

## Hai-O Enterprise Bhd

17 July 2006

Analyst: Teo Yin Zhi  
+603 7729 2425 Ext 401  
yzteo@sbbsec.com.my

### BUY

KLCI	913.63
Share Price	RM1.39
New 12-mth Target	RM1.73
Prev. 12-mth Target	RM1.45
Prev. Rec.	-
Upside To Target	24.5%

### Stock Codes

Bloomberg	HAIO MK
BMSB	HAIO/7668

### Stock and Market Data

Listing	Second Board
Syariah Compliance	No
Shares In Issue @ RM1.00	66.678m
Market Cap	RM92.71m
3M Ave Daily Vol	85,555
Est. Free Float	40%
52 Week Hi/Lo	RM1.55/RM0.87

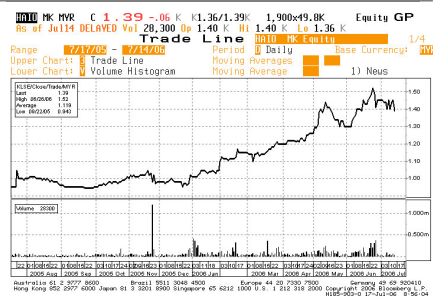
### Fundamentals – FY07F

ROE	12.1%
Net cash	RM15.0m
Free Cash Flow	RM9.8m
Tax Rate	30.0%

### Shareholders

Tan Kai Hee & Family	21.5%
Excellent Communication Sdn Bhd	5.4%

### 1-Year Share Price Chart



Source: Bloomberg

Share Performance	1M	3M	12M
Absolute	0.0%	15.6%	54.5%
Relative to KLCI	-3.2%	13.9%	50.6%

## Soaring like a 'hai-o'...

- BUY maintained.** Ascribing a 9.8x forward PER to CY06 EPS of 17.6sen, we arrive at a new target price of RM1.73 for Hai-O (means seagull in Mandarin), reflecting an upside potential of 24.5% from its current price of RM1.39.
- Divestment of non-core businesses a blessing.** Management has divested its non-core businesses. Without these loss-making units, we believe that Hai-O is able to achieve a net profit growth of 23.6% to RM12.2m or EPS of 18.5sen for FY07F.
- Charging ahead in the MLM business.** Despite stiff competition in the MLM business, we are confident that Hai-O will continue to soar ahead in its MLM division. This is attributable to its quality range of merchandise as well as high payout rate for its distributors, which in turn will motivate individuals to boost sales.
- Rewarding shareholders.** On 7 March 2006, Hai-O rewarded shareholders 1 share dividend for every 20 ordinary shares held. An upward dividend trend is observed from FY03 to FY06, ie from 4 sen to 8 sen. Hai-O's dividend payout policy of at least 50% garnered for the year shows its commitment in rewarding shareholders. We anticipate a GDPS of 10sen for FY07, translating into a dividend yield of 6.9% based on current price of RM1.45.
- Going forward.** Going forward, we anticipate a minimum 10%-15% growth for Hai-O in the next couple of years. Much attention has been given to the benefits of consuming traditional medications and food supplements recently. We expect consumers to turn to well-established brands such as Hai-O for quality and genuine products. Hence, we are optimistic on the earnings growth prospects of Hai-O, especially if its planned venture into the Middle East, Indonesia and Singapore market turns out successfully.

### EARNINGS & VALUATION PROFILE

FYE 30 Apr (RM'mil)	FY03	FY04	FY05	FY06	FY07F
Revenue	89.0	119.5	139.3	144.3	151.5
Growth	6.2%	34.3%	16.6%	3.6%	5.0%
EBIT	4.2	6.7	10.7	15.9	18.4
Growth	2.5%	59.7%	59.4%	48.3%	16.0%
Margin	4.7%	5.6%	7.7%	11.0%	12.2%
PBT	3.5	6.4	10.3	15.7	18.3
Growth	45.3%	83.7%	61.5%	52.6%	16.5%
Margin	3.9%	5.3%	7.4%	10.9%	12.1%
Net profit	1.0	3.9	5.5	9.9	12.2
Growth	86.3%	296.3%	41.7%	79.0%	23.6%
Margin	1.1%	3.3%	4.0%	6.8%	8.0%
EPS (sen)	1.5	5.9	8.4	15.9	18.5
GDPS (sen)	4.0	5.0	6.0	8.0	10.0
PER (x) @ RM1.39	93.0	23.5	16.6	8.8	7.5
Yield @ RM1.39	2.9%	3.6%	4.3%	5.8%	7.2%

