

Corporate Highlights



**RHB Research
Institute Sdn Bhd**
A member of the
RHB Banking Group
Company No: 233327 -M

Results Note

24 March 2011

Hai-O Enterprise

Within Expectations

Share Price : RM2.27
Fair Value : RM1.71
Recom : **Underperform**
(Maintained, Cease Coverage)

Table 1 : Investment Statistics (HAIO; Code: 7668)

Bloomberg: HAIO MK

FYE	Revenue	Net Profit	EPS	Growth	PER	C. EPS *	P/NTA	Net Gearing	ROE	GDY
Apr	(RMm)	(RMm)	(sen)	(%)	(x)	(sen)	(x)	(x)	(%)	(%)
2010a	511.1	70.9	35.0	35.4	6.5	-	2.4	Net cash	38.7	10.6
2011f	247.5	27.2	13.4	-61.6	16.9	14.0	2.5	Net cash	13.1	3.9
2012f	240.2	27.5	13.6	1.0	16.7	17.0	2.7	Net cash	12.4	4.0
2013f	272.0	31.4	15.5	14.0	14.7	19.0	2.9	Net cash	13.3	4.5

Main Market Listing / Trustee Stock

* Consensus Based On IBES Estimates

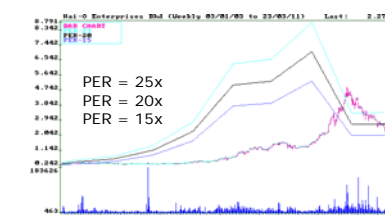
- ◆ **Within expectations.** Hai-O's 9MFY04/11 net profit of RM20.3m (-47.4% yoy) came in at 75% and 72% of our and consensus full-year estimates respectively. No dividends were declared during the quarter (3QFY04/10: 4 sen/share) given the contracting earnings.
- ◆ **MLM division shows slight growth.** Qoq MLM revenues grew by RM2.3m (+8.6%) to RM29m in 3QFY04/11, which is the first qoq upturn since the 4QFY04/10. Despite the slight improvement this quarter, we continue to be cautious on the division as we believe that the effect of the internal restructuring for the division due to the ammendment in the Direct Selling Act (DSA) may continue to impact its membership recruitment drive and slow the growth momentum of its membership base. On a 20.0cumulative basis, Hai-O's 9MFY04/11 MLM division revenues contracted by 73.7% yoy to RM91m (9MFY04/10: RM345m). Our projections assume a decline in MLM revenues of 64% in FY04/11 and a 8% decline in FY04/12.
- ◆ **Other divisions too small to take on the mantle.** For 9MFY04/11, Hai-O's wholesale and retail division grew by 14% yoy, to RM69.7m, while its other divisions (except MLM) revenues contracted 23.6% yoy on a combined basis. Despite the growth in its wholesale and retail division, we believe that it is too small to be able to make a significant impact on group earnings. Even if it continues to grow at a double-digit rate, we doubt that it would be able to replace MLM as the core revenue driver. In 9MFY04/11, the retail and wholesale division comprised 47.4% of revenues.
- ◆ **Energy division loss-making, for now.** We believe Hai-O's energy division has the potential to provide decent earnings growth in the future given its innovative boiler heat transfer technology which is currently being tested by a few rubber glove factories. However, given that it is yet to be commercialised, Hai-O is not generating any revenues from this division, while it continues to drain ~RM2m p.a. in R&D costs. The technology is not expected to be commercialised in FY11, and we have not projected it to have any contribution towards Hai-O's earnings for the next 1-2 years.
- ◆ **Risks.** 1) stronger-than-expected recovery of its MLM division; and 2) earlier-than-expected commercialisation of its energy division.
- ◆ **Forecasts.** No change to our earnings forecast.
- ◆ **Maintain Underperform, ceasing coverage.** We believe Hai-O needs to reinvent itself by moving away from its existing product mix to generate a new more sustainable earnings stream in order to excite investors again in the medium term. In view of the current skittish and volatile market environment, we believe investors are looking for more earnings stability and reliable returns, which Hai-O would not be able to offer at this juncture, in our opinion. We are thus ceasing coverage on the stock, with our last recommendation being an **Underperform** with an unchanged fair value of RM1.35. For exposure in the MLM sector, we like Amway (OP, FV=RM9.35), which offers strong dividend yields of 6-7%, coupled with a stable earnings outlook.

