

DXN Holdings (DXN MK)

Visiting DXN China

BUY maintained, TP unchanged at MYR0.90

We came away from our recent visit to DXN's Ningxia, China manufacturing facility feeling positive. This is premised on the group's clear strategies in pursuing new markets in China for longer-term growth, strong product innovation for export markets and use of automation in its production lines to minimise cross contamination and its reliance on labour. Our earnings estimates, BUY call and TP of MYR0.90 (on 11x FY24E PER) are unchanged.

DXN's manufacturing facility in Ningxia, China

DXN hosted a group of analysts and fund managers at their manufacturing facility in Ningxia, China on 13 Nov 2023. We were hosted by Mr Teo Hang Ching (CEO of DXN Holdings), Ms Teo Pei Shin (Executive Director of DXN Ningxia), and Ms Pong Vui Mei (Operations Director of DXN Ningxia). The facility spans across 167 acres of land with a total of 4 factories, housing production lines for spirulina tablets, solid beverages (powdered coffee/tea products), edible fungi mycelium powder, noodles, RTD coffee, tea, and sparkling juice products.

Working on its direct selling license in China

The group has strategically positioned itself in China as an export hub given China's proximity to key markets in Europe and the Middle East. DXN also hopes to obtain its direct selling license in China which will open up significant growth opportunities in an estimated CNY100b direct selling market, according to Euromonitor market research data. Until then, DXN is working on building its brand presence in the country through 4 recently launched (Aug 2023) RTD coffee products, which will be sold through retail supermarket/convenience store outlets in China.

Key growth areas remain in Latin America for now

In the near-term, DXN's earnings growth will largely stem from its increasing members and sales per member in its high growth markets in Latin America and planned entry into the African region in 2024. The direct selling industry in China is potentially a large market for DXN but we do not expect the group to obtain its direct selling license until 2026 at the earliest due to lengthy Government application processes.

FYE Feb (MYR m)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	1,243	1,601	1,947	2,282	2,416
EBITDA	401	496	603	695	734
Core net profit	237	306	342	401	426
Core EPS (sen)	4.9	6.3	7.1	8.3	8.8
Core EPS growth (%)	25.2	29.2	11.6	17.3	6.3
Net DPS (sen)	2.5	1.5	3.5	4.2	4.4
Core P/E (x)	na	na	9.4	8.0	7.5
P/BV (x)	na	na	2.6	2.2	1.9
Net dividend yield (%)	na	na	5.3	6.2	6.6
ROAE (%)	36.2	32.0	30.9	29.8	27.4
ROAA (%)	17.0	18.9	17.4	17.3	16.4
EV/EBITDA (x)	7.8	6.2	4.7	3.8	3.3
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	337	388	431
MIBG vs. Consensus (%)	-	-	1.5	3.4	(1.0)

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BUY

Share Price	MYR 0.67
12m Price Target	MYR 0.90 (+39%)
Previous Price Target	MYR 0.90

Company Description

DXN Holdings distributes consumer products globally under a direct selling model

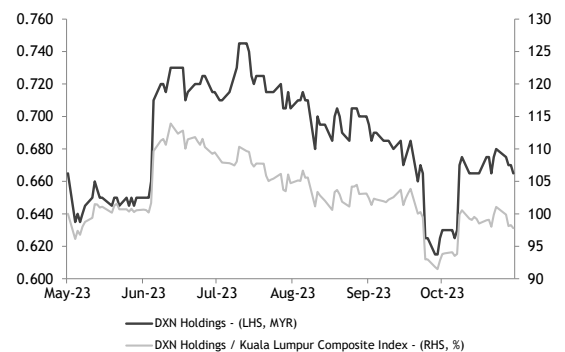
Statistics

52w high/low (MYR)	na/na
3m avg turnover (USDm)	0.4
Free float (%)	16.0
Issued shares (m)	4,825
Market capitalisation	MYR3.2B USD686M

Major shareholders:

LSJ Global Sdn Bhd	68.0%
Gano Global	13.3%

Price Performance



	-1M	-3M	-12M
Absolute (%)	8	(7)	na
Relative to index (%)	7	(8)	na

Source: FactSet

Abbreviation

RTD = ready to drink

Risk Rating & Score ¹	NA
Score Momentum ²	NA
Last Updated	NA
Controversy Score ³	NA

