

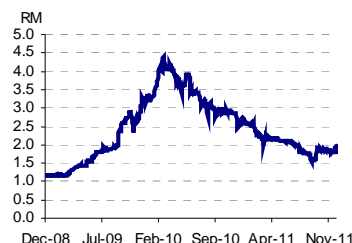
## Company Update

## Hai-O Ent

HAIO MK  
RM1.94

REDUCE (upgrade)

Target Price: RM1.80 (↑)



## Price Performance

	1M	3M	12M
Absolute	+4.3%	+16.2%	-26.5%
Rel to KLCI	+0.2%	+7.2%	-25.5%

## Stock Data

Issued shares (m)	202.2
Mkt cap (RMm)	392.2
Avg daily vol - 6mth (m)	0.08
52-wk range (RM)	1.55 – 2.86
Est free float	66.4%
NTA per share (RM) (end-Oct 11)	1.08
P/NTA (x)	1.80
Net cash/debt (RMm) (end-Oct 11)	35.8
ROE (FY12E)	14.8%
Derivatives	Nil

## Key Shareholders

Tan Kai Hee	9.6%
Akintan Sdn Bhd	7.2%

## Earnings &amp; Valuation Revisions

	12E	13E	14E
Prev EPS (sen)	16.5	19.0	21.8
Curr EPS (sen)	17.5	19.4	22.2
Chg (%)	+6.1	+2.2	+2.0
Prev target price (RM)		1.27	
Curr target price (RM)		1.80	

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## Banking on stronger margins to support earnings

## EBIT margin lifted by lower R&amp;D costs and higher margin products

In the recent 1HFY04/12 results, Hai-O reported core net profit of RM19.6m (+40.7% yoy), lifted primarily by a stronger EBIT margin (24.5% vs. 18.5% in 1HFY04/11). We gather that the improvement in margin was attributed to: 1) lower R&D costs in the technology division, and; 2) improved margins in the MLM, retail and wholesale divisions. According to management, customer interest in potential applications of the heat transfer technology has been slower-than-expected, due to the high investment cost (installation of boilers, etc). Consequently, Hai-O has been scaling back on R&D investments, which has contributed to lowering overall expenditures.

## New strategies bearing returns

After the implementation of the revised Direct Selling Act in 2Q10 caused FY04/11 net profit to plunge by -60% yoy, Hai-O implemented several strategies to rebuild its earnings base. One strategy was to introduce higher margin, but lower priced, products in the MLM division. Here, sales of Hai-O's skincare and foundation lingerie products (which command higher margins than the Bio Aura water filter) aided in keeping MLM 1HFY04/12 EBIT margin steady at 16.3% (1HFY04/11: 16%). EBIT margin was also higher in the retail and wholesale divisions, where Hai-O focused on promoting its higher margin house brand products. Sales of house brand products in 1HFY04/12 accounted for over 60% of total sales, vis-à-vis c. 50% in 1HFY04/11. Consequently, retail EBIT margin in 1HFY04/12 improved by +1-ppt yoy, while wholesale EBIT margin added +1.7-ppt yoy.

## But earnings still dependent on domestic sales

With new membership additions in the MLM division holding steady at 2,000/month, it's clear the worst is over for Hai-O. That said, we do not expect revenue contribution from the MLM division to return to its heyday of over RM100m/quarter. Management also guided that MLM operations in Indonesia remains sluggish. Thus, we believe earnings going forward will be supported by sturdy domestic sales and steady margins.

