

Hai-O (HAIO MK)

Consumer Non-cyclical - Pharmaceuticals

Market Cap: USD166m

Buy (Maintained)

Target Price: MYR3.28

Price: MYR2.68

Back On Track

Macro

Risks

Growth

Value



Source: Bloomberg

Avg Turnover (MYR/USD)	0.57m/0.19m
Cons. Upside (%)	0.4
Upside (%)	21.9
52-wk Price low/high (MYR)	1.98 - 2.72
Free float (%)	50

Shareholders (%)	
Tan Kai Hee	9.9
Akintan SB	7.6
Excellent Communications	5.3

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HAIO has picked itself up from the net profit plunge in FY11 and regained its earnings momentum. We believe its strategy of recruiting members aggressively and shifting its product mix from one-off, big-ticket items to recurring small-ticket ones will put it on the right track to deliver satisfactory results in the future. Maintain BUY, with a new FV of MYR3.328.

- ◆ **MLM bullish once more.** Hai-O (HAIO)'s multi-level marketing (MLM) sales and profitability took a plunge in FY11, mainly due to slower membership growth after the Company tightened its rules and procedures – relating to purchasing and other documentation – in order to comply with industry regulations introduced in 2010. Consequently, MLM FY11 sales and EBIT plummeted to MYR125.2m and MYR22.3m, from RM418.1m and MYR75.3m respectively in FY10. It has since adopted more proactive measures to attract new members/distributors and improve its performance. The Company also shifted its focus from big-ticket items, such as water filters, to consumer-centric products like beauty and health products, of which sales have been largely consistent and recurring in nature.
- ◆ **Enlarging member base.** As HAIO has 140,000 registered members, of which ~80% are Bumiputera, it is planning to introduce new products that appeal to non-Bumiputera users (ie Chinese and Indians) in order to capture the relatively untouched market. The Company will also continue to launch five to eight new products each year.
- ◆ **Dividend yield at >5%.** HAIO has been paying out more than 50% of its net profit as dividends over the last five years. We are anticipating a 15 sen and 17 sen DPS for FY14 and FY15 respectively, which translates into a decent dividend yield of >5% at the current share price level.
- ◆ **Maintain BUY.** In view of better sales and fatter margins coming from the MLM segment, we nudge our FY14 and FY15 numbers up by 4% and 6.6% respectively. Since HAIO's performance have been improving on the back of stronger MLM earnings, we reiterate our positive view on the stock, especially as it comes with a decent dividend yield of >5%. Maintain BUY with a higher FV of MYR3.28, based on 12x CY14 EPS.

Forecasts and Valuations	Apr-11	Apr-12	Apr-13	Apr-14F	Apr-15F
Total turnover (MYRm)	223	240	268	297	325
Reported net profit (MYRm)	27.4	32.8	47.4	51.2	57.4
Recurring net profit (MYRm)	27.4	33.4	43.5	51.2	57.4
Recurring net profit growth (%)	(61.3)	21.9	30.1	17.7	12.1
Core EPS (MYR)	0.14	0.16	0.21	0.25	0.28
DPS (MYR)	0.07	0.09	0.14	0.15	0.17
Dividend Yield (%)	2.8	3.3	5.2	5.6	6.3
Core P/E (x)	19.9	16.3	12.5	10.7	9.5
Return on average equity (%)	13.4	15.4	20.5	20.1	20.4
P/B (x)	2.67	2.46	2.27	2.02	1.86
P/CF (x)	na	10.9	15.3	11.1	12.2
EV/EBITDA (x)	10.8	8.5	6.6	6.1	5.4
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (%)				0.0	0.0

Source: Company data, RHB estimates

Gaining earnings momentum. HAIO's MLM division, which contributes >60% to its total revenue and ~50% of PBT, has been picking up gradually over the last two financial years after a dismal FY11. The segment recorded solid annual revenue and EBIT growth of 18.4% and 24.7% respectively in FY13. Its GPM widened to 39.4% from 38.2% y-o-y, while the EBIT margin grew from 20.3% to 23.7% as well. This was largely driven by: i) aggressive strategies to recruit new members and distributors, ii) the introduction of higher-margin new products, and iii) better sales from its health food and personal care products. The division currently has around 140,000 registered members, with around 2,500 new members signing up each month. We believe that this division's growth momentum is sustainable in view of the Company's improved marketing strategy and more balanced product mix.

