Normalising growth, valuations undemanding

After a recent meeting with management, we make adjustments to our distributorship growth forecast as we see a tapering off of that growth but foresee potentially higher revenue per distributor, which will likely be further spurred by the introduction of new fashion and lifestyle products. While we expect the slowdown seen in 4QFY18 to linger into 1QFY19, we believe sales will pick up in the subsequent quarters. As valuations appear undemanding, we maintain our BUY rating albeit with a lower TP of RM5.39 based on 17x CY19E earnings.

Striking a balance between quality and quantity of distributors

Despite recording a slower growth in the number of distributors in FY18 (+10k compared to +57k in FY17 and +30k in FY16), we estimate that revenue per agent improved by 6% yoy (vis-à-vis declines of 6% and 8% in FY16 and FY17 respectively). We believe this indicates a more stable and higher quality distributor base. We are forecasting Hai-O's MLM distributor force to grow to 160,000 by end of FY19 (vs. 150,000 as of end-FY18).

Direct selling of fashion products still relatively small in Malaysia

We believe that the ramping up of fashion product launches by Hai-O is timely given the fact that sales of such products are a relatively small proportion of total direct selling sales in Malaysia. This also ties in well with their distributor base which is predominantly female and in the Bumiputra community. This should spur higher sales/distributor as new product launches provide new revenue generators to the existing distributor base.

Softness likely to continue into 1Q19, should normalise sequentially

To recap, Hai-O recorded weaker-than-expected 4Q18 results due to a slowdown in MLM activities as members turned cautious prior to the general election (GE). We believe that the slowdown continued to linger in the few months post-GE, which coincides with 1Q19 despite the extension of the deadline of the incentive trip to May 2018. Nonetheless, we foresee a pick-up in the subsequent quarters.

Maintain BUY with revised TP of RM5.39

After adjusting our distributor growth assumptions, we are revising down our earnings forecasts by c.15%-2% for FY19-21. Nonetheless, we are still seeing sustainable earnings growth for 2019E supported by new product launches and attractive incentive programs. We believe that the recent share price weakness provides an opportunity for entry into this stock and thus retain our BUY call with a revised TP of RM5.39 based on a lower 17x CY19E PER (from 18x previously). Key risks to our call include loss of distributors in the MLM division and weak take-up of new products.

Earnings & Valuation Summary

FYE Apr	2017	2018	2019E	2020E	2021E
Revenue (RMm)	404.2	461.8	497.8	556.6	633.5
EBITDA (RMm)	81.1	105.6	115.7	131.7	149.3
Pretax profit (RMm)	78.3	99.0	111.2	127.1	144.7
Net profit (RMm)	59.4	75.4	84.8	97.0	110.4
EPS (sen)	20.2	25.7	28.9	33.1	37.6
PER (x)	21.2	16.7	14.9	13.0	11.4
Core net profit (RMm)	59.4	75.4	84.8	97.0	110.4
Core EPS (sen)	20.2	25.7	28.9	33.1	37.6
Core EPS growth (%)	63.3	27.0	12.5	14.3	13.8
Core PER (x)	21.2	16.7	14.9	13.0	11.4
Net DPS (sen)	16.0	20.0	18.8	21.5	24.5
Dividend Yield (%)	3.7	4.7	4.4	5.0	5.7
EV/EBITDA (x)	13.9	10.8	9.5	8.1	0.0
Chg in EPS (%)			-14.7%	-8.5%	-2.2%
Affin/Consensus (x)			0.82	0.88	0.98

Source: Company, Bloomberg, Affin Hwang forecasts

Company Update

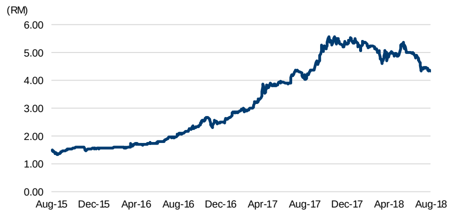
HAI-O

HAIO MK
Sector: Consumer

RM4.34@ 8 August 2018

BUY (maintain)
Upside: 24.2%

Price Target: RM5.39
Previous Target: RM6.10



Price Performance

	1M	3M	12M
Absolute	-7.3%	-11.8%	7.7%
Rel to KLCI	-14.5%	-9.7%	6.3%

Stock Data

Issued shares (m)	290.8
Mkt cap (RMm)/(US$m)	1,262/309.7
Avg daily vol - 6mth (m)	0.2
52-wk range (RM)	3.95-5.6
Est free float	55.2%
BV per share (RM)	1.06
P/BV (x)	4.09
Net cash/ (debt) (RMm) (4Q18)	67.61
ROE (2019E)	25.9%
Derivatives	Nil
Shariah Compliant	No

