15 January 2008

AFFIN INVESTMENT BANK

Company Update

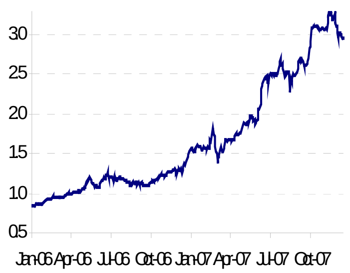
Hai-O Ent

HAIO MK

RM3.26

BUY (maintain)

Target Price: RM4.18



Price Performance

	1M	3M	12M
Absolute	10.1	5.2	104.8
Rel to KLCI	2.6	-4.0	53.2

Stock Data

Issued shares (m)	82.6
Mkt cap (RMm)	269.2
Avg daily vol - 6mth (m)	0.1
52-wk range (RM)	1.36-3.40
Est free float	50%
NTA per share (RM)	1.5
P/NTA (x)	2.2
Net cash/ (debt) (RMm) (July 07)	68.9
ROE (2008F)	26.5%
Derivatives	Nil

Key Shareholders

Tan family	25.6%
Maybank Smallcap	3.9%

Earnings & Valuation Revisions

	08E	09E	10E
Prev EPS (sen)	37.4	44.1	52.0
Curr EPS (sen)	37.4	44.1	52.0
Chg (%)	-	-	-
Prev target price (RM)			4.18
Curr target price (RM)			4.18

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Putting long-term growth drivers in place

Upbeat on prospects of new MLM venture in Indonesia

We are optimistic on the longer term prospects of Hai-O's new MLM venture in Jakarta – expected to commence operations in mid 2008, by replicating its successful MLM business model here. Indonesia, in our view, offers a huge untapped market for Hai-O given: 1) its huge consumer market with a population base of nearly 10x that of Malaysia; 2) growing young population - half the population is below age of 25; 3) high income base of urbanites - per-capita income in Jakarta of US$4,500/year is close to Malaysia's national per-capita income of US$5,490/year, and 4) Indonesia shares similar demographics and taste as that of Malaysia.

New export market – China and Hong Kong, equally as exciting

Meanwhile, a new export division (at preliminary stage of establishment) to tap into the fast growing China, Hong Kong and Middle East markets. Hai-O intends to export its own local brand products such as Tongkat Ali Coffee, bird's nest and vitamin supplement known as "Tri-E" (a form of natural vitamin E capsule). We view this move positively given the huge potential of bird's nest and Tri-E in these markets.

Source of new growth drivers if new ventures take off successfully

Until there is better clarity on the successful launch and take off of the new ventures with revenue streams flowing in, we will not impute any earnings contributions from them into our earnings forecasts. However, if successful, these new markets may provide new source of growth drivers to Hai-O. Meanwhile, exposure risk is low given the minimal capital commitment involved – at around US$0.5m for the Indonesia JV.

Maintain FY08-10 earnings, projecting 3-year EPS CAGR of 32%

All in all, we are positive on both developments as they put Hai-O's longer-term growth drivers in place. Hai-O will be positively re-rated should contributions from these operations materialise sooner-than-expected. We maintain our FY08-FY10 EPS forecast, which translates into a strong 3-year CY07-10 EPS CAGR of 32%.

Maintain BUY, target price of RM4.18 yielding a 24% upside

Maintain BUY on Hai-O with a target price of RM4.18 based on SOP. We continue to like Hai-O for its: 1) fast expanding MLM division; 2) robust 3-year EPS CAGR of 32% over CY07-10; 3) highly attractive valuations – FY04/08 PE of 8.7x, and 4) excellent FY08-10 dividend yields of 6%-8%.

