23 October 2018

Consumer Cyclical | Health & Beauty

Best World

Put Your Skin In The Best Game; Initiate BUY

BUY

Target Price:	SGD1.97
Price:	SGD1.49
Market Cap:	USD594m
Bloomberg Ticker:	BEST SP

Initiate coverage with a BUY and Street-high SGD1.97 TP, 32% upside. Best World is one of the few local consumer firms that have successfully penetrated the Chinese market. As the group transited into a new business model in China at end-2Q18, it is now able to generate higher revenue and earnings for each product unit sold there. We expect earnings to jump at a CAGR of 21% over the next three years, which deems the current 10x FY19F P/E valuation as very compelling.

"Best" way to sell products. Best World is a premium skincare and supplements player that operates in 12 countries. While it mainly distributes its products to consumers through direct-selling channels, it also sells products via franchisees in China and export agents in Myanmar. Consequently, the group is largely immune to labour and rental cost pressures. This allows Best World to scale its business or expand to new markets without incurring huge capex or major start-up/fixed costs.

Change in China business model to provide big jump in earnings. In China, the group converted its export model into a franchise one at end-2Q18. While retail prices for end-customers remained unchanged, the new model allows Best World to sell its products at a higher price to franchisees vs prices charged to export agents. This essentially transfers the margins earned by the latter to the group and its franchisees.

1H18 earnings were weak due to the business model change transition period. But, given the increase in profitability of this new model, we expect 2H18 earnings to catch up when the franchise model commences operations. We also expect FY19 earnings to jump by 40%, largely from the full-year impact of this business model change and buoyant market demand.

Tapping into China's premium skincare market. We are positive on Best World's ability to grow its China market. According to Euromonitor, the East Asian nation's premium skincare market expanded 22% in 2017 and is forecasted to grow at a CAGR of 12% over the next five years. Notwithstanding the big jump in sales – derived largely from the business model change – we are still expecting Chinese revenue to grow at a reasonably high pace of 15% in FY20 on market size growth and rising market share.

Initiate coverage with Street-high TP of SGD1.97, based on 13x FY19F P/E. We expect EPS to grow at a CAGR of 21% over FY17-20F. This deems the current valuation as compelling. The stock is trading at 10x FY19F P/E, a steep discount to other direct-selling peers (average: 16x) despite superior growth and margins. Best World is also sitting on SGD87m net cash and could comfortably maintain its historical dividend payout ratio of c.40% – this should bring FY19F dividend yield to 4%.

Key risks to our call include regulatory changes, reputational risks, and lack of visibility in inventory management.

Forecasts and Valuations	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Total turnover (SGDm)	200.8	220.9	235.9	374.9	429.5
Reported net profit (SGDm)	34.6	55.7	59.1	83.4	98.7
Recurring net profit (SGDm)	34.6	55.7	59.1	83.4	98.7
Recurring net profit growth (%)	242.1	61.0	6.2	41.1	18.3
Recurring EPS (SGD)	0.06	0.10	0.11	0.15	0.18
DPS (SGD)	0.02	0.04	0.04	0.06	0.07
Recurring P/E (x)	23.9	14.7	13.8	9.8	8.3
P/B (x)	9.1	6.3	5.0	3.8	3.0
P/CF (x)	20.3	14.3	36.9	14.1	8.0
Dividend Yield (%)	1.5	2.8	2.9	4.1	4.8
EV/EBITDA (x)	14.4	10.3	9.4	6.4	5.0
Return on average equity (%)	38.2	43.0	35.8	38.8	36.0
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			15.2	47.2	37.7

Source: Company data, RHB

Share Data

Avg Daily Turnover (SGD/USD)	3.0m/2.2m
52-wk Price low/high (SGD)	1.9 - 1.15
Free Float (%)	48.9
Shares outstanding (m)	549
Estimated Return	32%

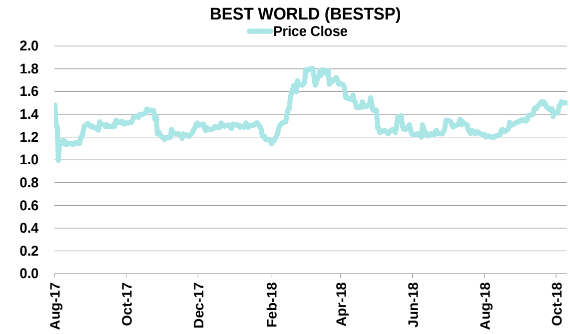
Shareholders (%)

D2 Investments	35.1%
Dora Hoan	5.9%
Doreen Tan	5.7%

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	13.6	7.9	14.5	(5.1)	6.0
Relative	23.4	12.5	21.4	9.0	14.1

Source: Bloomberg



Source: Bloomberg

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Analyst

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Financial Exhibits

Financial model updated on: 2018-10-17

Asia
Singapore
Consumer Cyclical
Best World
Bloomberg BEST SP
Buy

Valuation basis

13x FY19F P/E.

Key drivers

i. Change in China business model;
ii. Robust market demand;
iii. Cheap valuation;
iv. Strong dividend yield;
v. Potential acquisitions.

Key risks

i. Regulatory risks;
ii. Reputational risks;
iii. Lack of visibility;
iv. Intense competition.

Company Profile

Best World is a premium skincare and wellness products player. Its list of brands includes *DR's Secrets, Aestier, Avance, Miraglo, Optrimax, Pentalab, Pureflo* and *UberAir*. The group distributes its products mainly through direct-selling distributors, franchisees, and export agents.

Financial summary	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Recurring EPS (SGD)	0.06	0.10	0.11	0.15	0.18
EPS (SGD)	0.06	0.10	0.11	0.15	0.18
DPS (SGD)	0.02	0.04	0.04	0.06	0.07
BVPS (SGD)	0.16	0.24	0.30	0.39	0.50
Weighted avg adjusted shares (m)	554	550	549	549	549

Valuation metrics	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Recurring P/E (x)	23.9	14.7	13.8	9.8	8.3
P/E (x)	23.9	14.7	13.8	9.8	8.3
P/B (x)	9.1	6.3	5.0	3.8	3.0
FCF Yield (%)	1.0	6.7	2.0	5.1	11.9
Dividend Yield (%)	1.5	2.8	2.9	4.1	4.8
EV/EBITDA (x)	14.4	10.3	9.4	6.4	5.0
EV/EBIT (x)	15.2	11.0	10.1	6.9	5.4

Income statement (SGDm)	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Total turnover	201	221	236	375	430
Gross profit	147	153	173	278	319
EBITDA	53	72	79	114	135
Depreciation and amortisation	3	5	5	8	9
Operating profit	51	67	74	106	126
Net interest	0	0	0	0	0
Income from associates & JVs	0	0	0	0	0
Exceptional income - net	0	0	0	0	0
Pre-tax profit	51	68	74	107	127
Taxation	(17)	(13)	(16)	(24)	(29)
Minority interests	(0)	(1)	(1)	(1)	(1)
Recurring net profit (adj)	35	56	59	83	99

Cash flow (SGDm)	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Change in working capital	(27)	(3)	(41)	(32)	(4)
Cash flow from operations	20	57	22	58	103
Capex	(12)	(3)	(6)	(17)	(6)
Cash flow from investing activities	(12)	(12)	(5)	(16)	(5)
Dividends paid	(8)	(17)	(24)	(33)	(39)
Cash flow from financing activities	(0)	(20)	(27)	(36)	(42)
Cash at beginning of period	41	49	73	63	70
Net change in cash	8	24	(10)	6	56
Ending balance cash	49	73	63	70	126

Balance sheet (SGDm)	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Total cash and equivalents	55	82	73	79	135
Tangible fixed assets	9	9	10	19	17
Intangible assets	15	13	13	12	11
Total investments	3	2	2	2	2
Total other assets	78	90	118	150	157
Total assets	160	196	215	261	321
Short-term debt	3	5	2	0	0
Total long-term debt	5	2	2	2	0
Other liabilities	64	62	49	47	51
Total liabilities	72	69	53	50	51
Shareholders' equity	91	130	165	215	274
Minority interests	(2)	(3)	(3)	(4)	(4)
Total equity	89	127	162	211	270
Net debt	(48)	(75)	(68)	(77)	(135)
Total liabilities & equity	160	196	215	261	321

Key metrics	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Revenue growth (%)	97.5	10.0	6.8	58.9	14.6
Recurrent EPS growth (%)	52.4	(36.9)	55.9	31.0	20.2
Gross margin (%)	73.2	69.1	73.4	74.2	74.2
Operating EBITDA margin (%)	26.6	32.6	33.6	30.5	31.5
Net profit margin (%)	17.2	25.2	25.1	22.3	23.0
Dividend payout ratio (%)	36.6	40.5	40.0	40.0	40.0
Capex/sales (%)	6.1	1.2	2.4	4.4	1.3
Interest cover (x)	858.5	432.6	590.8	na	na

Source: Company data, RHB

Investment Summary

A health & beauty play in North Asia. Founded in 1990 with its headquarters in Singapore, Best World is a direct-selling company that distributes premium skincare and wellness products. Its key brands include *DR's Secret* (skincare range), *Avance* (supplements), and *Optrimax* (weight management products). Over the years, the group's direct-selling network has expanded into regional markets, including Taiwan, Indonesia, Malaysia, Thailand, Philippines, Vietnam, South Korea, Hong Kong, and United Arab Emirates (UAE). It also distributes to China via franchisees and Myanmar through export agents. In 2017, China became Best World's biggest market, contributing 50% of revenue – this is followed by Taiwan, which made up 40% of topline.

