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|---|-------------------------------|-------------------------|
| ESTHETICS INTERNATIONAL GROUP Results Report Stock Code: 5081 | Price: | RM0.96 |
| | Market Capitalisation: | RM115.2m |
| | Board: | Main Board |
| | Sector: | Trading/Services |
| | Recommendation: | Hold |

KEY STOCK STATISTICS

| | 2005 | 2006F |
|-----------------------------|-----------------|-------|
| EPS (sen) | 10.4 | 10.6 |
| P/E (x) | 9.2 | 9.0 |
| Dividend/Share (sen) | 6.0 | 9.0 |
| NTA/Share (RM) | 0.74 | 0.80 |
| Book Value/Share (RM) | 0.74 | 0.80 |
| Issued Capital (mil shares) | 117.8 | 120.0 |
| 52-weeks Share Price Range | RM0.88 - RM1.25 | |
| <u>Major Shareholders</u> | <u>%</u> | |
| Li mYee Soon | 25.1 | |
| Melissa Chen | 22.4 | |

PER SHARE DATA

| YE 30 Jan | 2003 | 2004 | 2005 | 2006F |
|----------------------|----------|----------|----------|----------|
| Book value (RM) | 0.55 | 0.67 | 0.74 | 0.80 |
| Cash Flow (RM) | 0.14 | 0.14 | 0.12 | 0.12 |
| Earnings (sen) | 12.0 | 12.1 | 10.4 | 10.6 |
| Gross Dividend (sen) | - | 2.5 | 6.0 | 9.0 |
| Payout Ratio (%) | - | 15.4 | 35.3 | 50.8 |
| PER (x) | 8.0 | 7.9 | 9.2 | 9.0 |
| P/Cash Flow (x) | 6.8 | 6.8 | 8.3 | 7.9 |
| P/Book Value (x) | 1.7 | 1.4 | 1.3 | 1.2 |
| Dividend Yield (%) | - | 2.6 | 6.3 | 9.4 |
| ROE (%) | 21.7 | 19.7 | 15.8 | 13.8 |
| Net Gearing (%) | net cash | net cash | net cash | net cash |

P&L ANALYSIS (RMm)

| YE 30 Jan | 2003 | 2004 | 2005 | 2006F |
|-------------------------|--------------|--------------|--------------|--------------|
| Revenue | 65.57 | 62.59 | 80.66 | 88.50 |
| Operating profit | 19.30 | 17.87 | 19.72 | 20.89 |
| Depreciation | (2.25) | (2.17) | (2.33) | (2.63) |
| Net interest income | 0.46 | 0.53 | 1.23 | 0.84 |
| Exceptional items | - | - | - | - |
| Pre-associate profit | 17.51 | 16.22 | 18.62 | 19.10 |
| Associates | (0.22) | (0.19) | (0.89) | (0.80) |
| Pretax profit | 17.30 | 16.04 | 17.73 | 18.30 |
| Taxation | (5.65) | (4.33) | (5.46) | (5.49) |
| Minorities | (0.03) | (0.02) | (0.06) | (0.06) |
| Net profit | 11.61 | 11.69 | 12.22 | 12.75 |
| Operating margin (%) | 29.4 | 28.6 | 24.4 | 23.6 |
| Pretax margin (%) | 26.4 | 25.6 | 22.0 | 20.7 |
| Net margin (%) | 17.7 | 18.7 | 15.2 | 14.4 |
| Effective tax rate (%) | 32.7 | 27.0 | 30.8 | 30.0 |

1 1Q 2005 Result Highlights

| YE 30 Jan (RMm) | 1Q05 | 1Q06 | % Change |
|--------------------------|-------|-------|----------|
| Revenue | 17.3 | 19.3 | 11.5 |
| Operating Profit | 3.5 | 2.7 | (22.5) |
| Net Interest Inc / (Exp) | 0.1 | 0.2 | |
| Depreciation | (0.6) | (0.6) | |
| Pretax Profit | 3.0 | 2.2 | (26.0) |
| Net Profit | 1.9 | 1.5 | (20.8) |
| Operating margin (%) | 20.0 | 13.9 | |
| Pretax margin (%) | 17.4 | 11.6 | |
| Net margin (%) | 11.1 | 7.9 | |

Below expectations. For the 3 months ended April 2005, Esthetics International Group ("EIG") posted a net profit of RM1.5m on a turnover of RM19.3m. Although EIG's first quarter is usually its weakest, its 1QFY06 earnings accounted for only 11.9% of our full year forecast of RM14.8m, down from the 15.7% in 1QFY05.