RHBRI	Vs.	Consensus
✓	Above	
	In Line	✓
	Below	

Issued Capital (m shares)	202.2
Market Cap (RMm)	459.0
Daily Trading Vol (m shs)	0.3
52wk Price Range (RM)	2.23-4.68
Major Shareholders:	(%)
Tan Family	30.0

FYE Apr	FY11	FY12	FY13
EPS chg (%)	-	-	-
Var to Cons (%)	(4.3)	(20.0)	(18.4)

PE Band Chart



Relative Performance To FBM KLCI



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Table 2: Earnings Review (QoQ)

FYE April (RMm)	3Q10	2Q11	3Q11	% chg QoQ	% chg YoY	9M10	9M11	% chg YoY	Comments
Revenue	131.3	52.6	57.6	9.5	(59.9)	412.2	165.0	(60.0)	Lower revenue due to contraction in MLM revenues of 74% yoy
- Wholesale & Retail	22.8	24.4	27.3	12.2	6.6	61.1	69.7	14.0	
- MLM	106.2	26.7	29.0	8.6	(74.8)	345.5	91.0	(73.7)	Significant decline as a result of applying more stringent rules on new member recruitment and tightening of stock management
- Other	1.5	1.5	1.3	(18.3)	5.8	5.6	4.3	(23.6)	
EBIT	25.2	9.1	9.0	(0.6)	(63.9)	96.0	28.9	(69.9)	Refer to EBIT margin
Finance cost	0.0	(0.0)	(2.1)	41760.0	(119.2)	(0.1)	(2.1)	2616.7	
PBT	25.2	9.1	9.0	(0.6)	(64.0)	80.2	28.9	(64.0)	
Taxation	(7.0)	(2.5)	(2.3)	(4.9)	(65.1)	(23.0)	(7.7)	(66.5)	
MI	(0.2)	(0.5)	(0.4)	(30.4)	151.5	(0.5)	(0.9)	102.4	
Net profit	18.0	6.1	6.3	3.5	(66.0)	56.7	20.3	(64.2)	
EPS (sen)	8.9	3.1	3.2	3.6	(65.4)	28.4	10.2	(47.4)	
Gross dividend	0.0	0.0	0.0	-	-	-	-	-	
EBIT margin (%)	19.2	17.3	15.7	(1.6)	(1.9)	23.3	17.5	(5.8)	Overall EBIT margin was weaker due to weaker MLM division EBIT
PBT margin (%)	19.2	17.3	15.7	(1.6)	(2.0)	19.4	17.5	(1.9)	
Net profit margin (%)	13.7	11.7	11.0	(0.6)	(2.1)	13.7	12.3	(1.5)	
Effective tax rate (%)	27.8	27.0	25.8	(1.2)	(0.9)	28.7	26.6	(2.1)	

Source: Company, RHBRI estimates

Table 2. Earnings Forecasts

FYE Apr (RMm)	FY10a	FY11F	FY12F	FY13F
Turnover	511.1	247.5	240.2	272.0
Wholesale	43.9	46.1	48.4	50.8
MLM	418.1	150.1	138.1	165.1
Retail	41.8	44.3	46.7	49.2
Manufacturing	1.8	3.0	3.5	3.5
Other	5.6	4.0	3.5	3.5
Turnover growth (%)	17.4	(51.6)	(2.9)	13.2
Cost of Sales	(311.7)	(164.1)	(158.7)	(176.1)
Gross Profit	199.3	83.4	81.5	95.9
EBITDA	100.4	40.6	40.3	45.2
EBITDA margin (%)	19.6	16.4	16.8	16.6
Depreciation	(4.3)	(4.4)	(4.4)	(4.4)
Net Interest	(0.1)	1.1	1.5	1.9
Associates	0.0	0.0	0.0	0.0
Pretax Profit	95.9	37.3	37.4	42.6
Tax	(23.8)	(9.3)	(9.3)	(10.7)
Minorities	(1.3)	(0.7)	(0.5)	(0.6)
Net Profit	70.9	27.2	27.5	31.4

Table 3. Forecast Assumptions

FYE Apr	FY11F	FY12F	FY13F
Core distributor force (CDF)	110,000	86,000	98,000
Revenue per active member (RM/CDF)	7,172	7,244	7,317
Opening of new retail outlets	3	3	3
Revenue per outlet (RM'000)	643	649	656

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Outperform = The stock return is expected to exceed the FBM KLCI benchmark by greater than five percentage points over the next 6-12 months.

Trading Buy = Short-term positive development on the stock that could lead to a re-rating in the share price and translate into an absolute return of 15% or more over a period of three months, but fundamentals are not strong enough to warrant an Outperform call. It is generally for investors who are willing to take on higher risks.

Market Perform = The stock return is expected to be in line with the FBM KLCI benchmark (+/- five percentage points) over the next 6-12 months.

Underperform = The stock return is expected to underperform the FBM KLCI benchmark by more than five percentage points over the next 6-12 months.

Industry/Sector Ratings

Overweight = Industry expected to outperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Neutral = Industry expected to perform in line with the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Underweight = Industry expected to underperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

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