Earnings and Valuation Summary

FYE 30 April	2005	2006	2007	2008F	2009F	2010F
Revenue (RMm)	141.5	146.8	189.3	256.4	294.6	339.8
EBITDA (RMm)	13.5	17.3	32.6	46.4	53.9	62.9
Pretax profit (RMm)	10.3	15.1	30.6	43.1	50.1	59.4
Net profit (RMm)	5.5	10.2	21.4	30.9	36.7	43.5
EPS (sen)	8.0	12.4	26.0	37.4	44.1	52.0
EPS growth (%)	41.7	55.2	110.0	43.6	18.2	17.8
PER (x)	40.9	26.3	12.5	8.7	7.4	6.3
Core net profit (RMm)	5.5	10.2	21.4	30.9	36.7	43.5
Core EPS (sen)	8.0	12.4	26.0	37.4	44.1	52.0
Core PER (x)	40.9	26.3	12.5	8.7	7.4	6.3
DPS (sen)	5.0	6.7	15.1	19.2	22.4	27.2
Dividend Yield (%)	1.5	2.1	4.6	5.9	6.9	8.3
EV/EBITDA (x)	16.4	15.1	7.3	5.1	4.1	3.2
Consensus profit (RMm)				26.6	31.4	43.5
Affin/Consensus (x)				1.2	1.2	1.0

Indonesian MLM venture to commence operations in mid-2008

Hai-O's new MLM venture (vide a 70%-owned JV) in Jakarta, Indonesia is expected to commence operations in mid-2008. The JV will replicate its successful Malaysian MLM business model. Bulk of the preparation work had already been undertaken, including the registration of companies. The relevant approvals required for the distribution of traditional Chinese medicine have also been sought. Meanwhile, non-consumables such as beauty products and water filters, which accounted for 88% of FY07 MLM turnover, are exempted from the authority's approvals, thus reducing the risk of delays in products rollout. The local distributor force has also started its networking exercise, and once a MLM licence is issued, recruitment and agency build-up will go into full swing. Management has allocated a minimal capex of USD0.5m for the expansion.

Optimistic on the new Indonesian venture – demographics supportive

We note that the return on investment of Hai-O's MLM business in Malaysia, which was established in 1992, was fast at less than 1.5 years given the minimal capital invested. While we believe that the return in the new Indonesian venture will likely be fast, mirroring the success of its Malaysian experience, we have however not imputed any contributions from Indonesia into our forecast. Our optimism is underpinned by the following considerations: 1) Indonesia's largely untapped and huge consumer market with a massive population of nearly 10x that of Malaysia; 2) its growing young population - half the population is below the age of 25; 3) high income base of urbanites with Jakarta's per-capita income (US$4,500/year) close to Malaysia's national per-capita income (US$5,490/year), and 4) Indonesia shares similar demographics and taste (refer to Appendix 1 for detail comparisons of the two countries' demographics and MLM business).

Two-tier market segment in Indonesia

Hai-O plans to target two different market segments based on its products range in Indonesia; 1) mid to high level income – beauty products and water filter; and 2) mass market – small ticket items such as healthcare and food products. We believe this strategy is feasible given the widening disparity in income levels between the rich and poor where urbanites earn 4x higher than the rural folks (e.g. urban workers earn an estimated US$4,500/year in Jakarta vs rural workers average of US$1,000/year in Kalimantan). This means Indonesia's income distribution is skewed towards Jakarta and we note that Jakarta's per-capita income of US$4,500/year is similar to that of Malaysia's national per-capita income of US$5,490/year. This offers a huge potential market for Hai-O. In addition, rapid urbanization (approx 3.8m Indonesians moving to the cities each year) will provide a pool of growing households and expanding market.

New markets - targeting bird's nest for China and Hong Kong

Separately, Hai-O reiterated its plans to tap into the fast growing China, Hong Kong and Middle East markets. It intends to export its own local brand products such as Tongkat Ali Coffee, bird's nest and vitamin supplement known as "Tri-E" (a form of natural vitamin E capsule) for which it has been granted exclusive sales and distribution rights in China by Golden Hope Bioganic Sdn Bhd. Management has guided that bird's nest will be the key product largely due to the high demand in China and Hong Kong, as both countries have been increasing imports from Malaysia, Thailand, Indonesia and Vietnam.

