

Singapore Company Focus

OSIM International

Bloomberg: OSIM SP | Reuters: OSIL.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

28 Oct 2015

FULLY VALUED (Downgrade from HOLD)

Last Traded Price: S\$1.615 (STI : 3,052.53)

Price Target : S\$1.22 (25% downside) (Prev S\$1.61)

Reason for Report : Recommendation/earnings/TP downgrade

Potential Catalyst: Earnings recovery

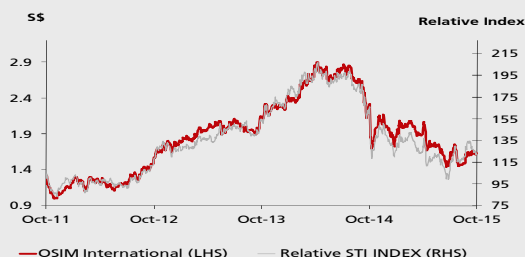
Where we differ: We believe outlook lacks visibility

Analyst

Alfie Yeo +65 6682 3717 alfieyeo@dbs.com

Andy Sim +65 6682 3718 andysim@dbs.com

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2014A	2015F	2016F	2017F
Revenue	691	593	611	633
EBITDA	158	106	110	114
Pre-tax Profit	132	77.5	89.4	93.4
Net Profit	102	58.5	67.1	70.1
Net Pft (Pre Ex.)	108	65.5	67.1	70.1
EPS (S cts)	13.4	7.57	8.69	9.07
EPS Pre Ex. (S cts)	14.2	8.47	8.69	9.07
EPS Gth (%)	(4)	(44)	15	4
EPS Gth Pre Ex (%)	4	(40)	3	4
Diluted EPS (S cts)	12.8	7.57	8.69	9.07
Net DPS (S cts)	6.00	6.00	6.00	6.00
BV Per Share (S cts)	56.3	58.3	61.0	64.1
PE (X)	12.0	21.3	18.6	17.8
PE Pre Ex. (X)	11.4	19.1	18.6	17.8
P/Cash Flow (X)	10.5	14.1	13.3	12.9
EV/EBITDA (X)	6.4	9.6	8.9	8.3
Net Div Yield (%)	3.7	3.7	3.7	3.7
P/Book Value (X)	2.9	2.8	2.6	2.5
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	28.8	13.2	14.6	14.5
Earnings Rev (%):		(29)	(24)	(27)
Consensus EPS (S cts):		10.1	11.4	12.3
Other Broker Recs:		B: 3	S: 3	H: 5

ICB Industry : Consumer Goods

ICB Sector: Leisure Goods

Principal Business: OSIM is in the business of marketing, distributing and franchising of a comprehensive range of healthy lifestyle products.

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

Weak outlook

- **3Q15 earnings below expectation on weak topline and higher costs**
- **Expect less positive outlook on weak demand**
- **Cut FY15-17F earnings by 24-29%**
- **Downgrade to FULLY VALUED, TP cut to S\$1.22**

3Q15 earnings disappoints. Headline net profit of S\$6.2m (-62% y-o-y) was significantly below our forecasts. 3Q15 revenue declined by -10% y-o-y to S\$142m as a result of slower sales from North and South Asia on the back of weak consumer sentiment, store closures and lower sales per store. Operating margins dropped 7.8ppts to 9.2% due to higher opex such as rents, labour and marketing expenses. Earnings included S\$4m of legal costs. Excluding the one-off legal costs, earnings would still have been disappointing at S\$10.2m. OSIM declared DPS of 1 Scts per share, in line with our expectations.

End demand remains weak, dampening growth. We believe that end demand for OSIM products are weak. Store count is being rationalised and quarterly sales per store have declined. In addition, inventory days have increased. With the inventory build-up and slower sales traction, we do not expect aggressive store expansion and sales per store to be strong going forward.

Slashed FY15-17F earnings. We have cut our FY15-17F earnings by 24%-29%. We reduced our store expansion and sales per store assumptions and imputed a relatively higher cost structure to account for the longer period for new TWG stores to breakeven in light of weak consumer sentiment and slower regional GDP growth environment.

