

Company Update

Hai-O Ent

HAIO MK
RM3.07

SELL (maintain)

Target Price: RM2.71 (↔)



Price Performance

	1M	3M	12M
Absolute	+1.3%	-14.2%	-0.3%
Rel to KLCI	-1.6%	-22.5%	-18.0%

Stock Data

Issued shares (m)	202.2
Mkt cap (RMm)	620.7
Avg daily vol - 6mth (m)	0.6
52-wk range (RM)	2.55 – 4.93
Est free float	66.6%
NTA per share (RM) (end-Jul 10)	1.05
P/NTA (x)	2.92
Net cash/debt (RMm) (end-Jul 10)	34.6
ROE (FY11F)	23.2%
Derivatives	Nil

Key Shareholders

Tan Kai Hee	9.6%
Akintan Sdn Bhd	7.2%

Earnings & Valuation Revisions

	11E	12E	13E
Prev EPS (sen)	25.4	27.9	31.8
Curr EPS (sen)	25.4	27.9	31.8
Chg (%)	-	-	-
Prev target price (RM)		2.71	
Curr target price (RM)		2.71	

Shakira Hatta
(603) 2142 8158
shakira@affininvestmentbank.com.my

Still on shaky ground

Branching off into a new direction with property

We spoke to Hai-O's management on its recent venture into the property development business. To recap, Hai-O entered into a Share Sale and Shareholders Agreement with Sierra Equatorial Development Sdn Bhd on 24th October, for the purpose of entering the business of property investment and development in Malaysia (via a 60% stake in Hai-O Development Sdn Bhd). The new business represents a completely new direction for Hai-O. The rationale behind the new venture was to broaden Hai-O's earnings base. This would then help to buffer bottomline should the core MLM division be subject to any further volatility in MLM regulations or consumer spending. We gathered that Hai-O and Sierra Equatorial have identified several pieces of land, largely for the purpose of residential development. However, management remained mum on the location as well as the timeline on potential property development projects.

Energy division to hit the commercial arena

In the energy division, Hai-O plans to launch sales of a boiler by early next year, based on its patented heat-transfer technology. The boiler, a product of RM4m worth of investment in research, would be tentatively priced at approximately RM500,000 per unit. However, pricing of the boiler is still subject to market demand, which is still uncertain. Management guided that meaningful contribution from the energy division will likely take another 1-2 years. Thus, we have not yet imputed in any contribution from Hai-O Energy.

But MLM division still suffering

While the new foray into property development, as well as progression in the energy division, indicate Hai-O's focus in diversifying their portfolio, we remain concerned over the sharp revenue declines in the MLM division. The MLM division contributes c. 80% of total revenue and commands the highest margins. However, thanks to the imposition of stricter new membership recruitment guidelines in 2Q10, 1QFY11 MLM revenue slid by -51.4% qoq and a whopping -73% yoy. The upcoming 2QFY11 results (to be released in December) will continue to exhibit impact from the new guidelines, although management believes the earnings decline has bottomed out. Hai-O's Indonesian operations are also progressing slower than expected. Due to stronger-than-expected competition, management guided that they are focusing on smaller towns outside of Jakarta. Hai-O has just recently opened a stockist in Pekan Baru, in addition to its main office in Mangga Dua, Jakarta. Currently, Indonesia has about 300-400 distributors.