- A premium skincare and wellness company, founded in Singapore

Scalable business model. We like the group's business model, which allows it to scale or expand into new markets without the need to incur major capex and start-up costs. By selling through distributors, franchisees and export agents, Best World is devoid of labour and rental cost pressures. The group also has a structured compensation plan to keep its distribution costs between 30% and 40% of a products' retail price.

- Ability to expand without incurring high capex and fixed costs

Unveiling the secret to the Chinese skincare model. The change in Best World's business model in China – from an export model to a franchise one – should bring about a big jump in revenue and earnings. This is as the group transfers margins earned by export agents to Best World and its franchisees. Prior to Jun 2018, it was selling into the China market via such agents. According to management, Best World is now selling products to its franchisees at a franchise wholesale price that is at least 2x higher than prices charged to export agents. Although part of the margins will be eroded as the group incurs higher distribution and administrative costs with the new franchise model, we expect profits – in absolute terms – to be higher, given the surge in revenue.

- Change in China business model to provide a big jump in revenue and earnings

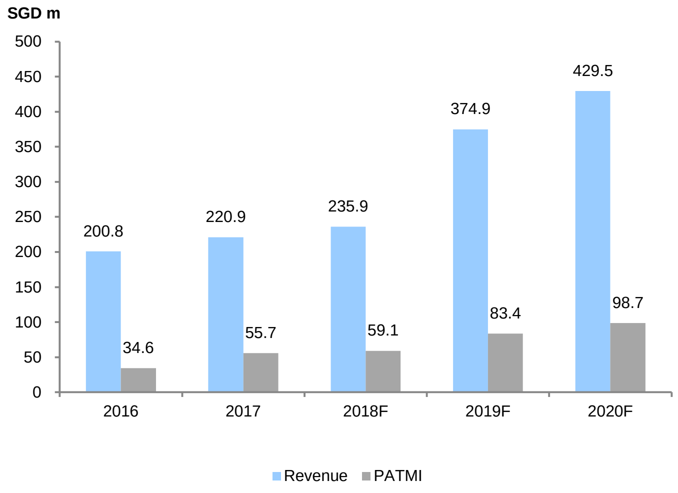
Capitalising on Chinese beauty ideals. Best World entered the Taiwan market in 2007 and has a solid track record of penetrating this market. Based on FY17 revenue, we estimate the group holding a c.5% share in the premium skincare market there. Since China's premium skincare market is 7x larger than Taiwan's, we see significant growth potential in the former arising from an increase market penetration as well as consumption growth when income levels increase.

- Huge market size and buoyant demand in China should continue to spur Best World's growth

Initiate coverage with a BUY and Street-high TP of SGD1.97. Our TP is pegged to 13x FY19F P/E. We ascribed a 15% discount to its historical P/E average of 15x on lower earnings visibility as a result of the transition into a new business model in China. We believe share price will see a re-rating when there is greater earnings visibility to this new model in the upcoming 3Q18 and 4Q18 results.

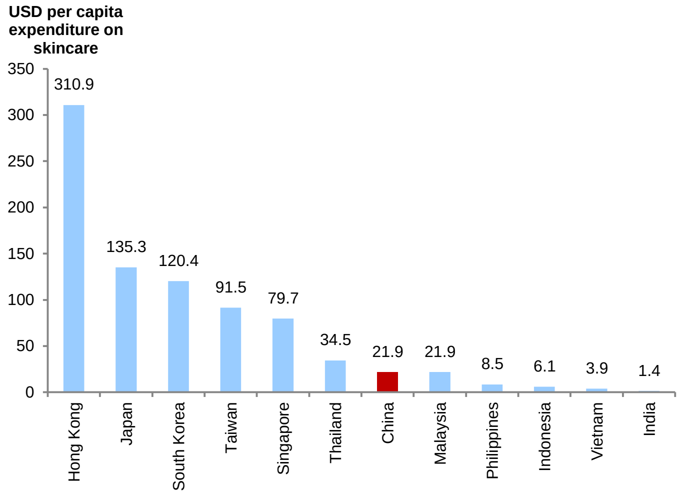
- Initiate BUY with a SGD1.97 TP

Figure 1: Best World's growth track record



Source: Company data, RHB

Figure 2: Huge growth potential in China's skincare market



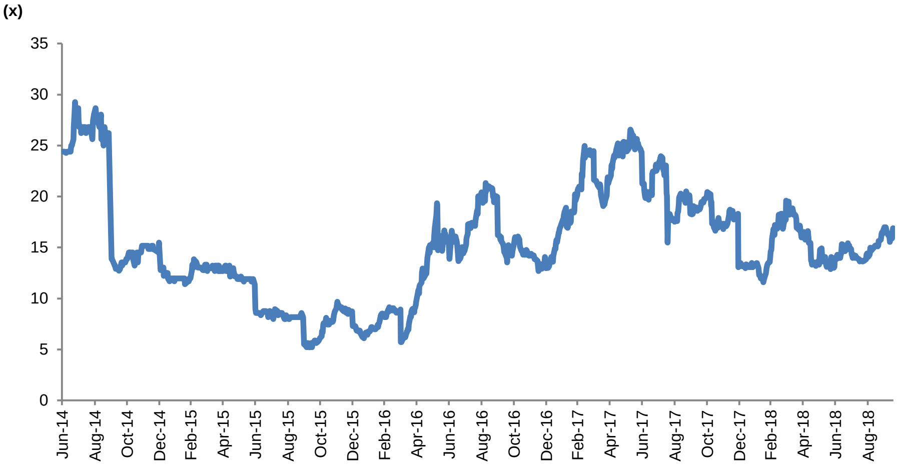
Source: Euromonitor

Valuation

Initiate coverage with a BUY with SGD1.97 TP. Our TP is based on 13x FY19F P/E and represents a 32% upside. We ascribe a 15% discount to its 5-year average of 15x, as we think the change in its China business model has led to a temporary weakening of investor confidence and earnings visibility in 1H18.

♦ Our TP is pegged to 13x FY19F P/E

Figure 3: Best World's 5-year historical P/E band



Source: Bloomberg

Nonetheless, we think the stock is compelling, given the big jump in FY19F earnings arising from the full-year impact of the business model change and market growth in China. We estimate earnings to surge 40% in FY19, as well as a 3-year CAGR of 21% for FY17-20F.

An undervalued gem compared to direct-selling peers. Best World now trades at 10x FY19F P/E. This is a steep discount to its direct-selling peers, which are trading at an average of 16x, despite having superior earnings growth and net margins.

♦ Trading at a steep discount to peers despite superior growth and margin.

Figure 4: Peer comparison

	BB Code	Share price (lcl ccy)	Market cap (USD m)	P/E FY18F (x)	P/E FY19F (x)	P/E FY20F (x)	Sales growth FY17 (%)	Net margin FY17 (%)	EPS CAGR FY17-20F (%)	EV/ EBITDA FY18F (x)	P/BV Historical (x)	ROE FY19F (%)	Div Yield FY19F (%)
BEST WORLD	BEST SP	1.49	594.4	13.8	9.8	8.3	10.0	25.2	21.0	9.4	6.3	38.8	4.1
HERBALIFE	HLF US	54.47	8,561.2	19.3	16.6	13.9	-1.4	4.8	19.5	12.7	N/A	N/A	0.0
NU SKIN	NUS US	70.46	3,912.7	19.0	17.1	15.4	3.2	5.7	12.2	10.0	4.9	29.0	2.1
NATURA COSMETICOS	NATU3 BZ	30.77	3,571.7	22.9	17.6	14.8	24.5	6.8	10.1	10.1	5.7	33.7	1.9
USANA	USNA US	104.39	2,532.0	21.1	18.0	N/A	4.1	6.0	N/A	10.9	6.1	23.5	N/A
TUPPERWARE	TUP US	31.31	1,566.2	7.4	7.0	6.8	1.9	-11.8	0.4	5.8	N/A	N/A	8.7
NOEVIR	4928 JT	5010.00	1,517.6	22.5	20.9	19.6	6.4	13.0	8.6	N/A	3.6	N/A	3.2
ORIFLAME	ORI SS	221.60	1,392.7	12.2	11.0	9.8	9.1	6.8	10.0	7.6	14.1	73.2	8.5
AVON PRODUCTS	AVP US	1.99	880.3	39.0	13.7	8.8	0.0	0.4	57.4	6.0	N/A	N/A	0.0
AMWAY MSIA	AMW MK	6.75	266.8	27.3	23.3	24.5	-9.5	5.3	-4.9	17.3	5.7	20.4	3.7
AVERAGE				***21.2***	***16.1***	***14.2***	***4.3***	***4.1***	***14.2***	***10.0***	***6.7***	***36.0***	***3.5***

Note: Data is as at 22 Oct 2018
Source: Bloomberg, RHB

Our conservative DCF cross-check derived an intrinsic value of SGD1.90. We did a conservative cross-check on our valuation using a 3-year DCF model with a terminal growth rate of 1%. Coincidentally, we derived at a similar intrinsic value of SGD1.90.