Key Shareholders

Tan Kai Hee	10.1%
Akintan Sdn BHd	7.9%
Excellent Communication	5.4%

Source: Affin Hwang, Bloomberg

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Quality over quantity

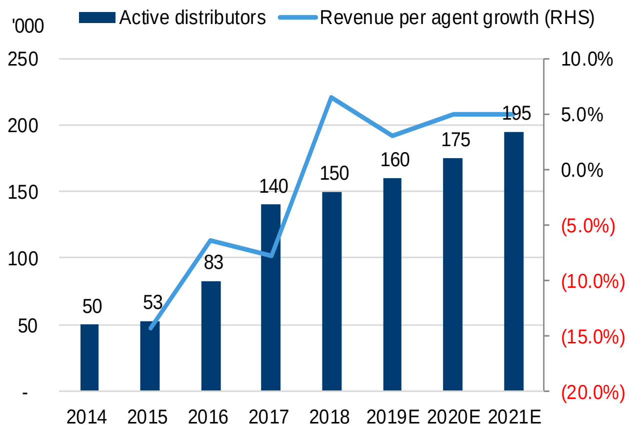
Slowdown in distributorship growth

After rapid growth in its distributor base (+30k in FY16 and +57k in FY17), Hai-O's distributor base grew at a slower pace of +10k in FY18 to approximately 150,000 distributors as at end of FY18. We estimate the growth in distributor base in FY19 to mirror that of FY18 (+5,000 new distributors per month), and targeting a net distributor base of 160,000 after accounting for attrition from expiry and non-renewal by members. We believe that there is still ample room for growth in Hai-O's distributor base when compared to the largest player in the MLM segment, Amway, which has 252,000 active members (as of FY17).

Improvements in revenue per distributor

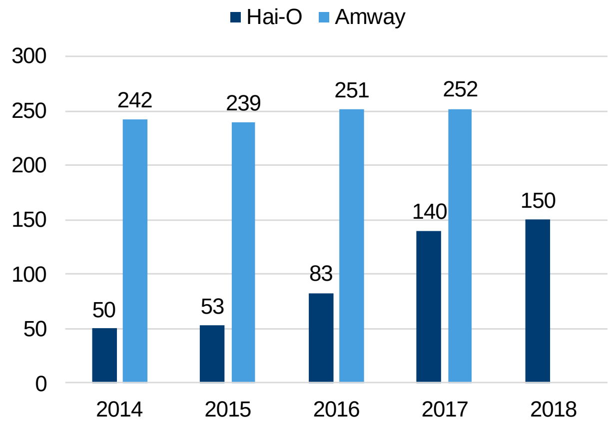
Despite the slowdown in distributor growth, we notice that revenue per distributor has inched up (estimated to increase by 6.5% in FY18). This has led to a 14% yoy increase in MLM revenue despite only a 7% yoy increase in distributorship. We believe that this was due to Hai-O's continual efforts to improve its product line-up and also the improvement in quality of active distributors.

Fig 1: Steady growth in distributorship, revenue/agent



Source: Company, Affin Hwang forecasts

Fig 2: Still room for growth in Hai-O's distributors



Source: Companies. Note: Difference in financial year end for Hai-O (April) and Amway (Dec)

Incentives to support member retention

We understand that Hai-O has put in place various initiatives to support both distributor growth and retention, which is validated by the rapid distributorship growth in the span of a few years. As such, we continue to be positive on its incentive strategies, with some examples listed below:

- One of the highest payout ratios among MLM companies in Malaysia (up to 67%).
- >2 annual incentive trips to motivate sales by members.
- Tutorials and training courses to enhance the product knowledge and entrepreneurial skills of members.
- Recognition/Awards events and business trips to give a sense of accomplishment and progression for the members.

