

Initiating Coverage

13 June 2012

# Hai-O Enterprise Berhad

**BUY**

*Back In The Reckoning*

**Target Price: RM2.34**

<b>Share Price</b>	<b>RM2.10</b>
<b>Target Price</b>	<b>RM2.34</b>

## Investment Highlight

### Company Description

Hai-O Enterprise Berhad was offering a wide range of Chinese medicines, medicated tonic, wellness, beauty and healthcare.

### Stock Data

Bursa / Bloomberg code	7668 / HAI0 MK
Board / Sector	Industrial / Food & Drug Retailers
Syariah Compliant status	Yes
Issued shares (m)	202.19
Par Value (RM)	0.50
Market cap. (RM'm)	424.60
52-week price Range	RM1.55– 2.42
Beta (against KLCI)	0.93
3-m Average Daily Volume	0.07m
3-m Average Daily Value <sup>A</sup>	RM0.15m

### Share Performance

	1m	3m	12m
Absolute (%)	-3.23	-3.67	-3.23
Relative (%-pts)	-2.72	-3.92	-4.45

### Major Shareholders

	%
KAI HEE TAN	9.62
AKINTAN SDN BHD	7.31
EXCELLANT COMMUNICATIONS	5.13

### Historical Chart



Source: Bloomberg

- **We initiate coverage on Hai-O with a BUY call recommendation and target price of RM2.34.** We value Hai-O at 12.5x FY13PER, which is at its upcycle PE in view of its earnings regaining momentum and attractive dividend. We reckon the stock will be back on investors' radar screen once it posts a more convincing earnings growth in future.
- **Well recovery of MLM division in 2QFY12.** Since the new strict membership guideline for MLM has been implemented in early April 2010, the Group's revenue and net earnings declined 56% and 59% respectively from FY10 to FY11. However, we started to witness the Group slowly regaining its earnings momentum in 2QFY12 with both topline and bottomline started to register qoq (revenue: +10.25%; net profit: +4.58%) and yoy (revenue: +6.80% and net profit: +26.69%) positive growth following dismal performance of last 8 consecutive quarters. Looking forward, we expect the revenue and net earnings growth in MLM division is sustainable on the back of the Group's continuous effort in recruiting new members targeting 2000-3000 monthly, launching of new key product such as Bamboo Salt and concentrating of selling high margin household products.
- **Continuous healthy growth from retail division.** The Group's retail division recorded 19% growth in revenue and 10% growth in operating profit for FY11. The impressive growth was mainly due to aggressive promotion and sales of higher profit margin house brand products. The Group opened 3 new outlets in 2011, which make a total number of 70 outlets and targets to open 3-5 new outlets per annum. Furthermore, the Group also plans to upgrade and expand its pharmaceutical factory with offering new and innovative healthcare products.
- **Focusing on repeating consumer items to have better recurring income.** Hai-O recently signed an agreement with KAEAM Food Corp of South Korea and now has been actively offering KAEAM Bamboo Salt, wherein the salt is one of Hai-O star products and the best selling repeating item. Furthermore, the Group is now more focusing on wellness, beauty and personal care products instead of big-ticket items as evidenced by the result improvement of MLM division for FY12.

### Team Coverage

**03-87361118, ext. 752**

**research.dept@jfpex.com.my**

- **Potential re-rating catalyst upon successful penetration of overseas market.** The Group's topline contribution from Indonesian MLM market is still making slow progress. The Group tweaked its strategy of capturing second or third tier cities such as Batam, Medan and Pekan Baru instead of Jakarta because of heightening competition. Besides, the Group also plans to export bird nest products to mainland China via its subsidiary, Yan Ou Holdings (M) Sdn Bhd. Should these ventures be successful, it would further strengthen its MLM and wholesale divisions.
- **Attractive dividend.** Hai-O has a minimum dividend payout policy of not less than 50% of net profit. It has consistently committed for the dividend payment over the last 5 years. In FY11, the payout dividend was 52% equivalent to DPS of 27-sen/share or dividend yield of 3.37%. Assuming dividend payout of 50% for FY12-13, it will translate into DPS of 16.5 sen/share in FY12 and 18.70 sen/share in FY13, or equivalent to decent dividend yield of 3.96% and 4.49% respectively.