Downgrade to FULLY VALUED, with lower TP of S\$1.22. Our S\$1.22 TP is based on 14x FY16F earnings, which is pegged to the stock's average 3-year historical mean valuation. Further earnings disappointment would put DPS for 4Q15 and future quarters at risk. Downgrade to FULLY VALUED.

At A Glance

Issued Capital (m shrs)	756
Mkt. Cap (S\$m/US\$m)	1,221 / 877
Major Shareholders	
Chye Hock Sim (%)	66.7
Capital Group Companies Inc (%)	5.1
Free Float (%)	28.2
3m Avg. Daily Val (US\$m)	1.7

INVESTMENT THESIS

Profile	Rationale
<p>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, Australia and Taiwan; and a majority owner of the TWG brand of high end luxury tea cafes and saloons.</p>	<p>Negative on the stock. We are negative on OSIM as we believe sluggish consumer sentiment and weaker regional GDP growth environment will dampen end demand. The 3Q15 results pointed to inventory build-up, falling sales per store, and rationalisation of store count. Thus, we are now more cautious of growth prospects going forward. We have cut FY15-17F earnings by 24-29%, and earnings growth is now muted at 3-4%, which has led to a lower TP of S\$1.22 based on 14x FY16F PE.</p> <p>In need of blockbuster products to induce earnings recovery. The catalyst for the stock is an earnings turnaround. OSIM's business is predominantly in massage chairs, with at least 60% of sales from OSIM massage products. While TWG is growing and has exciting prospects, we estimate its contribution to group earnings is small at 8-10%. GNC's business is also rather stable in nature. Hence, any growth catalyst rests on chair sales. New chairs will need to be blockbusters in order to reverse the declining revenue trend. ASPs for new chairs are also declining, requiring volumes to work harder to attain revenue growth. At the moment, there are no signs to suggest that blockbuster products will help to turn OSIM's earnings around.</p> <p>Declining sales growth trend. Since 3Q12, revenue growth y-o-y on a quarterly basis has declined from +15% to -11% in 3Q15, excluding TWG. This was despite the continued launch of new chairs.</p>
Valuation	Risks
<p>Our target price of S\$1.22 is based on 14x FY16F earnings. OSIM has been expanding very quickly in key markets of Singapore, Malaysia, Hong Kong, China and Taiwan. As such, we see earnings growth as an integral part of OSIM's fair valuation. Our target PE valuation of 14x is pegged to the stock's average 3-year historical mean valuation.</p>	<p>Strong reliance on new chair sales to drive turnaround. Despite new chair launches (uMagic, uDivine, uDiva) in the previous quarters, revenue growth rate ex TWG has continued to decline. We now believe that different types of new lifestyle products such as uMagic are required to reverse this trend.</p> <p>Litigation cases present unknown earnings risks. The two ongoing litigation cases in Singapore and Hong Kong where the costs remain relatively uncertain are two unknowns that could spring negative surprises.</p> <p>Consumer sentiment. OSIM is ultimately a retailer of lifestyle products, and its fortunes depend on discretionary consumption. Poor consumption sentiment will be a drag on demand while strong consumption cycle will fuel demand for its products.</p>

Source: DBS Bank

3Q15 below expectations on weak demand

Earnings disappoints on weaker sales, higher costs. Headline net profit of S\$6.2m (-62% y-o-y) was significantly below our forecasts. Headline net profit of S\$6.2m (-62% y-o-y) was significantly below our forecasts. 3Q15 revenue declined by -10% y-o-y to S\$142m as a result of slower sales from North and South Asia on the back of weak consumer sentiment, store closures and lower sales per store. OSIM declared DPS of 1 Scts per share, in line with our expectations.

