Hai-O

Sector: Consumer

HAIO MK
RM2.48 @ 26 March 2014

ADD (maintain)

Price Target: RM2.97 (↑)

Price Performance

	1M	3M	12M
Absolute	+1.6%	-3.1%	+11.4%
Rel to KLCI	+0.7%	-4.4%	-4.3%

Stock Data

Issued shares (m)	196.5
Mkt cap (RMm)/(US$m)	487.3/147.7
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)	1.89
Net cash/ (debt) (RMm) (3Q14)	57.5
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)	44.0	48.2	54.4
Chg (%)	- 2.4	-4.4	-5.9
Prev target price (RM)			2.95
Curr target price (RM)			2.97

Source: Affin, Bloomberg

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Weaker as the group promoted "more affordable" items

Hai-O's 3QFY04/14's bottomline were flat despite a healthy revenue growth

Hai-O registered healthy 3QFY04/14 revenue growth of 9.2% qoq to RM71.6m. We attribute this to the higher contribution from its wholesale and retail divisions, in which revenue have grown by 22% qoq and 31% qoq to RM46.3m and RM13.3m respectively. The higher revenue was also in conjunction with the Chinese New Year 2014 festivities, which in turn drove the sales for its Chinese medicated tonic, health and duty free products. Notwithstanding the healthy topline growth, Hai-O's 3QFY04/14's core earnings slipped 1.1% qoq to RM10.4m impacted by higher sales of lower margin products as the group promoted its smaller-ticket-items and higher promotional cost (+13.3% qoq). On a yoy comparison, revenue grew 4.8% but EBIT margin contracted 3.5ppts, no thanks to the higher sales of lower margin products and a sharp jump in operating cost (+9.5% yoy). As such, the group's core earnings fell 9.7% yoy.

9MFY04/14 numbers are lower yoy

On a 9MFY04/14 YTD basis, Hai-O's revenue and core earnings fell by 1.2% and 9.9% to RM192m and RM30m respectively. We attribute this to Hai-O's weak 1H14 results (core earnings slipped by 10% yoy), which was affected by weaker demand for its foundation garments. To recap, Hai-O delayed its promotional activities for its big-ticket-item products, pending the launch of an improved version of its foundation garment. While waiting for the launch of its latest range of foundation garments, which typically fetch lucrative margins, Hai-O had taken this opportunity to pursue its strategy in promoting "small ticket" items which has received good response from both existing and new members. Together with a higher effective tax rate of 25.5% vs 9M13's 23%, Hai-O's core earnings fell 9.9% yoy. Results were lower-than-expected, accounted for 67% and 65% of both our and consensus full year forecasts.

FY14-16 EPS forecast were trimmed

While the market may be taken aback by the weaker set of 9M14 earnings, we are of the view that this is merely an operational blip with the slack to be made up for in 4Q14. Management has already guided for positive growth momentum in the final quarter, as the group's improved foundation garment as well as "small ticket" product businesses have been encouraging. Importantly, Hai-O believes that these products will continue to support the group's earnings going forward. Nonetheless, we believe our FY14 earnings forecast of RM45m is too aggressive. Taking into account slower private consumption, and given that the group is encouraging its distributors to market its "small ticket" products, which is more affordable to consumers, we trim our assumption for the growth of revenue per agent from 7% to 5%/6%/6.5% over FY14-16. As such, our FY14-16 EPS forecast is now lowered by -2.4%/-4.4%/-5.9% respectively.