## Upgrade to REDUCE with a higher TP of RM1.80

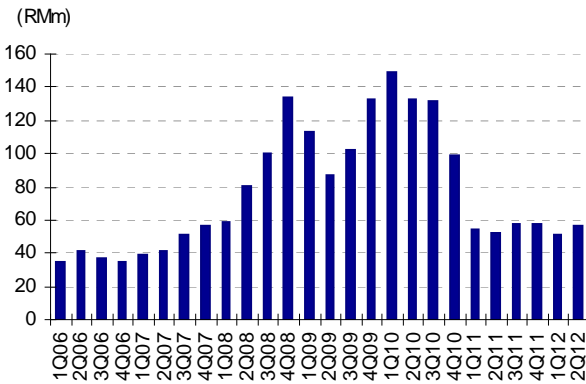
Notwithstanding that, we raise our FY04/12-14 net earnings forecasts by +2-6% after imputing in the stronger-than-expected 1HFY04/12 results. Given: 1) that earnings decline has bottomed out, and; 2) our thesis that consumer spending will remain resilient in 2012, we raise our CY12 PE target to 9x (previously, 7x). Our target price is hence raised from RM1.27 to RM1.80. Upgrade from Sell to REDUCE. Key re-rating catalysts for Hai-O would be: 1) a pick-up in new monthly memberships in the MLM division, and; 2) sustained stronger sales across all divisions.

## Earnings and valuation summary

FYE 30 April	2010	2011	2012E	2013E	2014E
Revenue (RMm)	511.1	223.3	251.3	285.3	320.3
EBITDA (RMm)	99.1	44.8	51.4	58.6	66.4
Pretax profit (RMm)	95.6	41.3	43.9	55.0	62.8
Net profit (RMm)	70.6	28.4	31.4	39.4	45.0
EPS (sen)	34.8	14.0	15.5	19.4	22.2
PER (x)	5.6	13.9	12.5	10.0	8.7
Core net profit (RMm)	70.6	28.4	35.4	39.4	45.0
Core EPS (sen)	34.8	14.0	17.5	19.4	22.2
EPS growth (%)	35.0	-59.8	24.9	11.2	14.2
Core PER (x)	5.6	13.9	11.1	10.0	8.7
Net DPS (sen)	9.4	7.5	9.0	11.0	12.0
Net Dividend Yield (%)	4.8	3.9	4.6	5.7	6.2
EV/EBITDA (x)	2.9	7.3	6.2	5.2	4.3
Consensus profit (RMm)			29.9	33.8	44.1
Affin/Consensus (x)			1.1	1.2	1.0

