

Hai-O

Sector: Consumer

HAIO MK
RM2.59 @ 21 July 2014

ADD (maintain)

Price Target: RM3.01 (↔)



Price Performance

	1M	3M	12M
Absolute	+3.6%	+5.7%	-3.7%
Rel to KLCI	+4.5%	+5.4%	-7.4%

Stock Data

Issued shares (m)	195.6
Mkt cap (RMm)/(US\$m)	506.7/159.7
Avg daily vol - 6mth (m)	0.1
52-wk range (RM)	2.36-2.85
Est free float	67.3%
BV per share (RM)	1.24
P/BV (x)	2.08
Net cash/ (debt) (RMm) (4Q14)	54.14
ROE (2015F)	18.5%
Derivatives	Nil
Shariah Compliant	NO

Key Shareholders

Tan Kai Hee	9.9%
Akintan Sdn Bhd	7.6%
Siow Eng Tan	6.8%

Earnings & Valuation Revisions

	15E	16E	17E
Prev EPS (sen)	24.2	27.2	29.9
Curr EPS (sen)	24.2	27.2	29.9
Chg (%)	-	-	-
Prev target price (RM)			3.01
Curr target price (RM)			3.01

Source: Affin, Bloomberg

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40th anniversary special reward for shareholders?

Steady progress in core divisions

After our recent meeting with Hai-O's management, we remain optimistic on the company's long-term prospects, which should be mainly driven by the: i) on-going recruitment strategies for new members and distributors for its multi-level-market (MLM) segment, ii) introduction of improved higher-margin products (ie, water filter and foundation garments), and iii) stronger contributions from its retail segment, driven by improved sales from its higher margined in-house products.

A more balanced product mix

Hai-O's multi-level marketing (MLM) division currently has approximately 140k registered members. Recall that, management has previously taken on a new marketing strategy where their focus has shifted from the higher-end value products (ie, water filters, energy blankets and foundation garments) to the more affordable products (ie, healthcare and food supplements). This strategy has attracted around 2k new monthly membership additions each month, which is in line with our 2-2.1k growth assumption of new members for FY15-17F. In view of this, we are positive that the current marketing strategy and the company's balanced product mix are able to sustain the division's growth momentum moving forward.

Diversifying membership base and product offerings

Currently, 85% of the company's MLM members are Bumiputera. Hai-O has also taken initiatives to also expand its non-bumiputera market (ie, Chinese and Indians). This includes launching new products such as *Pantas Jelly*, which is a high growth jelly for 3-18 year olds to capture a relatively new and untouched market. Other than that, we gather that sales for its KAEAM bamboo salt from South Korea that was launched back in 1Q FY13 is still going strong. Note that, its food and beverage (F&B) segment made up 20% of total MLM revenue in FY14. The company plans to continue to roll-out 5-6 new products this year, including its newest "big-ticket" product, the 3rd generation water filter which will be launched by 4QCY14.

Higher dividend payout in store?

Since 2007, Hai-O has maintained a minimum dividend payout policy of 50%. We note that the company paid out a DPS of 14 sen for FY14, bringing its total payout ratio to 68% (vs. 60% in FY13). In view of the company's strong net cash position of RM54.1m or RM0.26/share (end-FY14), we are retaining our forecast for a payout ratio forecast of 65% for FY15-17F. This translates into dividend yields of 6-7.5% over the period. Also, in conjunction with Hai-O's 40th year anniversary, we do not rule out the possibility of a higher payout for FY15 given improving fundamentals and the rising payout ratio in FY13-14 (also well in excess of minimum target levels). Assuming a 100% dividend payout (ie 24 sen) in FY15, the yield would be 9%.

Earnings & Valuation Summary

FYE 30 April	2013	2014	2015E	2016E	2017E
Revenue (RMm)	267.9	253.4	284.0	309.4	339.6
EBITDA (RMm)	67.7	58.0	71.3	79.8	87.3
Pretax profit (RMm)	64.1	54.6	67.9	76.5	84.1
Net profit (RMm)	47.4	42.0	49.0	55.2	60.7
EPS (sen)	23.4	20.7	24.2	27.2	29.9
PER (x)	11.1	12.5	10.7	9.5	8.7
Core net profit (RMm)	43.5	42.0	49.0	55.2	60.7
Core EPS (sen)	21.5	20.7	24.2	27.2	29.9
Core EPS growth (%)	31.1	-3.6	16.7	12.7	9.9
Core PER (x)	12.1	12.5	10.7	9.5	8.7
Net DPS (sen)	14.0	14.0	15.7	17.8	19.5
Dividend Yield (%)	5.4	5.4	6.1	6.9	7.5
EV/EBITDA (x)	6.2	7.1	5.5	4.6	4.0
Consensus profit (RMm)			44.9	50.6	60.7
Affin/Consensus (x)			1.1	1.1	1.0

