

Hai-O

Sector: Consumer

HAIO MK
RM2.51 @ 11 March 2014

ADD (maintain)

Price Target: RM2.95 (↔)



Price Performance

	1M	3M	12M
Absolute	-1.2%	-2.0%	+9.9%
Rel to KLCI	-1.0%	-3.1%	-4.4%

Stock Data

Issued shares (m)	196.5
Mkt cap (RMm)/(US\$m)	493.2/150.3
Avg daily vol - 6mth (m)	0.10
52-wk range (RM)	2.21-2.85
Est free float	69%
BV per share (RM)	1.31
P/BV (x)	1.91
Net cash/ (debt) (RMm) (2Q14)	56.0
ROE (2014F)	17.8%
Derivatives	Nil
Shariah Compliant	NO

Key Shareholders

Tan Kai Hee	9.9%
Akintan Sdn Bhd	7.7%
Excellent Communications	5.3%

Earnings & Valuation Revisions

	14E	15E	16E
Prev EPS (sen)	45.1	50.4	57.8
Curr EPS (sen)	45.1	50.4	57.8
Chg (%)	-	-	-
Prev target price (RM)			2.95
Curr target price (RM)			2.95

Source: Affin, Bloomberg

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3QFY04/14 preview: Strong boost likely from CNY 2014

Hai-O's 3QFY04/14's top and bottomline likely to be stronger

Hai-O will report its 3QFY04/14's results on 26 March 2014. We believe the group's 3QFY04/14 top and bottomline would be higher on sequential and yoy bases lifted by: 1) a recovery in demand growth for its big-ticket items and also best-selling products, namely foundation garments, as well as BioVelocity mattresses; and 2) resilient sales in conjunction with the Chinese New Year celebration (CNY 2014).

9MFY04/14 net profit should still be lower yoy

While the market may expect a stronger set of 3Q14 results, we believe that the group's 9M14 YTD numbers would still be marginally lower yoy (9M13's net earnings was RM37.4m), given Hai-O's weak 1H14 results (core earnings slipped by 10% yoy), which was affected by weaker demand for its foundation garments. We also understand that Hai-O delayed its 1H14 promotional activities, pending the launch of an improved version of its foundation garment in 3Q14. As such, we believe that sales for its foundation garments will improve in 2H14 in tandem with the promotional activities. Importantly, we believe Hai-O's improved foundation garment business will continue to support the group's earnings going forward. Management has already guided for positive growth momentum in 2H14. All in, we believe Hai-O's 9MFY04/14 results will fall within expectation.

Higher dividend on the cards?

Hai-O has a minimum dividend payout policy of 50%. Nonetheless, the group's payout ratio was 54% over 2011-12, and in FY13, Hai-O's final dividend payout was raised to 60%. On 10 February 2014, the group declared a single-tier interim dividend of 4sen/share. While this was 2sen/share lower than in 1H13 mainly due to the weaker earnings, we are of the view that this is merely a minor setback, with the slack to be made up for in 2H14. We believe that management will likely reward its shareholders with a final dividend of at least 10sen/share, bringing FY14 DPS to 14sen/share, on par with FY13's DPS. Our FY14-16 DPS forecast is revised upwards by 9%/12%/12% respectively after we factor in a higher dividend payout assumption (63%/65%/65% from 58% previously). The company could potentially raise its dividend payout in FY15, in conjunction with Hai-O's 40th year anniversary celebration.

Reaffirm ADD and target price at RM2.95

On the whole, we remain positive on Hai-O's prospects given: 1) the company's healthy fundamentals (cash-rich with zero borrowings, improving earnings visibility from the recovery in its core multi-level-marketing (MLM) division; 2) Hai-O's generosity in rewarding shareholders (decent yield of 5.6%); and 3) its still appealing valuations of 11x FY14E PER. Hence, we reiterate our **ADD** rating on Hai-O with a TP of **RM2.95**, based on an unchanged target multiple of 12x CY14 EPS. Key risks to our view are: 1) a sharp slowdown in consumer spending, dampening distributors' sales; and 2) stiffer-than-expected competition from other MLM companies.

