The Constant Investor

Chinese company, Eagle Health to list on the ASX

From Alan Kohler - May 22, 2017

On June 29, Chinese company, Eagle Health will begin an IPO on the ASX. The decision to list in Australia is part of the company's strategy to increase confidence with health-conscious Chinese consumers.

Rod Hannington, Non-Executive Director, of Eagle Health, says the goal is to raise between $25 and $30 million. Eagle Health is in 23 provinces in China and Rod sees even more growth opportunities.

Whether it's leveraging healthcare IP or incorporating Australia's quality ingredients – our products are hot in the eyes upwardly mobile Chinese.

Rod Hannington tells Alan Kohler how the capital raising will help their growth in China and how Eagle is different from Blackmores

Rod, Eagle Health is in the middle of an IPO in Australia- when is it due to list?

We’re hoping to list June 29.

Tell us about the IPO itself – how much are you raising?

We’re raising between $25 and $30 million on a current capitalization of $100. So after the raise, market capitalization will be $125 to $130 million.

And how much of the business is being floated?

That capitalization is the proportion of the business being floated, following with the ASX.

It’s 20%?

20% liquidity, yes.

And the other 80% is owned by whom?

The other 80% is owned by ten shareholders. The top three are Mr Zhang, the founder of the company, and his wife, and then another non-executive director, and then the other seven shareholders and minority shareholders. They’ve all been escrowed by the way.

How long for?

12 months, the top three, and then a range of three to six months for the remaining seven.

Just tell us a bit about the background of the business.

Mr Zhang is the company founder and he started the business in 2001. It's a company that has a range of nutritional food supplements and supplements in its portfolio. There's approximately 90 SKUs or stock keeping units in the portfolio. The large proportion of the sales come from existing protein and amino acid supplementation products, powder products mixed with water.

Are these for bodybuilders or for everybody?

It's not in the bodybuilding category. These products are aimed at consumers who want to build their immunity, and also build their overall well being to keep up with the country's massive growth.

When it started in 2001, what was it?

It started in the amino acids protein area, and has extended a range then into other supplement area like macca and a couple of others leveraging traditional Chinese medicine. And the way the portfolio has evolved is a blend of Western ingredients in the portfolio, as well as traditional Chinese medicine products in the portfolio. And the category we're tapping is a $25 billion category that's going at a 12% compound annual growth rate. The company's almost tripling that category growth rate through new product development.

I've heard it described as the Chinese version of Blackmores, but Blackmores is vitamins and protein powders as well. Does Eagle Health do that now, or is it planning to?

It's not a bad analogy to say it's a Chinese Blackmores. Certainly Blackmores scales much greater than this organisations, but we're playing in the same space in terms of the category of supplements. And in terms of the consumer benefits we offer, we're offering similar benefits to a range like that, except we do have a range of supplementation via food products in our portfolio. This business really started from that food supplement place, space first, and then it moved into vitamins.

There's been a rocky experience in Australia with some companies selling into the Chinese supplements or food market, such as Bellamy's, which have come up against changes or difficulties with Chinese regulation. Tell us about how that sort of thing affects Eagle Health. Why won't Eagle Health go the same way? Is that, because they are Chinese?

There's no rocky experience to Eagle Health. We've got excellent compound annual growth rate, almost three time the category, and steadily growing gross margins through sensible management of pricing in the marketplace, as well as great cost structure in the organization. They do the manufacturing in Xiamen. And we're selling 99% of our sales through pharmacy and supermarket. We've got an online presence, but it's only 1% of our business. And I don't know a lot about how those guys are experiencing their online business, but it's a pretty competitive market and you're either hot or you're not. Whereas for our business it,s down line bricks and mortar, consumer shopping the category every week.

And what about the branding? Are all the products one brand, or are you several brands?

We have subcategories. Some of the categories we're playing are men's health, women's health, and family health, as well as general supplementation. All the products are currently branded Eagle, and the Eagle brand is a registered famous trademark in Fujian province, and holds a lot of brand equity in the marketplace. So everything's branded Eagle. There will be opportunity for sub-branding into the future as the business grows, but for now Eagle brand is the dominant branding form.

It's based in Xiamen?

Yes.

Is it national distribution?

Currently distributing to 23 provinces out of the 31 we could go to. Out of those 23 provinces, there's various levels of market penetration. This is where the growth potential of this company is. We're very dominant on the East coast, obviously Xiamen is on the East coast, so halfway between Hong Kong and Guangzhou. And there's a higher disposable income on that east coast, so naturally our products are selling the best on that east coast, but as we further penetrate more broadly across China, we're getting some great coverage.

The company's got great growth potential not only from continuing repeat purchase and new product development, but also from geographic expansion. We have the geographic footprint in the 23 provinces with the wholesalers and distributors, and all we need to do is just keep adding products to that portfolio. It's a bit like a distribution superhighway for an Australian company, because we've already got a great footprint. We navigate the regulatory authorities very well. We know how to launch products, in which part of that CFDA categorization – we're well positioned.

Why is it an Australian company? What's going on?

There's a couple of reasons, but my background is marketing, so let me tell you the marketing story here. This business's gross margins have grown from new product development. Chinese consumers love shopping in new products in this category. This new product development has been the real engine room of growth. Now, you know Australian products are selling really well in China, and it's not only Australian products, but Australian ingredients are very highly regarded. By having an ASX listing gives us great credibility with the Chinese consumer, because they trust Australian regulations and corporate governance and reliability.

Don't they realise it's a Chinese company?

