

# Corporate Highlights



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

## Results Note

28 June 2010

# Hai-O Enterprise

MLM Division Slows Down

Share Price : RM4.12  
Fair Value : RM4.06  
Recom : **Market Perform**  
(Under Review)

**Table 1 : Investment Statistics (HAI O; Code: 7668) Bloomberg: HAI O MK**

FYE	Revenue (RMm)	Net		Growth (%)	PER (x)	C. EPS * (sen)	P/NTA (x)	Net		
		Profit (RMm)	EPS (sen)					Gearing (x)	ROE (%)	GDY (%)
Apr										
2009a	435.2	52.4	25.8	7.9	15.9	-	2.0	Net cash	34.2	4.2
2010a	511.1	70.3	34.7	34.2	11.9	-	2.4	Net cash	38.1	5.8
2011f	576.7	75.7	37.3	7.6	11.0	46.0	2.9	Net cash	33.7	6.3
2012f	673.5	85.7	42.3	13.3	9.7	54.0	3.5	Net cash	31.8	7.1

Main Market Listing / Trustee Stock \* Consensus Based On IBES Estimates

◆ **In line.** Hai-O's FY04/10 core net profit of RM70.3m (+34.4% yoy) was in line with our but below consensus expectations, accounting for 96% and 92% of our and consensus full year forecasts respectively. In 4Q10, Hai-O proposed a final dividend of 10 sen (less 25% tax) and a single tier dividend of 4.5 sen, bringing FY10 gross dividend to 24.1 sen, which was within expectations. This translates to a net payout of only 52%, in line with company's guidance of 50%.

◆ **QoQ earnings affected by MLM division.** Yoy, full year net profit jumped 34.4%, on the back of a 17.4% increase in revenue (from improvement in all divisions), improved margins (+1.3% EBIT margin) and lower effective tax rate (FY10: 24.9%; FY09: 30.1%). However, 4Q10 net profit fell 20.8% qoq, mainly due to a sharp drop in revenue contribution from the MLM division (> -30%); slightly offset by the lower tax rate during the quarter (4QFY10: 4.9%; 4QFY09: 27.8%).

◆ **MLM division slowing down?** 4Q10 MLM division results came in below management's internal target, due to the company's more stringent rules on new membership recruitment, to be in line with regulations set by the authorities, coupled with a recent hike in interest rates, which affected the growth of new membership recruitment. We had highlighted this earlier in our report dated 21 May 10.

◆ **Cutting MLM division numbers.** The more stringent MLM ruling, we believe, could affect Hai-O's membership recruitment drive for another 3-6 months, which could lower member's productivity and even result to memberships being revoked by the company. Furthermore, as RHBRI's economic team expects another interest rate hike in Sep 10 by another 25bps, we expect this slowdown in membership growth to continue to hamper Hai-O in the near term. However, this will be slightly offset by the launches of another 1-2 key new products and a range of health supplements and skincare products. Following this, we have cut our MLM division's net membership growth to 0/mth (from 1,500) for FY11 and 1,000/mth (from 1,500) for FY12. We have also reduced our revenue/distributor growth to -5% (from flat) in FY11 but maintained it at 1% for FY12.

◆ **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.** Following the above changes and adjusting for FY10 results, our earnings forecasts are reduced by 13-23% for FY11-12.

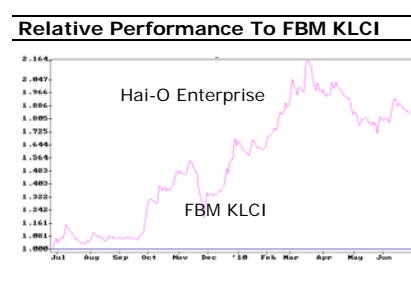
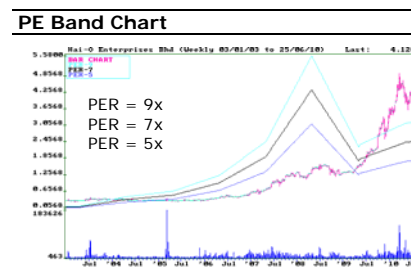
◆ **Investment case.** We roll forward our valuation target to CY11 (from FY11). As such, our fair value has now been reduced to RM4.06 (from RM4.30) based on unchanged 10x CY11 EPS, which is a 30% discount to our consumer sector target PER of 14.5x. Our recommendation for the stock is currently under review pending a company briefing later today.