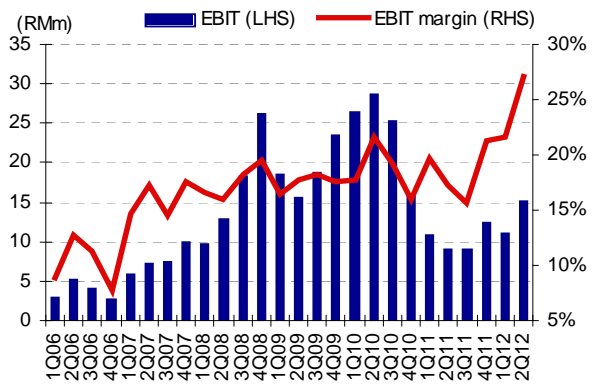
## Focus Charts

Fig 1: Quarterly revenue trend



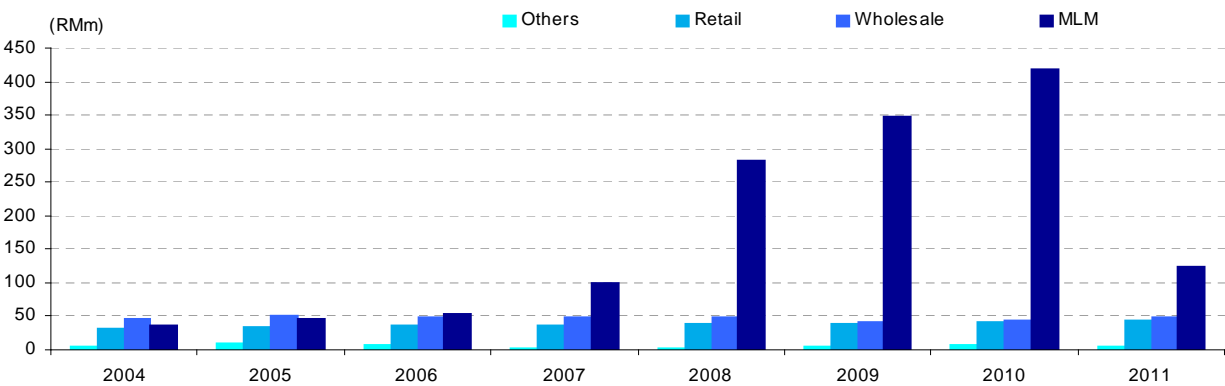
Source: Company

Fig 2: Quarterly EBIT and EBIT margin trend



Source: Company

Fig 3: Breakdown of annual revenue



Source: Company

Fig 4: MLM peers comparison

Stock	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x) CY11	Core PE (x) CY12	EPS growth (%) CY11	EPS growth (%) CY12	EV/EBITDA (x)	P/B (x)	ROE (%) Pros1	ROE (%) Pros2	Net Div. Pros1	Yield (%) Pros2
Amway	N.R.	9.25	n.a.	1,521	Dec	17.7	17.1	10.0	3.5	12.3	8.2	36.6	36.6	7.1	6.3
HA-O	REDUCE	1.94	1.80	392	Apr	11.9	10.3	-22.1	15.1	6.2	1.8	14.8	17.2	4.6	5.7
Zhulian	N.R.	1.73	n.a.	796	Nov	8.0	7.0	12.7	14.2	5.2	2.0	26.3	26.3	7.5	8.7
<b>Simple average</b>						<b>12.5</b>	<b>11.5</b>	<b>0.2</b>	<b>10.9</b>	<b>7.9</b>	<b>4.0</b>	<b>25.9</b>	<b>26.7</b>	<b>6.4</b>	<b>6.9</b>

Source: Bloomberg, Affin

Fig 5: Affin peers comparison

Stock	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x) CY11	Core PE (x) CY12	EPS growth (%) CY11	EPS growth (%) CY12	EV/EBITDA (x)	P/B (x)	ROE (%) Pros1	ROE (%) Pros2	Net Div. Pros1	Yield (%) Pros2
AEON	ADD	7.20	7.58	2,527	Dec	12.8	12.7	-0.8	17.5	5.1	2.0	16.6	14.9	1.7	1.9
BAT	ADD	49.20	52.28	14,048	Dec	19.3	18.1	1.5	6.7	13.4	124.8	141.3	135.5	5.5	5.4
BONIA	BUY	2.00	2.70	403	Jun	6.9	6.5	15.4	6.1	3.6	1.9	22.1	19.9	3.0	3.0
CARLSBERG	BUY	8.53	10.90	2,628	Dec	16.4	15.3	19.5	7.0	11.3	13.8	27.3	27.0	3.0	3.3
GUINNESS	ADD	16.00	16.00	4,018	Jun	24.5	23.3	5.7	5.1	13.0	11.5	44.0	54.7	8.9	4.6
HA-O	REDUCE	1.94	1.80	392	Apr	11.9	10.3	-22.1	15.1	6.2	1.8	14.8	17.2	4.6	5.7
JTI	ADD	7.00	7.88	1,831	Dec	13.8	12.9	-1.1	7.0	8.4	4.3	32.5	30.4	5.4	3.2
MSM	ADD	4.89	4.80	3,438	Dec	13.1	11.1	-0.2	17.8	6.6	2.5	12.9	14.2	3.8	4.5
NESTLE	ADD	56.70	60.55	13,296	Dec	28.9	26.7	17.7	7.9	19.8	21.2	70.9	70.3	3.4	3.7
PARKSON	BUY	5.56	7.15	6,081	Jun	16.1	13.6	20.4	18.4	3.6	2.5	17.3	18.7	3.1	3.8
<b>Simple average</b>						<b>16.4</b>	<b>15.1</b>	<b>5.6</b>	<b>10.9</b>	<b>9.1</b>	<b>18.6</b>	<b>40.0</b>	<b>40.3</b>	<b>4.2</b>	<b>3.9</b>