New product segments provide new sources of revenue growth

Hai-O has been actively engaging in product development, by introducing new product ranges in the food and beverage segment (under the D'Chef brand), beauty and lifestyle products (under the Infinence and Cozuma brand) as well as line extensions of existing product ranges. Included in the beauty and lifestyle product range are fashion items such as shoes, handbags and leather purses, for which the renowned fashion designer Dato' Professor Jimmy Choo is a consultant.

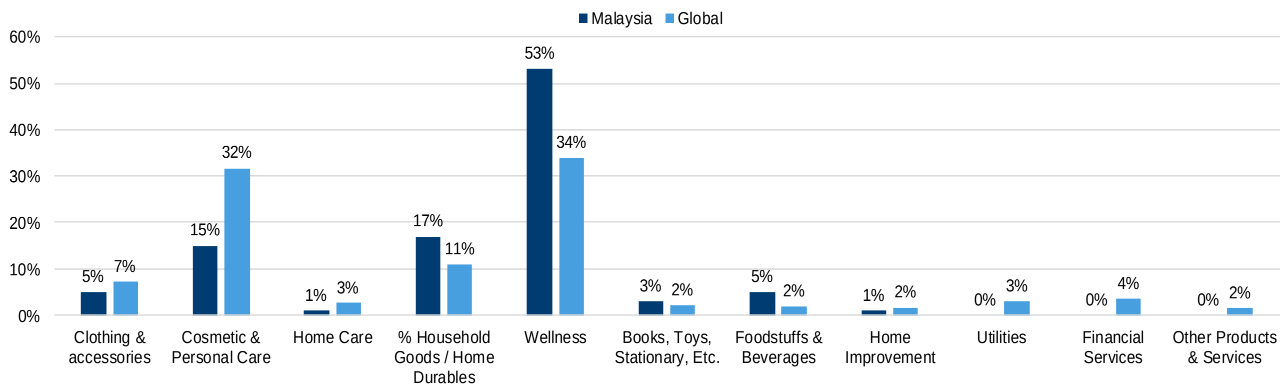
Fig 3: Examples of new fashion and lifestyle products introduced

Source: Company, Affin Hwang

Direct selling of fashion products still relatively untapped

Data from the World Federation of Direct Selling Association (refer to Fig 4) shows that the direct selling of clothing & accessories and cosmetics & personal care in Malaysia still represents a relatively small portion of total sales compared to globally. As such, we are positive on Hai-O's strategy to introduce more product lines in the female fashion segment, as it appears relatively untapped. Furthermore, Hai-O is able to leverage on its existing distributor base, of which a majority (70%) are female and below 45 years old. The fashion segment is also well suited with Hai-O's strategy of increasing its social media presence, which will improve brand visibility and attract more distributors among the youth.

Fig 4: Breakdown of total direct selling revenue



Source: World Federation of Direct Selling Associations

Growing in East Malaysia and Indonesia

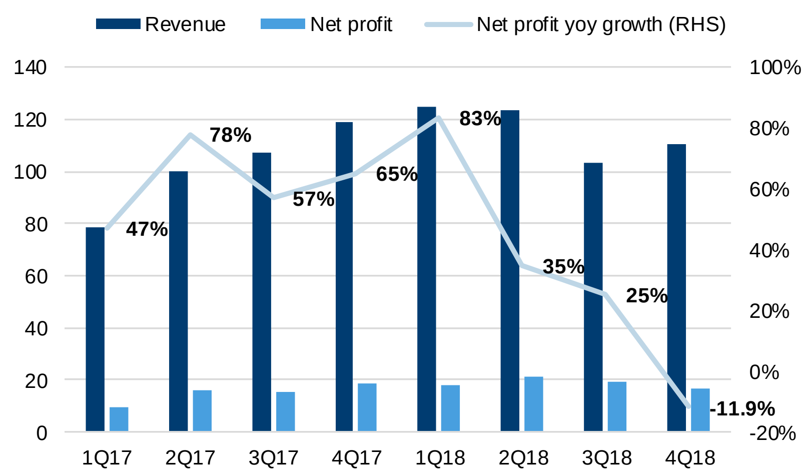
Due to increasing market demand from East Malaysia, Hai-O has set up new branches in Tawau and Sandakan to serve as distribution centres for its MLM members. We understand that East Malaysia MLM sales currently account for approximately 30% of total MLM revenue, with potentially higher growth. Likewise, Hai-O is also eyeing the Indonesian market as a source of distributorship growth. To encourage this, a 'Jakarta Business Summit' trip is on the books for this year with the intention to facilitate existing distributors to build their network in Indonesia. We understand that this trip is catered for approximately 600 qualifiers who have notched up more than RM80,000 in sales in the 3 months from June-August 2018.

