

Company Research

RM Group Holdings (8185 HK)



Turning Health Supplements into Healthy Earnings

Sector : Healthcare

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RM Group Holdings is engaged in the business of formulation, marketing, sales and distribution of health supplements and beauty supplements and products mainly in Hong Kong. Its products are sold under its proprietary brands and private label brands specifically developed for and owned by a renowned retail chain of health and beauty products in Hong Kong and Macau. According to a third party research, the group ranked 3rd as a Proprietary Chinese Medicine ("PCM") health supplements provider in Hong Kong in 2012. Its best selling products, Royal Medic No. 1 Chinese CS-4, ranked 1st in terms of sales value in the Cordyceps market in Hong Kong for five consecutive years ended August 2013. The group efficiently operates on fixed assets light platform and yields high ROA of 45.5% and ROE of 100.9% for FY3/13A. Leveraging on the renowned retail chain with over 350 outlets in Hong Kong and Macau as its major distributors, the group distributes its products efficiently without assuming heavy rental and overhead costs. The group has strong R&D capability, allowing it to introduce a new product to the market within four months. Going forward, the group will launch a new product line with CUCAMed Company Limited, a wholly-owned subsidiary of The Chinese University of Hong Kong Foundation Limited, and is expanding into the Taiwan market.

The group went public by listing on the HKEx GEM board in October 2013.

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Overview

Market leader. According to a third party research, the group ranked 3rd as a Proprietary Chinese Medicine ("PCM") health supplements provider in Hong Kong in 2012, with a market share of 10.4% in terms of retail sales value. The group's best selling products, Royal Medic No. 1 Chinese CS-4, ranked 1st in terms of sales value in the Cordyceps market in Hong Kong for five consecutive years ended August 2013.

Efficient product development and marketing platform. The group has launched approximately 100 products since its inception in 2002. Currently, the group has 58 health supplements and 16 beauty supplements and products being sold in the market. Thanks to its promoter and sales feedback system and strong execution capability of its product development committee, the group can develop and launch new products within four months. Accompanied by its extensive sales network and multi channel of marketing and promotion, the group's new products can hit the market timely.

Face-to-face marketing approach. The group promotes its products via multimedia channels. In addition, it has employed 77 sales promoters stationing at selected stores of the retail chain in Hong Kong to promote its products. Typically, consumers of health and beauty supplement products concern about the ingredient and effectiveness of the products. Sales promoters at outlet directly interact with and educate consumers on face-to-face basis. Such interaction provides confident on the group's products to the consumer. Furthermore, direct feedback from the consumer is valuable marketing information for the group's product development.

Extensive sales network in HK at low cost. The group established a strong working relationship with the renowned retail chain since 2005. The retail chain is indirectly owned by one of the leading pan-Asian retailers that has approximately 5,600 retail outlets in Asia. As at the latest practicable date, the chain had approximately 355 stores in Hong Kong and approximately 15 stores in Macau. Over 70% of the group's sales were generated from sales at retail chain during the track record period. By leveraging on the extensive sales network of retail chain, the group gains board geographic coverage and market share without assuming heavy fixed costs such as rental and overhead expenses. Furthermore, logistic associated with its distribution is simplified.

Fixed-asset light model. The group outsources encapsulation, bottling and blister-packing services to subcontracting manufacturers. As a result the group neither commits heavy capital expenditure nor assumes overhead and labor costs associated with production. Thus, the group can focus its resources on marketing and product development. Light fixed assets have yielded high return on the group's equity.

Business Analysis

Business model

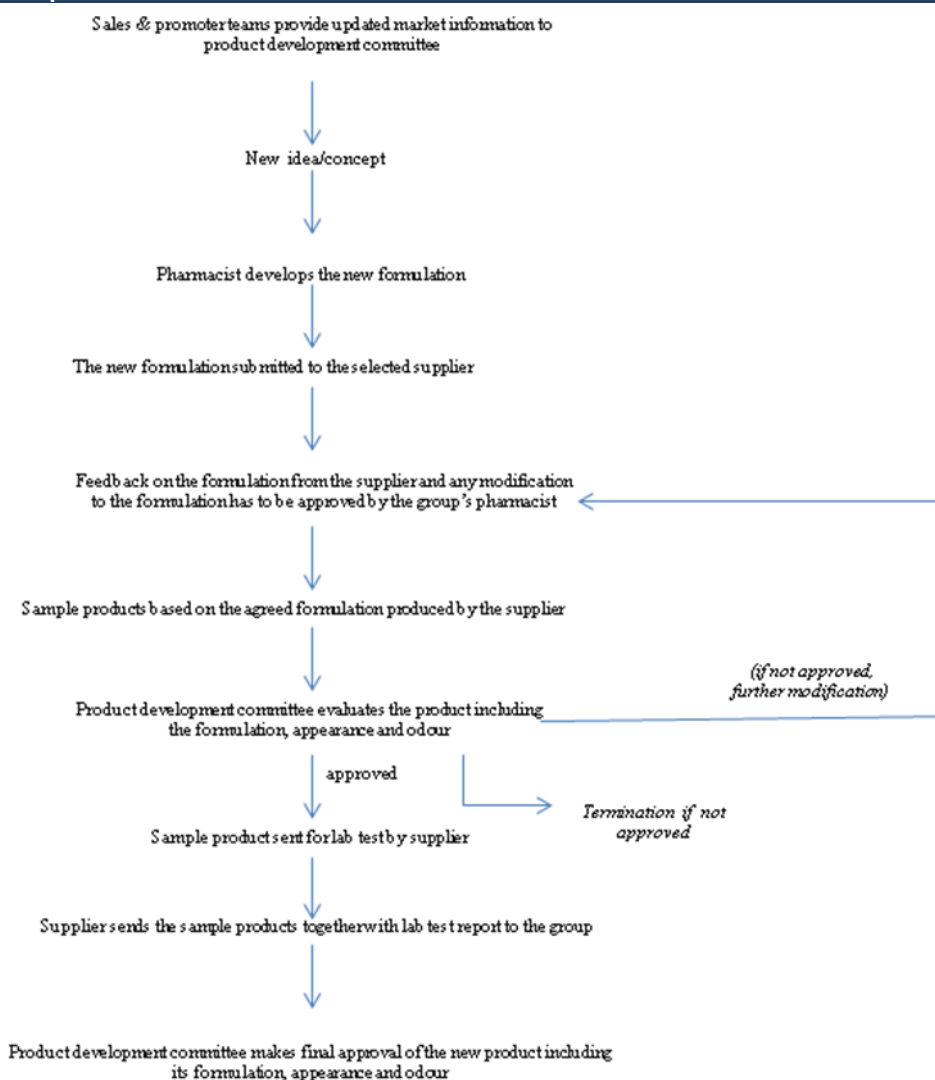
The group is engaging in the business of formulation, marketing, sales and distribution of health supplements and beauty supplements and products mainly in Hong Kong. Its products are sold under its proprietary brands and private label brands specifically developed for and owned by a renowned retail chain of health and beauty products in Hong Kong and Macau. It outsources most of its production to subcontracting manufacturers and distributes its products mainly through the renowned retail chain of health and beauty products in Hong Kong and Macau ("retail chain"). The group also operates two Chinese medicine clinics to provide traditional Chinese medicine treatments, services and retailing of health supplements to the general public consumers.