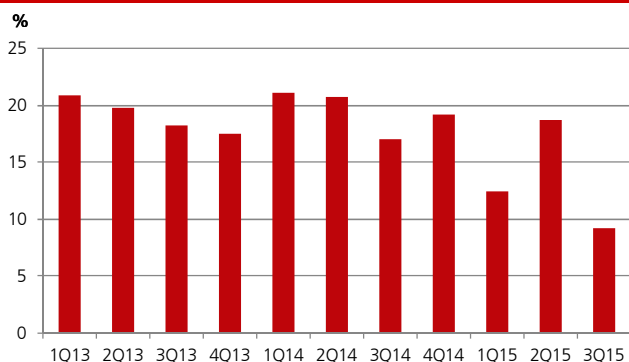
Revenue slowdown across north and South Asia

S\$m	3Q14	3Q15	% chg
North Asia	80	74	-8%
South Asia	67	60	-10%
America/EMEA/Ocenania	11	8	-27%
Total	158	142	-10%

Source: Company, DBS Bank

Relatively higher costs. Operating margins were lower at 9.2% (-7.8ppt) due to higher opex such as rents, labour and marketing expenses. Earnings included S\$4m of legal costs. Excluding one-off legal costs, earnings would still have disappointed at S\$10.2m.

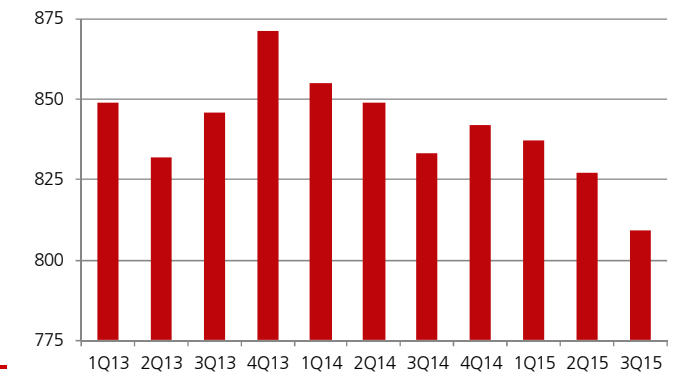
EBIT margins fell on relatively higher opex



Source: Company, DBS Bank

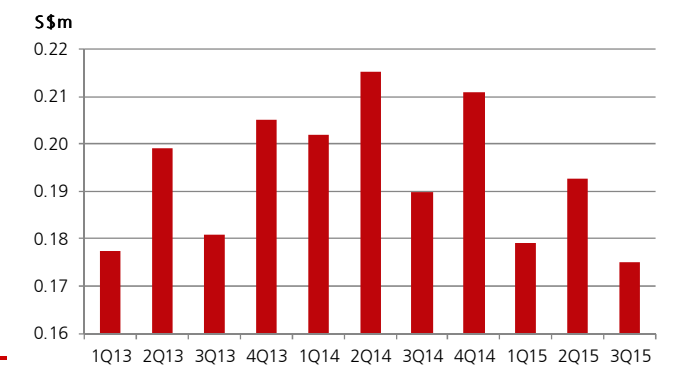
Store count and sales per store declined. Store count now stands at 809, the lowest since 2013, along with quarterly sales per store. OSIM closed a total of 18 stores in the quarter, of which 6 were GNC stores (mainly Malaysia) and 14 were OSIM stores (mainly in China). TWG added two stores in Hong Kong (Pacific Place and Harbour City).