Expanding membership base. Currently, 80% of its MLM members are Bumiputera. HAIO now targets to penetrate the Chinese/Indian (ie non-Bumiputera) market. The company will launch new products such as *Premium Beautiful Foundation Lingerie* tailored for Chinese and Indian clientele to enter the relatively untouched market. It also plans to continue launching five to eight new products every year. *Bio Velocity Sleep Mate*, its newest product this year, has received an encouraging response so far, contributing around 10% to monthly MLM revenue.

Potential businesses. In April 2012, HAIO signed a global distributorship agreement with South Korea's KAEAM Food Corp, the pioneer manufacturer of "bamboo salt" which it introduced to the Malaysian market four years ago via an exclusive collaboration. The global distributorship will allow the Company to explore new markets as well. Meanwhile, HAIO's new subsidiary, Yan Ou Holdings SB (Yan Ou), will be tasked with the sourcing, processing, trading and distribution of bird's nest. This will provide a good revenue stream once the Company obtains the licence to export this delicacy – given the popularity of bird's nest in Asia, especially China. As we are unable to quantify the contribution from these two new businesses at this juncture, we have not imputed any numbers from either in our forecast.

Lucrative dividend. The Company is committed to a minimum 50% payout ratio and has in fact been paying out more than 50% of its earnings as dividends over the last five years. HAIO declared a 14 sen single-tier DPS in FY13, translating into a dividend payout of 65% and dividend yield of 5.2%. We are expecting a 15 sen and 17 sen DPS for FY14 and FY15.

Forecast. We are bumping up our earnings forecasts by 4% and 6.6% for FY14 and FY15 respectively as we believe its aggressive recruitment drive for new members and introduction of higher-margin products will lift revenue and margins further. As such, our FV is raised to MYR3.28 from MYR2.91.

Key risks. Key investment risks include: i) a decline in consumer spending power, and ii) intensifying competition.

Maintain BUY. With the strong recovery from its MLM business and the rewarding dividend yield of >5%, we are maintaining our BUY call on HAIO, with a higher FV of MYR3.28, based on 12x CY14 EPS.

Financial Exhibits

Profit & Loss (MYRm)	Apr-11	Apr-12	Apr-13	Apr-14F	Apr-15F
Total turnover	223	240	268	297	325
Cost of sales	(138)	(148)	(163)	(181)	(197)
Gross profit	85	91	105	116	128
Gen & admin expenses	(21)	(23)	(21)	(24)	(26)
Selling expenses	(27)	(26)	(29)	(33)	(36)
Other operating costs	2	4	5	10	11
Operating profit	39	47	60	69	77
Operating EBITDA	41	49	62	71	79
Depreciation of fixed assets	(2)	(2)	(3)	(2)	(2)
Operating EBIT	39	47	60	69	77
Interest income	1	1	-	-	-
Interest expense	(1)	(1)	1	(1)	(1)
Exceptional income - net	-	(1)	4	-	-
Pre-tax profit	39	46	64	68	76
Taxation	(12)	(13)	(16)	(17)	(19)
Minority interests	-	-	(1)	-	-
Profit after tax & minorities	27	33	47	51	57
Reported net profit	27	33	47	51	57
Recurring net profit	27	33	43	51	57

Source: Company data, RHB estimates

Cash flow (MYRm)	Apr-11	Apr-12	Apr-13	Apr-14F	Apr-15F
Operating profit	39	47	60	69	77
Depreciation & amortisation	2	2	3	2	2
Change in working capital	(9)	12	(10)	(31)	(6)
Other operating cash flow	(44)	3	1	25	(10)
Operating cash flow	(12)	63	54	65	63
Interest received	(1)	(1)	-	-	-
Interest paid	1	1	(1)	1	1
Dividends received	(1)	(2)	(2)	-	-
Tax paid	(17)	(11)	(16)	(17)	(19)
Cash flow from operations	(31)	50	36	49	45
Capex	-	-	(11)	(15)	(15)
Other investing cash flow	43	(21)	15	10	4
Cash flow from investing activities	43	(21)	4	(5)	(11)
Dividends paid	(34)	(15)	(24)	(31)	(34)
Shares repurchased	(0)	(2)	-	-	-
Increase in debt	(2)	(3)	(2)	4	-
Other financing cash flow	(1)	(1)	(4)	9	4
Cash flow from financing activities	(37)	(21)	(30)	(18)	(30)
Cash at beginning of period	71	46	54	65	91
Total cash generated	(25)	8	10	26	3
Implied cash at end of period	46	54	65	91	94

