

## Natural Beauty Bio-Technology Ltd

### Turnaround opportunity watch!

to summarize...

- 2011 can be a turnaround year for Natural Beauty (NB), non-core and non-performing businesses were disposed, follow by redefining of brand positioning, opening New Concept Store (NCS) and upgrading existing stores.
- NCS has a new and improved image targeting walk-in and younger customers. NCS shows "Sell-In" increased 44% versus a non-NCS of -6%. Total "Sell-Thru" increased by 49%. Payback period shortened from 48-60 months to 27-36 months.
- There were 80 NCS across the PRC as the end of FY2010. Targets for FY2011 is to open over 100 additional new NCS and upgrade 100 from the existing shops, bring total number to over 300.
- New strategic cooperation is setup with Carrefour China, where franchisees are encourage to lease space in a Carrefour hypermarket and shopping malls.
- NB is currently trading at 26.7x 1-yr fwd P/E and 18.7x 2-yr fwd P/E on consensus.

**Thesis:** 2011 can be a turnaround year for Natural Beauty (NB). The company has been on the downward trend for the last three years. Net profit decreased from 2008 (HK\$238.9m) to 2010 (HK\$64.6m). In 2010, Carlyle Partners became a new shareholder and begin the reorganization of the group. First by hiring of new managements, follow by disposing of non-performing and non-core businesses, than implementing of new branding strategy.

Table 1. FY2010A Result

| 12 months to Dec | Turnover (HK\$) | Gross Profit (HK\$) | Gross margin (%) | Pre-tax profit (HK\$) | Net profit (HK\$) |
|------------------|-----------------|---------------------|------------------|-----------------------|-------------------|
| FY2010A          | 485.4           | 355.4               | 73.2             | 75.8                  | 30.7              |
| FY2009A          | 538.1           | 415.2               | 77.2             | 186.8                 | 143.9             |
| YoY(%)           | (9.8)           | (14.4)              |                  | (59.4)                | (78.6)            |

Source: Company data

**Turnaround:** Carlyle Asia Partner became a new shareholder in November 2009. The family previously owned 65.52% was then sold 50% of it to Carlyle. New CEO (Mr. John Hsin-Sheng Tseng) was hired on December 2009 follow by new CFO (Mr. Chan Yiu Wing) on February 2010. Mr. Tseng aged 59 with pass experience as the Chairmen and President for Greater China the Goodyear Tire & Rubber from 2005 to 2008 and worked as a General Manager for Eastman Kodak Company from 2000 to 2005. Mr. Chan was the General Manager of Evergreen Packaging and had been worked in Eastman Kodak Company from 1980 to 2007. Non-performing businesses were disposed: Fonperi, Corsage, Non-core self-owned clinics in Taiwan and six lost-making SPAs.

**New Strategy:** Previously the group focused on "Sell-In", where inventory was sold to franchisee without properly accounting for how the inventory will flow to the end customers. The new strategy is to focus on "Sell-Through", taking account of inventories levels of the franchisees. Another major part of the strategies is to redefine brand positioning by ways of opening New Concept Store (NCS) and upgrading existing stores into NCSs.

**New Concept Stores:** The NCS is a key part of the new brand positioning and marketing strategy. Each NCS has an improved image targeting to attract more walk-in and younger customers. The initial NCS pilot test was performed in Xi'an Shaanxi province with promising result. It was than strategically implemented across

| Ticker                 | 0157 HK   |
|------------------------|-----------|
| Rating                 | NR        |
| Price (HK\$)           | 1.44      |
| Target Price (HK\$)    | n.a.      |
| 12m Price Range (HK\$) | 1.35-2.55 |
| Market cap. (US\$m)    | 369.6     |
| Daily t/o (US\$m)      | 0.1       |
| Free float (%)         | 34.4      |

#### Financial summary

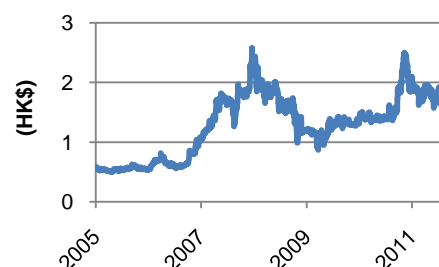
| Year to Dec       | 08A   | 09A   | 10A   |
|-------------------|-------|-------|-------|
| Turnover (HK\$)   | 592.7 | 485.4 | 485.4 |
| Net Profit (HK\$) | 238.5 | 149.6 | 31.3  |
| EPS (HK\$)        | 1.110 | 0.075 | 1.280 |
| P/E (x)           | 12.1  | 19.3  | 92.1  |
| P/B (x)           | 3.39  | 3.32  | 3.68  |
| EV/EBITDA (x)     | 7.2   | 11.2  | 24.2  |
| Yield (%)         | 10.4  | 4.8   | 5.2   |
| ROE (%)           | 28.1  | 17.4  | 3.8   |
| ROCE (%)          | 36.3  | 21.7  | 9.2   |
| N. Gear. (%)      | Cash  | Cash  | Cash  |