Earnings and valuation summary

FYE 30 April	2012	2013	2014E	2015E	2016E
Revenue (RMm)	239.5	267.9	278.5	296.9	328.5
EBITDA (RMm)	52.3	67.7	66.8	73.4	83.5
Pretax profit (RMm)	48.8	64.1	63.2	69.9	80.1
Net profit (RMm)	34.0	47.4	45.1	50.4	57.8
EPS (sen)	16.8	23.4	22.3	24.9	28.5
PER (x)	15.0	10.7	11.3	10.1	8.8
Core net profit (RMm)	33.2	43.5	45.1	50.4	57.8
Core EPS (sen)	16.4	21.5	22.3	24.9	28.5
Core EPS chg (%)	17.0	31.1	3.7	11.8	14.5
Core PER (x)	15.3	11.7	11.3	10.1	8.8
Net DPS (sen)	9.0	14.0	14.0	16.2	18.5
Net Dividend Yield (%)	3.6	5.6	5.6	6.4	7.4
EV/EBITDA (x)	7.9	5.8	5.5	4.7	3.9
Consensus profit (RMm)			46.5	51.2	57.8
Affin/Consensus (x)			1.0	1.0	1.0

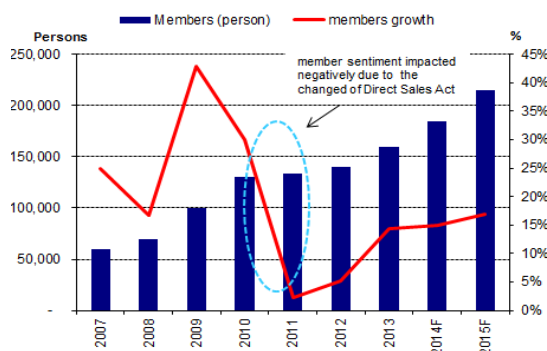
Source: Affin

Fundamentals are still intact

Healthy membership growth, benefiting its MLM division

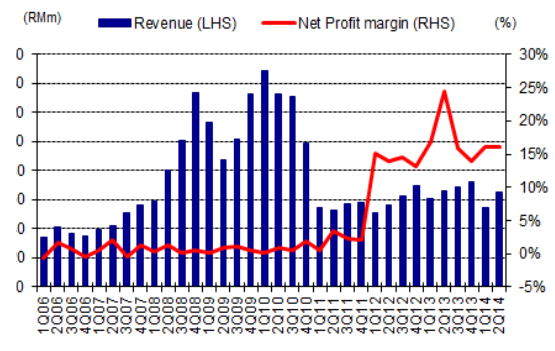
To recap, Hai-O's MLM division experienced poor sales and membership growth over FY11-FY12 (FY11: +2.3%, FY12: +5.3% vs FY10's +30%) owing to the imposition of more stringent rules on new member recruitment under the new Direct Sales Act implemented in 4QFY10. Consequently, the company's net profit plunged -60% yoy in FY11 to RM28m. We understand that management has since developed a successful operating strategy for its MLM division, and is currently experiencing a strong rebound in membership growth. With a sizeable membership of c.160k currently, Hai-O is confident of achieving a 10% growth in membership (c.2.0-2.5k/month) in FY14-16. This is in line with our own projection, as we have factored in monthly new members of 2.2k.

Fig 1: Hai-O's members and growth rate



Source: Company, Affin estimates

Fig 2: Hai-O's revenue and net profit margin



Source: Company, Affin

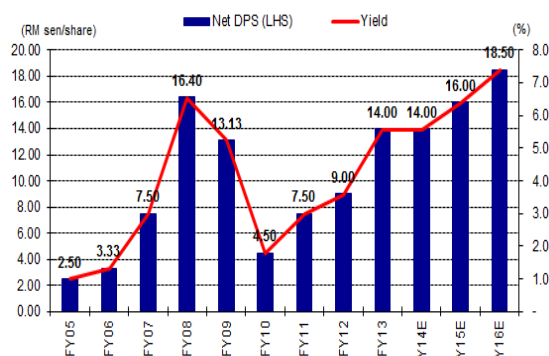
Healthy retail expansion; targeting 2 new outlets in FY15-16

