

Natural Beauty

Tough year ahead

HOLD (from BUY)

Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (HK\$m)	450.1	592.7	518.7	594.9	720.3
Net Profit (HK\$m)	178.7	238.5	172.6	212.3	269.1
EPS (RMB)	0.089	0.119	0.086	0.106	0.135
EPS Δ%	45.1	33.4	(27.6)	23.0	26.8
P/E (x)	12.8	9.6	13.2	10.7	8.5
P/B (x)	2.49	2.66	2.65	2.43	2.25
EV/EBITDA (x)	7.7	5.4	7.0	5.7	4.3
Yield (%)	8.1	7.3	5.3	6.5	8.3
ROE (%)	19.9	26.9	20.1	23.6	27.6
ROCE (%)	19.8	26.7	20.0	23.6	27.6
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

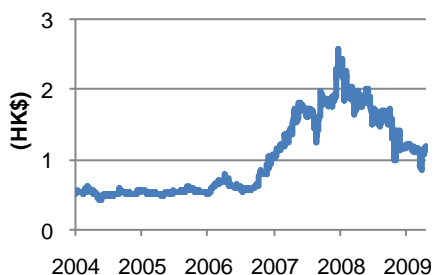
Source: SBI E2-Capital

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+2.2	-20.4	-1.5
Actual price changes (%)	+26.7	-4.2	-35.2

	09F	10F	11F
Consensus EPS (HK\$)	0.148	0.163	0.150
Previous forecasts (HK\$m)	313.9	386.2	-
Previous EPS (HK\$)	0.157	0.193	-

Price Chart


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Ticker:	0157.HK	12 mth range:	HK\$0.84-2.01
Price:	HK\$1.14	Market cap:	US\$292.4m
Target:	HK\$1.27(+10%)	Daily t/o, 3 mth:	US\$2.8m
		Free float %:	46.4%

Key points:

- * FY12/08A turnover up 31.7% and net profit up 33.4%. Strong gross margin of 85.5%
- * PRC Revenues were up 37.8% while Taiwan achieved 24.8% growth
- * Strong headline numbers masked a dramatic 2H slowdown. Turnover growth decelerated to 7.8% from 63.4% in 1H, though the strong 1H growth was likely result of inventory stocking
- * Growth in emerging health supplement segment may partially cushion slowdown going forward
- * Revise down FY12/09F earnings to HK\$172.6m. More importantly, we are only factoring in a moderate rebound in FY12/10F with a net profit of HK\$212.3m
- * Downgrade to HOLD, revised target price HK\$1.27, representing 9.0x FY12/10F ex-cash P/E

FY12/08A net profit up 36.0%. Natural Beauty's (NB) FY12/08A turnover was up 31.7% YoY to HK\$592.7m, gross profit up 36.0% YoY to HK\$506.6m while net profit came in at HK\$238.6m, representing an increase of 33.4% YoY. Gross margin came in at 85.5%, up 2.7pcp YoY. The results came in below our already below consensus estimates.

Geographical breakdown. On a geographical basis, PRC revenues were up 37.8% YoY to HK\$436.5m, and represented 73.6% of revenues. Meanwhile, Taiwan revenues were HK\$146.8m, up 24.8% YoY. China's average sales per store was up 30.2% YoY to HK\$293.0k and Taiwan's increased 30.4% YoY to HK\$300.0k. As at end-Dec 2008, China had 1,510 stores (FY12/07A: 1,465) while Taiwan had 457 stores (FY12/07A: 457).

2H deterioration. The strong headline numbers masked a significant business in 2H FY12/08, which is traditionally a stronger than 1H. For 2H FY12/08A, turnover increased only 7.8% YoY to HK\$277.1m (1H: +63.4%), though we have remarked previously that we think 1H growth was boosted by inventory stocking of new large sized stores opened in the first half of 2008. China was up 13.2% YoY (1H: +69.1%) but Taiwan was down 6.9% (1H: +49.8%). This was not surprising given the global economic slowdown that occurred throughout 2H last year. Management remarked that they began to witness the slowdown in Oct for Taiwan and Nov for China.

Difficult FY12/09 ahead. NB looks to have a difficult 2009 ahead. The company's products are largely discretionary, which means that the current economic conditions would have a large impact on NB's operations. Management remarked that thus far, IQ average sales per store is down ~20% YoY in both China and Taiwan. They indicated that customers remain loyal, with frequency of visits largely remain the same though "average spend per visit" was down. We were slightly surprised by this given that consumer spend in China has continued to show sustainable growth. The company is likely to stay away from product price cuts, instead preferring to "offer more value" by throwing in more sample products per purchase and launching more "affordable" mid-price products. One bright spot for the company however, is their health supplement business. Sales in FY12/08 grew 187.3% YoY to HK\$47.4m, representing 8.0% of overall revenues. This emerging growth driver may cushion some of the slowdown for the company in FY12/09F and FY12/10F.

Revising down estimates. We are taking down our FY12/09F net profit estimate to HK\$172.6m (from HK\$313.9m). The significant cut in our earnings estimate is due to a combination of: 1) revenue decline of 12.5% YoY, 2) gross margin decline of 2.5pcp and 3) significant operating deleveraging of its opex. More importantly, we are only projecting a mild revenue rebound of 14.7% YoY in FY12/10F. Our reasoning is that customer visit frequency remain stable thus far in 2009 as many are tied to perhaps yearly plans. But as they come off their plans, we think NB may face some difficulties to renew subscriptions. We are projecting FY12/10F net profit to be HK\$212.3m and for the company's net profit in FY12/11F to reach HK\$269.1m.

Downgrade to HOLD. We downgrade our call on NB to HOLD (from BUY) and revise down our target price to HK\$1.23 representing 9.0x FY12/10F ex-cash P/E.

Table xx: P & L

Year to Dec (RMBm)	07A	08A	09F	10F	11F
Turnover	450.1	592.7	518.7	594.9	720.3
Cost of sales	(77.6)	(86.1)	(87.8)	(102.6)	(121.0)
Gross profit	372.6	506.6	430.8	492.3	599.3
Other net (loss)/income	32.5	58.2	37.8	41.6	36.0
Selling and distribution costs	(117.9)	(127.6)	(121.9)	(136.8)	(154.9)
Administrative expenses	(74.5)	(112.7)	(108.9)	(119.0)	(129.7)
Operating profit	212.6	324.5	237.9	278.1	350.8
Other operating expenses	(4.2)	(16.0)	(7.8)	(5.9)	(5.8)
Share of loss of an associate	(0.3)	-	-	-	-
Pre-tax profit	208.0	308.5	230.1	272.2	345.0
Tax	(29.2)	(69.9)	(57.5)	(59.9)	(75.9)
Minority interests	(0.1)	(0.1)	-	-	-
Net profit	178.7	238.5	172.6	212.3	269.1

Source: Company data and SBI E2-Capital

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