MALAYSIA
INVESTMENT RESEARCH REPORT

JF APEX SECURITIES BERHAD
(47680-X)

Company Result | 27 June 2018

Hai-O Enterprise Berhad

4QFY18: Temporary blip of MLM division

BUY
Maintained

Share Price	**RM4.85**
Target Price	**RM6.41**

Company Description

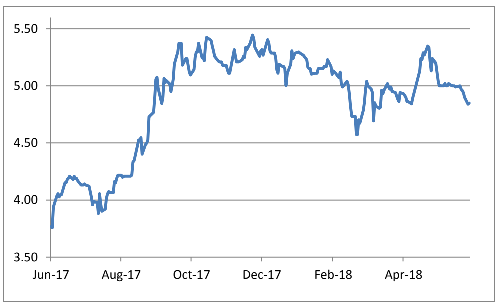
Hai-O Enterprise Berhad is offering a wide range of Chinese medicines, medicated tonic, wellness, beauty and healthcare.

Stock Data	
Bursa / Bloomberg code	7668 / HAIO MK
Board / Sector	Industrial/Food & Drug Retailers
Syariah Compliant status	No
Issued shares (m)	290.94
Par Value (RM)	0.50
Market cap. (RMm)	1,411.06
52-week price Range	RM3.88 – 5.60
Beta (against KLCI)	0.68
3-m Average Daily Volume	0.19m
3-m Average Daily Value^	RM0.97m

Share Performance	1m	3m	12m
Absolute (%)	-8.0	-3.6	23.7
Relative (%-pts)	-1.3	11.9	31.4

Major Shareholders	**%**
Kai Hee Tan	10.11
Akintan Sdn Bhd	7.83
Excellent Communications	5.34

Historical Chart



Source: Bloomberg

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Result

- **Hai-O reported a net profit of RM16.3m for its 4QFY18.** The quarterly net profit dropped by 15.5% QoQ and 42.4% YoY. Meanwhile, the Group recorded quarterly revenue of RM110.6m, increasing 7.4% QoQ but declining by 6.5% YoY.
- **For 12MFY18,** the Group attained a higher topline and bottomline of 14.3% and 8.0% YoY respectively.
- **Full year net profit below expectations.** 12MFY18 net profit was below our and consensus expectations by accounting for 84%/87% of our/consensus full year earnings forecast respectively. The lower-than-expected earnings were mainly due to weaker revenue, as a result of subdued consumer sentiment prior to general election (GE14) as consumers held back their spending amid political and economic uncertainties coupled with higher tax expense and minority interest.

Comment

- **Lower QoQ earnings due to weaker margin achieved and one-off item in previous quarter.** The Group achieved a higher revenue of 7.4% from MLM division (+5%) and retail division of (+2%), thanks to members' sales promotion coupled with Chinese New Year (CNY) sales in the fourth quarter. However, the Group recorded a lower EBIT margin, -3.2ppts mainly due to the year-end overseas incentive trip sales campaign to its members along with the resale of treasury shares amounting to RM2m in 3QFY18.
- **Disappointing YoY earnings as a result of weaker topline coupled with the higher tax expense and minority interest.** The Group achieved a higher revenue from its wholesale and retail divisions, +40 and +47% respectively, thanks to higher sales generated from its Chinese medicated tonic from wholesale segment along with CNY sales which boosted the retail sales. However, the higher revenue generated by wholesale and retail divisions were offset by lower revenue from the MLM division, -17%, mainly due to slow down of business activities prior to general election, as members were more cautious ahead of uncertainties poised by the GE14. Besides, the lower net profit was further aggravated by the higher tax expenses along with higher minority interest.
- **Stronger 12MFY18 earnings contributed by all three divisions……** The Group recorded a better revenue of 16% mainly driven by MLM division, thanks to higher sales from most of the products, coupled with better sales from the 25th year anniversary grand sales promotion and introduction of several range of product under food and

beverages, beauty and lifestyle categories. Besides, the higher revenue also contributed by wholesale division from the sales of premium Chinese medicated tonic, patented medicine and vintage Puer tea.