♦ Our conservative DCF cross-check derived a similar TP of SGD1.90

Figure 5: DCF assumptions

(SGDm)	FY19F	FY20F	FY21F
Net income	83.4	98.7	114.2
+ Non-cash charges	8.1	9.0	9.8
+ Fixed capital investment	-16.5	-5.5	-5.5
+ Change in net working capital	-32.5	-4.0	-3.0
+ Change in debt	-2.3	-2.2	0.0
FCFE	40.3	96.1	115.5
Terminal value			1,158.6
PV	36.3	77.9	929.9
Total discounted FCFE	1,044.1		
Value/share (SGD)	**1.90**		

Cost of equity	11.1%
Risk-free rate	2.8%
Beta	1.1
Market return	9.5%
Country risk premium	0.8%
Terminal growth	1.0%

Source: RHB

Possible re-rating upon more visibility in 2H18. The stock received a series of analysts' downgrades earlier this year – this was because its business model transition in China resulted in weak 1H18 earnings and an underestimation of the market demand for the Best World's products.

♦ Potential re-rating post 3Q18 and 4Q18 results

Given that the transition into a new business model was completed at end-2Q18, we believe the stock could re-rate to its historical average of 15x P/E, if the group's 3Q18 and 4Q18 financial results provide more clarity and investor confidence about its earnings prowess in China.

Scenario analysis

The value of Best World's stock is largely dependent on its earnings growth potential in China. Despite the lack of visibility in the new business model and volume growth, here are a few things we know, according to management guidance:

i. Under the old export model, Best World sold to export agents at 33-35% of the retail price;

ii. Under the new franchise model, the group sells to franchisees at 75-80% of the retail price;

iii. Management expects the group's overall net margins to maintain at similar levels, ie 20-25%, even after the change in business model;

iv. Best World targets to capture 5% of the Chinese skincare market in 2022 based on total retail value in 2016, which approximates to CNY10bn in terms of retail value.

Best case scenario

Under our best case scenario, we assume that the group is able to reach its target of capturing CNY10bn in retail value in the Chinese skincare market in FY22F. This implies sales to consumers (at retail price) will grow at a CAGR of 58% over FY17-22F. In such an eventuality, we think Best World's share price could potentially double to SGD3.04 from the current level.

Figure 6: TP derivation and assumptions of best case scenario

Best case	Forecast	Formula	Comment
FY17 export revenue (SGDm)	106.5	(i)	Best World front-loaded 3-6 months of sales in 4Q17. We assume this figure represents six quarters of sales volumes.
Normalised 2017 export revenue (SGDm)	71.0	(ii) = (i) ÷ 6 x 4	We normalised 2017 export revenue to four quarters.
Conversion to retail value (SGDm)	202.9	(iii) = (ii) ÷ 0.35	We assume Best World sold to export agents at 35% of retail price based on management's guidance.
CAGR	58%	(2000÷202.9)^(1÷5)-1	To acquire CNY10bn (SGD2bn) of the Chinese skincare market, sales have to grow at 58% CAGR over FY17-FY22.
FY19F retail value (SGDm)	506.4	(iv) = (iii) x 1.58^2	
FY19F revenue from China franchise segment (SGDm)	379.8	(v) = (iv) x0.75	We assume Best World sells to franchisees at 75% of retail price based on management's guidance.
FY19F revenue from other segments (SGDm)	119.7	(vi)	Similar to base case forecast.
FY19F total revenue (SGDm)	499.5	(vii) = (v) + (vi)	
Net margin	22%	(viii)	Similar to base case forecast.
FY19F PATMI (SGDm)	111.4	(ix) = (vii) x (viii)	
EPS (SGD)	0.20	(x)	
P/E	15	(xi)	Under the best case scenario, we expect P/E multiples to revert to its mean of 15x.
TP	**3.04**	(x) x (xi)	In the best case scenario, we see 100% upside from the current share price.

Source: RHB

Worst case scenario

Under our worst case scenario, we assume Best World is unable to grow its sales with the franchisee model. We took the lower end of management's guidance on net margins. In such an unfortunate event, we see a 50% downside from the current share price.

Figure 7: TP derivation and assumptions of worst case scenario

Worst case	Forecast	Formula	Comment
FY17 export revenue (SGDm)	106.5	(i)	Best World front-loaded 3-6 months of sales in 4Q17. We assume this figure represents six quarters of sales volume.
Normalised 2017 export revenue (SGDm)	71.0	(ii) = (i) ÷ 6 x 4	We normalised 2017 export revenue to four quarters.
Conversion to retail value (SGDm)	202.9	(iii) = (ii) ÷ 0.35	We assume Best World sold to export agents at 35% of retail price based on management's guidance.
CAGR	0%		In the worst case scenario, we assume 0% growth in sales.
FY19F retail value (SGDm)	202.9	(iv) = (iii)	
FY19F revenue from China franchise segment (SGDm)	152.1	(v) = (iv) x0.75	We assume Best World sells to franchisees at 75% of retail price based on management's guidance.
FY19F revenue from other segments (SGDm)	119.7	(vi)	Similar to base case forecast.
FY19F total revenue (SGDm)	271.8	(vii) = (v) + (vi)	
Net margin	20%	(viii)	In the worst case scenario, we take the lower end of management's guidance on net margins.
FY19F PATMI (SGD m)	54.4	(ix) = (vii) x (viii)	
EPS (SGD)	0.10	(x)	
P/E	10	(xi)	Under the worst case scenario, we expect P/E multiples to drop by 1SD deviation to 10x.
TP	**0.99**	(x) x (xi)	In the worst case scenario, we see a 50% downside from the current share price.

Source: RHB

Key Risks

Changes in regulations. Changes in product or import regulations could negatively impact the sale of Best World products as well as its share price. We note that c.85% of the group's revenue comes from the sale of its skincare products, which are generally sold in sets. The restriction on one product could, therefore, affect the sale of an entire skincare range. This was evident in Best World's Indonesia market, where product restrictions in 2009 resulted in Indonesia sales declining by 41% that year and 78% in 2010.

In addition, changes to regulations on direct selling/multi-level-marketing/pyramid schemes or negative news on such business models could also hurt the group's share price. In 2017, China's crackdown on pyramid schemes caused Best World's share price to fall c.20%, as investors misinterpreted the group's business model as a pyramid selling one. The crackdown in China was on pyramid Ponzi-schemes that profited from the collection of members' fees upon the recruitment of members.

Operationally, Best World does not conduct direct-selling in China, while its direct-selling model in other markets derives revenue from the sale of products, and not the recruitment of distributors.

Reputational risks. Erroneous linkages to pyramid Ponzi-schemes or distributors' over-claiming of a product's effectiveness can also damage the group's reputation.

Lack of visibility. Unlike traditional retailers, there is less visibility on sales growth and inventory management. Best World also has limited control over sales efforts and purchases made by its distributors. The latter may load on more purchases in a particular month if there are discounts or if they are looking to hit certain sales targets. Inventory build-up by franchisees and export agents may also occur without the group or investment community being aware of it.

Intensifying competition. Skincare is a highly-competitive industry with competition from many international and domestic players. With skin diagnosis and customised skincare showing greater traction, Best World's "one-size-fits-all" range of skincare products needs to be of exceptional quality to withstand the test of time.

FX risk. The group is subjected to FX fluctuations of the USD, as most of the raw material costs are denominated in that currency, while sales are made in local currencies. However, we think the FX risk remains minor for now, given Best World's strong gross margins of 70-80%.