Tri-E to meet China's growing nutraceutical demand
The "Tri-E" vitamin supplement (to reduce risk for coronary heart disease, cancer and premature-aging related diseases) is anticipated to contribute positively. China is a fast growing nutraceutical market as strong economic growth has led to the extensive upgrading and diversification of food, beverage and pharmaceutical demand. An independent research survey indicates that world demand for vitamins in nutraceutical products will increase 4.6% annually to nearly US$4.2bn in 2010. If anything, the stumbling block is the fairly long process in obtaining regulatory approvals, as it can take 6 months to a year. Until there is better clarity on the commencement of sales, we will not factor this new market into our earnings forecast.

Key risks lie in slower consumption and ROI
Key risks lie in: 1) slower than expected ROI, 2) failure to tackle consumer needs and preference; 3) long gestation of healthcare and food products registration; and 4) inconsistencies in the law are not unusual (particularly when foreign companies are involved). As such, we have not imputed any impact from the Indonesia operations and new export markets into our forecast. However, if successful, these could potentially provide new growth areas to Hai-O.

Maintain FY08-10 earnings: 3-year CY07-10 EPS CAGR of 32%
We maintain our FY08-FY10 EPS forecast, which translates into a strong 3-year CY07-10 EPS CAGR of 32%. We expect gross profit margins to be sustainable at around 36-39% due to management's continuing efforts to: 1) push higher value and margins products; 2) introduce higher-priced branded and quality products (1-2 new products pa), and 3) stronger ringgit against US$ which benefits Hai-O's MLM business (imports account for 50%-60% of group purchases). Our earnings model reflects a fairly flat albeit marginal improvement in EBIT margin to 16.8% in FY08, 16.9% in FY09 and 17.3% in FY10.

Maintain BUY, target price of RM4.18 yielding a 24% upside
We maintain BUY on Hai-O with a target price of RM4.18 based on SOP. We continue to like Hai-O for its: 1) fast expanding MLM division, 2) robust 3-year EPS CAGR of 32% over CY07-10; 3) highly attractive valuations – FY04/08 PE of 8.7x, and 4) highly attractive FY08-10 dividend yields of 6%-8%.

Fig 1: SOP valuation of RM4.18

Divisions	CY08 net profit (RM m)	Applied PER (x)	Value (RM m)	Comments
MLM	18.9	9	169.9	Target PER at a 10% discount to industry MLM average
Retail	1.8	9	16.7	Retail franchise PERs range from 11x-20x
Wholesale	13.2	7	93.1	Fair PER for a fairly stable business
Manufacturing	0.6	9	5.3	Regional pharmaceutical companies trade betw een 9x-44x
Others	2.0	4	8.1	Reasonable for its traditional Chinese clinics
Net cash/debt			52.6	
			345.6	
No of shares (m)			82.7	
SOP/share			4.18	

Appendix 1: Demographics and MLM business comparisons between Malaysia and Indonesia

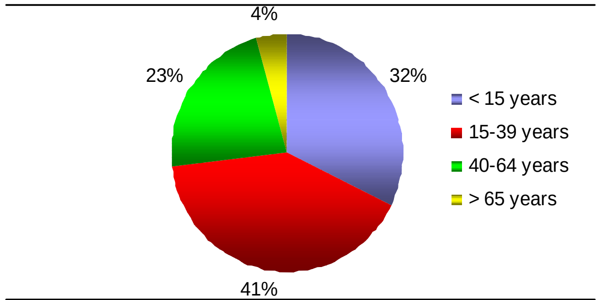
Malaysia	Indonesia

DEMOGRAPHICS

Malaysia

- Population of 25m *(July 2007 est..)*
- More than 41% of its population is below 39 years of age.

