JF APEX SECURITIES BERHAD
(47680-X)

Company Update | 19 November 2014

Hai-O Enterprise Berhad

HOLD

Slowing Down But On A Right Track

Maintained

Share Price	**RM 2.49**
Target Price	**RM 2.43**

Company Description

Hai–O Enterprise Berhad is offering a wide range of Chinese medicines, medicated tonic, wellness, beauty and healthcare.

Stock Data	
Bursa / Bloomberg code	7668 / HAIO MK
Board / Sector	Industrial / Food & Drug Retailers
Syariah Compliant status	No
Issued shares (m)	195.43
Par Value (RM)	0.50
Market cap. (RMm)	486.63
52-week price Range	RM2.36– 2.72
Beta (against KLCI)	0.93
3-m Average Daily Volume	0.10m
3-m Average Daily Value^	RM0.25m

Share Performance	1m	3m	12m
Absolute (%)	0.4	-2.4	-5.0
Relative (%-pts)	-1.3	-5.4	-5.5

Major Shareholders	%
KAI HEE TAN	10.0
AKINTAN SDN BHD	7.7
SIOW ENG TAN	6.9

Historical Chart

Source: Bloomberg

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What's New

- **We have met with the management of Hai-o- recently and came away with neutral feeling.** Management has enlightened us on the Group's current updates and its future strategic plans.

Comment

- **Current MLM's strategy yields desirable result…..**The Group's Multi-Level Marketing (MLM) division managed to attract more members by shifting their sales from "big-ticket items" strategy to "small-ticket items" strategy. The attraction of new members was due to their lower initial start-up capital on "small-ticket items" as compared to "big-ticket items". On average, the Group manage to recruit around 2,000 members per month after attrition rate.

- To further strengthen its current strategy, the Group has launched some new products for different market segments such as Bio Velocity Sleep Mate (resident segment), Alfalfa Concentrated and Pantaz jelly (health segment), Bio Seleze Feminine Pad (personal care segment), which is currently in the spotlight, and CC Cream (beauty segment). For the "medium-ticket items", it also introduced JTX Airtracker which helps efficient combustion of fuel in automobile.

- **……..But do not expect immediate positive effect**. Despite rising of its membership and introduction of new products, we envisage that any positive impact will only be felt over a longer period of time. In the short term, at least for FY15, we foresee that the revenue from its "small-ticket" items are unable to cushion the drop of its "big- ticket" items' as sales volume of the former with relatively lower value has yet to reach a satisfactorily stage to compensate the decline in the sales volume of the latter with relatively higher value. Thus, we expect there will be a marginal drop in the division's topline. However, in a longer run, as for FY16 and FY17, we foresee this division may start to pick up its growth momentum with sales of "small-ticket" items outweigh the "big-ticket" items.

- **New product to boost wholesale division**. Currently, the wholesale division carries exclusive distribution rights over 50 renowned brands of Chinese medicines, health tonic, tea and healthcare products with supply to 100 wholesalers and 2,000 retailers. Beside the risk of unfavorable exchange rate and higher imported cost as shown in recent quarterly results, the division has also been affected by the slower consumer spending due to anticipation of higher cost of living. We understand that the Group has been awarded a sole distributorship of *Maotai, a famous Chinese liquor.* We reckon that this will be the another source of income for the division. However, the reception of the product remains to be seen as whether the drink will be popular among the local community as compared to western liquor.

