

## 9. INDUSTRY EXPERTS' LETTER

*(Prepared for inclusion in this Prospectus)*



### VITAL FACTOR CONSULTING

Creating Winning Business Solutions

12 February 2004

The Board of Directors  
Esthetics International Group Berhad  
Wisma Dermal Esthetica  
54-58, Jalan SS22/25  
Damansara Jaya  
47400 Petaling Jaya  
Malaysia

Dear Sirs/Madam

**Vital Factor Consulting Sdn Bhd**  
(Company No.: 266797-T)

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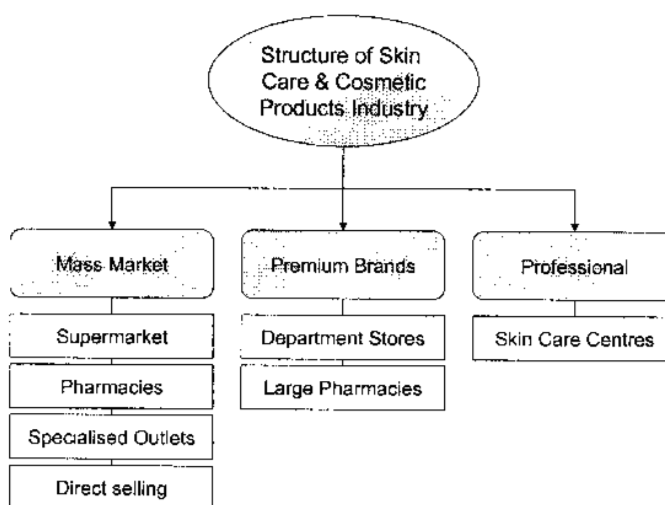
### Assessment of the Skin Care and Cosmetics Industry in Malaysia

The following is a summary of the Assessment of the Skin Care and Cosmetics Industry in Malaysia prepared by Vital Factor Consulting Sdn Bhd for inclusion in the Prospectus of Esthetics International Group Berhad (herein together with its subsidiaries will be referred to as Esthetics Group) in relation to its listing on the Main Board of the Malaysia Securities Exchange Berhad.

#### 1. Background

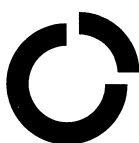
- The objective of the report is to provide an independent assessment of the Skin Care and Cosmetics Industry in Malaysia.
- Esthetics International Group Berhad is the holding company for nine fully owned and one majority owned subsidiaries, and one associate company. The Esthetics Group is principally involved in providing Professional Skin Care Services, and Distribution and Retailing of Skin Care and Cosmetic products.

#### 2. Overview of the Skin Care and Cosmetics Industry



**Figure 1 Structure of Skin Care and Cosmetics Industry**

9. INDUSTRY EXPERTS' LETTER (Cont'd)



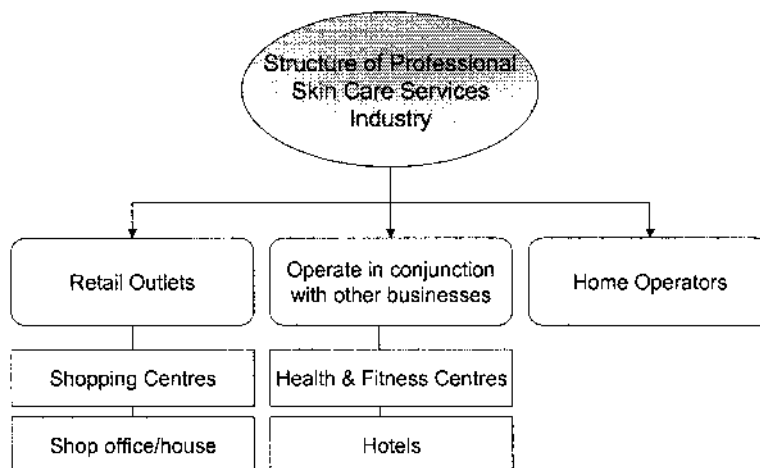
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- The Skin Care and Cosmetics Industry comprised three main sectors, each focusing on different target markets and distribution channels:
  - **Mass Markets:** A large majority of Skin Care products cater to the mass market comprising brands including, among many others, Nivea, L'Oreal, Simple, Johnson and Johnson, Neutrogena, Ponds Institute and Eversoft. These are primarily priced at the lower-end of the market. Most of these are sold through, among others, pharmacies, supermarkets, specialised retail outlets, convenience stores and direct selling.
  - **Premium Brands:** This segment comprised premium brands including prominent and worldwide brand names such as, among many others, Estee Lauder, Elizabeth Arden, Shiseido and Clarins. Apart from Skin Care, these brands are also known for their range of Cosmetics. These are mainly focused on targeting medium to high end of the market.
  - **Professional:** This is a sector whereby products are mainly available through Professional Skin Care Centres. There are many brands in this market, most of which are imported by local agents and distributed locally.