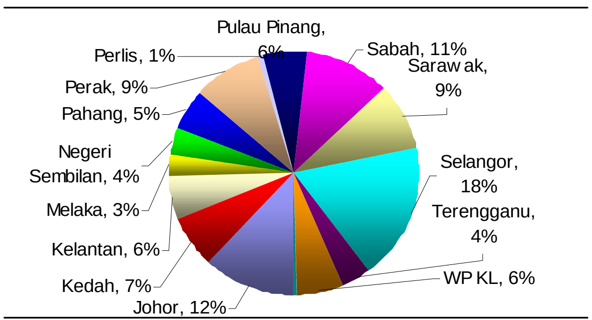
Age distributions



Source: Department of Statistics Malaysia

- Central of Peninsular Malaysia accounts the most population - about 30%

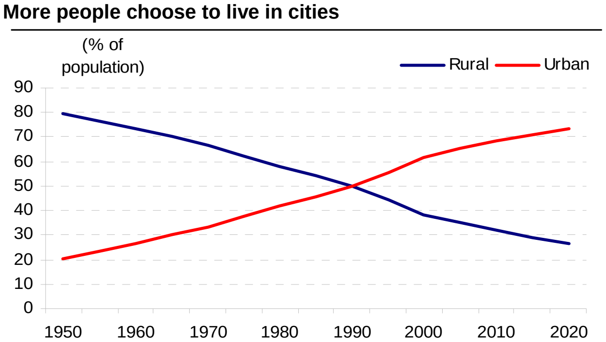
Population distribution



Source: Department of Statistics Malaysia

- Urbanization is rapid in Malaysia. The ratio of urban population has already surpassed the rural populations since the 1990s and by 2030, the urban population is expected to reach 27m from 17m in 2007.

More people choose to live in cities

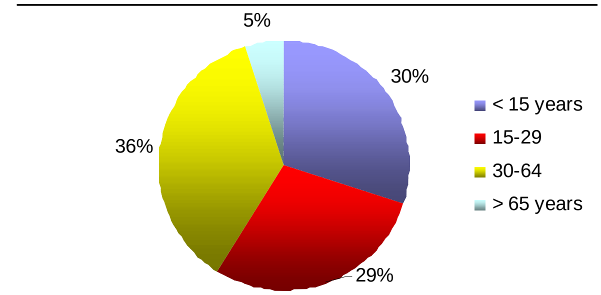


Source: Population Division of the United Nations

Indonesia

- Population of 235m *(July 2007 est.)* nearly 10x that Malaysia.
- Indonesia's population is young – half the population is below the age of 25.

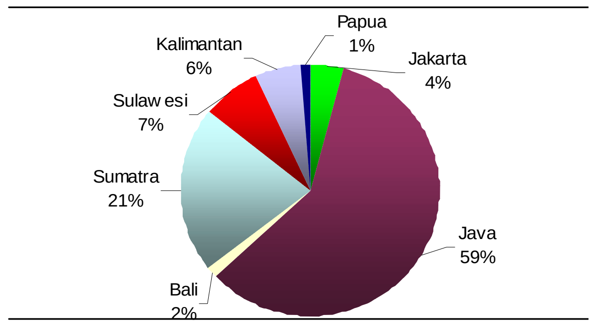
Young demographics



Source: Biro Pusat Statistik

- Java accounts for the lion's share of Indonesia's population, and bulk of economic activites.

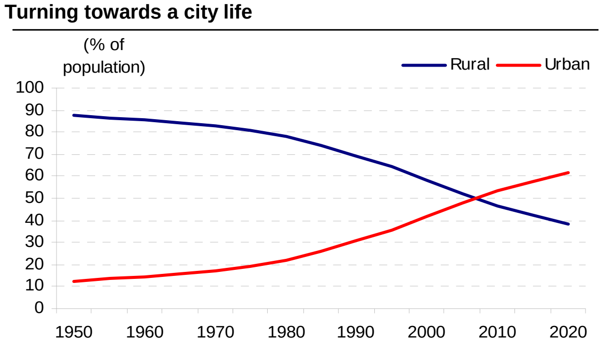
Java is the most populated region



Source: Biro Pusat Statistik

- About 110m Indonesians now live in cities, a tenfold increase since 1950. By 2030, the number of urban Indonesians will double again to 200m.

Turning towards a city life

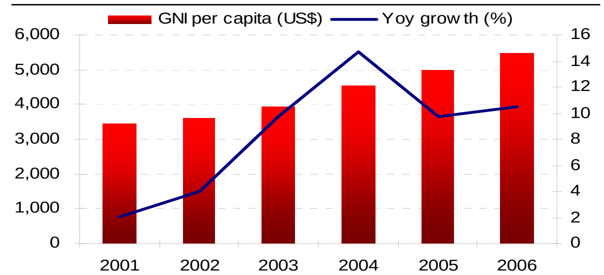


Source: Population Division of the United Nations

Malaysia

- Malaysia is an upper middle-income economy with average per-capita income of US$5,490 (2006).
- Statistics suggest that 56% of households make less than RM5, 000/month.

