
Source: CLSA, Company

Net cash equity will stabilise ~40%

As a direct distributor, BW’s commission-based scheme is an effective tool to generate sales. As the income of distributors depends on his/her rank and the revenue generated by his/her team, distributors are self-motivated to finesse their marketing techniques and expand their network of sellers. Nevertheless, we believe the numbers delivered are telling of their track record. Since listing in 2004, when the firm raised ~\$5m, it paid out ~\$36m dividends and has not raised capital since. BW is net cash and consistently generates positive free cashflow.

Figure 5

Best World – Net cash and net cash equity



Source: CLSA, Company

Taiwan and China contributes more than 80% of revenue

BW did not adopt an aggressive pricing strategy during its growth phase

Targets the mid- to high-end market

BW is a late entrant in Taiwan but succeeded in expanding its distributorship

Taiwan and China are key markets

Taiwan and China are BW's key markets, accounting for ~54% and ~33% of sales respectively. Although both markets are extremely competitive, BW has seen success in its market penetration. We opine the firm is still in the early stages of growth.

During its growth phase, it is important to note that Best World did not adopt an aggressive pricing strategy. The focus was on expanding the distribution network, ensure product quality and cultivate a premium brand. The key product is Dr's Secret range of skincare products. A set costs S\$800 in Singapore, RMB4,397 in China and NT\$18,100 in Taiwan.

Figure 6

Best World – Range of premium skin care products



Source: CLSA, company

Exponential growth in Taiwan

Although BW began operations as early as 2008, it was only in 2013 that marketing efforts in the Taiwan market began to intensify. Thus, BW is a relatively late entrant compared with major brands such as Nu Skin and Amway. Nonetheless, Taiwan has grown to become a key contributor, with sales accounting for 60% of group sales in 9M2016. Despite Taiwan's anaemic economic growth in recent years, BW achieved strong product penetration.

Revenue is projected to grow more than sevenfold since 2010 from S\$16m to S\$107m (58% of sales) by the end of 2016. The strongest revenue growth was registered in 2015 when Taiwan GDP growth fell from 5.7% to 3.7%. Management believed this was a result of BW's training and marketing efforts. Within the direct-selling industry, management estimates BW should be ranked #15 in Taiwan in terms of revenue, and thus, sales are yet to saturate. Going forward, we project sales growth of 20-30% YoY in 2017-18.

Management estimates
BW is ranked #15 in
terms of sales in Taiwan

BWL has achieved 5-year
revenue Cagr of 127% in
Taiwan

Figure 7

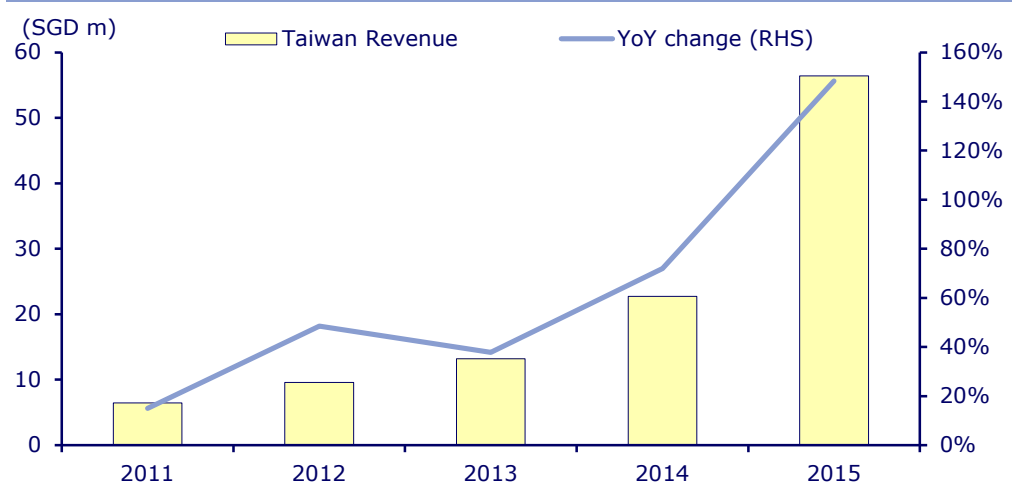
Taiwan's top-10 direct-selling companies

Rank	Company	Sales (NT\$bn)
1	Amway	11.7
2	Pro-Partner	7.1
3	Melaneuca	4.8
4	Herbalife	4.6
5	Nu Skin	4.5
6	Market America	4.3
7	Total Swiss International Group	4.2
8	Jeunesse Global	2.7
9	E. Excel	2.3
10	Avon Products	2.1

