Malaysia

MARKET DATELINE ● PP 7767/09/2010(025354)

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

Corporate Highlights

Company Update

26 November 2009

Hai-O Enterprise

Addressing Shareholders Concerns

Share Price	:	RM6.15
Fair Value	:	RM8.80
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	9.9	0.0	2.0	Net cash	34.2	6.8
2010f	619.3	67.5	79.9	28.9	7.7	79.0	2.4	Net cash	36.9	8.7
2011f	811.5	89.8	106.2	32.9	5.8	90.0	2.9	Net cash	40.3	11.5
2012f	942.9	106.2	125.7	18.3	4.9	100.0	3.5	Net cash	39.0	13.6

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

- **Price drop.** Recently, Hai-O's share price dropped 23% from its 11 Nov peak of RM7.99 and by 15% from the 19 Nov ex-date for its final gross dividend (32 sen). While the sharp drop in share price has triggered alarm bells to shareholders, our checks with management highlighted that fundamentally, Hai-O's revenue and profit growth remains intact.

- **Why the sudden drop in share price?** YTD, Hai-O's share price has jumped by 91%. Judging by the volume traded and the steepness of the price decline, we believe the share price weakness is mainly attributable to profit-taking activities by large non-strategic investors.

- **Fundamentally intact**. We believe Hai-O is on track to deliver another set of commendable results in 2QFY04/10 (to be announced in Dec 09), backed by still strong revenue per distributor together with an average increase of 4,000 to 5,000 new members per month. Furthermore, Hai-O recorded a record turnout of 12,000 members to its recent Hai-O Marketing (MLM division) 17th Anniversary Celebration, which is 100% higher vs. 2008, highlighting the growing strength of its MLM core distributor force.

- **Indonesia, an attractive growth market.** Hai-O has started the initial phase of its recruitment activities in the Indonesia market. Recall that the company has only invested a total of US$480k (or RM1.7m) for its Indonesia venture, which is a minimal amount for the potential significant growth in the Indonesia market. To be conservative, we have yet to input any contributions from this venture.

- **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.

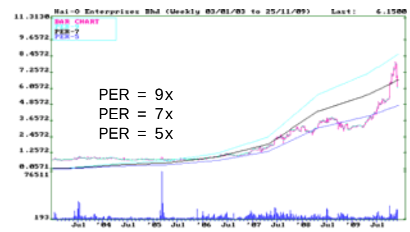
- **Forecasts.** No changes to our forecasts.

- **Investment case.** We believe the recent selldown in Hai-O's share price is driven by profit-taking activities, as the company's fundamentals remain strong. In our view, the current price weakness is an opportunity to buy Hai-O shares, which offer attractive net dividend yield of 6.5%, 8.6% and 10.2% for FY10-12, and potential significant earnings growth from the Indonesia venture. We thus reiterate our **Outperform** call on Hai-O with an indicative fair value of RM8.80, based on PER of 9x CY10 EPS, representing a 38% discount to our target PER for the consumer sector of 14.5x on account of its smaller market capitalisation as well as low liquidity.

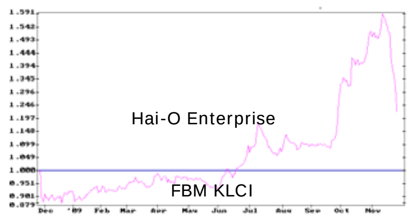
Issued Capital (m shares)	84.5
Market Cap(RMm)	519.4
Daily Trading Vol (m shs)	0.1
52wk Price Range (RM)	2.93 – 8.05
Major Shareholders:	**(%)**
Tan Family	30.0

FYE Apr	FY10	FY11	FY12
EPS chg (%)	-	-	-
Var to Cons (%)	1.2	18.0	25.7

PE Band Chart



Relative Performance To FBM KLCI



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- **Price drop.** Recently, Hai-O's share price dropped 23% from its 11 Nov peak of RM7.99 and by 15% from its 19 Nov ex-date for its final gross dividend of 32 sen. While the sharp drop in share price triggered alarm bells for shareholders, our checks with management highlighted that fundamentally, Hai-O's revenue and profit growth remains intact.