3. Industry Segmentation

- Following are the different types of segments within the Professional Skin Care Services Industry:



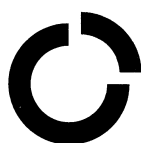
- The Professional Skin Care Services is segmented into 3 main sectors.

**Retail Outlets:** These are Professional Skin Care Centres and are usually operated in shopping centres or shop offices/houses. Products used are usually only available through authorised dealers and not found in retail shops. The larger operators have wide networks of Professional Skin Care Centres to cater to the convenience of their customers.

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## 9. INDUSTRY EXPERTS' LETTER (Cont'd)

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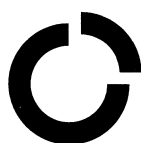
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**Home Operators:** These operators work from home and form the lower tier of players. In many cases, this group of home operators is also able to purchase global or reputable local brand name products for use in their provision of Professional Skin Care Services, thus adding competitive pressure to larger retail and chain operators.

**Operate in Conjunction with other Business Activities:** This segment of operators provide Professional Skin Care Services that are either part of, or operate in conjunction with other business activities such as hotels, health and fitness centres and spa centres.

#### 4. Government Legislation, Policies and Incentives

- The Drug Control Authority (DCA) is responsible for registration and licensing of Cosmetic Products. The secretariat to the DCA is the National Pharmaceutical Control Bureau (NPCB). DCA is part of the Ministry of Health.
- Prior to 1 February 2002, registration of Cosmetic Products, including Personal Care Products were required and limited to the following products:
  - Hair Dyes containing phenylenediamine, toluenediamine, salt and derivatives: 1 August 1991;
  - Tooth Whitener containing hydrogen peroxide/carbamide peroxide: 1 February 1996.
- However, effective from 1 February 2002, companies that are involved in the manufacturing, importing or distributing of Cosmetic Products, which are under the product classification of Category I and II, are required to register with the Drug Control Authority (DCA).
- The enforcement of regulations of Cosmetic Products commenced on 1 January 2004 (*Source: Cosmetic Unit, Drug Control Authority, Ministry of Health*).
- On 20 December 2003, the Ministry of Health announced that distributors and manufacturers would have a grace period of six months until the end of June 2004 to register the products provided the submission of applications are made prior to 1 January 2004 (*Source: Ministry of Health*).
- Submission of applications for cosmetic products on or after 1 January 2004 must be registered before they can be manufactured, distributed or imported into Malaysia (*Source: Cosmetic Unit, Drug Control Authority, Ministry of Health*).
- The registration of Cosmetic Products is enacted under the Control of Drugs and Cosmetics Regulations 1984. Generally, the registration of a Cosmetic Product shall be valid for 5 years.
- The authority responsible for the registration and licensing of Cosmetic Products is the Drug Control Authority (DCA). The secretariat to the DCA is the National Pharmaceutical Control Bureau (NPCB), which is responsible for the evaluation and assessment of Cosmetic Products.

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- The main task of DCA is to ensure the safety, quality and efficacy of pharmaceuticals, health and personal care products that are marketed in Malaysia. Its responsibilities are as follows:
  - registration of pharmaceutical products and cosmetics;
  - licensing of premises for importer, manufacturer and wholesaler;
  - monitoring the quality of registered products in the market;
  - adverse drug reaction monitoring.
- According to the DCA, Cosmetic Product refers to any substance or preparation intended to be placed in contact with various external parts of the human body or with teeth and the mucous membranes of the oral cavity, with a view exclusively or mainly to cleaning them, perfuming them, changing their appearance and/or correcting body odours and/or protecting them or keeping them in good condition.
- For the purpose of product registration, Cosmetic Products are classified into Category I and II. Category I refers to products that have the potential to be absorbed through the skin mucous membrane. Category II refers to products other than the ones listed in Category I. Products classified under these two categories are as follows:

