

Natural Beauty



BUY (unchanged)

Positive stance maintained

Key points:

- 1H FY12/08A results soundly beats our expectations. Net profit up 101.6% YoY to HK\$149.8m
- China remains key driver with revenue surging 69.0% YoY to HK\$235.5m, with average sales per store up 54.4% YoY to HK\$159,000
- Stronger than expected 1H results partly due to inventory ramp by franchisees. We expect growth in 2H to be more moderate
- Acquisition of Bio-Med is positive and paves the way for new growth driver in mid term. For 1H FY12/08A, health supplements revenue was HK\$20.4m, up 149.0% YoY
- Revising up FY12/08F to FY12/10F net profit by 20.0%, 17.0% and 13.3% respectively
- Maintaining BUY call and our target price of HK\$2.65, representing 16.0x FY12/09F ex-cash P/E. 52.3% upside

Exceeding expectations. Natural Beauty's (NB) 1H FY12/08A results soundly beat our expectations. Revenue jumped 63.4% YoY to HK\$315.6m on broad based growth (China up 69.0% YoY, Taiwan up 50.0% YoY). Net profit surged 101.6% YoY to HK\$149.8m on better control of unallocated expenses and a lower effective tax rate. The overall gross margin was steady at 83.9% (1H FY12/07A: 83.8%) and the net margin widened 8.9pcp to 47.4%. NB opened a total of 130 new stores and closed 98 in 1H FY12/08A.

China remains key driver. China revenue was up 69.0% YoY at HK\$235.5m. The average number of stores was 1,481.0 (from 1,407 for FY12/07), while average sales per store surged 54.4% YoY to HK\$159,000. The gross margin was flat at 84.8% while the operating margin contracted 3.0pcp to 57.4%, because of increasing sale and distribution expenses, in our view. Management said that NB was able to raise prices of some products by around 10%.

Taiwan bucks the trend. Despite a weak economic environment, NB's Taiwan revenue increased 50.0% to HK\$75.8m, with the new "Fonperi" line accounting for HK\$7.9m (10.4% of the total). The gross margin widened 2.8pcp YoY to 89.0% and operating margin 2.0pcp to 37.1%. We estimate that the Fonperi line lost HK\$5.9m in 1H FY12/08A. The company had 3,903 Fonperi points of sales at end-1H 2008, from 1,394 at end-Dec 2007 and 3,744 at 1Q 2008. NB also launched a series of 12 Fonperi products for men.

NB-1 series delivering value. The company sold 156,000 sets/bottles of NB-1 series products (high-end line) and generated revenue of HK\$111.5m, up 130.4% YoY. The NB-1 series now account for 35.3% of revenue (1H FY12/07A: 25.1%).

More moderate growth in 2H. Historically, NB's sales are

China Retail

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Stock data

Price	HK\$1.74
Target price	HK\$2.65 (+52.3%)
12 mth range	HK\$1.41-2.77
Market cap.	US\$446.3m
Daily t/o, 3 mth	US\$0.12m
Free float %	46.4%
Ticker	0157.HK/157 HK

Financial summary

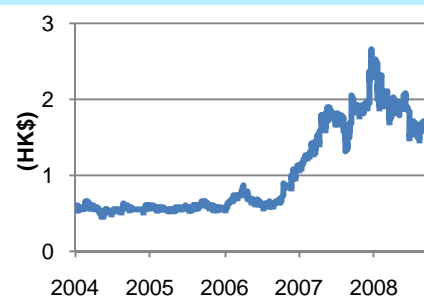
Year to Dec	06A	07A	08F	09F	10F
Turnover (HK\$m)	363.7	450.1	631.9	841.1	1046.0
Net Profit (HK\$m)	123.2	178.7	270.1	313.9	386.2
EPS (HK\$m)	0.062	0.089	0.135	0.157	0.193
EPS Δ%	51.9	45.1	51.2	16.2	23.0
P/E (x)	30.5	21.0	12.9	11.1	9.0
P/B (x)	4.28	4.13	3.86	1.66	1.36
EV/EBITDA (x)	17.6	14.5	8.6	4.3	2.7
Yield (%)	2.3	8.6	5.2	6.0	7.4
ROE (%)	14.6	20.0	29.7	21.0	16.6
ROCE (%)	14.4	19.8	29.5	20.9	25.7
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+15.4	+30.7	+30.2
Actual price changes (%)	+2.4	+8.8	-7.9

	08F	09F	10F
Consensus EPS (HK\$)	0.116	0.138	0.157
Previous forecasts (HK\$m)	225.1	268.2	340.9
Previous EPS (HK\$)	0.113	0.134	0.170

Price Chart



stronger in 2H but this may not be the case in FY12/08. In our view, the company's strong 1H results were partly driven by a combination of factors: 1) franchises' stocking up inventory prior to the Olympics Games in Beijing; 2) opening of larger stores, which required more inventory. We do not expect the same pace of growth in 2H as part of the 2H revenue has shifted to 1H and possible negative effects on China's economy from a potential global economic slowdown.

