Consumer

22 November 2007

AFFIN INVESTMENT BANK

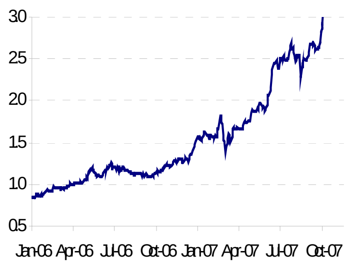
Company Update

Hai-O Ent

HAIO MK
RM3.24

BUY (maintain)

Target Price: RM4.18



Price Performance

	1M	3M	12M
Absolute	5.9	32.2	149.2
Rel to KLCI	5.2	23.9	119.0

Stock Data

Issued shares (m)	82.6
Mkt cap (RMm)	267.6
Avg daily vol - 6mth (m)	0.2
52-wk range (RM)	1.23-3.32
Est free float	40%
NTA per share (RM)	1.63
P/NTA (x)	2.0
Net cash/ (debt) (RMm) (July 07)	52.6
ROE (2008F)	26.6%
Derivatives	Nil

Key Shareholders

Tan family	25.6%
Maybank Smallcap	3.9%

Earnings & Valuation Revisions

	08E	09E	10E
Prev EPS (sen)	32.0	37.6	44.0
Curr EPS (sen)	37.4	44.1	52.0
Chg (%)	+16.9	+17.3	+18.2
Prev target price (RM)			3.88
Curr target price (RM)			4.18

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Overwhelmed by strong direct marketing earnings

MLM division likely to surprise on the upside for 2Q08

Hai-O is expected to report a robust 2QFY08 net profit – to be released in mid-Dec, underpinned by a stronger-than-expected MLM operations (67.6% of 1QFY08 revenue). Recall that Hai-O reported a 1QFY08 net profit of RM7.1m (+99.6% yoy, -9.1% qoq) on the back of revenue of RM59.3m (+50.6% yoy, +4.5% qoq), which already accounted for 26% of our previous full year FY08 forecast.

Four major thrusts on MLM business

The robust MLM earnings is been driven by: 1) strong growth in new distributor force. Monthly members have on average more than doubled to 2,000-2,500/month from 1,000/month previously (total member force now approaching 70,000 from 60,000 in mid 2007), 2) increased awareness of Hai-O's products and offerings following its recent sponsorship of the popular "Jom Heboh" TV program on TV3; 3) Hai-O being a key beneficiary of the recent civil servants pay hike (+7.5 to +35%) as nearly 95% of Hai-O's distributor force comprises of Bumiputera, and 4) relatively easy consumer financing (micro-credit) programme offered by Bank Rakyat, etc. which enables members to leverage to rapidly build their MLM network.

RM50m capex plan to enhance its pharmaceutical manufacturing division

Hai-O has recently proposed to purchase a 28-acre piece of land from Bata (M) Sdn Bhd (nearby its existing head office and factory in Jalan Kapar, Klang) to build a new pharmaceutical manufacturing plant, warehouse for its Pu-er tea storage and new office. This new building will only occupy approximately 30% of the vacant area with the remaining 70% occupied by Bata's factory and warehouse, which would be leased back to the latter on a 3-year renewal term. Total capex is RM50m (RM5m for the plant & new equipment and RM45m purchase price from Bata), and this will be funded partly by internal generated funds (RM25m) and borrowings or new share issue.

Minimal EPS dilution

We however believe a share placement is more likely, lifting stock liquidity while taking opportunity to potentially lock in a strong institutional Bumiputera shareholder. EPS dilution would be mitigated by recurring rental income yields of 6%-7% and increased earnings contribution from its in-house manufactured brands which has seen increasing demand and carry even better margins vis-à-vis its imported brands.

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)	40.6	26.2	12.5	8.7	7.3	6.2
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)	40.6	26.2	12.5	8.7	7.3	6.2
DPS (sen)	5.0	6.7	15.1	19.2	22.4	27.2
Dividend Yield (%)	1.6	2.1	4.7	5.9	6.9	8.4
EV/EBITDA (x)	16.3	15.0	7.3	5.1	4.0	3.1
Consensus profit (RMm)				25.7	29.7	37.3
Affin/Consensus (x)				1.2	1.2	1.2

FY08-10 earnings upgraded by 17-18%

All in, we have upgraded our FY08-FY10 EPS forecast by 17%-18% after raising our average revenue per agent to RM2,100 (previously RM1,900) on the back of higher number of distributors to 80k from 70k assumed for the MLM division. We have also raised the contribution from the manufacturing division. The revision yields a strong 3-year FY06-10 EPS CAGR of 26%. In tandem with the earnings upgrade, we have also raised our DPS forecast to: 19.2 sen in FY08 (from 16.6 sen), 22.4 sen in FY09 (from 20.0 sen) and 27.2 sen in FY10 (from 23.3 sen) on the assumption that management maintains a dividend payout policy of 50%. This translates to an even more exciting dividend yields of 6%-8%.