Source: Power Networking Monthly Magazine, company

Figure 8

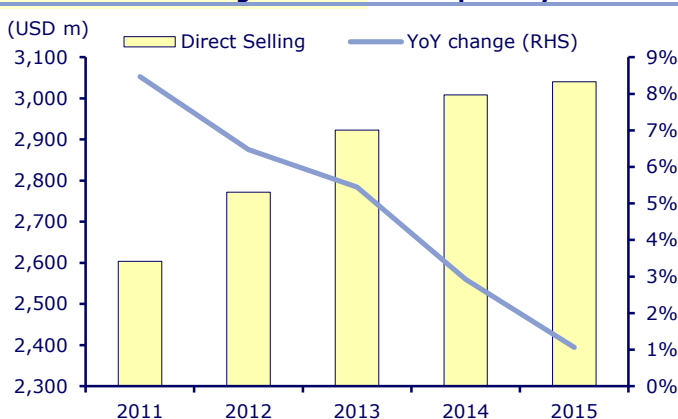
Strong growth in Taiwan over the past five years



Source: CLSA, Bloomberg

Figure 9

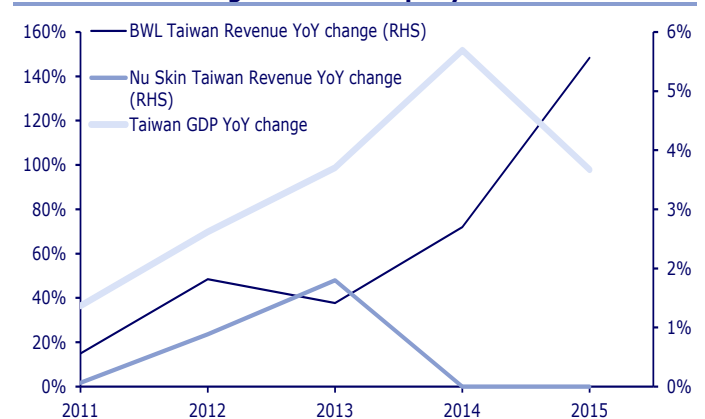
Taiwan direct-selling market over the past 5 years



Source: Euromonitor

Figure 10

Taiwan economic growth vs company sales



Source: Republic of China (Taiwan) National Statistics

Receptive consumers set the stage

A receptive consumer base sets the stage for BW to maintain its strong performance. In Taiwan, the biggest direct-selling category is consumer healthcare (40%), followed by beauty and personal care (13%).

Direct selling is well accepted in Taiwan, but not Singapore

Management avoided head-on competition with established names by focusing on Taichung instead of Taipei

According to Euromonitor, "Direct selling is a well-developed and well-recognized channel in Taiwan...Direct selling players continued to grow their customer bases, with new young consumers being the target to this expansion. Overall, direct selling products are perceived by Taiwanese consumers as being of good quality."

This makes it easier for BW to build a strong consumer base. This contrasts with Singapore where purchase of skincare is usually over the counter.

Taiwan's direct-selling market is highly fragmented and dominated by international players such as Amway, Melaleuca and Nu Skin. Since BW is a late entrant in Taiwan, management avoided head-on competition by launching its first regional centre in Taichung instead of Taipei. Marketing efforts were largely concentrated in Taichung to build reputation and distributor network. With the success, it began to roll out in other cities.

Figure 11

With a "Young Entrepreneur"



Source: CLSA

Figure 12

Former beauty salon owner turned BW's distributor



Source: CLSA

A litmus test for direct selling is ability to expand distributorship

Engaging the right distributors

A litmus test for a direct-selling company to succeed is the ability to expand its distributorship. One of the initiatives adopted was to recruit young and business-minded consumers as their "Young Entrepreneurs".

Younger distributors are also more adept in using online platforms to promote the products. Currently, 70% of its distributors are under the age of 35 in Taiwan. Since 2013, BW has launched three training centres across Taiwan. The opening of the centres provides a venue for recruitment, training and marketing initiatives.

These "Young Entrepreneurs" are generally beauticians or owners of beauty/hair & nail/spa salons. Many are certified beauty professionals, and thus, they have a ready customer base to reach out to. The distributors also use Facebook/LINE chat/WeChat to share their BW experience: "before-and-after" skin photos, starting a business with BW, etc. This a common practice but is also the most-effective marketing tool among multi-level marketing (MLM) players.

Capitalising on the momentum in China

On 17 November 2016, BW officially obtained its direct-selling licence from China’s Ministry of Commerce (MOFCOM). This is significant, as the Chinese government has always taken a cautious approach towards direct-selling companies.