Source: Affin

## Hai-O – FINANCIAL SUMMARY

### Profit & Loss Statement

FYE30 April (RMm)	2010	2011	2012E	2013E	2014E
Revenue	511.1	223.3	251.3	285.3	320.3
Operating expenses	-412.0	-178.4	-199.9	-226.8	-253.9
EBITDA	99.1	44.8	51.4	58.6	66.4
Depreciation	-2.1	-2.2	-2.3	-2.4	-2.5
EBIT	96.5	42.1	48.6	55.7	63.4
Net int income/(expense)	-0.8	-0.8	-0.8	-0.7	-0.6
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Pretax profit	95.6	41.3	43.9	55.0	62.8
Tax	-23.8	-11.6	-11.0	-13.8	-15.7
Minority interest	-1.3	-1.3	-1.5	-1.9	-2.1
Net profit	70.6	28.4	31.4	39.4	45.0

### Balance Sheet Statement

FYE30 April (RMm)	2010	2011	2012E	2013E	2014E
Fixed assets	62.2	72.2	74.9	77.5	80.0
Other long term assets	32.7	38.0	37.5	37.0	36.5
<b>Total non-current assets</b>	<b>94.9</b>	<b>110.2</b>	<b>112.4</b>	<b>114.5</b>	<b>116.5</b>
Cash and equivalents	70.9	46.1	53.0	66.0	81.0
Stocks	44.0	44.3	49.8	56.9	64.0
Debtors	19.7	19.1	21.5	24.4	27.4
Other current assets	49.6	37.4	37.4	37.4	37.4
<b>Total current assets</b>	<b>184.1</b>	<b>146.8</b>	<b>161.7</b>	<b>184.7</b>	<b>209.7</b>
Creditors	38.5	22.6	25.4	29.0	32.6
Short term borrowings	4.8	5.7	5.1	4.6	4.1
Other current liabilities	12.1	5.2	5.2	5.2	5.2
<b>Total current liabilities</b>	<b>55.4</b>	<b>33.4</b>	<b>35.7</b>	<b>38.7</b>	<b>41.9</b>
Long term borrowings	13.2	10.7	9.7	8.7	7.8
Other long term liabilities	0.0	0.1	0.1	0.1	0.1
<b>Total long term liabilities</b>	<b>13.2</b>	<b>10.9</b>	<b>9.8</b>	<b>8.8</b>	<b>8.0</b>
<b>Shareholders' Funds</b>	<b>203.1</b>	<b>204.4</b>	<b>218.8</b>	<b>240.0</b>	<b>262.6</b>
<b>Minority interest</b>	<b>7.4</b>	<b>8.3</b>	<b>9.8</b>	<b>11.6</b>	<b>13.8</b>

### Cash Flow Statement

FYE30 April (RMm)	2010	2011	2012E	2013E	2014E
EBIT	96.5	42.1	48.6	55.7	63.4
Depreciation & amortisation	2.6	2.6	2.8	2.9	2.9
Working capital changes	-16.0	-10.4	-5.1	-6.4	-6.5
Cash tax paid	-23.8	-11.6	-11.0	-13.8	-15.7
Others	9.9	-8.9	-3.8	0.0	0.0
<b>Cashflow from operation</b>	<b>69.2</b>	<b>13.9</b>	<b>31.6</b>	<b>38.5</b>	<b>44.2</b>
Capex	-3.7	-12.3	-5.0	-5.0	-5.0
Others	-16.1	10.6	0.0	0.0	0.0
<b>Cash flow from investing</b>	<b>-19.8</b>	<b>-1.7</b>	<b>-5.0</b>	<b>-5.0</b>	<b>-5.0</b>
Debt raised/(repaid)	-1.5	-1.6	-1.6	-1.5	-1.3
Dividends paid	-26.4	-33.9	-17.2	-18.2	-22.3
Others	-1.2	-1.3	-0.8	-0.7	-0.6
<b>Cash flow from financing</b>	<b>-29.1</b>	<b>-36.8</b>	<b>-19.6</b>	<b>-20.4</b>	<b>-24.2</b>
<b>Free Cash Flow</b>	<b>65.5</b>	<b>1.6</b>	<b>26.6</b>	<b>33.5</b>	<b>39.2</b>