Margins - slight concern. While we are still positive on the overall growth prospects of NB, we are slightly concerned about its margins. Despite 1) better product sales mix (favouring high-end NB-1); 2) repackaging efforts (cutting packaging costs) and 3) price rises for some products, NB was only able to improve its gross margin marginally. This suggests that NB may be facing production cost rises. Meanwhile, selling and distribution expenses have been rising in China. In the near term, we expect the narrowing losses (or turnaround) for Fonperi as revenue for this product line ramps up and continuing introduction of new products to help sustain margins.

Acquisition of health supplement maker. In Aug 2008, NB announced a connected transaction acquisition of Shanghai Natural Beauty Bio Med Co Ltd (Bio-Med) for HK\$25.8m in cash. The consideration represents a valuation of about 1.0x P/B and 13.1x P/E, based on 2007 numbers. Bio-Med is principally engaged in the R&D and manufacturing of health supplements. NB already sources its health supplement products from Bio-Med. In 1H FY12/08A, health supplements generated HK\$20.4m in revenue (up 149.0% YoY). The acquisition and consolidation of Bio-Med will help lift NB's margins.

Still positive. The company aims to open 250 stores in FY12/08F and not less than 250 in FY12/09F. We expect the company to miss this target slightly due to its preference for large stores. In the near term, NB's growth will come from the expansion of its franchise network, new product launches and Fonperi's turnaround. In the mid-term, the emerging health product line will become the next key growth driver.

Maintain BUY call, target price HK\$2.65. We revise up our FY12/08F to FY12/10F net profit numbers by 20.0%, 17.0% and 13.3% respectively to HK\$270.1m, HK\$313.9m and HK\$386.2m. The company remains cash rich with HK\$780.5m in cash and cash equivalents at end-1H FY12/08A. We maintain our positive outlook on NB and re-iterate our BUY call. We maintain our target price at HK\$2.65 representing 16.0x FY12/09F ex-cash P/E. We have adjusted our valuation to reflect a lower risk appetite of the market.

Disclosure of interests: SBI E2-Capital Securities Ltd. acted as the bookrunner for Natural Beauty on November 28, 2007 for vendor share placement at HK\$1.91 per share for 94.47m shares.

