

Company Update

Hai-O Ent

HAIO MK
RM3.00

BUY (maintain)

Target Price: RM4.24



Price Performance

	1M	3M	12M
Absolute	-11.2%	-2.6%	89.5%
Rel to KLCI	-7.3%	-0.5%	62.8%

Stock Data

Issued shares (m)	82.6
Mkt cap (RMm)	247.7
Avg daily vol - 6mth (m)	0.11
52-wk range (RM)	1.36-3.40
Est free float	50%
NTA per share (RM)	1.46
P/NTA (x)	2.06
Net cash/ (debt) (RMm) (July 07)	68.9
ROE (2008F)	26.5%
Derivatives	Nil

Key Shareholders

Tan family	25.6%
Maybank Smallcap	3.9%

Earnings & Valuation Revisions

	08E	09E	10E
Prev EPS (sen)	37.4	44.1	52.0
Curr EPS (sen)	37.4	45.9	54.9
Chg (%)	-	4.1	5.6
Prev target price (RM)		4.18	
Curr target price (RM)		4.24	

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New contract manufacturing job; raising EPS forecast

Secured 5-year contract manufacturing job worth RM30m

Hai-O's wholly owned unit, SG Global Biotech S/B (formerly known as Hai-O Pharmaceutical (M) S/B) has entered into a 5-year contract manufacturing agreement worth RM30m with PureCircle Sdn Bhd ("PureCircle") to manufacture "Stevia Natural Sweetener" products under the brand name, Greenlite. Greenlite is a natural (as opposed to artificial or chemically synthesized) substitute to sugar with high intensity sweetness (200x sweeter than sugar) and virtually zero calories, and is currently marketed in the Middle East, Russia, US, Canada and SEA. The appointment and engagement of SG Global to manufacture the Stevia tabletop sweeteners is on an exclusive basis for PureCircle.

Background of PureCircle

PureCircle Malaysia (formerly known as Stevia Biotechnology Corporation S/B) is owned by the PureCircle Group, which was listed in London's Alternative Investment Market in 2007. PureCircle is involved in the manufacturing, development and production of natural, high intensity sweetener (HIS) (also known as Rebaudioside-A or "Reb-A") extracted from the Stevia plant, for supply to the global food and beverage, pharmaceutical and chemical industries. The group supplies the calories-free natural sweetener to a number of international food and beverage companies such as Coca-Cola Co. and Cargill Inc.

Pharmaceutical manufacturing division margin is expected to edge up

Management has guided that this contract manufacturing agreement is expected to nudge up the pharmaceutical manufacturing division's PBT margin to 11-13% (previously 9-10%) and boost revenue by 5% over the next 3-5 years. Hai-O is expected to produce 85k tonnes/annum in the first 3 years, and double production to 150k tonnes/annum in subsequent years. The planned capacity expansion could be easily housed at its existing factory (150-200 tonnes/annum). Also, Hai-O has recently purchased a 28-acre piece of land from Bata (M) S/B (near its existing head office and factory in Jalan Kapar, Klang) to build a new pharmaceutical manufacturing plant, warehouse for its Pu-er tea storage and new office. This new plants is scheduled for completion in 2009/10.

Earnings and Valuation Summary

FYE30 April	2005	2006	2007	2008F	2009F	2010F
Revenue (RMm)	141.5	146.8	189.3	256.4	297.4	346.9
EBITDA (RMm)	13.5	17.3	32.6	46.4	55.9	66.2
Pretax profit (RMm)	10.3	15.1	30.6	43.1	52.1	62.7
Net profit (RMm)	5.5	10.2	21.4	30.9	38.2	46.0
EPS (sen)	8.0	12.4	26.0	37.4	45.9	54.9
EPS growth (%)	41.7	55.2	110.0	43.6	22.8	19.7
PER (x)	37.6	24.2	11.5	8.0	6.5	5.5
Core net profit (RMm)	5.5	10.2	21.4	30.9	38.2	46.0
Core EPS (sen)	8.0	12.4	26.0	37.4	45.9	54.9
Core PER (x)	37.6	24.2	11.5	8.0	6.5	5.5
DPS (sen)	5.0	6.7	15.1	19.2	22.4	27.2
Dividend Yield (%)	1.7	2.2	5.0	6.4	7.5	9.1
EV/EBITDA (x)	15.1	13.9	6.7	4.7	3.5	2.6
Census profit (RMm)				26.6	31.4	43.5
Affin/Census (x)				1.2	1.2	1.1

