

Nova Wellness Group

Invest in Health

By Raymond Choo Ping Khoon | pkchoo@kenanga.com.my

ACE Market bound, Nova Wellness Group Berhad (NOVA) will be raising RM44.9m with a market capitalisation of RM174.8m. The proceeds arising from the IPO is mainly for setting up a new GMP-compliant production facility, which could see a quantum leap in earnings progressively over the next five years. We like Nova Wellness for: (i) superior margins, which are head and shoulders above its peers, and (ii) new capacity expansion to boost earnings. Our indicative TP is RM0.600 based on 15x FY19E EPS, 30% premium to closest peer due to its superior profit margins.

A home grown nutraceutical player. Over the years, the group has evolved from purely trading in animal health products into a research, production and sales of nutraceutical and skincare products. Standing testimony to their success, Nova Wellness has successfully developed and produced a number of nutraceutical products under its house brands. Presently, the group has developed 144 product formulations with 88 products sold under five different various house brands, namely 'Nova', 'ActivMax', 'Sustinex', 'Novavis' and 'SP8' for both the local and overseas markets.

Expansion plans to drive growth going forward. Moving ahead, the group plans a production facility next to a piece of land owned by the Group currently housing the head office and existing production facility in Sepang, Selangor. The construction of the new GMP-compliant production facility, including machineries and equipment costing RM16.5m is expected to be completed by November 2018. The construction involved two phases targeting production of functional food products and skincare products.

Quantum leap in earnings from new plant. For illustration purposes, if we extrapolate the new plant which is three times the size of the existing plant, Nova Wellness' incremental revenue is expected to rise from an average of RM25m to RM100m. Assuming a net margin of 25-30%, this translates to an aggregate net profit of RM25-30m implying a PER of 5.9x-7.1x at IPO price of 55.0 sen. Note that the current plant has a built-up area of 4,496 sq. m compared to the new one with a built-up area of 15,661.69 sq m. The plant is only expected to gradually ramp up over the next 3-5years.

Earnings forecast. In line with the industry sector growth rate of 11%, we forecast 11% and 19% revenue growth for FY18 and FY19, respectively. We have factored in lower margins taking into account the start-up cost incurred in construction of new GMP-compliant production facility, higher depreciation costs with the new machineries and time taken to commence operations in the new production facility and the expiration of tax exemption in FY17. Hence, we are forecasting Nova Wellness to register a net profit of RM10.3m and RM12.7m in FY18E and FY19E, respectively.

Indicative Target price of RM0.600. We value Nova Wellness at RM0.600 based on 15x FY19E EPS. We believe the stock could command a higher PER of 15x, which is at a 30% premium over closest listed peer Bioalpha Holdings Berhad 1-year Forward PER of 11x due to Nova Wellness' superior pre-tax margin averaging 48-50% compared to Bioalpha (FY17 pre-tax margin : 17.3%). The other peer, Kotra Industries Berhad is trading at 20x 1- year historical PER.

Risks to our forecasts include: (i) slower-than-expected ramp-up in the new plant, and (ii) lower-than-expected margins.

Not Rated

IPO Price : RM0.550
Target Price : RM0.600

Share Price Performance

KLCI	1,690.65
YTD KLCI chg	-5.9%
YTD stock price chg	N.A.

Major Shareholders

Tan Sook Mooi	42.50%
Phang Nyie Lin	7.95%

IPO proceeds (RM'm)

CAPEX	16.5
R&D activities	11.6
Working cap	9.2
Expansion of retail market presence	5.0
Estimated Listing expenses	2.6
Total	44.9

Summary of IPO

Enlarged Share Cap (m)	317.7
IPO Price (RM)	0.550
Market Cap Upon Listing (RM'm)	174.8

Summary Earnings Table

FY Jun (RM'm)	2017A	2018E	2019E
Turnover	24.5	27.2	32.5
EBITDA	14.0	13.8	18.1
PBT	13.6	12.9	15.8
Net Profit (NP)	13.7	10.3	12.7
Core NP	13.7	10.3	12.7
Consensus (CNP)	n.a.	n.a.	n.a.
Earnings Revision	n.a.	n.a.	n.a.
Core EPS (sen)	4.3	3.3	4.0
Core EPS growth (%)	1.3	(24.6)	22.6
NDPS (sen)	-	1.0	1.2
BV/Share (RM)	0.06	0.11	0.21
Core PER (x)	12.7	16.9	13.8
Price/BV (x)	9.0	5.0	2.6
Net Div. Yield (%)	-	1.8	2.2

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BACKGROUND & BUSINESSES

Evolving from trading in animal health products into nutraceuticals. ACE Market bound Nova Wellness was founded in 1989 to initially undertake the trading of animal health products with co-founder, Promoter, Managing Director and Chief Research Officer, Phang Nyie Lin. Over the years, the group evolved from purely trading in animal health products into a research, production and sales of nutraceutical which includes health supplements, functional food products and skincare products. In 1997, the group commence a small-scale R&D on *Phyllanthus niruri* (a species of herb that has been traditionally used for the treatment of liver diseases). In 2000, the group developed Hepar-P Capsule as a liver tonic and in 2002, and were granted approval for the marketing and sales of Hepar-P Capsule in Malaysia. Fast-forward to 2004, the group set up a Good Manufacturing Practice (GMP)-compliant production facility with R&D facilities in Sepang, Selangor and commence production of dietary supplements and animal health products.

A home-grown nutraceutical player. Standing testimony to their success, Nova Wellness has successfully developed and produced a number of nutraceutical products under its house brands. Presently, the group has developed 144 product formulations with 88 products sold under five different various house brands, namely 'Nova', 'ActivMax', 'Sustinex', 'Novavis' and 'SP8' in both the local and overseas markets. They have received Halal certification from JAKIM for 37 of House Brand products (in-house brands). Under the OEM segment, the group has developed 88 product formulations with 74 products manufactured for OEM customers under brands such as 'Powerlife', 'Eastern', 'ActiveLife', 'HSC', 'Nexus', 'COCO.LAB', and 'BELVEA'. Presently, the group has a wide range of products comprising 49 dietary supplements (18 are herbal products and 31 are health supplements), 11 functional food products and 28 skincare products that are all available for sale under in-house brands in both the local and overseas markets. All dietary supplements are approved with MAL registration numbers by the DCA.

