Company Update | **RM2.11 @ 9 October 2020**

"Resilient MLM performance amid pandemic"

Share price performance

	1M	3M	12M
Absolute (%)	16.9	8.3	-8.0
Rel KLCI (%)	15.2	12.9	-6.0

	BUY	HOLD	SELL
Consensus	-	1	1

Source: Bloomberg

Stock Data

Sector	Consumer
Issued shares (m)	289.9
Mkt cap (RMm)/(US$m)	603/145.4
Avg daily vol - 6mth (m)	0.2
52-wk range (RM)	1.12 - 2.40
Est free float	56.5%
Stock Beta	0.96
Net cash/(debt)	61.5
ROE (CY20E)	11.4%
Derivatives	No
Shariah Compliant	No

Key Shareholders

Kai Hee Tan	10.6%
Akintan Sdn Bhd	8.1%
Excellent Communication	5.4%

Source: Affin Hwang, Bloomberg

Chow Wei Nien
T (603) 2146 7579
E weinien.chow@affinhwang.com

Hai-O (HAIO MK)

HOLD (maintain)
Up/Downside: -4.1%

Price Target: RM2.02
Previous Target (Rating): RM1.93 (HOLD)

Seeking to build on resiliency

- **From our recent conversation with management, we gather that MLM distributor base had largely sustained at c.114,000**
- **Looking ahead, the group strives to intensify marketing campaigns: (i) to retain and attract new members and (ii) to sustain buying interest.**
- **We lift our earnings forecasts by 3.3-3.5% for FY21-22E to account for better MLM sales. TP is revised to RM2.02, based on 16x PER. Maintain HOLD.**

MLM distributor base steadied at c.114,000

Hai-O's distributor base sustained at around 114,000, largely on par with end-FY20. Recall, its distributor force has been on a downtrend since peaking at 153,000 in FY18, owing to lower renewals and a slowdown in recruitment. Near term, the management has put in place various measures to regain members, amongst others, by launching a free-member fees campaign. As such, we now expect the number of distributors to see a smaller attrition to 110,000 in FY21 (vs 105,000 previously).

Intensifying marketing campaigns to drive sales

We observed that sales per distributor hovered at c.RM1,339/annum for FY20, down from the highs of RM2,922/annum in FY16 – likely on a ramp-up in distribution base and higher focus on smaller-ticker items. Nonetheless, we believe attrition in the past years has weeded out less active members, leaving the more loyal and productive ones. As such, we estimate sales/agent to see an uptick to c.RM1,600 for FY21 backed by a suite of intensified promotional campaigns to sustain buying interest.

Wholesale and retail segments likely to remain soft

Elsewhere, Hai-O wholesale and retail divisions were both noticeably affected by the lockdowns. We envisage continued softness in both divisions, as certain end-retailers for the wholesale segment (Chinese medical halls, restaurants, etc) may face continued suppressed sales whereas Hai-O's 57 physical retail outlets continue to remain susceptible to uncertainties of pandemic disruptions.

Maintain HOLD

We raise our earnings estimates by 3.3-3.5% for FY21-22E, accounting for higher MLM sales on the back of its sustained recruitment drive. Post revision, our TP is revised higher to RM2.02, based 16x PER. While MLM had a fairly resilient performance amid pandemic disruptions, we are of the view that near-term consumer sentiment remains subdued, with macro conditions remain volatile. Maintain HOLD.

Earnings & Valuation Summary

FYE 30 Apr	2019	2020	2021E	2022E	2023E
Revenue (RMm)	328.4	255.2	259.2	277.8	296.4
EBITDA (RMm)	66.9	40.9	45.9	50.6	53.9
Pretax profit (RMm)	63.4	41.5	42.7	47.2	54.7
Net profit (RMm)	47.7	32.6	33.2	36.8	42.6
EPS (sen)	16.4	11.2	11.4	12.7	14.7
PER (x)	12.8	18.8	18.5	16.7	14.4
Core net profit (RMm)	47.7	32.6	33.2	36.8	42.6
Core EPS (sen)	16.4	11.2	11.4	12.7	14.7
Core EPS growth (%)	(33.9)	(31.8)	1.9	10.7	15.9
Core PER (x)	12.8	18.8	18.5	16.7	14.4
Net DPS (sen)	13.0	10.0	9.1	10.1	11.7
Dividend Yield (%)	6.2	4.7	4.3	4.8	5.6
EV/EBITDA	7.7	12.6	11.1	9.9	9.2
Chg in EPS (%)			+3.5	+3.3	-3.5
Affin/Consensus (x)			n.a	n.a	n.a