Business Model & Industry Issues

- ESG risks for fully-integrated direct marketing companies like DXN revolve around product health & safety, energy consumption, and safe disposal of wastes.
- In this regard, DXN has developed a comprehensive sustainability policy, outlining short-term ESG targets and action plans to fulfil them in order to improve group ESG compliance.
- With majority of DXN's sales coming from food consumables, it is paramount that product consumer confidence is upheld with stringent quality control throughout its production process to avoid any negative health & safety issues.
- DXN's ESG strategy is comparable to its peers, and the industry as a whole has moderate ESG exposure, in our view.

Material E issues

- DXN is actively incorporating the recommendations of the Task Force on Climate-related Financial Disclosures into its sustainability policy.
- Majority of its Scope 1 GHG emissions come from its manufacturing process (93% of Scope 1 GHG emissions in 2022), particularly during the drying stage of its natural ingredients (i.e. Ganoderma).
- Invested MYR4.2m in the installation of a solar panel system in 2021 to decrease its reliance on non-renewable energy sources.
- Actively seeking opportunities to reduce wastes throughout its production process by improving its storage, waste segregation methods, and recyclable materials.

Material S issues

- In FY23, DXN employed a total of 2,822 employees with a 50:50 male to female ratio.
- A comprehensive quality control process is implemented throughout all its stages of production, spanning across the cultivation of raw materials, receipt of materials from suppliers to the final production stages.
- DXN holds various domestic and foreign certifications for its goods manufacturing practices, quality management systems and environmental management systems.
- Random product sampling is conducted for its materials, packaging and labels to ensure that internal product quality standards are met.
- No cases of non-compliance have occurred in FY23 resulting in death, illness, or adverse health effects, due to the consumption of DXN products.

Key G metrics and issues

- DXN's board of directors (BOD) comprises of 9 members - 5 independent non-executive directors, 4 non-independent executive directors, including the chairman and CEO.
- Independent directors make up 56% of its BOD which is consistent with recommended Malaysian Code of Corporate Governance (MCCG) practise of at least 50% share of independent members.
- The BOD male:female ratio was 67:33 in 2023, meeting the recommended MCCG practise of at least 30% women directors for large companies.
- The chairman and CEO positions are held by separate individuals.
- Annual shareholder's approval is required for independent directors serving beyond 9 years. At present, there are no independent directors who have served beyond 9 years.
- The CEO's remuneration package amounted to MYR0.8m (0.2% of DXN's FY23 pre-tax profit) while the BOD's total remuneration package equalled MYR4.3m (0.9% of DXN's FY23 pre-tax profit).
- The group does not disclose detailed remuneration of each member of senior management due to confidentiality purposes.
- DXN has been audited by KPMG PLT since its public listing in 2023.
- The group's recurring related party transactions mainly involves the purchase and sales of raw materials, trading goods, rental of properties, travel expenses and purchases of PPE.

¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

DXN's manufacturing plant in Ningxia

We visited DXN's manufacturing facility in Ningxia, China on 13 Nov 2023. Taking us through the project site was Mr Teo Hang Ching, CEO of DXN Holdings, Ms Teo Pei Shin, Executive Director of DXN Ningxia and Ms Pong Vui Mei, Operations Director of DXN Ningxia.

To recap:

- DXN established its business in Ningxia, China back in Dec 2015 by invitation of the foreign capital investment arm of the People's Government of Dawukou District. Since then, DXN has built an integrated manufacturing plant on c.167 acres of land, which includes farming, research & development, and production operations of various natural ingredients and ready-to-eat (RTE) F&B products for both domestic Chinese market and export sales.
- DXN's Ningxia manufacturing facility houses four factories: 1) solid beverage production line (eg. powder for 3-in-1 products), spirulina tablet production line, 2) enzyme and fermented jam production line, 3) noodle production line, goji and jujube repacking line, and 4) its newly built ready-to-drink (RTD) liquid beverage production line for bottled coffee, tea and sparkling juices.
- The group also set up its own spirulina farm in Ningxia, accounting for the largest spirulina production within the DXN Group, putting the natural ingredients' cultivation, processing, and end-packaging activities under one roof. DXN Ningxia also completed the construction of its mycelium factory in 2021 which are used to produce mycelium powder products.