**Background**

Hai-O Enterprise Berhad was established in 1975, offering a wide range of Chinese medicines, medicated tonic, wellness, beauty and healthcare products. The principal business of the Company involves multi-level marketing, wholesale and retail, pharmaceutical manufacturing and Chinese medicinal clinics. For over three decades, Hai-O has honed its expertise by building extensive and efficient distribution network and strong marketing strategies in Malaysia. In recent years, it has established a growing range of high quality healthcare products under its own house brands.

**Multi-Level Marketing (MLM)**

Established in 1992, Hai-O Marketing has been leveraging on a strong partnership with its distributors. Since then, Hai-O Marketing has been rewarded with continuous and robust growth. Today, the company is one of the leading local multi-level direct selling companies in Malaysia.

**Wholesale**

The Wholesale Division is one of the main pillars of Hai-O Group. Over a period of 30 years, the company has secured and accumulated exclusive agency rights for importing and distributing in Malaysia more than two hundred branded products from China. Currently, Hai-O has more than 50 experienced and dynamic sales personnel and promoters to serve the wholesale market. As part of quality service, professional herb masters to provide advice on herbs and healthcare to customers and staff.

**Retailing**

Hai-O has a strong retail presence across the country with over 70 Hai-O Chain Stores in major cities and towns. These retail outlets carry extensive range of Traditional Chinese Medicines teas, health tonic, wines, gift packs or hampers and other healthcare products.

**Others**

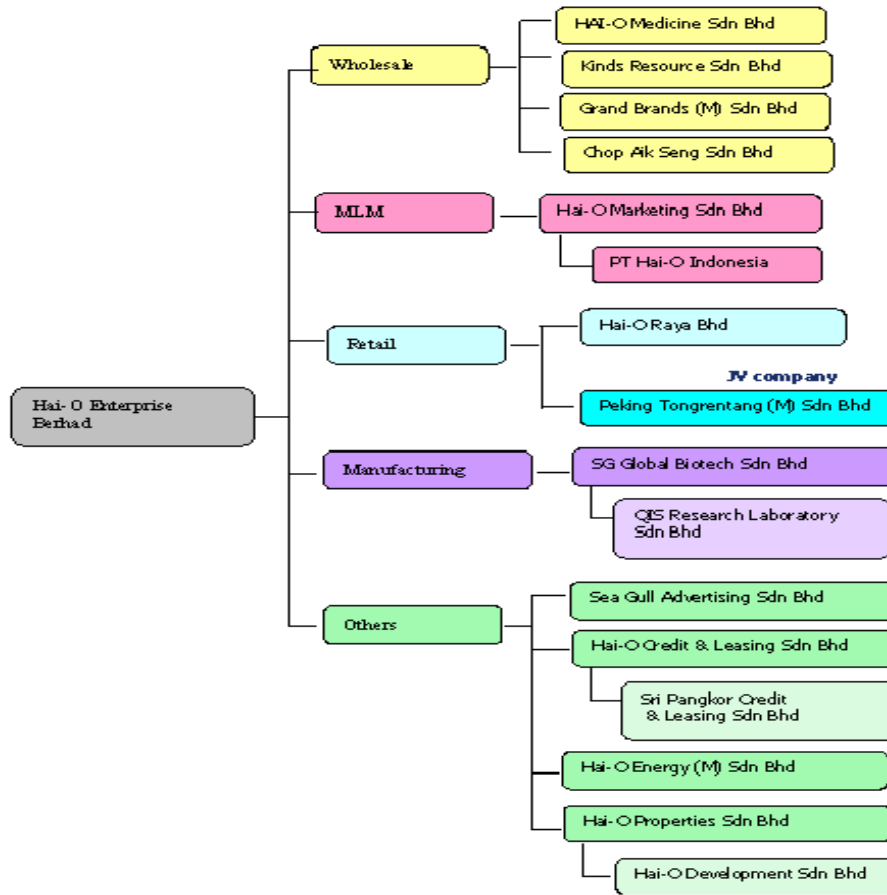
The company also involves in pharmaceutical manufacturing, Chinese consulting clinics and offering a wide range of research in the areas of the microbiology and chemical analysis in medicine, beverage and food products.