Product Development

The Group has set up a product development committee to develop and evaluate new products. The product development committee is composed of executives covering the functions of finance, sales, marketing, licensing, formulation, raw material sourcing, packaging and regulatory compliance, namely, the chief executive officer, the chief production officer, the chief financial officer, marketing controller and the sale controller of the group. New products are developed in one of the following manners:

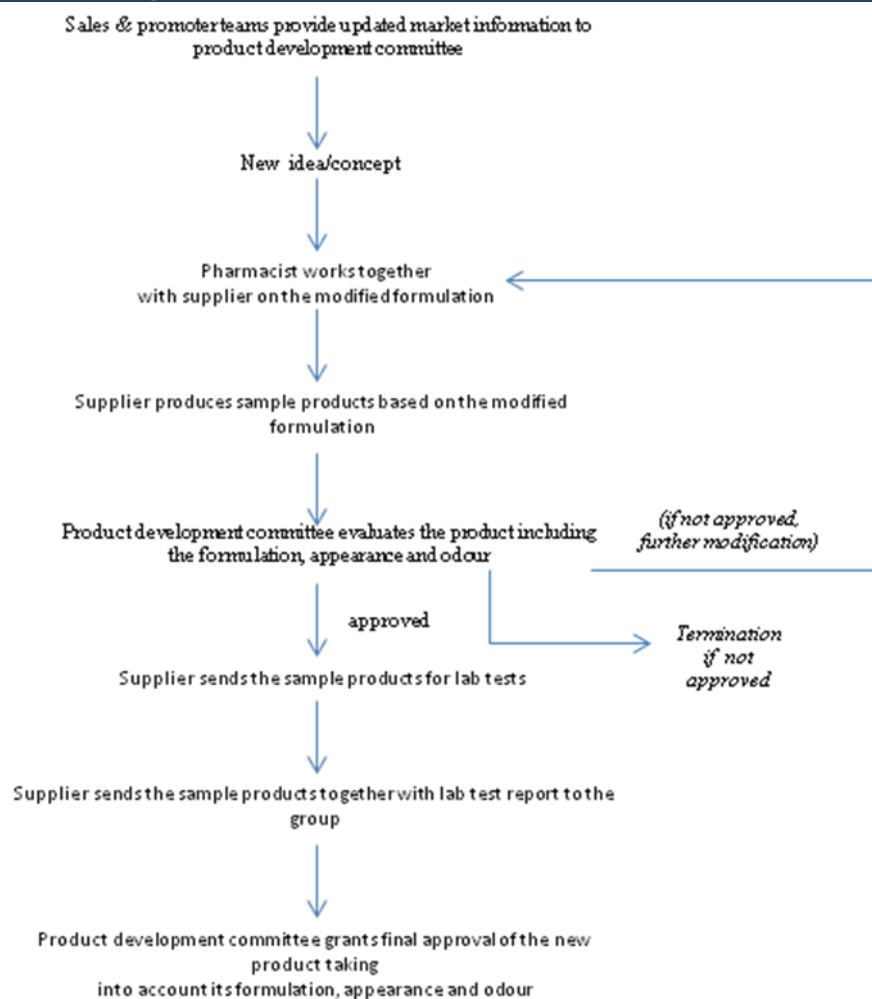
1. Own formulation (time to market: approximately 3–4 months),
2. Suppliers' formulation with the group's modification (time to market: approximately 3 months)
3. Suppliers' existing formulation (time to market: approximately 1 month).

