RHB Research Institute Sdn Bhd
A member of the RHB Banking Group
Company No: 233327 -M

Corporate Highlights

Results Note

23 December 2009

Hai-O Enterprise

1HFY04/10 Results Above Expectations, Proposes Bonus Issue, Share Split And Private Placement

Share Price	:	RM7.50
Fair Value	:	RM9.90
Recom	:	**Outperform** (Maintained)

Table 1 : Investment Statistics (HAIO; Code: 7668) — **Bloomberg: HAIO MK**

FYE Apr	Revenue (RMm)	Net Profit (RMm)	EPS (sen)	Growth (%)	PER (x)	C. EPS * (sen)	P/NTA (x)	Net Gearing (x)	ROE (%)	GDY (%)
2009a	435.2	52.4	62.0	7.9	12.1	0.0	2.0	Net cash	34.2	5.6
2010f	623.8	78.6	93.0	50.0	8.1	82.0	2.4	Net cash	42.3	8.3
2011f	815.5	100.4	118.9	27.9	6.3	99.0	3.0	Net cash	43.5	10.6
2012f	946.4	120.8	143.0	20.3	5.2	114.0	3.8	Net cash	42.1	12.7

Main Board Listing / Trustee Stock — ** Consensus Based On IBES Estimates*

♦ **Above expectations.** Hai-O's 1HFY04/10 core net profit of RM38.0m (+53.9% yoy) was above our and consensus expectations, accounting for 56% and 55% of full year net profit forecasts, respectively. In its 2Q results, Hai-O recorded an exceptional gain of RM0.6m. Key variances include higher-than-expected operating profit margin of 19.6% in 1H10 (vs. our full-year assumption of 15.4%) as well as higher contribution from rental income. As expected, Hai-O declared an interim gross dividend of 10 sen (less 25% tax), which is in line with our full-year expectations of 53 sen gross dividend.

♦ **Increasing our FY04/10 profit forecast**. Following the better-than-expected operating profit margin, we have raised our margin assumptions for Hai-O's MLM, wholesale and retail divisions to 16.5-17.5%, 36.0-40.0% and 5.0-6.0% respectively for FY10-12 (vs. 15.5%, 33.5% and 4.0% respectively previously) due to its focus on higher margin products. Subsequently, based on unchanged 50% net payout, our gross dividend assumption for FY10 have been raised to 62-95 sen (from 53-85 sen), translating to net dividend yield of 6.2-9.5% for FY10-12.

♦ **Bonus issue, share split and private placement**. In a separate announcement, Hai-O has proposed four exercises to be completed in sequence: firstly, a 1-for-five bonus issue; secondly, a 1-to-2 share split; thirdly, an amendment to the Memorandum and Articles of Association and lastly, a non conditional private placement of up to 10% of its enlarged share base. The rationale of these exercises is to improve the liquidity and marketability of Hai-O shares as well as to attract strategic institutional investors and is aimed at completion by 2Q2010. Ex-all, Hai-O's theoretical share price would be RM2.84.

♦ **Risks.** The risks include: 1) termination of supply agreements from its suppliers in China; 2) stronger-than-expected strengthening of US$; and (3) weaker-than-expected increase in consumer spending.

♦ **Forecasts.** All in, our FY10-12 earnings forecasts have been raised by 11.9-16.3%.

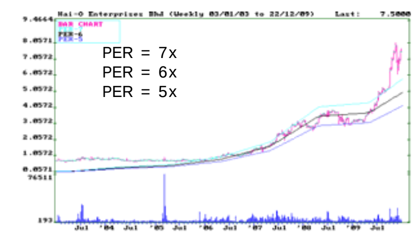
♦ **Investment case.** We raise our fair value estimate to RM9.90/share (from RM8.80) based on unchanged target PER of 9x CY10 EPS after accounting for earnings changes. We reiterate our **Outperform** call on the stock.

RHBRI	Vs.	Consensus
✓	Above	✓
	In Line	
	Below	

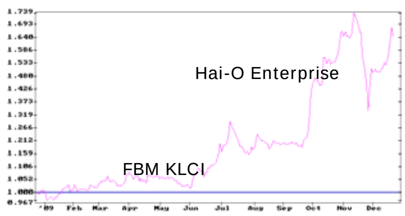
Issued Capital (m shares)	84.5
Market Cap(RMm)	633.4
Daily Trading Vol (m shs)	0.1
52wk Price Range (RM)	3.10-8.05
Major Shareholders:	**(%)**
Tan Family	30.0

FYE Apr	FY10	FY11	FY12
EPS chg (%)	16.3	11.9	13.8
Var to Cons (%)	13.4	20.1	25.4

PE Band Chart



Relative Performance To FBM KLCI



Hoe Lee Leng
(603) 92802239
hoe.lee.leng@rhb.com.my

Table 2: Earnings Reviews (YoY Cumulative)