- **Retail segment could be hit by weak consumer sentiment**. Meanwhile, for retail segments, the Group currently has 65 outlets where 9 are under franchise. Hai-O targets to open at least 2 outlets per year. However, weak consumer sentiment pursuant to the rising cost of living will likely to dampen the division's prospect coupled with the fact that the newly opened stores in general would require 2-3 years to breakeven, but still subject to locality. Thus, we expect the revenue contribution of this division will only increase marginally, mainly spurred by its loyalty programme membership on festival occasions.
- **Potential property venture?** We understand that Hai-O acquired 4 parcels of lands measuring 25 acres in Mantin for less than RM10m. We do not rule out the possibility that the Group may venture into property development to further boost its income in view of lower capex requirement for coming years, RM1-3m p.a. after completion of its 1st GMP Traditional Chinese Medicine factory in Malaysia. Mantin is strategically located in southern part of Klang Valley with easy accessibility to LEKAS highway. Currently, developer such as MKH is having a landed residential project named Pelangi Heights there. Based on our back-of-the-envelope calculations, the land could yield GDV of RM100m and net earnings of c.RM20m (assuming low density of 8 units per acre with mixture of terrace and semi-D houses with pricing of RM400k and RM600k respectively, and operating margin of 25%).
- **Generous in rewarding shareholders.** With the dividend policy of minimum 50% payout, we expect the Group will distribute a dividend of 14 sen per share, which translates into dividend yield of 4.0%. Having said that, the Group may raise its dividend payout to 100% for FY15 in conjunction with its 40th year anniversary and hence we expect shareholders to be rewarded handsomely with DPS of 20 sen or translating into yield of 5.9%.

Earnings Outlook/Revision

- **We maintain our FY15 net earnings forecast** of RM 39.6m, which is 1.8% yoy lower, amid a challenging outlook for their retail and wholesale divisions. Besides, its main topline contributor, MLM division will likely to face a temporary "blip" as to cushion the impact of reduction in sales of "big-ticket" items. However, we expect the FY16-FY17F earnings will rebound and able to achieve a double-digit growth, as we foresee its MLM's strategy will be fruitful in longer term.

Valuation & Recommendation

- **Maintain HOLD call on Hai-O with a lower target price of RM2.35 (previous TP: RM2.43).** We pegged our target price at 11.6x 2015F EPS of 20 sen which is +0.5 standard deviation above its historical mean (from previous 12x PE at +1 standard deviation). We reckon that share price could be well supported by its potential increase in dividend payout.

Figure 2: Financial Summary

Year to 31 March (RMm)	2010	2011	2012	2013	2014	2015F	2016F	2017F
Revenue	511.1	223.2	239.3	266.6	253.5	253.6	280.7	300.4
Operating profit	96.5	41.3	48.7	63.1	52.1	50.7	65.1	70.6
Net profit	70.6	28.4	34.0	47.2	40.3	39.6	49.1	55.6
EPS (sen)	36.1	14.5	17.4	24.1	20.6	20.2	25.1	28.4
P/E (x)	7.0	17.3	14.4	10.4	12.2	12.4	10.0	8.8
P/BV (x)	2.3	2.3	2.1	2.0	1.8	1.8	1.8	1.8
Dividend yield (%)	6.8%	2.8%	3.0%	4.3%	4.2%	4.0%	4.3%	4.8%
PBT margin (%)	18.7%	18.5%	20.3%	24.0%	21.0%	21.0%	24.2%	24.6%
Net Gearing (%)	-22.7%	-12.4%	-15.8%	-19.4%	-19.3%	-18.1%	-18.8%	-18.9%
ROE (%)	33.5%	13.3%	14.7%	18.8%	15.2%	14.7%	18.0%	20.1%

Source: Company, JF Apex Estimates

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JF APEX SECURITIES - RESEARCH RECOMMENDATION FRAMEWORK

STOCK RECOMMENDATIONS

BUY : The stock's total returns* are expected to exceed 10% within the next 12 months.

HOLD : The stock's total returns* are expected to be within +10% to – 10% within the next 12 months.

SELL : The stock's total returns* are expected to be below -10% within the next 12 months.

TRADING BUY : The stock's total returns* are expected to exceed 10% within the next 3 months.

TRADING SELL : The stock's total returns* are expected to be below -10% within the next 3 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT : The industry as defined by the analyst is expected to exceed 10% within the next 12 months.

MARKETWEIGHT : The industry as defined by the analyst is expected to be within +10% to – 10% within the next 12 months.

UNDERWEIGHT : The industry as defined by the analyst, is expected to be below -10% within the next 12 months.

*capital gain + dividend yield

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