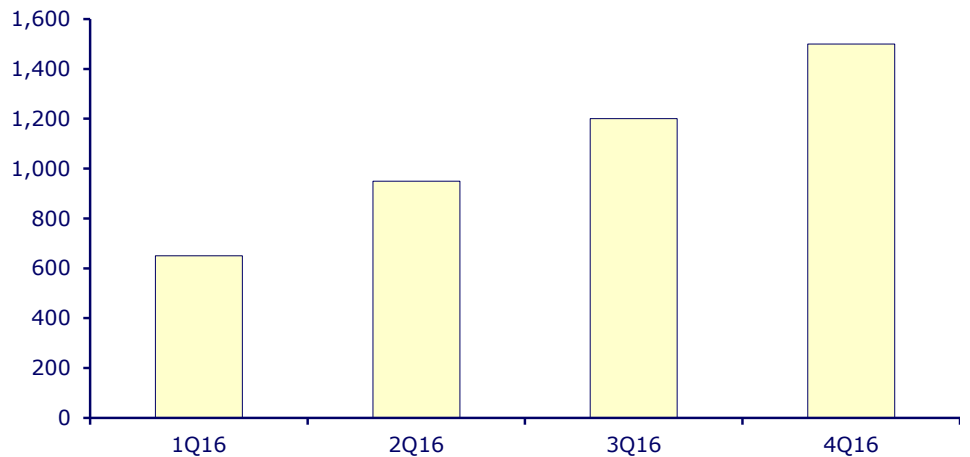
The award of the licence can be a game changer for BW and help expand market share. The licence enables the firm to gain credibility, differentiate its products, and importantly attract more distributors. BW has been working to expand its distribution network in China over the past few years in anticipation of securing the licence; therefore, it is now poised to further capitalise on its network with this approval.

Prior to the direct-selling licence, BW has already built certain scale in China via the export model. Under the export model, BW relies on several export agents to distribute its products to a network of beauty salons, nail & hair salons and spas. It has a strong presence in tier-2 or tier-3 cities such as Changsha, Wenzhou, Harbin and Zhongshan. They achieved consistent growth from 2012 to 2015, followed by a sharp increase in 9M2016. Revenue in 9M2016 exceeded total export revenue in 2015, with 704% QoQ growth in 1Q2016, 615% in 2Q2016 and 366% in 3Q2016.

Post the announcement of BW’s licence award in Nov-2016, BW’s quarterly marketing events attracted a turnout of 1,500 participants in Dec-2016, higher than the usual 600-900 turnout per quarter. Compared with 2015, the average turnout per quarter ranges between 300-700. The number of participants during such events reveals the potential of the distributorship across China. This is a signal of its product acceptance. As a result, management has plans to raise prices in China by 7% in 2017.

Figure 13

BW – Participants turnout during quarterly marketing events in Changsa



Source: Company

Direct-selling award reinforces credibility of the firm and its products

BW plans to convert export model to direct-selling model in several phases

Turnout during marketing events has risen threefold since award of direct selling licence

Sharp increase in participants signals potential market penetration and successful product positioning

Figure 14

Distributor turnout



Source: CLSA, company

Figure 15

Changsha



Source: CLSA, company

The inclusion of more cities under the direct-selling licence will take ~6 months

Exponential growth achieved for the Chinese market

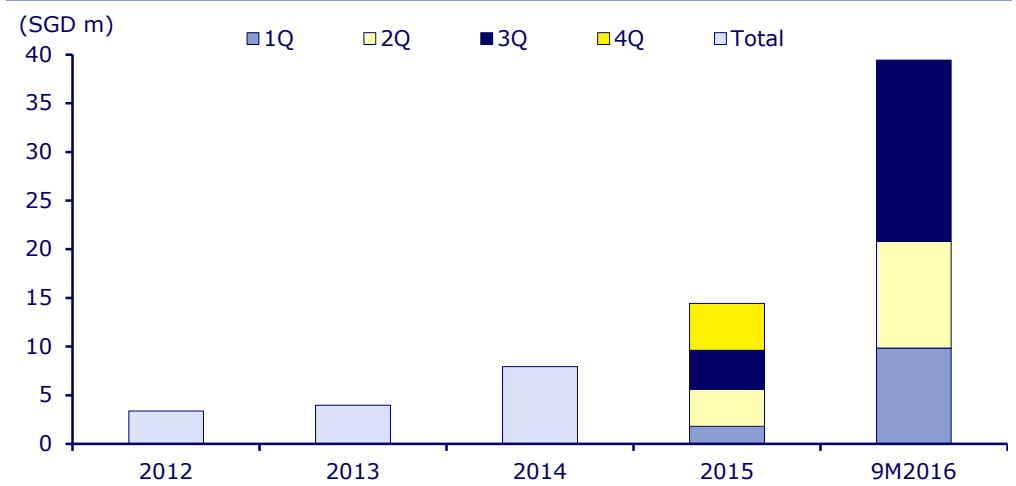
China market potential is much larger than Taiwan

Market dynamics for direct selling in China are similar to Taiwan. It is rampant with distributors using online platforms such as WeChat to advertise their products. Distributors range from consumers to beauty salon owners, who also distribute these products to their salon customers.

With the licence, BW can easily expand its geographical and product coverage and convert from the current export model to direct selling. By 2017, BW hopes to start the application for cities where it has a presence such as Changsha, Wenzhou, Harbin, and Zhongshan.