Source: Company, Affin forecasts, Bloomberg

ASPs increased to remain competitive

We also gather that Hai-O plans to adjust their average selling prices (ASPs) upwards by 5-10% for a few of their key products by end-2014 to counter rising operating costs as well as in anticipation of the goods and service tax (GST) implementation. The company's last price revision was back in 2009, while some of their competitors have already revised their prices as early as two years ago. We believe that this would help keep the company's margins intact. Sales volume may potentially come off slightly due to higher ASPs in the short term, however, management mentioned that this can be mitigated by aggressively ramping up sales and promotions (ie, 'last buy' promotions) before the price adjustment to cushion the impact on customers.

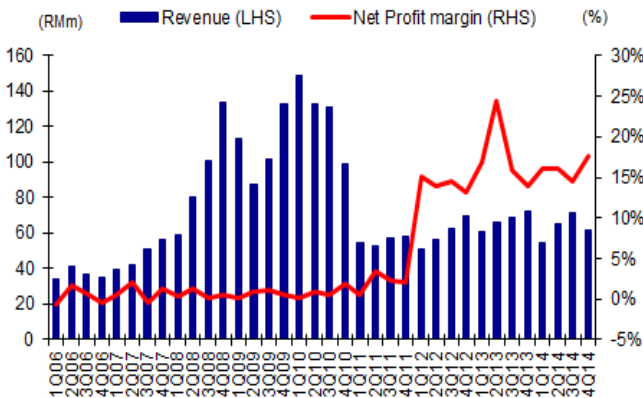
Retail division continuing its expansion

In FY13, Hai-O opened a total of 7 new retail outlets, bringing its total footprint to 70 stores nationwide. The company plans to continue expanding its presence by opening 3-5 retail chain stores in strategic locations every year. Management expects capex per outlet at around RM200-300k, which is minimal against the company's operating cash flow of around RM26m in FY14. We also gathered that Hai-O had just recently closed one of its loss-making outlets and management expects to continue consolidating and refurbishing its unprofitable outlets. Additionally, Hai-O plans to focus on increasing sales from its in-house brand products (making up 48% of retail sales in FY14), which typically command higher margins. Management is targeting to achieve at least 50-55% of sales contributions from these products.

Reaffirm ADD, with TP of RM3.01

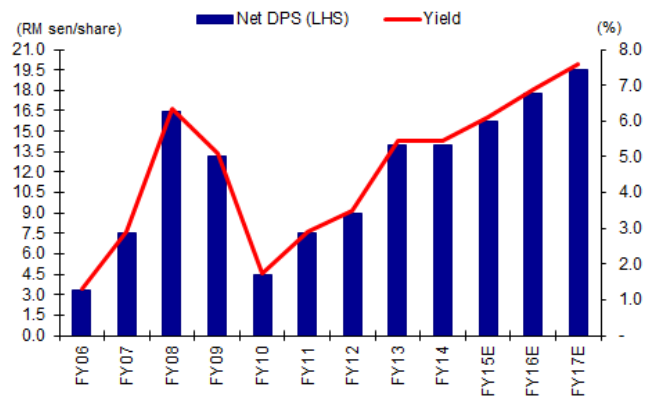
Overall, we make no major changes to our core assumptions. We continue to like Hai-O for its solid long-term fundamentals, coupled with improved earnings visibility from its core MLM division and attractive dividend yields of 6-7.5% over the next three years. Hence, we reiterate our ADD rating on Hai-O with an unchanged 12-month TP of RM3.01, based on an unchanged target multiple of 11.5x (in-line with its historical 3-year mean trading band) on CY15E EPS. Key risks would include: i) a sharp slowdown in consumer spending, which would dampen distributors' sales and ii) stiffer-than-expected competition from other MLM companies.

Fig 1: Hai-O's net profit (LHS) and NP margin (RHS)



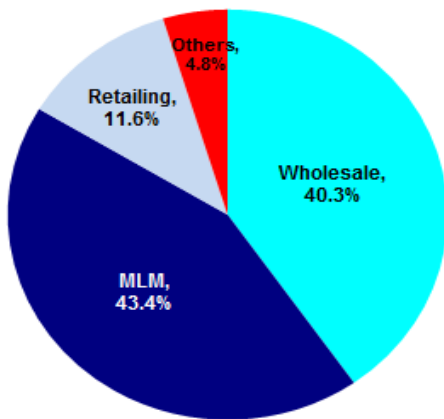
Source: Company, Affin

Fig 2: Hai-O's net DPS (LHS) and dividend yield (RHS)