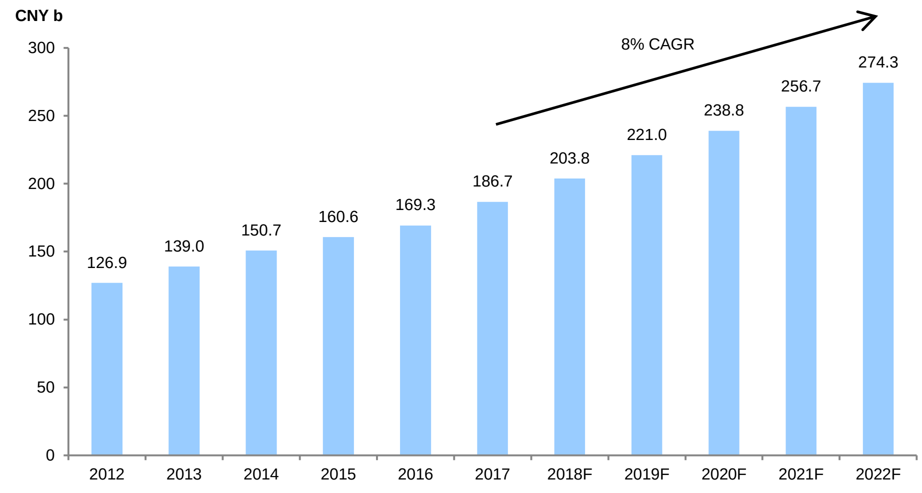
Industry Overview

Leveraging on the growth of the Chinese beauty segment

Exciting skincare market in China. Based on Euromonitor's 2018 estimates, China has a huge skincare market with an amassed retail value of CNY204bn (c.USD30bn). This market can only grow larger as the country's middle class grows.

♦ China's skincare market has a retail value of CNY204bn

Figure 8: China's growing skincare market



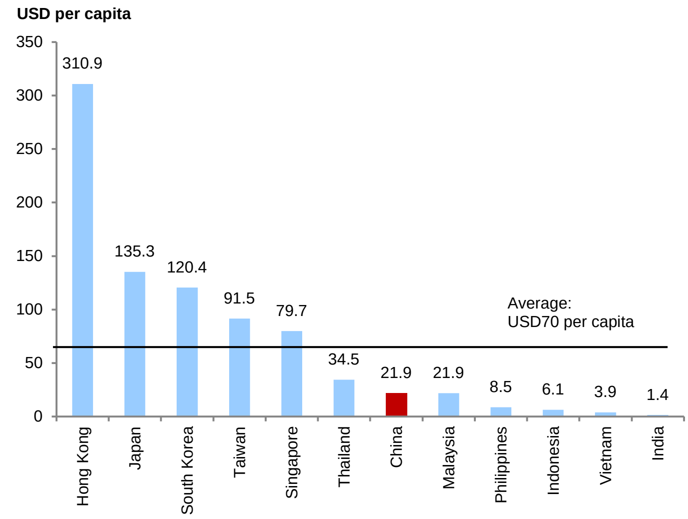
Source: Euromonitor

Potential for skincare expenditure to rise. Currently, China's per capita expenditure on skincare is as low as USD22. This is much lower than Asia's average of USD70, as well as other Chinese-dominated markets like Hong Kong and Taiwan, which spend USD311 and USD92 per capita on skincare.

In fact, while Hong Kong and Taiwan's average disposable incomes are c.7x and 3x higher than China, their skincare expenditures are c.14x and 4x greater than their counterparts on the mainland. We believe there is immense potential for China's skincare spending as a proportion of disposable income to emulate Taiwan and Hong Kong's levels – this is as Mainland Chinese women gain more sophistication and knowledge in this field.

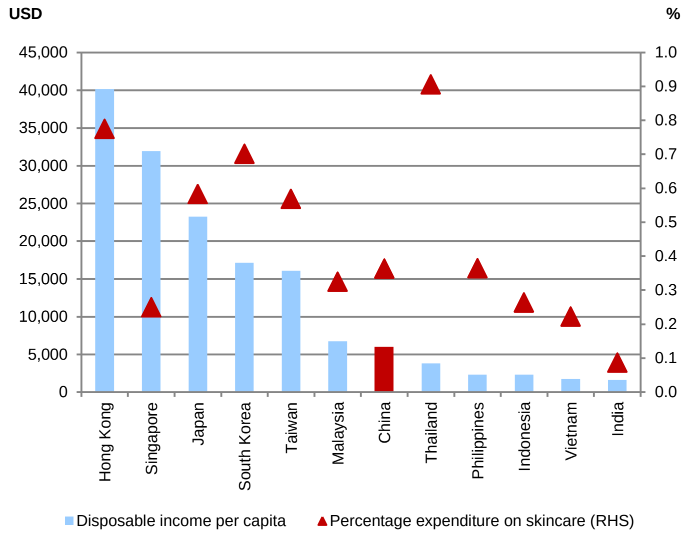
♦ Percentage of income spent on skincare is much more modest when compared to other Chinese-dominated markets

Figure 9: China's per capita consumption of skincare is much lower than Asia's average



Source: Euromonitor

Figure 10: China's percentage of income spent on skincare is also much lower than other Chinese-dominated markets like Taiwan and Hong Kong



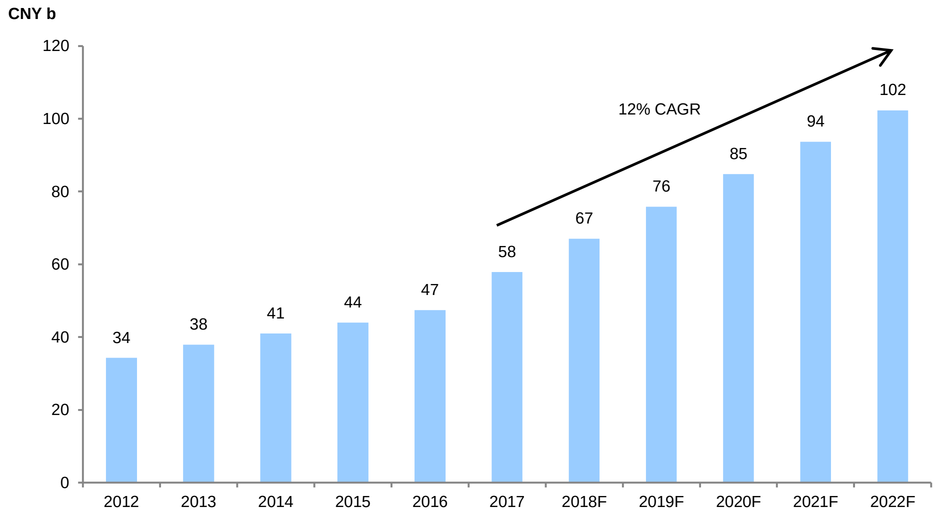
Source: Euromonitor

Premiumisation already happening. A survey held by OC&C Strategy Consultants in 2017 further showed that 88% of respondents had increased their skincare spending over the past one year. 58% of respondents claimed they traded-up to more expensive product lines within the same brand, while 36% upgraded to more premium brands. Euromonitor forecasts the premium skincare market to grow at a CAGR of 12% over the next 5 years.

♦ Best World's products – which are perceived as premium – are likely to benefit from faster growth, given premiumisation within the industry

One set of *DR's Secret*'s skincare range – #1 to #7 (seven stock-keeping units or SKUs) – costs CNY3,998 in China. In this respect, we believe Best World's *DR's Secret* skincare range – which is priced at a premium and perceived to be high-end products – will benefit from the faster growth in China's premium skincare market.

Figure 11: Premium skincare is expected to grow at much faster rate – 12% CAGR

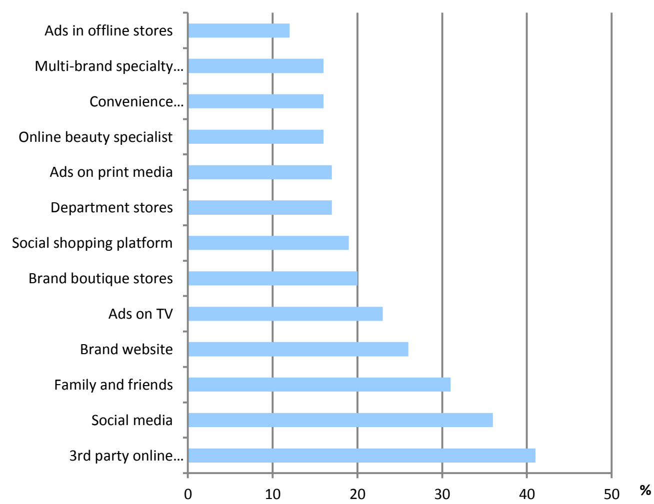


Source: Euromonitor

Penetrating the skincare market using social media

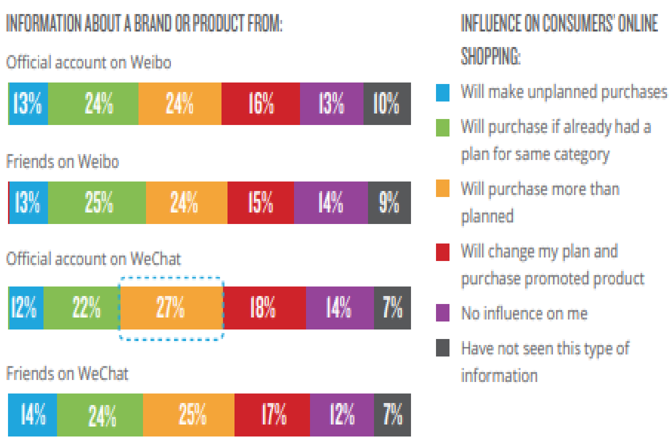
Using social media to help brand penetration. The OC&C Strategy Consultants survey also revealed that 90% of respondents conducted extensive research prior to the purchasing of skincare products. Top information sources include third-party online platforms, social media, as well as friends and family.

