Malaysia
MARKET DATELINE ● PP 1505(7767)/09/2008(010132)

Corporate Highlights

Results Note

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

27 June 2008

Hai-O Enterprise

Best Ever FY04/08 Performance Underpinned By Higher Contribution From MLM

Share Price	:	RM3.85
Fair Value	:	RM4.74
Recom	:	**Outperform** (Maintained)

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

FYE Apr	Revenue (RMm)	Net Profit (RMm)	EPS (sen)	EPS gwth (%)	PER (x)	C.EPS* (sen)	NTA/share (x)	Net gearing (x)	ROE (%)	Net. Div. Yld. (%)
2008a	373.8	48.5	64.4	144.1	6.0		1.7	Net cash	18.1	10.4
2009f	437.8	52.2	62.9	-2.3	6.1	52.0	2.2	Net cash	16.3	3.7
2010f	493.7	58.2	70.1	11.4	5.5	58.0	2.7	Net cash	14.3	4.1
2011f	551.9	65.5	78.8	12.5	4.9	-	3.4	Net cash	12.9	4.5

Main Board Listing / Trustee Stock / Syariah-Approved Stock By The SC — *^ Consensus based on IBES Estimates*

- **Above expectations.** FY04/08 net profit beat our expectations and consensus forecasts by 16-27%. The variance was largely due to higher contribution from the MLM division and higher-than-expected operating margin for the wholesale division. Hai-O has proposed a final gross dividend of 32 sen, bringing the YTD gross dividend to 40 sen for FY04/08 vs 18 sen in FY04/07. On top of that, Hai-O has proposed a distribution of its 3.3m treasury shares to shareholders on the basis on 1 for 25. This will give shareholders an additional net yield of 4%.

- **FY04/08 net profit surged 129% yoy.** The increase in MLM contribution can be attributed to good response to its new water treatment system, thereby increasing distributor's productivity. For the wholesale division, operating margin surged to 75% (vs our projections of 40%) from 45% a year ago, mainly due to increased sales of Hai-O's house-brand products.

- **Manufacturing contract of Stevia to start contributing in FY04/09.** This contract will provide the company a total minimum guaranteed revenue of RM30m p.a. for three years. The profit margin for producing this product could be higher than its existing manufacturing margin, i.e. >30%.

- **Risks to our view.** The major risks include: 1) termination of supply agreements from its suppliers in China; and 2) slowdown in consumer spending in Malaysia.

- **Change in earnings projections.** We raise our FY04/09-10 earnings forecasts by 35-37% to RM52-58m to reflect the higher distributor productivity and raise the operating margin for the wholesale division for FY04/09-10.

- **Investment case.** Given the reduction in our target market multiple by 2x, we now reduce our target PE for the consumer sector to 13x (from 15x). We also roll forward our base-year to CY2009 from CY2008. Following our change in earnings projection and target PE, Hai-O's fair value is raised to RM4.74, based on target PE of 7x, which is at an unchanged 40% discount to our target PE for the consumer sector. Maintain **Outperform.**

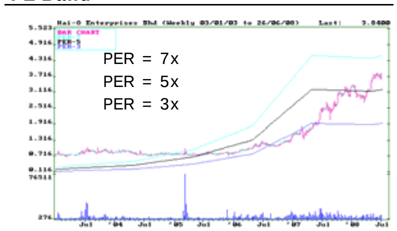
Please read important disclosures at the end of this report.

RHBRI	Vs.	Consensus
✓	Above	✓
	In Line	
	Below	

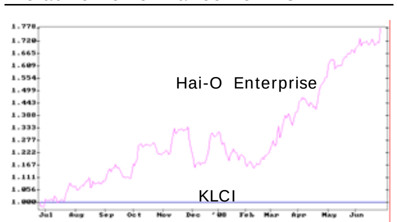
Issued Capital (m shares)	83.1
Market Cap(RMm)	319.1
Daily Trading Vol (m shs)	0.1
52wk Price Range (RM)	2.28-3.85
Major Shareholders:	**(%)**
Tan Family	25.0
Excellent Communication	5.2

FYE Apr	FY09	FY10	FY11
EPS chg (%)	35	37	-
Var to Cons (%)	21	21	-

PE Band



Relative Performance To KLCI



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- **Above expectations.** FY04/08 net profit beat our expectations and consensus forecasts by 16-27%. The variance was largely due to higher contribution from the MLM division and higher-than-expected operating margin for the wholesale division. For this quarter, Hai-O has proposed a final gross dividend of 32 sen, bringing the YTD gross dividend to 40 sen for FY04/08 vs 18 sen in FY04/07, which was above our expectations. This is equivalent net yield of 7.7% and a net payout of 44%. On top of that, Hai-O has proposed a distribution of its 3.3m treasury shares to shareholders on the basis on 1 for 25. This will give shareholders an additional net yield of 4%.
- **FY04/08 net profit surged 129% yoy.** The increase in MLM contribution can be attributed to good response to its new water treatment system, thereby increasing distributor's productivity to RM4,000/distributor in FY04/08 vs RM1,600/distributor in FY04/07. As at FY04/08, Hai-O's core distributors stood at 70,000 members, an increase of 10,000 new members over the year. For the wholesale division, operating margin surged to 75% (vs our projections of 40%) from 45% a year ago, mainly due to increased sales of Hai-O's house-brand products.