Figure 1. Own formulation process



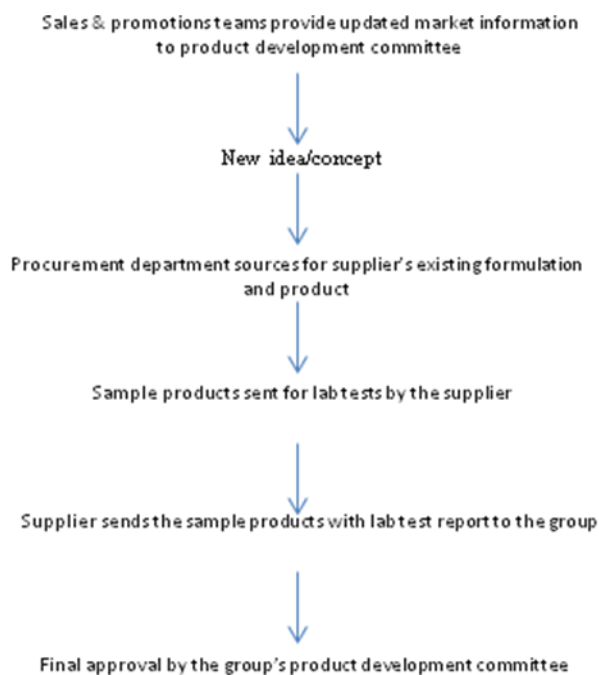
Source: Company data, SBI E2-Capital

Figure 2. Suppliers' formulation with the group's modification



Source: Company data, SBI E2-Capital

Figure 3. Suppliers' existing formulation process



Source: Company data, SBI E2-Capital

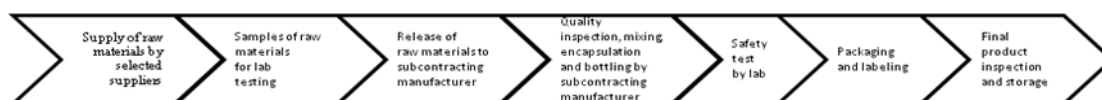
Production

Supply of raw materials. Currently, the group purchases raw materials and packaging materials from independent third parties. As at the latest practicable date, the group had 101 suppliers based in Hong Kong and other areas such as China, New Zealand, Malaysia, the United States, Japan and Taiwan. The raw materials include raw materials in powder form and semi-finished products in the forms of capsules, tablets, caplets, sachets or syringes containing the ingredients. The packaging materials for the group's products are mainly containers, paper boxes, composite packaging materials, transparent shrink film and labels. The group selected its suppliers based on criteria such as production capacity and financial status, capability such as GMP status, track record, product quality, pricing, etc.

The group usually places orders to its suppliers on an order-by-order basis and has not entered into any long-term agreements, with an exception of the China based supplier who is supplying the raw material in power form for the production of the group's flagship products Royal Medic CS-4. It had entered into a long term supply contract with such Chinese supplier, with specific terms governed product specifications, periodic minimum purchase quantities and pricing.

Production. The group outsources encapsulation, bottling and blister-packing services to subcontracting manufacturers based in Hong Kong. It procures the raw materials and packaging materials from its suppliers who deliver these items to the subcontracting manufacturers for encapsulation and bottling. The group also operates two bottling production lines in its headquarters in Hong Kong for certain semi-finished products with a capacity of bottling 3000 to 4,000 bottles per day. In addition, it perform almost all the packaging and labeling in-house with a capacity of between 3,000 and 6,000 boxes per day depending on the complexity of the packaging. In general, the group's production process could be divided into two categories, depending on the form of the raw materials:

A) Raw materials in powder form



B) Semi-finished products in capsule, tablets, caplets, sachet or syringe forms



The group entered into annual contract manufacturing service agreements with a well-established manufacturer with GMP accreditation in Hong Kong since July 2011 for the provision of encapsulation and bottling service of Royal Medic CS-4 and RM Broken Ganoderma Spore. It also engaged another GMP manufacturer in Hong Kong for bottling services on an order-by-order basis. It has a local subcontracting manufacturer for the provision of blister-packing service on an order-by-order basis. Currently, the group outsources most of the production of the health supplements and beauty supplements and products to its selected suppliers and subcontracting manufacturers.

The production lead time for most of the group's health supplements and beauty supplements and products is approximately 6 to 8 weeks, with the exception of a small portion of the health supplements and beauty supplements and products for which the lead time is about 10 to 12 weeks. To ensure the quality of the products, the group adopts stringent processes for selecting its suppliers and subcontracting manufacturers. It also maintains quality control over the products manufactured by its suppliers and subcontracting manufacturers.

Sales and Distribution

The group distributes its products through the following channels: (i) on shelves at the stores of the retail chain, which has long term working relationship with the group; (ii) at special designated counters ("SDCs") located at some of the stores of the retail chain; (iii) at the Hong Kong Brands and Products Expo; (iv) direct sales via the group's membership club, namely, the Wisdom Club; (v) at the Royal Medic Chinese Medicine Clinics; and (vi) wholesaling.

1. **The retail chain's stores:** The retail chain is indirectly owned by one of the leading pan-Asian retailer which has approximately 5,600 retail outlets across Asia, including Hong Kong, Macau, China and Southeast Asia. As at latest practicable date, the chain had approximately 355 stores in Hong Kong and approximately 15 stores in Macau. Based on third party research, the chain is the largest retail chain of health supplements and beauty supplements and products in Hong Kong and has an extensive retail network throughout Hong Kong. Over 70% of the group's sales were generated from sales at the retail chain in both FY3/12A and FY3/13A. The group's relationship with the retail chain has been established since 2005. As at the end of March 2013, the group employed 46 promoters to station at the selected stores to promote its products. The group is required to pay one-off initial fee for putting its products on the shelves of the stores of the chain. The chain usually places replenishment orders with the group on daily basis except for the purpose of special one-day sale events, when the group would advise the chain to stock up to avoid out-of-stock situations. The group provides a payment term up to 120 days from invoice.
2. **Special designated counter ("SDC"):** The group had 15 Royal Medic SDCs and 12 SDCs in the stores of the chain in Hong Kong. All SDCs are designed by and built at the expense of the group. The group employs promoters at each of the SDCs to promote and sell the products directly to consumers. Products being sold at the SDCs will not be sold at the chain shelves. The group decides on the products to be sold at the SDCs and no approval is required from the chain. The retail chain provides cashier service to the SDCs. In return, the chain shares a pre-agreed percentage of the proceeds of each sale made at the SDCs, subject to a minimum monetary amount each month for each SDC. Such share of pre-agreed percentage of proceeds is reported as rental expenses by the group.
3. **Hong Kong Brands and Products Expo:** The Group has participated in the annual Hong Kong Brands and Products Expo since 2006. It has participated as an official sponsor since 2007. At the Hong Kong Brands and Products Expo, the Group sets up booths to promote and sell its products to consumers directly.
4. **Wisdom Club:** The group established a loyalty club, the "Wisdom Club" in 2003. The key objectives of the Wisdom Club are to promote the group's products, build customer loyalty and maintain customers' relationship by offering various rewards and privileges to members. Wisdom Club had about 54,000 members as at the latest practicable date. The group only sells products that are discontinued at the retail chain's store to the Wisdom Club members.

Pricing process. After taken into consideration the estimated costs of market research formulation, preliminary clinical trial, raw materials, manufacturing, packaging and marketing, etc., the group forms an initial price range for the new product. Following the evaluation of market demand and comparison with similar products already available in the market and consultation with the retail chain, the group will decide the retail price of a product. Negotiation with the chain will be held to determine the wholesale price, after the retail price is fixed.