Number of stores contributing to topline has fallen



Source: Company, DBS Bank

Quarterly sales per store is the lowest since 2013

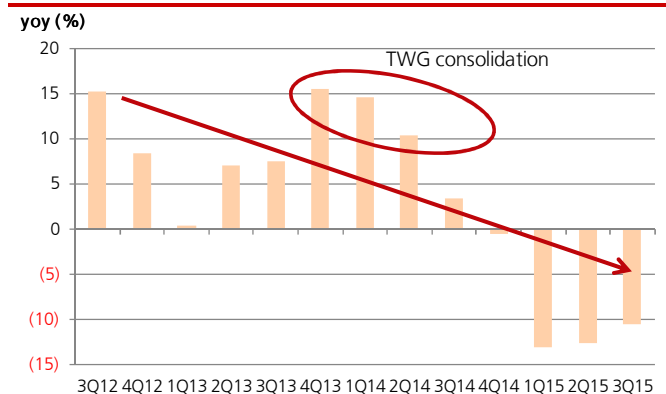


Source: Company, DBS Bank

Weak outlook

In need of blockbuster products to induce earnings recovery. The catalyst for the stock is an earnings turnaround. However, sales and earnings continue to record a y-o-y decline. As approximately 60% of sales are from massage chairs, we believe OSIM will need its new uMagic chair to be a blockbuster in order to reverse the declining revenue trend.

Sales growth continues to decline albeit at a slower pace

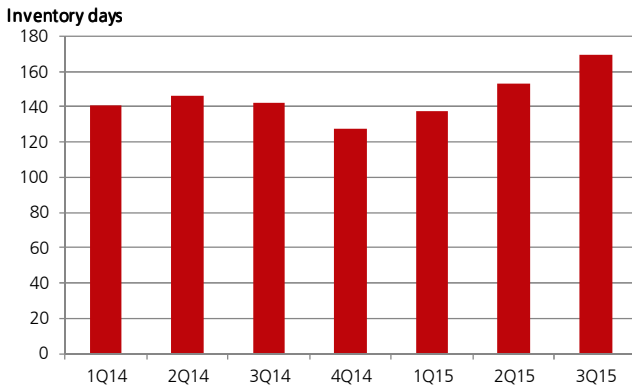


Source: Company, DBS Bank

OSIM International

Higher inventory days, slower sales per store suggest slower end demand. We believe that end demand for OSIM products is weak. We noted that store count is rationalising and quarterly sales per store have declined. In addition, inventory days have increased. With the inventory build-up and slower sales traction, we do not expect aggressive store expansion and strong sales per store numbers going forward.

Inventory days has increased



Source: Company, DBS Bank

Slash FY15-17F earnings by 24-29%

Lowering FY16-17F earnings growth to a more muted 3-4%. Going forward, OSIM will have a smaller store network base to support topline growth. Along with falling sales per store, we do not expect topline growth to be fantastic. Nonetheless, we continue to see growth coming from new

products – uCrown 3, uGallop 2, uPamper 2 and uDiva classic. We reduce our FY16F and FY17F topline growth from 8% to 3.5%. We have trimmed our assumption for new stores, and reduced sales per store projections in FY16F and FY17F to match the current run rate of S\$730,000 per year. Our core FY16F/FY17F earnings growth is 3-4% after imputing a relatively higher cost structure and more conservative breakeven time frame for the newer TWG outlets on the back of weaker regional consumer sentiment.

FY16-17F earnings cut by 24%/27%. The earnings disappointment this quarter has led us to rebase our FY15F earnings significantly. We have cut FY15F earnings by 29% and now expect core FY15F earnings to decline 40% y-o-y. As we are reflecting slower growth rate going forward, our FY16F/FY17F's earnings forecasts are also lowered by 24%/27%.

Valuation

Downgrade to FULLY VALUED, TP lowered to S\$1.22. Our S\$1.22 TP is based on 14x FY16F earnings, which is pegged to the stock's average 3-year historical mean valuation. Although the company has been paying DPS of 6 Scts per share from its strong net cash balance sheet for the past three years, further earnings disappointment could put 4Q15 and future quarters' DPS at risk. Downgrade to FULLY VALUED.