|                    |  |
|--------------------|--|
| <b>Category I</b>  | <ul style="list-style-type: none"> <li>- products for application in the area around the eyes (except eye brow products)</li> <li>- lip products</li> <li>- oral cavity products</li> <li>- hair dyes containing phenylenediamine, toluenediamine, salts and derivatives</li> <li>- sun tanning products containing topical dyes or tan accelerators, applied over a large area of the body and remain in contact with the skin solely for the purpose of browning the skin.</li> </ul>  |
| <b>Category II</b> | <ul style="list-style-type: none"> <li>- hair dyes not containing phenylenediamine, toluenediamine, salts and derivatives</li> <li>- sun tanning products not containing topical dyes or tan accelerators</li> <li>- products for the application on the hair, scalp, skin, without rinsing including, but not exclusive to:               <ul style="list-style-type: none"> <li>. deodorants</li> <li>. skin lotions/creams</li> <li>. shaving preparations</li> <li>. depilatories</li> <li>. talcum powder</li> <li>. bar soaps</li> </ul> </li> <li>- products, which remain in traces after rinsing or use including, but not exclusive to:               <ul style="list-style-type: none"> <li>. bath oils, salts</li> <li>. hair shampoo, conditioner</li> <li>. body/face cleansers</li> </ul> </li> </ul> |

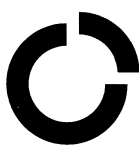
*(Source: Cosmetic Unit, Drug Control Authority, Ministry of Health)*

- Generally, there are no import tariffs on Skin Care and Cosmetic Products with the exception of 20% import tax for face and talcum powder. However, with the implementation of Asian Free Trade Area (AFTA), import duties on face and talcum powder has been reduced to 5%. *(Source: Royal Customs and Excise Department, Ministry of Finance).*

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## 9. INDUSTRY EXPERTS' LETTER (*Cont'd*)

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#### 5. Barrier to Entry and Exit

##### Government Regulations

- All Drugs and Cosmetics (including Skin Care) need to be registered with the Ministry of Health before any such products can be imported or manufactured in Malaysia effective as at February 2002.
- The Government's registration requirements may pose some barriers to entry for new entrants.
- In addition, there is a 5% import tax on face and talcum powder with the implementation of AFTA (*Source: Royal Customs and Excise Department, Ministry of Finance*)

##### Capital and Set-up Costs

###### *Skin Care Products and Cosmetics*

- The barriers to entry into the marketing and distribution of Skin Care Products and Cosmetic are **low** and this is mainly predicated by the low capital cost requirement for setting-up a small trading establishment to operate in this type of business.
- However there is a need to have working capital including purchasing of stocks and advertising and promotions.

###### *Professional Skin Care Services*

- Barriers to entry into the Professional Skin Care Services are **low** and this is predicated by the ease of entry into the industry at the most basic level as home operators.
- However to set-up a retail outlet in shopping center to provide Professional Skin Care Services would require some capital for the following basic items:
  - Renovation and furnishing costs whereby to renovate an average size retail lot of 1,500 square feet would cost approximately RM300,000;
  - The cost of basic machinery and equipment is approximately RM50,000 to RM100,000 for an average retail outlet.

*(Source: Esthetics International Group Berhad).*

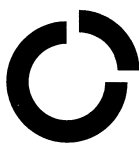
##### Skills and Expertise in the Professional Skin Care Services Industry

- The need for certification forms some barriers to entry, as it is important for operators to have certified therapists that have the necessary skills and expertise to provide Skin Care Services.
- The appropriate recognised certifications can be obtained upon completion of basic and advanced courses on Cosmetology. In order to have access to the supply of therapists, some of the larger operators have their own in-house Institute to provide education and training on appropriate courses.

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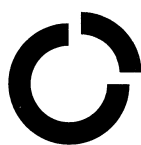
#### Barriers to Exit

- Barriers to exit for marketing and distribution of Skin Care Products are **low**. Unlike the manufacturing industry, the marketing and distribution of Skin Care and Cosmetics does not involve investment in equipment with the exception of those used in the provision of the Professional Skin Care Services.
- Most of the machinery and equipment may be sold to other operators within the Professional Skin Care Services Industry.
- However, unlike manufacturing business, investments in machineries for the Professional Skin Care Service Industry are relatively low.

#### 6. Supply and Supply Dependencies

- As Esthetics Group imports Skin Care and Cosmetics either in semi-finished or finished form, the following is an assessment of the supply and sources of supply under this category of products:
  - Between 1998 and 2002, the value of imports of Perfumery, Cosmetics and Toiletries increased at an average annual rate of 8.1% amounting to RM795.0 million in 2002 (*Source: Department of Statistics*).
  - In 2002, United States and Thailand were major sources of imports of Perfumery, Cosmetics and Toiletries, each of them contributed approximately 18.2% and 17.8% respectively. This is followed by France and Hong Kong, each at 9.8% and 9.3% respectively (*Source: Department of Statistics*).
  - Between 1998 and 2002, the import value of Beauty or Make-up Preparations and Preparations for the Care of the Skin grew at an average annual rate of 6.9% amounting to RM369 million in 2002 (*Source: Department of Statistics*).
  - In 2002, the import value of Beauty, Cold, Make-up and Cleansing Creams (the sub-category Beauty or Make-up Preparations and Preparations for the Care of the Skin) of increased by 2.0% amounting to approximately RM175.3 million. Between 1998 and 2002, the import value of Beauty, Cold, Make-up and Cleansing Creams increased at an average annual rate of 1.2%.
  - In 2002, the import value of Skin Food and Skin Tonics or Body Lotion (Beauty or Make-up Preparations and Preparations for the Care of the Skin) declined by 4.0%, amounting to approximately RM43.2 million. However, between 1998 and 2002, the import value of Skin Food and Skin Tonics or Body Lotion grew at an average annual rate of 14.4%.

