

Outthink. Outperform.

Doing things right

After a recent management update, we remain upbeat that the MLM segment can continue to do well driven by membership growth and more product launches that cater to the needs of Bumiputra segments. We revise up our FY17-19E net profit by 6%-8% to reflect a likely higher growth rate in membership, hence arriving at a higher 12-month target price of RM4.22. The share price has performed well in the past one month, and we reiterate our BUY call with potential upside of 15.9%.

Major recap on 3Q17 results

Hai-O recorded an increase in revenue by 33% yoy whereas net profit increased by 57% yoy. This was mainly driven by strong growth in the MLM segment which recorded a 52% yoy increase in revenue and 66% yoy increase in operating profit. The MLM distributor force has reached 120,000 (vs. 83,000 in FY2016), which was higher than our expectation as the company saw higher average growth of 6,000 distributors/month. The average revenue/distributor also saw a small uptick due to new product launches.

MLM segment's momentum should be sustainable

Post the meeting, we are more confident that the management's initiatives, such as an attractive commission scheme, incentive trips and an emphasis on underpenetrated Bumiputra segments, should lead to sustainable growth in the MLM distributor force. We forecast Hai-O's distributor force to grow by 2,500 and less than 2,000 members/month in FY18 and FY19 respectively. Moreover, we are encouraged by management's strategy to launch more products and introduce fashion and lifestyle products which fit well for the Bumiputra community.

Positive catalysts: stronger MYR

Hai-O's net profit margin declined from 16% in FY13 to 12% in FY16 as the weakening of the MYR has resulted in higher imported product costs, especially for the retail and wholesale segments, but it improved to 14% in 9M17 as its suppliers shared the cost increase burden. Hai-O sees upside for its net profit margin if the MYR strengthens from the current level.

Maintain BUY with higher TP of RM4.22

We revise up our FY17-19E net profit by 6%-8% to reflect likely higher growth in the MLM segment. Therefore, we increase our TP by 7% to RM4.22, using the same CY17 PE ratio of 18x. We are positive on Hai-O's management quality and its ability to deliver growth going forward, and we reiterate our BUY call on the stock with upside potential of 15.9%.

Earnings & Valuation Summary

FYE Apr	2015	2016	2017E	2018E	2019E
Revenue (RMm)	239.9	297.6	424.2	513.3	580.7
EBITDA (RMm)	48.5	51.7	83.9	104.3	117.6
Pretax profit (RMm)	43.0	49.1	80.0	100.4	113.6
Net profit (RMm)	30.1	36.3	58.7	73.7	83.4
EPS (sen)	10.3	12.4	20.0	25.1	28.4
PER (x)	35.5	29.4	18.2	14.5	12.8
Core net profit (RMm)	30.1	36.3	58.7	73.7	83.4
Core EPS (sen)	10.3	12.4	20.0	25.1	28.4
Core EPS growth (%)	-25.3	20.8	61.5	25.5	13.2
Core PER (x)	35.5	29.4	18.2	14.5	12.8
Net DPS (sen)	10.0	10.0	13.0	16.3	18.5
Dividend Yield (%)	2.7	2.7	3.6	4.5	5.1
EV/EBITDA (x)	19.9	18.6	11.6	9.1	7.9
Chg in EPS (%)			+6.2	+8.2	+7.0
Affin/Consensus (x)			1.1	1.1	1.1

Source: Company, Bloomberg, Affin Hwang forecasts

Company Update

HAI-O

HAIO MK
Sector: Consumer

RM3.64 @ 13 April 2017

BUY (maintain)

Upside 15.9%

Price Target: RM4.22

Previous Target: RM3.93



Price Performance

	1M	3M	12M
Absolute	+20.5%	+27.3%	113.3%
Rel to KLCI	+19.4%	+22.5%	111.4%

Stock Data

Issued shares (m)	289.4
Mkt cap (RMm)/(US\$m)	1053.4/238.5
Avg daily vol - 6mth (m)	0.4
52-wk range (RM)	1.63-3.99
Est free float	47.3%
BV per share (RM)	0.92
P/BV (x)	3.95
Net cash/ (debt) (RMm) (9M17)	63.11
ROE (2017E)	22.2%
Derivatives	Nil
Shariah Compliant	NO