Marketing channel. The group has adopted a multi-faceted marketing strategy to market and promote its brands and products. It implements its branding and marketing strategies through various media and channels, such as television commercials, printed media, digital media, outdoor advertising, in-store promotion, the Wisdom Club and product road shows. To enhance recognition of the Group's brands, the Group has engaged a number of famous local artistes to endorse its products, including Ms. Michelle Yim Wai Ling (米雪), and Mr. Michael Miu Kiu Wai (苗僑偉).

Product portfolio

The group sells and distributes 22 health supplements and 8 beauty supplements and products under its proprietary brands. It also sells and distributes 36 health supplements and 8 beauty supplements and products under the retail chain's private label brands, namely, "Kiwi Lab" and "Health Proof". In aggregate, the group has 74 product offerings.

The group sells only one Proprietary Chinese Medicine ("PCM") product (as defined under the Chinese Medicine Ordinance), Royal Medic CS-4. All of the other products are orally consumed products and are not required to be registered under the Chinese Medicine Ordinance or the Pharmacy and Poisons Ordinance. The following table sets out the brand names, number of products and their product development methods:

Figure 4. Product portfolio

Type of Products & Brands	Number of Products	Development method	Retail price range (HK\$)
Health Supplements			
— Proprietary brands			
Royal Medic (御藥堂)	17	Group modify and suppliers	69-2,995
Herballand	3	modified	393-483
Haruka	1	Suppliers'	499
Mr. 75	1	Suppliers'	299
Total	22		
— Private label brands			
Health Proof	35	Group modify and suppliers	148-2,688
Kiwi Lab	1	Modified	30
Total	36		
Beauty Supplement and Products			
— Proprietary brands			
La Gusto	2	Modified	128-218
Royal Medic (御藥堂)	1	Group's	239
Herballand	1	Group's	139
Papaya Slim	1	Modified	368
Dissolution	1	Modified	268
Melty Enz	1	Modified	268
Dr. S	1	Modified	158
Total	8		
— Private label brands			
Kiwi Lab	4	Modified	220-258
Health Proof	4	Suppliers, Modified	268-1,600
Total	8		
Grand total	74		

Source: Company data, SBI E2-Capital

The Group's top 5 best-selling products for the year ended 31 March 2013 were Royal Medic CS-4, La Gusto Slim Coffee (格斯圖特濃燒脂咖啡), Kiwi Lab Magic Mix (奇異立寶奇妙瘦), RM Broken Ganoderma Spore (御藥堂破壁靈芝孢子) and Royal Medic Liver Guard (御藥堂淨肝健).

Figure 5. Royal Medic CS-4



Source: Company data

Royal Medic CS-4 is a proprietary brand PCM health supplement launched in 2008. This product contains fermented Cordyceps CS-4 powder and is presented in capsule form. Royal Medic CS-4 aims to improve the health of the lungs and the liver, enhancing the immune system and improving sleep quality. Royal Medic CS-4 was the Group's best-selling product throughout the Track Record Period. For FY3/12A and FY3/13A, sales of Royal Medic CS-4 generated revenue of HK\$60.6m and HK\$57.1m, representing approximately 38.2% and 34.9% of the group's total revenue respectively.

Figure 6. La Gusto Slim Coffee



Source: Company data

La Gusto Slim Coffee is a proprietary brand beauty supplement launched in 2010. This product primarily contains coffee powder, tea polyphenol (an antioxidant), Garcinia Cambogia (an appetite suppressant) and L-Carnitine (an amino acid) and is presented in sachet form. La Gusto Slim Coffee was developed with the aim of helping consumers to control weight. La Gusto Slim Coffee was the group's second best-selling product for FY3/13A. For FY3/12A and FY3/13A, and the sales of La Gusto Slim Coffee generated revenue of approximately HK\$10.1m and HK\$11.9m, representing 6.4% and 7.3% of the group's total revenue respectively.

Figure 7. Kiwi Lab Magic Mix



Source: Company data

Kiwi Lab Magic Mix is a private label beauty supplement launched in 2013. This is a slimming product which primarily contains dietary fiber and other natural ingredients and is presented in sachet form. Kiwi Lab Magic Mix is a colorless, tasteless and odorless slimming sachet, which can be added into beverages without affecting the flavor of it. Kiwi Lab Magic Mix was the third best-selling product for the year FY3/13A, which generated revenue of about HK\$8.8m, representing approximately 5.4% of the group's total revenue.

Figure 8. Royal Medic Liver Guard



Source: Company data

Royal Medic Liver Guard is a proprietary brand health supplement launched in 2009. This product primarily contains L-Cysteine (an amino acid), bee pollen, aloe vera and yeast powder and is presented in blister packs. Royal Medic Liver Guard aims to strengthen the liver, eliminate toxicant and reduce hair loss. Royal Medic Liver Guard was the fourth best-selling product for FY3/13A. For FY3/12A and FY3/13A, the sales of Royal Medic Liver Guard generated revenue of about HK\$6.4m and HK\$7.3m, representing 4.0% and 4.5% of the group's total revenue respectively.

Figure 9. RM Broken Ganoderma Spore



Source: Company data

RM Broken Ganoderma Spore is a proprietary brand health supplement launched in 2005. This product primarily contains broken Red Ganoderma Spore (fungus spores) and Agaricus Blazei Murill (a fungus) and is presented in capsule form. RM Broken Ganoderma Spore aims to improve immunity and reduce the adverse effects from therapy and is anti-aging. RM Broken Ganoderma Spore was the fifth best-selling product for FY3/13A. For FY3/12A and FY3/13A, the sales of RM Broken Ganoderma Spore generated revenue of about HK\$9.3m and HK\$7.3m, representing approximately 5.9% and 4.5% of the group's total revenue respectively.

