

21 November 2023

Consumer Cyclical | Consumer Products

DXN Holdings (DXN MK)

Buy (Maintained)

Beyond Just Direct Selling; Stay BUY

- **Maintain BUY and TP of MYR0.93, 39% upside with 5% FY24F (Feb) yield.** We came away more reassured with DXN's entrenched fundamentals and prospects, post our site visit to its China operation. We continue to like DXN for its attractive valuation and exciting earnings growth prospects. We highlight the upside potential of dividend payouts (formal policy: 50% of net profit), in view of its sturdy balance sheet and strong cash flow generation. We also look forward to contributions from upcoming key ventures into the Argentina and Brazil markets.
- **Laying the foundation for a massive China opportunity.** We recently travelled to Ningxia, China to visit DXN's manufacturing plants and cultivation facilities. To recap, DXN ventured into China in 2015 with an ambition to secure the all-important direct selling license. To meet the requirements (detailed on page 4), investments and efforts have been poured in to establish a track record. Apart from that, diversifying manufacturing sources into China makes sense from an efficiency perspective, considering the access to cheap raw materials, higher cultivation yields, financial aid and infrastructure support from the local government, as well as the potential of Ningxia as an important region under the Belt and Road initiative.
- **Engagement with key stakeholders.** The trip provided an opportune window for us to engage with various stakeholders. CEO Teoh Hang Ching expressed his optimism on DXN's growth prospects and highlighted the upside potential of dividend payouts, given its strong balance sheet. Senior independent director Datuk Noripah Kamso pledged to uphold the high standard of corporate governance and foresees DXN to be further institutionalised going forward. Meanwhile, for the private equity shareholder, KV Asia, an exit is not on the horizon – notwithstanding the lapse of the moratorium on 19 Nov, as the firm believes that this counter is currently undervalued.
- **More than just direct selling.** The visit showcased DXN's biotechnological expertise, which has been instrumental in supporting its brand equity (popular products with high efficacy) and cost efficiency (c.80% GPM, with >90% of products manufactured in-house). Meanwhile, the China market will serve as a vital medium-term catalyst, with DXN targeting to file the application for a direct selling license in 2-3 year once all of the requirements are met. Apart from expansion into new markets, its other growth strategy include the plans to diversify its Fortified Food & Beverages (FFB) portfolio by rolling out more convenient ready-to-eat (RTE) or ready-to-drink (RTD) products to further expand the addressable markets.
- **Downside risks to our recommendation** include unfavorable regulatory changes and major delays in expansion.

Forecasts and Valuation	Feb-22	Feb-23	Feb-24F	Feb-25F	Feb-26F
Total turnover (MYRm)	1,243	1,601	1,849	2,097	2,356
Recurring net profit (MYRm)	239	301	332	381	431
Recurring net profit growth (%)	15.8	26.2	10.1	14.7	13.2
Recurring P/E (x)	13.98	11.08	10.06	8.77	7.75
P/B (x)	4.4	3.5	2.7	2.3	2.0
P/CF (x)	12.85	13.52	8.09	7.70	6.89
Dividend Yield (%)	2.1	1.8	5.0	5.7	6.5
EV/EBITDA (x)	9.85	7.49	5.78	4.81	3.96
Return on average equity (%)	36.2	32.0	30.1	28.5	28.0
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Target Price (Return):	MYR0.93 (+39%)
Price (Market Cap):	MYR0.67 (USD715m)
ESG score:	2.9 (out of 4)
Avg Daily Turnover (MYR/USD)	1.78m/0.38m

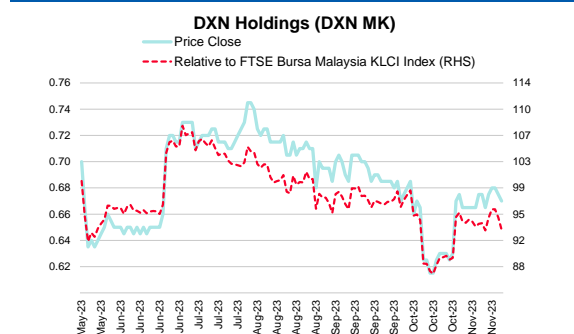
Analyst

Soong Wei Siang
+603 9280 8865
soong.wei.siang@rhbgroup.com



Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	0.0	7.2	(5.0)	0.0	0.0
Relative	0.0	5.6	(5.4)	0.0	0.0
52-wk Price low/high (MYR)				0.62 – 0.75	