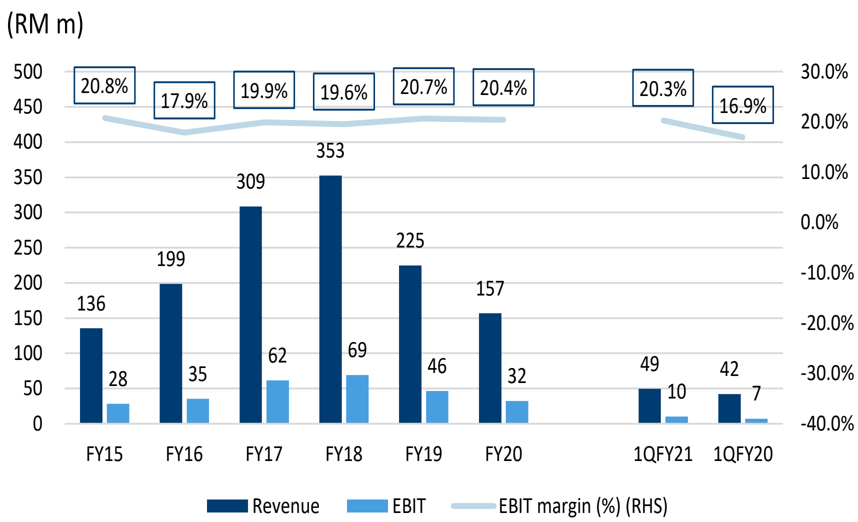
Source: Company, Affin Hwang estimates

Resilient MLM performance amid lockdown

Holding up well amidst the pandemic gloom

To recap, Hai-O's 1QFY21 revenue and core net profit increased by 7.8% and 27.6% yoy to RM71.2m and RM9.9m respectively. This was predominantly driven by the group's MLM segment which saw revenue rise +17% yoy to RM49.3m, coming off the success of its "Duit Raya" campaign as well as good reception for its newly-launched lady-wear items over the period. The corresponding uptick in EBIT margin to 20% from 17%, partly owing to a better product mix, has led to a +41% yoy increase in MLM operating profit to RM10m (from RM7m in 1QFY20).

Fig 1: MLM sales and operating profit



Source: Company, Affin Hwang forecasts

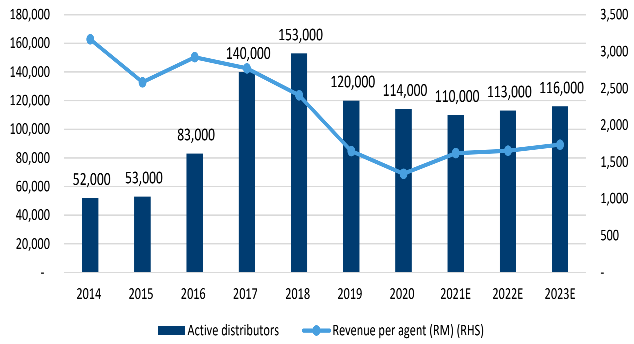
Distributor base steadied at c.114,000

We gather that Hai-O's MLM distributor base sustained at around 114,000 at this juncture (similar to end FY20). Recall, the distributor force at its peak was 153,000 back in FY18, but had since been on a downtrend, owing to lower renewal rates and a slowdown in members' recruitment after the cessation of an aggressive promotional campaign held in conjunction with the group's 25th anniversary celebration. We understand that the management has put in place measures to retain and recruit new members, for instance the B-XTRA starter plan offering extra savings / rebates in FY20 as well as more recently launching a free-member fees campaign (typical renewal cost c.RM30-40). In part driven by the promotional campaigns, we now expect its distributor force to likely see smaller attrition to 110,000 in FY21 (from 105,000 previously) whilst forecasting FY22 at 113,000.