FY09-10 earnings upgraded by 4-6%; 3-year CY07-10 EPS CAGR of 34%

Given the new contract manufacturing agreement and also upping our pharmaceutical division margin to 11-13% (from 9-10% previously), we have upgraded our FY09-FY10 EPS forecast by 4-6%. The revised earnings yield a strong 3-year CY07-10 EPS CAGR of 34%. Our earnings model imputes a fairly flat albeit marginal improvement in EBITDA margin to 18.7% in FY09 and 19.1% in FY10.

Maintain BUY with an upgraded target price of RM4.24

In tandem with our earnings upgrade, we have raised our target price to RM4.24 (previously RM4.18) based on SOP. We continue to like Hai-O for its: 1) fast expanding MLM division, 2) robust 3-year EPS CAGR of 34% over CY07-10; 3) highly attractive valuations – CY08 PE of 8.9x, and 4) highly attractive FY08-10 dividend yields of 6%-9%.

Fig 1: Sum-of-parts valuation

Divisions	CY08 net profit	Applied PER (x)	Value RM'm	Comments
MLM	19.9	9	179.1	Target PER at a 10% discount to MLM average
Retail	1.8	9	17.0	Retail franchise PERs range from 11x-20x
Wholesale	12.3	7	86.4	Fair PER for a fairly stable business
Manufacturing	0.8	9	7.2	Regional pharmaceutical companies trade between 9x-44x
Others	2.1	4	8.3	Reasonable for its traditional Chinese clinics
Net cash/debt			52.6	
			<u>350.5</u>	
No of shares (m)			82.7	
SOP/share			4.24	

Hai-O Enterprise - Financial Summary

Profit & Loss Statement

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
Revenue	146.8	189.3	256.4	297.4	346.9
Operating expenses	-129.5	-156.7	-210.0	-241.5	-280.7
EBITDA	17.3	32.6	46.4	55.9	66.2
Depreciation	-1.9	-1.8	-3.2	-4.1	-4.2
EBIT	15.1	30.5	43.1	51.7	61.9
Net int income/(expense)	0.1	0.1	0.1	0.4	0.8
Associates' contribution	-0.1	0.0	0.0	0.0	0.0
Pretax profit	15.1	30.6	43.1	52.1	62.7
Tax	-4.3	-8.5	-11.2	-13.0	-15.7
Minority interest	-0.6	-0.7	-1.0	-0.9	-1.1
Net profit	10.2	21.4	30.9	38.2	46.0

Balance Sheet Statement

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
Fixed assets	22.2	22.0	48.2	47.0	45.7
Other long term assets	31.9	31.7	31.8	31.7	31.7
Total non-current assets	54.1	53.8	80.0	78.8	77.4
Cash and equivalents	4.4	16.9	21.6	41.7	65.3
Stocks	28.5	33.9	36.6	42.5	49.6
Debtors	22.3	14.8	23.3	28.6	33.4
Other current assets	16.3	29.6	18.6	18.6	18.6
Total current assets	71.6	95.2	100.1	131.5	166.8
Creditors	23.1	21.6	29.6	34.3	39.4
Short term borrowings	4.4	7.4	7.8	7.4	7.4
Other current liabilities	4.0	9.0	10.6	11.5	12.8
Total current liabilities	31.6	38.0	48.0	53.2	59.7
Long term borrowings	0.1	0.0	0.0	0.0	0.0
Other long term liabilities	0.0	0.1	0.1	0.1	0.1
Total long term liabilities	0.1	0.1	0.1	0.1	0.1
Shareholders' Funds	89.4	105.7	127.2	152.5	180.5
Minority interest	4.6	5.2	4.8	4.5	4.0