Average per-capita income (2006)



Source: World Bank

Income distribution

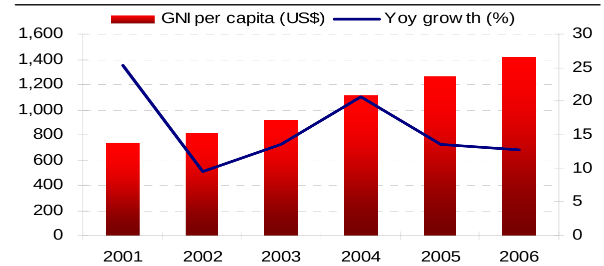
(RM/month)	Official stats (%)
<2,000	28
2,000-4,999	28
5,000-9,999	27
10,000-19,999	9
>20,000	8
Total	**100**

Source: Euromonitor

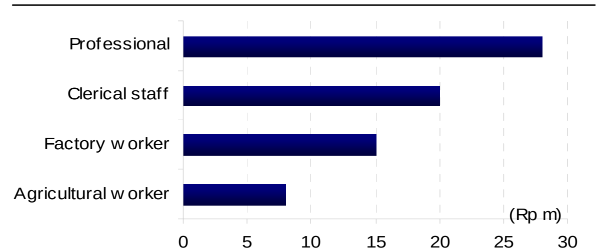
Indonesia

- Indonesia is a lower middle-income economy with an average per-capita income of US$1,420 (2006), which is 4x lower than Malaysia.
- Urban workers earn almost 4x more (est. US$4,500/year in Jakarta) than rural workers (est. US$1,000 in Kalimantan).
- Indonesia's income distribution is also skewed towards Jakarta.

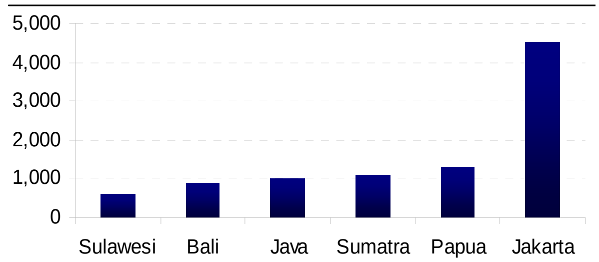
Average per-capita income (2006)



Per-capita average income (2003)



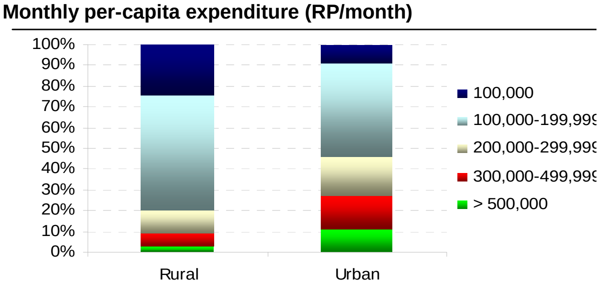
Regional per-capita income (US$/year)



Source: World Bank, Biro Pusat Statistik

- In rural areas, 80% of the population has monthly per capita spending of <RM120/month. Whereas about 47% of the urban population spends >RM180/month.

Monthly per-capita expenditure (RP/month)



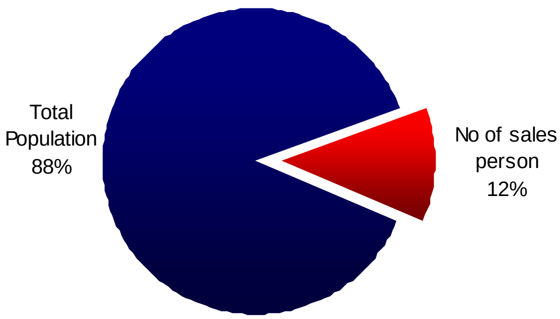
Source: Biro Pusat Statistik

Malaysia	Indonesia

MULTI-LEVEL-MARKETING (MLM)

- About 73 MLM companies established
- MLM in Malaysia was established in the early 1970's and rank no. 13 (or US$1.4bn) for directs sales in the world.