Figure 16

Export revenue growing fast



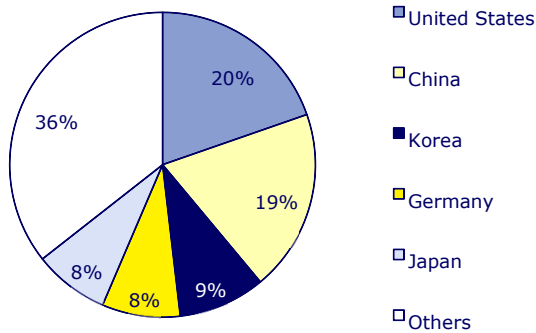
Source: CLSA, Company

China market offers significant potential

China is the second-largest direct-selling market in the world. According to Euromonitor, the direct-selling market in China has achieved 10% growth in 2015, reaching US\$19.2bn in retail value. It projected the market will continue to expand at 6% Cagr. As a backdrop, McKinsey projects household income to rise, with the affluent household income group growing from 11% in 2012 to 25% in 2022.

Figure 17

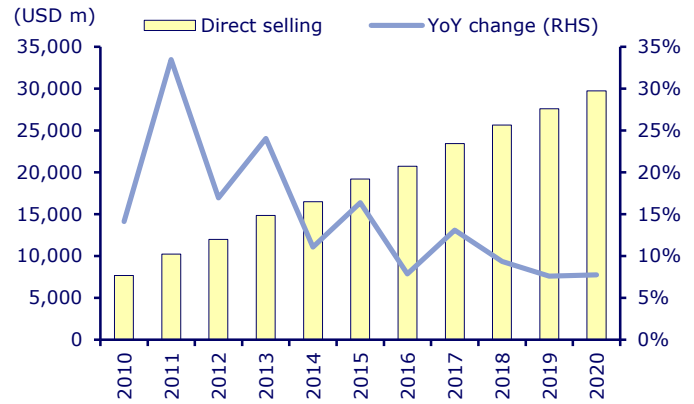
Top-5 global direct selling market - 2015 retail sales



Source: CLSA, World Federation Direct Selling Association

Figure 18

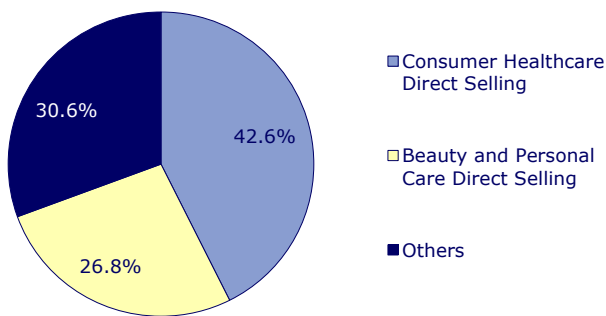
China direct-selling retail value against YoY change



Source: CLSA, Euromonitor

Figure 19

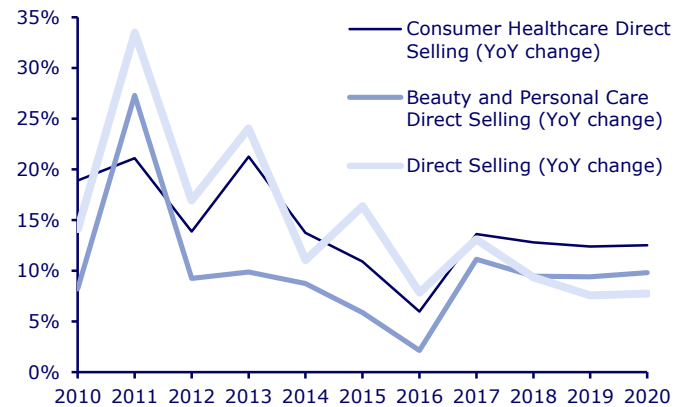
China direct-selling market breakdown in 2015



Source: CLSA, Euromonitor

Figure 20

Top-2 direct-selling categories in China



Source: CLSA, Euromonitor

Personal beauty care is one of the top-selling categories in China

BW's product positioning can meet the demand of discerning consumers

The top-two direct selling categories in China are: 1) consumer healthcare; 2) beauty and personal care. These two categories are projected by Euromonitor expected to grow at 10% per annum, higher than the growth of other direct-selling categories.

BW product positioning is well poised to meet the demand of increasingly discerning consumers at the mid to high end level. Management plans to raise prices in China in 2017.