Revised forecasts is 20% above street

Our optimism on Hai-O is reflected by our above street FY08 net profit estimate. The 20% deviation against consensus, in our view, is due to: 1) our stronger forecast for Hai-O's MLM business, 2) higher contributions from its pharmaceutical manufacturing, and 3) recurring rental income from Bata with an estimated 6-7% rental yield or RM2m p.a.

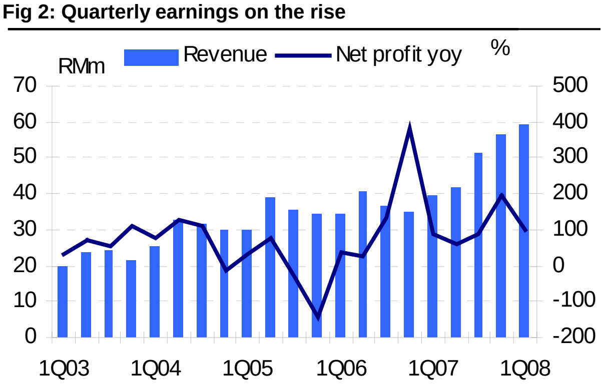
Maintain BUY, target price raised to RM4.18 yielding a 31% upside

Maintain BUY on the stock with a higher target price of RM4.18 (previously RM3.88) based on SOP. While stock price has performed reasonably well (+5.2% gain since our initiation coverage on 8 Oct 2007, and outperforming the market by +5.2%), we think that upside it is still early to lock in gains in lieu of the potential earnings enhancement from its stronger-than-expected MLM division and growing contribution from its existing and new pharmaceutical manufacturing plant. In short, we believe that the market has yet to fully appreciate the strong growth prospects of the company, with potential of earnings upgrade being a further re-rating catalyst. In addition, as a diversified consumer goods company (MLM, retail, wholesale, pharmaceutical manufacturing and Traditional Chinese Medicine) in Malaysia, we believe Hai-O will vastly benefit from improving domestic consumption spending.

Fig 1: SOP valuation of RM4.18

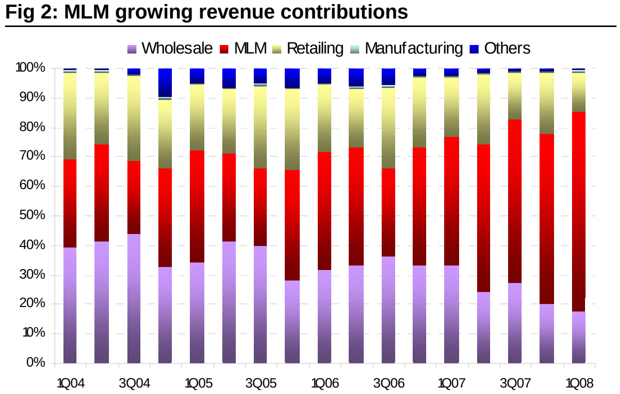
Divisions	CY08 net profit	Applied PER (x)	Value RM'm	Comments
MLM	18.9	9	169.9	Target PER at a 10% discount to MLM average
Retail	1.8	9	16.7	Retail franchise PERs range from 11x-20x
Wholesale	13.2	7	93.1	Fair PER for a fairly stable business
Manufacturing	0.6	9	5.3	Regional pharmaceutical companies trade betw een 9x-44x
Others	2.0	4	8.1	Reasonable for its traditional Chinese clinics
Net cash/debt			52.6	
			345.7	
No of shares (m)			82.7	
SOP/share			4.18	

Fig 2: Quarterly earnings on the rise



Source: Company

Fig 2: MLM growing revenue contributions



Source: Company

AFFIN INVESTMENT BANK

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	39.36	41.87	51.40	56.72	59.28
Operating expenses	-33.58	-34.68	-43.90	-46.67	-49.47
EBITDA	5.78	7.19	7.50	10.05	9.81
Depreciation	0.00	0.00	0.00	0.00	0.00
EBIT	5.78	7.19	7.50	10.05	9.81
Net int income/(expense)	-0.02	-0.04	0.00	0.14	0.03
Associates' contribution	0.00	0.00	0.00	0.00	0.00
Exceptional Items	0.00	0.00	0.00	0.00	0.00
Pretax profit	5.76	7.15	7.50	10.19	9.84
Tax	-1.80	-2.01	-2.27	-2.42	-2.86
Minority interest	-0.43	-0.20	-0.27	0.00	-0.08
Net profit	3.54	4.94	4.97	7.77	7.06
Core net profit	3.54	4.94	4.97	7.77	7.06
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

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