

Adapting to weakness in the market

We recently met up with Hai-O's management for an update on the company's outlook. Our key takeaways were: (i) soft market conditions afflicting the MLM segment; (ii) new products and promotions in response to the former; and (iii) more resilient prospects for its Retail and Wholesale segments. Subsequently, we hold onto our FY19-21E EPS estimates respectively while taking note of Hai-O's dividend policy which would remain in place, offering attractive yields of 4.5%-5.6% at current levels. Maintain HOLD with an unchanged TP of RM2.50.

MLM underperformance dragged on 9MFY19's results

To recap, Hai-O's 9MFY19 results disappointed both our and consensus expectations, accounting for only 68% and 62% of our previous FY19E estimates respectively as the MLM's segment's sales performance (-35% yoy) remained lacklustre. Management experienced challenges with membership attrition (falling from a peak of 160k distributors) following the company's 25th anniversary grand sales promotion in 1HFY18, alongside persisting weakness in the market. Other segments including the Wholesale and Retail segments performed better, but collectively contributed only c.26% of group EBIT FYTD.

Reshuffle in MLM strategy amid soft market conditions

In order to revitalise its MLM segment's depressed distributor base, management is looking to carry out a revamped recruitment and retention program throughout 2019, while launching a new product pipeline focused on "small-ticket" items which acknowledges the shift in market demand.

Turbulent quarters remain seen ahead

While a shift in the company's strategy for the MLM segment reflects well on management's planning in response to the change in underlying market conditions, we believe the company could be set for more volatile performances in 2019. Sequentially however, we expect a stronger 4QFY19 due to seasonally better performance for the MLM segment.

Maintain HOLD

Although management's pivot could pay off in the long run, we foresee CY19 to remain challenging for Hai-O. Consequently, we maintain HOLD on Hai-O with a unchanged TP of RM2.50 based on an unchanged 13x FY20E EPS. Upside/downside risks: i) strong/weak expansion in MLM distributor base; ii) better/lower-than-expected take-up rate of new products.

Earnings & Valuation Summary

FYE 30 Apr	2017	2018	2019E	2020E	2021E
Revenue (RMm)	404.2	461.8	346.5	369.9	413.5
EBITDA (RMm)	81.1	105.6	69.3	75.5	86.4
Pretax profit (RMm)	78.3	99.0	66.2	72.4	83.3
Net profit (RMm)	59.4	75.4	50.5	55.3	63.5
EPS (sen)	20.4	25.9	17.4	19.0	21.8
PER (x)	12.3	9.7	14.5	13.3	11.5
Core net profit (RMm)	59.4	75.4	50.5	55.3	63.5
Core EPS (sen)	20.4	25.9	17.4	19.0	21.8
Core EPS growth (%)	63.3	27.0	(33.0)	9.4	15.0
Core PER (x)	13.2	10.4	15.5	14.2	12.4
Net DPS (sen)	16.0	20.0	11.3	12.3	14.2
Dividend Yield (%)	6.3	7.9	4.5	4.9	5.6
EV/EBITDA (x)	7.4	5.8	8.5	7.5	6.3
Chg in EPS (%)			-	-	-
Affin/Consensus (x)			1.0	1.0	1.0

Source: Company, Bloomberg, Affin Hwang forecasts

Outthink. Outperform.

Company Update

HAI-O

HAIO MK
Sector: Consumer

RM2.52 @ 5 April 2019

HOLD (maintain)

Downside: 1%

Price Target: RM2.50

Previous Target: RM2.50



Price Performance

	1M	3M	12M
Absolute	-10.0%	-9.0%	-48.4%
Rel to KLCI	-7.6%	-7.5%	-42.2%

Stock Data

Issued shares (m)	290.4
Mkt cap	731.7/178.9
Avg daily vol - 6mth (m)	0.2
52-wk range (RM)	2.47-5.4
Est free float	55.3%
BV per share (RM)	1.03
P/BV (x)	2.45
Net cash/ (debt) (RMm)	117.8
ROE (2019E)	16.3%
Derivatives	Nil
Shariah Compliant	No

Key Shareholders

Kai Hee Tan	10.1%
Akintan Sdn Bhd	8.0%
Excellent Communication	5.4%

Source: Affin Hwang, Bloomberg

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Unfavourable market conditions

Attrition in MLM members after 25th anniversary grand campaign

After hitting a record quarterly sales of over RM100m for its MLM division in 1QFY18 during its 25th anniversary campaign, Hai-O has been struggling to retain its distributor base, which declined from ~160k to c.130k currently following the cessation of a highly attractive one-off incentive scheme which included a nine-month-long lucky draw enjoyed up till 1HFY18, while the proportion of active members have also tapered to ~30% from <40% previously. Consequently, MLM sales have declined 45% to RM56m in 3QFY19 vs. 1QFY18. However, management believes based that the attrition rate is offset by the current renewal as well as recruitment rate, and hence the existing base of c.130k members would at the very least hold up.