Figure 21

Comparison of skincare selling prices

Brand	Cleanser (RMB)	Cleanser (RMB/ml)	Moisturizer (RMB)	Moisturizer (RMB/ml)	Essence (RMB)	Essence (RMB/ml)
BW (Dr's Secret)	400	3.39	568	18.93	998	33.27
Nu Skin (ageLOC)	265	8.83	400	16.00	1500	50.00
SK II (R.N.A. POWER)	410	4.10	860	17.20	850	28.33
Estee Lauder (Perfectly Clean, Advanced Time Zone, Advanced Night Repair)	310	2.07	780	15.60	590	19.67

Source: CLSA

Figure 22

China pricing for select Dr's Secret products

	2012	2013	2014	2015	2016	2017
T1 Cleanser (118ml)	¥380	¥390	¥392	¥400	¥400	¥428
T2 Toner (118ml)	¥380	¥390	¥392	¥400	¥400	¥428
T3 Moisturizer (30ml)	¥530	¥550	¥556	¥568	¥568	¥608
C15 Essence (15ml)	¥640	¥660	¥666	¥678	¥678	¥725
T9 Serum (30ml)	¥380	¥395	¥398	¥406	¥406	¥434

Source: CLSA, Company

With the licence, BW can easily expand its geographical and product coverage. Approval for subsequent applications will be much faster: less than 6 months for simultaneous applications and up to 5 provinces. By 2017, BW hopes to start the application for cities where it has a presence such as Changsha, Wenzhou, Harbin, and Zhongshan.

The inclusion of other products under the direct-selling licence is expected to take approximately a few months, given these products have already passed extensive tests (animal test, human clinical trials, etc) and obtained approval from China Food and Drug Administration.

Figure 23

Application plans for broader coverage under direct-selling licence

Time	Geography	Products	Remarks
2017	Cities where BW has a strong presence, such as Changsha, Wenzhou, Harbin, zhongshan etc, in at least 5 provinces	All products	These products will be manufactured by BW's current third-party manufacturers
2018 onwards	Other major cities and provinces in China	All products	Products will be manufactured by third-party manufacturers until the approval of skincare products, which will be manufactured by BW's Singapore plant

Source: CLSA, Company

The inclusion of more cities in the direct-selling licence will take ~ 6-12 months

Inclusion of other products under the licence will take a few weeks

Taiwan and China are key to BW's profit growth momentum

We project operating margin to rise above 20% for 2016-18 and project positive free cashflow

Strong financial projections

We project BW can deliver net profit Cagr of 27% over 2016-18. This translates to net profit of S\$31m in 2016 and S\$39m in 2017. Growth in profit is underpinned largely by Taiwan and China. Both markets are critical to fundamental outlook, as the firm continues to expand market penetration. Over the next three years, we expect operating margins to stay above 20% (vs 2-16% in 2013-15) as it enjoys the effects of operating leverage due to strong topline growth.

In 2017, operating margin could contract slightly by ~1% due to increase in operating expenses, as BW sets up service centres and marketing events to promote the Dr's Secret skincare range. Nonetheless, strong revenue growth would still enable the firm to deliver 27% CAGR profit growth over 2016-18.

Three critical success factors underpin our optimism:

- ❑ Successfully built the right product positioning that caters to a discerning group of consumers. This is evident via product sales growth in Taiwan and China. Importantly, the success in its marketing efforts for Dr's Secret range of premium skincare was not driven by a strategy of price cuts. Prices have increased steadily over the past few years instead.
- ❑ Successful rollout of distribution centres in China. BW has already built certain scale with a network of beauty salons as distributors. Their market presence is especially strong in Changsa.
- ❑ Award of direct-selling licence by China Ministry of Commerce. This is a testimony of product quality and significantly enhances credibility of the brand. Well-heeled consumers in China are willing to pay premium prices.

Figure 24

Global Valuation Comparison

Company	Ticker	Price	Market Cap	PE (x)		EV/Ebitda		EPS Growth (%)		PB (X)		ROE (%)	Div Yield (%)
				2017	2018	2017	2018	2017	2018	2017	2018		
			(US\$m)										
HK/China													
XIANGXUE PHARM-A	300147 CH	12.9	1,238	36.9	30.1	31.1	25.1	66.7	22.9	2.4	2.2	6.5	-
BAIYUNSHAN PH-H	874 HK	19.2	5,390	16.4	15.3	14.8	13.2	3.3	7.2	1.8	1.8	13.2	1.7
Taiwan													
GRAPE KING BIO	1707 TT	171.5	724	14.2	12.3	7.8	6.6	22.6	15.3	3.7	3.1	29.1	4.5
CHLITINA HOLDING	4137 TT	149.5	375	17.3	13.7	8.9	7.0			3.1	2.8	17.5	4.7
Malaysia													
HAI-O ENTERPRISE	HAIO MK	4.15	179	16.0	14.1	10.0	9.0	39.0	13.5	3.0	2.8	18.9	4.3
AMWAY MALAYSIA H	AMW MK	7.50	276	18.8	15.5	11.3	8.6	19.4	20.8	5.7	5.0	20.4	4.5
United States													
NU SKIN ENTERP-A	NUS US	49.6	2,703	15.5	14.2	7.4	7.1	8.8	9.6	5.2	4.7	21.3	3.0
HERBALIFE LTD	HLF US	49.7	4,628	10.3	9.9	7.1	6.7			-	-	-	-
USANA HEALTH SCI	USNA US	61.3	1,496	13.7	11.1	7.8	NA	9.9	23.3	8.1	6.6	30.3	-
Singapore													
BEST WORLD INTL	BEST SP	1.40	271	9.9	7.8	5.8	4.3	27.3	21.4	3.7	2.9	42.0	4.3

Source: Bloomberg

We value BW at 0.7x PEG, translates to 19x PE multiple; this is on par with global peers but BW enjoys superior financials

Despite aggressive growth projections, we do not expect working capital to intensify, thus we project positive free cashflow in 2017-18. Capex requirement for BW is for the set-up of a manufacturing plant in Singapore by end-2017. The objective of setting up the plant is to reduce the long lead times from third-party OEMs which could stretch up to 6 months and will cost the firm S\$15m. More than S\$10m will be committed in 2016; therefore, capex in 2017-18 will reduce significantly.