The group opened 7 new retail outlets in FY13, bringing the total to 72 outlets nationwide (4 owned, 68 leased). While the group has not opened any new outlet in FY14, we gather that Hai-O has instead refurbished and relocated some of its unprofitable outlets. We think that Hai-O will continue to expand its footprint, and that expansion will only resume in FY15. We gather from management that the group is committed to opening 2 new outlets in Klang Valley in FY15. CAPEX is estimated at RM300-400k per outlet, which is insignificant against its operating cash flow of around RM10m.

Dividend payout assumption revised upward, maintain ADD

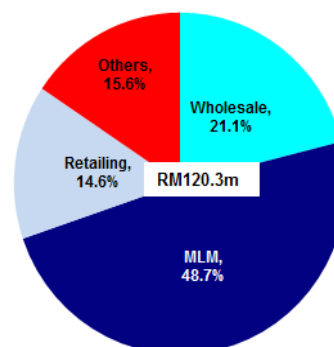
In light of Hai-O's: 1) strong balance sheet (net cash per share of RM0.64 as of end-October 2013); and 2) low CAPEX, we are confident that the company will continue to reward its shareholders with good dividends. We have revised our FY14-16's dividend payout assumption from 58% to 60%/65%/65% respectively, and reckon that a 5.6% yield is highly attractive. We reiterate our ADD rating on Hai-O as we like the company's attractive yields. Furthermore, we believe that the government's push to instill Bumiputera entrepreneur skills will continue to drive Hai-O's core MLM business as c.80% of its agents are Bumiputeras.

Fig 3: Hai-O's dividend and yield



Source: Company, Affin estimates

Fig 4: Hai-O's 1H14 revenue breakdown by division



Source: Company, Affin estimates

Financial Summary

Profit & Loss Statement

FYE 30 April (RMm)	2012	2013	2014E	2015E	2016E
Revenue	239.5	267.9	278.5	296.9	328.5
Operating expenses	-187.3	-200.2	-211.7	-223.5	-245.0
EBITDA	52.3	67.7	66.8	73.4	83.5
Depreciation	-2.1	-2.9	-2.3	-2.3	-2.3
EBIT	49.5	64.7	63.8	70.5	80.6
Net int income/(expense)	-0.7	-0.6	-0.6	-0.5	-0.5
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Pretax profit	48.8	64.1	63.2	69.9	80.1
Tax	-13.1	-15.8	-15.8	-17.5	-20.0
Minority interest	-1.7	-0.9	-2.3	-2.0	-2.3
Net profit	34.0	47.4	45.1	50.4	57.8

Balance Sheet Statement

FYE 30 April (RMm)	2012	2013	2014E	2015E	2016E
Fixed assets	62.1	64.1	62.8	62.5	62.2
Other long term assets	50.3	49.6	49.6	49.0	48.3
Total non-current assets	112.4	113.7	112.4	111.5	110.5
Cash and equivalents	54.2	69.8	92.4	114.2	138.0
Stocks	37.8	41.5	43.4	46.3	50.7
Debtors	21.9	24.5	25.5	27.2	30.0
Other current assets	63.4	63.4	63.4	63.4	63.4
Total current assets	177.3	199.2	224.7	251.0	282.1
Creditors	32.5	35.7	37.3	39.8	43.6
Short term borrowings	5.2	4.7	4.2	3.8	3.4
Other current liabilities	12.4	12.4	12.4	12.4	12.4
Total current liabilities	50.1	52.8	53.9	56.0	59.5
Long term borrowings	8.1	7.3	6.6	5.9	5.3
Other long term liabilities	0.0	0.2	0.2	0.2	0.2
Total long term liabilities	8.1	7.5	6.8	6.1	5.5
Shareholders' Funds	221.7	242.6	263.4	285.4	310.4
Minority interest	9.7	10.6	12.9	14.9	17.2