P & L (HK\$m)	06A	07A	08F	09F	10F	Cash Flow (HK\$m)	06A	07A	08F	09F	10F
Year to Dec						Year to Dec					
Turnover	363.7	450.1	631.9	841.1	1,046.0	EBIT	170.1	201.3	295.3	392.2	471.5
% chg	1.6	23.8	40.4	33.1	24.4	Depre./amort.	21.9	17.5	19.8	21.0	22.0
Gross profit	295.0	372.6	527.7	693.8	846.5	Net int. paid	4.3	6.8	8.4	10.2	23.6
EBITDA	192.1	218.8	315.1	413.2	493.5	Tax paid	(44.2)	(52.2)	(25.8)	(64.3)	(91.5)
Depre./amort.	(21.9)	(17.5)	(19.8)	(21.0)	(22.0)	Dividends received	-	-	-	-	-
EBIT	170.1	201.3	295.3	392.2	471.5	Gross cashflow	152.1	173.4	297.7	359.0	425.6
Net int. income/(exp.)	4.3	6.8	8.4	10.2	23.6	Chgs. in working cap.	(42.6)	79.2	5.3	(137.9)	(127.2)
Exceptionals	-	-	-	-	-	Operating cashflow	109.6	252.5	303.0	221.1	298.5
Associates	-	-	-	-	-	Capex	(25.8)	(53.8)	(25.0)	(20.0)	(20.0)
Jointly-controlled entit.	-	-	-	-	1.0	Free cashflow	83.8	198.8	278.0	201.1	278.5
Pre-tax profit	174.5	208.0	303.7	402.4	495.1	Dividends paid	(80.3)	140.0	300.0	142.0	146.0
Tax	(51.6)	(29.2)	(33.4)	(88.5)	(108.9)	Net distribution to MI	-	-	-	-	-
Minority interests	0.4	(0.1)	(0.2)	0.0	0.0	Investments	(0.4)	0.3	0.0	-	-
Net profit	123.2	178.7	270.1	313.9	386.2	Disposals	0.1	157.7	-	-	-
% chg	51.9	45.1	51.2	16.2	23.0	New shares	-	-	-	-	-
Dividends	80.0	300.0	179.5	208.5	256.6	Change in loans	-	-	-	-	-
Retained earnings	203.2	478.7	449.6	522.4	642.7	Others	15.5	(292.0)	(386.3)	596.1	-
EPS (HK\$) - Basic	0.062	0.089	0.135	0.157	0.193	Net cashflow	18.7	204.8	191.8	939.2	424.4
EPS (HK\$) - F.D.	-	-	-	-	-	Net (debt)/cash - Beg.	365.2	384.0	588.7	780.5	1,719.7
DPS (HK\$)	(0.040)	(0.150)	(0.090)	(0.104)	(0.128)	Net (debt)/cash - End.	384.0	588.7	780.5	1,719.7	2,144.1
No. sh.s o/s (m) - W.A.	2,000.0	2,000.0	2,000.0	2,000.0	2,000.0	Interim Results (HK\$m)	06A	07A			
No. sh.s o/s (m) - Y.E.	2,000.0	2,000.0	2,000.0	2,000.0	2,000.0	Six months to Jun					
No. sh.s o/s (m) - F.D.	-	-	-	-	-	Turnover	163.6	193.2			
Margins (%)						% chg	0.3	18.1			
Gross	81.1	82.8	83.5	82.5	80.9	Profit from operations	72.8	95.5			
EBITDA	52.8	48.6	49.9	49.1	47.2	Interest expenses	-	-			
EBIT	46.8	44.7	46.7	46.6	45.1	Associates	0.0	0.0			
Pre-tax	48.0	46.2	48.1	47.8	47.3	Jointly-controlled entit.	-	-			
Net	33.9	39.7	42.7	37.3	36.9	Pre-tax profit	72.8	95.5			
						Tax	(23.4)	(21.2)			
						Minority interests	0.2	0.0			
						Net profit	49.4	74.3			
						% chg	50.7	50.4			
						EPS (HK\$) - Basic	0.025	0.037			
						DPS (HK\$)	(0.020)	(0.050)			
Balance Sheet (HK\$m)	06A	07A	08F	09F	10F	Shareholding Structure					
Year to Dec									Shares o/s (m)	%	
Fixed assets	335.7	222.6	235.6	222.2	224.7	Dr. Tsai Yen Yu			933.0	46.7	
Intangible assets	-	-	-	(0.0)	(0.0)	Dr. Su Chien Cheng			233.5	11.7	
Other LT assets	49.3	50.8	52.1	52.7	53.3	Dr. Su Sh Hsyu			233.5	11.7	
Cash and cash equiv.	384.0	588.7	780.5	1,719.7	2,144.1	Martin Currie			180.0	9.0	
Accounts receivable	86.0	59.4	79.6	110.9	137.9	Keywise Capital Management			120.0	6.0	
Other receivables	78.9	39.6	-	74.0	92.1	Public shareholders			300.0	15.0	
Inventories	63.6	71.0	82.2	134.8	182.6	Total			2000.0	100.0	
Due from related co.s	-	-	-	-	-	Background					
Other current assets	0.2	0.3	0.3	-	0.0	Founded by Dr. Tsai Yen Yu in 1972, Natural Beauty is principally engaged in the manufacture and sale of skin, care, beauty and aroma therapeutic products and provision of skin treatments, beauty and spa services and skin care consulting and beauty training. Currently, the company operates 2,099 stores in Greater China. According to 2005 China Beauty Economy Annual Report, Natural Beauty is one of the top 10 most influential cosmetics brands in China with the highest consumer recognition rate of 49.7%. It was listed in Hong Kong in Mar 02.					
Total assets	769.2	1,032.3	1,230.3	2,314.3	2,834.7	Key Ratios	06A	07A	08F	09F	10F
Accounts payable	(16.6)	(21.8)	(86.2)	(40.8)	(50.7)	Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Other payable	(53.6)	(68.5)	-	(128.0)	(159.2)	Net ROE (%)	14.5	19.9	29.7	21.0	16.6
Tax payable	(27.6)	(4.7)	(12.3)	(24.2)	(29.7)	EBIT ROCE (%)	20.4	23.1	33.2	26.8	21.2
Due to related co.s	-	-	-	-	-	Dividend payout (%)	(64.9)	(167.9)	(66.4)	(66.4)	(66.4)
ST debts	-	-	-	-	-	Effective tax rate (%)	29.6	14.1	11.0	22.0	22.0
Other current liab.	(9.3)	(9.8)	(210.4)	(10.4)	(10.4)	Net interest coverage (x)	na	na	na	na	na
LT debts	-	-	-	-	-	A/R turnover (days)	86.3	48.1	46.0	48.1	48.1
Other LT liabilities	(11.3)	(11.9)	(13.1)	(13.1)	(13.1)	A/P turnover (days)	88.2	102.6	302.0	101.0	92.7
Total liabilities	(118.5)	(116.7)	(322.0)	(216.4)	(263.1)	Stock turnover (days)	337.6	334.2	288.0	334.2	334.2
Share capital	200.0	200.0	200.0	200.0	200.0						
Reserves	678.7	709.6	701.9	1,891.7	2,365.5						
Shareholders' funds	878.7	909.6	901.9	2,091.7	2,565.5						
Minority interest	0.4	6.0	6.2	6.2	6.2						
Total	879.2	915.7	908.1	2,097.9	2,571.7						
Capital employed	879.2	915.7	908.1	2,097.9	2,571.7						
Net (debt)/cash	384.0	588.7	780.5	1,719.7	2,144.1						

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