Source: Bloomberg

Overall ESG Score: 2.9 (out of 4)

E: GOOD

DXN has taken active steps to manage its environmental risks. It has established policies and procedures for responsible energy consumption management and scheduled waste disposal.

S: GOOD

DXN promotes equality with career advancement based on merit, regardless of race and gender. It supports employee development through sponsored training and engages in charitable activities like educational tours, direct donations, health contributions, disaster relief matching, and blood drives. In 2020, DXN launched the One Dollar One Child campaign, distributing free spirulina to underprivileged children and encouraging member donations.

G: GOOD

DXN has applied and adopted the majority of the best practices of the Malaysian Code on Corporate Governance. The company has a diverse board of skilled directors, with women representing over 30% of the Board. It provides timely, consistent, and accurate information to shareholders.

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Financial Exhibits

Asia	Financial summary (MYR)	Feb-22	Feb-23	Feb-24F	Feb-25F	Feb-26F
Malaysia	Recurring EPS	0.05	0.06	0.07	0.08	0.09
Consumer Cyclical	DPS	0.01	0.01	0.03	0.04	0.04
DXN Holdings	BVPS	0.15	0.19	0.25	0.29	0.33
DXN MK	Return on average equity (%)	36.2	32.0	30.1	28.5	28.0
Buy						
Valuation basis	Valuation metrics	Feb-22	Feb-23	Feb-24F	Feb-25F	Feb-26F
DCF	Recurring P/E (x)	13.98	11.08	10.06	8.77	7.75
	P/B (x)	4.4	3.5	2.7	2.3	2.0
	FCF Yield (%)	2.1	4.7	9.7	10.3	11.8
	Dividend Yield (%)	2.1	1.8	5.0	5.7	6.5
Key drivers	EV/EBITDA (x)	9.85	7.49	5.78	4.81	3.96
i. New market ventures;	EV/EBIT (x)	8.80	6.86	5.25	4.37	3.61
ii. Innovative product launches;						
iii. Capacity expansion.						
Key risks	Income statement (MYRm)	Feb-22	Feb-23	Feb-24F	Feb-25F	Feb-26F
i. Major delay in expansion plans;	Total turnover	1,243	1,601	1,849	2,097	2,356
ii. Unfavourable regulatory changes;	Gross profit	1,012	1,303	1,501	1,694	1,899
iii. Country risks.	EBITDA	324	419	496	563	635
	Depreciation and amortisation	39	39	50	57	62
	Operating profit	363	457	546	619	697
	Net interest	0	(2)	0	6	9
	Pre-tax profit	363	456	546	625	706
	Taxation	(117)	(166)	(199)	(228)	(258)
	Reported net profit	243	275	332	381	431
	Recurring net profit	239	301	332	381	431
Company Profile	Cash flow (MYRm)	Feb-22	Feb-23	Feb-24F	Feb-25F	Feb-26F
DXN is principally involved in marketing health-orientated and wellness consumer products through a direct selling model. Other business activities include conducting laboratory testing services for third parties, offering lifestyle products, and operating a café.	Change in working capital	(71)	(52)	32	2	1
	Cash flow from operations	260	247	413	434	485
	Capex	(189)	(91)	(90)	(90)	(90)
	Cash flow from investing activities	(27)	(95)	(90)	(90)	(90)
	Dividends paid	(123)	(70)	(166)	(190)	(216)
	Cash flow from financing activities	(150)	(103)	(176)	(185)	(256)
	Cash at beginning of period	326	410	459	606	765
	Net change in cash	83	50	147	159	139
	Ending balance cash	409	459	606	765	904
	Balance sheet (MYRm)	Feb-22	Feb-23	Feb-24F	Feb-25F	Feb-26F
	Total cash and equivalents	443	503	650	809	948
	Tangible fixed assets	585	646	687	720	748
	Total assets	1,474	1,760	1,995	2,261	2,501
	Short-term debt	214	188	100	100	50
	Total long-term debt	33	50	15	15	15
	Total liabilities	662	735	692	767	792
	Total equity	812	1,025	1,303	1,493	1,709
	Total liabilities & equity	1,474	1,760	1,995	2,261	2,501
	Key metrics	Feb-22	Feb-23	Feb-24F	Feb-25F	Feb-26F
	Revenue growth (%)	18.3	28.8	15.5	13.4	12.4
	Recurrent EPS growth (%)	15.8	26.2	10.1	14.7	13.2
	Gross margin (%)	81.4	81.4	81.2	80.8	80.6
	Operating EBITDA margin (%)	26.1	26.1	26.8	26.8	27.0
	Net profit margin (%)	19.5	17.2	17.9	18.2	18.3
	Dividend payout ratio (%)	28.8	21.8	50.0	50.0	50.0
	Capex/sales (%)	15.2	5.7	4.9	4.3	3.8
	Interest cover (x)	139	78	62	108	155