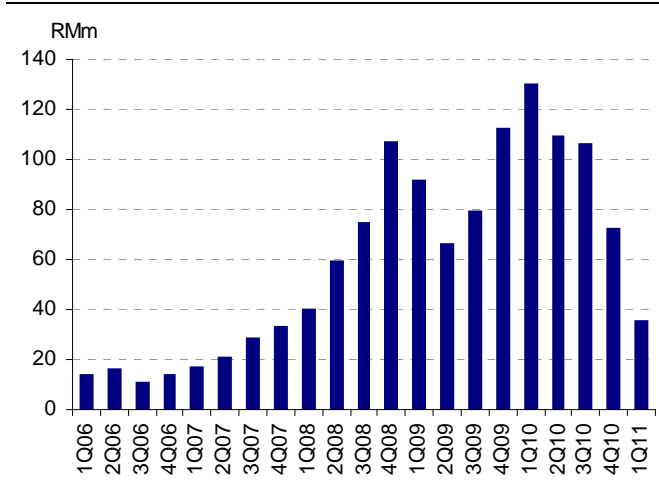
Earnings and valuation summary

FYE 30 April	2009	2010	2011F	2012F	2013F
Revenue (RMm)	435.2	511.1	431.2	473.1	506.1
EBITDA (RMm)	77.0	96.8	75.1	82.2	92.8
Pretax profit (RMm)	75.9	95.9	69.8	76.9	87.4
Net profit (RMm)	52.3	70.9	51.4	56.6	64.4
EPS (sen)	25.8	35.0	25.4	27.9	31.8
EPS growth (%)	7.7	35.6	-27.5	10.1	13.7
PER (x)	11.9	8.8	12.1	11.0	9.7
Core net profit (RMm)	52.3	70.9	51.4	56.6	64.4
Core EPS (sen)	25.8	35.0	25.4	27.9	31.8
Core PER (x)	11.9	8.8	12.1	11.0	9.7
Net DPS (sen)	13.1	19.6	15.2	16.8	19.1
Net Dividend Yield (%)	4.3	6.4	5.0	5.5	6.2
EV/EBITDA (x)	7.3	5.4	6.5	5.6	4.7
Consensus profit (RMm)			41.9	44.3	-
Affin/Consensus (x)			1.2	1.3	-

Maintain SELL, unchanged TP of RM2.71

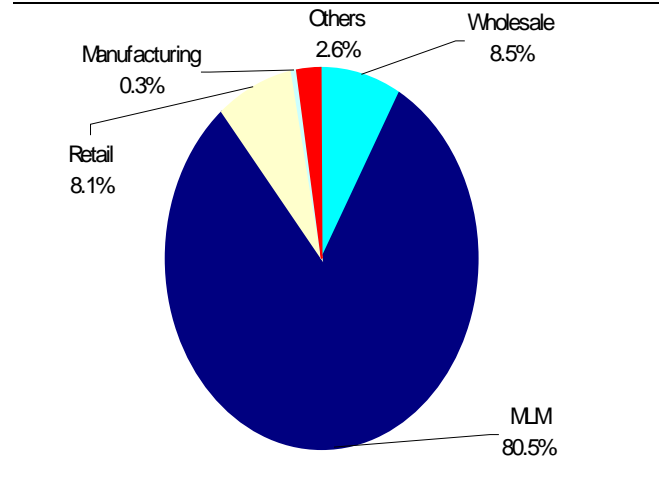
Diversification into other businesses may help cushion impact from changes in retail spending or regulations in the MLM industry in the long term. However, in the immediate term, the long adjustment period for the stricter recruitment guidelines (more than 6 months) will continue to put a dampener on consumer purchases as well as stock sentiment. Risk of distraction from its core retail operations is also a concern. We maintain our SELL recommendation, with an unchanged target price of RM2.71, pegged to an unchanged PE target of 10x on CY11 EPS. Although Hai-O's net dividend yields are attractive at 5-6% (premised on a minimum dividend payout ratio of 50%), risks to yields are high in view of further negative earnings surprises. Turnaround in earnings will hinge on a pick-up in new membership additions in the MLM division, which we do not anticipate will happen before 2HFY11.

Fig 1: Quarterly MLM revenue trend



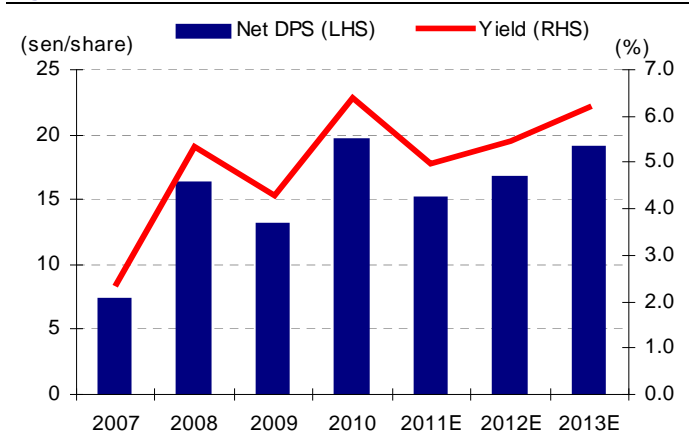
Source: Company

Fig 2: Breakdown of revenue (FY04/10)



