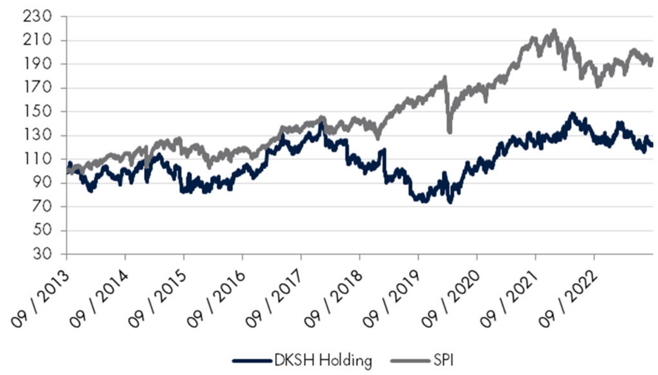
September 2023

DKSH Holding

Market profile

Country	Switzerland
Sector	Communications
Market cap (CHF bn)	4.4
52-week high / low (CHF)	80.95 / 63.55

Evolution of stock price with respect to benchmark (rebased)



Key metrics (CHF)

	2022	2023e	2024e
EPS	3.09	3.29	3.59
PE	22.7x	20.4x	18.7x
Dividend Yield	2.9%	3.2%	3.4%

Executive summary

DKSH Holding is a Swiss based conglomerate company that mainly distributes products in Asian countries. The company has over 2200 clients and 2100 suppliers. DKSH is a facilitator of distribution in Asian countries for all sized companies in 4 distinct end-markets: Healthcare, Consumer Goods, Performance Materials (Chemicals) and Technology. The group can perform such mundane tasks as simply importing goods into an Asian country, all the way to full-service sales & marketing of specific products, taking responsibility for a product in a country or the whole Asia-Pacific zone.

The company also has a small portfolio of company owned brands in the over the counter healthcare business. Typically these are old, declining brands that DKSH acquires from pharma companies and turns them around by focusing on country synergies and brand marketing.

We like DKSH's value proposition as they address promising growth trends in the Asia-Pacific region. Their business is asset light, cash generative and surprisingly resilient. The group holds leading positions in the segments in which they operate.

Asia is the fastest growing region in the world, taking an increasing percentage of the world's annual trade value each year. DKSH is one of the few Swiss companies who has such a focus on Asia.

Management is also shareholder friendly, paying a generous dividend (leaving aside fiscal considerations). Its focus on cash returns is laudable. Overall, management appears as prudent realists, and never issue hard figures in their outlook, but only qualitative statements.

DKSH Holding

Daniel Pfund, Senior Financial Analyst

September 2023

Company description

DKSH Holding is a Swiss based conglomerate company that mainly distributes products in Asian countries. The company has over 2200 clients and 2100 suppliers. DKSH is a facilitator of distribution in Asian countries for all sized companies in 4 distinct end-markets: Healthcare, Consumer Goods, Performance Materials (Chemicals) and Technology. The group can perform such mundane tasks as simply importing goods into an Asian country, all the way to full-service sales & marketing of specific products, taking responsibility for a product in a country or the whole Asia-Pacific zone.

The business model is shown in Figure 1, as well as some of their most well-known customers. Amazingly, even big name customers such as Nestlé, Beiersdorf, Procter and Gamble, Mars, … use DKSH to distribute their products in Asian countries. One of the reason is that those countries are still very fragmented and don't have wholesalers as in more developed countries. And even if the product manufacturer would be big enough to warrant having its own distribution/marketing service in the country, the cost is still relatively low that oftentimes it's not warranted to set up a wholly owned distribution system. Indeed, DKSH's operating margins are quite low (under 3%), and it would be easier for a consumer goods company to cut costs elsewhere to justify gaining an extra 3% margin.