Specifically, the group is in the nutraceutical industry chiefly involved in:

- (i) research and development, production and sales of nutraceutical and skincare products under House Brands; and
- (ii) OEM development and production of nutraceutical products.

Nutraceuticals are products derived from food sources that provide health benefits in addition to basic nutritional value. Examples of nutraceuticals include dietary supplements, herbal supplements and functional food. Dietary supplements include vitamin, mineral and herbal supplements, which are sold under the 'Nova' House Brand whereas functional food products are developed with vitamins and other nutrients, and formulated to have low glycemic index and balanced nutrients to fulfil consumers' daily nutritional needs and management of sugar level. The functional food products are sold under two House Brand namely 'ActivMax' and 'Sustinex'. Meanwhile, skincare products are mainly developed using natural ingredients from plants, which are suitable for those who seek natural skin care solutions.

Key Milestones Achieved

Year	Key Achievements, Milestones and Awards
2006	Awarded the 'BioNexus Status' by Malaysian Bioeconomy Development
2007	Granted patent for herbal composition used in Hepar-P Capsule and Hepar-P Forte Caplet by MyIPO
2009	<ul style="list-style-type: none"> • Granted patent for stabilised composition used in Hepar-P Capsule and Hepar-P Forte Caplet by MyIPO • Published a book containing 15 monographs of standardised botanical extracts of Malaysian origin
2010	Launched the NWPP for independent retail pharmacies
2013	Granted patent for the standardised extract from oil palm leaves comprising phenolic acids by State Intellectual Property Office of the PRC
2015	<ul style="list-style-type: none"> • Completed first clinical trial on Hepar-P Capsule for treatment of non-alcoholic fatty liver disease • Awarded 'BioNexus Achievement Award' by Malaysian Bioeconomy Development for outstanding achievement in the bio-based industries
2016	Granted patent for the standardised extract from oil palm leaves comprising phenolic acids by MyIPO

Source: Nova Wellness Group IPO Prospectus

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Range of dietary supplements



Source: Nova Wellness Group IPO Prospectus

Range of functional food products



Source: Nova Wellness Group IPO Prospectus

Range of skincare products



Source: Nova Wellness Group IPO Prospectus

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Wide distribution network for in-house brands. In-house brand products are sold in Malaysia and the overseas market (contribute <8% of revenue). Typically, in Malaysia, house brand products are distributed via independent retail pharmacies of which 227 independent retail pharmacies in Malaysia are distributing its house brand products. 105 of the independent retail pharmacies are also the group's Nova Wellness Partner Programme (NWPP) partners.

Typically under NWPP, the selected customer is made an exclusive distributor for certain areas specified in each NWPP Agreement for specific products. NWPP partners are given exclusive distribution rights in specific areas and discounts and incentives for House Brand products via an NWPP agreement.

Local distribution network

State	No. of Independent Retail Pharmacies	NWPP Partners
Johor	36	20
Kedah	4	2
Melaka	22	9
Negeri Sembilan	7	3
Pahang	15	7
Penang	14	11
Perak	25	9
Perlis	2	-
Terengganu	3	1
Sabah	2	1
Sarawak	21	8
Selangor	50	23
Kuala Lumpur	26	11
Total	227	105

Source: Nova Wellness Group IPO Prospectus

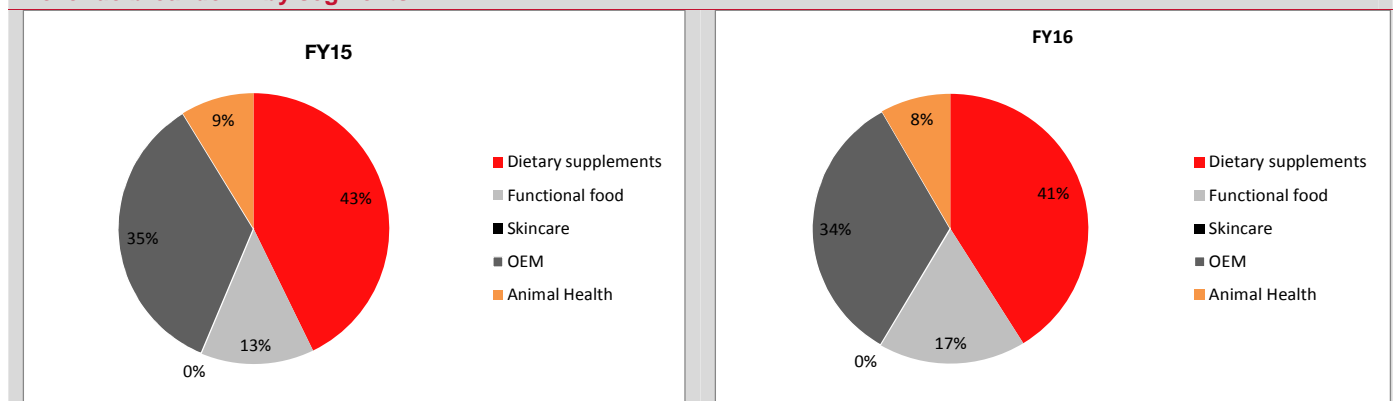
A suite of nutraceutical products. Under nutraceutical products, the group has 49 dietary supplements, 11 functional food products and 28 skincare products that are available for sale under in-house brands in both the local and overseas markets. In the OEM services, presently, Nova Wellness manufactures 72 dietary supplements, which are sold under the 'Nova' house brand and two functional food products that are sold under OEM brands. Note that OEM services for skincare products are not manufactured. The dietary supplements include vitamin, mineral and herbal, which are formulated to increase the daily intake of nutrients and provide various health benefits such as improving blood circulation and enhancing vitality.