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- In 2002, the import value of Other Cosmetics and Products for Care of the Skin (Beauty or Make-up Preparations and Preparations for the Care of the Skin) increased by 21.3% amounting to approximately RM176.1 million. Between 1998 and 2002, the import value of Other Cosmetics and Products for Care of the Skin grew at an average annual rate of 13.6%.
- In 2002, United States accounted for 28.6% of total value of imports of Beauty of Make-up preparations and Preparations for the Care of the Skin. This is followed by Japan and Thailand, each accounting for 15.7% and 12.1% respectively of total imports under this category (*Source: Department of Statistics*).

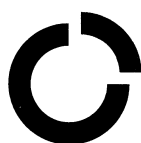
### 7. Demand and Demand Dependencies

- Essentially, demand for Skin Care and Cosmetic products will come from the following markets:
    - Local market in terms of consumers;
    - Overseas as in export market demand.
  - Demand for Professional Skin Care Services will come primarily from consumers in the local market.
  - Between 1993/94 and 1998/99, the average monthly household expenditure on barber and beauty shops (including Skin Care Services) increased at an average annual rate of 8.3% (*Source: Report on Household Expenditure Survey, Malaysia 1993/84 and 1998/99, Department of Statistics*).
  - The average monthly household expenditure on toiletries (including Skin Care Products and Cosmetics) grew at an average annual rate of 18.6% between 1993/94 and 1998/99. (*Source: Report on Household Expenditure Survey, Malaysia 1993/84 and 1998/99, Department of Statistics*).
  - Demand for Skin Care and Cosmetic Products also comes from export demand, the following is an analysis of export performance of such products.
    - The export value of Perfumery, Cosmetics and Toiletries increased by 27.8% to reached RM302.9 million in year 2002.
    - Between 1998 and 2002, the export value of Perfumery, Cosmetics and Toiletries grew at an average annual rate of 13.6%.
- (*Source: Department of Statistics*)
- As consumers are the ultimate end-users of Skin Care and Cosmetics and Professional Skin Care Services, the demand for these types of products and services will be dependent on population growth and expenditure:
    - Between 2000 and 2003, the population in Malaysia grew at an average annual rate of 2.2% and is expected to reach 25.08 million by 2003 (*Source: Mid-Term Review of The Eighth Malaysia Plan 2001-2005, Economic Planning Unit, Ministry of Finance*).

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## 9. INDUSTRY EXPERTS' LETTER (*Cont'd*)

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- The population is forecasted to grow at an average growth rate of 2.2% between 2000 and 2005. (*Source: Mid-Term Review of The Eighth Malaysia Plan 2001-2005, Economic Planning Unit, Ministry of Finance*).
- Population growth will continue to stimulate demand for consumer based products and services including Skin Care Products and Services, and Cosmetics.
- Other factors that will also impact on consumer demand and expenditure on Skin Care and Cosmetics are the following:
  - increasing affluence of the population
  - the growing sophistication in lifestyles
  - growth in disposable income

## 8. Competitive Nature of the Industry

### Competitive Nature of Skin Care Products

- All manufacturers, resellers and retailers of Skin Care Products operate under **normal** competitive conditions.
- Skin Care Products compete at many levels:
  - Lower priced mass Skin Care products normally sold through, among others, supermarkets and other grocery outlets, pharmacies, departmental stores and discount retail outlets.
  - Lower priced mass Skin Care products sold through direct marketing channels.
  - Premium Skin Care products sold in specialised cosmetic counters in departmental stores and large pharmacies.
  - Professional Skin Care Products sold through authorised Skin Care Centres.