Source: SBBSR



## **PREAMBLE**

---

We visited Hai-O recently and discussed with management on its latest developments and growth potential of Hai-O.

## **BUSINESS DEVELOPMENTS**

---

### ***Maintaining its position in wholesaling, retailing and MLM***

After more than 30 years of business presence, Hai-O is still going strong, maintaining its position as one of the market leaders in wholesaling, marketing and MLM divisions. Its forte lies in the marketing of traditional Chinese medicines, health care and consumer products.

### ***Venturing into Chinese tea business***

Hai-O has recently made foray into Chinese tea business as it sees great potential in the global tea business. Equipped with more than ten years of experience in marketing the tea business, Hai-O is determined to gain a prominent foothold in marketing PU-ER tea, the star among all tea products in China. It has recently secured the sole distributorship from a large and established Pu-Er tea producer in Yunnan Province.

### ***Pu-Er tea to shine in the future***

The group has made PU-ER tea as one of its core products and plans to expand its business of this unique tea in the next few years. For FYE4/06, Pu-Er tea has contributed RM1.5m to Hai-O's PBT of RM15.7m, ie approximately 10% of the group's total PBT. PU-ER tea is the only tea in the market that improves in flavour as it matures and ages, just like good wine. The discovery of this fact has led to a surge in interest by investors and consumers for this product. Malaysia's climate is favourable for the fermentation process of PU-ER tea, thus aiding Hai-O's effort in cementing the foundation for a proposed tea trading centre in Malaysia.

### ***Strengthening of ringgit is beneficial to the group***

Hai-O's products and raw materials are mainly sourced from China in US dollar. Hence, any strengthening of ringgit, say 5% would lower the cost of sales, and would subsequently increase the profit margin of Hai-O's products by approximately 3%.

### ***Plans to spread wings to Indonesia and Singapore***

Currently, Hai-O does not have MLM business presence in Singapore and Indonesia. Therefore, the group is exploring the idea of spreading their MLM wings to those two countries.

### ***Halal certification provides an edge Hopes to tap into Middle East market***

The halal certification obtained for Hai-O's products enables Hai-O to have an edge over other Chinese traditional medicine and supplements products sellers. The confidence brought about by the halal certification helps explain why more than 90% of its products channeled through MLM are purchased by the non-Chinese community. Besides, armed with the halal logo on its products, Hai-o plans to tap into the Middle-East market.

### ***Rebranding exercise and promotion of loyalty card continues***

Hai-O will continue to press on its accelerator in brand-building exercise as well as fine-tuning its range of goods in order to boost sales. Its loyalty card programme, which entitles its members to enjoy 5%-20% discount on certain products from its retail outlets currently, attracts more than 100,000 members.



**Lucrative payout rate to boost agents' sales for MLM**

The group is aware that the effort by MLM's agents is vital for its growth. Hai-O has one of the most attractive payout rates in the MLM business in Malaysia. Having a high rate would boost agents' motivation in marketing its MLM merchandise. A diligent team of agents would minimize adverse competition in the MLM business these days and consequently, enables Hai-O's topline growth for the MLM business at an envisaged rate of 10% for the next three years.

**Divestment of non-core business will improve profits**

The group has completed its divestments of loss-making non-core businesses and retailing outlets. This would thus enable Hai-O to concentrate on its focal divisions such as wholesaling and MLM in order to realize our projected three-year CAGR growth of 10%.