Figure 12: Top 3 information sources used for research before buying skincare products



Source: OC&C Strategy Consultants

Figure 13: Social network influence on China's shoppers



Source: Nielsen

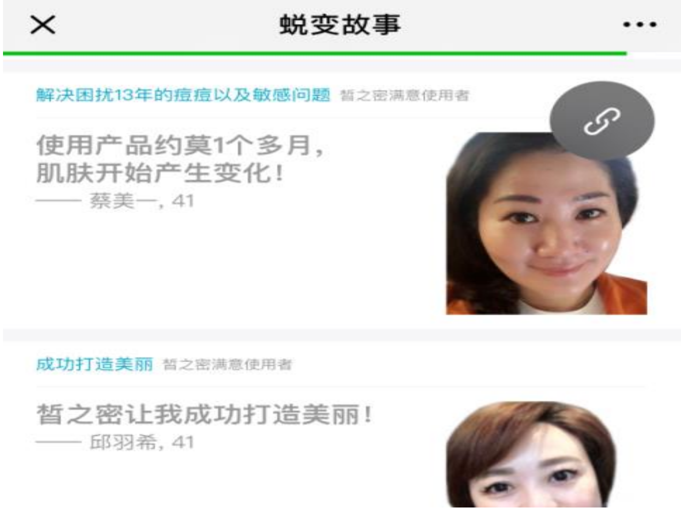
We believe this is congruent with how Best World is penetrating the China market. The sales personnel of its franchisees are trained to sell like the group's direct-selling distributors in Taiwan. Using social media platforms to share pictures of before/after results are common sales tactics. The group also hosts workshops and sharing sessions. Consumers are also strongly recommended to give their reviews on its products online.

- Strong usage of social media to promote brand awareness

Figure 14: Online sharing of before/after results of using *DR's Secret*

Source: Baike.com

Figure 15: Reviews of *DR's Secret* products on Best World China's *WeChat* page



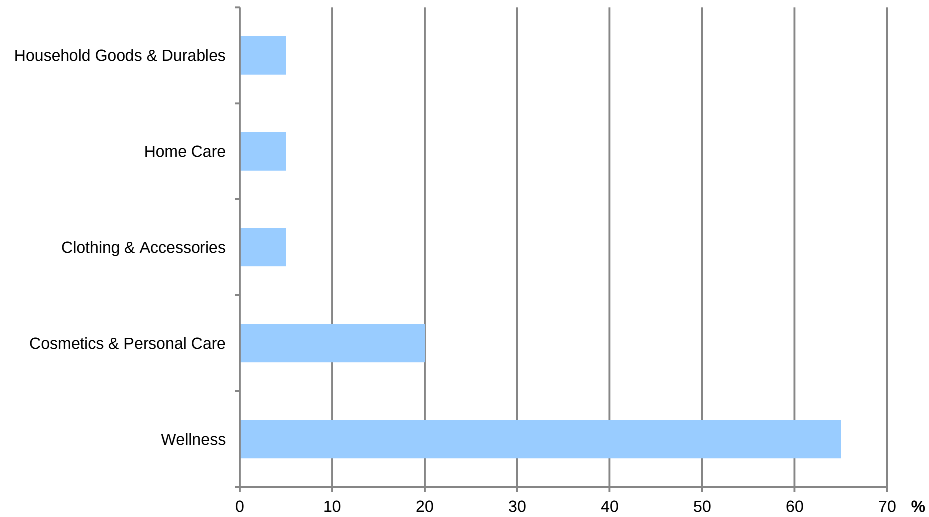
Source: WeChat

Taiwan – a mature market for beauty and direct-selling

Taiwan has a fairly mature market for direct-selling, with long-established players like Amway and Pro-Partner. Due to the low average disposable income, Taiwanese are generally receptive to working as direct-sales personnel. 12.5% of its population work either full- or part-time as independent representatives of direct-selling companies – this is based on the World Federation of Direct Selling Associations' 2017 data. Cosmetics, personal care, and wellness products constitute 85% of the direct-sales category in Taiwan.

- Direct selling of skincare and wellness products is common in Taiwan

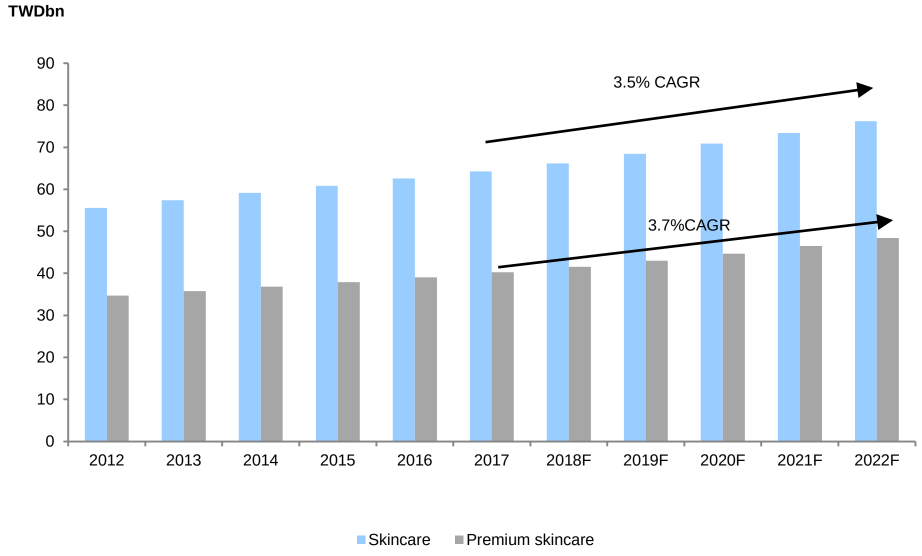
Figure 16: Taiwan's direct-sales breakdown by product category



Source: World Federation of Direct Selling Associations

The skincare market is also well-established in Taiwan, with very advanced products from both international and local players. 63% of the skincare sales are made up of premium products. According to Euromonitor, the skincare market is expected to grow at a CAGR of 3.5% over FY17-22, while the premium skincare segment is to grow slightly faster – at a CAGR of 3.7%.

Figure 17: Taiwan's premium skincare market is expected to grow slightly faster than the overall skincare market



Source: Euromonitor

Track record for capturing Chinese beauty ideals

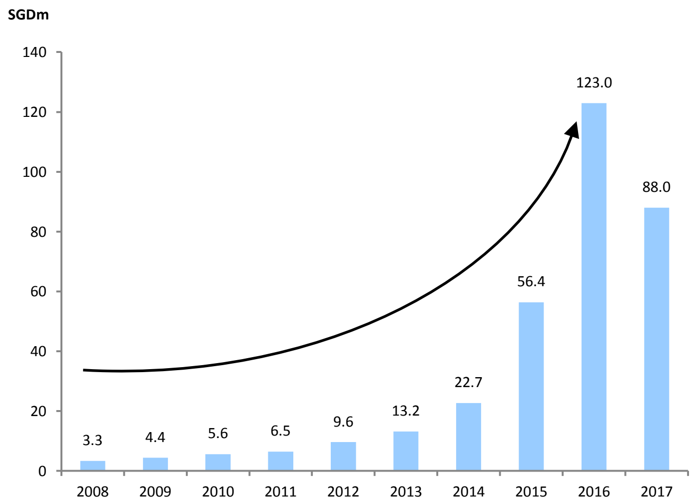
Best World entered the Taiwan market in 2007. Since then, revenue from there grew exponentially till 2016, before registering a decline in 2017. Even so, its Taiwan sales still make up c.5% of the island's premium skincare market – this is based on Euromonitor's forecast in 2017.