- **Why the sudden drop in share price?** YTD, Hai-O's share price has jumped by 91%. Judging by the volume and the steepness of the price decline, we believe the share price weakness is mainly attributable to profit-taking activities by large non-strategic investors. Nevertheless, we see the current share price weaknesses as an opportunity for investors to buy Hai-O shares.

- **Fundamentally intact.** We believe Hai-O is on track to deliver another set of commendable results in 2QFY04/10 (to be announced in Dec 09), backed by still strong revenue per distributor together with an average increase of 4,000 to 5,000 new members per month. Furthermore, Hai-O recorded a record turnout of 12,000 members at its recent Hai-O Marketing (MLM division) 17th Anniversary Celebration, which is a 100% increase vs. 2008, highlighting the growing strength of its MLM core distributor force. The 2Q of the financial year is normally weaker qoq due to seasonal factors, but we understand that this year's 2Q results will likely be flattish qoq which again highlights the positive earnings outlook.

- **Indonesia, an attractive growth market.** Hai-O has started the initial phase of its recruitment activities in the Indonesia market. Recall that Hai-O only invested a total of US$480k (or RM1.7m) for its Indonesia venture, which is a minimal amount for the vast potential growth of the market. Management targets a conservative 5-10k in new members in FY10, and projects a minimum of one year to break even. To be conservative, we have yet to input any contributions from this venture.

- **Rumours on abuse within the MLM system?** There have been rumours circulating on an abuse within the MLM system in Malaysia. Management highlighted that this rumour has already been circulating around the industry for the past few years and could have been triggered by other MLM companies, as they compete for the recruitment of members. Management emphasised that there is a strict code of ethics and compliance, in which membership would be revoked if any members are found guilty of abusing the system.

- **Weakening of US$ in Hai-O's favour.** The US$ has weakened against the ringgit by 5-6% from mid-2009 to date. Like Amway, Hai-O will benefit from the weakening of US$ as approximately 20% of its products are imported in US$.

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

- No changes to our forecasts.

Recommendation

- **Investment case.** We believe the recent selldown in Hai-O's share price is driven by profit-taking activities as the company's fundamentals remain strong. Hai-O also has in place an attractive net dividend payout policy of 50%, which translates to a net dividend yield of 6.5%, 8.6% and 10.2% for FY10-12 respectively based on our forecasts. Together with minimal capex for its Indonesia JV and the vast earnings potential from the Indonesia market potentially driving future growth, we reiterate our **Outperform** recommendation on Hai-O with an indicative fair value of RM8.80, based on PER of 9x CY10 EPS, representing a 38% discount to our target PER for the consumer sector of 14.5x on account of its smaller market capitalisation as well as low liquidity. In our view, the current share price weakness is an opportunity to buy.

Table 2. Earnings Forecasts

FYE Apr (RMm)	FY09a	FY10F	FY11F	FY12F
Turnover	**435.2**	**619.3**	**811.5**	**942.9**
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	0.0	0.0	0.0
Growth (%)	*16.4*	*42.3*	*31.1*	*16.2*
Gross Profit	130.1	221.7	292.8	341.5
EBITDA	**78.2**	**99.7**	**129.9**	**150.7**
Margin (%)	18.0	16.1	16.0	16.0
Depreciation	(2.1)	(4.3)	(4.4)	(4.4)
Net Interest	(0.2)	1.1	0.9	1.2
Associates	0.0	0.0	0.0	0.0
Pretax Profit	**75.9**	**96.5**	**126.4**	**147.5**
Tax	(22.8)	(27.0)	(34.1)	(38.3)
Minorities	(0.7)	(1.9)	(2.5)	(2.9)
Net Profit	**52.4**	**67.5**	**89.8**	**106.2**

Table 3. Forecast Assumptions

FYE Apr	FY10F	FY11F	FY12F
Core distributor force (CDF)	107,500	121,000	133,000
Distributor productivity (RM/CDF)	4,741	4,883	4,932
Opening of new retail outlets	1	0	0
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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