Fig 1: China Ningxia location map



<https://www.mapsof.net>

Fig 2: DXN's Ningxia manufacturing facility

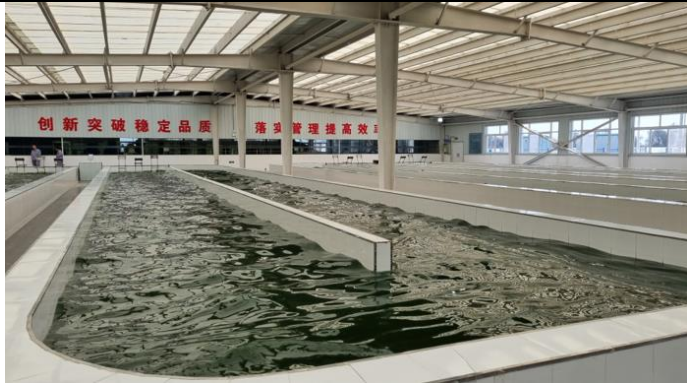


Source: Maybank IBG Research

Main production capabilities:

- **Spirulina cultivation and processing.** DXN's Ningxia spirulina production is the largest within the DXN group. It has both indoor and outdoor spirulina farms for cultivation, harvesting and final processing into finished goods. DXN has continuously increase the number of cultivation ponds over the years, driving its annual output of spirulina powder up to 150 tons from just 52 tons in 2020. Majority of its annual spirulina powder output is exported to DXN's oversea factories (59%) as raw materials while 29% of its supply is used in China for its finished goods and the remaining 12% as buffer stock.

Fig 3: Indoor spirulina ponds



Source: Maybank IBG Research

Fig 4: Outdoor spirulina cultivation ponds



Source: Maybank IBG Research

Fig 5: Outdoor spirulina cultivation ponds



Source: Maybank IBG Research

- Edible fungi mycelium cultivation and processing.** DXN’s mycelium factory is split into its inoculation, cultivation and processing operations and can produce numerous edible fungi mycelium at multiplied rates for further cultivation (eg. for lion’s mane, cordyceps etc.). DXN’s inoculation operations are fully automated which ensures zero contamination and it has 12 cultivation rooms that are temperature and humidity controlled. At present, its utilisation rate is 9% but is expected to grow alongside the penetration of F&B RTD products in China and increasing export demand.

Fig 6: Edible fungi mycelium inoculation room



Source: Maybank IBG Research

Fig 7: Edible fungi mycelium cultivation room



Source: Maybank IBG Research

- **Solid beverage, spirulina tablet, noodle and RTD production.** DXN's production of solid beverage mainly involves the mixing and filling process of powdered ingredients. The production line was running at a utilisation rate of 46% in FY23 (vs. 34% in FY22). The group's spirulina tablet production line is estimated to run at a higher utilisation rate of 62% in FY24E as product registration in oversea markets are approved. Its spirulina tablets have been successfully registered in 5 out of 13 countries thus far.

DXN also produces instant noodles at its Ningxia manufacturing facility (est. FY24E utilisation rate 88%) such as *Spirulina Buckwheat Noodle* and *DXN Oocha Noodle* (Fig. 8 & 9). Lastly, DXN's new liquid beverage factory produces its RTD series of coffee, sparkling juice, and tea products which the group estimates to run at a utilisation rate of 35% in FY25E in tandem with its introduction within China and other export markets.

Fig 8: DXN's spirulina noodle "Spirudle"



Source: Company

Fig. 9: DXN Oocha Noodle



Source: Company

Key takeaways from our visit:

- **To apply for direct selling license in China as soon as possible.** One of the stipulated conditions for companies to apply for a direct selling license in China is for the business to possess three years of trading sales records. DXN is already in its third year. That said, we understand that the Government has halted the approval of new direct selling licenses since the onset of the COVID-19 pandemic, and it is unclear when the application process will be reopened. At the earliest, we believe DXN will only be able to obtain its direct selling license in China sometime in 2026, considering that further Government product registration and testing will be required before the license is formally approved.
- **Building DXN's brand in China through retail sales.** As a workaround to China's restrictions in direct selling, DXN has started selling its newly launched RTD coffee products in retail stores (supermarkets, convenience stores) priced at CNY12/bottle. Four SKUs under its Lion's Mane coffee series coined, "Yang Series" (Fig. 10) has been rolled-out to retailers sometime in Aug 2023, with plans to launch its tea and fermented sparkling juice series in the near term. The group plans to target consumers in second tier cities including Chengdu, Xian, and Hangzhou instead of first tier cities (Beijing & Shanghai) due to lesser competition and exposure to coffee products.

