



**CONSUMER**

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**Stock Profile/Statistics**

Bloomberg Ticker	HAI0 MK Equity
KLCI	1351.45
Issued Share Capital (m)	68.81
Market Capitalisation (RMm)	155.52
52 week H   L Price (RM)	2.30   1.27
Average Volume (3m) '000	114.14
YTD Returns (%)	0.49
Net gearing (x)	(0.17)
Altman Z-Score	4.08
ROCE/WACC	1.23
Beta (x)	1.06
Book Value/share (RM)	1.36

**Major Shareholders (%)**

Tan Kai Hee & Family	22.9
Excellent Communication SB	5.3

**Share Performance (%)**

Month	Absolute	Relative
1m	13.00	5.18
3m	21.78	6.28
6m	59.30	12.59
12m	74.09	15.39

**6-month Share Price Performance**



**Company Update**

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**Hai-O Enterprise**

<b>BUY</b>	<b>Maintain</b>
<b>Price</b>	<b>RM2.26</b>
<b>Target</b>	<b>RM2.86</b>

**Higher Salary Higher Earnings**

We believe the imminent salary revision for the civil servant will have a significant effect on Hai-O's earnings from the anticipated increase in overall consumer spending power. It is worthwhile to note that the bumiputra segment comprises to 90% of the company's MLM division. Furthermore, the MOU with Golden Hope Plantations to market Tri E in China will enhance FY08 earnings and the strengthening of Ringgit against the US\$ provides huge advantage for Hai-O as it increases the group's margins from lower imported costs. We upgraded our earnings estimate hence revising our target price up from RM2.33 to RM2.86 and maintaining our BUY call on the stock.

**Impending civil servants pay rise a boost.** As 90% of Hai-O's MLM products are sold to the bumiputra community, we foresee the impending pay rise for the civil servant as recommended by the Prime Minister will have a significant increase in MLM sales

**Venturing into China market.** In April 2007 Hai-O had entered into a Memorandum of Understanding (MOU) with Golden Hope Plantations, whereby Hai-O was granted the exclusive right as its distributor of "Tri E" (a soft-gel capsule of vitamin E extract from palm oil) in China. Currently Hai-O is in talk with several retailers which have wide distribution network in China and expect Tri E to have a significant impact on FY08 earnings.

**Strengthening Ringgit beneficial to the company.** Imports account for 60% of the group's total purchases thus the appreciation in Ringgit, would definitely boost Hai-O's gross profit margin. Based on our estimates, for every 1% appreciation in Ringgit, Hai-O's gross profit margin will increase by 0.3%-0.4%.

**Strong earnings and dividend.** We expect Hai-O to register net earnings of RM16.9m and RM19.8m for FY07 and FY08 respectively. Net earnings growth is expected to be around **32% CAGR** from FY06-FY09. We expect the company to pay dividend of 18 sen per share translating into yield of 8.0% based on the current share price.

**Maintain BUY.** We are revising our fair value from RM2.33 to RM2.86 by applying the composite average of 10x PER over FY08 EPS of 29.5 sen, P/BV of 1.7x and Gordon Growth model. We maintain our BUY recommendation on the stock. Hai-O has promised to pay at least 50% of net profit as dividend to shareholders. For FY07, we expect the company to pay dividend of 18 sen per share translating into yield of 8%.

FYE Apr (RMm)	FY04	FY05	FY06	FY07f	FY08f
Total revenue	119.5	139.3	144.3	170.8	190.7
EBITDA	8.5	12.8	17.1	25.5	30.1
Pretax profit	6.4	10.3	15.1	25.6	30.0
Net Profit	3.9	5.5	10.2	16.9	19.8
% chg YoY	295.9	41.6	84.9	66.2	17.1
EPS (sen)	5.8	8.2	15.1	25.2	29.5
Gross DPS (sen)	2.1	2.5	8.0	18.0	21.0
Gross Div Yield (%)	0.9	1.1	3.6	8.0	9.3
PER (x)	38.9	27.5	14.9	8.9	7.6
BV/ share	1.2	1.2	1.3	1.4	1.6
P/BV	1.9	1.9	1.7	1.6	1.4

## KEY HIGHLIGHTS

### BACKGROUND

**Long establishment.** Hai-O is a famous household name offering a wide range of Chinese medicines, medicated wines and health care products since 1975. The company was successfully listed on the Bursa Malaysia in 1996, being the first traditional healthcare company on the stock exchange. The principal business of the company involves **wholesaling, retailing, multi-level marketing (MLM), pharmaceutical factory** and **modern Chinese Medicinal Clinics**. For the past three decades, Hai-O had honed its expertise by building extensive and efficient distribution network and strong marketing strategies.