Key Shareholders

Siow Eng Tan	10.5%
Kai Hee Tan	10.1%
Akintan Sdn Bhd	7.9%

Source: Affin Hwang, Bloomberg

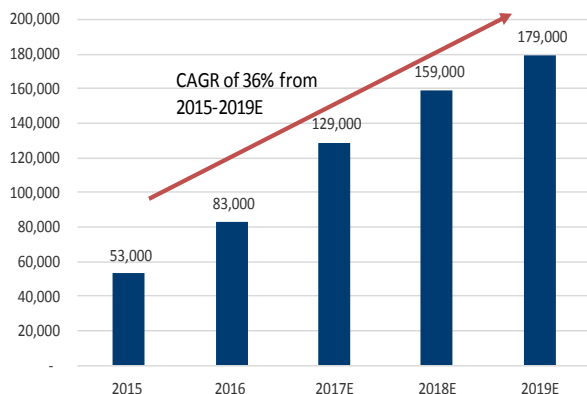
Yap Po Leen
(603) 2146 7547
poleen.yap@affinhwang.com

Out think. Out perform.

Higher-than-expected growth of MLM distributor force

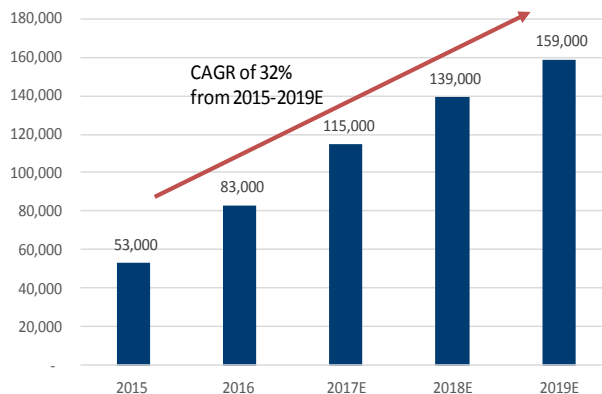
Referring to Figures 1 and 2 below, we revised up the number of distributors for FY17-19 to reflect the effectiveness of Hai-O’s MLM business strategy to attract more members. To recap, its distributor force was 120,000 as of the end of 3Q17 (vs. 83,000 in FY16).

Figure 1: New assumption on distributor force



Source: Company, Affin Hwang forecasts

Figure 2: Old assumption on distributor force



Source: Company, Affin Hwang forecasts

We have argued that Hai-O’s MLM business still has room to grow (refer to our update note, [Soaring to greater heights](#), 22 March 2017) due to likely stable 12% growth in annual direct selling turnover in Malaysia and consolidation in the MLM industry with Hai-O having done many right things to ensure the sustainability of its MLM business.

