AFFIN INVESTMENT BANK
PP 10251/07/2013/(032736)

Results Note

Hai-O Ent

HAIO MK
RM2.62

ADD (maintain)

Target Price: RM2.95 (↓)

Price Performance

	1M	3M	12M
Absolute	-0.8%	-2.6%	+25.8%
Rel to KLCI	-3.7%	-6.6%	+13.0%

Stock Data

Issued shares (m)	196.9
Mkt cap (RMm)	515.6
Avg daily vol - 6mth (m)	0.20
52-wk range (RM)	2.07 – 2.85
Est free float	67.6%
NTA per share (RM)	1.26
P/NTA (x)	2.08
Net cash/debt (RMm) (2Q14)	56.01
ROE (FY14E)	19.4%
Derivatives	Nil

Key Shareholders

Tan Kai Hee	9.6%
Akintan Sdn Bhd	7.3%
Excellent Communications	5.3%

Earnings & Valuation Revisions

	14E	14E	15E
Prev EPS (sen)	24.5	27.4	31.0
Curr EPS (sen)	22.3	25.1	28.5
Chg (%)	-8.9	-8.4	-8.1
Prev target price (RM)			3.15
Curr target price (RM			2.95

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Below expectation

1HFY04/14 core earnings fell -10% yoy due to weaker MLM division

Hai-O's 1HFY04/14 revenue contracted -4.5% yoy to RM120m owing to the lower revenue contribution from its core Multi-level-marketing (MLM) division (-28% yoy to RM59m). We attribute this to the high base effect, in 1HFY04/13 where sales were boosted by special price promotions for its best selling foundation garment products. We understand that the group's foundation garment products has slowed down in 1HFY04/13, due to the absence of promotional activities. Meanwhile, distributors are also waiting for the upcoming improved version of the foundation garment. As a result, EBIT margins from the MLM division fell by -3.1%-points to 14.7%. Taken together with a higher tax expenses, (1HFY04/14's effective tax rate of 26% vs 1HFY04/13's 21.7%) Hai-O's core earnings fell -10% yoy to RM19.4m. Results were below expectation, accounting for 39% of ours and 37% of street' expectations.

2QFY04/14 core earnings grew +19% qoq due to lower interest expenses

On a sequential basis, Hai-O's revenue surged +20% to RM66m driven by improved wholesale (+49% qoq growth in revenue) and retail divisions (+37% qoq). We gather that the healthy sales recorded from its wholesale division was due to stronger sales orders from medical halls for its patented Chinese mediated tonic products and Chinese tea. EBIT margin improved to 22.1% (1QFY04/14: 21.3%) was also underpinned by a turnaround in its retail division in 2QFY04/14, given by stronger sales generated from member sales' promotions. Coupled with a -10.5% qoq drop in interest expenses the group's core earnings increased by +19% qoq to RM10.5m. On a yoy comparison, the group had managed to maintain its topline revenue despite a -39% yoy drop in revenue for its MLM division. A key reason for the weak MLM performance was due to a change in marketing strategy. While waiting for the launch for its improved foundation garment products, the group changed its marketing strategy by promoting more "small ticket" items in 2QFY04/14. Although Hai-O incurred lower operating and interest expenses, Hai-O's core earnings slipped -6.8% yoy due to: 1) a sharp drop in interest income; and 2) a higher effective tax rate, (2QFY04/14's effective tax rate: 25.6% vs 2QFY04/13's 19.4%).

Cutting FY14-16 EPS forecast on slower consumption trend

In light of an anticipated slowdown in consumer spending, impacted by higher fuel prices, food and sugar prices as well as higher electricity tariff going forward, we see higher demand risk for Hai-O's products going forward. (Affin's economist expects private consumption growth to moderate further in 2014 to 7% from 7.5% in 2013. Malaysia's private consumption growth was at +7.7% in 2012). As such, we have lowered our growth assumption for new agents from 2.3k/month to 2k/month. Besides, we also revise lower our revenue per agent assumption from a growth of 9% to 7% in FY14-16 (FY04/13: 15%). As a result, our FY14-16 EPS forecast is cut by -8.9%/-8.4%/-8.1% respectively.

Maintain ADD but with a lower target price

Following our EPS downgrade, our TP for Hai-O has been trimmed to **RM2.95**, pegged at an unchanged PER target of 12x FY14 EPS (RM3.15 previously). We nevertheless still like Hai-O for its: 1) healthy fundamentals; and 2) high dividend yield. Furthermore, we believe Hai-O's upcoming improved foundation garment will continue to support the group's earnings going forward.

