

Company Update

Hai-O Ent

HAIO MK
RM2.98

BUY (maintain)

Target Price: RM4.26



Price Performance

	1M	3M	12M
Absolute	0.3%	-8.6%	79.7%
Rel to KLCI	19.3%	6.6%	82.1%

Stock Data

Issued shares (m)	82.58
Mkt cap (RMm)	246.1
Avg daily vol - 6mth (m)	0.09
52-wk range (RM)	3.40-1.63
Est free float	40%
NTA per share (RM)	1.46
P/NTA (x)	2.05
Net cash/ (debt) (RMm)	68.9
ROE (2008F)	31.8
Derivatives	Nil

Key Shareholders

Tan family	25.6%
Maybank Smallcap	3.9%

Earnings & Valuation Revisions

	08E	09E	10E
Prev EPS (sen)	37.3	45.9	54.9
Curr EPS (sen)	44.9	52.4	60.5
Chg (%)	20.3	14.2	10.2
Prev target price (RM)			4.24
Curr target price (RM)			4.26

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Robust earnings driven by MLM division

MLM division likely to surprise on the upside in 3QFY08

Hai-O is expected to report a robust 3QFY08 net profit – to be released this week, underpinned by stronger-than-expected MLM operations (71.2% of 1HFY08 revenue) due to the continued growth in distributor force and increasing revenue per distributor. Recall that Hai-O reported a 1HFY08 net profit of RM16.2m (+90.6% yoy) on the back of revenue of RM139.8m (+72.1% yoy), which accounted for 44% of our full year FY08 earnings forecast.

Strong direct marketing driving earnings

The robust MLM earnings is driven by the continued strong growth in new distributors force. Monthly members have on average more than doubled to 2,000-2,500/month from 1,000/month previously (ytd total members force now approaching 70,000 from 60,000 in mid-07). Additionally, growth is also lifted by stronger core distributor productivity with revenue per distributor doubling to an estimated RM180-190k/month compared to RM90-100k/month a year ago. The number of core distributors also accounts for more than 20% of the total distributors force today. Besides, sales of its 2nd generation BioAura water filters (launched in early 2007) have picked up significantly and is already on par with its inner beauty wear product line. Both its inner beauty wear and water filters (price range between RM2,000-RM3,000) account for more than 80% of MLM turnover. The aggressive seminar and training programme accorded to distributors have also aided members in building their MLM network as well as product knowledge. Moving forward, we believe the MLM division is likely to maintain its growth momentum in 4QFY08 given its: 1) increased distributor force; 2) growing core distributor force productivity; and 3) better acceptance of Hai-O brand and products.

FY08-10 earnings upgraded by 10-20%

In anticipation of a strong set of numbers, we have upgraded our FY08-FY10 EPS forecast by 10%-20% after raising our average revenue per distributor assumption to RM3,100 (previously RM2,100). The revision yields a strong 3-year FY07-10 EPS CAGR of 39%. In tandem with the earnings upgrade, we have also raised our DPS forecast to: 22.5 sen in FY08 (from 19.2 sen), 26.5 sen in FY09 (from 22.4 sen) and 30.5 sen in FY10 (from 27.2 sen) on the assumption that management maintains a dividend payout policy of 50%. This translates to an even more exciting dividend yields of 8%-11%.

Earnings and Valuation Summary

FYE 30 April	2006	2007	2008F	2009F	2010F
Revenue (RMm)	146.8	189.3	307.5	356.0	407.8
EBITDA (RMm)	17.3	32.6	55.0	64.2	73.3
Pretax profit (RMm)	15.1	30.6	51.8	59.9	69.6
Net profit (RMm)	10.2	21.4	37.1	43.5	50.5
EPS (sen)	12.4	26.0	44.9	52.3	60.3
EPS growth (%)	55.2	110.0	72.6	16.5	15.4
PER (x)	24.1	11.5	6.6	5.7	4.9
Core net profit (RMm)	10.2	21.4	37.1	43.5	50.5
Core EPS (sen)	12.4	26.0	44.9	52.3	60.3
Core PER (x)	24.1	11.5	6.6	5.7	4.9
DPS (sen)	6.7	15.1	22.5	26.5	30.5
Dividend Yield (%)	2.3	5.1	7.6	8.9	10.2
EV/EBITDA (x)	13.8	6.6	4.0	3.1	2.4
Consensus profit (RMm)			28.4	34.0	46.0
Affin/Consensus (x)			1.3	1.3	1.1

Maintain BUY, target price raised slightly to RM4.26

Despite our earnings upgrade, we only raise our target price slightly to RM4.26 (previously RM4.24). In deriving our SOP, we have imputed a higher discount of 35% to sector MLM PE of 9.7x (previously 30% discount to Amway which trade at PE of 12.4x) and 7x for the pharmaceutical manufacturing division, inline with the lower pharmaceutical industry average PE of 7.8x (previously PE of 9x). Our higher discount for the MLM division is largely to take into account: 1) Hai-O's lower stock liquidity; 2) weaker market sentiment due to uncertainties in global financial markets; and 3) investors current preference for big-cap stocks rather than mid-cap stocks given the attractive valuations following the recent sharp fall in share price.