**3-5 new outlets in 12 months**

A total of three to five outlets, costing circa RM100,000 each are to be set up in strategic places of Peninsular Malaysia. Hai-O is exploring the long-term viability of running integrated health food store and TCM (Traditional Chinese medicine) clinic in retail outlets. We laud this movement as we believe that this would enhance the value of what Hai-O has to offer in its retail outlets and attract more customers.

**Dividend payout ratio of at least 50%.**

Hai-O has expressed its commitment in rewarding its shareholders by having a dividend payout ratio of at least 50% for each financial year. Besides, it is also looking into declaring interim dividends as well. We are optimistic that Hai-O is able to declare a total GDPS of 10 sen for FY2007 on the back of 23% growth in bottomline and its net cash position of RM8.7m as at 30 April 2006.

**Considering interim dividend**

## **REVIEW OF FY2006 FINANCIAL PERFORMANCE & PROSPECTS**

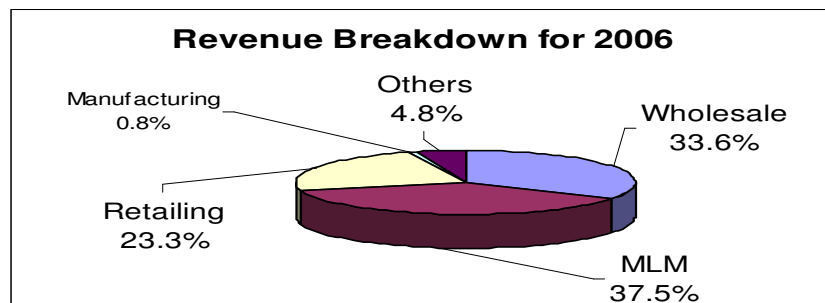
**Healthy growth in financial performance, improved turnover**

In the financial year ending 30 April FY06, Hai-O enjoyed a commendable 79% growth in net profit supported by a 3.6% growth in turnover. The higher revenue was attributable to effective marketing strategies which focused on promoting branded healthcare and house-brand products in wholesale and retailing divisions, as well as the relentless effort demonstrated by the distributors in the MLM business.

**79% y-o-y leap in net profit**

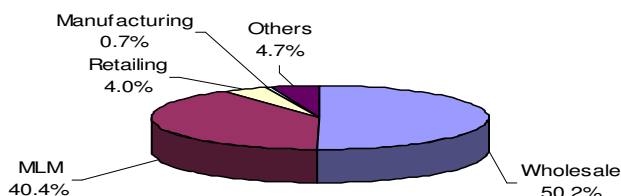
Higher margins from sales of branded healthcare products in wholesale divisions, coupled with the divestment of loss-making non-core businesses contributed positively to the escalation in net profit for FY06.

**Rosy future growth**





### FY 2006 Operating Profit Breakdown



### SEGMENTAL PERFORMANCE

FY 30 April (RM '000)	2005	2006	2007F
<b>Turnover</b>			
Wholesale	50,658	48,490	52,370
MLM	45,096	54,161	62,290
Retailing	34,633	33,555	35,230
Manufacturing	785	1,087	1,650
Others	8,089	6,983	0
<b>Total</b>	<b>139,261</b>	<b>144,276</b>	<b>151,540</b>
<b>Operating profit</b>			
Wholesale	5,757	8,093	8,641
MLM	4,492	6,511	8,097
Retailing	25	637	881
Manufacturing	414	512	825
Others	-186	-796	0
Elimination	-61	655	0
<b>Total</b>	<b>10,441</b>	<b>15,612</b>	<b>18,444</b>
<b>Growth</b>			
<b>Turnover</b>			
Wholesale	7.4%	-4.3%	8.0%
MLM	25.5%	20.1%	15.0%
Retailing	10.7%	-3.1%	5.0%
Manufacturing	-33.0%	38.5%	51.8%
Others	107.3%	-13.7%	-100.0%
<b>Growth</b>			
<b>Operating profit</b>			
Wholesale	-11.0%	44.9%	6.8%
MLM	248.2%	2448.0%	24.4%
Retailing	-96.2%	328.0%	38.3%
Manufacturing	155.6%	23.7%	61.1%

We envisage a bottomline growth of approximately 15% for Hai-O in the next couple of years, supported by the MLM and wholesale divisions. From our perspective, the advertising and rebranding exercise by Hai-O will bear fruits soon.