Shift in product mix while members' optimism also tapered off

The decline in sales also occurred as the MLM market turned more cautious in recent quarters over moderating consumer sentiment, with members stocking up less while favouring more fast-moving, smaller-ticker items over higher-priced inventories, therefore also impacting revenue recorded per agent. Thus far, smaller ticket items (RM300 and below) stood at close to 80% of MLM sales, with F&B/healthcare products accounting for >50% of total sales while home care products accounted for ~20%, with the remainder consisting of bigger ticket items such as water filters. Although small-ticket items are higher-margin in nature (9MFY19 MLM EBIT margin: 20.4%, +1.2ppts yoy), sales profitability is typically lower on an absolute basis

Infinance: beauty products doing better vs. fashion

We understand that the group's apparel and fashion line under its Infinance lifestyle brand (brand sales of c.RM1.5m/month) has likewise obtained lower-than-expected reception, with the group's skincare and beauty products still performing better relatively. Management has not thrown in the towel however – having incurred substantial A&P costs to promote the Infinance brand – with the intention to expand its fashion line.

New product pipeline reflects current market circumstances

In relation to the shift in MLM market demand for smaller-ticket inventory, management is looking to introduce new products from April-June 2019, with emphasis placed on items within the beauty (facial masks, lip cream) and health (enzymes, weight loss, sugar substitute) categories.

Fig 1: New product pipeline from April-June 2019

Beauty	Health	Lifestyle	Kid's
Infinance Facial Scrub	Prolicious	Infinance Men's	Head to Toe Wash
Infinance Facial Masks	Shake Me Cocoa	Infinance RTW	Natural Moisturizing Lotion
Infinance Intensive Treatment Serum	Sweetality		
Cozuma Velvety Matte Lip Cream			
Cozuma High Precision Liquid Eye Liner			
Cozuma Long Lasting Eye Brow Pencil			
Cozuma Fiber Lash Mascara			

Source: Company

Aggressive membership recruitment and retention campaign

To beef up its existing membership base alongside participation rate, we gather that management is looking to carry out: (i) member carnival roadtour; (ii) new sign-up/renewal packages; and (iii) monthly 24-hour flash sales promotion. The roadtour will see management hit the road nationwide from April-December 2019 to engage prospective members with attractive “newbie” packages offering free tea products alongside vouchers with potential value exceeding that of initial membership fees. At the same time, the company will also engage existing members with additional incentives to remain active such as 24-hour flash sales on every 11th of the month (30-40% discounts on selected products) which also benefits newly-recruited members. Additionally, management will carry out a new Hari Raya campaign starting April to consolidate interest from its predominantly Bumiputera target market, with a view to expand their digital reach over the same period, particularly on social media platforms.

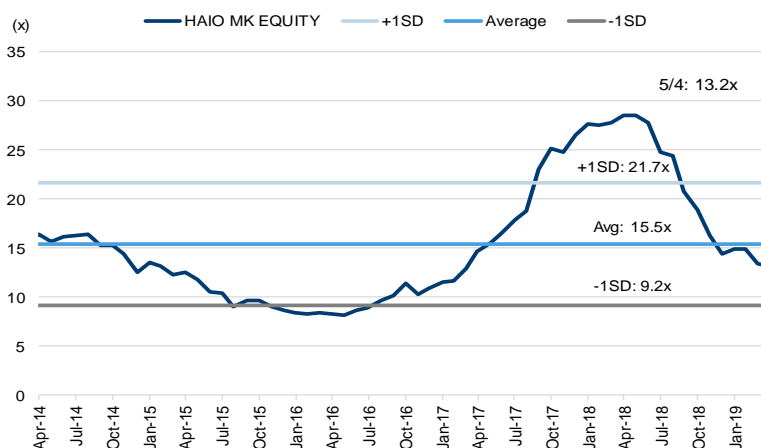
Expansion plans in store for Wholesale and Retail

For the Wholesale segment (18% of 9MFY19 revenue), the group’s growth plan includes tapping into new key accounts such as expansion via modern trade channels and product placement within pharmacy outlets as well as restaurant chains. Management is also in the midst of preparing the necessary documentation to gain approval on exporting its bird’s nest products to China, which previously imposed a total ban on Malaysian-based imports due to the composition of certain chemical compounds. For the Retail segment (12% of 9MFY19 revenue), management is looking to focus on higher-margin in-house products (contributing >40% of retail sales currently), while looking to open 1-2 new Hai-O outlets in FY2020.

Maintain HOLD

We maintain our HOLD call on Hai-O with an unchanged TP of RM2.50 based on 13x FY20E EPS. While the group’s Wholesale and Retail segments appear to be on a sturdy footing, we expect its key MLM segment (9MFY19: 69% of revenue and 74% of EBIT) to remain subdued in the near term, affected by soft market conditions seen to persist for the rest of 2019. On the other hand, Hai-O’s dividend policy of >50% is guided to remain (2018: 20sen / 77% payout ratio), which could attract interest in the stock whereby prices have retraced 53% from its peak of RM5.40 last year. Upside/downside risks: i) strong/weak expansion in MLM distributor base; ii) better/lower-than-expected take-up rate of new products.