### Competitive Intensity of Skin Care Products

- Competition among Skin Care Products within Malaysia is **intense** based on the following observations:
  - The market is highly fragmented with many different forms of competition. Within each sector of the market, there are many players competing:
    - Mass Market: Targeting the lower-end of the market and sold in pharmacies, supermarkets, departmental stores, discount retail outlets or through direct selling. Some major brands include L'Oreal, Avon, Simple, Nivea, Hazeline, Eversoft, Ponds Institute, Ginvvera, Follow Me, Johnson and Johnson, Freeman, St. Ives and Neutrogena.
    - Premium Market: Mainly focused on targeting medium to higher end of the market. Include prominent worldwide brand names for example, Estée Lauder, Elizabeth Arden, Shiseido and Clarins.
    - Professional Skin Care Market: Products are mainly available through authorised Professional Skin Care Centres only.



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## 9. INDUSTRY EXPERTS' LETTER (*Cont'd*)

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- Between 1998 and 2002, the import value of Perfumery, Cosmetics and Toilet increased by an average annual rate of 8.1% amounting to RM795.0 million in 2002 (*Source: Department of Statistics*). The relatively large local market as well as good growth has attracted many local and overseas players into the market, thus increasing the intensity of competition.
- Currently the Skin Care sector of the Industry is not strongly regulated. As such, there is minimum barrier to entry for products. The ease of entry has meant a plethora of product brands and operators.
- The ease of entry also includes creation of new products and brands without need for technical knowledge, research and development facilities and manufacturing plant. This is because virtually anyone with sufficient working capital would be able to get the product formulated and manufactured by third parties. This ease of entry has encouraged the formation of many new brands in the market both locally and overseas.

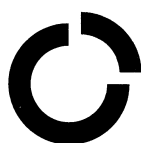
#### Competitive Nature of Professional Skin Care Services

- Competition for Professional Skin Care Services and Products is based on a number of factors including:
  - quality of products and services
  - effectiveness
  - price
  - facilities and location
  - value added services such as diagnosis, methodology and application
  - product brand name
  - operator market reputation.
- All Professional Skin Care Centres operate under **normal** competitive conditions.
- Providers of Professional Skin Care Services include the following:
  - Retail outlets located in shopping centres and in shop-offices/houses
  - Operated in homes partly converted to service centres
  - Operated in conjunction with another business activity for example operated in conjunction with Health and Fitness Centre Services, Spa, or hotel services.
- Professional Skin Care Centres usually use some form of specialised Skin Care products that are only available from authorised Professional Skin Care outlets or are exclusively distributed by the Professional Skin Care Centre itself.

#### Competitive Intensity of Professional Skin Care Services

- Competition among Professional Skin Care Services Industry in Malaysia is **intense** based on the following observations:
  - The ease of entry, particularly the low capital requirement, has meant that there are many operators of Skin Care Services in Malaysia. This range from single operators working from home to larger operators with chain outlets located in more expensive shopping centres.

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- Competition is also predicated on the reputation of the operators of the Professional Skin Care Centre and the brands of products used. As such, larger chain Professional Skin Care Service Centre operators have the financial resources and marketing power to promote its services. This would give such operators a distinct competitive advantage in their capability to appeal to a wider market to sustain business growth.
- At the lower tier level, particularly among operators working from homes, competition is also very intense. Such operators probably are found in most suburbs in Malaysia providing personalised services to their client base. In many cases, this group of home operators is also able to purchase global or reputable local brand name products for use in their provision of Skin Care Services, thus adding competitive pressure to larger chain operators.

### 9. Key Players in the Industry

- Some of the key players in the Skin Care and Cosmetics Industry are as follows:

#### Professional Skin Care Services

- Esthetics International Group Berhad
- Tung Pao Sdn Bhd
- Clara International Beauty Group Sdn Bhd
- CN Health and Beauty Group Sdn Bhd
- Lampang Padu Sdn Bhd
- Beaubelle Worldwide Sdn Bhd
- JF Beauty Group Sdn Bhd
- PT Mustika Ratu Sdn Bhd
- Bella Skin Care Sdn Bhd
- Clarins Sdn Bhd
- Excellent Combination Sdn Bhd
- Adonis Beauty Consultants Sdn Bhd

#### Distributors to Professional Skin Care Centres

- Esthetics International Group Berhad
- Clara International Beauty Group Sdn Bhd
- Beaubelle Worldwide Sdn Bhd
- JF Beauty Group Sdn Bhd
- Sky Resources Sdn Bhd
- PT Mustika Ratu Sdn Bhd
- Excellent Combination Sdn Bhd
- Societe Francaise de Cosmetiques Sdn Bhd
- Menard Cosmetics (M) Sdn Bhd
- Coap Cosbeau Sdn Bhd

*(Source: Primary Market Research undertaken by Vital Factor Consulting)*

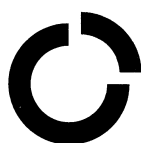
### 10. Industry Outlook and Growth Forecast

- The outlook for the Skin Care and Cosmetics Industry is **favourable**.