\$2.50 target price

We expect net cash position of \$32m in 2017. With a healthy balance sheet and cashflow, dividend payout ratio can comfortably be maintained at 40% or higher. We value Best World at ~18x 2017CL PE multiple. This is based on a PEG of 0.65x using 2016-2018CL EPS Cagr of 27%. This translates to ~18x PE and a target price of S\$2.50. The PEG of ~0.65x is based on a ~30% discount to the PEG of the peer group average of ~0.9x. On PE multiple, we expect the stock to trade on par with regional peers.

Given the stronger growth rate, we believe this fair value multiple is not aggressive. Other comparables are trading at an average of ~19x 2017 PE multiple but offer lower ROE.

BW has been listed since 2004

Company background

Founded in 1990, Best World International Ltd (BW) is a Singapore-based direct-selling company that specialises in the development, manufacturing and distribution of premium skincare, personal care, nutritional and wellness products. In 2004, it was listed on the SGX and remains the only direct-selling company listed in Singapore. Today, it has become a regional player with 429,000 independent distributors and members in 12 markets across China, South East Asia, and the Middle East.

Management

Key management members are Dr Dora Hoan (CEO), Dr Doreen Tan (President) and Huang Ban Chin (Group COO). Each of them has been with the firm for more than 20 years. Collectively, they own 55% stake in the company. The Group Financial Controller is Ms Koh Hui, who has been with BW for the past 13 years.

Figure 25

Key management equity stake (%)

Name	Prior to IPO	Post IPO	Current stake	Remarks
Dr Dora Hoan	34	10.3	6	Vendor share sale in 2007
Dr Doreen Tan	34	10.3	6	Vendor share sale in 2007
Huang Ban Chin	4	3	4.5	NM
D2 Investment	nil	36.4	37.7	D2 Investment is jointly owned by Dr Dora and Dr Doreen

Source: Company

Figure 26

Details - Management and Board of Directors

Name	Rank	Service length	Other directorships and commitments
Dr Dora Hoan Beng Mui	Co Chairman/Group CEO	26 years	Chairman, Direct Selling Association, Singapore, Chairman, World Learner Exchange Program, Vice chairman, Radin Mas CCC
Dr Doreen Tan Nee Moi		26 years	Corporate Council Board Member, Asean Alliance of Health Supplements Associations Vice chairman, World Learner Exchange Program Patron, Pasir Ris CCC
Huang Ban Chin	Executive Director and Chief Operating Officer	22 years	None
Mr Lee Sen Choon	Chairman of Audit Committee, Lead Independent Director	12 years	Board of director in Hor Kew Corp and Soon Lian Holdings, Chairman, Hwa Chong Institution Board of Directors
Mr Ravindran Ramasamy	Chairman of Nominating Committee	13 years	Director at Serial System Practicing Partner at Colin Ng & Partners LLP
Mr Chan Soo Sen	Chairman of Remuneration Committee	NA	Director at Breadtalk, Midas and Cogent Previously served as Minister of State, Various Ministries in Singapore and formerly CEO Sino-Singapore Suzhou Industrial Park

Source: Company

In 9M16, Taiwan accounted for 60% of revenue, followed by China at 30%

Segmental breakdown

The company's business can be segmented into three parts, with direct selling contributing ~69% of 9M2016 revenue. The export segment which captures retail sales from China contributed ~28% in 9M2016. The remaining overall sales comes from the manufacturing/wholesale segment, which captures revenue realised through the wholesale channel in China only.

As of 9M2016, Taiwan is the company's biggest revenue earner at 60%, and China is second at 30%. Singapore and Indonesia come next at 3.5% and 2.8% respectively, while the rest of the markets total ~4% of overall revenue.

In terms of product line, the biggest revenue generator for the company is its skincare products. This was followed by nutrition and wellness products at 10.6% and health supplements of 9.8%.