Source: Company data, RHB

Beyond Just Direct Selling

We attended a trip to China, hosted by DXN's management. There, we visited its manufacturing plants and cultivation facilities in Ningxia. The trip was attended by a dozen sell-side analysts and buy-side investors, and we were brought around by the local management team and accompanied by DXN's independent director and private equity shareholders.

With an ambition to expand its direct selling business into the gigantic China market, DXN established a branch and production base here in 2015. Thereafter, the company installed production lines and converted the plants accordingly to be in compliance with F&B standards in 2017. Subsequently, the spirulina farms and cultivation facilities were set up on a site near its manufacturing plants.

Boxes to tick for a direct selling license in China. According to Article 7 of the Direct Selling Regulations promulgated by the Ministry of Commerce for applying to become a direct selling company, the following conditions to be met are detailed as below:

As manufacturer of direct selling products (6 categories) in Cosmetics, Cleaning supplies, Food Supplement, Health equipment and instrument, Kitchen utensils, Household appliances. The manufacturer should obtain licensing issued by the local authorities for eg. the food supplement manufacturer should secure the "food supplement registration certificate" issued by the food and drug supervision department.

- i. The company has a good business reputation and has no major illegal business records for five consecutive years before the application is filed;
- ii. Foreign investors should also have more than three years of experience in direct marketing abroad;
- iii. The company's paid-up registered capital is not less than CNY80m;
- iv. Full deposit paid in the designated bank;
- v. The information reporting and disclosure system is established in accordance with regulations.

Other rationale behind the China move. Apart from the capacity expansion to cater to growing demand, the strategy to extend the manufacturing footprint into China gives DXN the access to cheap raw material sources (apple, cherry, goji, etc) and higher cultivation yields, thanks to the weather. Additionally, the local government is highly accommodative – by offering tax rebates, subsidies and incentives (a total of c.MYR18m received by DXN since 2016), on top of the supporting infrastructure. With Ningxia being regarded as a strategic location by Beijing for the Belt and Road initiative, more efficiency gains are expected to be derived as DXN continues to invest and strengthen its presence.