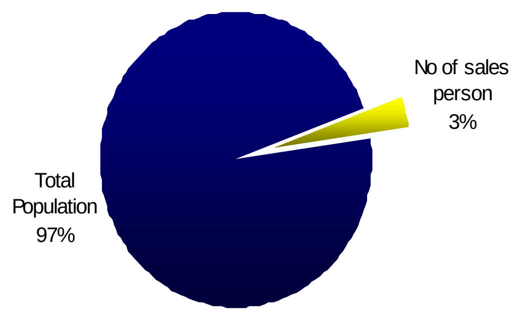
Malaysia ranks no. 13 in direct sales in world



Source: www.wfdsa.org, Affin Investment Bank estimate

- Only 55 MLM companies established which provide huge opportunity for Hai-O to grow.
- Indonesia's direct sales were established in the late 1980's. It ranks no. 19 (or US$800m) direct sales in the world with no. of sales per distributor force only accounting for 3% of total Indonesia population vis-à-vis Malaysia no. of sales per distributor force which account for 12% of total Malaysia population. The latter ranks no. 13 direct sales in the world. We believe there are lots of room to grow as the no. of distributor force increase. However, we note that the average sales per distributor force (avg. RM350 in Indonesia vis-à-vis RM1,500 in Malaysia) is nearly 4x lower as compare to Malaysia, which we believe is due to the majority of MLM companies sales targeting lower income earners. However, we believe with the rapid urbanisation (with some 3.8m Indonesians moving to the cities per year), growing young population and recovery of FDI is set to drive economic growth which in turn translates to a higher per-capita income.

Indonesia ranks no. 19 in direct sales in world



Source: www.wfdsa.org, Affin Investment estimate

- Provides easy consumer financing (micro-credit) programme (offered by Bank Rakyat, etc). which enables members to leverage to rapidly build their MLM network.
- Cash remains the key method of payment and business transaction. Meanwhile, credit cards penetration is still low largely due to limited knowledge of the function. Therefore, we believe the easy consumer financing are still not available/discovered yet.

Hai-O Enterprise - Financial Summary

Profit & Loss Statement

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
Revenue	146.8	189.3	256.4	294.6	339.8
Operating expenses	-129.5	-156.7	-210.0	-240.6	-276.9
EBITDA	17.3	32.6	46.4	53.9	62.9
Depreciation	-1.9	-1.8	-3.2	-4.1	-4.2
EBIT	15.1	30.5	43.1	49.8	58.6
Net int income/(expense)	0.1	0.1	0.1	0.4	0.8
Associates' contribution	-0.1	0.0	0.0	0.0	0.0
Pretax profit	15.1	30.6	43.1	50.1	59.4
Tax	-4.3	-8.5	-11.2	-12.5	-14.9
Minority interest	-0.6	-0.7	-1.0	-0.9	-1.0
Net profit	10.2	21.4	30.9	36.7	43.5

Balance Sheet Statement

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
Fixed assets	22.2	22.0	48.2	47.0	45.7
Other long term assets	31.9	31.7	31.8	31.7	31.7
Total non-current assets	**54.1**	**53.8**	**80.0**	**78.8**	**77.4**
Cash and equivalents	4.4	16.9	21.6	40.6	62.2
Stocks	28.5	33.9	36.6	42.1	48.5
Debtors	22.3	14.8	23.3	28.4	32.7
Other current assets	16.3	29.6	18.6	18.6	18.6
Total current assets	**71.6**	**95.2**	**100.1**	**129.7**	**162.1**
Creditors	23.1	21.6	29.6	34.1	38.8
Short term borrowings	4.4	7.4	7.8	7.4	7.4
Other current liabilities	4.0	9.0	10.6	11.3	12.4
Total current liabilities	**31.6**	**38.0**	**48.0**	**52.8**	**58.6**
Long term borrowings	0.1	0.0	0.0	0.0	0.0
Other long term liabilities	0.0	0.1	0.1	0.1	0.1
Total long term liabilities	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**
Shareholders' Funds	**89.4**	**105.7**	**127.2**	**151.0**	**176.7**
Minority interest	**4.6**	**5.2**	**4.8**	**4.5**	**4.1**