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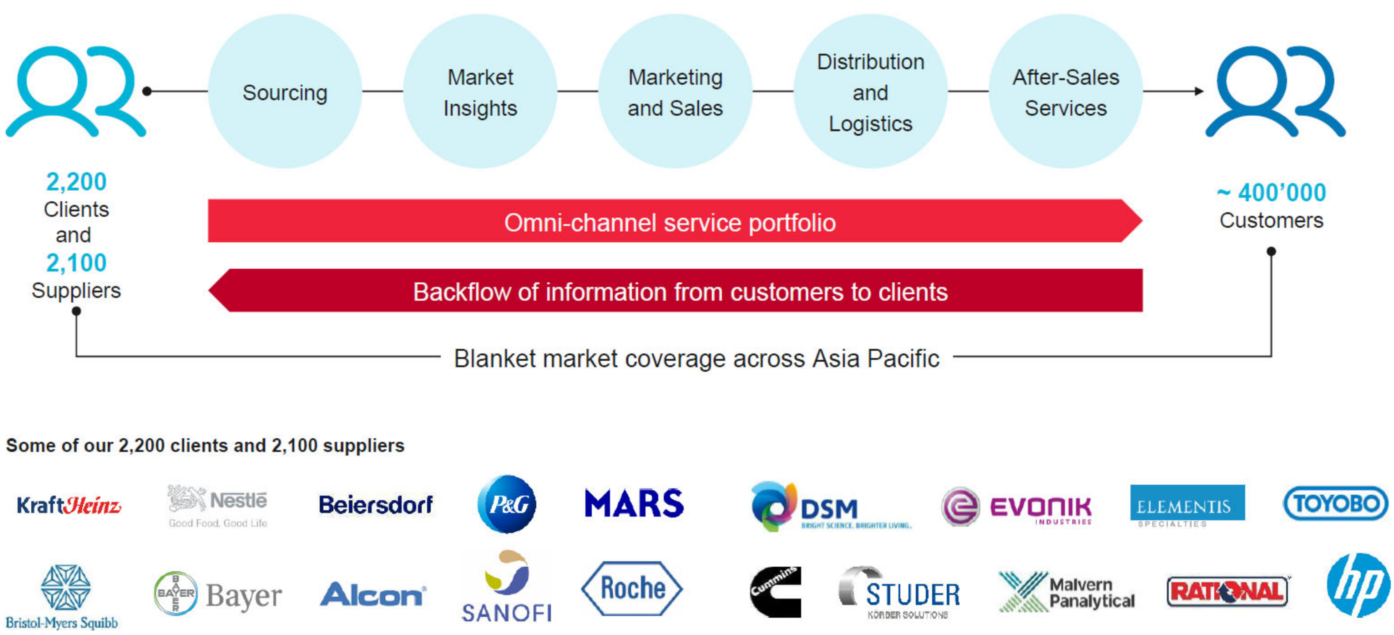
Fig. 1: DKSH's business model and some of their clients
Source: Company data, IAM research



DKSH also owns Maurice Lacroix, a high-end Swiss watchmaker. Clearly this has no synergy with the Asian business and is in a turnaround phase before being sold to another watch manufacturing group. DKSH has confirmed since 2015 that this brand is for sale, but they are waiting for a good offer. As it's cash flow positive, they are not in a hurry to sell the business.

History of the company

DKSH, or Diethelm Keller Siber Hegner, is a fascinating story of entrepreneurship and global trade. The story begins in 1865. Switzerland, known for its chocolates and watches, was also home to a few adventurous souls who decided to venture out into the world. Among them were three Swiss families: Diethelm, Keller, and Siber Hegner. The Diethelms established a trading company in Singapore, the Kellers in Manila, Philippines, and the Siber Hegners in Yokohama, Japan. They traded everything from textiles to machinery, and over time, they built successful businesses.

Fast forward to the 20th century. The world has changed, and these companies have grown. They've survived wars, economic crises, and all sorts of challenges. And then, in a twist of fate, they decide to join forces.

In 2002, Diethelm Keller and Siber Hegner merged to form DKSH. Historically, Diethelm Keller was active in Healthcare and Consumer Goods, while Siber Hegner was active in Performance Materials and Technology.

After the merger, DKSH made a strategic decision to focus on providing market expansion services. This was a significant turning point in the company's history.