- **……. and better margins**. The Group recorded a higher PBT margin, +2.0ppts, contributed by leverage of digital marketing platform along with the resale of treasury sales amounting to RM2m was added on to the profit.
- **Dividend declared.** The Group has declared a final single tier dividend of 11 sen per share for this quarter.
- **MLM division – continuous expansion.** The Group will continue to carry out more new product development and plan to roll out wider range of skin care and food supplements, coupled with the effort to penetrate into fashion & lifestyle related range of products. Besides, the Group will continue to widen its distributor base through digital marketing platform. Overall, we are sanguine on its FY19 earnings.
- **Wholesale division – broadening product base.** The Group will continue to promote its key products (Chinese medicine tonic) to the younger generations and secure more overseas agencies to further expand its customer base.
- **Retail division – expanding products portfolio and enhancing margin.** The Group will collaborate with hypermarkets to open concession counters and develop more house brand products in order to improve margin.
- **Better quarter ahead.** Although the Group recorded a temporary blip for its 4QFY18 results, we envisage Hai-O will resume its growth momentum in 1QFY19, particularly benefiting from the zero-rated GST starting 1 June 2018 for the period of 3 months.
- **Positive outlook.** Basically, we remain positive and believe that the Group is able to achieve better revenue and margin for its FY19F. Hai-O's prospects are underpinned by: 1) Anticipated better sales from the lifestyle fashion brands which will boost its MLM division, 2) Leverage on digital marketing platform for its MLM ecosystem which continue enhancing its operational efficiency and margins, and 3) Higher recurring sales from wholesale division stemming from its premium medicated tonic and Chinese tea.

Earnings Outlook/Revision

- **We maintain our earnings forecast for FY19F (+45.6% yoy)** as we believe that the Group will generate higher earnings from the introduction of new products as well as positive impact from zero-rated GST. We also introduce our FY20F net earnings of RM117.2m, representing growth of +6.8%.

Valuation & Recommendation

- **Maintain BUY with an unchanged target price of RM6.41**. Our target price is pegged at PE multiple of 17.5x of FY2019F EPS of 36.6sen.

- **We continue to favour Hai-O for its:** 1) Stable and decent profit margin with effective cost rationalization, 2) Strong brand name among Malaysian household, 3) Strong balance sheet with net cash position, 4) Lower risk as is less exposed to foreign market and foreign currency risk, and 5) Better margin as compared to its peers (Amway) coupled with better growth prospects.

Figure 1: Quarterly Figures

Year ended 30 April	4QFY18 RM'm	3QFY18 RM'm	4QFY17 RM'm	QoQ %	YoY %	12MFY18 RM'm	12MFY17 RM'm	YoY %
Revenue	110.6	103.1	118.4	7.4%	-6.5%	461.8	404.0	14.3%
Gross profit	39.0	39.4	40.3	-1.2%	-3.4%	162.2	132.9	22.1%
Operating profit	22.8	24.6	23.2	-7.2%	-1.5%	97.6	77.3	26.3%
PBT	23.1	25.0	23.5	-7.9%	-2.0%	99.0	78.1	26.8%
PAT	16.7	19.2	18.2	-13.3%	-8.3%	75.1	59.2	26.9%
Net profit	16.3	19.3	18.5	-15.5%	-11.9%	74.8	59.5	25.8%
Margin (%)				***ppts***	***ppts***			***ppts***
Gross profit margin	35.2%	38.2%	34.1%	*-3.0*	*1.1*	35.1%	32.9%	*2.2*
EBIT margin	20.6%	23.8%	19.6%	*-3.2*	*1.1*	21.1%	19.1%	*2.0*
PBT margin	20.8%	24.3%	19.9%	*-3.4*	*1.0*	21.4%	19.3%	*2.1*
PAT margin	15.1%	18.6%	15.4%	*-3.6*	*-0.3*	16.3%	14.7%	*1.6*
Net profit margin	14.7%	18.7%	15.6%	*-4.0*	*-0.9*	16.2%	14.7%	*1.5*