- Best World has established a strong track record for penetrating Chinese-dominated markets

Given the maturity of Taiwan's direct-selling and skincare markets – as well as Best World's market share – we do not expect the group to aggressively grow this market from here on. However, its track record in Taiwan does give us confidence in its products and ability to grow in Chinese-dominated markets.

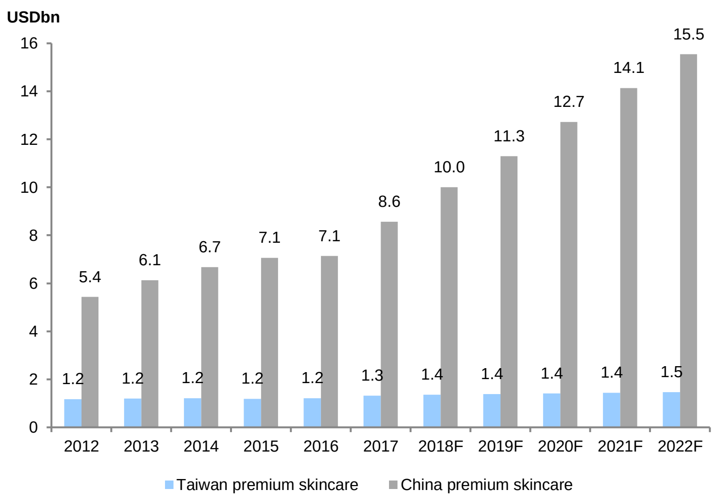
According to *Euromonitor's* 2018 estimates, China's premium skincare market is 7x larger than Taiwan's. Consequently, we see significant growth potential in the former, arising from an increase market penetration as well as growth in market size.

Figure 18: Best World's Taiwan revenue grew exponentially for eight years before tapering off



Source: Company data

Figure 19: China's premium skincare segment is 7x bigger than Taiwan's



Source: WeChat

Financials

We expect revenue to rebound in 2019. There was a major dip in 1H18 revenue, as the group was in a transition period – it was converting the China export model into a franchise model. Moving into 2019, we expect revenue to surge 59% to SGD374.9m due to the following factors:

i. **Recognising higher ASPs.** As mentioned, Best World was selling to export agents at discounted export prices, which were 33-35% of the retail price. With the new franchise model, the group is now selling products to its franchisees at a franchise wholesale price, which is 75-80% of the retail price.

   As the retail price to end-consumers remains unchanged, the change in business model is unlikely to have any negative impact on volume. We have conservatively assumed that the ASP to franchisees to be double that of the export price – this is to account for any potential shortfalls in VAT refunds in China;

ii. **Growth in China demand.** China revenue grew at a CAGR of more than 100% during 2013-2017, albeit from a small base. While there is limited visibility on China's actual demand growth, we believe other operating income in 2Q18 was an indicator of actual demand for Best World's products in the country.

   Other operating income is service fees paid by export agents from the previous business model to the group for market support activities, product training, and IT services. These fees are incurred by export agents when they engage Best World to hold training or sharing sessions with customers, or when they use IT services to record sales to end customers.

   In 2Q18, before the transition to the franchise model, other operating income grew 58% to SGD4.4m. We believe this signals demand for Best World's products from end-consumers remained strong during the last quarter and is unlikely to change significantly over the next quarter;

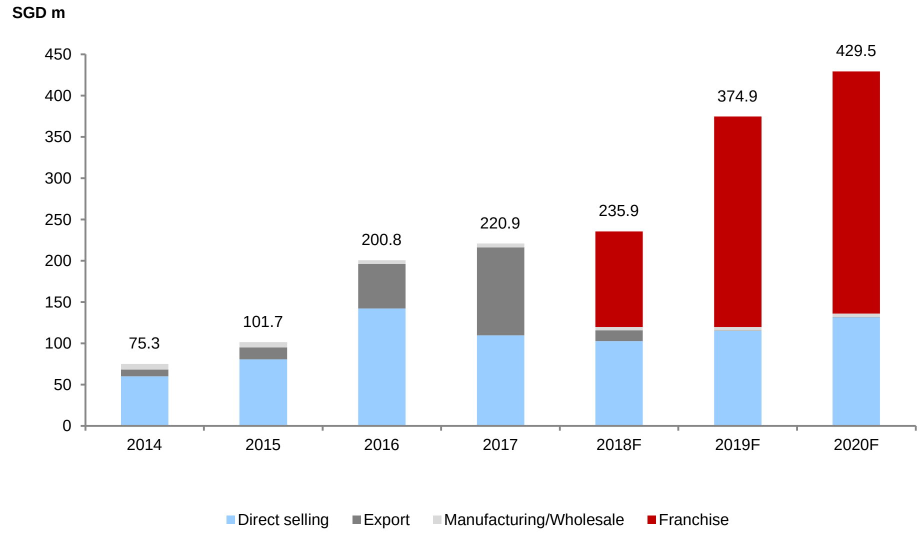
   However, as Best World's China business grows to a decent scale, we believe it is fair to forecast that demand for its products will moderate, with volumes expected to grow at a lower CAGR of 35% over 2017-2019, before tapering to a more sustainable rate of 15% in FY20;

iii. **Low base effect in 2018.** To prevent potential delays in imports and shortage of stock to end-consumers from the change in business model that took place in 1H18, the group had front-loaded an additional 3-6 months' of sales to export agents in 4Q17. This resulted in lower 1H18 revenue, and a low base for 2019F;

iv. **Outside of China,** we expect direct sales in Taiwan to stabilise. Growth in the direct-selling segment should largely be driven by the Indonesian market.

- 2019F revenue projected to surge 59% on:
  i. Higher selling price of new models;
  ii. Market growth in China;
  iii. Low base effect in 2018;
  iv. Demand growth in Indonesia.

Figure 20: Revenue expected to grow 59% in FY19 and 15% in FY20

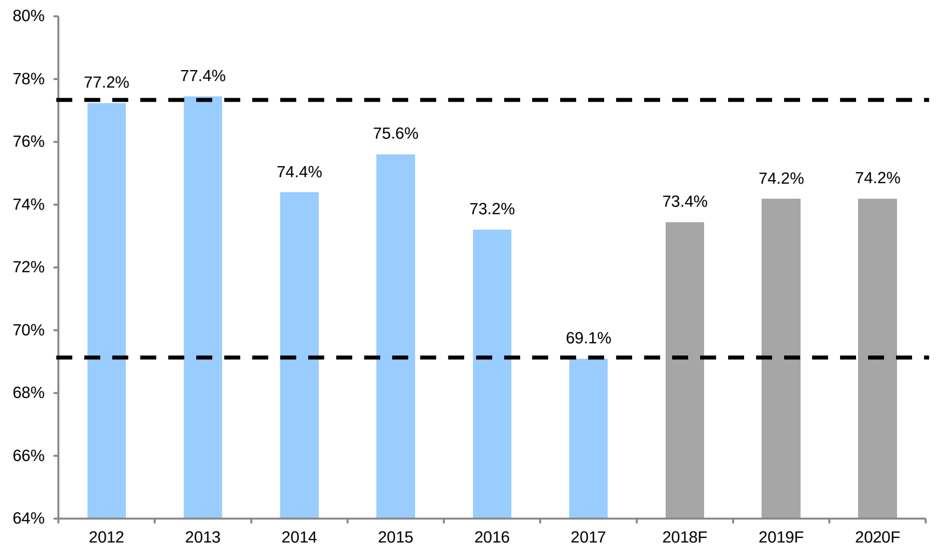


Note: China revenue is largely represented by franchise, export, and the manufacturing/wholesale segments
Source: RHB

Overall gross margins are expected to be higher with the new franchise model, as the group would recognise higher revenue per unit of product sold in China. However, revenue per unit for the franchise model is still below that of direct-selling. As such, we assume gross margins to hover below the pre-2014 levels (at c.77%) before export sales take off, but higher than 2017's level (c.69%) – this was when the export segment made up close to 50% of total sales.