Source: SBI

|                      | 11F   | 12F   |
|----------------------|-------|-------|
| Consensus EPS (HK\$) | 0.054 | 0.077 |
| Previous EPS (HK\$)  | -     | -     |

#### Price performance

| Year to Dec              | 1m    | 3m    | 12m  |
|--------------------------|-------|-------|------|
| Relative to HSI (%)      | -8.7  | -1.6  | 10.1 |
| Actual price changes (%) | -20.4 | -17.7 | 0.7  |



Source: Bloomberg

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the PRC from August 2010. As the end of 2010 there were 80 NCS across the PRC. Total “Sell-In” increased by 44% versus a non-NCS of -6%. Total “Sell-Thru” increased by 49%. Also the payback period has significant shorted from 48-60 months to 27-36 months. For the upgraded stores, the payback periods are 3-6 months. For FY2011, NB is targeting to open over 100 additional new NCS and upgrade 100 from the existing shops, bring total number of NCS to over 300 NCS by the end of 2011.

Chart 1. New Concept Store (NCS)



Source: Company data

**Partnership with Carrefour:** NB has setup strategic cooperation relationship with Carrefour in China, where their franchisees are encourage to lease space in a Carrefour hypermarket and shopping malls for retail operations. This takes advantage of the higher traffics in the retails stores to drive more business. The shop setup in each Carrefour is smaller in size compare to a regular NB outlet, but by having shops in Carrefour, they’re essentially creating a business concept of “Hub and Spoke”, where the Hub and can send clients to retails outlets for more comprehensive services and products. There are currently around 180 Carrefour in the PRC, as the end of 2010, they have already opened ten NB store. Of the ten stores, they have over seen over 1,800 new walk in customers in the two months periods with a conversion rate of 24%. The sell-thru growth momentum at 37% growth rate. Among the customers, white-collar customers accounted for 48%, housewife accounted for 37%, office-lady accounted for 12% and students accounted for 6%.

Table 2. Store Growth (No. of stores opened in 2H 2010)

|         | May | Jun. | July | Aug. | Sept. | Oct. | Nov. | Dec. | Total |
|---------|-----|------|------|------|-------|------|------|------|-------|
| New     | 0   | 0    | 0    | 0    | 4     | 1    | 2    | 18   | 25    |
| Upgrade | 1   | 0    | 1    | 5    | 11    | 5    | 4    | 28   | 55    |
| Total   | 1   | 0    | 1    | 5    | 15    | 6    | 6    | 46   | 80    |

Source: Company data

### About Natural Beauty (NB)

**Description:** NB engages in manufacturing and selling of skin care, beauty, aroma therapeutic products, skin treatments, skin care consulting and spa services. They operate in the PRC Taiwan, Hong Kong, Malaysia and Macau. They sell their products through franchise spas, self-owned spas and counters in department stores. As at 31 December 2010, there were 1,427 spas and 47 counters. With 1,085 POS in the POS, 355 POS in Taiwan, and 34 in the rest of the region.

Table 3. Geographic Coverage (As of 31 Dec. 2010)

|           | Franchisee-owned | Entrusted | Entrusted | Self-owned | Self-owned | Total | Average      | Average      | Chg (%) |
|-----------|------------------|-----------|-----------|------------|------------|-------|--------------|--------------|---------|
|           | Spas             | Spas      | Counters  | Spas       | Counters   |       | Sales/Stores | Sales/Stores |         |
|           |                  |           |           |            |            |       | 2009         | 2010         |         |
| The RPC   | 1,034            | -         | 14        | 4          | 33         | 1,085 | 293,000      | 318,000      | 8.5     |
| Taiwan    | 348              | -         | -         | 7          | -          | 355   | 299,000      | 292,000      | -2.3    |
| Hong Kong | -                | -         | -         | -          | -          | -     | -            | -            | -       |
| Macau     | -                | -         | -         | 1          | -          | 1     | -            | -            | -       |
| Malaysia  | 33               | -         | -         | -          | -          | 33    | -            | -            | -       |
| Total     | 1,415            | -         | 14        | 12         | 33         | 1,474 | 294,000      | 312,000      | 6.1     |

Source: Company data

**FY2010/11A results:** Last reported earnings was for FY12/10A. Revenue decreased 9.8% to HK\$485.4 m from HK\$538.1m in FY12/10A. Gross profit decreased 14% to HK\$355.4m from HK\$415.2m. Profit for the year decreased 78.7% to HK\$30.7m from HK\$143.9m.

