

Corporate Highlights

Briefing Note

Hai-O Enterprise

Short-term Pain For A Longer-Term Sustainable Gain



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

29 June 2010

Share Price : RM3.87
Fair Value : RM4.06
Recom : **Market Perform**
(Maintained)

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
	(RMm)	(RMm)	(sen)	(%)	(x)	(sen)	(x)	(x)	(%)	(%)
2010a	511.1	70.9	35.0	35.4	11.1	-	2.4	Net cash	38.7	6.2
2011f	576.7	75.7	37.3	6.7	10.4	46.0	2.8	Net cash	34.5	6.4
2012f	644.8	85.7	42.3	13.2	9.2	54.0	3.3	Net cash	32.9	7.3
2013f	707.8	94.5	46.6	10.3	8.3	-	3.9	Net cash	30.8	8.0

Main Market Listing / Trustee Stock

* Consensus Based On IBES Estimates

◆ **Stringent ruling, affecting MLM division.** Hai-O has recently complied with a more stringent Direct Selling Act (DSA), which took effect in Apr 10. Coupled with an increasing interest rate environment, management expects this to lead to a slowdown in its membership recruitment drive in the next 3-6 months. The amended DSA requires greater transparency from MLM members and involves additional protocols to comply with, which led to a temporary disruption in the operations of the existing MLM members. This is expected to resume to normal in 6 months. Management does not discount the possibility of members dropping out of the company as a result of the changes, and highlighted that total MLM members may even drop on a yoy basis. We currently project net membership to be 0/mth in FY11 (total FY10 members: 140,000) and net membership growth of 1,000/mth in FY12.

◆ **Putting in efforts to mitigate the negative impact from these ruling.** To mitigate the negative impact from this ruling, management intends to help its current members by: 1) conducting product roadshows and events; 2) providing mentoring, training and support to its members; and 3) introducing a new range of products to appeal to a wider customer base. With this new ruling in place, Hai-O expects to separate members who are dedicated to their business from those who are not, and this could provide a more sustainable earnings platform in the future.

◆ **Maintaining its dividend payout policy.** Despite the short-term bearish outlook for the company, Hai-O has affirmed that it will maintain its net dividend payout policy of 50%. This would translate to net dividend yield of 5-6% for FY11-13.

◆ **Risks.** The risks include: 1) termination of supply agreements from its suppliers in China; 2) stronger-than-expected strengthening of US\$; and (3) weaker-than-expected increase in consumer spending.

◆ **Forecasts.** We have introduced our FY13 numbers into our forecasts.

◆ **Investment case.** We believe that the next two quarters will be critical for Hai-O to test its success in maintaining its current membership base and even attracting new members despite the short-term negative environment. We maintain our **Market Perform** recommendation for the stock with unchanged fair value of RM4.06, based on unchanged 10x CY11 EPS.

Issued Capital (m shares)	202.2
Market Cap (RMm)	782.5
Daily Trading Vol (m shs)	0.6
52wk Price Range (RM)	1.84-4.93

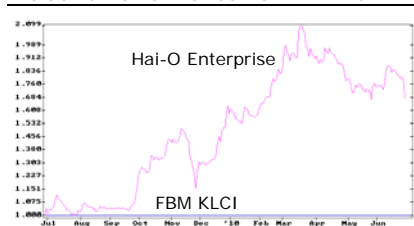
Major Shareholders: (%)
Tan Family 30.0

FYE Apr	FY11	FY12	FY13
EPS chg (%)	-	-	-
Var to Cons (%)	(18.8)	(21.7)	-

PE Band Chart



Relative Performance To FBM KLCI



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Table 2. Earnings Forecasts

FYE Apr (RMm)	FY10a	FY11F	FY12F	FY13F
Turnover	511.1	576.7	644.8	707.8
Wholesale	43.9	46.1	48.4	50.8
MLM	418.1	479.3	542.7	600.8
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
<i>Turnover growth (%)</i>	17.4	12.9	11.8	9.8
Cost of Sales	(311.7)	(357.5)	(398.2)	(429.4)
Gross Profit	199.3	219.2	246.6	278.4
EBITDA	100.4	106.3	119.2	130.6
EBITDA margin (%)	19.6	18.4	18.5	18.4
Depreciation	(4.3)	(4.4)	(4.4)	(4.4)
Net Interest	(0.1)	1.1	1.5	2.2
Associates	0.0	0.0	0.0	0.0
Pretax Profit	95.9	103.0	116.3	128.3
Tax	(23.8)	(25.8)	(29.1)	(32.1)
Minorities	(1.3)	(1.6)	(1.5)	(1.7)
Net Profit	70.9	75.7	85.7	94.5

Table 3. Forecast Assumptions

FYE Apr	FY11F	FY12F	FY13F
Core distributor force (CDF)	140,000	146,000	158,000
Revenue per active member (RM/CDF)	19,468	19,663	19,859
Opening of new retail outlets	3	3	3
Revenue per outlet (RM'000)	643	649	656

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Stock Ratings

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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