Attractive commission payout ratio and incentive trips

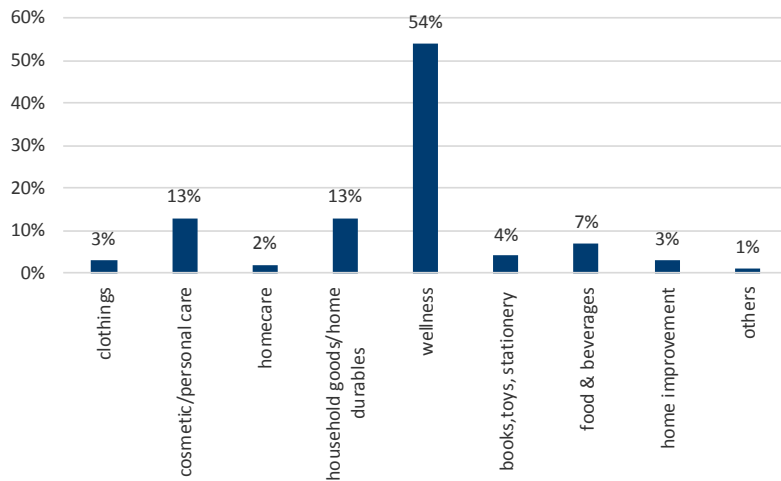
In order to attract people to join as distributors, Hai-O offers as high as a 67% commission payout ratio for products sold (the payout ratio is one of the highest among MLMs in Malaysia). The joining fee of RM50 is also one the lowest in the industry and Hai-O provides training courses to equip new members with product knowledge and entrepreneur skills. The company also offers at least 2 attractive incentive trips to encourage members to achieve higher sales targets. The company aims to have at least 600 qualifiers who can achieve at least RM200,000 in personal sales (vs. 400 in FY16). Therefore, we think a proper reward system in place will help to increase distributor numbers and sales/distributor.

New product launches

Hai-O has launched around 20 new products, most of which are health food & beverage (ShakeMe and N’licious) and skincare products (Infinence). Hai-O also intends to introduce more fashion products with famous designer Jimmy Choo on board as a fashion and lifestyle advisor. For example, Hai-O will be introducing 18 new Hijab SKUs (with selling prices of RM100-300) designed by famous local designers Rizman Bin Nordin and Ruzaini Wan Jamil to target the Bumiputra women market. We are positive on Hai-O’s strategy to introduce more fashion products that target the Bumiputra market because 70% of its distributors are Bumiputra women and the fashion segment is still an untapped market in Malaysia’s direct selling industry.

Out think. Out perform.

Figure 3: Clothing account for only 3% of total direct selling turnover in Malaysia



Source: WFDSA

Figure 4: Showcase of Hai-O's Hijab at a Milan fashion show



Source: Nanyang newspaper

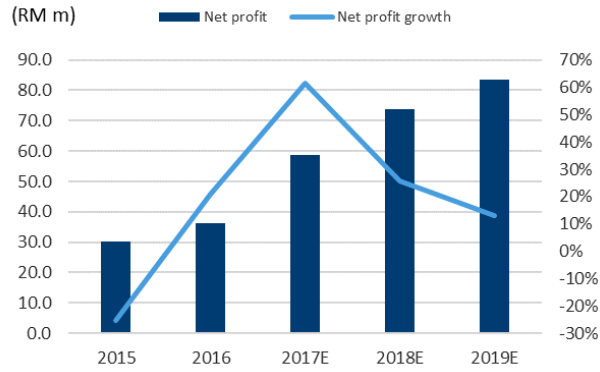


Source: Nanyang newspaper

Recommendation and valuation

We revise up our FY17-19E net profit by 6%-8% to reflect the likely higher growth of distributors in the MLM segment. Therefore, we increase our TP by 7% to RM4.22, using the same CY17 PE ratio of 18x. We are still positive on Hai-O's management quality and its ability to deliver growth going forward, and we reiterate our BUY call on the stock with an upside potential of 15.9%. The downside risks include the loss of distributors in the MLM division, lack of exciting new products to enhance growth and further weakness in the wholesale/retail divisions.

Figure 5: Hai-O's forecast net profit



Source: Company, Affin Hwang estimates

Out think. Out perform.

Figure 6: Hai-O's past 3-year PE ratio



Source: Company, Affin Hwang estimates.

