

Company Update

Hai-O Ent

HAIO MK
RM3.85

ADD (downgrade)

Target Price: RM4.45 (↓)



Price Performance

	1M	3M	12M
Absolute	-0.8%	-13.2%	+106.4%
Rel to KLCI	-5.0%	-13.6%	+67.5%

Stock Data

Issued shares (m)	202.2
Mkt cap (RMm)	782.5
Avg daily vol - 6mth (m)	0.6
52-wk range (RM)	4.93-1.84
Est free float	65.7%
NTA per share (RM) (end-Apr 10)	1.03
P/NTA (x)	4.0
Net cash/debt (RMm) (end-Aor 10)	52.9
ROE (FY11F)	35%
Derivatives	Nil

Key Shareholders

Tan Kai Hee	9.6%
Akintan Sdn Bhd	7.2%

Earnings & Valuation Revisions

	11E	12E	13E
Prev EPS (sen)	47.6	54.2	61.2
Curr EPS (sen)	38.1	42.2	47.0
Chg (%)	-20%	-22%	-23%
Prev target price (RM)		5.34	
Curr target price (RM)		4.45	

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Cleaning up the MLM reputation

Weaker 4QFY04/10 net profit attributed to -31.7% qoq decline in MLM sales

Hai-O hosted an analyst briefing yesterday to discuss its 4QFY04/10 results. To recap, Hai-O reported an unexpectedly weak quarter, with 4QFY04/10 net profit declining -20.8% qoq to RM14.3m. Sequential revenue fell by -47% and -32% in the wholesale and MLM divisions.

Stricter recruitment measures to preserve integrity of MLM industry

The sharp drop in MLM sales was attributed to the company's implementation of more stringent rules on new member recruitment, following the recent tabling of the revised Direct Selling Act. The revised Act prohibits pyramid schemes and unethical direct selling practices, with higher penalties for offenders. While Hai-O's MLM complies with the Act, the company had decided to take certain measures to meet the more stringent guidelines under the new Act. Stricter guidelines have thus been implemented for leaders' recruitment of new members, to ensure that registered members who purchase stocks are genuinely able to sell it. As a result of the increased monitoring and guidelines, new member additions have dropped. Post the implementation of the stricter requirements in March 2010, average new members per month have fallen to 3,000, from 5,000 previously.

Strategies in place to mitigate fewer new member additions

Fewer new member additions, as well as the termination of certain non-active or non-compliant members, would reduce the growth in Hai-O's distributor force. Management plans to mitigate the effect by increasing the percentage of active distributors (typically c. 15-20% of total distributors). Among strategies to be adopted are: 1) introducing a wider range of new products (including a high value product, akin to the Bio Aura water filter) and improving product mix; 2) increasing motivational training for members, and; 3) increased A&P activities. Nevertheless, we believe performance from the MLM division will remain weak in the next few quarters, as leaders adjust to the new recruitment guidelines.

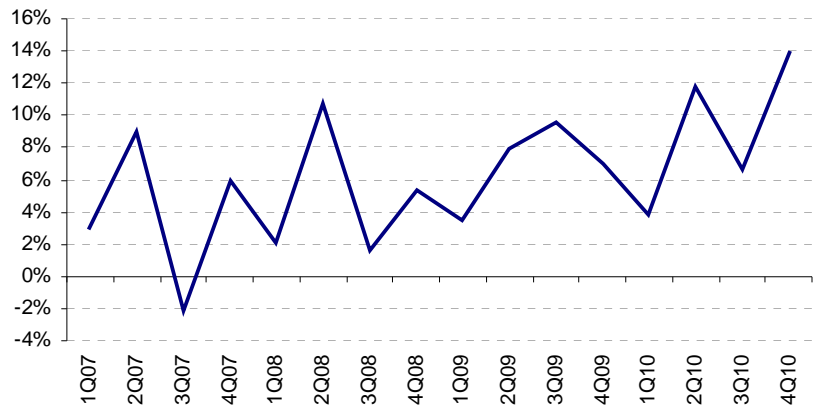
Retail division coming to prominence

Meanwhile, Hai-O's retail division continues to show increasing promise. The retail division recorded its highest ever revenue of RM13.8m in 4QFY04/10, while EBIT margin soared from 6.6% in 3QFY04/10 to 13.9%. This is attributed to increased sales of Hai-O's higher margin house brand products, which currently account for more than 50% of total retail sales (FY09: 30-40%). Management plans to raise the percentage to 80% in the next few years.