Earnings and valuation summary

FYE 30 April	2012	2013	2014E	2015E	2016E
Revenue (RMm)	239.5	267.9	299.0	329.7	373.8
EBITDA (RMm)	52.3	67.7	66.7	74.7	84.5
Pretax profit (RMm)	48.8	64.1	63.0	70.9	80.7
Net profit (RMm)	34.0	47.4	45.1	50.8	57.8
EPS (sen)	16.8	23.4	22.3	25.1	28.5
PER (x)	15.6	11.2	11.8	10.5	9.2
Core net profit (RMm)	33.2	43.5	45.1	50.8	57.8
Core EPS (sen)	16.4	21.5	22.3	25.1	28.5
Core EPS chg (%)	17.0	31.1	3.7	12.6	13.8
Core PER (x)	16.0	12.2	11.8	10.5	9.2
Net DPS (sen)	9.0	14.0	12.9	14.5	16.5
Net Dividend Yield (%)	3.4	5.4	4.9	5.5	6.3
EV/EBITDA (x)	8.3	6.1	6.0	5.0	4.2
Consensus profit (RMm)			50.7	56.7	62.9
Affin/Consensus (x)			0.9	0.9	0.9

Fig 1: Quarterly results comparison

FYE April (RMm)	2QFY13	1QFY14	2QFY14	QoQ % chg	YoY % chg	Comment
Revenue	65.3	54.7	65.6	20.0	0.5	Higher qoq brought by strong revenue growth in wholesale and retail division. Flattish yoy despite poor sales in MLM division. Poor MLM sales due to lower pomotional and marketing activities for its best selling foundation garment products.
Op costs	(80.9)	(66.3)	(80.1)	20.8	(0.9)	Lower marketing & promotional activities pending launching of the new version of foundation garment
EBIT	15.6	11.7	14.5	24.6	(6.7)	
EBIT margin (%)	*23.8*	*21.3*	*22.1*	*0.8*	*(1.7)*	Yoy impacted by lower sales for its high margin foundation garment products
Int expense	(0.2)	(0.1)	(0.1)	(10.5)	(31.9)	
Int and other inc	0.3	0.3	0.2	(33.6)	(13.9)	
Associates	0.0	0.0	0.0	nm	nm	
Exceptional gain/losses	4.8	(0.1)	0.0	nm	nm	2QFY04/13 EI: Gain on disposal of PPE
Pretax	**20.5**	**11.8**	**14.6**	24.1	(28.5)	Lower yoy impacted by higher operating cost in the retail division and lower sales of "big ticket" items
Tax	(4.0)	(3.1)	(3.7)	22.0	(5.6)	
Tax rate (%)	*19.4*	*26.0*	*25.6*	*nm*	*nm*	
MI	(0.4)	0.1	(0.4)	nm	nm	
Net profit	**16.1**	**8.8**	**10.5**	19.8	(34.6)	
EPS (sen)	8.0	4.4	5.2	19.8	(34.6)	
Core net profit	**11.3**	**8.9**	**10.5**	**18.8**	**(6.8)**	Below expectation, accounts for 14% of our and 11% total consensus estimates

Source: Affin

Fig 2: Cumulative results comparison

FYE April (RMm)	1HFY13	1HFY14	YTD % chg	Comment
Revenue	125.9	120.3	(4.5)	Driven primarily by the slowdown in its "bigger ticket items" - key foundation garment and BioVelocity mattress products
Op costs	(155.3)	(146.5)	(5.7)	Timing effect - lower A&P activities pending the launch for its new variant foundation garment products
EBIT	29.3	26.2	(10.8)	
EBIT margin (%)	*23.3*	*21.8*	*(1.5)*	Margin squeezed attributed to lower sales of higher margin products
Int expense	(0.3)	(0.2)	(31.5)	Lower interest expense
Int and other inc	0.5	0.6	12.9	
Associates	0.0	0.0	nm	
Exceptional gain/losses	4.8	(0.1)	nm	EI: Gain in disposals of a piece of freehold vacant land recognized in 2QFY04/13
Pretax	**34.3**	**26.4**	**(22.9)**	
Tax	(7.5)	(6.8)	(8.6)	
Tax rate (%)	*21.7*	*25.8*	*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)	(0.3)	(38.1)	
Net profit	**26.4**	**19.3**	**(26.7)**	
EPS (sen)	13.0	9.6	(26.7)	
Core net profit	**21.6**	**19.4**	**(10.0)**	Below expectations, accounting for 39% of our and 37% 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

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