**Figure 1: Hai-O Major Brand Product**



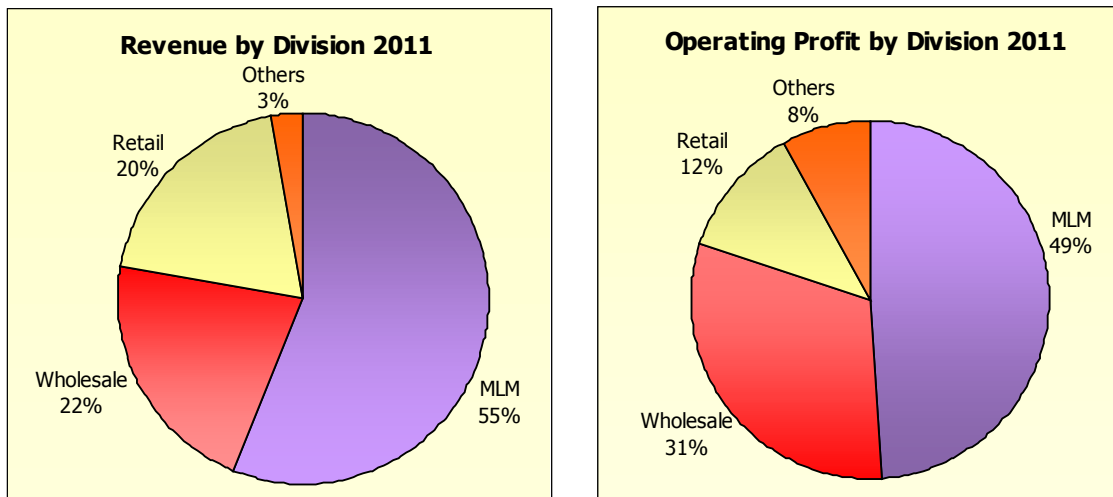
Source: Company, JF Apex

Figure 2: HAI-O Structure



Source: Company, JF Apex

Figure 3: Hai-O's Revenue and Operating Profit Percentage by Division for 2011.



Source: Company, JF Apex

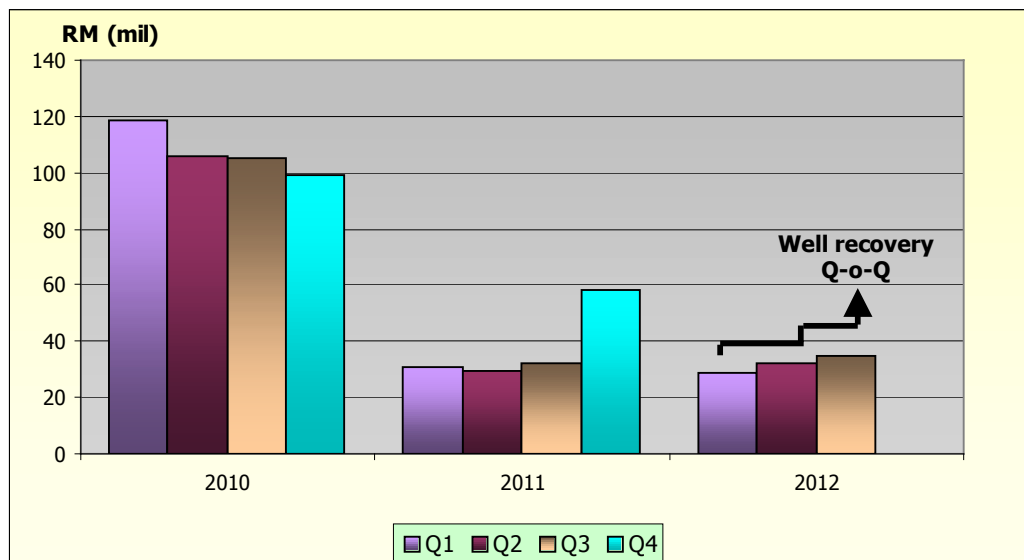
## Investment Merit

**Well recovery of MLM division in 2QFY12.** Since the new strict membership guideline for MLM has been implemented in early April 2010, the Group's revenue and net earnings declined 56% and 59% respectively from FY10 to FY11. However, we started to witness the Group slowly regaining its earnings momentum in 2QFY12 with both topline and bottomline started to register both qoq (revenue: +10.25%; net profit: +4.58%) and yoy (revenue: +6.80% and net profit: +26.69%) positive growth following dismal performance of last 8 consecutive quarters. Looking forward, we expect the revenue and net earnings growth momentum in MLM division is sustainable on the back of the Group's continuous effort in recruiting new members targeting 2000-3000 monthly, launching of new key products such as Bamboo Salt and concentrating of selling high margin household products.