Earnings and valuation summary

FYE 30 April	2009	2010	2011E	2012E	2013E
Revenue (RMm)	435.2	511.1	600.7	666.0	733.9
EBITDA (RMm)	77.0	96.8	110.2	121.3	134.7
Pretax profit (RMm)	75.9	95.9	104.9	116.0	129.3
Net profit (RMm)	52.3	70.9	77.3	85.5	95.2
EPS (sen)	25.8	35.0	38.1	42.2	47.0
EPS growth (%)	7.7	35.6	9.0	10.6	11.4
PER (x)	15.0	11.1	10.2	9.2	8.2
Core net profit (RMm)	52.3	70.9	77.3	85.5	95.2
Core EPS (sen)	25.8	35.0	38.1	42.2	47.0
Core PER (x)	15.0	11.1	10.2	9.2	8.2
GDPS (sen)	32.0	28.5	28.5	32.0	35.0
Dividend Yield (%)	8.3	7.4	7.4	8.3	9.0
EV/EBITDA (x)	9.4	7.1	6.3	5.7	5.2
Consensus profit (RMm)			93.2	106.0	-
Affin/Consensus (x)			0.8	0.8	-

Fig 1: Quarterly retail EBIT margin trend



Source: Affin, Company data

R&D in the technology division producing results

In the technology division, Hai-O Energy, which focuses on high intensity heat transfer technology, has also been active, albeit still in the R&D stage. The company has submitted 7 patents for applications of the heat transfer technology, and has identified and produced prototypes for several different uses such as hot water boilers, heat pipe steam boilers, energy saving lamp posts and solar heat collectors. We have yet to impute any contribution from Hai-O Energy into our forecasts.

Downgrade to ADD, lower TP of RM4.45

As the MLM division accounts for c. 80% of total revenue, we are slicing our FY11-13 net earnings forecasts by 20-23% after adjusting for a lower distributor base and incorporating the weaker 4QFY04/10 results. Rolling forward our valuation window to CY11, our target price is revised downwards to RM4.45 (previously RM5.34) based on a PER of 11x (previously 12x) on CY11 EPS. The lower multiple is in line with industry average. Despite the earnings downgrade, valuations for Hai-O still remain undemanding. Stock is currently trading at CY11 PE of 9.8x (vs consumer sector average of 11.5x). Furthermore, gross dividend yield remains high at 7.4% (vis-à-vis market dividend yield of 3-4%). Key risks to our view are: 1) slow take-off in its Indonesian MLM operations; 2) slowdown in consumer spending from the rollback of subsidies, and; 3) loss of distributors.

Fig 2: Sector earnings & valuation summary

Stock	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x)		EPS growth (%)		EV/EBITDA (x)	P/B (x)	ROE (%)		Div. Yield (%)	
						Pros1	Pros2	Pros1	Pros2			Pros1	Pros2	Pros1	Pros2
AEON	REDUCE*	4.90	4.81	1,720	Dec	12.2	11.4	5.4	6.8	4.1	1.6	13.5	13.1	3.1	3.1
BAT	ADD	44.52	46.32	12,712	Dec	16.9	16.2	0.6	4.6	11.3	123.9	157.6	142.1	5.3	5.6
BONIA	ADD	1.05	1.15	212	Jun	7.0	6.4	27.8	9.1	3.2	1.1	15.4	15.0	2.9	2.9
CARLSBERG	BUY	5.01	5.78	1,543	Dec	13.0	11.9	54.0	9.5	8.1	5.6	21.3	20.7	5.7	5.7
GUINNESS	BUY	7.74	8.87	2,338	Jun	14.9	14.0	10.2	7.0	8.1	5.1	34.5	34.6	5.7	5.7
HAI-O	BUY	3.87	5.34	782	Apr	10.2	9.2	48.3	24.4	6.0	3.4	25.6	27.7	7.4	8.3
JTI	ADD	5.30	5.85	1,386	Dec	12.1	11.4	5.6	6.2	7.1	3.7	33.3	30.2	5.7	5.7
Simple average						12.3	11.5	21.7	9.7	6.8	20.6	43.0	40.5	5.1	5.3