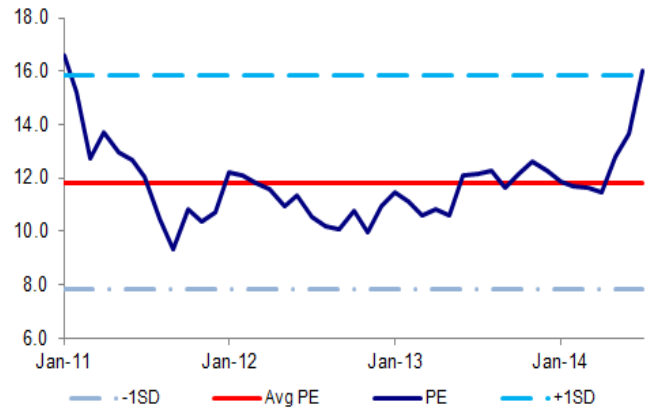
Source: Company, Affin

Fig 3: FY14's revenue contribution



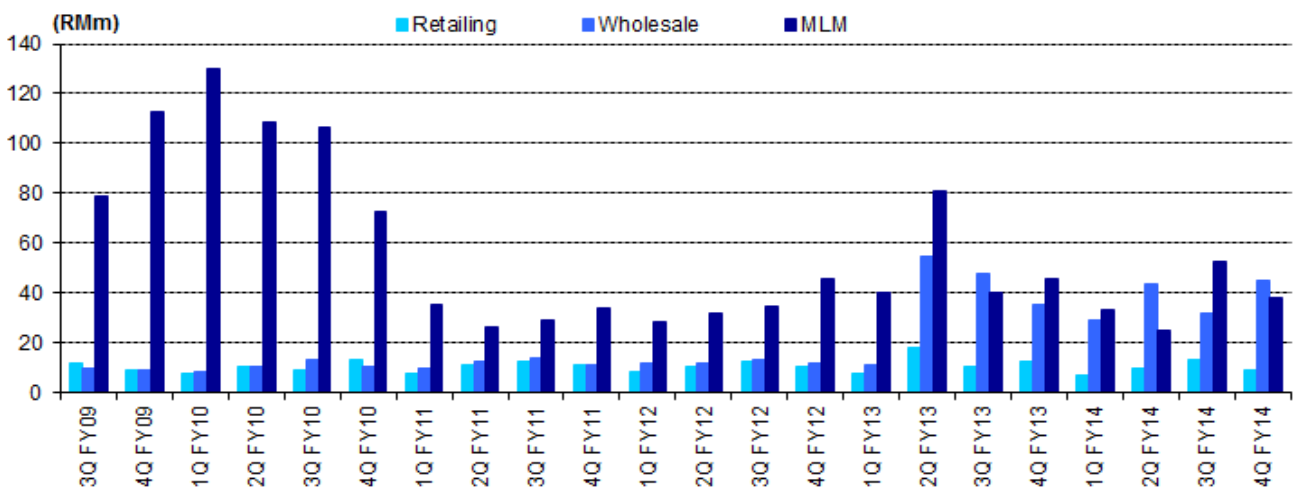
Source: Company

Fig 4: 3-year historical P/E band



Source: Bloomberg

Figure 5: Hai-O's quarterly revenue contribution



Source: Company

Hai-O – FINANCIAL SUMMARY

Profit & Loss Statement

FYE 30 April (RMm)	2013	2014	2015E	2016E	2017E
Revenue	267.9	253.4	284.0	309.4	339.6
Operating expenses	-200.2	-195.4	-212.7	-229.6	-252.3
EBITDA	67.7	58.0	71.3	79.8	87.3
Depreciation	-2.9	-2.3	-2.4	-2.4	-2.4
EBIT	64.7	55.0	68.3	76.8	84.4
Net int income/(expense)	-0.6	-0.4	-0.4	-0.3	-0.3
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Pretax profit	64.1	54.6	67.9	76.5	84.1
Tax	-15.8	-12.1	-17.0	-19.1	-21.0
Minority interest	-0.9	-0.6	-1.9	-2.2	-2.4
Net profit	47.4	42.0	49.0	55.2	60.7

