Malaysia

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

Corporate Highlights

Results Note / Visit Note

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

29 June 2009

Hai-O Enterprise

One Step Closer To Indonesia

Share Price	:	RM4.44
Fair Value	:	RM5.10
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 (%)
2008a	373.8	48.5	57.4	127.0	7.7	-	1.7	Net cash	39.4	9.0
2009a	435.2	52.0	61.6	7.2	7.2	-	2.0	Net cash	34.0	6.8
2010f	531.5	56.6	67.0	8.8	6.6	58.0	2.4	Net cash	30.7	6.8
2011f	606.1	64.2	76.0	13.4	5.8	66.0	3.0	Net cash	28.3	7.9

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

- **Earnings momentum continues.** Hai-O's FY04/09 net profit was above our and consensus expectations, accounting for 109% and 107% of our and consensus full year net profit forecasts. The key variance was mainly due to higher-than-expected MLM sales. Full year net profit increased 7.2% yoy on the back of: 1) 24% yoy increase in MLM division revenue (which accounted for 80% of total revenue in FY09); offset by: 2) 8.3% yoy drop in revenue for wholesale and retail division due to slower demand; 3) lower EBIT margin of 17.4% (vs. 18.0% in FY08) due to strengthening of US$ against RM (average FY09: RM3.468/US$; average FY08: RM3.347/US$) coupled with writedown of inventories in 4Q09; and 4) higher effective tax rate in FY09 of 30.2% (vs. 27.5% in FY08) from the underprovision of taxation in prior years and losses in some subsidiaries.
- **32 sen final dividend announced.** A final gross dividend of 32 sen (less 25% tax) has been declared (higher than our projected 30 sen), bringing its full year gross DPS to 42 sen (or 7% net yield) or 50% net payout. As such, we have adjusted our net dividend payout assumptions to 50% (from 40%) for FY10-11 to 34-39sen (from 30-35sen initially), or a net yield of 8-9%.
- **MLM continues to be key driver.** Year-to-date, Hai-O's distributor force has increased by 25% to 100,000 (from 80,000 end-CY08). Meanwhile, its distributor productivity increased about 2% yoy, averaging at RM4.1k in FY09 (vs. RM4k in FY08). Following the stronger-than-expected distributor productivity for FY09, we have revised our assumptions for productivity to +1% in FY10 (from -9% previous) and maintain our assumption for FY11 at +3%, as we expect consumer spending to slowly recover from 2HCY09 onwards. Meanwhile, we have also increased our distributor growth numbers to 12-15k p.a. for FY10-11 (from 12k p.a. previously) following the increase in new members.
- **MLM venture in Indonesia.** Hai-O's MLM division is venturing into the Indonesian market and is targeting its recruitment drive to begin from Jul 09 onwards. 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$360k (or RM1.3m) is for working capital. Hai-O targets a conservative 5-10k new members in FY10 and a minimum 2 years to break even. We have yet to input any contributions from the operations pending the final stages of endorsement from the direct selling association.
- **Risks.** The risks include: 1) termination of supply agreements from its suppliers in China; 2) stronger-than-expected strengthening of US$; and (3) worse-than-expected contraction in consumer spending.
- **Forecasts.** We have revised our FY10-11 forecasts up by 18-19% following FY09's results as well as to reflect our revised assumptions on distributor productivity and CDF.
- **Investment case.** Indicative fair value for Hai-O has been increased to RM5.10 (from RM4.40), based on unchanged 7x 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**.

RHBRI	Vs.	Consensus
✓	Above	✓
	In Line	
	Below	

Issued Capital (m shares)	84.5
Market Cap(RMm)	375.0
Daily Trading Vol (m shs)	0.1
52wk Price Range (RM)	2.86 – 4.44
Major Shareholders:	**(%)**
Tan Family	30.0

FYE Apr	FY09	FY10	FY11
EPS chg (%)	8.4	19.4	17.9
Var to Cons (%)	-1.6	15.5	15.1

PE Band Chart

Relative Performance To KLCI

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Table 2: Earnings Reviews (YoY Cumulative)

FYE Apr (RMm)	4Q08	3Q09	4Q09	QoQ (%)	YoY (%)	FY08	FY09	YoY (%)	Comments
Revenue	133.5	102.1	132.8	30.1	(0.5)	373.8	435.2	16.4	Higher revenue contribution from the MLM division offsetting lower revenue from wholesale & retail division.
- Wholesale & retail	*25.2*	*22.0*	*18.9*	(14.1)	(24.8)	88.7	81.3	*(8.3)*	Decline due to lower contributions from both wholesale and retail division from slower demand.
- MLM	*107.3*	*78.9*	*112.5*	42.5	4.9	281.6	348.9	*23.9*	Yoy increase in CDF as well as distributor productivity from higher A&P activities.
- Others	*1.1*	*1.2*	*1.4*	22.5	29.9	3.5	5.0	*41.2*	
EBIT	26.2	18.6	23.0	23.6	(12.0)	67.2	75.7	12.6	Filtered down from revenue and lower margin (refer to EBIT margin).
Interest income/(expense)	0.3	(0.1)	(0.1)	(0.0)	>100	0.5	(0.2)	>100	Higher finance cost on term borrowing.
PBT	26.4	18.6	23.0	23.7	(13.2)	67.7	75.5	11.5	Filtered down from EBIT and higher interest expense.
Taxation	(7.2)	(6.2)	(8.2)	33.6	14.4	(18.6)	(22.8)	22.5	Refer to effective tax rate.
MI	(0.2)	(0.4)	(0.1)	(85.7)	(73.5)	(0.6)	(0.7)	30.4	
Net profit	19.0	12.0	14.7	22.4	(22.9)	48.5	52.0	7.2	Filtered down from PBT and higher effective tax rate.
EPS (sen)	23.6	14.6	17.8	21.6	(24.7)	60.4	63.1	4.5	
Gross dividend (sen)	32.0	0.0	32.0	n.m.	0.0	40.0	42.0	5.0	
EBIT margin (%)	19.6	18.2	17.3	(0.9)	(2.3)	18.0	17.4	(0.6)	Lower margin for wholesale division due to US$ strengthening against RM (average FY09: RM3.468/US$; average FY08: RM3.347/US$) coupled with writedown of inventories in 4Q09.
PBT margin (%)	19.8	18.2	17.3	(0.9)	(2.5)	18.1	17.4	(0.8)	
Net profit margin (%)	14.2	11.7	11.0	(0.7)	(3.2)	13.0	12.0	(1.0)	
Effective tax rate (%)	27.2	33.1	35.8	2.7	8.6	27.5	30.2	2.7	Underprovision of taxation in prior years, certain expenses not deductible for tax purposes and losses in some subsidiaries.