Earnings Outlook

Softness likely to continue in 1Q19

Hai-O recorded a weaker-than-expected set of 4QFY18 results, which was mainly attributed to a slowdown in activities in the MLM segment as members turned more cautious leading up to the GE. Revenue and EBIT for the MLM segment declined by 17% and 13% yoy respectively, which contributed to the 11.9% decline in net profit for 4QFY18 (first yoy decline in net profit in 12 quarters). We expect the softness in the MLM segment arising from post-GE uncertainties to have continued to linger in the following couple of months (May & June), which coincides with 1QFY19. Nonetheless, we foresee a pick-up in subsequent months as the uncertainty fades and more new products get rolled out.

Fig 5: Quarterly revenue and net profit

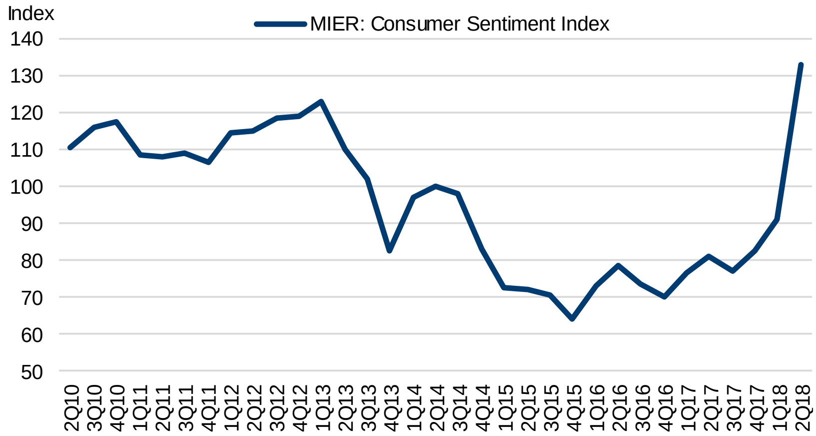


Source: Company

Expecting wholesale & retail segments to hold up

After 2 years of external revenue declines in the wholesale & retail segments due to weak consumer sentiment in FY16 and FY17, Hai-O saw a pick-up in external revenue for both segments in FY18 (+20.9% and +8.7% respectively). As consumer sentiment is in recovery mode, we believe that both the wholesale and retail segments will continue to hold up. Hai-O is looking to expand the array of Chinese medicines, health tonics, tea and healthcare products to cater to younger consumers.