### DIVERSIFIED SOURCES OF INCOME

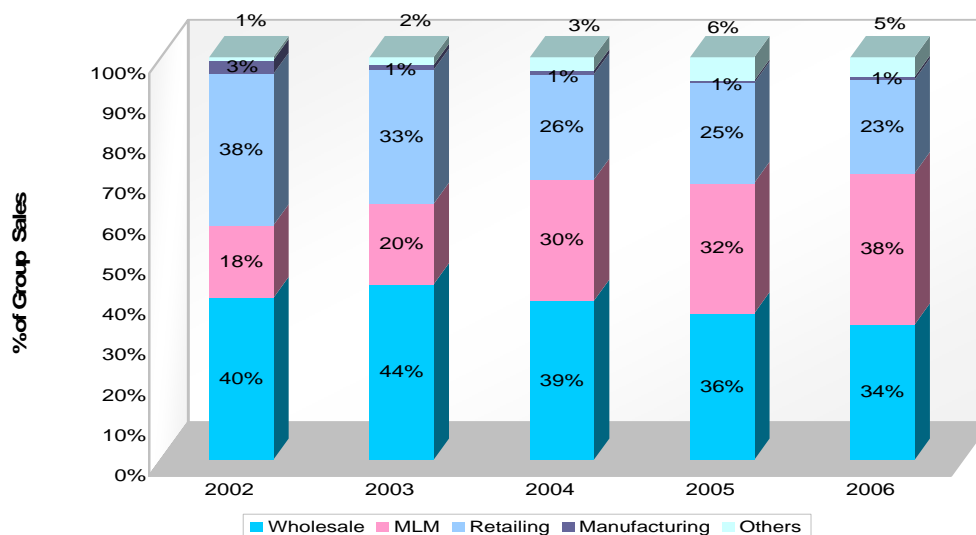
**Manufacturing.** Hai-O Pharmaceutical factory was established in 1994 with the technological support and know-how transfer from China. The products consists of two main lines namely traditional pharmaceutical products and food supplementary products under Hai-O's own brand names, "Hai-O" and "Seagull" approved by Drug Control Authority of the Health Ministry.

**Wholesale.** The wholesale division has more than 100 wholesalers and 3,000 retailers including Chinese Medical Halls nationwide carrying more than 200 brands of renowned Chinese medicines, wines, tea and healthcare products. This would be the pillar of growth as it forms part of the Group's "Golden Triangle" strategy to focus on tea, traditional medicines and wine.

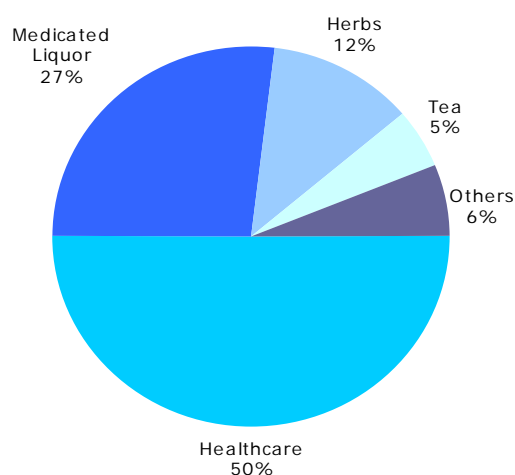
**Retail.** The retail division accounted for 23% of FY06 revenue. Currently there are 54 outlets, including 15 franchise shops and online E-Store. Hai-O Raya Customer Loyalty Program currently has more than 120,000 members.

**Multi-Level-Marketing (MLM).** MLM is the fastest growing division within the Group with CAGR of more than 40% in the past 3 years and is currently contributing about 38% to the Group's total turnover. Currently 90% of MLM sales are purchased by the Bumiputra community.

Figure 1: Segmental breakdown



Source: Company

**Figure 2: Sales mix**

Source: Company

## EARNINGS DRIVERS

**Boost from civil servant pay rise.** The salary revision as recommended will raise the disposable income of civil servants which in turn may increase consumer spending and its contribution to the GDP growth. According to our economist, the 2007 GDP growth may rise to 6.4% from 6.2% for this year and to 6.8% from 6.3% for 2008. Using the Marginal Propensity to Consume (MPC) ratio 0.45 in 2006 and an import leakage assumption of 10%, the salary revision could generate an additional RM2.7bn of consumer spending per annum. The additional consumption could lift private consumption growth by 0.5ppt and 1ppt respectively in 2007 and 2008. After applying the respective deflators, the entire salary revision scheme will contribute an additional 0.2ppt and 0.5ppt respectively to real GDP growth in 2007 and 2008. Moreover, the halal certification on selected products enables Hai-O to have an edge over other Chinese traditional medicine and supplements products sellers to tap into the Malay market in Malaysia and 90% of its products channelled through MLM are purchased by the Malay community. We expect this would be the right timing for Hai-O to boost its MLM sales.