Our revised SOP target price nevertheless implies a CY08 PER multiple of only 8.6x, decent considering the strong earnings momentum from its MLM division and potential for future upside surprise. Maintain BUY.

Figure 1: Sum-of-part valuations

Divisions	CY08 net profit	Applied PER (x)	Value RM'm	Comments
MLM	26.2	6	163.3	Target PER at a 35% discount to local MLM average of 9.6x
Retail	2.1	9	19.1	Fair PER for a fairly stable business
Wholesale	12.1	7	84.7	Fair PER for a fairly stable business
Manufacturing	0.9	7	6.3	Local pharmaceutical companies trade between 4x-9x
Others	2.4	4	9.7	Reasonable for its traditional Chinese clinics
Net cash/debt			68.9	
			352.0	
No of shares (m)			82.7	
SOP/share			4.26	

Figure 2: Peers comparisons

Company	FYE	Market Cap (USD)	PER(x)		Div Yld (%)		ROE (%)		EV/EBITDA(x)		
			CY08	CY09	CY08	CY09	CY08	CY09	CY08	CY09	
Retail											
Guangzhou Pharmaceutical Co Ltd	Hong Kong	Dec	555.7	14.8	10.0	2.4	3.0	8.9	12.2	8.0	6.9
Tong Ren Tang Technologies Co Ltd	Hong Kong	Dec	60.4	8.5	7.4	4.6	5.3	15.6	16.2	5.0	4.6
Eu Yan Sang International Ltd	Singapore	June	142.6	11.0	10.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Average				11.4	9.3	3.5	4.2	12.2	14.2	6.5	5.7
MLM											
Amway (Malaysia) Hldgs	Malaysia	Dec	328.6	12.4	11.6	9.1	9.3	34.8	33.9	7.5	7.2
Zhulian Corp Bhd*	Malaysia	Nov	111.9	5.5	4.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
CNI Holdings Bhd*	Malaysia	Dec	79.1	11.2	10.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Average				9.7	8.9	9.1	9.3	34.8	33.9	7.5	7.2
Manufacturing											
CCMDuopharma Biotech Bhd	Malaysia	Dec	111.5	10.3	9.2	8.5	8.9	26.4	26.1	6.9	6.2
Pharmaniaga Bhd	Malaysia	Dec	107.7	5.3	3.6	5.7	8.3	15.0	15.0	4.2	3.3
Average				7.8	6.4	7.1	8.6	20.7	20.6	5.5	4.8
Wholesale											
Yunnan Baiyao Group Co Ltd	China	Dec	2,251.5	51.6	38.6	0.4	0.6	26.9	29.5	32.4	28.1
China National Medicines Corp Ltd	China	Feb	1,009.1	53.6	40.7	0.6	0.7	14.7	12.0	56.4	52.4
Average				52.6	39.7	0.5	0.7	20.8	20.8	44.4	40.2

Source: Bloomberg

*No consensus forecast but we assumed 10% growth for each company in reference of historical track records

Hai-O Enterprise - Financial Summary

Profit & Loss Statement

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
Revenue	146.8	189.3	307.5	356.0	407.8
Operating expenses	-129.5	-156.7	-252.5	-291.8	-334.5
EBITDA	17.3	32.6	55.0	64.2	73.3
Depreciation	-1.9	-1.8	-3.2	-4.1	-4.2
EBIT	15.1	30.5	51.7	60.0	69.0
Net int income/(expense)	0.1	0.1	0.1	-0.1	0.6
Associates' contribution	-0.1	0.0	0.0	0.0	0.0
Pretax profit	15.1	30.6	51.8	59.9	69.6
Tax	-4.3	-8.5	-13.5	-15.0	-17.4
Minority interest	-0.6	-0.7	-1.2	-1.4	-1.7
Net profit	10.2	21.4	37.1	43.5	50.5