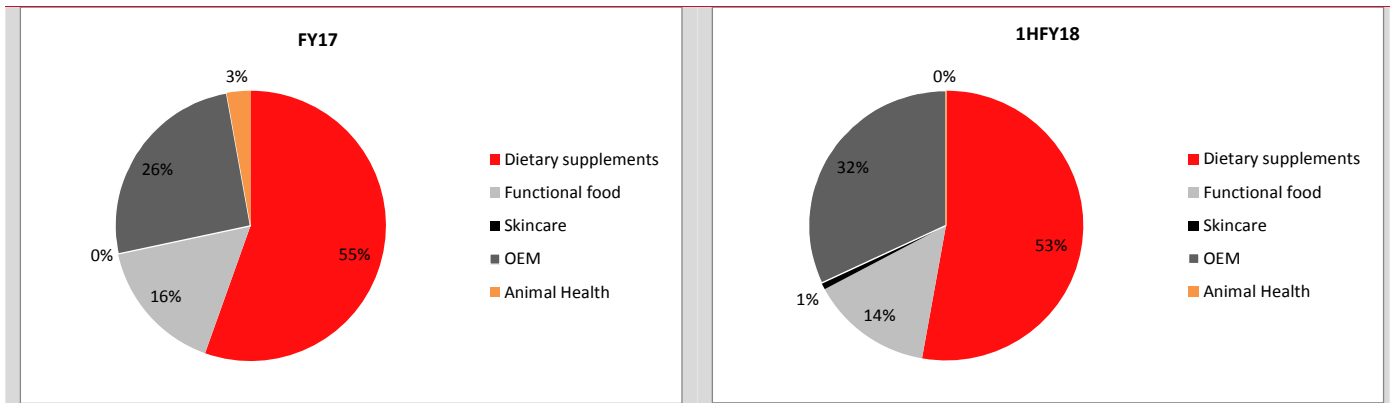
Patents. The group has two patents for Hepar-P Capsule with MyIPO and two patents for standardised extract from oil palm leaves comprising phenolic acids with MyIPO and the State Intellectual Property Office of the PRC. In 2017, the group ceased animal health business to focus on development and production of our House Brand and OEM products. The Hepar-P Capsule which contains Phyllanthus niruri standardised extract that is used as a liver tonic to improve liver health is a key product to the group which accounted for 6-7% of total revenue over FY15-FY17.

Crux of revenue derived from dietary supplements. Over the past three years, sale of dietary supplements has consistently been its major revenue contributor with >40% of total revenue. Dietary supplements accounts for 42.9%, 41.2% and 55.5% in FY15, FY16 and FY17 revenue, respectively. The Hepar-P Capsule which contains Phyllanthus niruri standardised extract that is used as a liver tonic to improve liver health is a key product to the group which accounts for 6.2%, 5.7% and 7.7% of total revenue in FY15, FY16 and FY17, respectively. Skincare products accounted for 0.2%, 0.1% and 0.1% of total revenue generated in FY15, FY16 and FY17, respectively.

The group provide OEM services for the manufacturing of dietary supplements and functional food products whereby customers sell the OEM products under their own brands. OEM services include formulation of products, procurement of raw materials and packaging materials, production and final packaging of finished products. OEM services accounts for 34.8%, 33.6% and 25.5% of total revenue in FY15, FY16 and FY17, respectively. In the overseas market, the group have seven local OEM customers and two OEM customers from Hong Kong and Singapore, respectively.

Revenue breakdown by segments





Source: Nova Wellness Group IPO Prospectus

House brand accounts for >50% of group revenue. The crux of revenue is derived from the House Brand segment, which contributed approximately 56.6%, 58.5% and 71.6% to Group's total revenue in FY15, FY16 and FY17, respectively. Zooming in on House Brand products, contribution is derived mainly from dietary supplements and functional foods, accounting for 56.4%, 58.4% and 71.5% of Group's total revenue in FY15, FY16 and FY17, respectively. Skincare products contribution to Group's total revenue is 0.2%, 0.1% and 0.1% in FY15, FY16 and FY17, respectively. Presently, the group has 49 dietary supplements, 11 functional foods and 28 skincare products. The OEM segment is the second largest contributor to revenue, contributing 34.8%, 33.6% and 25.5% of FY15, FY16 and FY17 revenue, respectively. Animal health segment accounts for 8.6% and 7.9% of total revenue in FY15 and FY16, respectively. The Group had discontinued the production of animal health products and ceased trading of these products since 9 Jan 2017. As a result, the animal health segment only contributed 2.9% of Group's total revenue in FY17.

Segmental Revenue Breakdown

FYE June	Revenue contribution							
	FY15		FY16		FY17		1HFY18	
	RM'm	%	RM'm	%	RM'm	%	RM'm	%
House Brand								
- Dietary supplements	9.8	42.9	10.0	41.2	13.7	55.5	6.6	53.2
- Functional food	3.1	13.5	4.2	17.2	4.0	16.0	1.8	14.6
- Skincare	0.0	0.2	0.0	0.1	0.0	0.1	0.1	0.5
Total House brand	12.9	56.6	14.2	58.5	17.6	71.6	8.5	68.3
OEM	8.0	34.8	8.1	33.6	6.3	25.5	4.0	31.7
Animal Health	2.0	8.6	2.0	7.9	0.7	2.9	0	0
Total Revenue	22.8	100	24.3	100	24.5	100	12.5	100

*Source: Nova Wellness Group IPO Prospectus

Revenue contribution from three channels

Mode of distribution and sales	Revenue contribution			
	FY15 (%)	FY16 (%)	FY17 (%)	1HFY18 (%)
Independent Retail Pharmacies (including NWPP partners)	48.0	52.9	66.0	63.0
OEM Customers	34.8	33.6	25.5	31.7
Others	8.6	5.6	5.6	5.3
Agents (for Overseas Markets)	-	-	*	-

Source: Nova Wellness Group IPO Prospectus
 1HFY18 = FPE17 = Financial Period Ending 31 December
 *negligible

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30% of revenue concentrated on three major clients. Three customers namely, Powerlife (M) Sdn Bhd, All Day Pharmacy and AM PM Pharmacy Sdn Bhd, contributed approximately 30% of group revenue. Powerlife (M) Sdn Bhd contributed 13.4%, 13.9% and 9.9% and AM PM Pharmacy Sdn Bhd contributed 7.3%, 8.5% and 10.4%, respectively, to Group's total revenue. All Day Pharmacy contributed 10.3% to total revenue in FY17.

High utilisation rate of 72% in softgel. The group's production facility is located at Sungai Pelek, Sepang, Selangor with a land area of approximately 22,257 sq. m. whilst its built-up production and administration floor area is approximately 4,496 sq. m.

High utilisation rate of 72% in softgel.