#### **Problems of fake medicine pose vast opportunities for Hai-O**

Cases of patients suffering from the misuse of fake traditional Chinese medicines and supplementary products have caught the attention of the media recently. We are of the view that consumers will most likely shift their preference to more reliable manufacturers and distributors of traditional merchandise such as Hai-O in order to avoid suffering the adverse effects of fake medicines. The goodwill and brand name of the 31-year-old Hai-O would definitely be able to gain consumers confidence, hence increasing its sales in the long run.



**Net cash position maintained with a GDPS of 10sen**

Due to lack of major investments, we believe that Hai-O is able to maintain its net cash position for FY07, forecasted to be approximately RM15.0m. Total FY07 anticipated GDPS is 10sen, translating into a decent yield of 6.9% based on the current market price of RM1.45.

**En route to main board transfer next year**

Hai-O is confident its net profit for FY2007 would enable it to submit for an application to transfer to the main board by end-2007. It would serve as a price catalyst for Hai-O next year as well as enhance the reputation of Hai-O among the investment fraternity.

## VALUATION & RECOMMENDATION

Ascribing a CY06 PER of 9.8x for CY06EPS of 17.6sen, we arrive at a target price of RM1.73 for Hai-O. The target CY06 PER represents a 45% discount to Amway's CY06 PER of 17.9. We opine that the large discount is warranted due to the reasons stated below:

- Hai-O's significantly smaller capitalisation;
- Hai-O's lower PBT margin and ROE
- Hai-O's lower gross dividend yield
- Amway's strong international brand name.

Our target price of RM1.73 represents a 24.5% upside potential. Hence, a BUY is recommended due to Hai-O's anticipated praiseworthy FY07 EPS of 18.5sen, forecasted GDPS of 10.0sen and net cash position of RM8.7m as at 30 April 2006.

### COMPARISON TABLE

	Price	Mkt Cap	EPS	CY06	Updated	P/NTA	DPS	Div	ROE	Operating
	RM	RM'mil	CY06	PER	NTA	(x)	(FY06)	Yield	(FY06)	margin
			(sen)	(x)	(RM)			(%)		(FY06)
Hai-O	1.39	92.7	17.6	9.1	1.34	0.99	8.0	5.8%	11.5%	11.0%
Amway	6.35	1,043.9	35.5	17.9	1.25	5.04	50.0	7.9%	30.0%	16.3%

Source: SBBSR, Bloomberg

**Note:**

-Financial year-end for Hai-O is 30 April 2006 while Amway's is 31 Dec 2006.  
GDPS for Amway is consensus forecast for FY06.



### Balance Sheet

FY 30 Apr (RM' mil)	2003	2004	2005	2006	2007F
Fixed Assets	47.6	49.8	48.3	45.5	48.5
Intangible Assets	0.5	0.6	0.5	0.3	0.0
Other Fixed Assets	2.9	4.0	4.4	9.0	7.7
Inventories	23.9	24.1	25.2	28.0	27.6
Receivables	12.2	16.6	20.1	22.7	24.9
Others	3.1	1.9	1.8	6.9	9.5
Cash	13.5	12.9	17.4	13.1	20.5
<b>Total Assets</b>	<b>103.8</b>	<b>109.9</b>	<b>117.7</b>	<b>125.5</b>	<b>138.6</b>
Payables	11.1	16.5	21.7	26.0	26.5
ST Borrowings	5.6	5.7	5.4	4.4	4.6
Other ST Liability	2.9	2.4	3.9	1.2	1.4
LT Borrowings	0.0	0.0	0.0	0.0	0.0
Other LT Liability	0.2	0.4	0.2	0.2	0.2
Minority Interest	3.9	4.3	4.6	4.7	5.3
<b>Net Assets</b>	<b>80.0</b>	<b>80.6</b>	<b>81.9</b>	<b>89.1</b>	<b>100.6</b>
Share Capital	65.6	65.7	65.8	66.3	66.7
Reserves	14.4	14.9	16.1	22.7	33.9
<b>Shareholders' Funds</b>	<b>80.0</b>	<b>80.6</b>	<b>81.9</b>	<b>89.1</b>	<b>100.6</b>