It is a Chinese company, but to see a Chinese company being prepared to operate in the good governance spirit of the Australian stock exchange is very highly regarded. They trust the products and they trust the brand already. Because obviously you wouldn't sell $84 million worth of product so well and make $16 million growth net profit after tax if you didn't have good consumer trust. But by being here in Australia on the ASX we can tap Australian IP for this category, we can get some very nice stream of innovation over the next three and five years by tapping that IP.

What do you mean about tapping the IP?

There's some really nice IP here. I guess a lot of your investors know that Australian start-up in the medical and healthcare space is very, very impressive. A lot of these start-ups need a step up into China, and it's not for the faint-hearted. Being able to have a relationship with a company that's based in Australia, but yet has a superhighway to China, is a really attractive proposition.

Are you saying that Eagle Health will become a distributor of other Australian products?

We could distribute other Australian brands, we could take Australian ingredients and put them into our portfolio. There two very nice innovation opportunities for us. And in the raise you'll see that out of the $25 to $30 million we're raising, we're actually keeping $6.2 million of that raise here in Australia as a development fund for Australian-sourced new products, or Australian-sourced new ingredients.

For example, we want to extend into our amino acid portfolio and add omega oil for cardiovascular health and cognition benefits, well understood by Chinese consumers. We want to source that from Australia where we know we'll get great credibility, a really nice ingredient that's highly regarded. And that will enable us to have an Australian stamp on the product to say, "Australia inside". That's just one ingredient example.

Or at the completely opposite end of that spectrum we could bring a totally Australian brand, made in Australia, into China. All that makes sense, but as I said at the very beginning, this business's profitability comes from its gross margin improvement year in, year out.

What is the gross margin?

We're sitting around 58%. The best gross margin SKU in this portfolio, is 65%, which is not bad for this category. And any new product we bring from Australia as either an ingredient or finished product, providing it meets our gross margin benchmark so that we don't erode the gross margin, is going to be considered. And of course, it has to be a healthcare product.

Tell us about how you arrived at the pricing of the float?

The company is valued at $100 million. And we're raising between $25 and $30 million to make a post market capitalization of $130 million.

What's the thinking on the 100 million? It's a nice round number.

It's a nice round number. If you have a look at PE ratio at 100, at post market capitalization, it's about 8.2, which actually represents very good value for investors when you compare the likes of other companies playing in this space, like Blackmores. When I think, if I'm correct, they're around 20 in PE.

They have been higher.

They have been higher. But the pricing of this is more around the value it represents for investors than the PE ratio.

So a PE of 8.2 – what other sort of assets are there in the business? What's the NTA?

The company currently has $5 million cash in the bank, and net profit after tax is $16 million on the $84 million revenue from 2016. The company owns its land, all its plant, and is fully vertically integrated.

Eagle owns all the factories?

Owns all the factories.

And what's the value of those, do you know? He's looking up his presentation here folks.

As I said to you, I'm a marketing guy, so you can refer to the prospectus for the capital value of the company!

What are you going to do with the 25 million that's raised? Nobody's getting an exit, are they? It's not turning into a liquidity event for existing shareholders?

Absolutely not. As I said to you the top shareholders are escrowed. In addition to that, Mr Zhang has spent his whole life in this supplements category, and he intends to spend the rest of his life in the supplements category.

How old is he?

Mr Zhang is 53.

Right.

He is extremely passionate about that category. When you started off by saying it's a bit like a Blackmores, if you think about a guy like Marcus Blackmore, who I know only through media presence, I would see Mr Zhang as being a Chinese version of a guy like Marcus Blackmore. Everything about health supplements and Chinese consumers and health is in his blood. There's no exit strategy here at all.

Tell us about the plans with the money?

Yes, so out of the raise, I guess there are three big buckets I can talk about in terms of investment. Firstly, we're keeping $6.2 million of the raise here in Australia to dedicate to the development of new products to launch in China.

Would that be a lab here?

Not necessarily a lab, but more various ways of collaborating with local companies. We may at some point in time, if the board approves, consider the acquisition of a small company. We may invest or co-invest in intellectual property that's being developed in various spaces. For example, there's some very nice work being done on Type 2 Diabetes management, and Type 2 Diabetes is a huge issue in China. It may be that we invest a little bit in co-developing that, or paying milestone payments and licencing fees. So that's the 6.2.

And then in addition to that there's another $10 million that we'll invest primarily in continuing to doing what we're doing now, but at a faster rate. The company's growth is coming from market penetration through building our brand, but it's also coming from geographic expansion. If you can imagine when you're selling in 23 provinces in a market as big as this, the company's investing nicely, let's say in the top 10 markets, but there's another 13 provinces that we're not investing in yet. The extra money that we're raising here will enable the company to grow faster through geographic expansion, as well as promoting the brand more widely in these broader provinces.

And in addition to that, we're going to invest in some alternative distribution channels. 24/7 Gyms is a big growth area in China.

You're going to do gyms?

No, but we're going to look at doing distribution via vending machines in 24/7 Gyms to make our products accessible 24/7. These products are not about weightlifting and weekend warrior sport, it's more focused on supplementation for strength and immunity.

One of the big insights here in China is that this country is growing, as you know, and Chinese consumers even consider a day off work as being left behind. Anything they can do to keep themselves strong, healthy and fit to keep up with their countries growth, they will. And that's why supplementation in this area is going so well.

Given all that and the size of China, there's no need for geographic expansion outside of China?

There is potential for that in the future, but right now our current view is all the growth's going to come from within China.

And what about Australia?

We would consider launching some products here in Australia, over time, but it's not our number one priority.

I think we'll leave it at that. Thanks for Rod.

Thanks Alan.

https://theconstantinvestor.com/chinese-company-eagle-health-list-asx/