- Gross margins to hover between 69% and 77%

Figure 21: Gross margins projected to stay within the 69-77% band



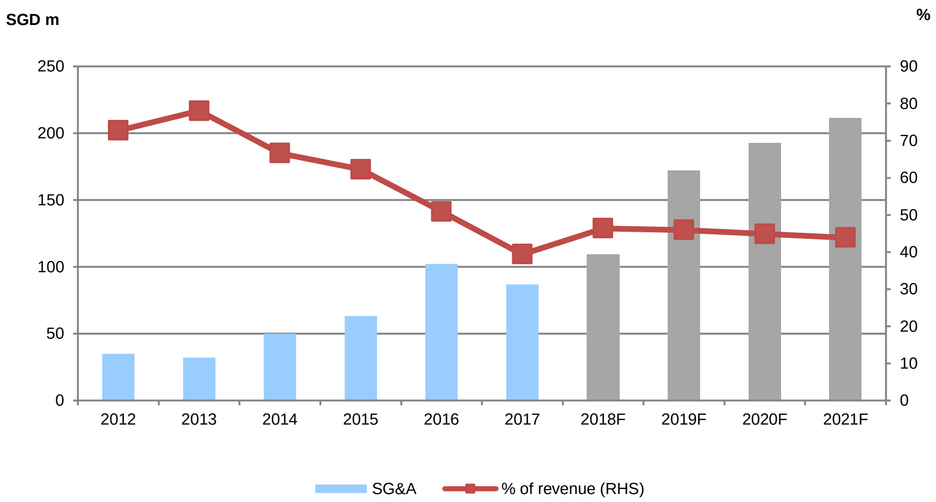
Source: Company data, RHB

However, this would be offset by higher distribution costs, as the franchise model should incur higher distribution expenses compared to the export model. Best World is also likely to incur higher administrative costs as it increases headcount at the China office to oversee and train its franchisees. We expect the group's net margins to fall to 22-23% during 2019-2020, in line with management's guidance that net margins should remain at the 20-25% range.

- Management guided for net margins to remain at 20-25% despite higher distribution costs

Distribution and administrative costs to grow. Previously, China did not incur much distribution and administrative costs under the export business model. Under the new franchise model, management highlighted that it is to pay commissions and incentives to franchisees or sales managers when they hit certain sales targets, similar to its direct-selling model. As a result, distribution costs are expected to increase. We are also projecting higher administrative costs on increased staff count to manage and oversee the China franchisees.

Figure 22: We expect SG&A to rise, but as a percentage of revenue, it should come off due to higher topline

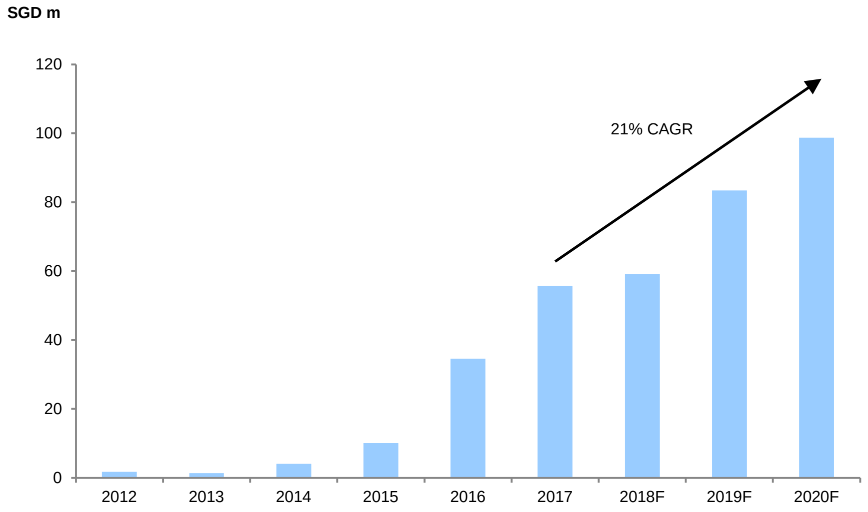


Source: Company data, RHB

PATMI to grow at CAGR of 21% over 2017-2020F. Overall, earnings growth would be largely driven by market demand and the change in the China business model. While we expect net margins to be eroded by higher distribution and administrative costs with the franchise model, this should be offset by increased ASPs.

♦ Strong PATMI 3-year CAGR of 21%

Figure 23: PATMI growth expectation



Source: Company data, RHB

Possible acquisitions to add to product range, given the strong net cash position. The group is sitting on a net cash position of SGD87m. We believe management is looking at possible acquisitions in the beauty & personal care space, as Best World will then be able to easily leverage on its network of distributors and customers to market new products in the adjacent space.

♦ Possible acquisitions, given a net cash position of SGD87m

Cash flow to remain healthy. Best World has a cash conversion cycle of c.110 days. We expect inventory levels to come down as its China business transitions into the franchise model, giving management greater visibility on actual demand. In addition, as its Tuas production facility is completed by end-2019, we expect the group to manufacture its own products and have better control over inventory from 2020 onwards. Outstanding sales days are also likely to come down, as previous export agents paid down on receivables over the next quarter.

♦ Cash conversion cycle to improve after the change in business model

Over the last two years, the group has spent c.SGD3-5m on capex pa. Even after factoring in an additional SGD10m of capex in 2019 for machinery at the new production facility, we still expect cash flows to be positive moving forward.

Dividends. Best World's dividend policy is to pay out no less than 30% of PATMI. Over the last three years, the group has paid out 37-44% of its PATMI as dividends. We expect it to maintain a payout ratio of 40% over the next three years.

♦ Expect 40% dividend payout, which would imply 4% dividend yield for FY19F

Company Background

The "Best" products. Best World specialises in the development, manufacturing, and distribution of skincare and wellness products. Close to 85% of its revenue was contributed by its skincare range, with *DR's Secret* being the key brand. Its other brands include *Aestier, Avance, Miraglo, Optrimax, Pentalab, Pureflo* and *UberAir*.

Figure 24: *DR's Secret* core product range

Source: Company

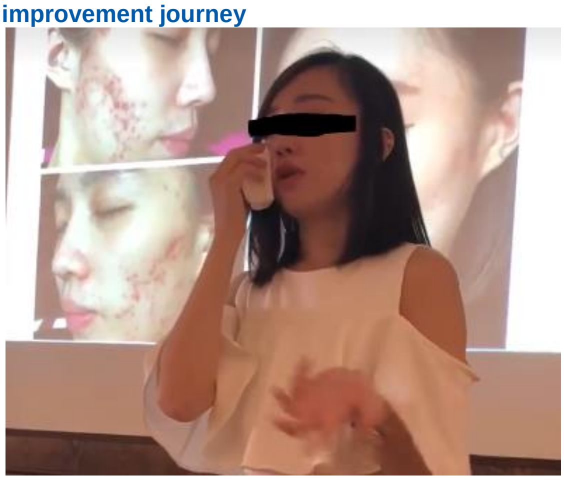
One size fits all. Best World only has c.20 different SKUs in its skincare range. However, it caters to all skin types as consumers can customise the products through the order of usage and quantity. Lead distributors for the direct-selling market (most markets) or sales managers for its franchisees (China market) would then hold workshops or sharing sessions with new/potential members on how to use the products according their needs. These workshops or sessions also serve as crucial platforms to recruit new members.

- One set of products for all skin types

The limited number of SKUs gives rise to efficiency in production. Ability to customise based on quantity and order of usage enables consumers to continue using the same products, even after their skin has improved.

- Customisation is based on order of product used and quantity applied

Figure 25: Best World's distributors sharing session on skin improvement journey



Source: Facebook, RHB

Figure 26: Sharing sessions allow people to know the products and are effective for the recruitment of members

Source: Facebook, RHB

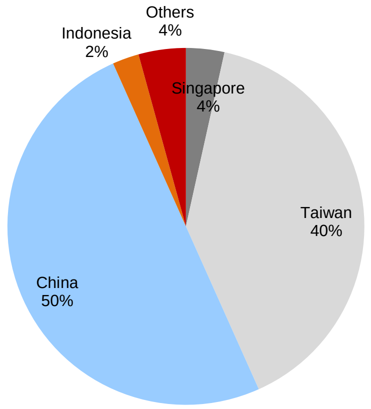
Geographical breakdown

Regional player with key presence in North Asia. Best World has presence in 12 countries: Singapore, Thailand, Taiwan, Indonesia, Malaysia, Vietnam, Hong Kong, China, South Korea, the Philippines, Myanmar, and UAE. As at 2017, China became the group's biggest market, accounting for 50% of revenue – this is followed by Taiwan, which contributed 40% of topline.

- Bulk of revenue is derived from China

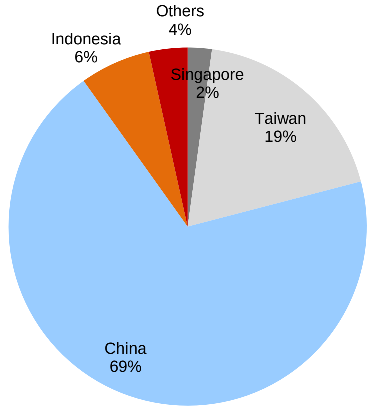
As Best World changed its China business into a franchise model from an export one in mid-2018, we estimate sales in the East Asian nation to contribute c.70% of the group's total revenue in 2019.