### Cashflow Statement

FY 30 Apr (RM' mil)	2003	2004	2005	2006	2007F
PBT	3.5	6.4	10.3	15.7	18.3
Net Interest Paid	0.2	-0.1	-0.3	0.0	0.0
Depreciation	2.1	2.3	2.5	0.0	2.4
Associates	0.3	0.1	0.2	0.0	0.0
Jointly controlled entities	0.0	-0.1	-0.1	0.0	0.0
Chg In Working Capital	-2.8	-2.6	-1.9	-12.8	-0.9
Others	2.4	1.4	-1.8	0.0	-3.1
<b>Operating Cashflow</b>	<b>5.6</b>	<b>7.4</b>	<b>8.9</b>	<b>10.5</b>	<b>16.8</b>
Capex	-1.0	-4.0	-2.2	-10.2	-6.1
Others	-0.2	-0.9	2.5	-0.8	0.0
<b>Investing Cashflow</b>	<b>-1.1</b>	<b>-4.9</b>	<b>0.3</b>	<b>-11.0</b>	<b>-6.1</b>
Chg In Debts	-9.9	0.2	-0.2	-1.0	0.2
Dividends Paid	-1.5	-1.9	-2.4	-2.8	-3.5
Share Issue	11.8	-1.3	-1.9	-0.5	0.0
Other	-0.4	0.0	0.0	0.6	0.0
<b>Financing Cashflow</b>	<b>-0.1</b>	<b>-3.0</b>	<b>-4.5</b>	<b>-3.8</b>	<b>-3.3</b>
Net Cashflow	4.4	-0.5	4.6	-4.3	7.4
Currency Translation Differ	0.0	0.0	0.0	0.0	0.0
Beginning Cash	8.9	13.3	12.8	17.4	13.1
<b>Ending Cash</b>	<b>13.3</b>	<b>12.8</b>	<b>17.4</b>	<b>13.1</b>	<b>20.5</b>
<b>Free Cashflow</b>	<b>4.5</b>	<b>2.5</b>	<b>9.1</b>	<b>-0.5</b>	<b>10.6</b>

Source: SBBSR

### Income Statement

FY 30 Apr (RM' mil)	2003	2004	2005	2006	2007F
<b>Turnover</b>	<b>89.0</b>	<b>119.5</b>	<b>139.3</b>	<b>144.3</b>	<b>151.5</b>
<b>EBITDA</b>	<b>6.3</b>	<b>9.0</b>	<b>13.2</b>	<b>15.9</b>	<b>20.8</b>
Depreciation	-2.1	-2.3	-2.5	0.0	-2.4
<b>Operating Profit</b>	<b>4.2</b>	<b>6.7</b>	<b>10.7</b>	<b>15.9</b>	<b>18.4</b>
Interest & Other Income	0.0	0.0	0.0	0.3	0.0
Interest Expense	-0.4	-0.4	-0.4	-0.3	-0.4
Associate	-0.3	-0.1	-0.2	0.0	-0.1
Jointly controlled entities	0.0	0.1	0.1	0.0	0.4
<b>PBT</b>	<b>3.5</b>	<b>6.4</b>	<b>10.3</b>	<b>15.7</b>	<b>18.3</b>
Taxation	-2.3	-2.2	-4.5	-5.2	-5.5
Minority Interest	-0.2	-0.3	-0.3	-0.6	-0.6
<b>Net Profit</b>	<b>1.0</b>	<b>3.9</b>	<b>5.5</b>	<b>9.9</b>	<b>12.2</b>