*Changes in accounting policies to FRS 34

Cash Flow Statement

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
EBIT	15.1	30.5	43.1	51.7	61.9
Depreciation & amortisation	2.2	2.1	3.3	4.2	4.3
Working capital changes	-10.3	-7.6	9.4	-5.6	-5.4
Cash tax paid	-4.3	-8.5	-11.2	-13.0	-15.7
Others	8.9	11.3	-14.0	-3.6	-7.0
Cashflow from operation	11.5	27.8	30.6	33.6	38.2
Capex	-1.9	-1.9	-29.0	-2.5	-2.5
Others	-9.9	-9.1	0.0	0.0	0.0
Cash flow from investing	-11.9	-11.0	-29.0	-2.5	-2.5
Debt raised/(repaid)	-1.2	2.8	0.4	-0.4	0.0
Dividends paid	-2.7	-7.1	-7.6	-11.4	-13.4
Others	-2.8	-5.5	-0.5	0.9	1.3
Cash flow from financing	-6.6	-9.8	-7.7	-11.0	-12.1
Free Cash Flow	9.6	25.9	1.6	31.1	35.7

Key Financial Ratios and Margins

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
Growth					
Revenue (%)	3.7	29.0	35.4	16.0	16.6
EBITDA (%)	28.3	89.1	42.1	20.4	18.5
Core net profit (%)	84.9	110.0	44.5	23.5	20.4
Profitability					
EBITDA margin (%)	11.8	17.2	18.1	18.8	19.1
PBT margin (%)	10.3	16.2	16.8	17.5	18.1
Net profit margin (%)	6.9	11.3	12.1	12.8	13.2
Effective tax rate (%)	28.8	27.8	26.0	25.0	25.0
ROA (%)	10.9	18.2	20.8	21.4	21.6
Core ROE (%)	11.9	21.9	26.5	27.3	27.6
ROCE (%)	16.6	29.5	34.7	35.1	35.6
Dividend payout ratio (%)	45.5	58.1	51.4	48.8	49.6
Liquidity					
Current ratio (x)	2.3	2.5	2.1	2.5	2.8
Op. cash flow (RMm)	11.5	27.8	30.6	33.6	38.2
Free cashflow (RMm)	9.6	25.9	1.6	31.1	35.7
FCF/share (sen)	11.6	31.5	1.9	37.4	42.6
Asset management					
Debtors turnover (days)	46.2	36.7	36.9	38.1	35.1
Stock turnover (days)	75.6	72.7	61.3	59.8	59.8
Creditors turnover (days)	63.0	52.0	44.5	48.3	47.9
Capital structure					
Net gearing (%)	net cash	net cash	net cash	net cash	net cash
Interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.

Quarterly Profit & Loss

FYE 30 April (RMm)	1Q07	2Q07	3Q07	4Q07	1Q08
Revenue	39.4	41.9	51.4	56.7	59.3
Operating expenses	-33.6	-34.7	-43.9	-46.7	-49.5
EBITDA	5.8	7.2	7.5	10.1	9.8
Depreciation	0.0	0.0	0.0	0.0	0.0
EBIT	5.8	7.2	7.5	10.1	9.8
Net int income/(expense)	0.0	0.0	0.0	0.1	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	5.8	7.2	7.5	10.2	9.8
Tax	-1.8	-2.0	-2.3	-2.4	-2.9
Minority interest	-0.4	-0.2	-0.3	0.0	0.1
Net profit	3.5	4.9	5.0	7.8	7.1
Core net profit	3.5	4.9	5.0	7.8	7.1
Margins (%)					
EBITDA	14.7	17.2	14.6	17.7	16.5
PBT	14.6	17.1	14.6	18.0	16.6
Net profit	9.0	11.8	9.7	13.7	11.9

Source: Company data and Affin Investment Bank estimates

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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