

Company Update

Hai-O Ent

HAIO MK
RM3.26

ADD (downgrade)

Target Price: RM3.66



Price Performance

	1M	3M	12M
Absolute	-14.2%	-10.3%	+27.9%
Rel to KLCI	-6.3%	+9.8%	+63.1%

Stock Data

Issued shares (m)	84.2
Mkt cap (RMm)	274.4
Avg daily vol - 6mth (m)	0.09
52-wk range (RM)	3.90-2.46
Est free float	40%
NTA per share (RM)	1.69
P/NTA (x)	1.93
Net cash/ (debt) (RMm)	86.7
ROE (2008F)	37.7%
Derivatives	Nil

Key Shareholders

Tan family	25.6%
Maybank Smallcap	3.9%

Earnings & Valuation Revisions

	08E	09E	10E
Prev EPS (sen)	58.9	64.4	70.4
Curr EPS (sen)	58.6	63.4	69.2
Chg (%)	-0.6	-1.6	-1.6
Prev target price (RM)		4.64	
Curr target price (RM)		3.66	

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Not immune to a slowdown: cutting price target

Wholesale division affected by dampened consumer spending and margins

In a recent meeting, management guided that 1QFY09 sales and net profit would decline qoq, dragged down by its weaker wholesale division (accounts for 13.2% of FY08 sales) affected by sharply lower purchases by its Chinese Medical Hall customers (2,000 customers, 500 active) after the fuel price hike in June 08. Besides, the fall in Pu-Er tea prices (-20% to -30% qoq) have also dampened the wholesale division's margins. In addition, 1Q (May to July) has historically been a seasonally weak quarter. As such, we are lowering our FY09-11 wholesale division margins to 13%-15% from 15%-18%.

Still see growth at direct marketing, but is expected to moderate

On the flipside, MLM sales (75.3% of FY08 sales) growth will moderate to single digit due to: 1) high base in 4QFY08 (+43.6% qoq) with distributors striving to achieve incentives target (e.g. trip to Paris); and 2) addition in new distributor force of 2,000 per month (active new distributors estimated at 500 to 1,000). This trend is expected as MLM provides additional income amidst the eroding disposable income. However, the increase will reduce the average revenue per distributor as the productivity of distributor has slowed down.

Defer construction of new pharmaceutical factory – capex cut

Given the economic slowdown, management will hold back the construction of its new pharmaceutical factory, which will be adjacent to its current factory in Jalan Kapar, Klang. We think that this move is sensible given the uncertain macro outlook. Besides, Hai-O still has sufficient production capacity of 80 tonnes per day to cope with its growing OEM contracts. We have therefore reduced our FY09 capex assumption to RM5m (previously RM12.5m).

FY09-11 earnings forecast trimmed by 1%-2%

All in, we have reduced our FY09-FY11 EPS forecast by 1%-2% after: 1) trimming our wholesale division margins to 13%-15% from 15%-18%; 2) but slightly compensated by lower depreciation charges in view of our lower capex assumption. DPS forecasts of 29.5 sen to 35.5 sen in FY09-11 are however kept on the assumption that management maintains a dividend payout policy of 50%.

Downgrade to ADD with lower target price of RM3.66

SOP-based target price is reduced to RM3.66 from RM4.64 after factoring: 1) a higher discount of 50% on MLM division's PER of 8.2x (from 9.7x), and 2) lower PER of 5x on wholesale segment (from 7x) based on an unchanged 80% discount to regional wholesale average of 24.7x. The latter's discount is to reflect: 1) Hai-O's smaller market cap; 2) earnings risk - slowdown would impact sales and margins, and 3) weaker market sentiment. Rating is lowered to ADD.

Earnings and Valuation Summary

FYE30 April	2007	2008	2009F	2010F	2011F
Revenue (RMm)	189.3	373.8	395.5	440.6	488.5
EBITDA (RMm)	32.6	67.3	72.1	77.3	83.1
Pretax profit (RMm)	30.6	67.7	67.7	73.3	80.1
Net profit (RMm)	21.4	48.5	49.2	53.2	58.1
EPS (sen)	26.0	58.1	58.6	63.4	69.2
EPS growth (%)	110.0	123.3	0.8	8.2	9.2
PER (x)	12.5	5.6	5.6	5.1	4.7
Core net profit (RMm)	21.4	48.5	49.2	53.2	58.1
Core EPS (sen)	26.0	58.1	58.6	63.4	69.2
Core PER (x)	12.5	5.6	5.6	5.1	4.7
DPS (sen)	18.0	40.0	29.5	32.5	35.5
Dividend Yield (%)	5.5	12.3	9.0	10.0	10.9
EV/EBITDA (x)	7.3	3.7	3.1	2.7	2.1
Consensus profit (RMm)			51.9	57.1	59.1
Affin/Consensus (x)			0.9	0.9	1.0

