

ESTHETICS INTERNATIONAL GROUP Update Report Stock Code: 5081	Price:	RM0.80
	Market Capitalisation:	RM96.0m
	Board:	Main
	Sector:	Trading/Services
	Recommendation:	Buy

KEY STOCK STATISTICS

	2005	2006F
EPS (sen)	10.4	11.2
P/E (x)	7.7	7.1
Dividend/Share (sen)	6.0	7.5
NTA/Share (RM)	0.74	0.81
Book Value/Share (RM)	0.74	0.81
Issued Capital (mil shares)	117.8	120.0
52-weeks Share Price Range	RM0.78 - RM1.18	
Major Shareholders	%	
Lim Yee Soon	25.1	
Melissa Chen	22.4	

PER SHARE DATA

YE 30 Jan	2004	2005	2006F	2007F
Book value (RM)	0.67	0.74	0.81	0.89
Cash Flow (RM)	0.14	0.12	0.13	0.16
Earnings (sen)	12.1	10.4	11.2	13.7
Gross Dividend (sen)	2.5	6.0	7.5	9.5
Payout Ratio (%)	15.4	35.3	40.0	41.6
PER (x)	6.6	7.7	7.1	5.8
P/Cash Flow (x)	5.7	6.9	6.3	4.9
P/Book Value (x)	1.2	1.1	1.0	0.9
Dividend Yield (%)	3.1	7.5	9.4	11.9
ROE (%)	19.7	15.8	14.5	16.1
Net Gearing (%)	net cash	net cash	net cash	net cash

P&L ANALYSIS (RMm)

YE 30 Jan	2004	2005	2006F	2007F
Revenue	62.59	80.66	99.33	112.60
Operating profit	17.87	19.72	22.10	25.31
Depreciation	(2.17)	(2.33)	(2.63)	(3.00)
Net interest income	0.53	1.23	0.69	0.95
Exceptional items	-	-	-	-
Pre-associate profit	16.22	18.62	20.15	23.26
Associates	(0.19)	(0.89)	(0.80)	-
Pretax profit	16.04	17.73	19.35	23.26
Taxation	(4.33)	(5.46)	(5.81)	(6.74)
Minorities	(0.02)	(0.06)	(0.06)	(0.06)
Net profit	11.69	12.22	13.49	16.46
Operating margin (%)	28.6	24.4	22.2	22.5
Pretax margin (%)	25.6	22.0	19.5	20.7
Net margin (%)	18.7	15.2	13.6	14.6
Effective tax rate (%)	27.0	30.8	30.0	29.0

1 Recent Developments

Higher selling prices to stem margin erosion. Earlier this year, Esthetics International Group's ("EIG") *Dermalogica* franchise suffered some margin erosion due to the increase in transport cost. To restore margins, EIG raised prices to dealers by 3-5% in June 2005 and to consumer by 3-5% in July 2005. The prices of treatments have also been increased in July 2005.

This has somewhat dampened demand but management would carry out promotions to drive sales and sustain revenue. We gather that costs related to these promotional programmes are easily recouped from sales generated.

EIG holds the exclusive rights to distribute *Dermalogica* products in Malaysia, Thailand, Singapore, Indonesia, Vietnam, Brunei, Cambodia, Hong Kong and Philippines. Its business arrangement with *Dermalogica* Inc, USA also entitles the Group to use the *Leonard Drake* trademark for its professional skin care service centres.

Taking it easy with expansion plans. As a strategy to boost revenue from the *Dermalogica* franchise and EIG's own range of professional skin care products *Belle Lina*, the Group had planned on tapping new customer segments, namely the bumiputera and male markets.

However, management has decided to put on hold plans to venture into the male market despite having done a concept study for the set-up of a professional skin care centre for men under *Belle Lina*. We believe this decision was prompted by the need to raise awareness of the *Belle Lina* brandname to ensure success of such a venture. As for attempts to penetrate the Malay market, the results have been slow.

Hence, we reckon that growth for its *Dermalogica* and *Belle Lina* franchises would continue to come from the opening of skin care centres in new shopping malls in the west coast of the Peninsular. Following the opening of centres in Hartamas Shopping Centre in Sri Hartamas and Shah Alam City Centre in March-April and Jusco Seremban in September, new locations lined up include KLCC Suria and Lot 10 (relocated from KL Plaza) in

November 2005, and Jusco Tebrau in Johor Baru by February 2006.

Clinelle making good progress. With revenue from the provision of professional services under *Leonard Drake* and *Belle Lina* projected to grow by 7-8% p.a. in FY06-07, EIG's turnover would be driven mainly by its distribution activities. The more aggressive marketing of its in-house brand "*Clinelle*", first launched in 2003, has raised contributions from the Group's distribution division to 70% of total revenue from 60% previously.

Clinelle is raking in sales of about RM550k-600k per month and management indicated that the brand has broke-even in the first half of financial year ending January 2006.

Clinelle is EIG's in-house range of cosmeceutical products that is positioned as higher-priced fast moving consumer goods ("FMCG"). Currently, the brand has 10 SKUs that are sold on major pharmacies such as Guardian, Vital Care Pharmacies, Watsons and Jusco stores.

Direct marketing business has kicked off. Another source of revenue for EIG's distribution division is its direct marketing business. Lexwel International Sdn Bhd, the unit undertaking this new venture, commenced operations in late-August 2005 with 3 SKUs consisting dietary supplements. Sales for its first month was RM130,000.

Lexwel's immediate task is to recruit multi-level marketing ("MLM") leaders. This is important as dynamic leaders would help drive growth in Lexwel's business.

Management is aiming for "a small" profit from the direct selling operations for FY06. We believe this is an ambitious target given that Lexwel would have been in operations for only five months come end-January 2006.

While EIG's venture into the direct selling business would provide the Group with a new source of earnings, we do not foresee Lexwel being a significant contributor over the next few years. The MLM business has

become very competitive in the last few years, as evident by Amway Malaysia Holdings' flat earnings of between RM51.9m-53.6m for FY8/03 to FY8/05. Given the numerous direct selling companies in the market, recruitment of agents has also become a challenging task.

2 Earnings Outlook

Bottomline to improve by 10% in FY06 ... For FY06, we expect EIG to improve its turnover by 23.1% to RM99.3m. Growth would come mainly from a projected 33% increase in revenue to RM66.6m from the Group's distribution activities. Growing sales from *Clinelle* as well as maiden contributions from the distribution of *Radiancy* range of skin care therapy equipment (agency secured in March 2005) would be key factors behind the expected jump in the distribution division's revenue.

However, EIG would not be able to fully translate the increase in revenue to its bottomline due to expenses incurred for the face-lift exercises for its *Leonard Drake* and *Belle Lina* centres coupled with higher transportation costs. With a projected 1.2%-point drop in EBITDA margin to 22.2%, net profit would rise by a smaller 10.4% to RM13.5m in FY06.

... but a stronger 22% in FY07. Earnings are projected to rise by a stronger 22% to RM16.5m in FY07 aided by a 13.4% increase in revenue to RM112.6m, a slight improvement in margin to 22.5%, stable depreciation charges and lower tax provisions.

3 Recommendation

EIG offers attractive dividend yields. At RM0.80, EIG is trading at 7.2x CY05 EPS of 11.2 sen and 5.9x CY06 EPS of 13.5 sen. Pegging CY06 EPS at a mere 7x multiple, which is a hefty 50% discount to current market average of 14x, we arrive at a fair value of RM0.95.

EIG may not appeal to investors looking for strong earnings growth prospects. But those looking for high dividend stocks would find its dividend yields of 9% and 12% for FY06-07 very attractive.

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