* under review

Source: Affin

Financial Summary – Hai-O Enterprise

Profit & Loss Statement

FYE 30 April (RMm)	2009	2010	2011E	2012E	2013E
Revenue	435.2	511.1	600.7	666.0	733.9
Operating expenses	-358.2	-414.3	-490.5	-544.7	-599.3
EBITDA	77.0	96.8	110.2	121.3	134.7
Depreciation	-2.5	-4.1	-4.4	-4.6	-4.8
EBIT	74.5	96.8	105.8	116.7	129.8
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	104.9	116.0	129.3
Tax	-22.9	-23.8	-26.2	-29.0	-32.3
Minority interest	-0.7	-1.3	-1.4	-1.6	-1.7
Net profit	52.3	70.9	77.3	85.5	95.2

Balance Sheet Statement

FYE 30 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	88.5	103.9	123.9
Stocks	36.2	44.0	51.5	57.6	64.3
Debtors	36.3	19.9	50.0	55.5	61.1
Other current assets	30.8	49.2	49.2	49.2	49.2
Total current assets	154.0	184.0	239.3	266.3	298.6
Creditors	47.1	32.4	67.0	74.9	83.6
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	82.4	89.4	97.3
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	232.8	253.4	277.6
Minority interest	6.3	7.4	8.8	10.4	12.1

*Changes in accounting policies to FRS 134

Cash Flow Statement

FYE 30 April (RMm)	2009	2010	2011E	2012E	2013E
EBIT	74.5	96.8	105.8	116.7	129.8
Depreciation & amortisation	2.6	3.0	4.4	4.6	4.8
Working capital changes	-3.3	-6.2	-3.1	-3.6	-3.7
Cash tax paid	-24.5	-24.6	-26.2	-29.0	-32.3
Others	4.1	0.0	16.0	12.9	13.4
Cashflow from operation	53.4	68.9	96.7	101.5	112.1
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	-57.8	-64.9	-70.9
Others	-6.7	-1.7	0.0	0.0	0.0
Cash flow from financing	-34.3	-28.9	-58.6	-65.6	-71.5
Free Cash Flow	26.5	48.4	76.2	81.0	91.5

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	17.5	10.9	10.2
EBITDA (%)	13.1	25.6	13.9	10.1	11.0
Core net profit (%)	7.7	35.6	9.0	10.6	11.4
Profitability					
EBITDA margin (%)	17.7	18.9	18.3	18.2	18.3
PBT margin (%)	17.4	18.8	17.5	17.4	17.6
Net profit margin (%)	12.0	13.9	12.9	12.8	13.0
Effective tax rate (%)	30	25	25	25	25
ROA (%)	24.5	29.0	25.6	26.0	0.0
Core ROE (%)	34.1	37.8	35.0	35.2	0.0
ROCE (%)	45.0	46.9	44.6	45.5	0.0
Dividend payout ratio (%)	124.0	81.5	74.8	75.9	74.5
Liquidity					
Current ratio (x)	2.6	3.7	2.9	3.0	3.1
Op. cash flow (RMm)	53.4	68.9	96.7	101.5	112.1
Free cashflow (RMm)	26.5	48.4	76.2	81.0	91.5
FCF/share (sen)	13.1	23.9	37.6	40.0	45.1
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	128.2	173.2

Quarterly Profit & Loss

FYE 30 April (RMm)	4Q09	1Q10	2Q10	3Q10	4Q10
Revenue	132.8	148.6	132.4	131.3	98.8
Operating expenses	-109.5	-122.3	-103.7	-106.1	-83.1
EBITDA	23.4	26.3	28.7	25.2	15.8
Depreciation	0.0	0.0	0.0	0.0	0.0
EBIT	23.4	26.3	28.7	25.2	15.8
Net int income/(expense)	-0.1	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	0.0
Pretax profit	23.3	26.3	28.6	25.2	15.8
Tax	-7.4	-7.8	-8.2	-7.0	-0.8
Minority interest	-0.1	-0.1	-0.3	-0.2	-0.7
Net profit	15.8	18.5	20.2	18.0	14.3
Core net profit	15.8	18.5	20.2	18.0	14.3
Margins (%)					
EBITDA	17.6	17.7	21.7	19.2	16.0
PBT	17.5	17.7	21.6	19.2	16.0
Net profit	11.9	12.4	15.2	13.7	14.4

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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