Fig. 1: Sum-of-part valuations

Divisions	CY09 net profit	Applied PER (x)	Value RM'm	Comments
MLM	35.2	4	143.8	Target PER at a 50% discount to local MLM average of 8.2x
Retail	1.5	8	11.7	Fair PER for a fairly stable business
Wholesale	9.5	5	46.7	Target PER at a 80% discount to regional w wholesales average of 24.7x
Manufacturing	2.2	6	13.4	Local pharmaceutical companies trade between 4x-9x
Others	0.8	4	3.3	Reasonable for its traditional Chinese clinics
Net cash/debt			89.2	
			<u>308.2</u>	
No of shares (m)			84.2	
SOP/share			3.66	

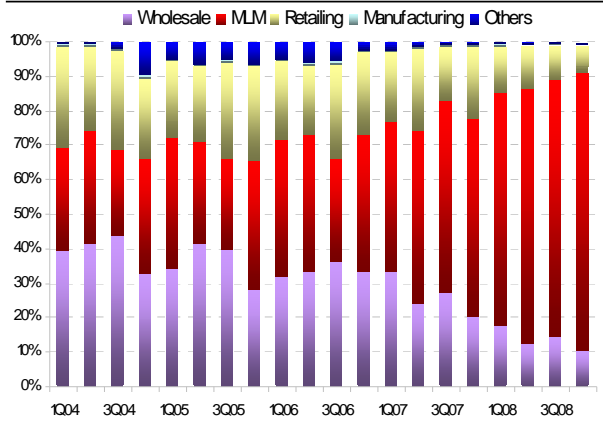
Fig. 2: Regional peers valuations

Company	FYE	Market Cap (USD)	PER (x)		Div Yld (%)		ROE (%)		EV/EBITDA (x)		
			CY08	CY09	CY08	CY09	CY08	CY09	CY08	CY09	
Retail											
Guangzhou Pharmaceutical Co Ltd	Hong Kong	Dec	297.2	7.5	6.9	4.2	4.8	9.3	9.4	4.4	4.2
Tong Ren Tang Technologies Co Ltd	Hong Kong	Dec	39.8	8.2	7.1	5.5	6.0	12.6	13.0	4.6	4.5
Eu Yan Sang International Ltd	Singapore	June	118.0	10.9	11.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Average				8.9	8.6	4.8	5.4	10.9	11.2	4.5	4.3
MLM											
Amway (Malaysia) Hldgs	Malaysia	Dec	318.7	13.0	12.6	8.5	8.7	39.0	39.8	8.3	8.0
Zhulian Corp Bhd*	Malaysia	Nov	92.3	5.0	4.7	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
CNI Holdings Bhd*	Malaysia	Dec	54.0	9.1	7.3	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Average				9.0	8.2	8.5	8.7	39.0	39.8	8.3	8.0
Manufacturing											
CCMDuopharma Biotech Bhd	Malaysia	Dec	92.4	9.4	8.5	9.3	9.8	20.5	19.8	6.4	5.9
Pharmaniaga Bhd	Malaysia	Dec	109.6	6.1	4.0	4.9	7.3	15.0	11.7	4.5	3.6
Average				7.7	6.3	7.1	8.6	17.7	15.7	5.4	4.7
Wholesale											
Yunnan Baiyao Group Co Ltd	China	Dec	2,015.4	31.4	25.4	0.5	0.6	27.8	29.0	23.6	18.4
China National Medicines Corp Ltd	China	Dec	853.4	30.8	24.1	0.9	1.2	23.0	24.6	46.6	43.3
Average				31.1	24.7	0.7	0.9	25.4	26.8	35.1	30.8

Source: Bloomberg

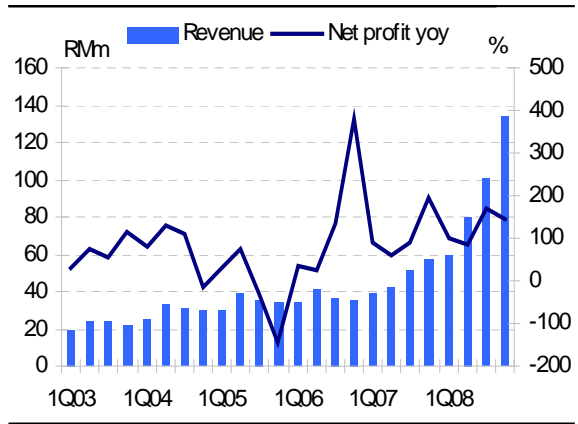
* No consensus forecast but we assumed 8% growth for each company in reference of historical track records