**MLM division currently has 140,000 registered members** with 90% of the members are Bumiputera. The Group is offering incentive tours to motivate members and hence boost its sales. Moreover, trainings and product seminars are being intensified to build second line leaders. As for product strategy, Hai-O has launched several new consumer products such as nutrition and skincare series to encourage repeating sales. These are some of the key measures taken to solidify the Group position as a key player in the MLM industry.

**Incentive tours to propel topline.** Hai-O has organised over 30 incentive tours thus far for its registered members who achieved sales target. Over 5000 distributors qualified for the trips to both local and overseas destinations. This incentive tour provided is to attract new members joining and motivate existing members by honoring their marketing efforts.

**Figure 4: Improving MLM Revenue**

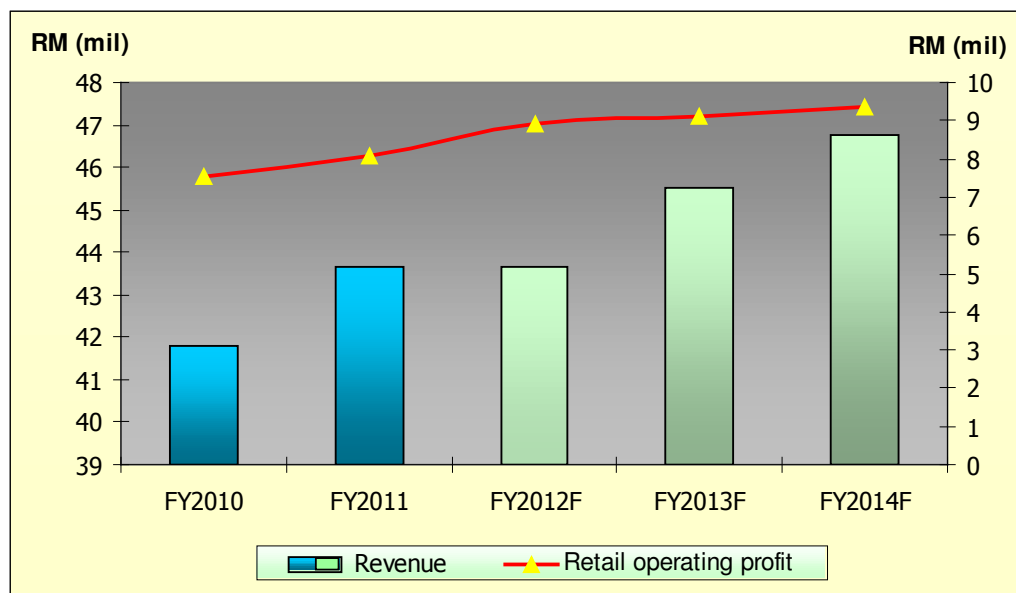


Source: Company, JF Apex

**Continuous healthy growth from retail division.** The Group's retail division recorded 19% growth in revenue and 10% growth in operating profit for FY11. The impressive growth was mainly due to aggressive promotion and sales of higher profit margin house brand products. The Group opened 3 new outlets in 2011, which make a total number of 70 outlets and targets to open 3-5 new outlets per annum. Furthermore, the Group also plans to upgrade and expand its pharmaceutical factory with offering new and innovative healthcare products.

**Strategic alliance with hypermarkets and pharmacies** such as Giant, Carrefour and Jusco is part of the Group strategies in promoting its herbs and healthcare products to reach out to local consumers. The Group is confident its product would be more easily accessible to customers and also enhance Hai-O's long-term commitment and image as a preferred healthcare brand to Malaysian. We believe the strategic alliance is a wise move in captivating consumers' hearts and increase its product visibility to local market.