Figure 1: DXN's manufacturing plants in Ningxia, China



Source: Company data

Figure 2: Front view of DXN's manufacturing plant in Ningxia, China



Source: RHB

Figure 3: Energy centre of the plant



Source: RHB

Figure 4: CEO Teoh Hang Ching giving welcome remarks



Source: RHB

Figure 5: Packaging lines of RTD products



Source: RHB

Figure 6: Noodle production line – dough pressing and forming



Source: Company data

Figure 7: Noodle production line – cutting and sorting



Source: Company data

Figure 8: DXN's farms and cultivation facilities in Ningxia, China



Source: Company data

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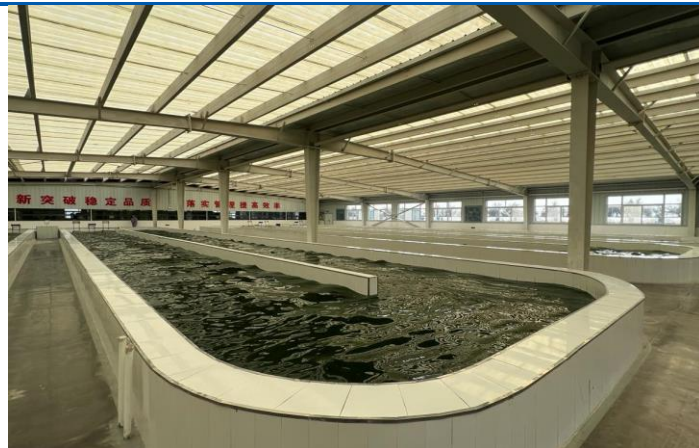
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Figure 9: DXN's spirulina farms



Source: RHB

Figure 10: DXN's spirulina cultivation facilities



Source: RHB

Figure 11: Mycelium inoculation room



Source: DXN

Figure 12: Mycelium cultivation room



Source: DXN

Currently, the plants are manufacturing products under multiple series:

- i. Coffee,
- ii. Oocha,
- iii. Matcha,
- iv. Spirulina,
- v. Instant noodles,
- vi. Fermented products.

The company has plans to further extend its product offerings by rolling out convenient RTE products in the future.

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Figure 13: Product portfolio – Ningxia plants



Source: Company data

Figure 14: DXN's lion's mane RTD coffee series



Source: Company data

Figure 15: DXN's lion's mane coffee



Source: Company data

Figure 16: DXN's apple enzyme drink



Source: Company data

Figure 17: DXN's spirulide product



Source: Company data

Figure 18: DXN spirulina tablets



Source: Company data

We visited the DXN One-Stop Centre, which serves as a hub for business receptions, product showcases and purchasing. We had an interactive engagement session, of which the key takeaways are as below:

- From management's perspective, CEO Teoh Hang Ching expressed his optimism on the growth prospects of the company, underpinned by robust sales in key existing markets and its imminent entry into major new markets like Brazil and Argentina. Having only been listed for six months, management is proactively seeking constructive feedback and suggestions from various stakeholders for the betterment of company, to deliver better value;

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- ii. Senior independent non-executive director Datuk Noripah Kamso shared the focus of the board of directors, in upholding the high level of corporate governance and ESG. She also revealed the founder's intention to institutionalise the company. The investors' feedback and suggestions will be conveyed accordingly and discussed amongst the board members.
- iii. Private equity shareholder KV Asia (c.13% stake in DXN) is happy with the progress made so far post-listing, in terms of earnings delivery and execution of expansion plans. The fund is not in a hurry to exit DXN, notwithstanding the lapse of the share moratorium on 19 Nov – as it believes the stock is currently undervalued.
- iv. Similarly, public equity shareholders are comfortable with the earnings delivery so far, and believe the expansion plans in the pipeline will be able to sustain its earnings growth going forward.
- v. Sell-side analysts shared the feedback when pitching the DXN idea to clients. Essentially, the two biggest pushbacks are: i) The negative stigma or mental block associated with the direct selling business; ii) The wariness or concerns on potential volatility of and inherent risks associated with the frontier markets DXN is in – these markets account for the bulk of its sales.