Hai-O FINANCIAL SUMMARY

Profit & Loss Statement

FYE 30 April (RMm)	2015	2016	2017E	2018E	2019E
Revenue	239.9	297.6	424.2	513.3	580.7
Operating expenses	-191.4	-246.0	-340.3	-409.0	-463.1
EBITDA	48.5	51.7	83.9	104.3	117.6
Depreciation	-2.4	-2.7	-3.1	-3.2	-3.3
EBIT	45.4	48.3	80.1	100.5	113.7
Net int income/(expense)	-0.3	-0.2	-0.1	-0.1	-0.1
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Pretax profit	43.0	49.1	80.0	100.4	113.6
Tax	-12.3	-12.5	-20.0	-25.1	-28.4
Minority interest	-0.7	-0.2	-1.3	-1.6	-1.8
Net profit	30.1	36.3	58.7	73.7	83.4

Balance Sheet Statement

FYE 30 April (RMm)	2015	2016	2017E	2018E	2019E
Fixed assets	64.6	66.3	73.2	75.0	76.7
Other long term assets	55.1	54.4	53.7	53.0	52.4
Total non-current assets	119.8	120.7	126.9	128.0	129.1
Cash and equivalents	48.3	53.7	43.9	65.7	91.2
Stocks	58.2	68.0	94.0	113.4	128.4
Debtors	23.4	25.2	35.9	43.5	49.2
Other current assets	56.1	53.8	53.8	53.8	53.8
Total current assets	186.1	200.7	227.7	276.4	322.5
Creditors	30.8	45.1	62.4	75.3	85.2
Short term borrowings	3.9	1.1	1.0	0.9	0.8
Other current liabilities	5.2	6.1	6.1	6.1	6.1
Total current liabilities	39.9	52.3	69.5	82.3	92.1
Long term borrowings	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	0.1	0.1	0.1	0.1	0.1
Total long term liabilities	0.1	0.1	0.1	0.1	0.1
Shareholders' Funds	253.9	257.4	272.1	307.6	343.1
Minority interest	12.0	11.6	12.9	14.5	16.4

Cash Flow Statement

FYE 30 April (RMm)	2015	2016	2017E	2018E	2019E
EBIT	45.4	48.3	80.1	100.5	113.7
Depreciation & amortisation	3.2	3.4	3.8	3.9	3.9
Working capital changes	-3.0	6.0	-19.5	-14.1	-10.7
Cash tax paid	-12.3	-12.5	-20.0	-25.1	-28.4
Others	-6.3	-3.5	0.0	0.0	0.0
Cashflow from operation	27.0	41.8	44.4	65.2	78.5
Capex	-12.1	-3.8	-10.0	-5.0	-5.0
Others	5.5	4.6	0.0	0.0	0.0
Cash flow from investing	-6.6	0.8	-10.0	-5.0	-5.0
Debt raised/(repaid)	-1.7	-2.8	-0.1	-0.1	-0.1
Dividends paid	-41.1	-44.0	-44.0	-38.1	-47.9
Others	10.4	9.5	-0.1	-0.1	-0.1
Cash flow from financing	-32.3	-37.3	-44.2	-38.3	-48.0
Free Cash Flow	14.9	38.0	34.4	60.2	73.5

Source: Affin Hwang

Key Financial Ratios and Margins

FYE 30 April (RMm)	2015	2016	2017E	2018E	2019E
Growth					
Revenue (%)	-5.3	24.1	42.5	21.0	13.1
EBITDA (%)	-16.5	6.6	62.3	24.4	12.7
Core net profit (%)	-25.3	20.8	61.5	25.5	13.2
Profitability					
EBITDA margin (%)	20.2	17.4	19.8	20.3	20.3
PBT margin (%)	17.9	16.5	18.9	19.6	19.6
Net profit margin (%)	12.5	12.2	13.8	14.4	14.4
Effective tax rate (%)	29	25	25	25	25
ROA (%)	12.0	13.6	19.5	21.0	20.9
Core ROE (%)	11.8	14.2	22.2	25.4	25.6
ROCE (%)	17.5	18.7	30.1	34.6	34.9
Dividend payout ratio (%)	97.5	80.7	65.0	65.0	65.0
Liquidity					
Current ratio (x)	4.7	3.8	3.3	3.4	3.5
Op. cash flow (RMm)	27.0	41.8	44.4	65.2	78.5
Free cashflow (RMm)	14.9	38.0	34.4	60.2	73.5
FCF/share (sen)	5.1	13.0	11.7	20.5	25.1
Asset management					
Debtors turnover (days)	35.7	30.9	30.9	30.9	30.9
Stock turnover (days)	137.8	126.4	126.4	126.4	126.4
Creditors turnover (days)	72.9	83.9	83.9	83.9	83.9
Capital structure					
Net gearing (%)		net cash	cash	net cash	net cash
Interest cover (x)	143.3	149.2	235.1	956.3	1322.1