Dosage Form	Production Capacity/Year (based on one shift a day)
Tablet	92 million tablets
Hard Capsule	27 million capsules
Softgel	17 million softgels
Powder in Bottle	686,000 bottles
Powder in Sachet	686,000 sachets

Source: Nova Wellness Group IPO Prospectus

Production line capacities

Process	Machine	Production Capacity/ Yearly (¹)	Actual Production Output	Utilisation Rate as at FYE 2017 (%)	Age(²) (years)	Audited NBV as at FYE 2017 (RM)	Audited NBV as at FPE 2017 (RM)
Granulation	Granulator 1	85,000 kg	-	-	4	44,241	39,136
	Granulator 2	33,000 kg	-	-	8	1,660	-
Mixer	Mixer 1	1 million kg	-	-	3	24,144	21,881
	Mixer 2	0.6 million kg	-	-	2	34,470	31,239
Tableting	Tableting machine 1	60 million tablets	14.0 million tablets	23.0	13	- ⁽³⁾	- ⁽³⁾
	Tableting machine 2	32 million tablets	6.50 million tablets	20.3	11	- ⁽³⁾	- ⁽³⁾
Coating	Tablet Coating Machine	30,000 kg	-	-	11	- ⁽³⁾	- ⁽³⁾
Capsulation	Capsule Filling Machine	27 million capsules	4.63 million capsules	17.1	11	- ⁽³⁾	- ⁽³⁾
Softgel Encapsulation	Softgel Encapsulation Machine	17 million softgels	12.17 million softgels	71.6	9	- ⁽³⁾	- ⁽³⁾
Blister Packing	Blister Packing Machine	1.50 million blisters	0.11 million blisters	7.4	8	- ⁽³⁾	- ⁽³⁾
Packaging	Tablet and Softgel Counting Machines and Powder Filling Machine	60 million pcs and 0.686 million bottles	-	-	6	9,268	6,698
Total						113,783	98,952

Notes:

- (1) Based on eight hours shift over five working days per week in FYE 2017.
(2) The average life span of our machineries is 8 to 10 years.

Source: Nova Wellness Group IPO Prospectus

R&D expenditure between 2-6% over FY15-FY17. In FY15, the Group completed the first clinical trial for the Hepar-P Capsule resulting in a higher percentage of R&D expenditure over the Group's revenue at 5.5%. The R&D expenditure as a percentage of the group revenue was approximately 2.9%, 2.8% and 2.2% for FYE 2016, FYE 2017 and the financial period ended 31 December 2017, respectively, in the absence of clinical trial related expenses.

Hepar-P capsule a major breakthrough. The first clinical trial for Hepar-P Capsule has been conducted to evaluate the effectiveness and safety of Phyllanthus niruri standardised extract contained in the product for the treatment of non-alcoholic fatty liver disease. The company initiated the first clinical trial in November 2012 and commissioned a local CRO to manage, coordinate and monitor the progress of the clinical trial. Nova Wellness provides expertise in the process of developing the protocol for the clinical trial as well as to manufacture and supply the investigational product namely, Hepar-P Capsule for use during the clinical trial. The total cost for the pre-clinical and clinical trials is estimated at RM13.2m. It intends to fund RM2.6m for the second clinical trial for Hepar-P Capsule using the NKEA grant; while the remaining pre-clinical and clinical trials will be funded via IPO proceeds of RM10.6m. In the event the pre-clinical trial is not successful, the IPO proceeds allocated for the clinical trial will be utilised for other R&D activities.

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IPO DETAILS

Raising RM44.9m. Nova Wellness will be issuing 81.7m new shares at 55.0 sen/share where allocation for institutional offering is at 62%, whilst retail is at 38%. Based on IPO price, implied market capitalisation is RM174.8m which we classify as within the small mid-cap space. **Private placement is at 50.7m new shares.**

Utilisation of IPO proceeds and IPO timeline. With the fund raised, the bulk of the IPO proceeds will be allocated for CAPEX (36.7%) to construct a new GMP-compliant production plant. **The closing date for shares subscription is on 9th July 2018, while the listing is on 20 July 2018.**

Allocation			
Categories	Number of shares ('m)	% of new shares	% of enlarged share cap*
Retail offering			
Malaysian Public Allocation	16.0	19.6%	5.0%
Pink Form Allocation	15.0	18.4%	4.7%
Private Placement			
Malaysian/Foreign Institutional offering	50.7	62.0%	16.0%
Total	81.7	100.0%	25.7%

Source: Nova Wellness Group IPO Prospectus

*Based on enlarged share capital of 317,743,815 shares

Utilisation of IPO Proceeds			
Details	RM m	%	Estimated timeframe for utilisation
Construction of a new GMP-compliant production facility	16.5	36.7	Within 24 months
R&D activities	11.6	25.8	Within 36 months
Expansion of the company retail market presence	5.0	11.2	Within 36 months
Working capital	9.2	20.5	Within 12 months
Estimated listing expenses	2.6	5.8	Immediate
Total gross proceeds	44.9	100.0	

Source: Company

Important Indicative Dates	
Events	Tentative Dates
Opening of application IPO	28 June 2018
Closing of application IPO	5pm, 9 July 2018
Balloting of the applications	11 July 2018
Allotment of IPO Shares to successful applicants	19 July 2018
Listing on the ACE market	20 July 2018

Source: Nova Wellness Group IPO Prospectus

Statistics in relation to IPO			
Share Capital	Number of shares ('m)	%	RM m
Issued share capital as at the date of the prospectus	236.1	74.3	15.2
New shares to be issued pursuant to the public issue	81.7	25.7	44.9
Enlarged issue share capital upon listing	317.7	100.0	60.1
IPO price per share	RM0.550		
Market capitalisation upon listing based on the IPO price	RM174.8m		

