

Corporate Highlights



RHB Research Institute Sdn Bhd
A member of the RHB Banking Group
Company No: 233327 -M

Results Note

20 December 2010

Hai-O Enterprise

Weak MLM Sales Continue

Share Price : RM2.93
Fair Value : RM1.71
Recom : **Underperform**
(Maintained)

Table 1 : Investment Statistics (HAIO; Code: 7668)

Bloomberg: HAIO MK

FYE	Net				Net					
	Revenue	Profit	EPS	Growth	PER	C. EPS *	P/NTA	Gearing	ROE	GDY
Apr	(RMm)	(RMm)	(sen)	(%)	(x)	(sen)	(x)	(x)	(%)	(%)
2010a	511.1	70.9	35.0	35.4	11.1	-	2.4	Net cash	38.7	6.2
2011f	305.0	35.1	17.3	-50.5	21.4	27.0	2.6	Net cash	16.8	3.1
2012f	288.3	34.3	16.9	-2.2	21.9	28.0	2.8	Net cash	15.1	3.0
2013f	327.3	39.0	19.3	13.7	19.2	32.0	3.0	Net cash	15.9	3.5

Main Market Listing / Trustee Stock

* Consensus Based On IBES Estimates

◆ **Below expectations.** Hai-O's 1HFY04/11 net profit of RM13.9m was below our and consensus estimates, accounting for only 25% and 22% of our and consensus full year net profit forecasts respectively. The main variance is the weaker-than-expected sales from its MLM division. For the 1HFY11, earnings dropped 64% yoy, on the back of a 62% drop in revenues.

RHBRI	Vs. Consensus
✓	Above In Line Below ✓

◆ **MLM division in a bad situation.** Its MLM division only contributed RM26.7m in revenues during the 2Q, which is a drop of 75% as compared to 2QFY10, while for 1HFY11, the decline was 74% yoy. The significant drop in MLM revenues was primarily due to the continued effects of the tightening of the Direct Selling Act, which caused further membership contraction in the division as well as weaker membership productivity. No details were given as to the quantum of the membership contraction, but we will be getting more details in our upcoming meeting with management. Meanwhile, we are cutting down our Core Distributor Force (CDF) assumption for FY11-13 by 10-28% and our membership productivity assumption (revenue per member) by 33% p.a..

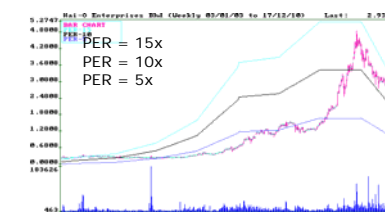
Issued Capital (m shares)	202.2
Market Cap(RMm)	592.4
Daily Trading Vol (m shs)	0.6
52wk Price Range (RM)	2.85-4.93

Major Shareholders:	(%)
Tan Family	30.0

FYE Apr	FY11	FY12	FY13
EPS chg (%)	(38.0)	(41.0)	(40.0)
Var to Cons (%)	(35.9)	(40.0)	(40.0)

◆ **MLM margins were weaker too.** For the 2Q, Hai-O's MLM operating margins at 13.2% were lower by 6.8%-pts and 4.8%-pts yoy and qoq respectively, and 4.8%-pts lower than our FY11 operating margin assumptions for its MLM division. We believe this is a result of lower economies of scale due to the weaker sales in the division. We are thus lowering our operating margin assumption for its MLM division to 15% (from 18% previously), which is slightly lower than 1HFY11's MLM division operating margin of 16%.

PE Band Chart



◆ **Risks.** The risks include: 1) termination of supply agreements from its suppliers in China; 2) stronger-than-expected strengthening of US\$; and 3) worse-than-expected contraction in consumer spending.

Relative Performance To FBM KLCI



◆ **Forecasts.** Our FY11-13 forecasts are reduced by 38-41% after adjusting our CDF, revenue per member, and operating margin assumptions.

◆ **Investment case.** After our reduction in earnings, our fair value is thus reduced to RM1.71 (from RM2.84 previously) based on unchanged target 10x CY11 EPS. We believe that Hai-O's outlook continues to be bleak on the domestic MLM front, although there could be some hope coming from its Indonesian venture in the future. Maintain **Underperform**.