Quarterly Profit & Loss

FYE 30 April (RMm)	3Q16	4Q16	1Q17	2Q17	3Q17
Revenue	80.5	88.6	78.7	99.8	107.2
Operating expenses	-66.5	-72.6	-65.2	-78.7	-84.9
EBITDA	14.0	16.0	13.4	21.1	22.3
Depreciation	-0.9	-1.0	-0.9	-0.9	-0.9
EBIT	13.1	15.0	12.6	20.2	21.4
Net int income/(expense)	0.2	0.6	0.2	0.4	0.3
Associates' contribution	0.0	-0.4	-0.1	-0.3	0.0
Exceptional items	0.0	0.0	0.0	0.0	0.0
Pretax profit	13.2	15.3	12.6	20.3	21.7
Tax	-3.3	-4.1	-3.1	-4.4	-6.0
Minority interest	-0.1	0.0	0.3	0.0	-0.3
Net profit	9.8	11.2	9.7	15.9	15.4
Core net profit	9.8	11.2	9.7	15.9	15.4
Margins (%)					
EBITDA	17.4	18.1	17.1	21.2	20.8
PBT	16.4	17.2	16.0	20.4	20.2
Net profit	12.2	12.6	12.4	15.9	14.3

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

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

This report is intended for information purposes only and has been prepared by Affin Hwang Investment Bank Berhad (14389-U) ("the Company") based on sources believed to be reliable. However, such sources have not been independently verified by the Company, and as such the Company does not give any guarantee, representation or warranty (express or implied) as to the adequacy, accuracy, reliability or completeness of the information and/or opinion provided or rendered in this report. Facts, information, views and/or opinion presented in this report have not been reviewed by, may not reflect information known to, and may present a differing view expressed by other business units within the Company, including investment banking personnel. Reports issued by the Company, are prepared in accordance with the Company's policies for managing conflicts of interest arising as a result of publication and distribution of investment research reports. Under no circumstances shall the Company, its associates and/or any person related to it be liable in any manner whatsoever for any consequences (including but are not limited to any direct, indirect or consequential losses, loss of profit and damages) arising from the use of or reliance on the information and/or opinion provided or rendered in this report. Any opinions or estimates in this report are that of the Company, as of this date and subject to change without prior notice. Under no circumstances shall this report be construed as an offer to sell or a solicitation of an offer to buy any securities. The Company and/or any of its directors and/or employees may have an interest in the securities mentioned therein. The Company may also make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

Comments and recommendations stated here rely on the individual opinions of the ones providing these comments and recommendations. These opinions may not fit to your financial status, risk and return preferences and hence an independent evaluation is essential. Investors are advised to independently evaluate particular investments and strategies and to seek independent financial, legal and other advice on the information and/or opinion contained in this report before investing or participating in any of the securities or investment strategies or transactions discussed in this report.

Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability for any damages of any kind relating to such data.

The Company's research, or any portion thereof may not be reprinted, sold or redistributed without the consent of the Company.

The Company, is a participant of the Capital Market Development Fund-Bursa Research Scheme, and will receive compensation for the participation.

This report is printed and published by:
 Affin Hwang Investment Bank Berhad (14389-U)
 A Participating Organisation of Bursa Malaysia Securities Berhad

22nd Floor, Menara Boustead,
 69, Jalan Raja Chulan,
 50200 Kuala Lumpur, Malaysia.

T : + 603 2146 3700
 F : + 603 2146 7630
 research@affinhwang.com

www.affinhwang.com