Results Summary and Comparison

FY Dec (\$m)	3Q14	2Q14	3Q15	YoY Chg	QoQ Chg
Sales	158.2	159.5	141.6	-10%	-11%
Cost of Goods Sold	(46.1)	(43.7)	(40.1)	-13%	-8%
Gross Profit	112.1	115.8	101.5	-9%	-12%
Other Operating Income	6.8	5.4	8.1	20%	50%
<i>Distribution Costs</i>	(31.7)	(27.2)	(32.7)	3%	20%
<i>Administration Expenses</i>	(5.5)	(5.7)	(5.8)	5%	1%
<i>R & D and other expenses</i>	(54.7)	(58.5)	(58.1)	6%	-1%
Other Operating Expenses	(92.0)	(91.4)	(96.6)	5%	6%
EBIT	26.9	29.8	13.1	-52%	-56%
Non-Operating Income	0.0	0.0	0.0	n/a	n/a
Interest Income	0.9	1.8	1.9	104%	8%
Interest Expense	(0.5)	(1.2)	(1.2)	157%	-1%
Share of Associates' or JV Income	0.5	0.5	0.3	-37%	-39%
Exceptional Gains/(Losses)	(5.0)	(2.0)	(4.0)	-20%	100%
Pretax Profit	22.9	28.8	10.0	-56%	-65%
Tax	(6.7)	(6.9)	(4.3)	-36%	-37%
Minority Interests	0.3	0.5	0.4	77%	-8%
Net Profit	16.4	22.4	6.2	-62%	-72%
Margins (%)					
Gross Margin	70.9	72.6	71.7		
SGA % Sales	58.1	57.3	68.2		
EBITDA Margin	20.5	22.3	13.3		
EBIT Margin	17.0	18.7	9.2		
Pre-tax Margin	14.5	18.1	7.1		
Net Margin	10.4	14.0	4.4		

Source: Company, DBS Bank

OSIM International

Key Assumptions

FY Dec	2013A	2014A	2015F	2016F	2017F
Store count	871	841	812	836	865
Blended sales per store	0.74	0.82	0.73	0.73	0.73

Segmental Breakdown

FY Dec	2013A	2014A	2015F	2016F	2017F
Revenues (\$\$m)					
North Asia	353	366	317	330	350
South Asia	250	279	244	248	250
America / Africa / Europe /	45.0	46.0	32.0	32.8	33.6

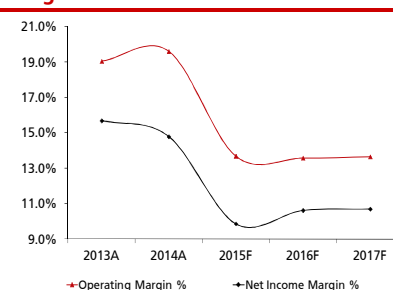
Total	648	691	593	611	633
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Income Statement (\$\$m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Revenue	648	691	593	611	633
Cost of Goods Sold	(193)	(205)	(170)	(177)	(184)
Gross Profit	455	486	422	434	450
Other Opng (Exp)/Inc	(332)	(351)	(341)	(348)	(360)
Operating Profit	123	135	81.1	85.8	89.4
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	2.92	0.98	1.52	1.52	1.52
Net Interest (Exp)/Inc	(0.4)	1.54	1.88	2.04	2.50
Exceptional Gain/(Loss)	3.35	(5.7)	(7.0)	0.0	0.0
Pre-tax Profit	129	132	77.5	89.4	93.4
Tax	(27.6)	(30.1)	(20.9)	(24.1)	(25.2)
Minority Interest	0.0	0.0	1.87	1.87	1.87
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	102	102	58.5	67.1	70.1
Net Profit before Except.	98.2	108	65.5	67.1	70.1
EBITDA	140	158	106	110	114
Growth					
Revenue Gth (%)	7.6	6.7	(14.2)	3.1	3.6
EBITDA Gth (%)	8.6	13.0	(33.3)	4.4	3.2
Opg Profit Gth (%)	6.9	9.8	(40.1)	5.8	4.2
Net Profit Gth (Pre-ex) (%)	13.0	9.8	(39.3)	2.5	4.4
Margins & Ratio					
Gross Margins (%)	70.3	70.4	71.3	71.0	71.0
Opg Profit Margin (%)	19.0	19.6	13.7	14.0	14.1
Net Profit Margin (%)	15.7	14.8	9.9	11.0	11.1
ROAE (%)	43.5	28.8	13.2	14.6	14.5
ROA (%)	17.7	13.3	6.9	7.8	7.9
ROCE (%)	21.9	16.7	8.2	8.6	8.7
Div Payout Ratio (%)	44.5	45.7	79.3	69.1	66.2
Net Interest Cover (x)	278.4	NM	NM	NM	NM