When DKSH made this strategic shift, globalization was accelerating at a rapid pace. The internet was becoming more widespread, trade barriers were falling, and companies were increasingly looking to expand beyond their home markets. As globalization accelerated, more and more companies wanted to expand into new markets, but they didn't know how. DKSH stepped in to fill this gap.

This shift allowed DKSH to leverage its deep understanding of Asian markets. The company had been operating in Asia for over a century, and it had built strong relationships and gained valuable insights.

By focusing on market expansion services, DKSH was able to meet a growing need and differentiate itself from other companies, carving out a unique niche for itself.

The company listed its shares on the Swiss market in 2012 through an initial public offering as some members of the founding families wanted to sell their shares.

Today, it operates in 36 countries and specializes in providing various services such as market research, sales and distribution, logistics, and after-sales services across a wide range of industries including healthcare, consumer goods, chemicals, technology, and more.

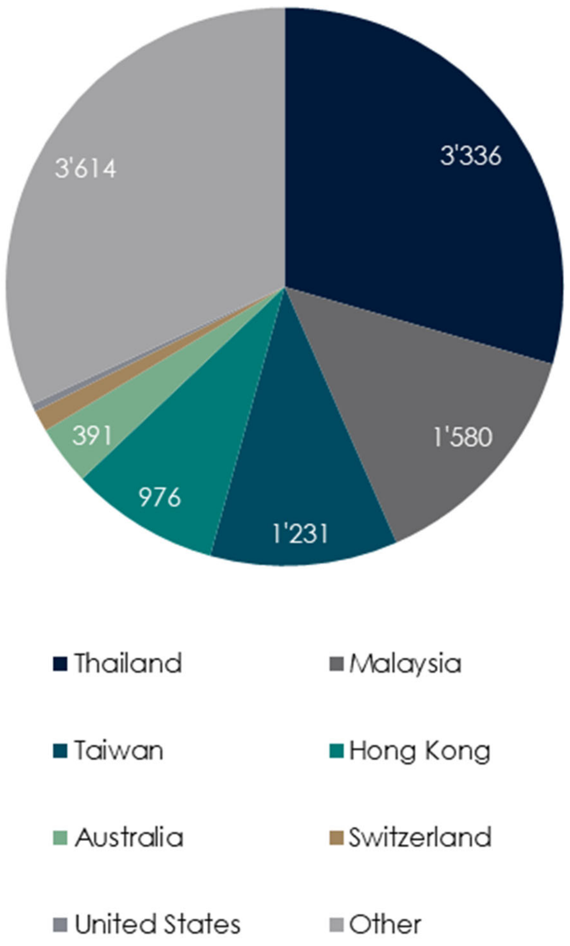
Geographic exposure

DKSH is active in most Asian countries as shown in Figure 2.

The company also provides a sales split by geography, but it is very diversified. One standout country is Thailand which is DKSH's biggest country by sales at 29% of total (see Figure 3).

Fig.2: Asian countries with DKSH presence in red
Source: Company data, IAM research

Fig.3: Revenues by region (CHF mn, 2022)
Source: Company data, IAM research



Asia in general, and Thailand in particular, are still strongly impacted by the consequences of COVID-19. For example, it is estimated that Thailand will only receive between 28 and 29 million visitors in 2023, which still represents less than 70% of the pre-COVID visitors. As tourism represents about 10-15% of Thailand's GDP, it has downstream implications for all sorts of companies, including DKSH. Nevertheless, economists still forecast Thailand's gross domestic product (GDP) to increase between 3% — 3.5% in 2023.

DKSH believes that it can grow revenues somewhat faster than Asian's GDP, which is somewhere in the range 3% — 4% per annum.

Industry Overview & Competitive positioning

The industry of "Market Expansion Services" in Asia-Pacific is not a common one, and there are few listed competitors. Compounding this difficulty is the fact that DKSH is a conglomerate with very disparate divisions, including own healthcare products.

We see competitors in four separate segments: global distribution service providers, healthcare manufacturing and distribution in Asia, fast-moving-consumer-goods and over the counter manufacturers and distributors in Asia, and finally global logistic service providers.

