Malaysia

MARKET DATELINE ● PP 7767/09/2009(022069)

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

Corporate Highlights

Results Note

30 September 2009

Hai-O Enterprise

Above Expectations, Once Again

Share Price	:	RM5.69
Fair Value	:	RM6.80
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	52.0	61.6	7.2	9.2	-	2.0	Net cash	34.0	7.4
2010f	594.5	65.1	77.1	25.2	7.4	67.0	2.3	Net cash	36.3	6.8
2011f	678.8	75.2	89.1	15.5	6.4	76.0	2.7	Net cash	35.8	7.9
2012f	746.9	84.4	99.9	12.2	5.7	85.0	3.7	Net cash	31.4	8.8

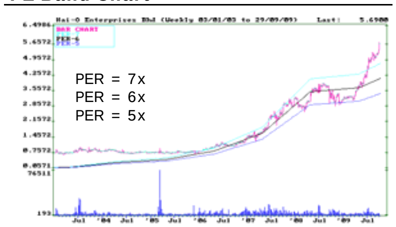
Main Board Listing / Trustee Stock — ** Consensus Based On IBES Estimates*

RHBRI	Vs.	Consensus
✓	Above	✓
	In Line	
	Below	

Issued Capital (m shares)	84.5
Market Cap(RMm)	480.6
Daily Trading Vol (m shs)	0.1
52wk Price Range (RM)	2.86 – 5.74
Major Shareholders:	**(%)**
Tan Family	30.0

FYE Apr	FY10	FY11	FY12
EPS chg (%)	15.5	17.4	19.1
Var to Cons (%)	15.1	17.2	17.6

PE Band Chart



Relative Performance To FBM KLCI

- **Above expectations.** Hai-O's 1QFY04/10 net profit was above our and consensus expectations, accounting for 33% of our and consensus full year net profit forecasts. The key variance was mainly due to: 1) higher-than-expected contribution from its MLM division, which grew by 42% yoy on the back of higher-than-expected increase in CDF as well as distributor productivity from buoyant sales of its health and wellness products and higher A&P activities; and 2) lower effective tax rate. As expected, no dividend was declared during the quarter.

- **MLM remains the star.** Following the stronger-than-expected distributor productivity for 1Q10, we have revised our assumptions for productivity to +5% in FY10 (from +1% previously) but maintain our assumption of +3% for FY11 and +1% for FY12. While we retain our distributor growth numbers of 12-15k p.a. for FY10-12, we increased our member retention rate to 22% p.a. (vs. 20% previously), following the stronger CDF numbers.

- **Favourable impact from MLM venture not factored in yet.** Recall that Hai-O's MLM division is in the midst of venturing into the Indonesian market, having started its recruitment drive from Jul 09. Hai-O would be investing a total of US$480k (or RM1.7m), of which US$120k (or RM0.4m) is for capex while the remaining US$360k (or RM1.3m) is for working capital. Management is targeting a conservative 5-10k in new members in FY10, and forecasts a minimum 2 years to break even. Note we have yet to input any contributions from Indonesia, pending feedback from management on its recruitment activities.

- **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.** We have revised our FY10-12 forecasts up by 15-20% after: 1) increasing our distributor retention rate; 2) increasing our distributor productivity for FY10; and 3) reducing our tax rate assumptions to 26-28% to reflect the normalisation of effective tax rate in 1Q10.

- **Investment case.** Indicative fair value for Hai-O has been increased to RM6.80 (from RM5.80), based on unchanged 8x CY10 EPS, representing a 48% discount to our target PE for the consumer sector of 14.5x on account of its smaller market capitalisation as well as low liquidity. Maintain **Outperform**.

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Please read important disclosures at the end of this report.

Table 2: Earnings Reviews (YoY Cumulative)

FYE Apr (RMm)	1Q09	4Q09	1Q10	QoQ (%)	YoY (%)	Comments
Revenue	112.9	132.8	148.6	11.8	31.6	Higher revenue contribution from the MLM division offsetting lower revenue from wholesale & retail division.
- Wholesale & retail	*20.2*	*18.9*	*16.8*	(11.2)	(16.9)	Decline due to lower contributions from both wholesale and retail division from slower demand in traditional Chinese medicine and herbs.
- MLM	*91.5*	*112.5*	*130.3*	15.8	42.4	Yoy increase in CDF as well as distributor productivity from buoyant sales of its health and wellness products and higher A&P activities.
- Others	*1.2*	*1.4*	*1.5*	1.8	25.6	
EBIT	18.7	23.0	26.3	14.3	40.9	Filtered down from revenue and higher margin (refer to EBIT margin).
Interest income/(expense)	0.1	(0.1)	(0.0)	(54.1)	>(100)	
PBT	18.7	23.0	26.3	14.5	40.7	Filtered down from EBIT.
Taxation	(5.1)	(8.2)	(7.8)	(5.5)	52.3	Refer to effective tax rate.
MI	(0.0)	(0.1)	0.1	>(100)	>(100)	
Net profit	13.6	14.7	18.5	25.8	36.2	Filtered down from PBT and lower effective tax rate.
EPS (sen)	16.8	17.8	22.2	24.6	32.0	
Gross dividend (sen)	0.0	32.0	0.0	>(100)	n.m.	
EBIT margin (%)	16.5	17.3	17.7	0.4	1.2	Improvement in wholesale and MLM margin by 58% and 5% respectively. We believe the higher margin was achieved through better product mix.
PBT margin (%)	16.5	17.3	17.7	0.4	1.1	
Net profit margin (%)	12.0	11.0	12.4	1.4	0.4	
Effective tax rate (%)	27.3	35.8	29.6	(6.3)	2.2	Normalisation of effective tax rate.

Source: Company; RHBRI

Table 3. Earnings Forecasts

FYE Apr (RMm)	FY09a	FY10F	FY11F	FY12F
Turnover	**435.2**	**594.5**	**678.8**	**746.9**
Wholesale	42.2	40.1	42.1	44.2
MLM	348.9	509.6	590.8	655.9
Retail	39.1	42.3	42.9	43.4
Manufacturing	2.5	2.5	3.0	3.5
Other	2.4	0.0	0.0	0.0
Turnover growth (%)	*16.4*	36.6	14.2	10.0
Cost of Sales	(280.9)	(381.3)	(434.8)	(477.5)
Gross Profit	154.2	213.2	244.0	269.4
EBITDA	**77.8**	**96.3**	**109.2**	**120.1**
EBITDA margin (%)	17.9	16.2	16.1	16.1
Depreciation	(2.1)	(4.3)	(4.2)	(4.1)
Net Interest	(0.2)	1.1	1.0	1.3
Associates	0.0	0.0	0.0	0.0
Pretax Profit	**75.5**	**93.1**	**106.0**	**117.3**
Tax	(22.8)	(26.1)	(28.6)	(30.5)
Minorities	(0.7)	(1.9)	(2.1)	(2.3)
Net Profit	**52.0**	**65.1**	**75.2**	**84.4**

Table 4. 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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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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