Balance Sheet Statement

FYE 30 April (RMm)	2013	2014	2015E	2016E	2017E
Fixed assets	62.2	65.2	64.8	64.4	64.0
Other long term assets	49.4	47.6	47.0	46.4	45.8
Total non-current assets	111.5	112.8	111.8	110.8	109.8
Cash and equivalents	64.3	59.8	78.3	100.2	122.6
Stocks	49.5	58.6	63.5	68.6	75.4
Debtors	20.1	18.5	20.7	22.6	24.8
Other current assets	59.5	58.2	58.2	58.2	58.2
Total current assets	193.4	195.0	220.8	249.7	280.9
Creditors	34.9	32.7	35.5	38.4	42.1
Short term borrowings	6.9	2.7	2.5	2.2	2.0
Other current liabilities	7.1	3.7	3.7	3.7	3.7
Total current liabilities	48.9	39.2	41.7	44.3	47.8
Long term borrowings	5.3	2.9	2.6	2.3	2.1
Other long term liabilities	0.1	0.0	0.0	0.0	0.0
Total long term liabilities	5.4	2.9	2.6	2.4	2.1
Shareholders' Funds	239.6	254.1	275.2	298.5	323.1
Minority interest	11.1	11.6	13.6	15.7	18.1

Cash Flow Statement

FYE 30 April (RMm)	2013	2014	2015E	2016E	2017E
EBIT	64.7	55.0	68.3	76.8	84.4
Depreciation & amortisation	2.7	3.0	3.0	3.0	3.0
Working capital changes	-9.0	-11.6	-4.4	-4.1	-5.2
Cash tax paid	-15.8	-12.1	-17.0	-19.1	-21.0
Others	-6.3	-8.4	0.0	0.0	0.0
Cashflow from operation	36.3	26.0	49.9	56.6	61.1
Capex	-7.1	-5.1	-2.0	-2.0	-2.0
Others	12.8	7.6	0.0	0.0	0.0
Cash flow from investing	5.7	2.5	-2.0	-2.0	-2.0
Debt raised/(repaid)	-1.0	-6.6	-0.6	-0.5	-0.5
Dividends paid	-25.7	-23.7	-28.4	-31.8	-36.1
Others	-3.7	-2.5	-0.4	-0.3	-0.3
Cash flow from financing	-30.5	-32.8	-29.3	-32.7	-36.8
Free Cash Flow	29.3	20.9	47.9	54.6	59.1

Source: Company data and Affin Investment Bank estimates

Key Financial Ratios and Margins

FYE 30 April (RMm)	2013	2014	2015E	2016E	2017E
Growth					
Revenue (%)	11.9	-5.4	12.1	8.9	9.8
EBITDA (%)	29.5	-14.3	22.9	12.0	9.4
Core net profit (%)	39.5	-11.5	16.7	12.7	9.9
Profitability					
EBITDA margin (%)	25.3	22.9	25.1	25.8	25.7
PBT margin (%)	23.9	21.6	23.9	24.7	24.8
Net profit margin (%)	17.7	16.6	17.3	17.8	17.9
Effective tax rate (%)	25	22	25	25	25
ROA (%)	18.6	16.1	17.2	17.6	17.6
Core ROE (%)	18.9	17.0	18.5	19.2	19.5
ROCE (%)	26.6	21.5	25.3	26.3	26.8
Dividend payout ratio (%)	59.8	67.6	65.0	65.3	65.3
Liquidity					
Current ratio (x)	4.0	5.0	5.3	5.6	5.9
Op. cash flow (RMm)	36.3	26.0	49.9	56.6	61.1
Free cashflow (RMm)	29.3	20.9	47.9	54.6	59.1
FCF/share (sen)	14.4	10.3	23.6	26.9	29.2
Asset management					
Debtors turnover (days)	33.4	26.7	26.7	26.7	26.7
Stock turnover (days)	93.2	133.9	133.9	133.9	133.9
Creditors turnover (days)	80.1	74.9	74.9	74.9	74.9
Capital structure					
Net gearing (%)	net cash	net cash	net cash	net cash	net cash
Interest cover (x)	70.3	105.3	143.2	195.5	243.3

Quarterly Profit & Loss

FYE 30 April (RMm)	4Q13	1Q14	2Q14	3Q14	4Q14
Revenue	72.1	54.7	65.6	71.6	61.5
Operating expenses	-60.0	-43.7	-51.8	-58.7	-48.6
EBITDA	12.1	11.0	13.8	13.0	12.9
Depreciation	0.8	0.7	0.8	0.8	-0.8
EBIT	12.9	11.7	14.5	13.8	12.1
Net int income/(expense)	0.3	0.2	0.1	0.4	0.4
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Exceptional Items	1.5	-0.1	0.0	0.0	0.0
Pretax profit	14.7	11.8	14.6	14.2	12.5
Tax	-4.2	-3.1	-3.7	-3.5	-1.7
Minority interest	-0.4	0.1	-0.4	-0.2	0.0
Net profit	10.1	8.8	10.5	10.4	10.8
Core net profit	8.6	8.9	10.5	10.4	10.8
Margins (%)					
EBITDA	16.8	20.0	21.0	18.1	20.9
PBT	20.3	21.6	22.3	19.8	20.4
Net profit	14.0	16.1	16.1	14.5	17.6

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

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