Competitive Strength

Accredited product quality. The group's Royal Medic CS-4 has undergone "Double Blind Preliminary Clinical Trials" to prove its effectiveness in improving insomnia by the Institute for the Advancement of Chinese Medicine (IACM) Ltd ("IACM"), and has been accredited with the "A-Mark" qualification by Hong Kong Chinese Medicine Authentication Centre. Another best selling product of the group, RM Broken Ganoderma Spore, has also participated in the A-Mark Quality Chinese Medicine Authentication Scheme and has been accredited with the "A-Mark" qualification by Hong Kong Chinese Medicine Authentication Centre in 2013. In addition, the group engaged IACM to conduct a preliminary clinical trial on RM Broken Ganoderma Spore. The preliminary clinical trial concluded that RM Broken Ganoderma Spore may have the effect of stabilizing blood lipids, blood glucose and cholesterol.

Beneficiary of the booming Chinese tourism. According to an independent research, it is estimated that sales value contributed by the mainland Chinese consumers accounted for approximately 25% of the total retail sales value of the health supplements market in Hong Kong in 2011. Meanwhile, it is estimated the retail sales value of beauty supplements and products contributed by the mainland Chinese consumers accounted for approximately of 35% of the total retail sales of the health supplements and products market in Hong Kong in 2011. Mainland Chinese tourists prefer to shop in Hong Kong because they have higher confidence to purchase quality products at Hong Kong stores, especially food products as compared to those in China. Health and beauty retail chains such as Mannings and Watsons are popular among mainland Chinese consumers due to their good reputation, extensive store network, wide range of brands and products for selection, and the stationed in-store pharmacists for enquiry from the customers. According to an independent third party research, health and beauty retail chain accounted for about 27.2% and 40.0% of the total sales value of beauty supplements and health supplements in HK in 2012, respectively. Chinese tourists not only boost sales of the group's product, but also increase the publicity and awareness of the group's product in mainland China.

Favorable market/social environment. Increasing health consciousness and awareness, projected higher healthcare cost, decreasing birth rate and ageing population, supportive policy by the government and private sector, and increasing consumption of Chinese medicine should help boost sales of health supplement products. Rising self-beauty awareness amongst the female population and acceptance of "beauty-from-within" concept are favorable to the expansion in demand for beauty supplement products.

Future Plans

Team up with Chinese University to launch new product line. In July 2013, the Group entered into a cooperation agreement with CUCAMed Company Limited (中大中醫藥科技有限公司) ("CUCAMed"), a wholly-owned subsidiary of The Chinese University of Hong Kong Foundation Limited, to promote and sell PCM products and health supplements developed by CUCAMed under the brand, "LEGEND". The said cooperation agreement is legally binding on the parties and for a term of seven years. In our view, the PCM products and health supplements developed by CUCAMed will enhance the group's product portfolio and expand the sales of the group.

Taiwan, the first stop of overseas expansion. Since the Group believes that its products are generally prevailing in Chinese communities, the group is eyeing to expand into another Chinese community outside Hong Kong in order to boost its sales and brand awareness. According to a third party research, the total retail sales of the health supplements market in Taiwan grew at a five-year CAGR of about 8.0%, from HK\$10.9b in 2007 to HK\$16.0b in 2012. Aging population, changing lifestyle and raising health awareness in Taiwan has turned health supplements into a necessity product. It is expected that the total retail sales of the health supplements market in Taiwan will continue to grow at CAGR of approximately 10.5% from 2013 to 2015. Since Taiwan is the market with high growth potential, the group's Taiwan expansion plan is rational.

Established foothold in Taiwan. The group has established an indirect wholly-owned subsidiary in Taiwan on 19 March 2013. It is adopting its existing business model, which is proven to be successful so far, in Taiwan. It outsources the production and has already engaged in trading terms agreement with a large health and beauty store chain with 480 stores across Taiwan as its distribution facilitator since May 2013. The group's products are displayed and sold on the retail shelf space of the Taiwan distribution facilitator's stores. On the other hand, the group appointed a manufacturer in Taiwan with GMP certification, ISO 22000:2005 and ISO2008 as the producer of its products. For the marketing and promotion, the group will place emphasis on the promotion of its flagship, "Royal Medic CS-4". It utilizes multi-channels/media to promote its market. Celebrities are enrolled as brand ambassadors to promote its products. Promoters are hired and stationed at select shops of the distribution facilitator's network. It has been proactively taking part in the promotional events organized by the Taiwan distribution facilitator. The group received its first purchase order from the Taiwan distribution facilitator in June 2013.

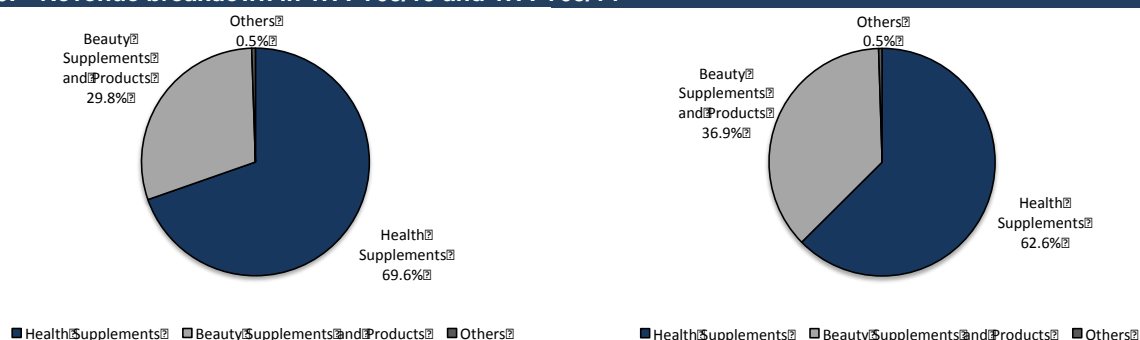
Financial Analysis

High return on asset. Since the group operates on a fixed asset-light platform and the management has been utilizing the asset efficiently, the group's assets are able to yield a very high return. The High ROE is attributable to relatively small equity base (typical for SME) and high ROA. Following the listing, the group will have new source of funding for business expansion. Thus we expect the group to yield a higher return for its investors in absolute terms.