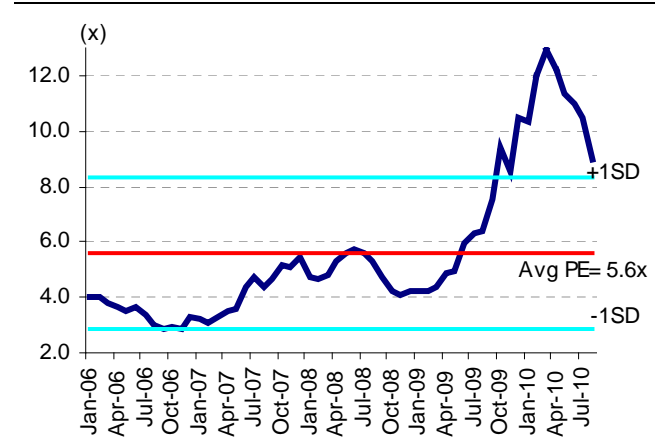
Source: Company, Affin

Fig 3: Net dividend trend



Source: Company, Affin

Fig 4: Rolling 1-year forward P/E



Source: Bloomberg, Affin

Fig 5: MLM peers comparison table

	Rating	Sh Pr (RM)	TP (RM)	Market Cap (RMm)	P/BV (x)		PER (x)		EPS Growth (%)		ROE (%)		P/NTA (x)	Dividend Yield (%)	
					Pros+1	Pros+2	Pros+1	Pros+2	Pros+1	Pros+2	Pros+1	Pros+2		Pros+1	Pros+2
Malaysia															
HAI-O	SELL	3.07	2.71	620.7	2.8	2.6	12.1	11.0	(27.5)	10.1	23.2	23.1	2.9	5.0	5.5
AMWAY	NR	8.00	na	1,315.1	5.5	5.4	15.8	14.9	4.1	5.9	32.4	34.8	5.8	6.2	6.4
ZHULIAN	NR	1.85	na	851.0	2.4	2.1	9.1	8.2	(11.7)	10.8	26.2	na	2.7	6.4	6.8
Simple average					3.6	3.4	12.3	11.4	(11.7)	9.0	27.2	29.0	2.7	5.8	6.2

Source: Affin, Bloomberg

Fig 6: Consumer peers comparison table

Stock	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x)		EPS growth (%)		EV/EBITDA (x)	P/B (x)	ROE (%)		Net Div. Yield (%)	
						Pros1	Pros2	Pros1	Pros2			Pros1	Pros2	Pros1	Pros2
AEON	BUY	5.50	6.36	1,931	Dec	10.5	9.9	37.5	5.8	3.9	1.7	17.3	16.0	2.0	2.0
BAT	REDUCE	47.88	45.02	13,671	Dec	18.2	17.8	-2.5	2.1	12.6	131.8	157.2	139.6	4.9	5.0
BONIA	BUY	1.73	1.87	349	Jun	8.9	7.6	35.7	17.1	3.5	1.5	17.9	18.2	2.5	3.1
CARLSBERG	BUY	5.42	6.18	1,670	Dec	12.4	11.8	75.1	5.4	7.7	5.8	23.8	21.9	3.9	4.2
GUINNESS	ADD	8.73	9.09	2,637	Jun	15.8	14.9	9.4	6.0	9.2	5.4	34.3	34.0	5.2	5.4
HAI-O	SELL	3.07	2.71	621	Apr	12.1	11.0	-27.5	10.1	7.0	2.8	23.2	23.1	5.0	5.5
JTI	ADD	5.88	6.16	1,538	Dec	12.8	12.4	10.7	3.9	7.1	4.1	34.9	31.2	3.8	3.8
Simple average						13.0	12.2	19.8	7.2	7.3	21.8	44.1	40.6	3.9	4.2

Source: Affin, Bloomberg

Financial Summary – Hai-O Enterprise

Profit & Loss Statement

FYE30 April (RMm)	2009	2010	2011E	2012E	2013E
Revenue	435.2	511.1	431.2	473.1	506.1
Operating expenses	-358.2	-414.3	-356.1	-391.0	-413.3
EBITDA	77.0	96.8	75.1	82.2	92.8
Depreciation	-2.5	-4.1	-4.4	-4.6	-4.8
EBIT	74.5	96.8	70.7	77.6	88.0
Net int income/(expense)	-1.2	-0.8	-0.9	-0.7	-0.6
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Pretax profit	75.9	95.9	69.8	76.9	87.4
Tax	-22.9	-23.8	-17.5	-19.2	-21.9
Minority interest	-0.7	-1.3	-0.9	-1.0	-1.2
Net profit	52.3	70.9	51.4	56.6	64.4

Balance Sheet Statement

FYE30 April (RMm)	2009	2010	2011E	2012E	2013E
Fixed assets	59.4	60.9	62.0	62.9	63.6
Other long term assets	34.7	34.2	33.9	33.4	32.9
Total non-current assets	94.2	95.1	95.9	96.4	96.6
Cash and equivalents	50.7	70.9	101.0	121.9	148.2
Stocks	36.2	44.0	37.2	41.1	44.6
Debtors	36.3	19.9	35.9	39.4	42.2
Other current assets	30.8	49.2	49.2	49.2	49.2
Total current assets	154.0	184.0	223.4	251.6	284.2
Creditors	47.1	32.4	48.4	53.4	57.9
Short term borrowings	3.7	4.8	3.4	2.3	1.6
Other current liabilities	9.5	12.1	12.1	12.1	12.1
Total current liabilities	60.4	49.3	63.8	67.9	71.7
Long term borrowings	15.7	13.2	11.2	9.5	8.1
Other long term liabilities	0.1	0.0	0.0	0.0	0.0
Total long term liabilities	15.8	13.2	11.3	9.6	8.1
Shareholders' Funds	165.7	209.2	233.8	256.5	282.2
Minority interest	6.3	7.4	8.3	9.4	10.5