Figure 19: DXN's 1-stop centre



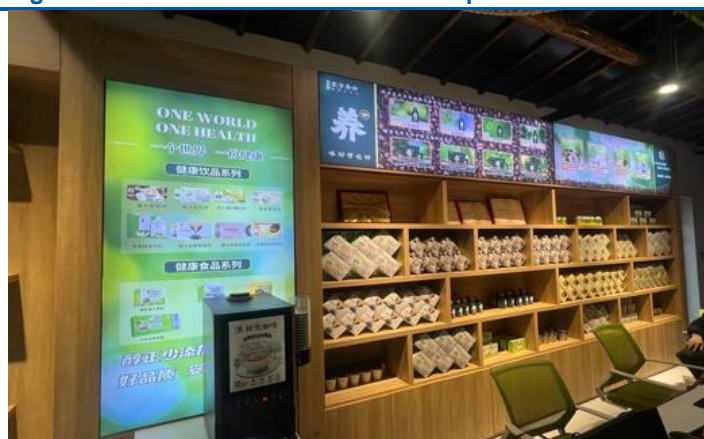
Source: RHB

Figure 20: Products showcased at the 1-stop centre



Source: RHB

Figure 21: Products stocked at the 1-stop centre



Source: RHB

Figure 22: Engagement session with the DXN team



Source: RHB

Emissions And ESG

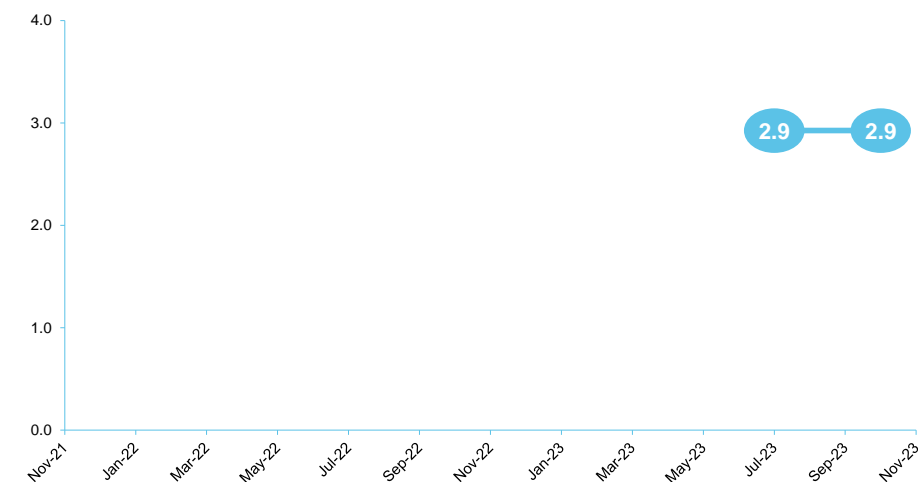
Trend analysis	Emissions (tCO2e)	Feb-21	Feb-22	Feb-23
N/A	Scope 1	na	na	2,755
	Scope 2	na	na	na
	Scope 3	na	na	na
	Total emissions	na	na	2,755

Source: Company data, RHB

Latest ESG-Related Developments

- Formulated sustainability policies to provide an underlying structure for its internal control and support governance.
- Integrated ESG practices into its product manufacturing and distribution processes by implementing a comprehensive quality control process at every stage of production.
- In FY23, DXN made various sponsorships and donations amounting to >RM5m as part of its efforts to contribute to the betterment of society.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-10-31	Buy	0.93	0.67

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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KUALA LUMPUR

RHB Investment Bank Bhd
Level 3A, Tower One, RHB Centre
Jalan Tun Razak
Kuala Lumpur 50400
Malaysia
Tel : +603 9280 8888
Fax : +603 9200 2216

JAKARTA

PT RHB Sekuritas Indonesia
Revenue Tower, 11th Floor, District 8 - SCBD
Jl. Jendral Sudirman Kav 52-53
Jakarta 12190
Indonesia
Tel : +6221 509 39 888
Fax : +6221 509 39 777

BANGKOK

RHB Securities (Thailand) PCL
10th Floor, Sathorn Square Office Tower
98, North Sathorn Road, Silom
Bangrak, Bangkok 10500
Thailand
Tel: +66 2088 9999
Fax :+66 2088 9799

SINGAPORE

RHB Bank Berhad (Singapore branch)
90 Cecil Street
#04-00 RHB Bank Building
Singapore 069531
Fax: +65 6509 0470