Revenue grew a healthy 11.5% YoY. EIG improved its revenue by 11.5% YoY to RM19.3m in 1QFY06. The increase was driven by higher revenue from its distribution business in Hong Kong and the launch of its new Radiancy beauty equipment unit.

In March 2005, the Group signed the Distributorship Agreement with Radiancy Asia Pte Ltd for the exclusive rights to distribute selected Radiancy products in Malaysia for 3 years. Maiden 1-month sales in April 2005 amounted to RM1.5m.

But dragged down by lower margins and start-up costs. Notwithstanding the higher revenue, EIG suffered a 26% YoY fall in pretax profit to RM2.2m. Management attributed the decline to lower gross profit margins and start-up losses from its direct selling operations. These led to a sharp 6.1%-points cut in operating margin to 13.9%.

EIG's gross margins were hurt by (1) a special sales arrangement with a major international corporate client in Hong Kong for purpose of brand promotion with minimal margin; and (2) lower sales to local dealers due to the softer retail market. EIG earns higher margins from sales to local dealers.

The Group had expensed off in 1QFY06 about RM180,000 of costs related to the establishment of its direct selling operations. Management expects its direct selling business to commence in July-August 2005.

2 Earnings Forecast

Addressing drop in margin. Notwithstanding the weak margins seen in 1QFY06, we believe EIG would be able to sustain its EBITDA margin at FY05's 24% level. It has announced a 3-5% increase in selling price of its Dermalogica products, to be effective 1 June 2005. Furthermore, losses from its direct selling division would be lower in the coming quarters as certain professional fees incurred in 1QFY06 would not be repeated.

Earnings projection lowered. Consumer sentiment has softened in recent times. This can be attributed to rising cost of living, due to the knock-on effect of high crude oil prices, as well as the poor performance of the local stock market. We believe weak consumer sentiment coupled with keen competition in the body wellness industry, would moderate growth of EIG's products and services in the coming quarters.

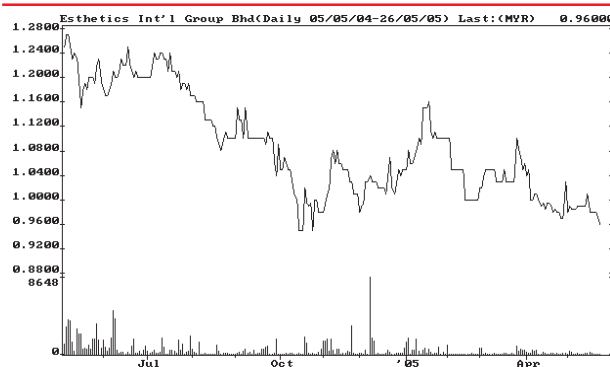
Factoring lower revenue growth of 10% vs 19% previously, we have lowered our net profit projection from RM14.8m to RM12.8m for FY06. This compared with earnings of RM12.2m achieved in FY05

3 Recommendation

Downgraded to a Hold. Pegging EIG's CY05 EPS of 10.6 sen at PER of 10x, which is a 20% discount to Eng Kah Corporation's multiple of 12.6x, we arrive at a fair value of RM1.06. This suggests potential upside of 10.4%.

We are downgrading our recommendation from Buy to **Hold** given the flat earnings outlook for FY06. However, investors looking for high dividend yield stocks should consider EIG's high yield of 9.4%.

PRICE CHART/COMPARATIVE CHART



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