Fig 6: MIER CSI breached the 100-point threshold in 2Q18



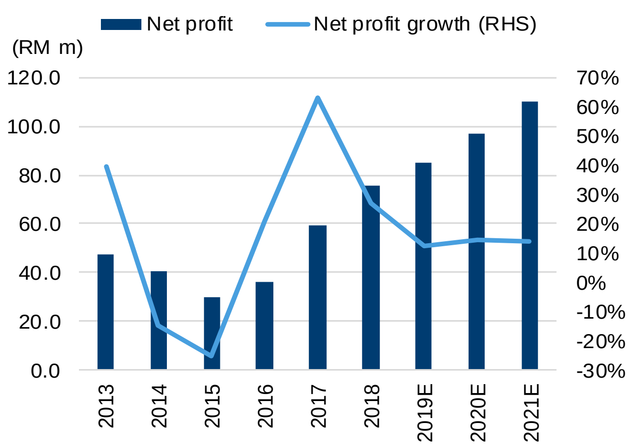
Source: MIER

Valuation and recommendation

Forecasting a 3-year earnings CAGR of 13.5% from FY19-21E

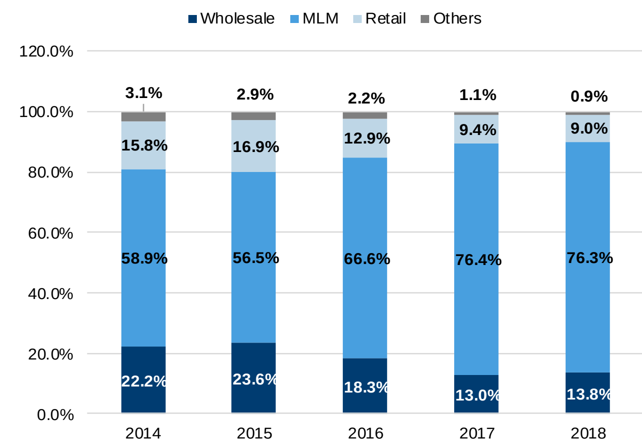
We are forecasting a c.13% earnings growth for FY19, which will still be driven by growth in the MLM segment. Although we remain cautious on the near-term (1QFY19) earnings growth, we believe that new product launches and attractive incentive plans should continue to support growth in the MLM segment in the subsequent quarters. However, in line with the launches of new fashion products, we have pencilled in a slight uptick in marketing and distribution costs for FY19.

Fig 7: Forecasting growth of 12-14% from FY19-21E



Source: Company, Affin Hwang Forecasts

Fig 8: MLM segment accounts for bulk of revenue

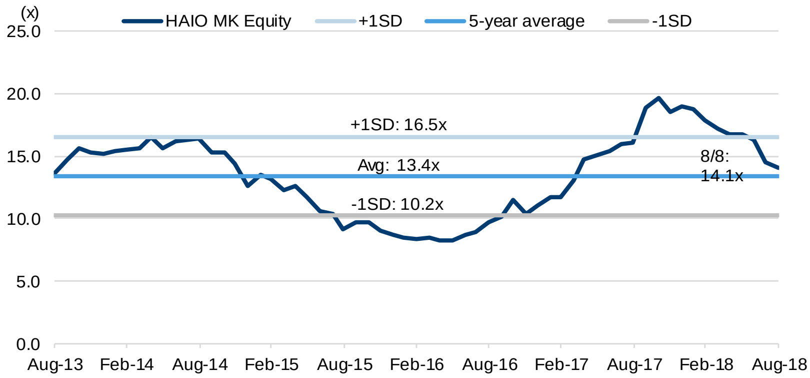


Source: Company

Maintain BUY with a lower TP of RM5.39, valuations still undemanding

In view of our adjustments on distributorship growth assumptions, we have reduced our target price to RM5.39 from RM6.10 previously, based on an lower 17x CY19E PER, which is slightly higher than +1SD above the 5-year mean (compared to 18x previously). Despite this, we still maintain our BUY rating on Hai-O as we deem the recent selling as overdone. We believe our target PER of 17x is justified at a c.43% discount to our consumer sector coverage PER of 30x. Even when compared with its closest peer, Amway (currently trading at 19.5x CY19 consensus forecast earnings), Hai-O's valuations still look undemanding considering that Hai-O is expected to record better margins and stronger earnings growth, according to the consensus.

Fig 9: Hai-O's 12-month forward PER chart



Source: Bloomberg, Affin Hwang

Fig 10: Peer comparison table

Stock	Rating	Sh Pr 8 Aug (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x) CY17	Core PE (x) CY18E	Core EPS growth (%) CY18E	Core EPS growth (%) CY19E	ROE (%) CY17	ROE (%) CY18E	DY (%) FY17	DY (%) FY18E
Hai-O	BUY	4.34	5.39	1,262.0	Apr	18.1	15.4	16.6	13.8	21.9	24.5	4.7	4.4
Amway	N/R	7.55	-	1,241.1	Dec	23.6	21.8	(3.6)	8.4	27.1	27.4	4.1	4.6
Zhulian	N/R	1.47	-	680.8	Nov	13.3	na	na	na	9.30	na	4.2	na