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Table 2: Earnings Review (QoQ)

FYE April (RMm)	2Q10	1Q11	2Q11	% chg QoQ	% chg YoY	1H10	1H11	% chg YoY	Comments
Revenue	132.4	54.8	52.6	(3.9)	(60.2)	280.9	107.4	(61.8)	Lower revenue due to significant drop in MLM division of 75% yoy.
- Wholesale & Retail	21.5	18.0	24.4	35.2	13.3	38.3	42.4	10.6	
- MLM	108.9	35.2	26.7	(24.1)	(75.5)	239.2	62.0	(74.1)	Significant decline as a result of applying more stringent rules on new member recruitment and tightening of stock management
- Other	1.6	1.5	1.5	2.7	(4.3)	3.4	3.0	(11.3)	
EBIT	28.7	10.8	9.1	(15.9)	(68.3)	55.0	19.9	(63.8)	Refer to EBIT margin
Finance cost	(0.0)	(0.0)	(0.0)	(76.2)	(85.3)	(0.1)	(0.0)	(75.0)	
PBT	28.6	10.8	9.1	(15.8)	(68.3)	54.9	19.9	(63.8)	
Taxation	(8.2)	(2.9)	(2.5)	(15.8)	(70.1)	(16.0)	(5.4)	(66.4)	
MI	(0.3)	(0.1)	(0.5)	618.6	90.5	(0.3)	(0.6)	123.8	
Net profit	20.2	7.8	6.1	(21.4)	(69.6)	38.6	13.9	(63.9)	
EPS (sen)	10.0	3.9	3.1	(21.5)	(69.2)	19.3	7.0	(63.8)	
Gross dividend	0.0	0.0	0.0	-	-	-	-	-	
EBIT margin (%)	21.7	19.7	17.3	(2.5)	(4.4)	19.6	18.5	(1.1)	Overall EBIT margin was weaker due to weaker MLM division EBIT
PBT margin (%)	21.6	19.7	17.3	(2.4)	(4.4)	19.6	18.5	(1.0)	
Net profit margin (%)	15.2	14.3	11.7	(2.6)	(3.6)	13.8	13.0	(0.8)	
Effective tax rate (%)	28.6	27.0	27.0	(0.0)	(1.6)	29.1	27.0	(2.1)	

Source: Company, RHBRI estimates

Table 3. Earnings Forecasts

FYE Apr (RMm)	FY10a	FY11F	FY12F	FY13F
Turnover	511.1	305.0	288.3	327.3
Wholesale	43.9	46.1	48.4	50.8
MLM	418.1	207.6	186.2	220.4
Retail	41.8	44.3	46.7	49.2
Manufacturing	1.8	3.0	3.5	3.5
Other	5.6	4.0	3.5	3.5
Turnover growth (%)	17.4	(40.3)	(5.5)	13.5
Cost of Sales	(311.7)	(198.7)	(187.3)	(208.8)
Gross Profit	199.3	106.3	101.0	118.5
EBITDA	100.4	51.2	49.5	55.5
EBITDA margin (%)	19.6	16.8	17.2	16.9
Depreciation	(4.3)	(4.4)	(4.4)	(4.4)
Net Interest	(0.1)	1.1	1.5	1.9
Associates	0.0	0.0	0.0	0.0
Pretax Profit	95.9	47.9	46.6	53.0
Tax	(23.8)	(12.0)	(11.6)	(13.2)
Minorities	(1.3)	(0.8)	(0.6)	(0.7)
Net Profit	70.9	35.1	34.3	39.0

Table 4. Forecast Assumptions

FYE Apr	FY11F	FY12F	FY13F
Core distributor force (CDF)	110,000	86,000	98,000
Distributor productivity (RM/CDF)	10,246	10,349	10,452
Opening of new retail outlets	3	3	3
Revenue per outlet (RM'000)	643	649	656

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Neutral = Industry expected to perform in line with the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Underweight = Industry expected to underperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

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