**Figure 5: Improving Retail Revenue and Operating**



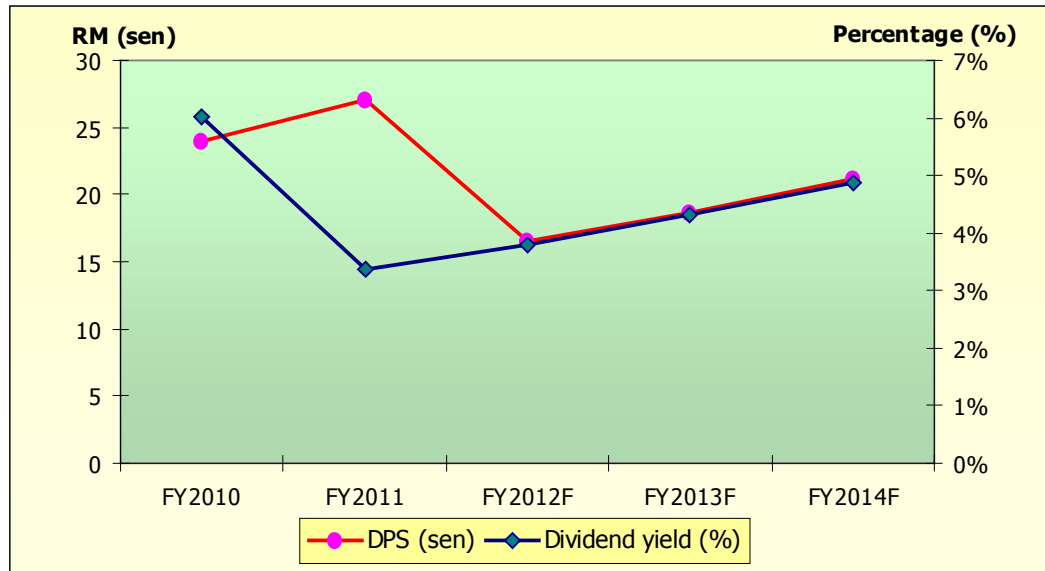
Source: Company, JF Apex

**Focusing on repeating consumer items to have better recurring income.** Hai-O recently signed an agreement with KAEAM Food Corp of South Korea and now has been actively offering KAEAM Bamboo Salt, wherein the salt is one of Hai-O star products and the best selling repeating item. Furthermore, the Group is now more focusing on wellness, beauty and personal care products instead of big-ticket items as evidenced by the result improvement of MLM division for FY12.

**Potential re-rating catalyst upon successful penetration of overseas market.** The Group's topline contribution from Indonesian MLM market is still making slow progress. The Group tweaked its strategy of capturing second or third tier cities such as Batam, Medan and Pekan Baru instead of Jakarta because of heightening competition. Besides, the Group also plans to export bird nest products to mainland China via its subsidiary, Yan Ou Holdings (M) Sdn Bhd. Should these ventures be successful, it would further strengthen its MLM and wholesale divisions.

**Attractive dividend.** Hai-O has a minimum dividend payout policy of not less than 50% of net profit. It has consistently committed for the dividend payment over the last 5 years. In FY11, the payout dividend was 52% equivalent to DPS of 27-sen/share or dividend yield of 3.37%. Assuming dividend payout of 50% for FY12-13, it will translate into DPS of 16.5 sen/share in FY12 and 18.70 sen/share in FY13, or equivalent to decent dividend yield of 3.96% and 4.49% respectively.