Expecting modest uptick in average sales per agent

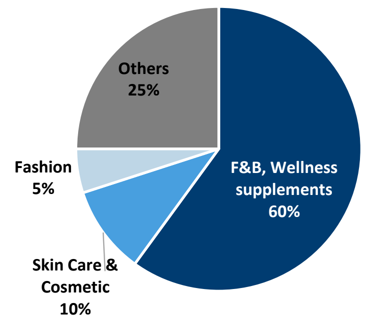
In terms of per agent sales, we observed that annual sales per distributor hovers at c.RM1,339/annum for FY20, since the highs of RM2,922/annum in FY16. We believe that is in part due to the ramp-up in distribution base as well as a higher concentration of smaller-ticker items over the period. Nevertheless, we envisage average sales per agent to see an uptick to c.RM1,600-RM1,700 for FY21-23E, as we believe the attrition in the past years has weeded out the less active members, leaving the remaining distribution force likely being the more loyal and productive in generating recurring sales. To stimulate sales amid a challenging operating environment, the group will also be intensifying its marketing campaigns. Post its successful "Duit Raya" campaign, there will be various promotional campaigns to sustain buying interest, such as monthly flash sales and local incentive trips to reward members.

Fig 2: Distributor base & average revenue per agent



Source: Company, Affin Hwang forecasts

Fig 3: Estimated MLM product mix



Source: Company, Affin Hwang forecasts

Affordable items should augur well with a more cautious trend

Since 2013, the group has been concentrating on offering "small ticket" items (not more than RM300) that are recurring in nature - predominantly consisting of health-food products and skincare products. The split between small ticket items and big ticket items is 80:20. More specifically, the current breakdown of Hai-O MLM offerings is 60% F&B and wellness supplements, 10% skin care & cosmetics, 5% fashion and the balance being bigger ticket items such as water filters. To note, during the past months, we understand that demand for food supplements was particularly strong, likely on the increased awareness to boost self-immunity amid the pandemic. On the flipside, though, demand for bigger ticket items such as water filters is rather moderate. With the group aiming to continuously roll out new products (latest being a lady-wear line "Thera Pants" launched prior to MCO), we believe this should augur well in keeping members' buying interest intact amid a more challenging economic backdrop.

Wholesale and retail businesses likely to remain soft

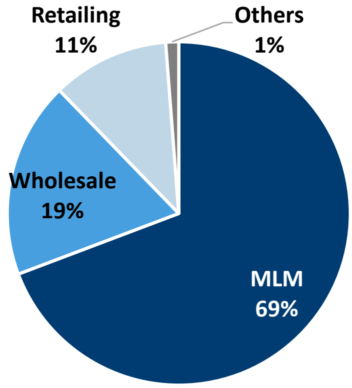
Wholesale: Likely some softness ahead

Hai-O's wholesale division (19% revenue; 21% EBIT) involves the trading of traditional medicines, healthcare products, herbs & tea – serving >100 wholesale customers and >2,000 retailers across Malaysia including Chinese medical halls, restaurants and supermarkets, to name a few. Though 1QFY21 saw a dip in sales to RM13.2m (-11.1% yoy), bogged down by lockdown disruptions, EBIT however saw an uptick to RM2.9m from RM1.3m, underpinned in part by stronger sales from its higher-margin Chinese medicated tonic as well as cost optimisation measures. We envisage some weakness in demand in this division, as certain end-retailers may face continued suppressed sales given the lingering uncertainties of Covid-19. Nevertheless, the group targets to improve the depth of its wholesale product range while also looking to focus on digital A&P in an appeal to build a presence with the younger consumers.