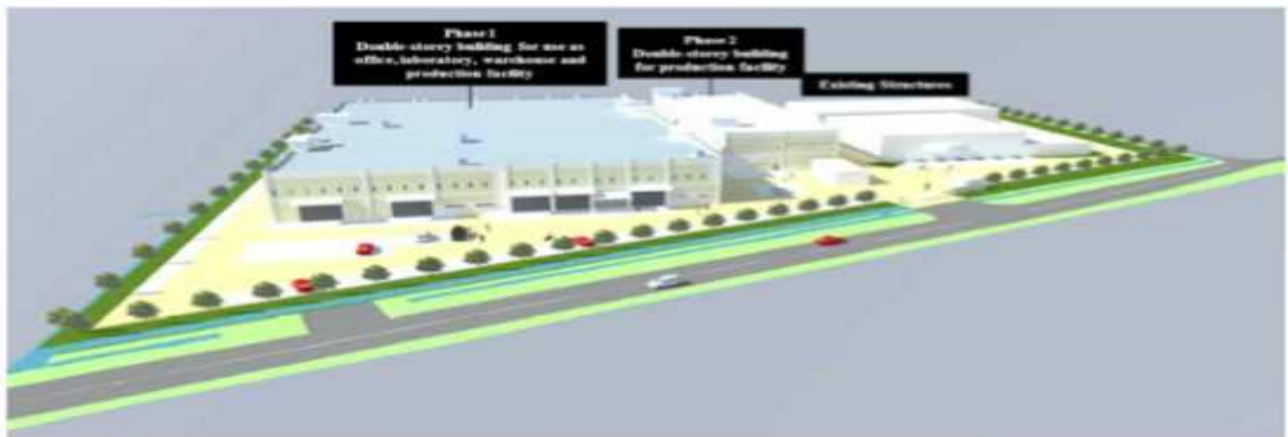
Source: Nova Wellness Group IPO Prospectus

INVESTMENT MERITS

Expansion plans to drive growth going forward. Moving ahead, the group has plans for a production facility next to a piece of land owned by the Group currently housing the head office and existing production facility in Sepang, Selangor. The construction of the new GMP-compliant production facility which includes machineries and equipment costing RM16.5m is expected to be completed by November 2018. The construction involved two phases namely; Phase 1 which involves the construction of a double-storey building for use of office, laboratory, warehouse and production facility for the production of functional food products. The total built-up of the double-storey production facility is approximately 12,636.87 sq. m; while Phase 2 involves the construction of a separate production facility for the production of skincare products. The total built-up of the double-storey production facility is approximately 3,024.82 sq. m. Subject to the receipt of all requisite approvals, including the GMP licence and manufacturer’s licence, the Group expects to commence production operations by 1Q 2019, production capacity for functional food is expected to increase from 0.69m bottles and 0.69m sachets to 3.43m bottles and 3.43m sachets. Additionally, the group will also start production of skincare products at the production facility of which presently is outsourced to a third party manufacturer.

New plant

Diagram: Layout of the new GMP-compliant production facility



Source: Nova Wellness Group IPO Prospectus

Tentative timeline for new plant

The following table outlines the tentative timeline for the completion of the construction of our new GMP-compliant production facility:

Milestone	Description
August 2017	Commencement of piling works
November 2018	Expected completion of construction
December 2018	Expected completion of interior renovation
February 2019	Expected receipt of all relevant approvals ⁽¹⁾
March 2019	Expected commencement of production operations

Source: Nova Wellness Group IPO Prospectus

Quantum leap in earnings from new plant. For illustration purposes, if we extrapolate the new plant which is 3 times the size of the existing plant, Nova Wellness’ incremental revenue is expected to rise from an average of RM25m to RM100m. Assuming a net margin of 25-30%, this translates to an aggregate net profit of RM25-30m implying a PER of 5.9x-7.1x at IPO price of 55.0 sen. Note that the current plant has a built-up area of 4,496 sq. m compared to the new one with a built-up area of 15,661.69 sq m. The plant is only expected to gradually ramp up over the next 3-5 years.

Going forward, we expect a higher tax rate at 20% (expiration of tax exemption in FY17). Nova Wellness incurred lower effective tax rate of between 0-0.2% over FY15-17, as compared to the statutory tax rate due to tax incentives arising from the BioNexus-status granted to Nova Laboratories (100% tax exemption for a period from FY08 till FY17). Upon expiry of the tax exemption, Nova Laboratories is entitled to a concessionary tax rate of 20% from FY18.

Margins could be crimped by weaker MYR against the USD. Raw and packaging materials purchased from overseas are denominated in RMB and USD while the sales with OEM customers are largely denominated in USD. The proportions of purchases of raw and packaging materials paid in USD were 66%, 62.1% and 64.4% of total purchases in FY15, FY16 and FY17, respectively. Meanwhile, for the same financial periods, the proportions of sales from overseas customers of which receipts were in USD are 9.3%, 12.9% and 5.4% of total revenue, respectively. Theoretically, Nova Wellness’ margins could be crimped by a weaker MYR against the USD.

Looking to expand into retail market space. In a bid to further enhance Nova Wellness House Brand products in the market place, the group plans to offer more independent retail pharmacies exclusive distributorship through the NWPP. The effort taken to increase brands presence includes securing prominent shelf space, dedicated display area, and co-organising health awareness campaigns. The group is moving into the online retail space to capture greater market share and reach more customers which was implemented in June 2018.

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INDUSTRY OUTLOOK

Growth in health supplement supported by ageing population. It is estimated that during the period of 2010-2040, Malaysia's population aged 65 and over is projected to increase more than three folds of the 2010 population. The increase will lead Malaysia to becoming an aging society in 2021 when the population aged 65 years and over reach 7.1%. Based on the United Nations (UN)'s definition, the aging society is when the population aged 65 and over achieve 7% of the total population. Population for the age group 0–14 years is projected to decline from 27.4% to 19.6% for the period of 2010–2040. However, the population for the age group 15–64 years and 65 years and over is expected to increase by 1.4 and 6.4 percentage points, respectively, for the same period. This trend contributed to the increment of the median age from 26.3 to 36.0 years. Longer life spans also resulted in a larger number of people aged 65 and above. This improvement has been attributed mainly to advances in medical technology, higher personal wealth and growing awareness of the importance of healthcare and disease prevention. As the general population lives longer, a consequence would be an increase in the number of those diagnosed with age-related disorders such as high blood pressure, Alzheimer's disease and heart conditions that require intensive care, and more advanced and long-term treatment.