Source: Company, Affin

### Key Financial Ratios and Margins

FYE30 April (RMm)	2010	2011	2012E	2013E	2014E
<b>Growth</b>					
Revenue (%)	17.4	-56.3	12.6	13.5	12.2
EBITDA (%)	24.5	-54.7	14.7	13.9	13.3
Core net profit (%)	35.0	-59.8	10.8	25.4	14.2
<b>Profitability</b>					
EBITDA margin (%)	19.4	20.1	20.5	20.5	20.7
PBT margin (%)	18.7	18.5	17.5	19.3	19.6
Net profit margin (%)	13.8	12.7	12.5	13.8	14.0
Effective tax rate (%)	25	28	25	25	25
ROA (%)	28.7	13.0	13.3	15.0	15.5
Core ROE (%)	38.3	13.9	16.7	17.2	17.9
ROCE (%)	47.5	19.1	21.4	22.9	24.0
Dividend payout ratio (%)	27.0	53.6	53.6	53.6	53.6

### Liquidity

Current ratio (x)	3.3	4.4	4.5	4.8	5.0
Op. cash flow (RMm)	69.2	13.9	31.6	38.5	44.2
Free cashflow (RMm)	65.5	1.6	26.6	33.5	39.2
FCF/share (sen)	32.3	0.8	13.1	16.5	19.3

### Asset management

Debtors turnover (days)	14.1	31.2	31.2	31.2	31.2
Stock turnover (days)	45.0	116.8	116.8	116.8	116.8
Creditors turnover (days)	39.3	59.5	59.5	59.5	59.5

### Capital structure

Net gearing (%)	net cash	net cash	net cash	net cash	net cash
Interest cover (x)	68.9	119.0	52.8	67.4	85.2

### Quarterly Profit & Loss

FYE30 April (RMm)	2Q11	3Q11	4Q11	1Q12	2Q12
Revenue	52.6	57.6	58.2	51.0	56.2
Operating expenses	-43.5	-48.6	-45.8	-39.9	-41.0
EBITDA	9.1	9.0	12.4	11.0	15.2
Depreciation	0.0	0.0	0.0	0.0	0.0
EBIT	9.1	9.0	12.4	11.0	15.2
Net int income/(expense)	0.0	0.0	0.1	0.0	0.0
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Exceptional Items	0.0	0.0	0.0	0.0	-4.0
Pretax profit	9.1	9.0	12.5	11.1	11.3
Tax	-2.5	-2.3	-3.5	-3.0	-2.8
Minority interest	-0.5	-0.4	-0.4	-0.3	-0.5
Net profit	6.1	6.3	8.5	7.7	7.9
Core net profit	6.1	6.3	8.5	7.7	11.9

### Margins (%)

EBITDA	17.3	15.7	21.4	21.7	27.1
PBT	17.3	15.7	21.5	21.7	20.0
Net profit	11.7	11.0	14.7	15.2	14.0

## Equity Rating Structure and Definitions

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<b>BUY</b>	Total return is expected to exceed +15% over a 12-month period
<b>TRADING BUY (TR BUY)</b>	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
<b>ADD</b>	Total return is expected to be between 0% to +15% over a 12-month period
<b>REDUCE</b>	Total return is expected to be between 0% to -15% over a 12-month period
<b>TRADING SELL (TR SELL)</b>	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
<b>SELL</b>	Total return is expected to be below -15% over a 12-month period
<b>NOT RATED</b>	Affin Investment Bank does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation
<b>OVERWEIGHT</b>	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
<b>NEUTRAL</b>	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
<b>UNDERWEIGHT</b>	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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