Source: Company data, RHB estimates

Financial Exhibits

Balance Sheet (MYRm)	Apr-11	Apr-12	Apr-13	Apr-14F	Apr-15F
Total cash and equivalents	46	54	65	91	95
Inventories	44	38	50	50	55
Accounts receivable	17	20	20	39	42
Other current assets	40	66	54	40	40
Total current assets	147	177	189	220	232
Total investments	35	47	46	30	30
Tangible fixed assets	72	62	67	79	92
Intangible assets	0	0	0	-	-
Total other assets	3	3	4	-	-
Total non-current assets	110	112	118	109	122
Total assets	257	290	306	329	354
Short-term debt	6	5	7	7	7
Accounts payable	23	32	35	24	26
Other current liabilities	5	12	7	7	7
Total current liabilities	33	50	50	38	40
Total long-term debt	11	8	6	10	10
Other liabilities	0	0	0	-	-
Total non-current liabilities	11	8	6	10	10
Total liabilities	44	58	56	48	50
Share capital	101	101	101	101	101
Retained earnings reserve	108	127	148	169	192
Other reserves	(4)	(6)	(10)	-	-
Shareholders' equity	204	222	240	270	293
Minority interests	8	10	11	11	11
Total equity	213	231	251	281	304
Total liabilities & equity	257	290	306	329	354

Source: Company data, RHB estimates

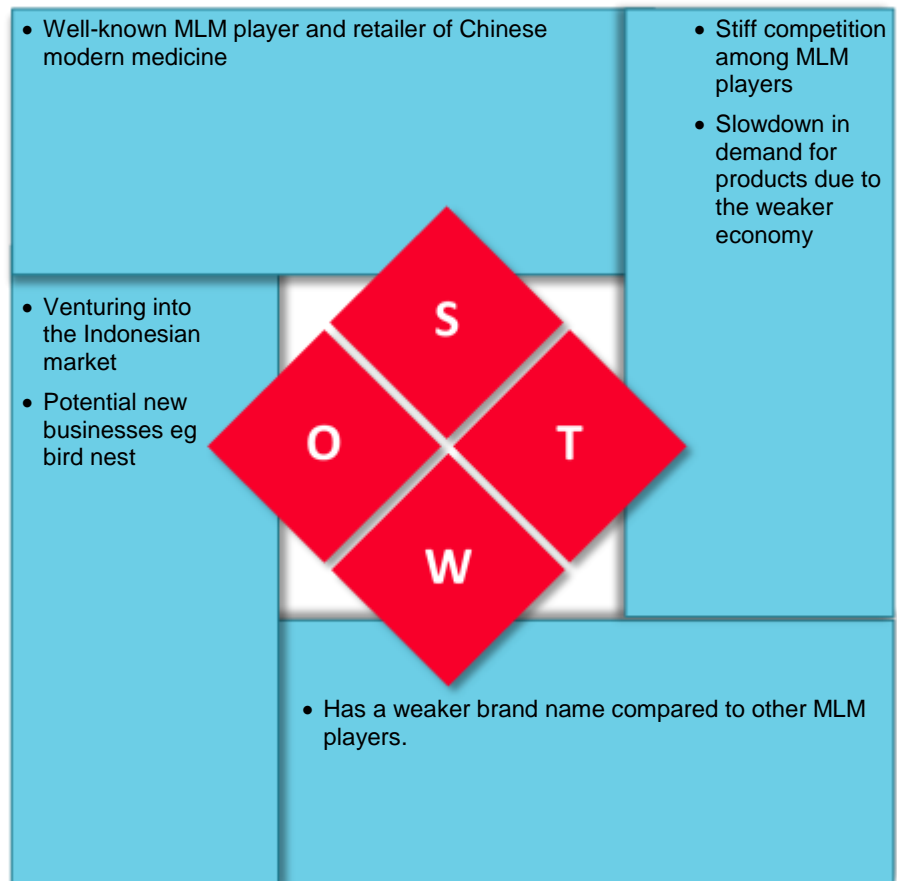
Key Ratios (MYR)	Apr-11	Apr-12	Apr-13	Apr-14F	Apr-15F
Revenue growth (%)	(56.3)	7.3	11.9	10.7	9.6
Operating profit growth (%)	(58.9)	19.6	27.7	15.9	12.0
Net profit growth (%)	(61.3)	19.8	44.3	8.0	12.1
EPS growth (%)	(61.3)	19.8	44.3	8.0	12.1
Bv per share growth (%)	0.6	8.5	8.1	12.6	8.5
Operating margin (%)	17.5	19.5	22.2	23.3	23.8
Net profit margin (%)	12.3	13.7	17.7	17.3	17.7
Return on average assets (%)	10.2	12.0	15.9	16.1	16.8
Return on average equity (%)	13.4	15.4	20.5	20.1	20.4
Net debt to equity (%)	(13.9)	(17.7)	(20.6)	(26.2)	(25.4)
DPS	0.07	0.09	0.14	0.15	0.17
Recurrent cash flow per share	(0.15)	0.25	0.18	0.24	0.22