**Figure 6: Hai-O's Dividend Yield & Dividend Per Share.**

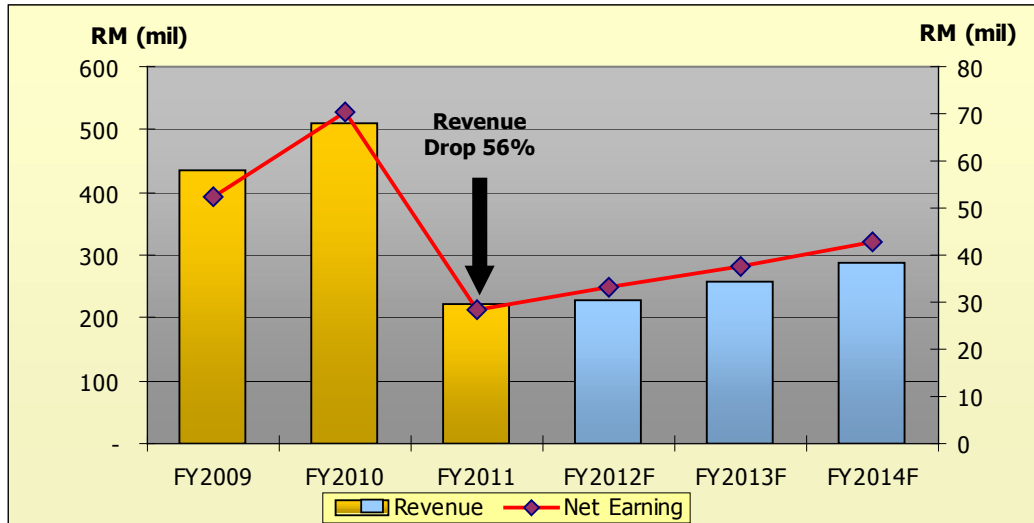


Source: Company, JF Apex

## Financial Highlight

**Higher MLM attrition rate caused dramatic drop in Group's FY2011 earnings.** Hai-O reported RM223.6 million in revenue and RM28.37 million of net profit in FY2011, declined by 56% and 59% y-o-y respectively consequence of implementation of strict guideline for MLM membership. Total Group's revenue contributed from MLM division was severely impacted, down from 81% in FY2010 to 55% in FY2011, translating revenue losses of RM292.86m. The drop was mainly due to higher MLM attrition rate and lesser new membership. Meanwhile, the retail division revenue and operating profit slightly improved by 4% and 7% respectively for FY2011. The increase was mainly due to shift of focus in the promotion and sales of higher profit margin house brand products and 3 new opening outlets. For wholesale division, the revenue and operating profit also climbed 7.23% and 3.03% respectively in FY2011 due to aggressive promotion and marketing.

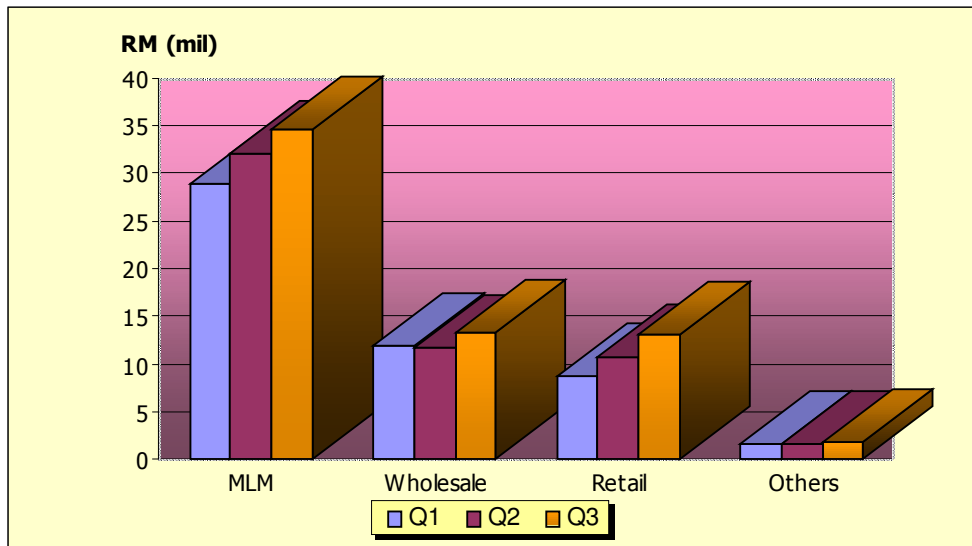
**Figure 7: Hai-O's Revenue and Net Profit**



Source: Company, JF Apex

**Earnings slowly regaining momentum in FY12F onwards.** The Group recorded RM169.96m revenue and RM25.95m of net profit as of 9MFY12, increased 3.01% and 27.94% y-o-y. The MLM division contributes 56% of total revenue and commands the highest margins followed by wholesale (22%), Retail (19%) and Others (3%). Our full year FY12F revenue and net profit estimates are at RM226.86m and RM33.33m, up 1.79% and 17.48% respectively. Moving forward to FY13F, we are confident that the revenue and net earnings will be further boosted by 13.22% and 15.15% respectively underpinned by the aggressive MLM recruitment, focusing on repeating consumer items to boost its recurring incomes and high margin healthcare and related products, new retail outlets opening, and overseas market expansion.

**Figure 8: Hai-O's Revenue by Division for FY12.**



Source: Company, JF Apex



## Valuation & Recommendation

**We initiate coverage on Hai-O with a BUY call recommendation and target price of RM2.34.**

We value Hai-O at 12.5x FY13PER, which is at its upcycle PE in view of its earnings regaining momentum and attractive dividend.

**We reckon the stock will be back on investors' radar screen** once it posts a more convincing earnings growth in future and investors would even re-rate the stock higher upon successful penetration of Indonesian MLM market.