In a presentation to investors, DKSH shows that it has leading positions in the Consumer Goods division as well as the Technology division. In Healthcare it is number 2 behind Zuellig Pharma, a family owned company. In Performance Materials, it estimates its position as number 3 in Asia, and number 6 globally (see Figure 4 on next page). The company acknowledges that its market share in Performance Materials is weak. At the same time, there are very few synergies between this division and others. It is likely that DKSH wants to continue making acquisitions in this division (such as the last one they made, Terra Firma) in order to boost market share and obtain even higher operating margins, due to operating leverage. But the end game seems to be either a sale or a spin-off of Performance Materials.

DKSH is positioned in the fastest growing region of the world, Asia. The market growth is driven by sound economic fundamentals, favorable demographic trends, and increasing consumption levels. The company doesn't give any formal guidance but targets top-line growth of "GDP+", meaning faster than GDP growth.

Industry trends are also favorable to DKSH as they offer companies an opportunity to expand in Asia without taking much risk. Outsourcing and digitization, more complexity and regulations, and distributor network consolidation are all trends DKSH can capitalize on.

Mergers and acquisitions is also ingrained in DKSH's genes. In 2022 alone, DKSH made 5 acquisitions, of which Terra Firma, it's largest ever. Management is taking some time to ingrate them correctly, especially with their complex SAP system, but we would expect to see bolt-on acquisitions again soon.

Fig.4: DKSH's market position by industry

Source: Company data, IAM research

	Healthcare	Consumer Goods	Performance Materials	Technology
Region	16 markets in Asia Pacific	23 markets in Asia Pacific	33 markets in Asia Pacific, Europe, and North America	16 markets in Asia Pacific
Position[1]	2	1	6 Global 3 Asia	1
EBIT share	ca. 40%	ca. 20%	ca. 30%	ca. 10%
EBIT margin	2.6%	2.3%	7.7%	6.5%

Business Lines

Financial analysis

Growth

The chart in Figure 5 shows DKSH's revenues since 2009 (the first year of public disclosure since the IPO). Over the 13 years period, the compound annual growth rate was 4.5%. Over the shorter period of the last 5 years, the compound annual growth rate was only 0.6%, which is very disappointing. We need to keep in mind however that this encompasses COVID-19 impacted years. Also, as we will see further in the next section on margins, it is not quite representative of the efforts the company has made. Indeed, during that period, the company has shifted away from low-margin businesses which has impacted its top-line negatively, but the bottom line positively.

Margins

Figure 6 shows DKSH's operating margin over time. The first point to notice is how low margins are. This is clearly a volume driven business, akin to a traditional retail company. Therefore, even minute basis point changes can make a huge difference over time. While it may not seem like much, the increase from the 2020 low is significant (from 2.4% to 2.8%, a 16% increase).

Fig.5: DKSH's revenues over time (mn CHF)

Source: Company data, IAM research

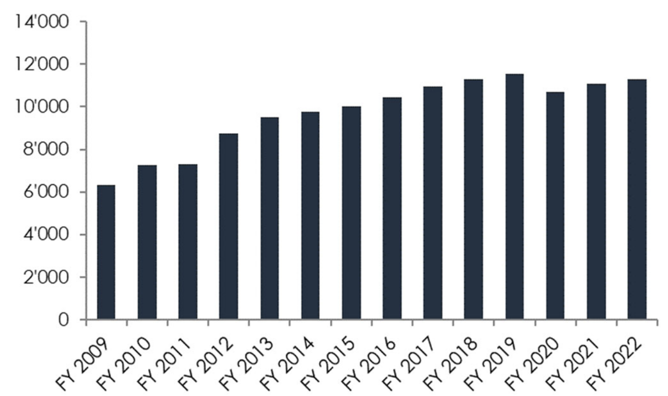
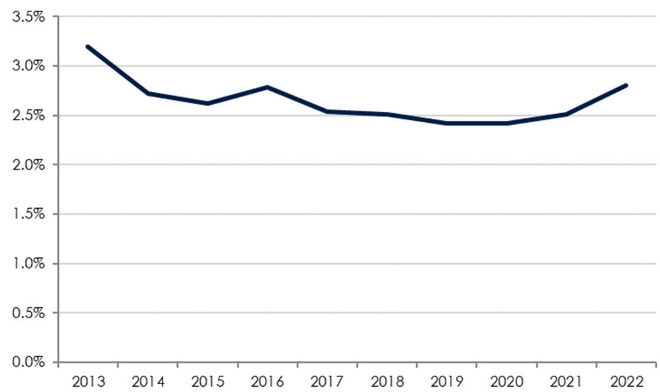