FYE Apr (RMm)	2Q09	1Q10	2Q10	QoQ (%)	YoY (%)	1H08	1H09	YoY (%)	Comments
Revenue	87.3	148.6	132.4	(10.9)	51.6	200.2	280.9	40.3	Yoy, higher revenue contribution from MLM and higher rental income offsetting lower revenue from wholesale & retail divisions.
- Wholesale & Retail	*20.2*	*16.8*	*21.5*	27.9	6.6	40.4	38.3	*(5.1)*	Yoy decline due to lower contributions from both wholesale and retail divisions from slower demand.
- MLM	*65.9*	*130.3*	*108.9*	(16.4)	65.3	157.4	239.2	*51.9*	Yoy increase in CDF as well as distributor productivity from higher A&P activities.
- Other	*1.2*	*1.5*	*2.0*	36.1	60.3	2.4	3.4	*43.5*	Higher rental income.
EBIT	15.5	26.3	28.7	9.1	85.1	34.2	55.0	60.9	Filtered down from revenue and higher margin (refer to EBIT margin).
Finance cost	(0.2)	(0.0)	(0.1)	>100	(60.7)	(0.1)	(0.1)	85.7	
EI	0.0	0.0	0.6	-	-	0.0	0.6	-	Realisation of exchange fluctuation reserve on disposal of foreign associate amounting RM624,799.
PBT	15.3	26.3	28.6	9.0	86.8	34.0	54.9	61.5	
PBT ex-EI	15.3	26.3	28.0	6.6	82.7	34.0	54.3	59.6	
Taxation	(4.2)	(7.8)	(8.2)	5.5	95.7	(9.3)	(16.0)	71.9	Refer to effective tax rate.
MI	0.3	(0.1)	(0.3)	371.4	>(100)	0.2	(0.3)	>(100)	
Net profit	11.2	18.5	20.2	9.3	81.0	24.7	38.6	56.4	
Net profit ex-EI	11.2	18.5	19.6	5.9	75.4	24.7	38.0	53.9	Filtered down from PBT, EI and higher effective tax rate.
EPS (sen)	13.1	22.2	24.2	9.3	85.5	29.9	46.4	55.4	
GDPS (sen)	10.0	0.0	10.0	-	-	10.0	10.0	-	Interim gross dividend of 10 sen (less 25% tax) was declared during the quarter.
EBIT margin (%)	17.8	17.7	21.7	4.0	3.9	17.1	19.6	2.5	Higher margin yoy due to company's focus on higher margin product sales.
Adj-PBT margin (%)	17.6	17.7	21.2	3.5	3.6	17.0	19.3	2.3	
Adj-Net profit margin (%)	12.8	12.4	14.8	2.4	2.0	12.3	13.5	1.2	
Effective tax rate (%)	27.3	29.6	29.2	(0.3)	2.0	27.3	29.4	2.1	Higher effective tax rate due to certain expenses which are not deductible for tax purposes and losses of certain subsidiary companies which cannot be offset.

Source: Company; RHBRI

1HFY04/10 Results Review

- **Above expectations**. Hai-O's 1HFY04/10 core net profit of RM38.0m (+53.9% yoy) was above our and consensus expectations, accounting for 56% and 55% of full year net profit forecasts, respectively. In its 2Q results, Hai-O recorded an exceptional gain of RM0.6m. Key variances include higher-than-expected operating profit margin of 19.6% in 1H10 (vs. our full-year assumption of 15.4%) as well as higher contribution from rental income. The higher operating profit margin was mainly achieved from its MLM division, which recorded 1H10 margin of 18.0% (vs. our full-year assumption of 15.5%). Meanwhile, Hai-O's other divisions namely wholesale and retail saw improvements in operating margin by +15.3%-pts and +2.4%-pts respectively. Hai-O attributed the improvement in margins on its focus to higher-margin as well as in-house brand products. As expected, Hai-O declared an interim gross dividend of 10 sen (less 25% tax), which is in line with our full-year expectations of 53 sen gross dividend.

- **Increasing our FY04/10 profit forecast.** Following the better-than-expected operating profit margin, we have raised our margin assumptions for Hai-O's MLM, wholesale and retail divisions to 16.5-17.5%, 36.0-40.0% and 5.0-6.0% respectively for FY10-12 (vs. 15.5%, 33.5% and 4.0% respectively previously) due to its focus on higher margin products. Subsequently, based on unchanged 50% net payout, our gross dividend assumption for FY10 have been raised to 62-95 sen (from 53-85 sen), translating to net dividend yield of 6.2-9.5% for FY10-12.