### Financial Data & Ratios

FY 30 Apr (RM' mil)	2003	2004	2005	2006	2007F
<b>Growth</b>					
Turnover	6.2%	34.3%	16.6%	3.6%	5.0%
EBITDA	-0.9%	43.2%	47.2%	20.4%	31.0%
Operating Profit	2.5%	59.7%	59.4%	48.3%	16.0%
PBT	45.3%	83.7%	61.5%	52.6%	16.5%
Net Profit	86.3%	296.3%	41.7%	79.0%	23.6%
<b>Profitability</b>					
EBITDA	7.0%	7.5%	9.5%	11.0%	13.8%
Operating Profit	4.7%	5.6%	7.7%	11.0%	12.2%
PBT	3.9%	5.3%	7.4%	10.9%	12.1%
Net Profit	1.1%	3.3%	4.0%	6.8%	8.0%
Effective Tax Rate	67.0%	34.8%	43.8%	33.3%	30.0%
ROA	1.4%	3.9%	5.0%	8.1%	9.1%
ROE	1.2%	4.8%	6.7%	11.1%	12.1%
<b>Dupont Analysis</b>					
Net Margin	1.1%	3.3%	4.0%	6.8%	8.0%
Total Assets Turnover	0.86x	1.09x	1.18x	1.15x	1.09x
Financial Leverage Multipl	1.30x	1.36x	1.44x	1.41x	1.38x
ROE	1.2%	4.8%	6.7%	11.1%	12.1%
<b>Leverage</b>					
Total Debt/Total Asset	0.05x	0.05x	0.05x	0.04x	0.03x
Total Debt/Equity	0.07x	0.07x	0.07x	0.05x	0.05x
Net Cash (RMmil)	7.9	7.2	12.0	8.7	15.8
<b>Valuations</b>					
EPS (sen)	1.5	5.9	8.4	15.9	18.5
GDPS (sen)	4.0	5.0	6.0	8.0	10.0
NTA (RM)	1.21	1.22	1.24	1.34	1.51
PER	93.0x	23.5x	16.6x	8.8x	7.5x
Gross Yield	2.9%	3.6%	4.3%	5.8%	7.2%
P/NTA	1.15x	1.14x	1.12x	1.04x	0.92x

Source: SBBR, Company



### Definition of Investment Ratings

Stocks ratings used in this report are defined as follows:

- BUY** Share price expected to appreciate 10% or more over a 12-month period  
**HOLD** Share price expected to be between 0% and 10% over a 12-month period  
**SELL** Share price expected to depreciate over a 12-month period

### Disclaimer

This report has been prepared by SBB Securities Sdn Bhd based on information from sources believed to be reliable for general circulation. We however do not make any representations as to its accuracy or completeness. All opinions and estimates in this report constitute SBB Securities' judgement as of this date and are subject to change without notice. Any recommendation contained in this document does not have regard to the specific investment objectives, financial situation and the particular needs of any specific person who may read this document. This document is for the information of addressees only and is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. SBB Securities accepts no liability whatsoever for any direct or consequential loss arising from any use of this document or further communication given in relation to this document. SBB Securities and its associates, directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein from time to time in the open market or otherwise, and may receive brokerage fees or act as principal or agent in dealings with respect to these companies.

### SBB Securities Sdn Bhd (100518-M)

A Participating Organisation of Bursa Malaysia Securities Bhd  
A member Company of the Southern Bank Group

Principal Office  
1<sup>st</sup>, 2<sup>nd</sup> & 3<sup>rd</sup> Floor, Plaza Damansara Utama  
No. 2, Jalan SS21/60, Damansara Utama  
47400 Petaling Jaya, Selangor  
MALAYSIA  
Tel: 603-77297345 (General)  
603-77292425 (Research)  
Fax: 603-77290588  
www.sbbsec.com.my

Branch Office  
51-53, Persiaran Greenhill  
30450 Ipoh  
Perak  
MALAYSIA  
Tel: 605-2530888  
Fax: 605-2537666

For SBB Securities Sdn Bhd

**Lau Yew Kong**  
Chief Executive Officer