Fig.6: DKSH's EBIT margin over time

Source: Company data, IAM research



DKSH doesn't give any guidance on what margin level they target, but it's quite obvious from their acquisitions. As they disclose operating margins by division, it turns out that Performance Materials is the most profitable (7.2% margin after allocated "elimination" costs), then comes Technology (5.9%), Healthcare (2.1%), and Consumer Goods (1.8%). Paradoxically, the biggest divisions (Healthcare and Consumer Goods) have the lowest margins of the group. That's probably why DKSH wants to grow in Performance Materials and has made its biggest acquisition in that division.

Management is cognizant that the Consumer Goods business needs a higher margin, and they are targeting at least 2.5%. To reach this level, they have started analyzing products, contract by contract, and have not hesitated to let go customers with too low margins. This has resulted in a lower overall revenue figure as we have seen, but a margin boost.

Dividends

DKSH's dividend over time is shown in Figure 7 with the corresponding dividend yield. We can see that the dividend has increased every year—which is the definition of a progressive dividend policy—even in the COVID impacted years of 2020 and 2021. This progressive dividend policy is explicitly stated in the company's annual report.

We would like to remind investors that dividends are not a tax efficient way to return capital. Indeed, the dividend comes from money the company already paid taxes on, as it cannot deduct it as an expense. Afterwards, the investor is also taxed on this same amount (35% at source), so there is a double taxation of the distributed dividend. In contrast, share buybacks are a more efficient way to return capital back to shareholders, as they are only taxed at the company level.

Alas, in DKSH's case, we don't foresee a change of dividend policy. Indeed, the founders still hold 45% of the shares through the Diethelm Keller Holding company and are mostly interested in receiving a dividend (as well as having 2 board seats). The payout ratio was 60% in 2022.

Free Cash Flow

Free cash flow (FCF) is an essential component of any company and can be considered its life blood. Free cash flow refers to the cash a business generates after is has accounted for the outflow of money towards operations and maintaining capital assets. It is from FCF that the company can decide to either reimburse debt (capital allocation), make acquisitions (mergers & acquisitions), or distribute cash to shareholders (dividends and share buybacks).

Figure 8 shows DKSH operating cash flow, their capital expenditures and the resulting free cash flow. We can see that FCF has always been positive. Another striking feature is how small the capital expenditures are. The group prides itself being an "asset light" company, and in fact, capital expenditures represent at most only 0.5% of sales, which is indeed very low. Even in their own branded healthcare division, the company relies on external manufacturers to produce their products, so the cost of the manufacturing site is outsourced. Distribution

Fig.7: Dividend per share in CHF and dividend yield (rhs)