**Figure 9: Peers comparison**

Company	Ticker	Price 13 June 12 (RM)	Target Price (RM)	Market cap RM'm	-----PE (x)-----			ROE (%)	P/B (x)	Yield (%)
					2011	2012F	2013F			
Hai-O	HAI0 MK	2.10	2.34	424.60	13.00	13.14	12.5	13.34	1.98	3.37
Zhulian*	ZHCB MK	2.00	NR	920.00	8.96	8.69	7.69	25.8	2.11	7.00
Amway*	AMW MK	9.70	NR	1594.54	18.76	16.49	15.52	29.93	8.58	6.75

Source: Bloomberg, JF Apex, \*Consensus estimates

**Figure 10: Hai-O's PE band**



Source: Bloomberg, JF Apex

## Risk

**Intense competition in MLM industry.** Close competitors of MLM are Zhulian, Amway, and CNI. However, Hai-O is focusing on variety of product offerings and different distribution channel to sell its products to customers.

**MLM attrition.** Reduction of membership in Hai-O MLM division occurred since the new guideline of MLM has been implemented. To mitigate the attrition rate, Hai-O is now more focus on its sales promotion and strategy planning by introducing more alluring incentive trips and bonus in order to retain its existing top-performer distributors while at the same time attract new members joining.

## Financial Summary

**Figure 11: Profit & Loss and Financial Ratio (FYE 30 April)**

Year to 30 April (RMm)	FY10	FY11	FY12F	FY13F	FY14F
Revenue	511.07	223.26	226.86	257.11	287.29
EBITDA	89.98	39.31	43.81	48.85	54.58
Operating profit	92.19	38.54	46.21	51.42	57.46
Net profit	70.60	28.37	33.33	37.79	42.66
EPS (sen)	34.92	14.03	16.49	18.69	21.10
DPS(sen)	0.240	0.270	0.165	0.187	0.211
P/BV (x)	2.02	2.00	1.97	1.82	1.73
EV/EBITDA	4.66	10.64	9.43	8.54	7.86
Dividend yield (%)	6.01%	3.37%	3.93%	4.45%	5.02%
PBT margin (%)	18.71%	18.49%	20.20%	20.00%	20.00%
Net profit margin (%)	13.81%	12.71%	14.69%	14.70%	14.85%
ROE (%)	33.54%	13.34%	15.49%	16.18%	17.35%
ROA (%)	25.30%	11.04%	12.34%	12.94%	14.16%

Source: Company, JF Apex

**Figure 12: Balance Sheet**

Year to 30 April (RMm)	FY10	FY11	FY12F	FY13F	FY14F
Current Assets	184.14	146.79	162.24	180.79	185.68
Total Assets	279.07	256.95	270.19	291.99	301.32
Current Liabilities	55.36	33.39	46.08	50.69	47.64
Long Term Loans	13.23	10.88	8.92	7.76	7.84
Shareholders' Funds	210.48	212.68	215.19	233.54	245.83
Total Equity & Liabilities	279.07	256.95	270.19	291.99	301.32

Source: Company, JF Apex

**Figure 13: Cash Flow**

Year to 30 April (RMm)	FY10	FY11	FY12F	FY13F	FY14F
Operating	69.20	13.87	32.79	36.07	39.68
Investing	(19.76)	(1.72)	(12.06)	(11.70)	(12.29)
Financing	(29.11)	(36.82)	(15.35)	(16.89)	(18.24)
Net Cash In/(out flow)	20.33	(24.67)	5.37	7.48	9.15
Begin Cash/Cash Equiv.	50.72	70.91	46.05	51.42	58.90
End'g Cash/Cash Equiv.	70.91	46.05	51.42	58.90	68.05

Source: Company, JF Apex

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**JF APEX SECURITIES - RESEARCH RECOMMENDATION FRAMEWORK**
**STOCK RECOMMENDATIONS**

**BUY** : The stock's total returns\* are expected to exceed 10% within the next 12 months.

**HOLD** : The stock's total returns\* are expected to be within +10% to – 10% within the next 12 months.

**SELL** : The stock's total returns\* are expected to be below -10% within the next 12 months.

**TRADING BUY** : The stock's total returns\* are expected to exceed 10% within the next 3 months.

**TRADING SELL** : The stock's total returns\* are expected to be below -10% within the next 3 months.

**SECTOR RECOMMENDATIONS**

**OVERWEIGHT** : The industry as defined by the analyst is expected to exceed 10% within the next 12 months.

**MARKETWEIGHT** : The industry as defined by the analyst is expected to be within +10% to – 10% within the next 12 months.

**UNDERWEIGHT** : The industry as defined by the analyst, is expected to be below -10% within the next 12 months.

\*capital gain + dividend yield

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