Review of FY03/13A results. The group's net earnings for FY03/13A dropped 8.8% YoY, due to higher unit cost of sales, increase in headcount and addition of certain senior management position and increase in research and development costs. The increase in unit cost of sales was primarily attributable to bundle sales, in which the group bundled products into multi-purchase units and price them at discount in order to boost sales and awareness of its brands. In our view, the bundle sales were one-off sales event. In FY03/12A and FY03/13A, the group incurred listing-related expenses of HK\$4.8m and 3.0m, HK\$2.8m and HK\$1.0m of which, respectively, was charged to the profit and loss accounts. It is estimated that upon the group successfully listed, HK\$13.4m of listing expenses (excluding underwriting commission) will charge to the group's FY14F profit and loss accounts, and HK\$1.5m will charge against the group's equity.

Review of 1H FY03/14 results. The group announced last week its interim results for 1H FY03/14. Revenue was up by 0.61% YoY to HK\$74.2m, mainly driven by its health supplements segment, which was up 11.9% YoY to HK\$51.7m. The health supplements segment remained the largest revenue contributor for the group, contributing 62.6% and 69.6% of the total revenue of the group in 1H FY03/14 and 1H FY03/13 respectively (See Fig. 10).

Figure 10. Revenue breakdown in 1H FY03/13 and 1H FY03/14



Source: Company data

Gross margin for the Group remained at 76.3%, the same level as compared to 1H FY03/13. However, due to an increase in listing expenses (up by HK\$4.0m from 1H FY03/13 to 1H FY03/14) and salary costs (up by HK\$3.3m from 1H FY03/13 to 1H FY03/14), the company's operating profit and net profit attributable to shareholders in 1H FY03/14 was down by 63.2% YoY and 67.7% YoY to HK\$6.0m and HK\$4.2m respectively. It is expected that there will be approximately HK\$9.0m in listing expenses incurred in 3Q FY03/14, with a tax effect amounting to approximately HK\$2.1m.

Although the group recorded a YoY decrease in profit in 1H FY03/14, we have a positive outlook on its prospects given the following: 1) the fall in profit was partly attributable to one-off items, and ii) the Group just started its business in Taiwan in June 2013. While there may be high marketing costs incurred during the initial stage of the business, we believe it has high-growth potential in the future. In fact, the company has already received its first purchase order from customers in Taiwan as of June 2013. We expect more purchase orders to come as the business matures going forward.

Figure 11. P&L of the Group

	FY03/12	FY03/13	1H FY03/13	1H FY03/14
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Revenue	158,793	163,767	73,729	74,177
Cost of good sold	(32,449)	(34,757)	(17,490)	(17,581)
Gross profit	126,344	129,010	56,239	56,596
Other revenue	31	1,337	64	2,203
SG&A	(73,650)	(83,753)	(39,996)	(52,796)
Profit from operation	52,725	46,594	16,307	6,003
Finance costs	(131)	(110)	(58)	(49)
taxation	(9,562)	(7,220)	(3,235)	(1,750)
Profit attributable to shareholders	43,032	39,264	13,014	4,204
Basic and diluted EPS (HK cents per share)	-	-	3.4	1.1

Source: Company data

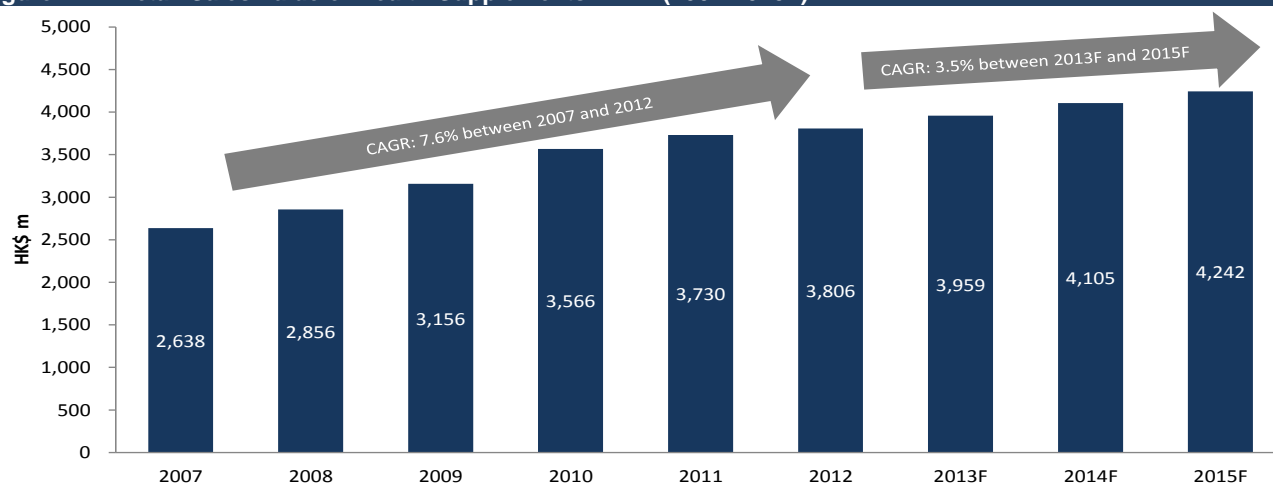
Industry Overview

Overview

The health supplements market in HK mainly consists of two segments, namely PCM health supplements and non-PCM health supplement. While the former solely comprises Chinese medicines, the latter contains traditional Chinese herbs, vitamins, fish oil and other health supplements for various health enhancement purposes.

According to the total retail sales of health supplements in Hong Kong grew from approximately HK\$2,638m in 2007 to approximately HK\$3,806m in 2012, representing a CAGR of approximately 7.6% during the 5-year period. Ipsos forecasts that the health supplements market will reach approximately HK\$4,242m by 2015, representing a CAGR of approximately 3.5% during the 2-year period between 2013 and 2015 (See fig. 10).