Future prospects

- **Manufacturing contract of Stevia to start contributing in FY04/09.** This exclusive manufacturing contract from Pure Circle to manufacture Stevia natural sweetener for the next five years is expected to begin contributing in FY04/09. This contract will provide the company a total minimum guaranteed revenue of RM30m p.a. for three years. We note that Hai-O would not incur significant capex to carry out this manufacturing activity. Also, the profit margin for producing this product could be higher than its existing manufacturing margin, ie. >30%. We have already imputed this into our forecasts.

Risks

- **Risks to our view.** The major risks include: 1) termination of supply agreements from its suppliers in China; and 2) slowdown of consumer spending in Malaysia.
- **Mitigating factors.** We believe Hai-O and its counterparts in China have long established a solid business relationship, which neither of them would want to jeopardise. As for consumer spending, although the recent hike in petrol price of 41% and the impending electricity tariff hike in July 2008 would lower consumer spending power, we believe Hai-O's products such as traditional Chinese medicine and medicated wine are less prone to a decline in consumer spending due to the generally inelastic demand for medicinal products.

Forecasts And Assumptions

- **Forecasts.** We raise our FY04/09-10 earnings forecasts by 35-37% to RM52-58m to reflect higher distributor productivity and raise the operating margins for the wholesale division. We introduce our FY04/11 net profit of RM66m, representing a growth of 12.5% yoy.
- **Earnings assumptions**. We raise our distributor productivity projections by 49% to RM4,100-4,300/member for FY04/09-10. We also raise the operating margin for the wholesale division to 55% from 35% previously for FY04/09-10. We continue to expect an additional 10,000-12,000 new distributors per year for FY04/09-10.

Valuations And Recommendation

- **Downgrading target PE.** Given the reduction in our target market multiple by 2x, we now reduce our target PE for the consumer sector to 13x (from 15x). We also roll forward our base-year to CY2009 from CY2008. Following our change in earnings projection and target PE, Hai-O's fair value is raised to RM4.74 (from RM4.17), based on target PE of 7x, which is at an unchanged 40% discount to our target PE for the consumer sector. We attribute a 40% discount to Haio's valuation to reflect its relatively small capitalisation. Maintain **Outperform.**

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Table 2. Earnings Review (YoY Cumulative)

FYE Apr (RMm)	4Q07	4Q08	YoY (%)	12M07	12M08	YoY (%)	Comments
Revenue	56.7	133.5	135.5	189.3	373.8	97.4	Mainly due to higher distributor productivity and operating margin for the wholesale division.
- Wholesale & Retail	*23.1*	*25.2*	8.9	86.0	88.7	*3.1*	
- MLM	*32.8*	*107.3*	227.0	99.7	281.6	*182.5*	
- Other	*0.8*	*1.1*	38.2	3.6	3.5	*-2.4*	
EBIT	10.1	26.2	160.4	30.5	67.3	120.3	MLM and wholesale generally provide higher margins than retail and manufacturing.
Finance cost	0.1	0.3	94.1	0.1	0.5	484.0	
PBT	10.2	26.4	159.5	30.6	67.7	121.3	Filtered down from operating profit.
Taxation	-2.4	-7.3	200.8	-8.5	-18.7	119.9	
MI	0.0	-0.2	n.a.	-0.9	-0.6	-38.6	
Net profit	7.8	18.9	143.8	21.2	48.5	128.6	
EPS (sen)	11.9	25.2	112.2	32.4	67.4	108.1	
Gross dividend	13.0	32.0	146.2	18.0	40.0	122.2	
EBIT margin (%)	17.7	19.6	3.7	16.1	18.0	1.9	Mainly due to increase in distributor productivity to RM4,000/distributor in FY04/08 vs RM1,600/distributor in FY04/07
PBT margin (%)	18.0	19.8	3.8	16.2	18.1	2.0	
Net profit margin (%)	13.7	14.2	3.7	11.2	13.0	1.8	
Effective tax rate (%)	23.7	27.5	-3.4	27.7	27.6	-0.2	

Source: Company, RHBRI

Table 3. Earnings Forecasts

FYE Apr (RMm)	FY08a	FY09F	FY10F	FY11F
Turnover	**373.8**	**437.8**	**493.7**	**551.9**
Turnover growth (%)	96%	18%	13%	12%
Cost of Sales	-236.2	-275.8	-311.0	-347.7
Gross Profit	135.7	162.0	182.7	204.2
EBITDA	**69.4**	**76.5**	**84.9**	**94.2**
EBITDA margin (%)	19%	17%	17%	17%
Depreciation	-2.2	-2.7	-3.4	-3.4
Net Interest	0.5	0.3	1.1	1.5
Associates	0.0	0.0	0.0	0.0
Pretax Profit	**67.7**	**74.1**	**82.6**	**92.3**
Tax	-18.7	-20.0	-22.3	-24.0
Minorities	-0.6	-1.9	-2.1	-2.8
Net Profit	**48.5**	**52.2**	**58.2**	**65.5**

Source: Company data, RHBRI estimates

Table 4. Forecast Assumptions

FYE Apr	FY09F	FY10F	FY11F
Core distributor force (CDF)	82,000	92,000	102,000
Distributor productivity (RM/CDF)	4,143	4,268	4,396
Opening of new retail outlets	2	1	0
Revenue per outlet (RM'000)	705	719	733

IMPORTANT DISCLOSURES

The recommendation framework for stocks and sectors are as follows : -

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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