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**9. INDUSTRY EXPERTS' LETTER (Cont'd)**


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- The Skin Care and Cosmetics Industry is forecasted to grow at approximately **5% to 8%** per annum for the next five years.
- This is supported by the following factors:
  - Between 1993/94 and 1998/1999, the average monthly household expenditure of services on barber and beauty shops (including Professional Skin Care Services) increased at an average annual rate of 8.3%. *(Source: Report on Household Expenditure Survey 1993/94 and 1998/99 Malaysia, Department of Statistics);*
  - However, when the increase in average monthly household expenditure of services on barber and beauty shops (including Professional Skin Care Services) is combined with the increase in number of households between 1993/1994 and 1998/1999, the average annual growth rate is 12.6% *(Source: Report on Household Expenditure Survey 1993/94 and 1998/99 Malaysia and Vital Statistics Malaysia (Special Edition) 2000, Department of Statistics and computed by Vital Factor Consulting);*
  - The average monthly household expenditure on toiletries (including Skin Care and Cosmetic Products) grew significantly at an average annual rate of 18.6% between 1993/94 and 1998/99. *(Source: Report on Household Expenditure Survey 1993/94 and 1998/99 Malaysia, Department of Statistics);*
  - However, when the increase in average monthly household expenditure of toiletries (including Skin Care and Cosmetic Products) is combined with the increase in number of households between 1993/1994 and 1998/1999, the average annual growth rate is 23.3% *(Source: Report on Household Expenditure Survey 1993/94 and 1998/99 Malaysia and Vital Statistics Malaysia (Special Edition) 2000, Department of Statistics and computed by Vital Factor Consulting);*
  - The import value of Perfumery, Cosmetics and Toiletries (including Skin Care Products) increased at an average annual rate of 8.1% between 1998 and 2002. *(Source: Department of Statistics);*
  - Between 1998 and 2002, the import value of Beauty or Make-up Preparations and Preparations for the Care of the Skin (other than medicaments), including Sunscreen or Sun Tan Preparations, Manicure or Pedicure Preparations (a sub-sector of Perfumery, Cosmetics and Toiletries) grew at an average annual rate of 6.9%. *(Source: Department of Statistics);*
  - The export value of Perfumery, Cosmetics and Toiletries increased by 27.8% to reached RM302.9 million in year 2002 *(Source: Department of Statistics);*
  - Between 1998 and 2002, the export value of Perfumery, Cosmetics and Toiletries grew at an average annual rate of 13.6% *(Source: Department of Statistics);*

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- From 1993/94 to 1998/99, the average monthly household expenditure increased at an average annual rate of 7.0% to reach RM1,631 per household (*Source: Report on Household Expenditure Survey 1993/94 and 1998/99 Malaysia, Department of Statistics*).

## 11 Areas of Growth and Opportunities

### **Targeting Male Segment of the Market**

- Currently, the Skin Care and Cosmetic Industry is primarily focused on females. The ability for operators to target their products and services would open up significant market opportunities.
- Targeting the male segment of the market as exemplified by the significant success with men's fragrances.

### **Targeting Teenagers**

- The major target segment for Professional Skin Care products and services are focused on females between 20 to 40 years of age. There are significant opportunities to target the female teenage group.
- This is because this segment of the market is especially susceptible to facial skin problems, especially acne. This is mainly due to hormonal changes during the teenage development years.
- The market size of this segment is large amounting to 2.2 million females aged between 10 and 19 years of age in 2000 (*Source: Vital Statistics (Special Edition) 2000, Department of Statistics*).

### **Product Innovations**

- Product innovation has the capability to offer significant growth and profit opportunities for operators.
- Such product innovation can come in many forms, for example:
  - use of different active ingredients that provides different levels of efficacies compared to the average products;
  - use of natural active ingredients to appeal to those who prefer natural products;
  - development of new applications;
  - development of additional benefits for existing products.

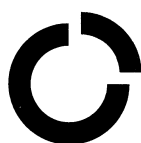
### **Original Brand Manufacturer**

- Many of the current operators import their products. There are very few successful local brands.
- There are opportunities to develop own brands in Skin Care Products and Cosmetics. The margins are significantly higher as brand owners.

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#### **Franchising**

- For Professional Skin Care Services, there are opportunities to develop franchising systems.
- Franchising systems not only provide franchisers with royalties, but also a wide network of users as well as resellers of new products.
- Franchising systems are also exportable, providing incremental profits beyond the local market.