**MOU with Golden Hope.** In April 2007 Hai-O had entered into a Memorandum of Understanding (MOU) with Golden Hope Plantations, whereby Hai-O was granted the exclusive right as its distributor of "Tri E" (a soft-gel capsule of vitamin E extract from palm oil) in China. Currently Hai-O is in talk with several retailers which have wide distribution over China and we expect Tri E will have a significant impact in FY08 earnings.

**Strengthening Ringgit, an advantage.** The strengthening of the Ringgit against the US\$ have contributed in reducing imported costs as 60% of the group's total purchases are imported, hence improving overall profit margin of the Group. Based on our estimates, every 1% appreciation in Ringgit, Hai-O's gross profit margin will increase by 0.3%-0.4%. From May 2006 till April 2007, Ringgit has strengthened by about 5% against the US\$, gross profit margin should improve by around 1.9% or more than RM3.3m which is about 20% of the group's net profit. For FY08, we expect Ringgit to trade at average RM3.25/US\$ and this would provide additional gain for Hai-O's profit margin.

**Various promotions.** Hai-O has participated in various exhibitions in Malaysia and overseas to promote its product. To further Improve market share, the group will penetrate the English-educated society through internet promotions and advertisements in English dailies. According to the management, in FY08 Hai-O will be more aggressive in promotions and advertisement throughout the country and in anticipation of the Beijing 2008 Olympics, Hai-O has and will organise various activities with China branded products as the main theme.

**Promoting “Pu-Er” tea as its growth driver.** “Pu-Er” tea is a premium grade of tea which has health benefits and the only tea which increase in investment value over time. Hai-O has secured the sole distributorship of “Pu-Er” tea from several established “Pu-Er” producer in Yunnan Province. The group has made Pu-Er tea one of its core products and plans to expand its business of this unique tea in the next few years. For FY06, Pu-Er tea has contributed approximately 10% of the group’s total PBT.

## FINANCIALS

**Earnings forecast revised.** With the boost from higher salary from civil servant, distributorship of Tri E in China; and strengthening of the Ringgit, we are increasing our FY07 and FY08 earnings forecast from RM16m and RM17.2m to RM16.9m (+5.6%) and RM19.8m (+15.1%) respectively.

**Attractive dividend payout.** Hai-O has planned to pay at least 50% of net profit as dividend to shareholders going forward. For FY07, we expect the company to pay dividend of 18 sen per share translating into gross yield of 8%.

**Maintain BUY.** We are revising our fair value from RM2.33 to RM2.86 by applying the composite average of 10x PER over FY08 EPS of 29.5 sen, P/BV of 1.7x and Gordon Growth model. We reiterate our **BUY** recommendation on the stock.

**Figure 3: Valuation parameters**

Valuation	Price
NTA/share	2.74
PER	2.95
Gordon growth model	2.91
<b>Average</b>	<b>2.86</b>

Source: OSK Research

FYE Apr (RMm)	FY04	FY05	FY06	FY07f	FY08f
Turnover	119.5	139.3	144.3	170.8	190.7
EBITDA	8.5	12.8	17.1	25.5	30.1
PBT	6.4	10.3	15.1	25.6	30.0
Net Profit	3.9	5.5	10.2	16.9	19.8
EPS (sen)	5.8	8.2	15.1	25.2	29.5
DPS (sen)	2.1	2.5	8.0	18.0	21.0
Margin					
EBITDA	7.1%	9.2%	11.8%	15.0%	15.8%
PBT	5.3%	7.4%	10.5%	15.0%	15.7%
Net Profit	3.3%	4.0%	7.1%	9.9%	10.4%
ROE	4.8%	6.8%	11.9%	18.0%	19.1%
ROA	3.6%	4.8%	8.4%	12.4%	12.6%
Balance Sheet					
Fixed Assets	54.4	53.2	54.6	54.9	54.8
Current Assets	55.5	64.5	70.6	100.6	118.0
Total Assets	109.9	117.7	125.2	148.5	165.9
Current Liabilities	24.6	31.0	31.1	45.3	52.9
Net Current Assets	30.9	33.6	39.4	55.3	65.1
LT Liabilities	0.4	0.2	0.0	0.0	0.0
Shareholders Funds	80.6	81.9	89.4	98.8	108.4
Net Gearing (%)	net cash	net cash	net cash	net cash	net cash

**OSK Research Guide to Investment Ratings****Buy:** Share price may exceed 10% over the next 12 months**Trading Buy:** Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain**Neutral:** Share price may fall within the range of +/- 10% over the next 12 months**Take Profit:** Target price has been attained. Look to accumulate at lower levels**Sell:** Share price may fall by more than 10% over the next 12 months**Not Rated:** Stock is not within regular research coverage

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