Retail: Lingering pandemic concerns impact retail outlets

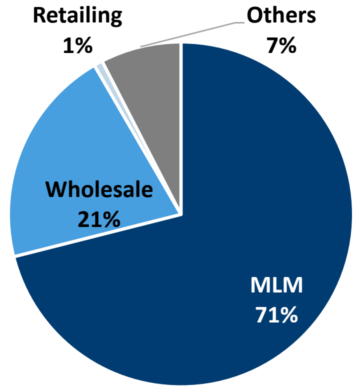
Elsewhere, Hai-O's retail segment (11% revenue; 1% EBIT) serves as the most visible point of engagement with customers; the retail segment entails 57 retail chain stores nationwide. Sales was similarly impacted by lockdown disruptions, with stores having to operate at shortened operating hours during the MCO. This was consequently reflected in 1QFY21, where revenue shed -3.2% to RM7.9m, but narrowly averted a negative EBIT, posting an operating profit of RM0.1m. Near term, as with wholesale, there are proactive measures to mitigate the pandemic impact, amongst others, plans on cost optimisation as well as to promote the adoption of digital platforms (recently launched on Lazada and Shopee) to capture the increasing migration toward e-commerce offerings.

Fig 4: 1QFY21 revenue breakdown



Source: Company, Affin Hwang forecasts

Fig 5: 1QFY21 operating profit breakdown



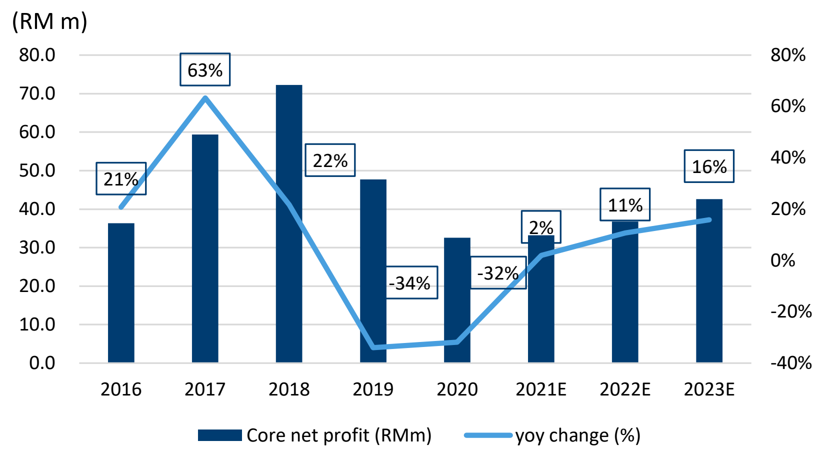
Source: Company, Affin Hwang forecasts

Valuation and Recommendation

Modest recovery from low base in FY21E

The past two financial years have seen sharp consecutive earnings contractions of 34% and 32% in FY18 and FY19 respectively, attributed to declines in contributions from the MLM segment owing to attrition in its distributor sales force and a more cautious consumption spending. Following through a commendable performance in 1QFY21, we reckon a modest recovery from a low base may transpire for FY21E, underpinned by a resilient MLM, albeit slightly offset by softness in the wholesale and retail segments. Longer term, we foresee earnings to only recover to near FY19 levels by FY23E, as the MLM segment gradually regains its peak distributor force.