Fig 2: Hai-O 5-year forward PER



Source: Bloomberg, Affin Hwang estimates

Hai-O – FINANCIAL SUMMARY

Profit & Loss Statement

FYE 30 April (RMm)	2017	2018	2019E	2020E	2021E
Revenue	404.2	461.8	346.5	369.9	413.5
Operating expenses	-323.2	-356.2	-277.3	-294.4	-327.1
EBITDA	81.1	105.6	69.3	75.5	86.4
Depreciation	-3.0	-4.0	-4.5	-4.5	-4.5
EBIT	77.4	101.6	64.8	71.0	81.9
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	66.2	72.4	83.3
Tax	-18.9	-23.9	-15.9	-17.4	-20.0
Minority interest	-0.1	0.3	0.2	0.2	0.2
Net profit	59.4	75.4	50.5	55.3	63.5

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	87.4	106.3	127.9
Stocks	71.7	91.5	65.6	70.0	78.3
Debtors	31.6	33.8	25.3	27.0	30.2
Other current assets	58.2	57.9	57.9	57.9	57.9
Total current assets	238.3	252.2	236.3	261.3	294.3
Creditors	57.5	67.6	48.5	51.8	57.9
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	58.0	61.3	67.4
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	312.3	334.7	362.4
Minority interest	11.4	11.0	10.8	10.6	10.4

Cash Flow Statement

FYE 30 April (RMm)	2017	2018	2019E	2020E	2021E
EBIT	77.4	101.6	64.8	71.0	81.9
Depreciation & amortisation	3.8	4.8	4.5	4.5	4.5
Working capital changes	-0.9	-10.8	15.2	-2.9	-5.3
Cash tax paid	-18.9	-23.9	-15.9	-17.4	-20.0
Others	2.6	-19.0	0.0	0.0	0.0
Cashflow from operation	64.2	52.8	68.6	55.3	61.1
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	-46.5	-58.2	-46.5	-32.8	-35.9
Others	14.2	14.5	1.4	1.4	1.4
Cash flow from financing	-30.5	-45.3	-45.1	-31.4	-34.5
Free Cash Flow	54.1	31.3	63.6	50.3	56.1

Source: Company data and Affin Hwang estimates

Key Financial Ratios and Margins

FYE 30 April (RMm)	2017	2018	2019E	2020E	2021E
Growth					
Revenue (%)	35.8	14.2	-25.0	6.7	11.8
EBITDA (%)	56.9	30.2	-34.4	9.0	14.4
Core net profit (%)	63.3	27.0	-33.0	9.4	15.0
Profitability					
EBITDA margin (%)	20.1	22.9	20.0	20.4	20.9
PBT margin (%)	19.4	21.4	19.1	19.6	20.1
Net profit margin (%)	14.7	16.3	14.6	14.9	15.4
Effective tax rate (%)	24	24	24	24	24
ROA (%)	19.0	22.5	15.8	16.0	16.8
Core ROE (%)	21.9	25.4	16.3	17.1	18.2
ROCE (%)	28.3	34.0	20.8	21.9	23.4
Dividend payout ratio (%)	78.4	77.2	65.0	65.0	65.0
Liquidity					
Current ratio (x)	3.5	3.3	4.1	4.3	4.4
Op. cash flow (RMm)	64.2	52.8	68.6	55.3	61.1
Free cashflow (RMm)	54.1	31.3	63.6	50.3	56.1
FCF/share (sen)	18.6	10.8	21.9	17.3	19.3
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	837.8	913.3

Quarterly Profit & Loss

FYE 30 April (RMm)	3Q18	4Q18	1Q19	2Q19	3Q19
Revenue	103.1	110.6	80.1	92.2	86.2
Operating expenses	-79.5	-86.8	-64.8	-72.9	-68.2
EBITDA	23.6	23.8	15.3	19.2	17.9
Depreciation	-1.0	-1.0	-1.1	-1.2	-1.3
EBIT	22.6	22.8	14.2	18.0	16.7
Net int income/(expense)	0.4	0.3	0.3	0.3	0.3
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	23.0	23.1	14.4	18.3	16.9
Tax	-5.8	-6.4	-3.8	-4.4	-4.1
Minority interest	0.0	-0.4	0.3	-0.3	0.0
Net profit	17.3	16.3	11.0	13.6	12.8
Core net profit	17.3	16.3	11.0	13.6	12.8
Margins (%)					
EBITDA	22.9	21.5	19.1	20.9	20.8
PBT	22.4	20.8	18.0	19.8	19.6
Net profit	16.8	14.7	13.7	14.8	14.8

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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
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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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