Source: Bloomberg, Affin Hwang forecasts
Note: Hai-O's DY figures are for FY18 and FY19E

Fig 11: Affin consumer sector coverage

Stock	Rating	Sh Pr 8 Aug (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x) CY18E	Core PE (x) CY19E	Core EPS growth (%) CY18E	Core EPS growth (%) CY19E	ROE (%) CY18E	DY (%) FY18E
Hai-O	BUY	4.34	5.39	1,262.00	Apr	15.4	13.6	16.6	13.8	24.5	4.4*
Aeon	BUY	2.20	2.65	3,088.80	Dec	23.9	21.5	5.2	11.2	6.5	1.9
Ajinomoto	HOLD	21.90	20.30	1337.60	Mar	22.6	20.5	20.0	10.0	12.9	2.2
BAT	BUY	34.18	43.10	9,759.4	Dec	22.1	17.1	(12.2)	29.3	114.0	4.5
Bonia	HOLD	0.44	0.43	354.5	Jun	11.9	11.2	(4.9)	6.5	6.6	1.8
Carlsberg	HOLD	19.58	18.60	6,023.2	Dec	22.4	21.3	21.4	5.4	83.9	4.5
Heineken	HOLD	23.04	20.75	6,960.3	Dec	23.8	22.4	8.4	6.0	75.1	3.8
MSM	HOLD	3.80	3.55	2,671.3	Dec	27.7	21.4	>100	29.4	4.9	2.3
Nestle	SELL	148.20	97.60	34,752.9	Dec	46.2	43.3	14.2	6.8	96.6	2.1
Oceancash	BUY	0.64	0.82	142.7	Dec	12.8	11.9	8.3	7.6	11.9	1.0
Average				**66,717.49**		**30.5**	**27.1**	**13.7**	**12.7**	**25.4**	**2.9**

Source: Bloomberg, Affin Hwang forecasts
Note:
.. FY19E for Hai-O

Hai-O FINANCIAL SUMMARY

Profit & Loss Statement

FYE 30 April (RMm)	2017	2018	2019E	2020E	2021E
Revenue	404.2	461.8	497.8	556.6	633.5
Operating expenses	-323.2	-356.2	-382.1	-424.9	-484.2
EBITDA	81.1	105.6	115.7	131.7	149.3
Depreciation	-3.0	-4.0	-4.5	-4.5	-4.5
EBIT	77.4	101.6	111.3	127.2	144.8
Net int income/(expense)	-0.1	-0.1	-0.1	-0.1	-0.1
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Pretax profit	78.3	99.0	111.2	127.1	144.7
Tax	-18.9	-23.9	-26.7	-30.5	-34.7
Minority interest	-0.1	0.3	0.3	0.4	0.4
Net profit	59.4	75.4	84.8	97.0	110.4

Balance Sheet Statement

FYE 30 April (RMm)	2017	2018	2019E	2020E	2021E
Fixed assets	73.7	83.0	83.5	84.0	84.5
Other long term assets	52.3	61.6	61.6	61.6	61.6
Total non-current assets	**126.0**	**144.7**	**145.2**	**145.7**	**146.1**
Cash and equivalents	76.8	69.0	101.9	135.6	172.5
Stocks	71.7	91.5	97.3	108.8	123.8
Debtors	31.6	33.8	36.4	40.7	46.3
Other current assets	58.2	57.9	57.9	57.9	57.9
Total current assets	**238.3**	**252.2**	**293.5**	**343.0**	**400.6**
Creditors	57.5	67.6	71.9	80.4	91.5
Short term borrowings	3.0	1.4	1.4	1.4	1.4
Other current liabilities	7.3	8.1	8.1	8.1	8.1
Total current liabilities	**67.9**	**77.2**	**81.5**	**89.9**	**101.1**
Long term borrowings	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	0.2	0.3	0.3	0.3	0.3
Total long term liabilities	**0.2**	**0.3**	**0.3**	**0.3**	**0.3**
Shareholders' Funds	**284.8**	**308.3**	**346.2**	**388.1**	**435.4**
Minority interest	**11.4**	**11.0**	**10.7**	**10.3**	**9.9**