Fig. 3: Quarterly revenue breakdown by division



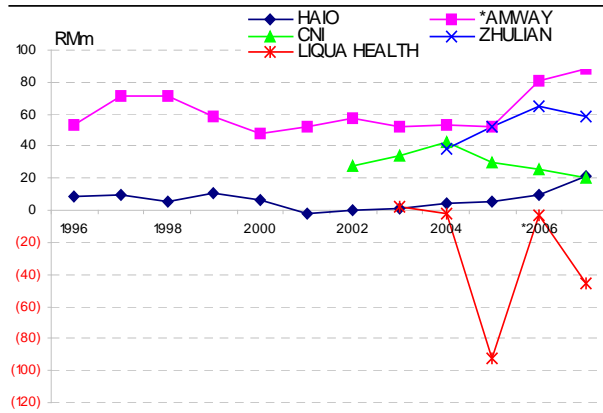
Source: Company

Fig. 4: Quarterly revenue and net profit trend



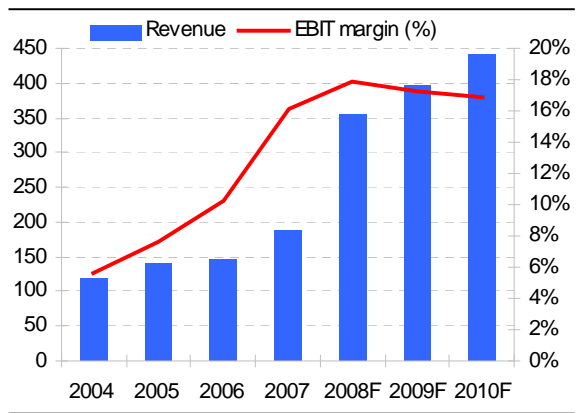
Source: Company

Fig. 5: Earnings trend by competitors



* Amway change of financial year from August to Dec
Source: Company, Affin Investment Bank estimates

Fig. 6: Hai-O's revenue and margin forecast



Source: Bloomberg, Affin Investment Bank estimates

Hai-O Enterprise - Financial Summary

Profit & Loss Statement

FYE 30 April (RMm)	*2007	2008	2009E	2010E	2011E
Revenue	189.3	373.8	395.5	440.6	488.5
Operating expenses	-156.7	-306.5	-323.4	-363.3	-405.4
EBITDA	32.6	67.3	72.1	77.3	83.1
Depreciation	-1.8	-3.2	-4.1	-4.4	-4.6
EBIT	30.5	67.3	67.9	72.8	78.5
Net int income/(expense)	0.1	0.5	-0.1	0.5	1.6
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Pretax profit	30.6	67.7	67.7	73.3	80.1
Tax	-8.5	-18.7	-16.9	-18.3	-20.0
Minority interest	-0.7	-0.6	-1.6	-1.8	-1.9
Net profit	21.4	48.5	49.2	53.2	58.1

Balance Sheet Statement

FYE 30 April (RMm)	*2007	2008	2009E	2010E	2011E
Fixed assets	22.0	48.2	49.5	50.4	48.7
Other long term assets	31.7	31.8	31.7	31.7	31.6
Total non-current assets	53.8	80.0	81.2	82.1	80.3
Cash and equivalents	16.9	12.3	56.6	77.6	105.3
Stocks	33.9	53.4	56.5	62.9	69.8
Debtors	14.8	33.9	38.1	42.4	47.0
Other current assets	29.6	18.6	18.6	18.6	18.6
Total current assets	95.2	118.3	169.8	201.6	240.7
Creditors	21.6	42.4	47.6	52.1	58.3
Short term borrowings	7.4	7.8	7.4	7.4	7.4
Other current liabilities	9.0	14.3	13.5	14.2	15.0
Total current liabilities	38.0	64.6	68.4	73.7	80.7
Long term borrowings	0.0	0.0	20.0	20.0	20.0
Other long term liabilities	0.1	0.1	0.1	0.1	0.1
Total long term liabilities	0.1	0.1	20.1	20.1	20.1
Shareholders' Funds	105.7	128.4	158.3	186.8	218.5
Minority interest	5.2	5.3	4.2	3.1	1.8