Figure 27: FY17 revenue breakdown by geographical location



Source: Company data, RHB

Figure 28: FY19F revenue breakdown by geographical location



Source: Company data, RHB

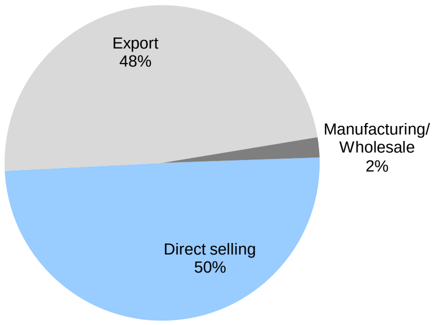
Segmental breakdown

Different business segments. Best World has four business segments: direct-selling, export, manufacturing/wholesale, and franchise. The latter segment was newly-created in 2Q18, and should formally replace the export segment sales for the China market in 2H18. Prior to the change in its China business model, direct-selling contributed 50% of the group's revenue – export (largely sales to China) contributed 48%, while manufacturing/wholesale contributed 2% in 2017.

- Franchise segment to overtake direct selling in 2019

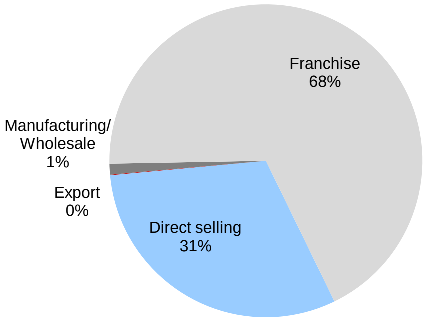
Post the change in its China business model, we expect franchise sales to dominate and contribute 68% of total 2019 revenue. Direct-selling should contribute c.31%, while manufacturing/wholesale and exports are likely to make up 1% of total revenue.

Figure 29: 2017 revenue breakdown by segment



Source: Company data, RHB

Figure 30: 2019F revenue breakdown by segment



Source: Company data, RHB

Figure 31: Operating business segments by geographical location pre-2Q18

Direct selling	Export	Manufacturing/wholesale
Singapore	Myanmar	China
Malaysia	China	
Indonesia		
Thailand		
Taiwan		
Hong Kong		
Vietnam		
Philippines		
Korea		
United Arab Emirates		

Source: Company data, RHB

Figure 32: Operating business segments by geographical location post-3Q18

Direct selling	Export	Franchise	Manufacturing/wholesale
Singapore	Myanmar	China	China
Malaysia			
Indonesia			
Thailand			
Taiwan			
Hong Kong			
Vietnam			
Philippines			
Korea			
United Arab Emirates			

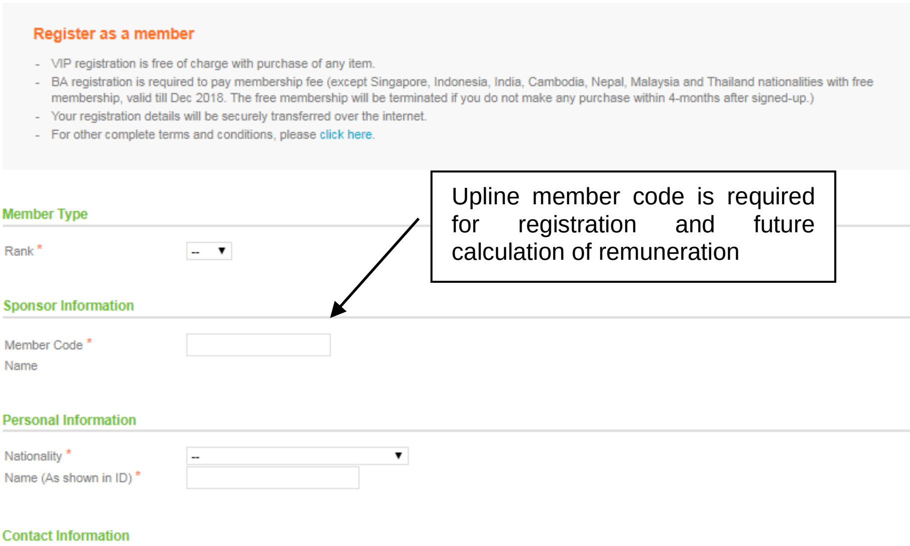
Source: Company data, RHB

Direct-selling segment. For 10 markets – Singapore, Malaysia, Indonesia, Thailand, Taiwan, Hong Kong, Vietnam, Philippines, South Korea and UAE – Best World reaches customers via direct-selling distributors. The latter are essentially satisfied customers of its products, who then refer the goods to new consumers. Upon hitting certain sales targets – either through their own purchases and/or purchases from their downlines – distributors would receive remuneration, which is paid out monthly. We estimate approximately 20% of Best World's members are distributors, while the rest are customers with no downlines.

♦ Best World does direct-selling in 10 countries

How does it work? All members in the group's direct-selling markets purchase the products directly from its experience centres or online store. Remuneration to distributors is tracked, as every customer has to sign up as a member and impute the member code of the distributor who recommended the products upon the first purchase. This distributor then becomes the new member's upline. Every purchase made by the new member and his/her subsequent downline is recorded – this contributes to the calculation of the distributor's remuneration.

Figure 33: Customers have to input the member code of their upline upon registration as members on Best World's website



Source: Company

Export segment. Best World only uses the export model in Myanmar. This business segment serves as a trial for the group in new markets. Under the export business model, Best World penetrates new markets by selling its products to export agents at a discounted bulk price, before obtaining a direct selling licence. These export agents would, in turn, distribute products to beauty salons and spas. The group then recognises the revenue upon selling to such agents. Export agents also pay service fees to Best World for IT, administrative, and marketing support.

- Export model now only applies to Myanmar

The journey from export to franchise model for the China market. China has always been a key focus market for Best World. The group began selling into China in 2011 through export agents to test market interest, with plans to eventually convert the export model into direct-selling in phases. In Nov 2011, it obtained the direct-selling licence and was authorised to conduct direct-selling in Hangzhou City. This raised retailers and consumers' confidence in Best World's products and, in turn, traction for its products escalated.

- Best World chose to operate a franchise model in China as opposed to the direct-selling one for tax-savings purposes

In Apr 2018, the group received the Commercial Franchise Certificate from China's Ministry of Commerce. Management believes the franchise model will result in greater tax-savings in China compared to the direct-selling model – it announced the launch of the franchise model in Jul 2018 to replace the export model from 2H18 onwards.

Franchise segment. Best World uses the franchise model for China only. It has signed 27 franchisees for key cities in the Hunan, Guangdong, Zhejiang and Heilongjiang Provinces. These franchisees are beauty salons and/or spa operators that have been supporting the group's products. They have since converted their stores, or opened new premises as Best World Experience Centres to exclusively sell the group's products.

- The group has 27 franchisees in China and may add 2-3 more this year

How does this work? Unlike most companies' franchise models, Best World does not collect franchise income and royalty fees from these franchisees – this is to reward their long-term support. Instead, the group recognises revenue when it sells the products to its franchisees. The latter would then sell the products to end-consumers at the retail price set by Best World. While most of the costs – including sales staff and rental – are borne by the franchisees, the group would incur more marketing development costs. It also pays commissions to the franchisees or sales managers when they hit certain sales targets, similar to its direct-selling model.

Manufacturing/wholesale segment. This segment comprises contributions from the group's acquisition of Zhejiang SolidGold Pharmaceutical in 2014. This entity manufactures and distributes the *Aurigen* line of supplements through drugstores in China.

Management

Figure 34: Best World's key management team

Key management	Position	Description
Dr Dora Hoan Beng Mui, PBM	Co-chairman, group CEO/managing director	Dr Hoan is the co-founder, and is in charge of the group's management and business development direction. Prior to setting up Best World, she was a marketing manager at another direct selling business. Dr Hoan has a PhD in Business Administration from Western Pacific University, US.
Dr Doreen Tan Nee Moi, PBM	Co-chairman, president	Dr Tan is also the co-founder, and was a top distributor at another direct selling firm prior to setting up Best World. She has deep knowledge of nutrition and skincare. She holds a degree in Applied Nutrition from the American Academy of Nutrition, a doctorate in Naturopathy from Canyon College, and an Honorary PhD from Kennedy Western University, US.
Huang Ban Chin	Executive director, chief operating officer	Mr Huang joined the group in 1990 as its marketing manager. He was promoted to the position of director in 1994, and assumed his position as executive director in 2003. He oversees the group's day-to-day operations and manages the key functions of finance, product development, information technology, and investor relations. Mr Huang is also responsible for the execution of the group's regional business expansion plans.
Koh Hui	Senior group financial controller	Ms Koh joined Best World in 2003 and has served in a number of finance and managerial positions. She was instrumental in the listing of the group. Her current responsibilities include overseeing accounting, finance, treasury, risk management and tax functions of the group. She also assists the executive director in investor relations matters.

Source: Company, RHB

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