Cash Flow Statement

FYE 30 April (RMm)	2017	2018	2019E	2020E	2021E
EBIT	77.4	101.6	111.3	127.2	144.8
Depreciation & amortisation	3.8	4.8	4.5	4.5	4.5
Working capital changes	-0.9	-10.8	-4.1	-7.3	-9.5
Cash tax paid	-18.9	-23.9	-26.7	-30.5	-34.7
Others	2.6	-19.0	0.0	0.0	0.0
Cashflow from operation	**64.2**	**52.8**	**84.9**	**93.9**	**105.0**
Capex	-10.1	-21.5	-5.0	-5.0	-5.0
Others	-0.6	6.3	0.0	0.0	0.0
Cash flow from investing	**-10.7**	**-15.1**	**-5.0**	**-5.0**	**-5.0**
Debt raised/(repaid)	1.9	-1.6	0.0	0.0	0.0
Dividends paid	-46.9	-58.7	-46.9	-55.1	-63.0
Others	14.5	15.0	-0.1	-0.1	-0.1
Cash flow from financing	**-30.5**	**-45.3**	**-47.0**	**-55.2**	**-63.1**
Free Cash Flow	**54.1**	**31.3**	**79.9**	**88.9**	**100.0**

Source: Company, Affin Hwang forecasts

Key Financial Ratios and Margins

FYE 30 April (RMm)	2017	2018	2019E	2020E	2021E
Growth					
Revenue (%)	35.8	14.2	7.8	11.8	13.8
EBITDA (%)	56.9	30.2	9.6	13.8	13.4
Core net profit (%)	63.3	27.0	12.5	14.3	13.8
Profitability					
EBITDA margin (%)	20.1	22.9	23.3	23.7	23.6
PBT margin (%)	19.4	21.4	22.3	22.8	22.8
Net profit margin (%)	14.7	16.3	17.0	17.4	17.4
Effective tax rate (%)	24	24	24	24	24
ROA (%)	19.0	22.5	22.5	22.7	0.0
Core ROE (%)	21.9	25.4	25.9	26.4	0.0
ROCE (%)	28.3	34.0	33.8	34.5	0.0
Dividend payout ratio (%)	79.0	77.8	65.0	65.0	65.0
Liquidity					
Current ratio (x)	3.5	3.3	3.6	3.8	4.0
Op. cash flow (RMm)	64.2	52.8	84.9	93.9	105.0
Free cashflow (RMm)	54.1	31.3	79.9	88.9	100.0
FCF/share (sen)	18.4	10.7	27.3	30.3	34.1
Asset management					
Debtors turnover (days)	28.5	26.7	26.7	26.7	26.7
Stock turnover (days)	96.3	111.5	111.5	111.5	111.5
Creditors turnover (days)	77.3	82.4	82.4	82.4	82.4
Capital structure					
Net gearing (%)	net	net	net	net	net
Interest cover (x)	235.1	600.6	806.1	1399.6	1592.4

Quarterly Profit & Loss

FYE 30 April (RMm)	4Q17	1Q18	2Q18	3Q18	4Q18
Revenue	118.6	124.5	123.5	103.1	110.6
Operating expenses	-94.4	-100.7	-95.1	-77.5	-86.6
EBITDA	24.2	23.8	28.4	25.6	24.1
Depreciation	-1.0	-1.0	-1.0	-1.0	-1.0
EBIT	23.3	22.8	27.4	24.6	23.1
Net int income/(expense)	0.4	0.3	0.4	0.4	0.0
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Exceptional Items	0.0	0.0	0.0	0.0	0.0
Pretax profit	23.7	23.1	27.9	25.0	23.1
Tax	-5.3	-5.5	-6.2	-5.8	-6.4
Minority interest	0.1	0.3	-0.2	0.0	-0.4
Net profit	18.5	17.9	21.4	19.3	16.3
Core net profit	18.5	17.9	21.4	19.3	16.3
Margins (%)					
EBITDA	20.4	19.1	23.0	24.8	21.8
PBT	19.9	18.6	22.5	24.3	20.8
Net profit	15.6	14.3	17.4	18.7	14.7

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

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