Source: Company, DBS Bank

Margins Trend



Quarterly / Interim Income Statement (\$m)

FY Dec	3Q2014	4Q2014	1Q2015	2Q2015	3Q2015
Revenue	158	178	150	159	142
Cost of Goods Sold	(46.1)	(54.1)	(44.1)	(43.7)	(40.1)
Gross Profit	112	124	106	116	101
Other Oper. (Exp)/Inc	(85.2)	(89.4)	(87.2)	(86.0)	(88.4)
Operating Profit	26.9	34.2	18.6	29.8	13.1
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.48	(0.1)	0.43	0.49	0.30
Net Interest (Exp)/Inc	0.46	0.54	0.0	0.54	0.69
Exceptional Gain/(Loss)	(5.0)	(0.7)	(1.0)	(2.0)	(4.0)
Pre-tax Profit	22.9	34.0	18.0	28.8	10.0
Tax	(6.7)	(6.3)	(4.9)	(6.9)	(4.3)
Minority Interest	0.25	(0.3)	0.49	0.49	0.45
Net Profit	16.4	27.4	13.5	22.4	6.17
Net profit bef Except.	21.4	28.1	14.5	24.4	10.2
EBITDA	32.9	39.6	24.5	36.0	19.2

Growth

Revenue Gth (%)	(13.4)	12.3	(15.7)	6.4	(11.2)
EBITDA Gth (%)	(24.1)	20.1	(38.0)	46.9	(46.8)
Opg Profit Gth (%)	(29.0)	26.9	(45.6)	60.4	(56.2)
Net Profit Gth (Pre-ex) (%)	(27.5)	31.1	(48.3)	68.0	(58.3)

Margins

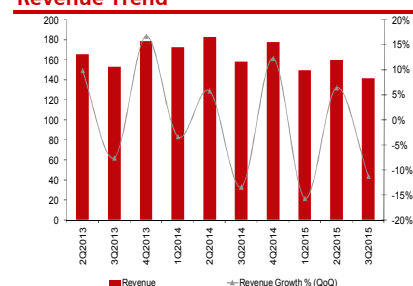
Gross Margins (%)	70.9	69.5	70.6	72.6	71.7
Opg Profit Margins (%)	17.0	19.2	12.4	18.7	9.2
Net Profit Margins (%)	10.4	15.4	9.0	14.0	4.4

Balance Sheet (\$m)

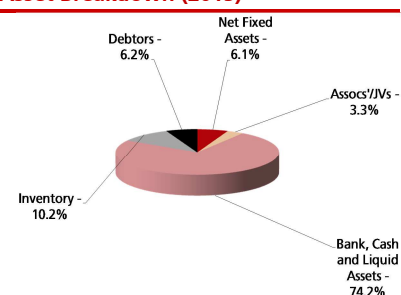
FY Dec	2013A	2014A	2015F	2016F	2017F
Net Fixed Assets	25.2	36.4	36.8	33.5	30.2
Invt in Associates & JVs	18.5	18.4	19.9	21.4	23.0
Other LT Assets	219	211	201	192	182
Cash & ST Invt	291	456	477	507	539
Inventory	72.5	71.6	61.5	63.3	65.7
Debtors	42.0	43.5	37.3	38.5	39.9
Other Current Assets	12.5	15.3	15.3	15.3	15.3
Total Assets	680	852	849	870	895
ST Debt	155	17.2	17.2	17.2	17.2
Creditor	107	96.5	82.8	85.3	88.4
Other Current Liab	35.2	42.9	42.9	42.9	42.9
LT Debt	0.06	168	168	168	168
Other LT Liabilities	39.1	35.7	35.7	35.7	35.7
Shareholder's Equity	271	438	450	471	495
Minority Interests	72.7	53.6	51.7	49.8	48.0
Total Cap. & Liab.	680	852	849	870	895
Non-Cash Wkg. Capital	(15.4)	(8.9)	(11.5)	(11.0)	(10.4)
Net Cash/(Debt)	136	271	292	321	354
Debtors Turn (avg days)	22.6	22.6	24.9	22.6	22.6
Creditors Turn (avg days)	201.2	203.0	221.7	198.8	197.2
Inventory Turn (avg days)	128.9	143.7	164.6	147.6	146.4
Asset Turnover (x)	1.1	0.9	0.7	0.7	0.7
Current Ratio (x)	1.4	3.7	4.1	4.3	4.4
Quick Ratio (x)	1.1	3.2	3.6	3.8	3.9
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	7.4	5.4	5.4
Z-Score (X)	0.0	0.0	0.0	0.0	0.0