*Changes in accounting policies to FRS 134

Cash Flow Statement

FYE30 April (RMm)	2009	2010	2011E	2012E	2013E
EBIT	74.5	96.8	70.7	77.6	88.0
Depreciation & amortisation	2.6	3.0	4.4	4.6	4.8
Working capital changes	-3.3	-6.2	6.7	-2.3	-1.7
Cash tax paid	-24.5	-24.6	-17.5	-19.2	-21.9
Others	4.1	0.0	18.1	15.5	16.8
Cashflow from operation	53.4	68.9	82.4	76.1	86.1
Capex	-26.9	-20.5	-20.5	-20.5	-20.5
Others	-14.8	0.7	0.0	0.0	0.0
Cash flow from investing	-41.8	-19.8	-20.5	-20.5	-20.5
Debt raised/(repaid)	-1.3	-0.8	-0.9	-0.7	-0.6
Dividends paid	-26.3	-26.4	-30.9	-34.0	-38.6
Others	-6.7	-1.7	0.0	0.0	0.0
Cash flow from financing	-34.3	-28.9	-31.7	-34.7	-39.2
Free Cash Flow	26.5	48.4	61.8	55.5	65.5

Source: Company data and Affin Investment Bank estimates

Key Financial Ratios and Margins

FYE 30 April (RMm)	2009	2010	2011E	2012E	2013E
Growth					
Revenue (%)	16.4	17.4	-15.6	9.7	7.0
EBITDA (%)	13.1	25.6	-22.4	9.5	13.0
Core net profit (%)	7.7	35.6	-27.5	10.1	13.7
Profitability					
EBITDA margin (%)	17.7	18.9	17.4	17.4	18.3
PBT margin (%)	17.4	18.8	16.2	16.2	17.3
Net profit margin (%)	12.0	13.9	11.9	12.0	12.7
Effective tax rate (%)	30	25	25	25	25
ROA (%)	18.5	18.5	18.5	18.5	18.5
Core ROE (%)	23.9	23.9	23.9	23.9	23.9
ROCE (%)	31.4	31.4	31.4	31.4	31.4
Dividend payout ratio (%)	67.8	74.8	60.0	60.0	60.0
Liquidity					
Current ratio (x)	2.6	3.7	3.5	3.7	4.0
Op. cash flow (RMm)	53.4	68.9	82.4	76.1	86.1
Free cashflow (RMm)	26.5	48.4	61.8	55.5	65.5
FCF/share (sen)	13.1	23.9	30.5	27.4	32.3
Asset management					
Debtors turnover (days)	28.6	28.6	28.6	28.6	28.6
Stock turnover (days)	44.6	44.6	44.6	44.6	44.6
Creditors turnover (days)	9.7	9.7	9.7	9.7	9.7
Capital structure					
Net gearing (%)	net cash	net cash	net cash	net cash	net cash
Interest cover (x)	173.9	66.7	117.2	87.4	117.3

Quarterly Profit & Loss

FYE 30 April (RMm)	1Q10	2Q10	3Q10	4Q10	1Q11
Revenue	148.6	132.4	131.3	98.8	54.8
Operating expenses	-122.3	-103.7	-106.1	-83.1	-43.9
EBITDA	26.3	28.7	25.2	15.8	10.8
Depreciation	0.0	0.0	0.0	0.0	0.0
EBIT	26.3	28.7	25.2	15.8	10.8
Net int income/(expense)	0.0	-0.1	0.0	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	0.0
Pretax profit	26.3	28.6	25.2	15.8	10.8
Tax	-7.8	-8.2	-7.0	-0.8	-2.9
Minority interest	-0.1	-0.3	-0.2	-0.7	-0.1
Net profit	18.5	20.2	18.0	14.3	7.8
Core net profit	18.5	20.2	18.0	14.3	7.8
Margins (%)					
EBITDA	17.7	21.7	19.2	16.0	19.7
PBT	17.7	21.6	19.2	16.0	19.7
Net profit	12.4	15.2	13.7	14.4	14.3

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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Affin Investment Bank Bhd (9999-V)
A Participating Organisation of Bursa Malaysia
Securities Bhd

www.affininvestmentbank.com.my

Email : research@affinsecurities.com.my

Tel : 603-2143 8668

Fax : 603-2145 3005