Source: Company; RHBRI

- **Key takeaways** from our company visit last Friday: 1) MLM continues to be key driver; and 2) venturing into Indonesia.

- **MLM continues to be key driver**. Year-to-date, Hai-O's distributor force has increased by 25% to 100,000 (from 80,000 end-CY08) or an average of 3-4k new members per month in 1HCY09 (from 2-3k new members in 2HCY08), with active membership of about 20%. Meanwhile, its distributor productivity increased about 2% yoy, averaging at RM4.1k in FY09 (vs. RM4k in FY08). The increase in new members as well as distributor productivity was mainly attributed to the success of its A&P activities (celebrity endorsement and TV commercials) for its water filter product (BioAura). In addition, in FY09, Hai-O introduced two new product ranges - its food supplement range (Nurich) in Dec 08 and its skin-care range in Mar 09. Feedback from management has indicated that sales from the food supplement range have been commendable, while sales from the skin-care range have been weak. Following the stronger-than-expected distributor productivity for FY09, we have revised our assumptions for productivity to +1% in FY10 (from -9% previous) and maintain our assumption for FY11 at +3%, as we expect consumer spending to slowly recover from 2HCY09 onwards. Meanwhile, we have also increased our net distributor growth numbers to 12-15k p.a. for FY10-11 (from 12k p.a. previously) following the recent increase in new members.

- **MLM venture in Indonesia**. As highlighted in the media recently, Hai-O's MLM division is venturing into the Indonesian market (through a 60:40 JV with an Indonesian entrepreneur), under the company PT. Hai-O Indonesia (PT Hai-O). PT Hai-O is targeting its recruitment drive to begin from Jul 09 onwards. 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. PT Hai-O's business licence has been approved, pending final stages of endorsement from the direct selling association. Hai-O targets a conservative 5-10k new members in FY10 and a minimum 2 years to break even from its Indonesian operations. We believe the total capex of RM1.7m has already been invested in FY09, but we have yet to input any contributions from the operations pending the final stages of endorsement from the direct selling association.

Risks

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

Forecasts and recomendation

- **We have revised our FY10-11 forecasts up** by 18-19% following FY09's results as well as to reflect our revised assumptions on distributor productivity and CDF.

- **Fair value increased, maintain Outperform.** Indicative fair value for Hai-O has been increased to RM5.10 (from RM4.40), based on unchanged 7x 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**.

Table 3. Earnings Forecasts

FYE Apr (RMm)	FY08a	FY09a	FY10F	FY11F
Turnover	**373.8**	**435.2**	**531.5**	**606.1**
Wholesale	49.4	42.2	40.1	42.1
MLM	281.6	348.9	445.6	516.7
Retail	39.3	39.1	42.3	42.9
Manufacturing	1.2	2.5	3.5	4.5
Other	2.3	2.4	0.0	0.0
Turnover growth (%)	97.4	16.4	22.1	14.0
Cost of Sales	(247.74)	(280.94)	(341.29)	(388.54)
Gross Profit	126.1	154.2	190.2	217.6
EBITDA	**69.5**	**77.8**	**86.7**	**96.4**
EBITDA margin (%)	18.6	17.9	16.3	15.9
Depreciation	(2.2)	(2.1)	(4.3)	(2.5)
Net Interest	0.5	(0.2)	1.1	0.7
Associates	0.0	0.0	0.0	0.0
Pretax Profit	**67.7**	**75.5**	**83.5**	**94.7**
Tax	(18.6)	(22.8)	(25.2)	(28.5)
Minorities	(0.6)	(0.7)	(1.7)	(1.9)
Net Profit	**48.5**	**52.0**	**56.6**	**64.2**

Table 4. Forecast Assumptions

FYE Apr	FY10F	FY11F
Core distributor force (CDF)	107,500	121,000
Distributor productivity (RM/CDF)	4,146	4,270
Opening of new retail outlets	1	0
Revenue per outlet (RM'000)	705	716

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Stock Ratings

Outperform = The stock return is expected to exceed the 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 KLCI benchmark (+/- five percentage points) over the next 6-12 months.

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

Industry/Sector Ratings

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

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

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

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