#### **Exports**

- There are significant opportunities for brand owners or exclusive distributors within a region, to export their Skin Care and Cosmetics products, especially within the Asian region.
- In addition, with the implementation of the Asean Free Trade Area, export opportunities increases for local manufacturers and brand owners.

## 12. Threats and Risk Analysis

### **Over-dependency on Imported Products**

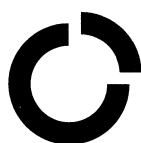
- To date, the majority of operators within Skin Care and Cosmetics Industry use imported products from countries such as the United States, France, Hong Kong, China and Japan (*Sources: Department of Statistics*)

#### **Mitigating Factors**

- Although imported products predominates, local production is slowly increasing as indicated below:
  - In 2002, the manufacture of Soaps and Cleaning Preparations amounted to RM1.1 billion;
  - Exports of Perfumery, Cosmetics and Toilet Preparations grew by 27.8% to RM302.9 million in 2002;
  - Export value of Soaps, Detergents, Cosmetics and Toiletries grew by 19.9% to reach RM1.2 billion in 2002;
  - Exports of Soaps, Cleansing and Polishing Preparations grew by 3.6% to RM736.7 million in 2002.(*Source: Department of Statistics*)
- Given this increasing production trend, the local market could in time accept local brands to compete side-by-side with global brands.

## 9. INDUSTRY EXPERTS' LETTER (*Cont'd*)

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#### **Exposure to Foreign Exchange Fluctuations**

- The industry is also vulnerable to fluctuations in foreign exchange. This is mainly predicated by the high level of imports of Skin Care and Cosmetic products.
- As consumer-based products, consumer demand is highly dependent on the price, an unfavourable foreign exchange movement against the Ringgit would either reduce consumer demand, as prices would need to be increased or operators' profitability would suffer if they decide to absorb the price increases.

#### **Mitigating Factors**

- The current pegging of the Ringgit to the United States of America's Dollar (USD) has helped significantly in stabilising the Ringgit against the USD. As most imports are quoted in USD, this has helped significantly in stabilising prices and enabling importers to better plan their business operations.
- However, Malaysia's current fixed currency regime may change at any time and have a direct impact on importers.

#### **Competition from Strong Global Brand Names**

- Many of the imported Skin Care and Cosmetic products used in Malaysia are very strong global brands like Elizabeth Arden, Shiseido, Clarins, Estee Lauder and many others. These imported brands have such a strong consumer following that it would be very difficult for local brands to compete against them.
- In addition, these global brands spend very significantly in promotions and advertising to continually increase their brand equity. Very few local brands would have the financial resources or the desire to spend significantly into building its brands.

#### **Mitigating Factors**

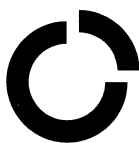
- Local manufacturers have some advantage over imported brands in their ability to tailor Skin Care and Cosmetics to better suit the Asian skin texture and colour, as well as taking into consideration the climatic differences, for example high temperature and humidity.
- As such, local manufacturers can compete based on product innovation and customising products to local conditions and consumer needs.

#### **Consumer Scare**

- Skin Care and Cosmetic products are highly sensitive to public opinion. This is because these products are applied to the skin, which is semi-permeable and able to absorb some of the active ingredients of the products.
- In addition, some of the active ingredients can cause allergic reactions or have adverse impact on exposed areas like the eyes.

## 9. INDUSTRY EXPERTS' LETTER (*Cont'd*)

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- As such, any adverse public opinions regarding any product, brand or effects of any active ingredients could have very significant negative impact on the affected operator.
- Another example is sabotage or extortion through product tampering which have the effect of eroding consumer confidence. This has been amply demonstrated in the United States and Australia where products were tampered with as part of extortion plans.

#### **Mitigating Factors**

- Operators and manufacturers must continually ensure that their products are safe and comply with the various local and overseas product standards.
- In Malaysia, it is imperative that products comply with the guidelines of the Drug Control Authority. In United States, manufacturers must comply with guidelines of the Food and Drug Administration.
- In addition to compliance, manufacturers must on their own initiatives continually undertake research and development to use safer active ingredients and fillers. This will build consumer confidence of a caring manufacturer to ensure consumer safety.
- In addition, Professional Skin Care Centre operators are better insulated against product tampering as their premises are significantly smaller compared to a supermarket, and working staff usually watches customers and visitors in their premises.

#### **Loss of Distributorship**

- Many local companies are distributors for foreign brand products. It is not uncommon for overseas principals to withdraw distributorship. Some of these reasons include poor performance of local agents, the need for expansion, which is beyond the capability of the existing local agent or if the principal simply wants to take over the distribution.
- Withdrawal of distributorship would have very significant impact on the local agent. This is especially critical if the agent depends exclusively on the principal's products to conduct business.