Figure 27

9M2016 revenue breakdown by segments

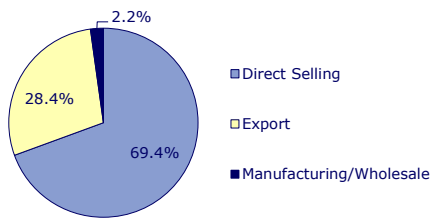


Figure 28

9M2016 Revenue breakdown by geography

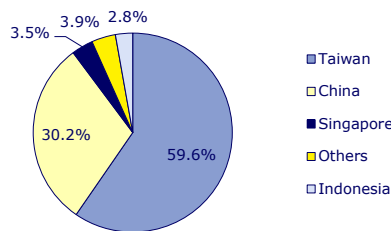
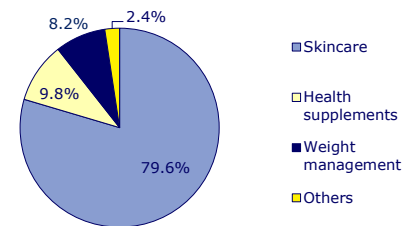


Figure 29

9M2016 Revenue breakdown by products



Source: CLSA, Company

Dr's Secret is the best-selling brand

The company has a total of 8 brands ranging from skincare to health supplements and Dr's Secret is its best-selling product. The Aurigen brand products were originally not developed by BW, but developed and manufactured by Zhejiang SolidGold Pharmaceutical Co Ltd in Hangzhou, China.

Figure 30

Company products at a glance

Product category	Brands	Remarks
Skincare		
	Dr's Secret	Best-selling skincare brand
	Miraglo	Patented ultrafine microfibre products for skincare
	Aestier	Repair and treatment range under Dr's Secret
Health supplements		
	Avance	Focus on beauty and skincare, for digestive health, circulatory health, natural resistance, rejuvenation, outer radiance and oral care
	Aurigen	Products developed by Zhejiang SolidGold Pharmaceutical Co Ltd before acquisition. Focus on general health.
Weight managements		
	Optrimax	
Others		
	Pentalab	Body and foot care
	UberAir	Air refresher

Source: CLSA, Company

All BW products were manufactured from third-party manufacturers with GMP licence

In terms of product supply, the company employs third-party manufacturers who are awarded with the Good Manufacturing Practice (GMP) licence from the Singapore Health Sciences Authority to manufacture its products. A GMP licence is granted when the manufacturing facility has been audited and found to demonstrate satisfactory compliance with the required GMP standard.

BW owns a manufacturing plant in China, producing non-core health supplements to be sold in drug stores

BW acquired a manufacturing plant in Singapore to manufacture Dr's Secret, in anticipation of strong demand from China and Taiwan

In 2014, BW completed the acquisition of a Chinese health supplements manufacturing plant, Zhejiang SolidGold Pharmaceutical Co Ltd in Hangzhou, China. The acquisition met one of the Chinese government's requirements for the application of a direct selling licence. Currently, this plant is manufacturing BW's health supplements brand, Aurigen, which is sold to drug stores across China.

BW is currently constructing a manufacturing plant in Singapore, which is expected to be in full operation in 3Q2017. Management guided that the plant would be fully automated to manufacture its best-selling skincare brand, Dr's Secret. This should help BW with greater control over its product supply, particularly in anticipation of greater demand from China and Taiwan.

Currently, the revenue generated from the China market comprises two parts: 1) Export and 2) Wholesale. In November, BW obtained its first direct-selling licence in China, but sales activities through the direct-selling channel have yet to kick in.

Figure 31

Current business model in China

Business segment	Geography	Products	Manufacturer	Remarks
Export	Strong presence in cities such as Changsha, Wenzhou, Harbin, Zhongshan, etc, across at least 5 provinces	All products	Third-party manufacturers around the world	All products are registered and can be sold across China
Wholesale	31 provinces in China	All Aurigen brand health supplements	Zhejiang SolidGold Pharmaceutical Co Ltd	Aurigen is being sold to agents who will then distribute to drug stores across China

Source: CLSA, Company

Figure 32

Earnings and balance-sheet risk scores (lower the better)

	Score	Comments
Earnings-quality flags		
Capex indiscipline		
Cash burn	0	
Rising non-core or intangibles	0	
Rising working capital	0	
Poor cash conversion	0	
Earnings-quality risk score (EQRS)	0/4	Working capital well managed; Operating margins can improve
Balance-sheet-quality flags		
Cash burn	0	
Excessive leverage	0	
Frequent fundraising	0	
Liquidity concerns	0	
Operational stress	0	
Balance-sheet-quality risk score (BQRS)	0/5	Not capital intensive

Source: CLSA

Valuation details

We value Best World at ~18x 2017CL PE multiple. This is based on a PEG of 0.65x using 2016-2018 EPS Cagr of 27%. This translates to a multiple ~18x PE and a target price of S\$2.50. The PEG of ~0.65x is based on a ~30% discount to the PEG of the peer group average of ~0.9x. On PE multiple, we expect the stock to trade on par with regional peers. Given the stronger growth rate, we believe this fair value multiple is not aggressive. Other comparables are trading at an average of ~19x 2017 PE multiple but offer lower ROE and growth potential.

Investment risks

1) Price war among direct-selling companies will impact margin, 2) Government regulations that could impede growth for direct-selling firms in key markets like Taiwan and China, and 3) inventory build-up should sales for new distribution centres in China disappoint.