Fig 6: Core net profit and yoy change

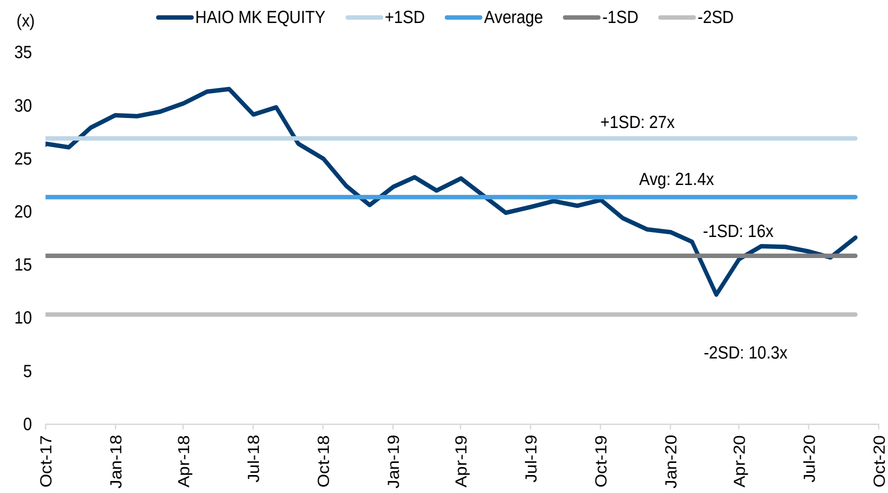


Source: Company, Affin Hwang forecasts

Maintain HOLD

We raised our earnings estimates by 3.3-3.5% for FY21-22E, largely to account for higher MLM sales underpinned by intensifying marketing campaigns and sustained recruiting campaigns. Post revision, our TP is revised higher to RM2.02, based on an unchanged target FY22E PER of 16x, representing 1SD below 3-year mean to reflect challenges in the operating environment amid Covid-19. While MLM had a fairly resilient performance amid pandemic disruptions, we are of the view that near-term consumer sentiment remains subdued, as macro conditions remain frail. This, coupled with a reduced physical interaction for MLM distributors may impede sales in the upcoming quarters. Meantime, wholesale and retailing divisions are susceptible to uncertainties of targeted lockdown measures, and hence we are doubtful of a strong uptick in sales. All in, we are keeping our HOLD rating, in view of the limited upside to the current share price. Up/downside risks: i) recovery/fall in MLM distributor base; ii) better-/worse-than-expected takeup rate for its new products; and (iii) higher/lower cost savings.

Fig 7: 3-year PER band



Source: Affin Hwang forecasts

Financial Summary – Hai-O

Profit & Loss Statement

FYE 30 April (RMm)	2019	2020	2021E	2022E	2023E
Revenue	328.4	255.2	268.9	287.7	310.2
Operating expenses	-261.5	-214.2	-221.3	-235.3	-253.8
EBITDA	66.9	40.9	47.6	52.4	56.5
Depreciation	-4.6	-3.9	-4.7	-4.7	0.0
EBIT	62.2	34.3	42.9	47.6	56.5
Net int income/(expense)	-0.1	-0.4	1.5	1.4	0.8
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Pretax profit	63.4	41.5	44.4	49.0	57.3
Tax	-15.9	-9.2	-9.8	-10.9	-12.7
Minority interest	0.3	0.3	0.0	0.0	0.0
Net profit	47.7	32.6	34.5	38.2	44.6

Balance Sheet Statement

FYE 30 April (RMm)	2019	2020	2021E	2022E	2023E
Fixed assets	97.1	86.5	86.8	87.1	92.1
Other long term assets	50.5	62.6	49.9	49.9	49.9
Total non-current assets	**147.6**	**149.1**	**136.7**	**137.0**	**142.0**
Cash and equivalents	53.8	58.0	65.7	72.5	80.7
Stocks	98.1	93.3	82.9	86.6	93.3
Debtors	21.8	20.4	17.9	19.1	20.6
Other current assets	42.8	41.0	39.8	39.8	39.8
Total current assets	**216.6**	**212.6**	**206.3**	**218.0**	**234.4**
Creditors	38.5	44.1	32.5	34.0	36.7
Short term borrowings	0.3	0.0	0.0	0.0	0.0
Other current liabilities	4.1	3.5	1.9	1.9	1.9
Total current liabilities	**42.9**	**47.7**	**34.5**	**35.9**	**38.6**
Long term borrowings	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	0.6	3.9	0.4	0.4	0.4
Total long term liabilities	**0.6**	**3.9**	**0.4**	**0.4**	**0.4**
Shareholders' Funds	**310.2**	**299.6**	**305.1**	**315.6**	**329.7**
Minority interest	**10.5**	**10.6**	**10.6**	**10.6**	**10.6**