Balance Sheet Statement

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
Fixed assets	22.2	22.0	48.2	47.0	45.7
Other long term assets	31.9	31.7	31.8	31.7	31.7
Total non-current assets	54.1	53.8	80.0	78.8	77.4
Cash and equivalents	4.4	16.9	17.9	57.6	79.6
Stocks	28.5	33.9	43.9	50.9	58.3
Debtors	22.3	14.8	27.9	34.3	39.3
Other current assets	16.3	29.6	18.6	18.6	18.6
Total current assets	71.6	95.2	108.3	161.4	195.7
Creditors	23.1	21.6	36.7	42.9	48.1
Short term borrowings	4.4	7.4	7.8	7.4	7.4
Other current liabilities	4.0	9.0	11.7	12.5	13.7
Total current liabilities	31.6	38.0	56.2	62.8	69.1
Long term borrowings	0.1	0.0	0.0	20.0	20.0
Other long term liabilities	0.0	0.1	0.1	0.1	0.1
Total long term liabilities	0.1	0.1	0.1	20.1	20.1
Shareholders' Funds	89.4	105.7	127.5	153.6	181.2
Minority interest	4.6	5.2	4.6	3.7	2.7

*Changes in accounting policies to FRS 34

Cash Flow Statement

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
EBIT	15.1	30.5	51.7	60.0	69.0
Depreciation & amortisation	2.2	2.1	3.3	4.2	4.3
Working capital changes	-10.3	-7.6	5.7	-6.4	-6.0
Cash tax paid	-4.3	-8.5	-13.5	-15.0	-17.4
Others	8.9	11.3	-14.5	-4.7	-8.1
Cashflow from operation	11.5	27.8	32.8	38.1	41.7
Capex	-1.9	-1.9	-29.0	-2.5	-2.5
Others	-9.9	-9.1	0.0	0.0	0.0
Cash flow from investing	-11.9	-11.0	-29.0	-2.5	-2.5
Debt raised/(repaid)	-1.2	2.8	0.4	19.6	0.0
Dividends paid	-2.7	-7.1	-13.5	-15.9	-18.4
Others	-2.8	-5.5	-0.4	0.4	1.1
Cash flow from financing	-6.6	-9.8	-13.6	4.1	-17.3
Free Cash Flow	9.6	25.9	3.8	35.6	39.2

Source: Company data and Affin Investment Bank estimates

Key Financial Ratios and Margins

FYE 30 April (RMm)	2006	*2007	2008E	2009E	2010E
Growth					
Revenue (%)	3.7	29.0	62.4	15.7	14.6
EBITDA (%)	28.3	89.1	68.5	16.6	14.2
Core net profit (%)	84.9	110.0	73.6	17.2	16.1
Profitability					
EBITDA margin (%)	11.8	17.2	17.9	18.0	18.0
PBT margin (%)	10.3	16.2	16.9	16.8	17.1
Net profit margin (%)	6.9	11.3	12.1	12.2	12.4
Effective tax rate (%)	28.8	27.8	26.0	25.0	25.0
ROA (%)	10.9	18.2	23.7	20.9	20.9
Core ROE (%)	11.9	21.9	31.8	31.0	30.2
ROCE (%)	16.6	29.5	41.6	37.9	35.4
Dividend payout ratio (%)	45.5	58.1	50.2	50.8	50.6
Liquidity					
Current ratio (x)	2.3	2.5	1.9	2.6	2.8
Op. cash flow (RMm)	11.5	27.8	32.8	38.1	41.7
Free cashflow (RMm)	9.6	25.9	3.8	35.6	39.2
FCF/share (sen)	11.6	31.5	4.6	42.8	46.9
Asset management					
Debtors turnover (days)	46.2	41.1	36.9	37.7	35.1
Stock turnover (days)	75.6	72.7	56.3	59.3	59.5
Creditors turnover (days)	63.0	52.0	42.1	49.8	49.6
Capital structure					
Net gearing (%)	net cash	net cash	net cash	net cash	net cash
Interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.

Quarterly Profit & Loss

FYE 30 April (RMm)	2Q07	3Q07	4Q07	1Q08	2Q08
Revenue	41.9	51.4	56.7	59.3	80.5
Operating expenses	-34.7	-43.9	-46.7	-49.5	-67.6
EBITDA	7.2	7.5	10.1	9.8	12.9
Depreciation	0.0	0.0	0.0	0.0	0.0
EBIT	7.2	7.5	10.1	9.8	12.9
Net int income/(expense)	0.0	0.0	0.1	0.0	0.1
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	7.2	7.5	10.2	9.8	13.0
Tax	-2.0	-2.3	-2.4	-2.9	-3.6
Minority interest	-0.2	-0.3	0.0	0.1	-0.3
Net profit	4.9	5.0	7.8	7.1	9.1
Core net profit	4.9	5.0	7.8	7.1	9.1
Margins (%)					
EBITDA	17.2	14.6	17.7	16.5	16.0
PBT	17.1	14.6	18.0	16.6	16.1
Net profit	11.8	9.7	13.7	11.9	11.3

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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