Fig 10: Newly launched “Yang series” RTD coffee products



Source: Company

Fig 11: RTD tea series to be launched



Source: Company

Fig 12: RTD fermented sparkling juices to be launched



Source: Company

- **Leveraging on China’s strategic location as an export hub and conducive conditions for spirulina production.** With the variety of products (29 SKUs) being produced out of its Ningxia manufacturing facility, it is a prime location as an export hub to support growing product demand in Europe and the Middle East under the *One Belt One Road* initiative. DXN’s top 3 export markets from China are Bolivia, Mongolia and the Philippines for its Lion’s Mane coffee, Ocha Noodle and Spirudle Noodle.

DXN’s Ningxia spirulina farm is the largest farm within the DXN group as Ningxia’s weather conditions are more conducive for spirulina cultivation, reducing cultivation time by more than half (every 3 days) as compared to spirulina farms in Malaysia (every 7 days). In regards to DXN’s new RTD products for fermented sparkling juices, its core ingredients (apple and cherry) are also able to be sourced cheaper in China given the proximity of the local fruit farms to DXN’s Ningxia facility.

- **Ongoing support from the local state Government in China.** DXN has received long term support from the local Chinese State Government since 2016, in the form of grants, subsidies and tax incentives in all stages of its R&D and production, and export operations. Notably, DXN has received 100% tax rebates for exports relating to its finished goods produced out of China amounting to c.CNY8m, since 2016. The group also received cumulative tax refunds (2016-2023) of CNY11.9m for capital investments including the construction project of its liquid beverage and mycelium factory in 2021. DXN has also received grants for capital investments from foreign enterprises and key industrial and innovative enterprises along with incentives for its R&D, and agricultural related projects.

Our views

Foundation for longer term growth. We believe that DXN is laying its foundation for continuous growth with the group's intention to obtain a direct selling license in China. Although DXN's group earnings growth will largely depend on its Latin American (Peru & Bolivia) and African presence in the medium term, its potential foray into the direct selling industry in China will open the doors for further growth opportunities in an estimated CNY100b direct selling sales market, based on Euromonitor's 2022 market research data.

In the meantime, DXN hopes to move up the value chain with its newly developed RTD coffee, tea and sparkling juice product ranges aimed at their sales potential in both Peru and Bolivia despite their higher price points. As RTD products are conventionally targeted towards out-of-home consumption, this portrays a move away from DXN's traditional product offering that offers lower price point items for in-home consumption (eg. 3-in-1 coffee/tea products). Separately, we understand that its RTD range is being sold through retail distributors (supermarkets, convenience stores) in China, a first for DXN, to circumvent its lack of a direct selling license in China. Product margins through retail channels will be lower than its direct selling model, but this sales method will allow DXN to kickstart its brand building strategies and gradually grow brand equity in a country that it is relatively unknown in.

Domestic peer valuation

Fig 13: Malaysia direct selling sector peer comparison

Stock	Shr px	Mkt cap	PER (x)		P/B (x)		EV/ EBITDA (x)		ROAE (%)		Div Yld (%)
	(Local)	(MYRm)	CY24E	CY25E	CY24E	CY25E	CY24E	CY25E	CY24E	CY25E	CY24E
Amway Malaysia	5.58	914.0	9.0	8.5	n.a.	n.a.	4.2	4.0	35.7	36.8	8.4
Beshom Holdings	1.00	300.1	19.5	18.6	1.2	1.2	6.2	7.3	4.8	5.0	3.7
Simple avg			14.3	13.6	1.2	1.2	5.2	5.7	20.3	20.9	6.1

*As at 17 Nov 2023 closing prices

Source: Bloomberg, Maybank IBG Research

Risk statement

There are several risk factors for our earnings estimates, price target, and rating for DXN Holdings. High concentration of sales in Latin America poses a risk to earnings if any country-specific risks arise. Additionally, sharp depreciation in USD/EUR against MYR will also affect its earnings as >90% of sales are denominated in foreign currency.