Source: Company data, IAM research

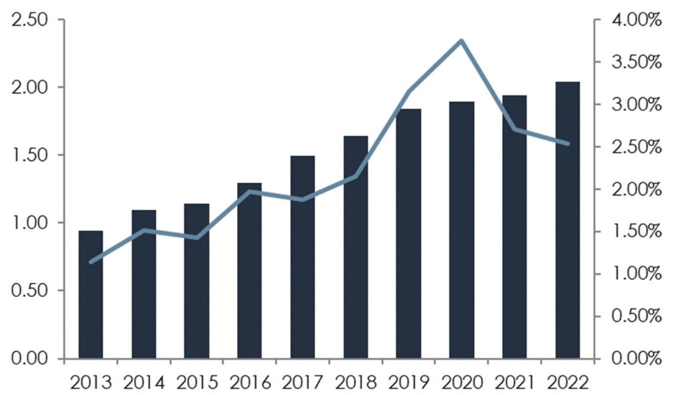
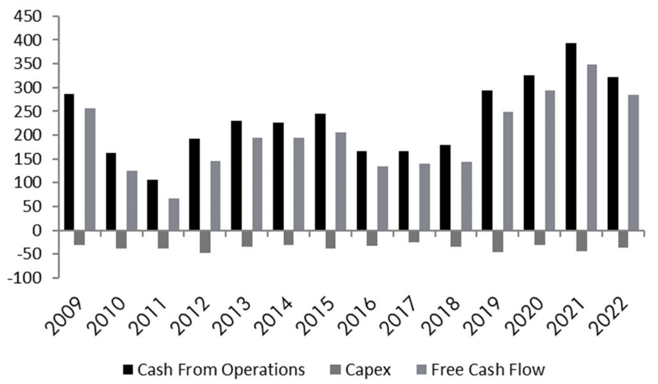


Fig.8: DKSH's cash flow over time

Source: IAM research



centers are typically leased and most of the transportation is outsourced to third parties.

We like how focused on FCF the company is. The group is even very conservative in their own definition of FCF and includes costs such as repayment of leases, purchases of intangible assets as well as trademarks/licenses.

Another metric the group measures is the cash conversion (free cash flow/core profit after tax). This shows how focused the company is on cash profits, not just accounting profits. On this metric, the group wants to achieve a ratio of over 100% (it was 100.6% in 2022 and 134.8% in 2021).

Return on Equity

Figure 9 shows DKSH's return on equity (ROE) over the last 13 years. The average is 13.6%.

For a company to add economic value, its ROE should be above its cost of equity. The cost of equity can be calculated with the risk free rate, the market return and the beta. Which beta to use can be subjective, so this is not a science. We take the current risk free rate from the Swiss National Bank's deposit rate of 1.75%. Using an adjusted beta of 0.8 and historic market return of 8%, we find a cost of equity of 6.75%. This means that DKSH is adding quite some economic value with its average ROE of 13.6%.

Balance Sheet

The chart in Figure 10 shows DKSH's Net Debt, as well as their Net Debt to EBITDA ratio (rhs). We can see that DKSH's management has always been conservative.

Fig.9: DKSH's Return On Equity (ROE)

Source: Company data, IAM research

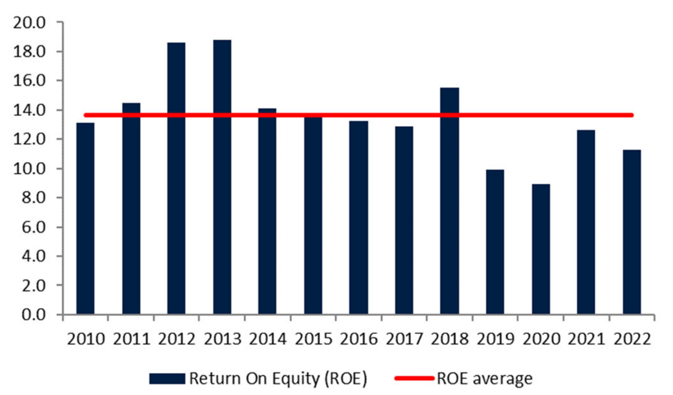
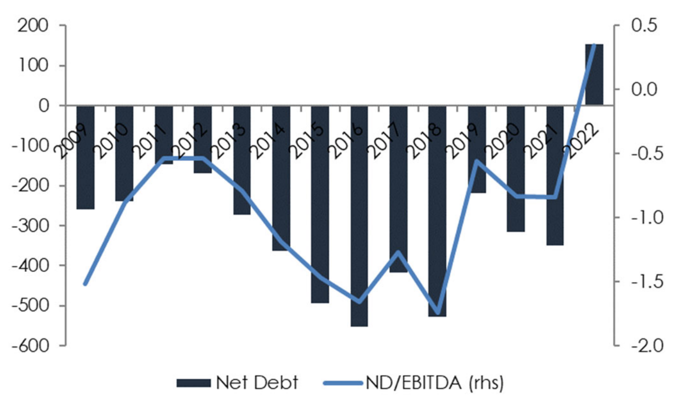


Fig.10: Net Debt (ND) and ND/EBITDA

Source: Company data, IAM research



Until 2022, the balance sheet had a net cash position. Only in 2022 did they increase the debt in order to purchase their largest acquisition (Terra Firma for an amount of USD 360 million).