Source: Company data, RHB estimates

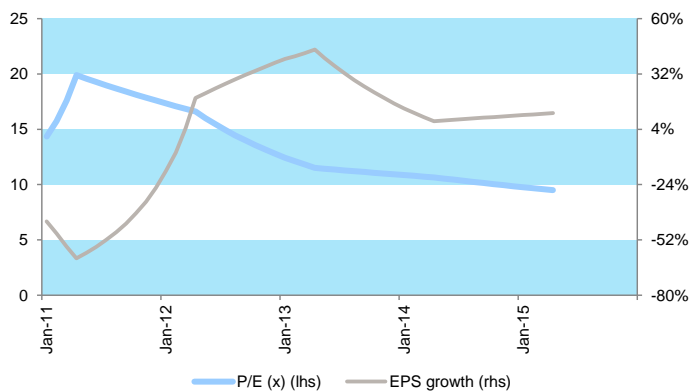
Forecast Assumptions	Apr-14F	Apr15F
Membership growth (%)	3	3
Distributor productivity growth (%)	6	6

Source: RHB estimates

SWOT Analysis

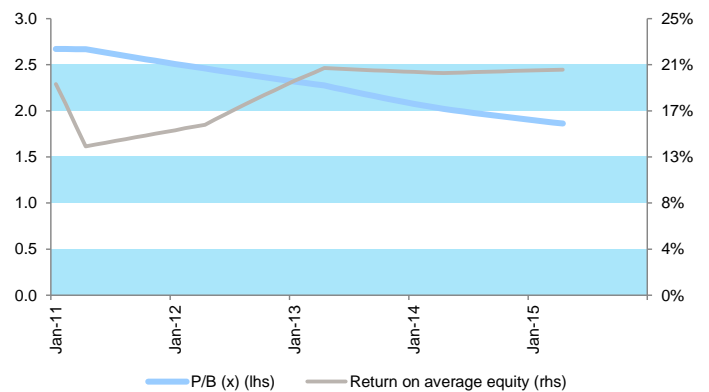


P/E (x) vs EPS growth



Source: Company data, RHB estimates

P/BV (x) vs ROAE



Source: Company data, RHB estimates

Company Profile

Hai-O is involved in wholesaling, retailing, multi-level marketing (MLM) and pharmaceuticals. It also operates modern Chinese medicinal clinics.

Recommendation Chart



Source: RHB estimates, Bloomberg

Date	Recommendation	Target Price	Price
2013-06-27	Buy	2.91	2.66
2013-03-28	Neutral	2.35	2.40
2012-06-29	Neutral	2.16	2.20
2012-04-20	Neutral	2.03	2.18
2012-03-30	Neutral	1.99	2.18

Source : RHB estimates, Bloomberg

RHB 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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