FYE 28 Feb	FY22A	FY23A	FY24E	FY25E	FY26E
Key Metrics					
P/E (reported) (x)	na	na	9.4	8.0	7.5
Core P/E (x)	na	na	9.4	8.0	7.5
P/BV (x)	na	na	2.6	2.2	1.9
P/NTA (x)	na	na	2.6	2.2	1.9
Net dividend yield (%)	na	na	5.3	6.2	6.6
FCF yield (%)	na	na	10.7	12.4	13.3
EV/EBITDA (x)	7.8	6.2	4.7	3.8	3.3
EV/EBIT (x)	8.6	6.7	5.0	4.1	3.6

INCOME STATEMENT (MYR m)

Revenue	1,242.9	1,600.8	1,946.8	2,282.0	2,416.3
EBITDA	401.4	496.4	603.2	694.5	733.6
Depreciation	(38.5)	(38.5)	(42.0)	(42.9)	(43.8)
Amortisation	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
EBIT	362.8	457.8	561.0	651.4	689.7
Net interest income / (exp)	0.1	(2.0)	(1.3)	1.3	3.1
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	6.2	(30.3)	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	362.9	455.8	559.7	652.8	692.8
Income tax	(117.5)	(166.2)	(204.2)	(238.2)	(252.8)
Minorities	(2.5)	(13.9)	(13.9)	(13.9)	(13.9)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	242.9	275.7	341.6	400.7	426.1
Core net profit	236.8	306.0	341.6	400.7	426.1
Preferred Dividends	0.0	0.3	0.0	0.0	0.0

BALANCE SHEET (MYR m)

Cash & Short Term Investments	409.6	459.0	734.1	924.3	1,132.6
Accounts receivable	77.5	114.4	139.1	163.1	172.7
Inventory	217.2	323.1	413.2	485.2	514.0
Property, Plant & Equip (net)	584.9	646.5	663.9	680.4	696.2
Intangible assets	0.1	0.1	0.1	0.1	0.1
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	184.3	216.8	216.8	216.8	216.8
Total assets	1,473.6	1,759.9	2,167.3	2,469.9	2,732.3
ST interest bearing debt	213.6	187.9	187.9	187.9	187.9
Accounts payable	337.0	396.8	507.4	595.8	631.2
LT interest bearing debt	32.6	49.7	49.7	49.7	49.7
Other liabilities	79.0	100.0	100.0	100.0	100.0
Total Liabilities	662.0	734.8	845.4	933.8	969.2
Shareholders Equity	760.7	963.1	1,245.9	1,446.2	1,659.3
Minority Interest	50.9	62.1	76.0	89.9	103.8
Total shareholder equity	811.6	1,025.1	1,321.9	1,536.1	1,763.1
Total liabilities and equity	1,473.6	1,759.9	2,167.3	2,469.9	2,732.3

CASH FLOW (MYR m)

Pretax profit	362.9	455.8	559.7	652.8	692.8
Depreciation & amortisation	38.6	38.6	42.2	43.1	43.9
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	(32.4)	(72.9)	(4.2)	(7.5)	(3.0)
Cash taxes paid	(112.1)	(183.8)	(204.2)	(238.2)	(252.8)
Other operating cash flow	3.4	7.9	0.0	0.0	0.0
Cash flow from operations	260.0	247.1	394.8	448.8	477.8
Capex	(187.9)	(88.2)	(50.0)	(50.0)	(50.0)
Free cash flow	72.1	158.9	344.8	398.8	427.8
Dividends paid	(122.7)	(70.0)	(170.8)	(200.3)	(213.1)
Equity raised / (purchased)	0.0	0.0	112.0	0.0	0.0
Change in Debt	(13.9)	(14.5)	0.0	0.0	0.0
Other invest/financing cash flow	147.3	(24.9)	(10.9)	(8.3)	(6.5)
Effect of exch rate changes	0.8	(0.3)	0.0	0.0	0.0
Net cash flow	83.7	49.2	275.1	190.2	208.3