Source: Company, JF Apex

Figure 2: Revenue and PBT by division

Year ended 30 April	4QFY18 RM'm	3QFY18 RM'm	4QFY17 RM'm	QoQ %	YoY %
MLM division	79.1	75.5	95.4	5%	-17%
Wholesale division	17.6	17.1	12.6	3%	40%
Retail division	13.7	9.3	9.3	47%	47%
Total Revenue	**110.4**	**101.9**	**117.3**	**8%**	**-6%**
MLM division	16.8	14.5	19.2	16%	-13%
Wholesale division	3.6	8.9	2.1	-60%	71%
Retail division	1.4	0.1	0.3	1300%	367%
Total PBT	**21.8**	**23.5**	**21.6**	**-7%**	**1%**
PBT margin (%)				**ppts**	**ppts**
MLM division	21.2%	19.2%	20.1%	2	1.1
Wholesale division	20.5%	52.0%	16.7%	-31.6	3.8
Retail division	10.2%	1.1%	3.2%	9.1	7

Source: Company, JF Apex

Figure 3: Peer Comparison

Company	Price RM	Recommendation	T.price RM	P/E	P/B	P/S	PAT margin %	Div Yield %
Hai-O	4.9	BUY	6.14	19	4.7	3.4	19.4	3.3
Amway	7.5	-	-	24	6.4	1.3	7.2	2.6

Source: Bloomberg, JF Apex

Figure 4: Financial Summary

Year ended 30 April	FY15 RMm	FY16 RMm	FY17 RMm	FY18 RMm	FY19F RMm	FY20F RMm
Revenue	239.9	297.6	404.0	461.8	671.9	721.5
Gross profit	85.6	101.4	132.9	162.2	201.6	221.5
Operating profit	42.2	48.3	77.3	97.6	140.1	149.3
PBT	43.0	49.1	78.1	99.0	141.0	150.4
PAT	30.8	36.6	59.2	75.1	109.9	117.4
Net profit	30.1	36.3	59.3	75.4	109.8	117.2
Margin (%)						
Gross profit margin	35.7%	34.1%	32.9%	35.1%	30.0%	30.7%
Operating profit	17.6%	16.2%	19.1%	21.1%	20.8%	20.7%
PBT margin	17.9%	16.5%	19.3%	21.4%	21.0%	20.8%
PAT margin	12.8%	12.3%	14.7%	16.3%	16.4%	16.3%
Net profit margin	12.5%	12.2%	14.7%	16.3%	16.3%	16.2%
Growth (%)						
Revenue growth	-5.4%	24.1%	35.7%	14.3%	45.5%	7.4%
Gross Profit growth	-8.5%	18.5%	31.0%	22.1%	24.3%	9.9%
PBT growth	-19.7%	14.0%	59.2%	26.8%	42.3%	6.7%
PAT growth	-25.6%	18.9%	61.9%	26.9%	46.4%	6.8%
Net profit growth	-25.4%	20.8%	63.1%	27.2%	45.6%	6.8%
Net gearing	Net cash	Net cash	Net cash	Net cash	Net cash	Net cash
ROA	9.8%	11.3%	16.3%	19.1%	23.8%	23.8%
ROE	11.3%	13.5%	20.0%	23.7%	29.3%	29.7%
EPS (sen)	10.0	12.1	19.7	25.1	36.6	39.0
P/E	15.4	15.4	15.4	15.4	15.4	15.4
DPS (sen)	10.0	10.0	16.0	16.0	16.0	16.0
Dividend Payout	98.2%	81.6%	80.6%	53.5%	43.5%	43.5%
Dividend yield (%)	2.2%	2.2%	3.4%	3.4%	3.4%	3.4%

Source: Company, JF Apex

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JF APEX SECURITIES - RESEARCH RECOMMENDATION FRAMEWORK

STOCK RECOMMENDATIONS

BUY : The stock's total returns* are expected to exceed 10% within the next 12 months.

HOLD : The stock's total returns* are expected to be within +10% to – 10% within the next 12 months.

SELL : The stock's total returns* are expected to be below -10% within the next 12 months.

TRADING BUY : The stock's total returns* are expected to exceed 10% within the next 3 months.

TRADING SELL : The stock's total returns* are expected to be below -10% within the next 3 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT : The industry as defined by the analyst is expected to exceed 10% within the next 12 months.

MARKETWEIGHT : The industry as defined by the analyst is expected to be within +10% to – 10% within the next 12 months.

UNDERWEIGHT : The industry as defined by the analyst, is expected to be below -10% within the next 12 months.

*capital gain + dividend yield

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