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Earnings per share attributed to equity holder decreased 79% to HK\$1.6 cents from HK\$7.5 cents. Gross profit margin decreased to 77.1% from 77.1%. Operating profit margin decreased to 15.6% from 26.7%. Net profit margin decreased to 13.2% from 27.2%.

**Revenue analysis:** In terms of geographic breakdown, the PRC accounted for 74.8% down 8.3% yoy. The Taiwan region accounted for 23.2%, down 14.8% yoy, and the rest accounted for 2.0% down 4.5% yoy. The sales of product accounted for 98.1% down 9.4% yoy and 1.9% comes from sales of services, down 25.2% yoy. The average sales per store rose 6.1% from HK\$294K to HK\$312K. Average sales from the PRC increased 8.5% from HK\$293K to HK\$318K while the average sales in Taiwan dropped 2.3% from HK\$299K to HK\$292K.

**Valuation:** NB is currently trading at 26.7x 1-yr fwd P/E and 18.7x 2-yr fwd P/E on consensus. The Hong Kong listed peers are currently trading on average at 19.4x current year fwd P/E and 15.3x 2-yr fwd P/E based on market consensus.

Table 4. Valuation Comparison

| Company name     | Ticker  | Mkt cap<br>(US\$m) | Last Price<br>(Local) | His P/E<br>(x) | 1-Yr P/E<br>(x) | 2-Yr P/E<br>(x) | PB<br>(x) | Est ROE<br>(%) |
|------------------|---------|--------------------|-----------------------|----------------|-----------------|-----------------|-----------|----------------|
| L'Occitane       | 973 HK  | 3,730.3            | 19.70                 | 26.1           | 21.7            | 17.6            | 4.7       | 27.7           |
| Sa Sa            | 178 HK  | 2,167.6            | 6.02                  | 33.0           | 25.6            | 20.5            | 12.5      | 40.1           |
| Bonjour          | 653 HK  | 497.9              | 1.32                  | 20.0           | 16.3            | 13.2            | 18.3      | 105.7          |
| Natural Beauty   | 157 HK  | 369.6              | 1.44                  | 92.3           | 26.7            | 18.7            | 3.7       | 3.8            |
| Magic            | 1633 HK | 339.3              | 3.17                  | 16.1           | 17.6            | 14.2            | -         | 47.8           |
| Veeko intl hldgs | 1173 HK | 108.2              | 0.39                  | 11.8           | -               | -               | 1.5       | 13.7           |
| Water Oasis      | 1161 HK | 79.3               | 0.81                  | 10.9           | 8.7             | 7.4             | 2.6       | 28.1           |
| Modern beauty    | 919 HK  | 67.7               | 0.73                  | 12.0           | -               | -               | 1.7       | 15.6           |
| <b>Average</b>   |         |                    |                       | <b>27.8</b>    | <b>19.4</b>     | <b>15.3</b>     |           |                |

Source: Bloomberg

Table 5. Historical P &amp; L

| Year to Dec (HK\$m)                         | 2008A   | 2009A   | 2010A   |
|---|---------|---------|---------|
| Revenue                                     | 592.7   | 538.1   | 485.3   |
| Cost of sales                               | (86.1)  | (122.9) | (130.0) |
| Gross profit                                | 506.6   | 415.2   | 355.4   |
| Other revenue                               | 58.2    | 20.8    | 17.5    |
| Distribution costs                          | (127.6) | (120.3) | (146.8) |
| Administrative expenses                     | (112.7) | (109.1) | (125.0) |
| Other operating expenses                    | (16.0)  | (19.8)  | (25.2)  |
| Profit before tax                           | (308.5) | 186.8   | 75.8    |
| Income tax                                  | (69.9)  | (42.8)  | (45.1)  |
| Exchange differences arising on translation | 238.6   | 143.9   | 30.7    |
| Profit for the year                         | 0.8     | 2.6     | 33.3    |
| Total comprehensive income for the year     | 239.4   | 146.5   | 64.0    |
| Profit for the year attributable to:        |         |         |         |
| Owners of the Company                       | 238.5   | 149.6   | 31.3    |
| Non-controlling interests                   | 0.1     | (5.7)   | (0.6)   |
|   | 238.6   | 143.9   | 30.7    |

Source: Company data, SBI E2-Capital

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