Figure 12. Retail Sales Value of Health Supplements in HK (2007-2015F)

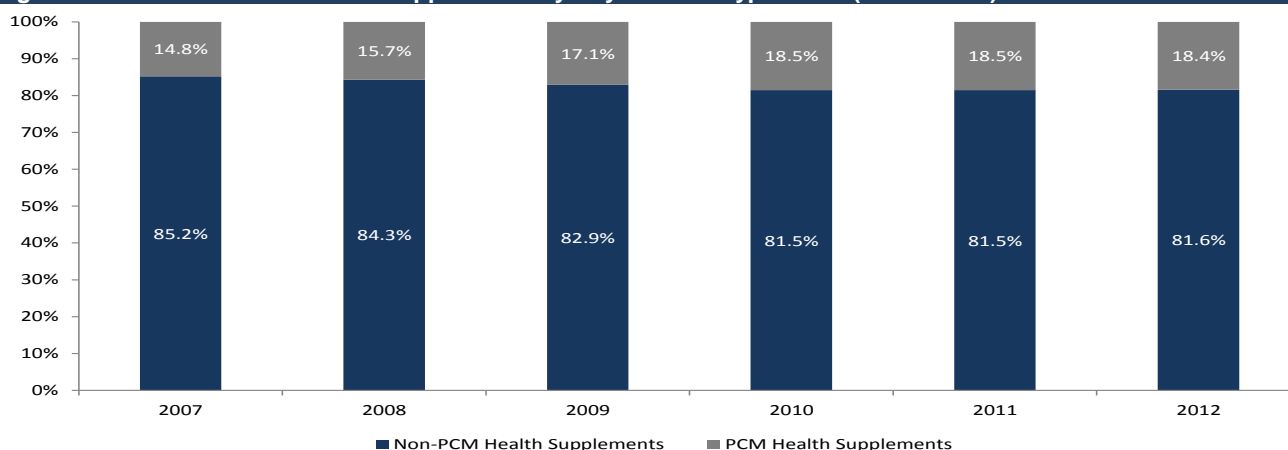


Source: Ipsos Reports

Consumption and retail sales pattern

Currently, non-PCM health supplements still dominate the health supplement market in Hong Kong, with total market share of 81.6% in Hong Kong in 2012, in terms of total retail sales value of health supplements. However, PCM health supplements segment has been growing at a CAGR of 12.5% during the 5-year period between 2007 and 2012, which is higher than the CAGR of 6.7% achieved by non-PCM health supplements segment during the same period (See fig. 11).

Figure 13. Retail Sales of Health Supplements by Key Product Type in HK (2007-2012F)

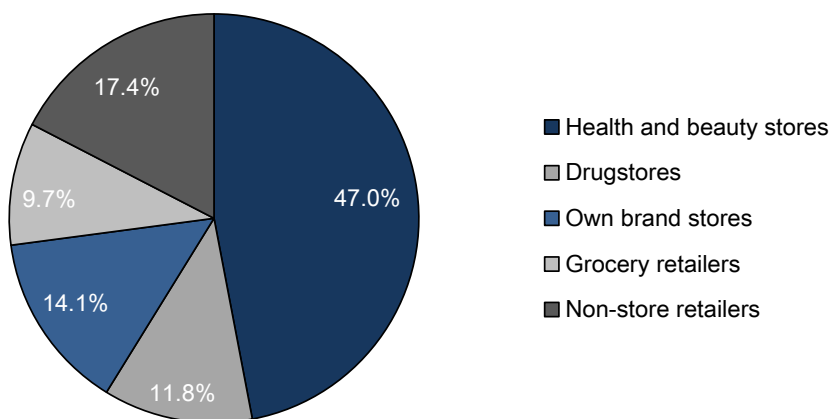


Source: Ipsos Reports

Sales Channel

There are primarily 5 sales channels for health supplements products, namely health and beauty stores (such as Mannings), non-store retailers (such as internet sales and direct selling), drugstores, grocery retailers and own branded stores. In 2012, health and beauty stores are the key retailers for PCM health products in HK, with total market share of 47% during the year, in terms of sales value.

Figure 14. Retail Sales of PCM Health Supplements by Retail Channel Types in HK in 2012

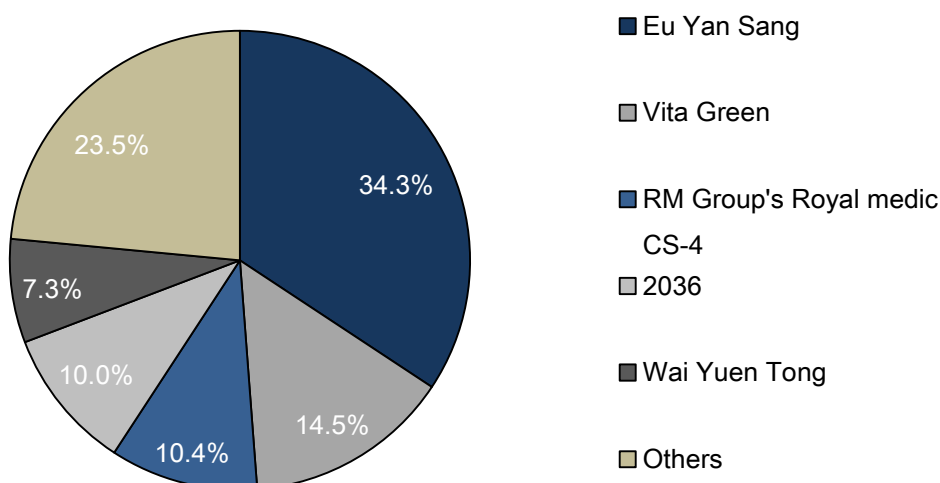


Source: Ipsos Reports

Market Share

The PCM health supplements market in HK is mainly dominated by local and international brands, with the top 5 brands accounted for approximately 76.5% of the total market share. As shown in fig.13, RM Group ranked the third among the top five brands in the PCM health supplements market in 2012 and have accounted for approximately 10.4% of the total retail sales value of PCM health supplements in Hong Kong, which was approximately HK\$73m.