Local nutraceutical industry market to grow at a CAGR of 2.5% over the next 6 years. The nutraceutical industry in Malaysia stood at RM98.8b in 2017 and has a forecast CAGR of 2.5% from 2018 to 2022. The industry size (revenue) of the nutraceutical industry is projected to reach RM111.5b in 2022. The nutraceutical industry is divided into two segments namely functional food and beverages and dietary supplements. The functional food and beverages segment (for imported and locally manufactured products) accounted for an estimated RM93.50b or 94.7% of the size of the nutraceutical industry in Malaysia for 2017, while the dietary supplements segment (for imported and locally manufactured products) accounted for an estimated RM5.27b or 5.3% of the size of the nutraceutical industry in Malaysia for 2017.

Industry Size (Revenue) and Growth Forecast for the Nutraceutical Industry in Malaysia, 2017-2021

Figure 2: Industry Size (Revenue) and Growth Forecast for the Nutraceutical Industry in Malaysia, 2016-2022

Year	Industry Size (Revenue) (RM billion)	Growth Rate (%)
2016	96.31	-
2017	98.77	2.6
2018*	101.08	2.3

Year	Industry Size (Revenue) (RM billion)	Growth Rate (%)
2019*	103.51	2.4
2020*	105.97	2.4
2021*	108.69	2.6
2022*	111.51	2.6

CAGR (2018-2022) (base year of 2017): 2.5 percent

Note: * denotes forecast

Source: Nova Wellness Group IPO Prospectus

Local dietary supplements market to grow at a CAGR of 9.7% over the next 5 years. In particular, the dietary supplements manufacturing industry in Malaysia was valued at RM1.25b in 2017. The base year growth was 8.5% and the forecast CAGR of the industry is 9.7% from 2018 to 2022. The Malaysian dietary supplement manufacturing industry is projected to reach RM1.98b by 2022. The local dietary supplements manufacturing industry is at its growth stage and likely to experience strong growth of between 9% and 10.5% from 2018 to 2022.

Industry Size (Revenue) and Growth Forecast for dietary supplements in Malaysia, 2016-2022

Year	Industry Size (Revenue) (RM billion)	Growth Rate (%)
2016	1.15	-
2017	1.25	8.5
2018*	1.36	9.0
2019*	1.48	9.2
2020*	1.63	10.0
2021*	1.80	10.5
2022*	1.98	10.0

CAGR (2018-2022) (base year of 2017): 9.7 percent

Note: * denotes forecast

Source: Nova Wellness Group IPO Prospectus

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RISKS

High dependency on major customers. 30% of its revenue is concentrated on three major clients, namely Powerlife (M) Sdn Bhd, All Day Pharmacy and AM PM Pharmacy Sdn Bhd, which contribute approximately 30% of group revenue. Powerlife (M) Sdn Bhd contributed 13.4%, 13.9% and 9.9% and AM PM Pharmacy Sdn Bhd contributed 7.3%, 8.5% and 10.4% respectively to Group's total revenue in FY15, FY16 and FY17, respectively. All Day Pharmacy contributed 10.3% to total revenue in FY17. While we do not expect the loss of these customers in the short-to-medium term given the length of their relationships as well as the contractual nature of services rendered, the non-renewal of service contracts with these customers would negatively affect the group's financial performance.

Major clients

Customer	Type of Customer	Length of Business Relationship as at the LPD (years)	FYE 2015		FYE 2016		FYE 2017	
			RM'000	%	RM'000	%	RM'000	%
AM PM Pharmacy Sdn Bhd	Retail chain pharmacy under NWPP	14	1,659	7.3	2,062	8.5	2,555	10.4
Powerlife (M) Sdn Bhd	OEM customer	7	3,069	13.4	3,369	13.9	2,420	9.9
All Day Pharmacy ⁽¹⁾	Retail chain pharmacy under NWPP	1	-	-	-	-	2,516	10.3
Total			4,728	20.7	5,431	22.4	7,491	30.6

Source: Nova Wellness Group IPO Prospectus

Risk of lower margins. Looking ahead, margins are expected to be negatively impacted due to the expiry of tax exemption (in FY17) and higher operating expenses, depreciation costs on new machinery, tax expenses and the commencement of operations in the new production facility. PBT and net margins over FY15-FY17 are 54-56% and 53-57%, respectively. However, 1H18 PBT margin and net margin are 47% and 36%, respectively.

Failure in clinical trials could scupper new-product break-through. If the pre-clinical and clinical trials turn out to be unsuccessful, it may affect the group's ability to increase the sales of the products. This could lead to the inability to recover cost incurred for the pre-clinical and clinical trials.

Dependant on commercialisation of new products. Slower-than-expected commercial operation of the new plant targeting new nutraceutical and/ or skincare products to generate new revenue stream in the future. The commercial success of future new products depends on a number of factors, including but not limited to the following; (i) ability to secure capital for product development on competitive terms; (ii) approval of the product from the relevant regulatory authorities; (iii) successful marketing and sale of new products; and (iv) acceptance by consumers of the benefits, efficacy and safety of the group's new products.

FINANCIAL ANALYSIS

3-year revenue CAGR of 3.6%. The group's revenue registered a 3-year CAGR of 3.6% to RM22.8m in FY17, amplified by house brands of which dietary supplements accounted for 43-60% of revenue. Revenue is largely derived from Malaysia (>90%) and the remaining balance from overseas market (5-8% combined from Vietnam, Japan, Hong Kong, Cambodia and Japan). The higher sales in FY17 was mainly driven by two rounds of promotional activities, which included price bundling and discounts for promotional packs of selected dietary supplement products.

Gross profit (GP) margins at a staggering 70-73%, lower forward looking net margins. In terms of margins, the GP margin remained high, ranging from 71-73% in FY15-FY17. However, going forward, due to start-up cost incurred in construction of new GMP-compliant production facility, higher depreciation costs with the new machinery and time taken to commence operations for the new production facility and the expiration of tax exemption in FY17, overall average net margins are expected to drop to 25-30%.

Going forward, we expect a higher tax rate of 18-20% (expiration of tax exemption in FY17). Nova Wellness incurred lower effective tax rate of 0.2%, 0.1% and 0.7% in FY15, FY16 and FY17, respectively, as compared to the statutory tax rate due to tax incentives arising from the BioNexus-status granted to Nova Laboratories (100% tax exemption for a period of 10 years from FY08 till FY17). Upon expiry of the tax exemption, Nova Laboratories is entitled to a concessionary tax rate of 20% from FY18.