Reaffirm ADD but with a slightly higher target price of RM2.97

Following our earnings downgrade and after rolling over our valuation horizon to CY15 EPS, our price target is raised to **RM2.97** from RM2.95 previously**,** pegged to an unchanged target multiple of 11.5x. Maintain **ADD** on Hai-O, as we like Hai-O's: 1) healthy fundamentals; 2) decent yield of 5.6%); and 3) appealing valuations at 10x FY15E PER. 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	271.3	284.0	309.4
EBITDA (RMm)	52.3	67.7	65.2	70.4	78.8
Pretax profit (RMm)	48.8	64.1	61.6	66.8	75.4
Net profit (RMm)	34.0	47.4	44.0	48.2	54.4
EPS (sen)	16.8	23.4	21.7	23.8	26.8
PER (x)	14.8	10.6	11.4	10.4	9.2
Core net profit (RMm)	33.2	43.5	44.0	48.2	54.4
Core EPS (sen)	16.4	21.5	21.7	23.8	26.8
Core EPS chg (%)	17.0	31.1	1.0	9.7	12.8
Core PER (x)	15.1	11.5	11.4	10.4	9.2
Net DPS (sen)	9.0	14.0	14.0	15.5	17.5
Net Dividend Yield (%)	3.6	5.6	5.6	6.2	7.1
EV/EBITDA (x)	7.7	5.7	5.6	4.9	4.1
Consensus profit (RMm)			46.5	51.1	57.8
Affin/Consensus (x)			0.9	0.9	0.9

Source: Affin

Fig 1: Quarterly Results comparison

FYE April (RMm)	3QFY13	2QFY14	3QFY14	QoQ % chg	YoY % chg	Comment
Revenue	68.3	65.6	71.6	9.2	4.8	Higher qoq and yoy brought by strong revenue growth in wholesale and retail division.
Op costs	(52.9)	(51.1)	(57.9)	13.3	9.5	Qoq higher marketing & promotional activities in conjunction with CNY 2014
EBIT	15.5	14.5	13.8	(5.3)	(11.2)	
EBIT margin (%)	22.7	22.1	19.2	(2.9)	(3.5)	Impacted by lower sales for its high margin foundation garment products. Hai-O promoted and had encouraged its distributors to sell more "small ticket" items
Int expense	(0.1)	(0.1)	(0.1)	(32.4)	(29.9)	
Int and other inc	0.3	0.2	0.5	112.1	79.2	
Associates	0.0	0.0	0.0	nm	nm	
Exceptional gain/losses	(0.6)	0.0	0.0	nm	nm	
Pretax	**15.1**	**14.6**	**14.2**	(3.3)	(6.1)	Lower yoy impacted by lower sales of "big ticket" items
Tax	(4.1)	(3.7)	(3.5)	(6.0)	(13.7)	
Tax rate (%)	27.1	25.6	24.9	nm	nm	Lower effective tax rate
MI	(0.0)	(0.4)	(0.2)	nm	nm	
Net profit	**11.0**	**10.5**	**10.4**	(1.1)	(5.0)	
EPS (sen)	5.4	5.2	5.2	(1.1)	(5.0)	
Core net profit	**11.5**	**10.5**	**10.4**	**(1.1)**	**(9.7)**	Below expectation, accounting for 17% of our and 15% of consensus annualized numbers

Source: Affin

Fig 2: Cumulative Results comparison

FYE April (RMm)	9MFY13	9MFY14	YTD % chg	Comment
Revenue	194.3	191.9	(1.2)	Driven primarily to weak 1H14 results. The sales slowdown in its "bigger ticket items" were the key factor
Op costs	(149.4)	(152.0)	1.7	Higher A&P activities as the group emphasizes and promotes the sales of "small ticket" items
EBIT	44.8	39.9	(10.9)	
EBIT margin (%)	23.1	20.8	(2.3)	Margin squeezed attributed to lower sales of higher margin products
Int expense	(0.5)	(0.3)	(31.1)	Lower interest expense
Int and other inc	0.8	1.0	36.0	
Associates	0.0	0.0	nm	
Exceptional gain/losses	4.2	(0.1)	nm	9M13 EI: Gain in disposals of a piece of freehold vacant land recognized in 2QFY04/13
Pretax	**49.4**	**40.6**	**(17.8)**	
Tax	(11.5)	(10.3)	(10.4)	
Tax rate (%)	23.4	25.5	nm	Higher effective tax rate due to a non-taxable gain in the sale of a disposal property recognized in 2QFY04/13
MI	(0.5)	(0.5)	4.2	
Net profit	**37.3**	**29.8**	**(20.3)**	
EPS (sen)	18.5	14.7	(20.3)	
Core net profit	**33.1**	**29.8**	**(9.9)**	Below expectations, accounting for 67% of our and 65% of consensus full year forecasts

Source: Affin

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
NOT RATED	Affin Investment Bank does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation
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

Investment Banking Relationship
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