Corporate Exercises

- **Bonus issue, share split and private placement.** Hai-O has proposed four exercises to be completed in sequence: firstly, a 1-for-five bonus issue; secondly, a 1-to-2 share split; thirdly, an amendment to the Memorandum and Articles of Association; and lastly, a non conditional private placement of up to 10% of its enlarged share base. The entitlement dates are to be announced later. The rationale of these exercises is to improve the liquidity and marketability of Hai-O shares as well as to attract strategic institutional investors and is aimed at completion by 2Q2010.

1. ***Proposed 1-for-5 bonus issue*** – based on current share capital of 84.46m (including treasury shares) of RM1.00 each and assuming all existing 1.27m shares are re-sold on the open market, up to 16.89m bonus shares to be issued, bringing Hai-O's total issued share capital to 101.35m upon completion;

2. ***Proposed 1-to-2 share split*** – based on enlarged share capital of 101.35m upon completion of bonus issue each to be split into 202.70m shares of RM0.50 each;

3. ***Proposed private placement*** – proposed private placement of new shares of up to 10% of its enlarged share base of 202.70m shares, equivalent to 20.27m shares. Management highlighted that this private placement is not conditional and its main purpose is to increase equity participation of institutional investors in Hai-O to increase visibility, as it does not require additional working capital due to its strong net cash position of more than RM1.00/share. Ex-all, Hai-O's theoretical share price would be RM2.84.

Table 3. Effect Of Proposals On Hai-O's Share Capital

Share Capital	Par value	No. Shares	RM'm value	Theoretical ex-price (RM)
Existing @ 30 Nov 09	1	84.46		7.50 (Current)
(incl 1.27m treasury shares)				
Upon completion of bonus issue (1)	1	16.89	16.89	6.25
Upon completion of share split (2)	0.5	101.35	84.46	3.13
Assuming full private placement (3)	0.5	20.27	10.13	**2.84**
TOTAL FD ISSUED SHARES		**222.97**	**111.48**	

Table 4: EPS Dilution From Private Placement (after share split and bonus issue)		
FY04/10 (RMm)	**Before**	**After**
Net profit	78.6	78.6
Additional interest income*	0	1.9
Adj net profit	78.6	80.5
Share capital	202.7	223.0
EPS (sen)	38.8	36.1
Change (%)		-6.9
**RM55m x 2.5%*		

- **Overall positive for sentiment**. While the proposed private placement would cause some dilution to earnings by approximately 6.9%, we understand that Hai-O would strengthen its shareholders list by increasing equity participation of strategic institutional investors in the company. Also given the enlarged share base, this may help improve liquidity of Hai-O shares, which would likely buoy retail sentiment on the stock.

Table 3. Earnings Forecasts

FYE Apr (RMm)	FY09a	FY10F	FY11F	FY12F
Turnover	**435.2**	**623.8**	**815.5**	**946.4**
Wholesale	42.2	40.1	42.1	44.2
MLM	348.9	534.4	723.6	851.8
Retail	39.1	42.3	42.9	43.4
Manufacturing	2.5	2.5	3.0	3.5
Other	2.5	4.5	4.0	3.5
Turnover growth (%)	16.4	43.3	30.7	16.0
Cost of Sales	(305.1)	(385.4)	(506.9)	(584.0)
Gross Profit	130.1	238.4	308.6	362.3
EBITDA	**78.2**	**115.4**	**144.9**	**170.8**
EBITDA margin (%)	18.0	18.5	17.8	18.0
Depreciation	(2.1)	(4.3)	(4.4)	(4.4)
Net Interest	(0.2)	1.1	1.0	1.4
Associates	0.0	0.0	0.0	0.0
Pretax Profit	**75.9**	**112.2**	**141.5**	**167.8**
Tax	(22.8)	(31.4)	(38.2)	(43.6)
Minorities	(0.7)	(2.2)	(2.8)	(3.4)
Net Profit	**52.4**	**78.6**	**100.4**	**120.8**

Table 4. Forecast Assumptions

FYE Apr	FY10F	FY11F	FY12F
Core distributor force (CDF)	124,000	163,000	190,000
Distributor productivity (RM/CDF)	4,310	4,439	4,483
Opening of new retail outlets	3	3	3
Revenue per outlet (RM'000)	705	716	723

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Stock Ratings

Outperform = The stock return is expected to exceed the FBM KLCI benchmark by greater than five percentage points over the next 6-12 months.

Trading Buy = Short-term positive development on the stock that could lead to a re-rating in the share price and translate into an absolute return of 15% or more over a period of three months, but fundamentals are not strong enough to warrant an Outperform call. It is generally for investors who are willing to take on higher risks.

Market Perform = The stock return is expected to be in line with the FBM KLCI benchmark (+/- five percentage points) over the next 6-12 months.

Underperform = The stock return is expected to underperform the FBM KLCI benchmark by more than five percentage points over the next 6-12 months.

Industry/Sector Ratings

Overweight = Industry expected to outperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Neutral = Industry expected to perform in line with the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Underweight = Industry expected to underperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

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