Steady FY15-17 net profit. In tandem with the 3.6% revenue growth and tax exemption, Nova Wellness recorded a solid net margin of >50% bringing net profit to RM13.6m in FY17.



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Segmental Revenue Breakdown

FYE June	Revenue contribution							
	FY15		FY16		FY17		1HFY18	
	RM'm	%	RM'm	%	RM'm	%	RM'm	%
House Brand								
- Dietary supplements	9.8	42.9	10.0	41.2	13.7	55.5	6.6	53.2
- Functional food	3.1	13.5	4.2	17.2	4.0	16.0	1.8	14.6
- Skincare	0.0	0.2	0.0	0.1	0.0	0.1	0.1	0.5
Total House brand	12.9	56.6	14.2	58.5	17.6	71.6	8.5	68.3
OEM	8.0	34.8	8.1	33.6	6.3	25.5	4.0	31.7
Animal Health	2.0	8.6	2.0	7.9	0.7	2.9	0	0
Total Revenue	22.8	100	24.3	100	24.5	100	12.5	100

*Source: Nova Wellness Group IPO Prospectus

Segmental GP Breakdown

FYE June	GP contribution							
	FY15		FY16		FY17		1HFY18	
	RM'm	%	RM'm	%	RM'm	%	RM'm	%
House Brand								
- Dietary supplements	8.2	48.9	8.6	48.4	10.6	60.3	4.9	57.9
- Functional food	1.7	10.1	2.3	12.8	2.0	11.3	1.0	11.8
- Skincare	0.0	0.3	0.0	0.1	0.0	0.1	0.1	0.6
Total House brand	9.9	59.3	10.9	61.3	12.6	71.7	6.0	70.3
OEM	5.8	34.5	5.8	32.9	4.6	26.3	2.5	29.7
Animal Health Products	1.0	6.2	1.0	5.8	0.4	2	0	0
Total GP	16.8	100.0	17.7	100.0	17.6	100.0	8.5	100.0

*Source: Company

Segmental GP margin Breakdown

FYE June	GP margin (%)							
	FY15		FY16		FY17		1H18	
		%		%		%		%
House Brand								
- Dietary supplements		83.6		85.8		77.8		74.1
- Functional food		55.2		54.0		50.8		55.1
- Skincare		81.8		89.3		90.9		77.9
Total House brand		76.8		76.5		71.8		70.1
OEM		72.6		71.5		73.8		63.8
Animal Health Products		53.5		52.9		48.7		-
Total GP		73.3		72.9		71.7		68.1

*Source: Nova Wellness Group IPO Prospectus

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Historical group's income statement				
FYE June	FY15	FY16	FY17	1H18
	RMm	RMm	RMm	RMm
Revenue	22.8	24.3	24.5	12.5
COGS	(6.1)	(6.6)	(7.0)	(4.0)
GP	16.7	17.7	17.6	8.5
Other Income	0.2	0.3	0.6	0.3
Administrative Exp.	(1.4)	(1.7)	(2.6)	(1.9)
Selling & Distribution expenses	(2.4)	(2.2)	(1.7)	(1.0)
Other Op. Exp.	(0.9)	(0.5)	(0.2)	(0.1)
PBT	12.3	13.6	13.6	5.9
Taxation	(0.0)	(0.0)	0.1	(1.4)
Minorities	-	-	-	-
PAT	12.2	13.5	13.7	4.5
Margin				
GP				
EBIT	73.3%	72.9%	71.7%	68.1%
PBT	53.9%	55.8%	55.5%	47.1%
PAT	53.7%	55.8%	55.9%	36.1%

* Source: Nova Wellness Group IPO Prospectus

DIVIDEND POLICY

30% dividend payout policy. Based on our forecast, Nova Wellness' strong average cash-flow from operations of RM10-12m p.a. over the next two years supports management's guidance of a dividend payout ratio of not less than 30%. Based on our earnings estimate and a 30% dividend pay-out assumption, we expect FY19E net DPS of 1.2 sen translating to an average yield of 2%.

VALUATIONS

In line with the industry sector growth rate of 11%, we forecast 11% and 19% revenue growth for FY18E and FY19E, respectively. We have factored in lower margins taking into account the start-up cost incurred in construction of new GMP-compliant production facility, higher depreciation costs with the new machinery and time taken to commence operations in the new production facility as well as the expiration of tax exemption in FY17. Hence, we are forecasting Nova Wellness to register a net profit of RM10.3m and RM12.7m in FY18E and FY19E, respectively. We value Nova Wellness at RM0.600 based on 15x FY19E EPS. We believe the stock could command a higher PER of 15x, which is at a 30% premium over closest listed peer Bioalpha Holdings Berhad 1-year forward PER of 11x due to Nova Wellness superior pre-tax margin averaging 48-50% compared to Bioalpha (FY17 pre-tax margin : 17.3%). The other peer, Kotra Industries Berhad is trading at 20x 1- year historical PER.

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APPENDIX

The group has an experienced management team that collectively contributed to the growth and development of Nova Wellness led by Managing Director and Chief Research Officer, Phang Nyie Lin who has approximately 20 years of work experience in the local nutraceutical industry. He is supported by a group of experienced key management personnel; each playing a vital role in their respective divisions.