FYE 28 Feb	FY22A	FY23A	FY24E	FY25E	FY26E
Key Ratios					
Growth ratios (%)					
Revenue growth	18.3	28.8	21.6	17.2	5.9
EBITDA growth	27.9	23.7	21.5	15.1	5.6
EBIT growth	28.3	26.2	22.5	16.1	5.9
Pretax growth	26.3	25.6	22.8	16.6	6.1
Reported net profit growth	26.8	13.5	23.9	17.3	6.3
Core net profit growth	25.2	29.2	11.6	17.3	6.3
Profitability ratios (%)					
EBITDA margin	32.3	31.0	31.0	30.4	30.4
EBIT margin	29.2	28.6	28.8	28.5	28.5
Pretax profit margin	29.2	28.5	28.8	28.6	28.7
Payout ratio	50.5	25.4	50.0	50.0	50.0
DuPont analysis					
Net profit margin (%)	19.5	17.2	17.5	17.6	17.6
Revenue/Assets (x)	0.8	0.9	0.9	0.9	0.9
Assets/Equity (x)	1.9	1.8	1.7	1.7	1.6
ROAE (%)	36.2	32.0	30.9	29.8	27.4
ROAA (%)	17.0	18.9	17.4	17.3	16.4
Liquidity & Efficiency					
Cash conversion cycle	(234.1)	(95.4)	(55.9)	(58.6)	(61.6)
Days receivable outstanding	24.7	21.6	23.4	23.8	25.0
Days inventory outstanding	298.4	326.7	348.1	361.7	379.7
Days payables outstanding	557.2	443.6	427.5	444.2	466.3
Dividend cover (x)	2.0	3.9	2.0	2.0	2.0
Current ratio (x)	1.3	1.5	1.8	1.9	2.1
Leverage & Expense Analysis					
Asset/Liability (x)	2.2	2.4	2.6	2.6	2.8
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	na	nm	nm	na	na
Debt/EBITDA (x)	0.6	0.5	0.4	0.3	0.3
Capex/revenue (%)	15.1	5.5	2.6	2.2	2.1
Net debt/ (net cash)	(163.4)	(221.5)	(496.6)	(686.8)	(895.0)

Source: Company; Maybank IBG Research

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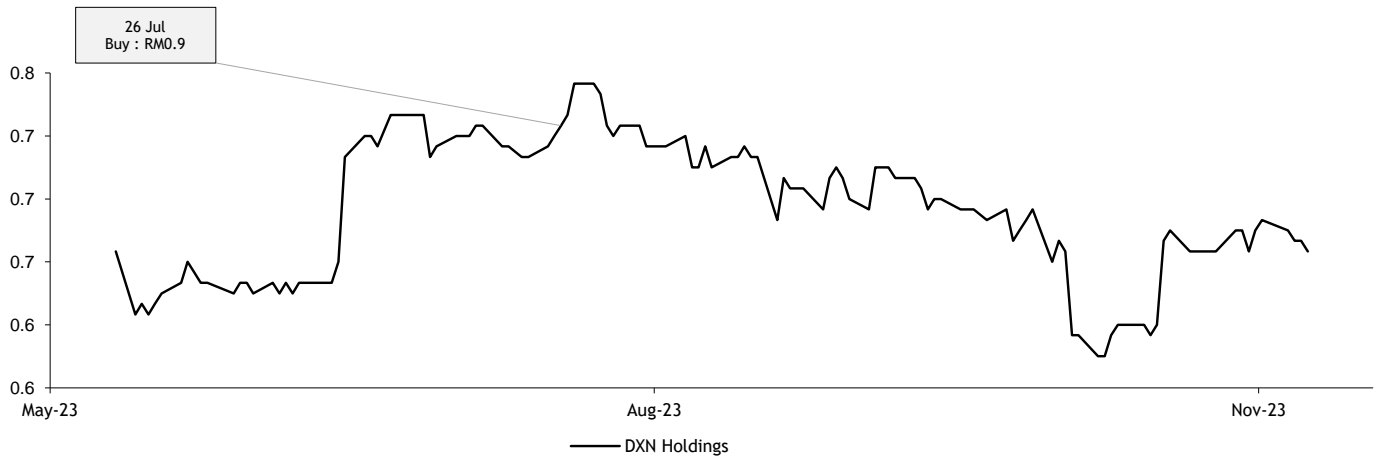
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