Source: Company, DBS Bank

Revenue Trend



Asset Breakdown (2015)



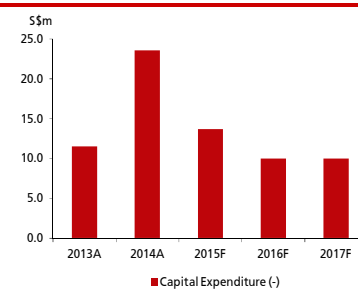
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Cash Flow Statement (\$m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Pre-Tax Profit	129	132	77.5	89.4	93.4
Dep. & Amort.	21.7	29.8	30.9	30.9	30.9
Tax Paid	(29.2)	(26.0)	(20.9)	(24.1)	(25.2)
Assoc. & JV Inc/(loss)	(2.9)	(1.0)	(1.5)	(1.5)	(1.5)
Chg in Wkg.Cap.	3.87	(16.0)	2.65	(0.5)	(0.6)
Other Operating CF	(9.5)	(2.3)	0.0	0.0	0.0
Net Operating CF	113	117	88.6	94.1	97.0
Capital Exp.(net)	(11.5)	(23.6)	(13.7)	(10.0)	(10.0)
Other Invt.(net)	(3.8)	(3.8)	0.0	0.0	0.0
Invt in Assoc. & JV	(7.0)	0.0	0.0	0.0	0.0
Div from Assoc & JV	1.36	0.0	0.0	0.0	0.0
Other Investing CF	16.5	4.40	0.0	0.0	0.0
Net Investing CF	(4.4)	(23.0)	(13.7)	(10.0)	(10.0)
Div Paid	(36.2)	(45.5)	(46.4)	(46.4)	(46.4)
Chg in Gross Debt	4.57	134	0.0	0.0	0.0
Capital Issues	(7.5)	0.0	0.0	0.0	0.0
Other Financing CF	(2.3)	(15.1)	0.0	0.0	0.0
Net Financing CF	(41.4)	73.4	(46.4)	(46.4)	(46.4)
Currency Adjustments	6.19	0.85	0.0	0.0	0.0
Chg in Cash	73.6	168	28.6	37.8	40.6
Opg CFPS (\$ cts)	15.1	17.4	11.1	12.2	12.6
Free CFPS (\$ cts)	14.1	12.3	9.70	10.9	11.3

Source: Company, DBS Bank

Capital Expenditure



Target Price & Ratings History



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

S.No.	Date	Closing Price	Target Price	Rating
1:	29 Oct 14	1.94	2.59	BUY
2:	18 Dec 14	2.01	2.59	BUY
3:	04 Feb 15	2.02	1.94	HOLD
4:	06 May 15	1.74	1.82	HOLD
5:	24 Jul 15	1.54	1.61	HOLD
6:	02 Sep 15	1.47	1.61	HOLD

Source: DBS Bank

DBS Bank recommendations are based on 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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DBS Bank Ltd.

12 Marina Boulevard, Marina Bay Financial Centre Tower 3
Singapore 018982
Tel. 65-6878 8888
Company Regn. No. 196800306E