Key Management Team		
Name	Designation	Background and Key Achievements
Phang Nyie Lin	Co-founder and Managing Director	<ul style="list-style-type: none"> - Appointed to Board on 31 October 2017. - graduated with a Bachelor of Pharmacy from Universiti Sains Malaysia, Malaysia in 1980. - Upon his graduation in 1980, he started his career as a pharmacist trainee in the pharmacy department of Ipoh General Hospital. - Became a registered pharmacist with the MOH after he completed his training in 1981.
Yeoh Kim Kooi	Group's CFO	<ul style="list-style-type: none"> - He graduated from Oxford Brookes University, United Kingdom in 2008 with a Bachelor of Science in Applied Accounting and a member of the Association of Chartered Certified Accountants since 2008. - He started his career as an audit junior with Ng Chin Huan & Associates in 2004 responsible for assisting senior audits. - He joined the Group as CFO in November 2016 and is mainly responsible for the management of the overall financial and corporate affairs.
Tan Kiat Wei	Group's Chief Production Officer	<ul style="list-style-type: none"> - He graduated from Cyberjaya University College of Medical Sciences with a Bachelor of Pharmacy in 2012. - He underwent training as a pharmacist trainee with Y.S.P. Industries (M) Sdn Bhd in 2012. - In 2014, he left Y.S.P. Industries (M) Sdn Bhd to join Nova Laboratories as a marketing manager. - In 2015, he was transferred to the production department as production manager where he was responsible for production planning and overseeing all production lines. - At present, he oversees the manufacturing process, works closely with various departments to ensure products meet the safety, quality and efficacy requirements and ensuring compliance with current GMP and relevant regulatory requirements.
Sangeetha A/P Thuraisingam	Group's Chief Quality Officer	<ul style="list-style-type: none"> - She graduated from Tunku Abdul Rahman University with a Bachelor of Science in Biotechnology in 2006. - Upon graduation, she joined Nova Laboratories in 2006 as a regulatory executive where she was responsible for preparing registration dossiers for Nova Laboratories' products and obtaining approval for the products from the NPRA and regulatory authorities. - In 2016, she was appointed as Chief Quality Officer where she is responsible for quality assurance of the Group's operations through development, implementation and compliance with corporate policies, processes, procedures and guidelines relevant to regulatory activities.
Nicholas Cheong Peck Hiang	Group's Chief Business Officer	<ul style="list-style-type: none"> - He started his career as a sales representative with Hovid Pharmacy Sdn Bhd (a subsidiary of Hovid Berhad) in 2004 where he was involved in selling and promoting generic products. - He joined Nova Laboratories as a sales representative and was promoted to sales manager in 2007. - He was promoted to the Group's Chief Business Officer in 2015 whereby he assists Phang Yeen Nung and Phang Yeen Aun in business development and marketing, respectively.

Source: Nova Wellness Group IPO Prospectus

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Income Statement						Financial Data & Ratios					
FYE Jun (RM m)	2015A	2016A	2017A	2018E	2019E	FYE Jun (RM m)	2015A	2016A	2017A	2018E	2019E
Revenue	22.8	24.3	24.5	27.2	32.5	Growth (%)					
EBITDA	12.7	13.9	14.0	13.8	18.1	Turnover	N.A	6.2	1.1	11.0	19.3
Depreciation	(0.5)	(0.4)	(0.4)	(0.7)	(1.7)	EBITDA	N.A	9.3	0.7	(1.9)	31.4
PBT	12.3	13.6	13.6	12.9	15.8	Operating Profit	N.A	9.9	(1.7)	0.2	25.0
Taxation	0.0	0.0	0.1	-2.6	-3.2	PBT	N.A	10.1	0.4	(5.1)	22.6
Minority Interest	0	0	0	0	0	Core Net Profit	N.A	10.2	1.3	(24.7)	22.6
Net Profit	12.3	13.5	13.7	10.3	12.7						
Core Net Profit	12.3	13.5	13.7	10.3	12.7	Profitability (%)					
						EBITDA Margin	56	57	57	51	56
						Operating Margin	53	55	53	48	50
						PBT Margin	54	56	55	47	49
						Core Net Margin	54	56	56	38	39
						Effective Tax Rate	0.2	0.1	-0.7	20.0	20.0
						ROA	160.4	174.5	167.9	59.1	39.9
						ROE	63.4	76.3	70.8	29.5	19.0
Balance Sheet						DuPont Analysis					
FYE Jun (RM m)	2015A	2016A	2017A	2018E	2019E	Net Margin (%)	53.7	55.8	55.9	37.9	39.0
Fixed Assets	4.4	4.0	3.9	13.2	27.5	Assets Turnover (x)	1.1	1.1	1.1	1.6	2.3
Intangible Assets	3.3	3.8	4.3	4.3	4.3	Leverage Factor (x)	1.3	1.5	1.4	1.2	1.1
Other FA						ROE (%)	63.4	76.3	70.8	29.5	19.0
Inventories	4.9	5.9	5.9	6.6	7.8	Leverage					
Receivables	10.6	8.2	9.2	10.2	12.2	Debt/Asset (x)	NM	NM	NM	NM	NM
Other CA	0.0	0.0	1.0	1.0	1.0	Debt/Equity (x)	NM	NM	NM	NM	NM
Cash	1.7	4.7	2.1	7.1	22.2	Net Cash/(Debt)	1.7	4.7	2.1	7.1	22.2
Total Assets	24.9	26.5	26.3	42.3	75.0	Net Debt/Equity (x)	NM	NM	NM	NM	NM
						Valuations					
Payables	2.4	5.3	3.7	4.1	4.9	EPS (sen)	3.9	4.3	4.3	3.3	4.0
ST Borrowings	-	-	-	-	-	GDPS (sen)	0.0	0.0	0.0	1.0	1.2
Other ST Liability	0.0	0.0	0.0	0.0	0.0	BV/Share (RM)	0.1	0.1	0.1	0.1	0.2
LT Borrowings	-	-	-	-	-	PER (x)	14.2	12.9	12.7	16.9	13.8
Other LT Liability	3.2	3.4	3.3	3.3	3.3	Net Div. Yield (%)	NM	NM	NM	1.8	2.2
Net Assets	19.4	17.7	19.4	35.0	66.8	P/BV (x)	NM	NM	NM	5.0	2.6
Share Capital	0.9	0.9	0.9	23.6	60.1						
Reserves & others	18.4	16.8	18.4	11.4	6.7						
Equity	19.4	17.7	19.4	35.0	66.8						
Cashflow Statement											
FYE Jun (RM m)	2015A	2016A	2017A	2018E	2019E						
Operating CF	12.2	15.1	11.1	9.8	12.0						
Investing CF	(0.7)	(0.0)	(0.9)	(0.6)	(16.0)						
Financing CF	(12.8)	(12.1)	(12.9)	(4.1)	19.2						
Change In Cash	(1.3)	2.9	(2.6)	5.0	15.2						
Free CF	11.5	15.0	10.3	9.1	(4.0)						

Source: Kenanga Research, Nova Wellness Group IPO Prospectus

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Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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KENANGA INVESTMENT BANK BERHAD (15678-H)
Level 12, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my



Chan Ken Yew
Head of Research