*Changes in accounting policies to FRS 34

Cash Flow Statement

FYE 30 April (RMm)	*2007	2008	2009E	2010E	2011E
EBIT	30.5	67.3	67.9	72.8	78.5
Depreciation & amortisation	2.1	3.3	4.2	4.5	4.7
Working capital changes	-7.6	-1.5	-3.0	-5.5	-4.4
Cash tax paid	-8.5	-18.7	-16.9	-18.3	-20.0
Others	11.3	-13.1	-5.1	-8.3	-8.6
Cashflow from operation	27.8	37.3	47.1	45.2	50.1
Capex	-1.9	-29.0	-5.0	-5.0	-2.5
Others	-9.1	0.0	0.0	0.0	0.0
Cash flow from investing	-11.0	-29.0	-5.0	-5.0	-2.5
Debt raised/(repaid)	2.8	0.4	19.6	0.0	0.0
Dividends paid	-7.1	-24.7	-17.8	-19.7	-21.5
Others	-5.5	0.7	0.4	0.5	1.6
Cash flow from financing	-9.8	-23.6	2.2	-19.2	-19.9
Free Cash Flow	25.9	8.3	42.1	40.2	47.6

Key Financial Ratios and Margins

FYE 30 April (RMm)	*2007	2008	2009E	2010E	2011E
Growth					
Revenue (%)	29.0	97.4	5.8	11.4	10.9
EBITDA (%)	89.1	106.1	7.1	7.3	7.5
Core net profit (%)	110.0	126.8	1.4	8.2	9.2
Profitability					
EBITDA margin (%)	17.2	18.0	18.2	17.5	17.0
PBT margin (%)	16.2	18.1	17.1	16.6	16.4
Net profit margin (%)	11.3	13.0	12.4	12.1	11.9
Effective tax rate (%)	27.8	27.6	25.0	25.0	25.0
ROA (%)	18.2	29.1	22.4	21.1	20.1
Core ROE (%)	21.9	41.4	34.3	30.8	28.7
ROCE (%)	29.5	54.0	42.2	36.4	34.1
Dividend payout ratio (%)	69.2	68.9	50.4	51.3	51.3
Liquidity					
Current ratio (x)	2.5	1.8	2.5	2.7	3.0
Op. cash flow (RMm)	27.8	37.3	47.1	45.2	50.1
Free cashflow (RMm)	25.9	8.3	42.1	40.2	47.6
FCF/share (sen)	31.5	9.9	50.1	47.8	56.6
Asset management					
Debtors turnover (days)	46.9	35.1	37.2	37.1	35.1
Stock turnover (days)	72.7	52.0	62.0	60.0	59.8
Creditors turnover (days)	52.0	38.1	50.8	50.1	49.7
Capital structure					
Net gearing (%)	net cash	net cash	net cash	net cash	net cash
Interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.

Quarterly Profit & Loss

FYE 30 April (RMm)	4Q07	1Q08	2Q08	3Q08	4Q08
Revenue	56.7	59.3	80.5	100.5	133.5
Operating expenses	-46.7	-49.5	-67.6	-82.1	-107.4
EBITDA	10.0	9.8	12.9	18.4	26.2
Depreciation	0.0	0.0	0.0	0.0	0.0
EBIT	10.0	9.8	12.9	18.4	26.2
Net int income/(expense)	0.2	0.0	0.1	0.1	0.3
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Exceptional Items	0.0	0.0	0.0	0.0	0.0
Pretax profit	10.2	9.8	13.0	18.5	26.4
Tax	-2.4	-2.9	-3.6	-4.9	-7.3
Minority interest	0.0	0.1	-0.3	-0.1	-0.2
Net profit	7.8	7.1	9.1	13.4	18.9
Core net profit	7.8	7.1	9.1	13.4	18.9
Margins (%)					
EBITDA	17.6	16.5	16.0	18.3	19.6
PBT	18.0	16.6	16.1	18.4	19.8
Net profit	13.7	11.9	11.3	13.3	14.2

Source: Company data and Affin Investment Bank estimates

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +15% over a 12-month period
TRADING BUY (TR BUY)	Total return is expected to exceed +15% over a 3-month period due to short-term positive development, but fundamentals are not strong enough to warrant a Buy call. This is to cater to investors who are willing to take on higher risks
ADD	Total return is expected to be between 0% to +15% over a 12-month period
REDUCE	Total return is expected to be between 0% to -15% over a 12-month period
TRADING SELL (TR SELL)	Total return is expected to exceed -15% over a 3-month period due to short-term negative development, but fundamentals are strong enough to avoid a Sell call. This is to cater to investors who are willing to take on higher risks
SELL	Total return is expected to be below -15% over a 12-month period
NOT RATED	Affin Investment Bank does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation
OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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