Company outline

The business

Best World International Ltd is a Singapore-based direct-selling company specialising in the development, manufacturing and distribution of premium skincare, personal care, nutritional and wellness products. Today, it is a regional player in 12 markets across China, South East Asia, and the Middle East.

Competition & market franchise

The company competes with local counterparts within Asia. There are three main business segments for the company; (i) direct selling, (ii) export and (iii) manufacturing/wholesale. Direct selling segment mainly comprises sales to customers through direct selling channels in Singapore, Malaysia, Indonesia, Thailand, Taiwan, Hong Kong, Vietnam, Philippines, Korea, Australia and United Arab Emirates ("UAE"); Export sales segment comprises sales to retail customers at export retail price through retailers in the People's Republic of China and Myanmar; Manufacturing/wholesale segment comprises sales to customers through wholesale channel in People's Republic of China. Geographically, BEST's largest exposure is Taiwan which contributes close to 60% of its revenues.

Summary financials

Year to 31 December	2014A	2015A	2016CL	2017CL	2018CL
Summary P&L forecast (\$m)					
Revenue	75	102	198	256	312
Op Ebitda	10	19	47	60	76
Op Ebit	7	16	44	55	69
Interest income	0	0	0	0	0
Interest expense	0	0	0	0	0
Other items	(2)	0	(2)	(2)	(2)
Profit before tax	6	17	42	54	68
Taxation	(2)	(8)	(11)	(13)	(17)
Minorities/Pref divs	0	(1)	(1)	(1)	(2)
Net profit	4	8	31	39	49
Summary cashflow forecast (\$m)					
Operating profit	7	16	44	55	69
Operating adjustments	(2)	1	(2)	(2)	(2)
Depreciation/amortisation	3	3	3	5	6
Working capital changes	4	0	(25)	(12)	(7)
Net interest/taxes/other	(1)	(3)	(11)	(14)	(17)
Net operating cashflow	11	17	9	33	50
Capital expenditure	-	-	-	-	-
Free cashflow	11	17	9	33	50
Acq/inv/disposals	0	(3)	(13)	(10)	(6)
Int, invt & associate div	(7)	0	0	0	0
Net investing cashflow	(7)	(3)	(13)	(10)	(5)
Increase in loans	2	(6)	2	(6)	0
Dividends	(1)	(2)	(13)	(17)	(21)
Net equity raised/other	2	(5)	0	0	-
Net financing cashflow	3	(13)	(10)	(23)	(21)
Incr/(decr) in net cash	8	2	(14)	1	24
Exch rate movements	2	6	6	6	6
Opening cash	32	39	41	27	27
Closing cash	41	47	33	34	57
Summary balance sheet forecast (\$m)					
Cash & equivalents	41	47	33	34	57
Debtors	9	11	22	32	38
Inventories	8	12	22	31	36
Other current assets	9	7	7	7	7
Fixed assets	8	7	17	22	22
Intangible assets	8	7	6	5	4
Other term assets	2	4	4	4	4
Total assets	84	94	111	135	169
Short-term debt	5	-	-	-	-
Creditors	19	25	20	28	32
Other current liabs	2	6	6	6	6
Long-term debt/CBs	1	0	0	0	0
Provisions/other LT liabs	2	2	2	2	2
Minorities/other equity	(1)	(2)	1	(5)	(4)
Shareholder funds	56	64	81	104	133
Total liabs & equity	84	94	111	135	169
Ratio analysis					
Revenue growth (% YoY)	83.2	35.1	94.4	29.6	21.7
Ebitda growth (% YoY)	352.3	89.7	143.8	29.4	26.0
Ebitda margin (%)	13.4	18.8	23.5	23.5	24.3
Net profit margin (%)	5.4	8.4	15.5	15.2	15.9
Dividend payout (%)	0.0	51.8	42.1	42.4	41.7
Effective tax rate (%)	28.0	45.3	25.0	25.0	25.0
Ebitda/net int exp (x)	-	-	-	-	-
Net debt/equity (%)	(63.4)	(76.2)	(40.0)	(34.1)	(44.6)
ROE (%)	7.7	14.2	42.3	42.0	41.8
ROIC (%)	25.9	45.7	95.3	69.1	73.7
EVA@/IC (%)	14.0	33.7	83.3	57.1	61.7

Source: CLSA

Expect net profit to achieve 27% Cagr

Minimal capex requirements

Remains in net cash position

High ROE, operating margins yet

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Companies mentioned

Best World (BEST SP - S\$1.41 - BUY)
Amway (N-R)
Baiyunshan Pharma (N-R)
Breadtalk (N-R)
Chlitina (N-R)
Cogent (N-R)
D2 Investment (N-R)
Grape King (N-R)
HAI-O ENTERPRISE (N-R)
Herbalife (N-R)
KINO BIOTECH (N-R)
Midas (N-R)
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SAGITTARIUS (N-R)
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