Cash Flow Statement

FYE 30 April (RMm)	2012	2013	2014E	2015E	2016E
EBIT	49.5	64.7	63.8	70.5	80.6
Depreciation & amortisation	2.7	3.1	3.0	3.0	2.9
Working capital changes	-5.1	-3.1	-1.2	-2.1	-3.5
Cash tax paid	-13.1	-15.8	-15.8	-17.5	-20.0
Others	16.1	-0.2	0.0	0.0	0.0
Cashflow from operation	50.2	48.7	49.8	53.8	60.0
Capex	-2.9	-5.0	-1.0	-2.0	-2.0
Others	-18.5	0.0	0.0	0.0	0.0
Cash flow from investing	-21.5	-5.0	-1.0	-2.0	-2.0
Debt raised/(repaid)	-3.1	-1.3	-1.2	-1.1	-1.0
Dividends paid	-15.0	-26.4	-24.3	-28.4	-32.8
Others	-2.4	-0.4	-0.6	-0.5	-0.5
Cash flow from financing	-20.5	-28.1	-26.1	-30.1	-34.2
Free Cash Flow	47.2	43.7	48.8	51.8	58.0

Source: Affin

Key Financial Ratios and Margins

FYE 30 April (RMm)	2012	2013	2014E	2015E	2016E
Growth					
Revenue (%)	7.3	11.9	3.9	6.6	10.6
EBITDA (%)	16.6	29.5	-1.3	9.9	13.7
Core net profit (%)	19.9	39.5	-4.9	11.8	14.5
Profitability					
EBITDA margin (%)	21.8	25.3	24.0	24.7	25.4
PBT margin (%)	20.4	23.9	22.7	23.5	24.4
Net profit margin (%)	14.2	17.7	16.2	17.0	17.6
Effective tax rate (%)	27	25	25	25	25
ROA (%)	14.2	18.0	15.7	16.1	16.8
Core ROE (%)	15.6	18.8	17.8	18.4	19.4
ROCE (%)	21.7	26.5	24.2	24.8	26.2
Dividend payout ratio (%)	53.6	59.8	63.0	65.0	65.0

Liquidity

Current ratio (x)	3.5	3.8	4.2	4.5	4.7
Op. cash flow (RMm)	50.2	48.7	49.8	53.8	60.0
Free cashflow (RMm)	47.2	43.7	48.8	51.8	58.0
FCF/share (sen)	23.3	21.6	24.1	25.6	28.6

Asset management

Debtors turnover (days)	33.4	33.4	33.4	33.4	33.4
Stock turnover (days)	93.2	93.2	93.2	93.2	93.2
Creditors turnover (days)	80.1	80.1	80.1	80.1	80.1

Capital structure

Net gearing (%)	net cash	net cash	net cash	net cash	net cash
Interest cover (x)	52.8	70.3	105.3	110.9	135.4

Quarterly Profit & Loss

FYE 30 April (RMm)	2Q13	3Q13	4Q13	1Q14	2Q14
Revenue	65.3	68.9	72.1	54.7	65.6
Operating expenses	-50.4	-54.0	-60.0	-43.7	-51.8
EBITDA	14.9	14.8	12.1	11.0	13.8
Depreciation	0.7	0.7	0.8	0.7	0.8
EBIT	15.6	15.6	12.9	11.7	14.5
Net int income/(expense)	0.1	0.1	0.3	0.2	0.1
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Exceptional Items	4.8	-0.6	1.5	-0.1	0.0
Pretax profit	20.5	15.1	14.7	11.8	14.6
Tax	-4.0	-4.1	-4.2	-3.1	-3.7
Minority interest	-0.4	0.0	-0.4	0.1	-0.4
Net profit	16.1	11.0	10.1	8.8	10.5
Core net profit	11.3	11.5	8.6	8.9	10.5
Margins (%)					
EBITDA	22.8	21.5	16.8	20.0	21.0
PBT	31.3	21.9	20.3	21.6	22.3
Net profit	24.7	15.9	14.0	16.1	16.1

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
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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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