#### **Mitigating Factors**

- Local agents that continually provide benefits to their principals in terms of higher profits and market share would significantly minimise loss of distributorship.
- If local distributors were able to grow the business on behalf of the principals, they would create a high dependency of the principals on the local distributors. Growth could come from developing regional markets that create incremental markets for the principals.

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## 9. INDUSTRY EXPERTS' LETTER (*Cont'd*)

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#### **Implementation of Asian Free Trade Area (AFTA)**

- The reduction of import duties with the implementation of AFTA would make imports competitive against locally manufactured products.

#### **Mitigating Factors**

- As most of the products used locally are imported, the impact of the implementation of AFTA would be minimal.
- This is reflected by the fact that all other Cosmetic products (including Skin Care) are already free of import duties with the exception of talcum and face powders.

#### **Economic Slowdown**

- As a consumer based product, any slowdown in the Malaysian economy would reduce disposable income and consumer confidence. All these have the impact of reducing spending on consumer items including Skin Care and Cosmetic products.

#### **Mitigating Factors**

- Operators with strong brand recognition, financial stability, extensive and established distribution network, and a wide and diverse range of products would be better able to survive the impact of the slowdown.
- In addition, operators that export their products overseas will effectively diversify some of their business risk on their dependency on the local economy.

## 13 Market Ranking

- For the financial year ended 31<sup>st</sup> January 2003, the turnover of Esthetics Group reached RM65.6 million.
- Using the financial year ended 31<sup>st</sup> January 2003 as an approximation for calendar year 2002:
  - Esthetics Group ranked **first** among companies that operate Professional Skin Care Centres in Malaysia;
  - Esthetics Group ranked **first** among companies that distribute Skin Care Products to Professional Skin Care Centres in Malaysia;

*(Source: Primary Market Research undertaken by Vital Factor Consulting Sdn Bhd)*



9. **INDUSTRY EXPERTS' LETTER (Cont'd)**

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Vital Factor Consulting Sdn Bhd has prepared this report in an independent and objective manner and has taken all reasonable consideration and care to ensure the accuracy and completeness of the report. It is our opinion that the report represents a true and fair assessment of the industry within the limitations of, among others, secondary statistics and information, and primary market research. Our assessment is for the overall industry and may not necessarily reflect the individual performance of any company. We do not take any responsibilities for the decisions or actions of the reader(s) of this document. This report should not be taken as a recommendation to buy or not to buy the shares of any company or companies.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Wooi Tan', with a long horizontal stroke extending to the right and a small upward tick at the end.

Wooi Tan  
Managing Director  
Vital Factor Consulting Sdn Bhd

## 10. DIRECTORS' REPORT



Registered Office

Level 7, Setia 1,  
No. 15, Lorong Dungun,  
Damansara Heights  
50490 Kuala Lumpur.

Date: **12 FEB 2004**

The Shareholders  
Esthetics International Group Berhad

Dear Sir/ Madam,

On behalf of the Board of Directors of Esthetics International Group Berhad ("Esthetics"), I wish to report after due inquiry that during the period from 31 August 2003 (being the date to which the last audited financial statements of Esthetics and its subsidiaries have been made up) to the date hereof, being the date not earlier than fourteen (14) days before the issue of this Prospectus, that:-

- (i) the business of Esthetics and its subsidiaries have, in the opinion of the Directors, been satisfactory maintained;
- (ii) in the opinion of the Directors, no circumstances have arisen, since the last audited financial statements of Esthetics and its subsidiaries, which have adversely affected the trading or the value of the assets within the Group;
- (iii) the current assets of Esthetics and its subsidiaries appear in the books at values which are believed to be realisable in the ordinary course of business;
- (iv) save as disclosed in Section 7.4.4 of this Prospectus, there are no contingent liabilities that have arisen by reason of any guarantees or indemnities given by Esthetics and its subsidiaries; and
- (v) there have not been, since the last audited financial statements of the company and its subsidiaries, any default or any known event that could give rise to a default situation, in respect of payments of either interest and/or principal sums in relation to any borrowings in which they are aware of; and
- (vi) save as disclosed in this Prospectus, there have been no changes in the published reserves nor any unusual factors affecting the profits of Esthetics and its subsidiaries since the last audited financial statements of the company and its subsidiaries.

Yours faithfully,  
For and on behalf of the Board of Directors of  
ESTHETICS INTERNATIONAL GROUP BERHAD

  
LIM YEE SOON  
Executive Chairman

Esthetics International Group Berhad (408061-P)  
(Formerly known as Esthetics International Berhad)

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47400 Petaling Jaya, Selangor Darul Ehsan.  
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