Cash Flow Statement

FYE 30 April (RMm)	2019	2020	2021E	2022E	2023E
EBIT	62.2	34.3	42.9	47.6	56.5
Depreciation & amortisation	4.7	5.0	4.7	4.7	4.7
Working capital changes	-12.8	11.6	2.6	-3.5	-5.6
Cash tax paid	-15.9	-9.2	-9.8	-10.9	-12.7
Others	-9.7	-5.5	0.0	0.0	0.0
Cashflow from operation	**28.6**	**36.2**	**40.3**	**38.0**	**42.9**
Capex	-8.3	-0.4	-5.0	-5.0	-5.0
Others	20.9	5.1	0.0	0.0	0.0
Cash flow from investing	**12.6**	**4.8**	**-5.0**	**-5.0**	**-5.0**
Debt raised/(repaid)	-1.1	-0.3	0.0	0.0	0.0
Dividends paid	-52.5	-35.1	-29.0	-27.6	-30.5
Others	-2.5	-1.5	1.5	1.4	0.8
Cash flow from financing	**-56.1**	**-36.9**	**-27.5**	**-26.2**	**-29.7**
Free Cash Flow	**20.3**	**35.9**	**35.3**	**33.0**	**37.9**

Source: Company, Affin Hwang estimates

Key Financial Ratios and Margins

FYE 30 April (RMm)	2019	2020	2021E	2022E	2023E
Growth					
Revenue (%)	-28.9	-22.3	5.4	7.0	7.8
EBITDA (%)	-32.4	-38.8	16.3	10.0	7.8
Core net profit (%)	-33.9	-31.8	6.1	10.5	16.8
Profitability					
EBITDA margin (%)	20.4	16.0	17.7	18.2	18.2
PBT margin (%)	19.3	16.3	16.5	17.0	18.5
Net profit margin (%)	14.5	12.8	12.8	13.3	14.4
Effective tax rate (%)	25	22	22	22	22
ROA (%)	15.2	10.9	11.8	12.5	13.7
Core ROE (%)	15.4	10.7	11.4	12.3	13.8
ROCE (%)	20.1	11.3	14.2	15.3	17.5
Dividend payout ratio (%)	79.1	89.2	80.0	80.0	80.0
Liquidity					
Current ratio (x)	5.0	4.5	6.0	6.1	6.1
Op. cash flow (RMm)	28.6	36.2	40.3	38.0	42.9
Free cashflow (RMm)	20.3	35.9	35.3	33.0	37.9
FCF/share (sen)	7.0	12.3	12.2	11.4	13.0
Asset management					
Debtors turnover (days)	24.3	24.3	24.3	24.3	24.3
Stock turnover (days)	177.1	177.1	177.1	177.1	177.1
Creditors turnover (days)	69.6	69.6	69.6	69.6	69.6
Capital structure					
Net gearing (%)	net cash	net cash	net cash	net cash	net cash
Interest cover (x)	755.6	621.5	113.3	-31.7	-37.4

Quarterly Profit & Loss

FYE 30 April (RMm)	1Q19	2Q19	3Q19	4Q19	1Q20
Revenue	80.1	92.2	86.2	70.0	66.1
Operating expenses	-64.8	-72.9	-68.2	-55.6	-54.5
EBITDA	15.3	19.2	17.9	14.4	11.5
Depreciation	-1.1	-1.2	-1.3	-1.0	-1.6
EBIT	14.2	18.0	16.7	13.4	10.0
Net int income/(expense)	0.3	0.3	0.3	0.4	0.2
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	14.4	18.3	16.9	13.8	10.2
Tax	-3.8	-4.4	-4.1	-3.6	-2.7
Minority interest	0.3	-0.3	0.0	0.2	0.2
Net profit	11.0	13.6	12.8	10.4	7.7
Core net profit	11.0	13.6	12.8	10.4	7.7
Margins (%)					
EBITDA	19.1	20.9	20.8	20.6	17.5
PBT	18.0	19.8	19.6	19.7	15.4
Net profit	13.7	14.8	14.8	14.8	11.7

Important Disclosures and Disclaimer

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

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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Affin Hwang Investment Bank Berhad (14389-U)
A Participating Organisation of Bursa Malaysia Securities Berhad

22nd Floor, Menara Boustead,
69, Jalan Raja Chulan,
50200 Kuala Lumpur, Malaysia.

T : + 603 2142 3700
F : + 603 2146 7630
research@affinhwang.com

www.affinhwang.com