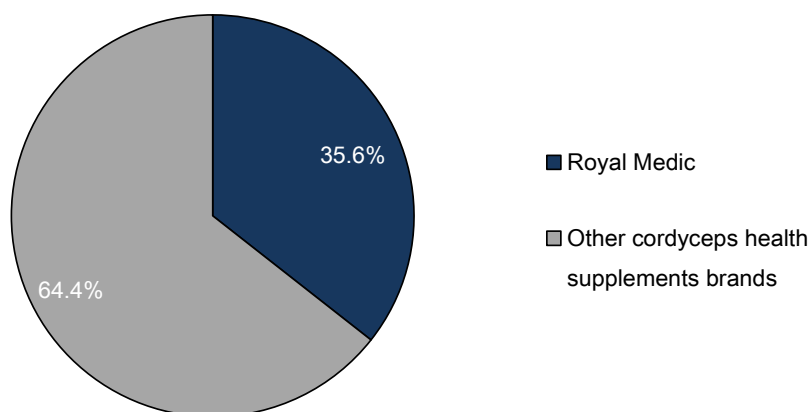
Figure 15. Retail Sales of PCM Health Supplements by Brands in HK in 2012



Source: Ipsos Reports

RM Group's flagship product, namely Royal Medic CS-4, ranked number 1, in terms of sales value, among all Cordyceps products in Hong Kong for five consecutive years ended August 2013. According to Ipsos, it is estimated that health supplements with cordyceps extracts accounted for about 5.4% of the total retail sales value of health supplements market in 2012 at about HK\$205m.

Figure 16. Retail Sales of Cordyceps Health Supplements by Brands in Hong Kong in 2012



Source: Ipsos Reports

Peers Comparison

International peers. According to Ipsos, the largest players in the beauty supplements (intake) market in HK in 2012 are international players including Herbalife (HLF US), Nu Skin (NUS US), USANA (USNA US), FANCL (4921 JP) and Yamada Miyura. As for the PCM healthcare supplements market in HK, the group ranked the third in 2012, below Eu Yan Sang (EYSAN SP) and Vita Green, and followed by 2036 and Wai Yuen Tong (0897 HK).

Among the international peers, we selected FANCL and Eu Yan Seng as closer comparables due to their APAC exposures:

- FANCL is a Japanese company that produces and sells additive-free skin care cosmetics like facial make up products and shampoos. It also makes and distributes dietary supplement including jelly and tablets with natural essences. As of 31 Dec 2013, FANCL has 177 stores in Japan, 202 stores in Greater China and 11 stores in Singapore.
- Eu Yan Seng is a company listed in Singapore which engages in the production and sales of healthcare and wellness products with a strong foundation in traditional Chinese medicine. As of 31 Dec 2013, Eu Yan Seng has 299 retail outlets globally, 54 of which are in HK and the rest are in Australia, China, Macau, Singapore and Malaysia.

Eu Yang Seng is trading at 17.75x historical P/E for the year ended 31 Dec 2012. This is compared to the group's 1-year historical P/E of 19.7x.

Figure 17. Peer Comparison (International)

Name	Ticker	Market Cap (HK\$ m)	Trailing 12M EV/EBITDA	Price to EBITDA	2012 P/E (x)	2013E P/E (x)	P/book (x)	ROE (%)
FANCL	4921 JP	5,499.20	n.a	10.05	n.a	33.84	0.97	-4.52
Eu Yan Sang International	EYSAN SP	2,112.57	10.80	11.07	17.75	19.62	2.46	17.48
Herbalife Ltd.	HLF US	54,181.27	8.96	9.02	13.42	13.15	15.34	n.a
Nu Skin Enterprises	NUS US	52,613.53	10.40	13.31	23.33	19.57	8.99	46.23
USANA Health Science	USNA US	7,453.24	7.15	7.78	12.76	12.91	4.00	35.44
Average		24,371.96	9.33	10.25	16.82	19.82	6.35	23.66

Source: Bloomberg, SBI E2-Capital

Taking also other abovementioned international players into account, overseas peers averaged at trailing 12-month historical P/E of 16.82x. We think that the discount of the group's valuation more than compensated for the disadvantage arising from the relatively small scale of business and limited capability to diversify risks geographically.

HK-Listed peers. As for HK-listed peers, there are six companies that are engaged in manufacturing and selling of healthcare products in HK and China. These companies include Wai Yuen Tong (897 HK) Tong Ren Tang (1666 HK), Beijing Tong Ren Tang Chines (8138 HK), CK Life Sciences International (775 HK), Besenyen (926 HK) and Reak Nutriceutical (2010 HK). On average, these companies are trading at trailing 12-month EV/EBITDA of 12.58x and trailing 12-month P/E of 24.52x.

Figure 18. Peer Comparison (HK)

Name	Ticker	Mkt Cap (HK\$ m)	Trailing 12M EV/EBITDA	Price to EBITDA	2012E P/E (x)	2013E P/E (x)	P/book (x)	ROE (%)
Wai Yuen Tong Medicine	897 HK	762.10	14.24	17.49	3.89	n.a.	0.45	9.70
Tong Ren Tang Technologies	1666 HK	14,921.13	16.51	17.08	28.17	24.95	4.93	19.17
CK Life Sciences International	775 HK	6,919.97	18.03	13.22	34.45	n.a.	1.39	3.89
Besunyen Holdings	926 HK	769.02	n.a.	n.a.	n.a.	n.a.	0.49	-13.55
Beijing Tong Ren Tang Chines	8138 HK	9,578.20	n.a.	33.01	52.25	44.38	n.a.	37.28
Reak Nutriceutical	2010 HK	2,234.84	1.53	2.32	3.86	n.a.	0.49	13.60
Average		5,864.21	12.58	16.62	24.52	34.67	1.55	11.68

Source: Bloomberg, SBI E2-Capital

Among these companies, Wai Yuen Tong Medicine, which is engaged in the production and sale of traditional Chinese and Western pharmaceutical products, health food products, Bottled Birds' Nest Drinks and Herbal Essence Products, is the closest peer of RM Group. According to Ipsos, in terms of sales value, Wai Yuen Tong Medicine commanded a market share of 7.3% in the PCM health supplements market in 2012, while RM group commanded a market share of 10.4% in the same year.

Wai Yuen Tong Medicine is trading at a 2012 P/E of 3.89x, which is far below the average level of its peers. The low valuation is mainly due to the fact that the company has incurred one-off items including fair value change in investments assets and properties. Excluding these items, 2012 P/EBITDA was 17.49x, which is around the average level of its peers, i.e., 12.58x.

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