Management has stated that if they found interesting acquisitions, the Net Debt/EBITDA could increase to a maximum of 2.0x.

Investment case

We like DKSH's value proposition as they address promising growth trends in the Asia-Pacific region. Their business is asset light, cash generative and surprisingly resilient. The group holds leading positions in the segments in which they operate.

Asia is the fastest growing region in the world, taking an increasing percentage of the world's annual trade value each year. DKSH is one of the few Swiss companies who has such a focus on Asia.

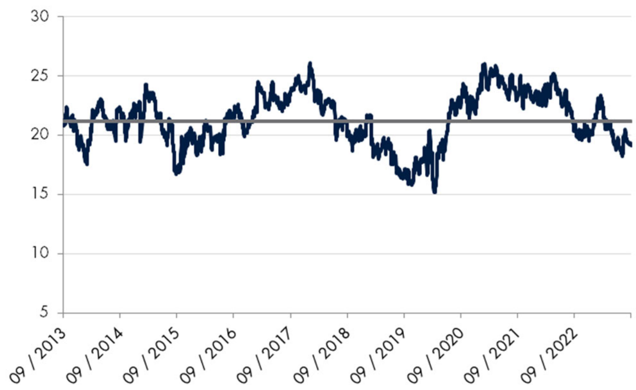
Management is also shareholder friendly, paying a generous dividend (leaving aside fiscal considerations). Its focus on cash returns is laudable. Overall, management appears as prudent realists, and never issue hard figures in their outlook, but only qualitative statements.

The balance sheet is clean and can be seen as conservative, but could clearly be leveraged in case of an interesting acquisition being available.

We dislike the conglomerate structure, but management reminded us that each division is run separately and each needs to cover its cost of capital.

Fig.11: 12M forward P/E over last decade

Source: IAM research



Valuation

The chart in Figure 11 depicts DKSH's price to earnings (P/E) multiple over the past decade and its average (21.2x).

The current valuation is below its historical average, which for us gives an attractive entry point. We doubt that valuation will fall back to COVID levels (bar an unforeseen other pandemic).

On the contrary, with increasingly positive news on the pandemic side, the return of tourists, and increasing operating margins, we believe that the valuation will return to new highs. What is lacking right now is a catalyst, so the time frame is uncertain. Investors are a bit in a "wait and see" mood, as management needs to show that topline growth can return, all the while improving operating margins.

We think that management can unlock value over time, but this will require that they refocus the company such as to remove the conglomerate discount.

SWOT

Strengths

- Largest provider of market expansion services in Asia with over 150 years of market experience and strong roots in Asia
- Scalable business model: new products are easily integrated into the existing network, and products from existing customers can easily be distributed in other countries
- High barriers to entry
- Strong management with focus on ROCE
- Exposure to Southeast Asia growth dynamics
- Strong balance sheet

Weaknesses

- Growth momentum has weakened significantly since the IPO in 2012
- High capital intensity (Net Working Capital) in Consumer Goods, but lower in Healthcare
- Dependence on many different distribution partners in individual countries

Opportunities

- Market expansion services is a growth industry with strong demand from western consumer companies to expand their exposure to Asia Pacific
- Expansion of services to other countries and regions
- Reference prices and generic substitution for large therapeutic categories increases pressure on pharmaceutical companies and could trigger outsourcing demand to DKSH

Risks

- Political and economic risks of Asia Pacific countries
- Declining demand from Asian consumers for products from Western consumer goods manufacturers
- Loss of important customers who want to take over distribution, development, or collection themselves (insourcing)
- Countries with high dependency on tourism (such as Thailand) have seen a large negative impact from COVID-19
- 45% of outstanding shares are held by a shareholder consortium, which could decide to sell and put pressure on the stock price