**Changes in accounting policies to FRS 134*

Cash Flow Statement

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
EBIT	15.1	30.5	43.1	49.8	58.6
Depreciation & amortisation	2.2	2.1	3.3	4.2	4.3
Working capital changes	-10.3	-7.6	9.4	-5.4	-5.0
Cash tax paid	-4.3	-8.5	-11.2	-12.5	-14.9
Others	8.9	11.3	-14.0	-3.5	-6.8
Cashflow from operation	**11.5**	**27.8**	**30.6**	**32.5**	**36.2**
Capex	-1.9	-1.9	-29.0	-2.5	-2.5
Others	-9.9	-9.1	0.0	0.0	0.0
Cash flow from investing	**-11.9**	**-11.0**	**-29.0**	**-2.5**	**-2.5**
Debt raised/(repaid)	-1.2	2.8	0.4	-0.4	0.0
Dividends paid	-2.7	-7.1	-7.6	-11.4	-13.4
Others	-2.8	-5.5	-0.5	0.9	1.3
Cash flow from financing	**-6.6**	**-9.8**	**-7.7**	**-11.0**	**-12.1**
Free Cash Flow	**9.6**	**25.9**	**1.6**	**30.0**	**33.7**

Key Financial Ratios and Margins

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
Growth					
Revenue (%)	3.7	29.0	35.4	14.9	15.3
EBITDA (%)	28.3	89.1	42.1	16.2	16.6
Core net profit (%)	84.9	110.0	44.5	18.9	18.5
Profitability					
EBITDA margin (%)	11.8	17.2	18.1	18.3	18.5
PBT margin (%)	10.3	16.2	16.8	17.0	17.5
Net profit margin (%)	6.9	11.3	12.1	12.5	12.8
Effective tax rate (%)	28.8	27.8	26.0	25.0	25.0
ROA (%)	10.9	18.2	20.8	20.8	21.0
Core ROE (%)	11.9	21.9	26.5	26.4	26.6
ROCE (%)	16.6	29.5	34.7	33.9	34.2
Dividend payout ratio (%)	45.5	58.1	51.4	50.7	52.3
Liquidity					
Current ratio (x)	2.3	2.5	2.1	2.5	2.8
Op. cash flow (RMm)	11.5	27.8	30.6	32.5	36.2
Free cashflow (RMm)	9.6	25.9	1.6	30.0	33.7
FCF/share (sen)	11.6	31.5	1.9	36.0	40.3
Asset management					
Debtors turnover (days)	46.2	36.7	36.7	37.8	35.1
Stock turnover (days)	75.6	72.7	61.3	59.7	59.7
Creditors turnover (days)	63.0	52.0	44.5	48.4	48.1
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)	1Q07	2Q07	3Q07	4Q07	1Q08
Revenue	39.4	41.9	51.4	56.7	59.3
Operating expenses	-33.6	-34.7	-43.9	-46.7	-49.5
EBITDA	5.8	7.2	7.5	10.1	9.8
Depreciation	0.0	0.0	0.0	0.0	0.0
EBIT	5.8	7.2	7.5	10.1	9.8
Net int income/(expense)	0.0	0.0	0.0	0.1	0.0
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	5.8	7.2	7.5	10.2	9.8
Tax	-1.8	-2.0	-2.3	-2.4	-2.9
Minority interest	-0.4	-0.2	-0.3	0.0	0.1
Net profit	3.5	4.9	5.0	7.8	7.1
Core net profit	3.5	4.9	5.0	7.8	7.1
Margins (%)					
EBITDA	14.7	17.2	14.6	17.7	16.5
PBT	14.6	17.1	14.6	18.0	16.6
Net profit	9.0	11.8	9.7	13.7	11.9

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

Affin Investment Bank Bhd (9999-V)
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