RHBRI	Vs.	Consensus
✓	Above	
	In Line	
	Below	✓

Issued Capital (m shares)	202.2
Market Cap(RMm)	833.0
Daily Trading Vol (m shs)	0.6
52wk Price Range (RM)	1.84-4.93

<b>Major Shareholders:</b>	<b>(%)</b>
Tan Family	30.0

<b>FYE Apr</b>	<b>FY11</b>	<b>FY12</b>
EPS chg (%)	(13.4)	(23.1)
Var to Cons (%)	(18.9)	(21.7)



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**Table 2: Earnings Reviews (YoY Cumulative)**

FYE Apr (RMm)	4Q09	1Q10	4Q10	QoQ (%)	YoY (%)	FY09	FY10	YoY (%)	Comments
<b>Revenue</b>	132.8	131.3	98.8	(24.7)	(25.6)	435.2	511.1	17.4	Yoy, higher revenue contribution from all divisions.
- Wholesale & Retail	18.9	22.8	24.5	7.4	29.6	81.3	85.7	5.3	Yoy increase due to better sales from wholesale division coupled with increasing no. of retail outlets yoy.
- MLM	112.5	106.2	72.6	(31.7)	(35.5)	348.9	418.1	19.8	Yoy increase in CDF as well as distributor productivity from higher A&P activities. However, qoq drop due to more stringent rules on new members' recruitment coupled with rising interest rate environment, which deterred the growth of new members.
- Other	1.4	2.2	1.7	(21.3)	21.3	5.0	7.4	47.7	Higher rental income.
<b>EBIT</b>	23.0	25.2	15.8	(37.4)	(31.5)	76.1	96.0	26.2	Filtered down from revenue and higher margin (refer to EBIT margin).
Finance cost	(0.1)	0.0	(0.0)	(111.5)	(95.9)	(0.2)	(0.1)	(60.2)	
EI	0.0	0.0	0.0	-	-	0.0	0.6	-	Realisation of exchange fluctuation reserve on disposal of foreign associate amounting to RM624,799.
<b>PBT</b>	23.0	25.2	15.8	(37.5)	(31.3)	75.9	95.9	26.4	
<b>PBT ex-EI</b>	23.0	25.2	15.8	(37.5)	(31.3)	75.9	95.3	25.6	
Taxation	(8.2)	(7.0)	(0.8)	(89.0)	(90.6)	(22.9)	(23.8)	3.9	Refer to effective tax rate.
MI	(0.1)	(0.2)	(0.7)	273.5	1145.0	(0.7)	(1.3)	75.7	
Net profit	14.7	18.0	14.3	(20.8)	(2.8)	52.3	70.9	35.6	
<b>Net profit ex-EI</b>	14.7	18.0	14.3	(20.8)	(2.8)	52.3	70.3	34.4	Filtered down from PBT and lower effective tax rate.
EPS (sen)	7.3	8.9	7.0	(20.8)	(3.6)	25.8	34.7	34.4	
GDPS (sen)	13.1	1.6	16.0	875.8	22.0	17.2	24.1	40.1	Final gross dividend of 10 sen (less 25% tax) and single tier dividend of 4.5 sen was declared during the quarter.
EBIT margin (%)	17.3	19.2	16.0	(3.2)	(1.4)	17.5	18.8	1.3	Higher margin yoy due to company's focus on higher margin product sales.
Adj-PBT margin (%)	17.3	19.2	16.0	(3.3)	(1.3)	17.4	18.7	1.2	
Adj-Net profit margin (%)	11.0	13.7	14.4	0.7	3.4	12.0	13.8	1.7	
Effective tax rate (%)	35.8	27.8	4.9	(22.9)	(30.9)	30.1	24.9	(5.2)	Lower effective tax rate due to certain income not taxable, overprovision of tax expenses in prior years and additional provision of current year tax assets.

Source: Company; RHBRI

**Table 3. Earnings Forecasts**

FYE Apr (RMm)	FY09a	FY10a	FY11F	FY12F
<b>Turnover</b>	<b>435.2</b>	<b>511.1</b>	<b>576.7</b>	<b>673.5</b>
Wholesale	42.2	43.9	46.1	48.4
MLM	348.9	418.1	479.3	571.4
Retail	39.1	41.8	44.3	46.7
Manufacturing	2.5	1.8	3.0	3.5
Other	2.5	5.2	4.0	3.5
<i>Turnover growth (%)</i>	16.4	17.4	12.9	16.8
Cost of Sales	(305.1)	(311.7)	(358.3)	(421.4)
Gross Profit	130.1	199.3	218.4	252.2
<b>EBITDA</b>	<b>78.2</b>	<b>100.4</b>	<b>105.5</b>	<b>118.7</b>
EBITDA margin (%)	18.0	19.6	18.3	17.6
Depreciation	(2.1)	(4.3)	(4.4)	(4.4)
Net Interest	(0.2)	(0.1)	1.1	1.6
Associates	0.0	0.0	0.0	0.0
<b>Pretax Profit</b>	<b>75.9</b>	<b>95.3</b>	<b>102.2</b>	<b>115.9</b>
Tax	(22.8)	(23.8)	(25.6)	(29.0)
Minorities	(0.7)	(1.3)	(1.0)	(1.2)
<b>Net Profit</b>	<b>52.4</b>	<b>70.3</b>	<b>75.7</b>	<b>85.7</b>

**Table 4. Forecast Assumptions**

FYE Apr	FY11F	FY12F
Core distributor force (CDF)	140,000	146,000
Distributor productivity (RM/CDF)	19,468	19,663
Opening of new retail outlets	3	3
Revenue per outlet (RM'000)	643	649

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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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