

Company Result

27 September 2019

Hai-O Enterprise Berhad

SELL

Unfavourable outlook for MLM division

Downgraded

Share Price	RM2.73
Target Price	RM2.20

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 / HAI0 MK
Board / Sector	Industrial/Food & Drug Retailers
Syariah Compliant status	No
Issued shares (m)	290.37
Par Value (RM)	0.50
Market cap. (RMm)	790.37
52-week price Range	RM2.11 – 4.09
Beta (against KLCI)	0.70
3-m Average Daily Volume	0.27m
3-m Average Daily Value ^A	RM0.63m

Share Performance

	1m	3m	12m
Absolute (%)	26.4	23.5	-32.4
Relative (%-pts)	27.0	-28.1	-23.7

Major Shareholders

	%
Kai Hee Tan	10.18
Akintan Sdn Bhd	8.05
Excellent Communications	5.35

Historical Chart



Source: Bloomberg

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Result

- **Hai-O reported a net profit of RM7.7m for its 1QFY20**, declining by 22.7% qoq and 29.6% yoy. Meanwhile, the group recorded quarterly revenue of RM66.1m, which was down 5.5% qoq and 17.5% yoy.
- **Result below expectations.** 1QFY20 net profit is below our and consensus expectation, accounting for 16.0%/16.8% of our/consensus full year estimates. We deem the result is below our expectation although 1Q is seasonally weaker (1Q traditionally accounts for c.20% of actual full year net earnings).

Comment

- **Lackluster QoQ earnings.** The Group recorded a lower revenue, -5.5% qoq mainly due to lower sales generated from MLM division (i.e. slow-down of distributors' business activities during the Ramadan fasting month and Hari Raya festive season) which offset higher sales from wholesale division (i.e. higher sales of Chinese medicated tonic, patented medicine and bird nest products). Also, the Group recorded a lower PBT/PBT margin of -26.5%/-4.4ppts, mainly due to reduction in A&P subsidy incomes.
- **Lower YoY earnings.** Again, Hai-O recognized lower revenue as a result of weaker sales from MLM division (i.e. slowdown in new member recruitment and member renewal) which offset higher revenue from wholesale division (i.e. higher sale from Chinese medicated tonic and vintage tea). Furthermore, the Group incurred higher cost (i.e. export of bird nest products to China) from wholesale division, resulting in lower PBT/PBT margin of -29.4%/-2.6ppts.
- **MLM division – Unfavorable outlook.** The members continued to cut back spending in view of weak market sentiment while the distributors have also slowed down activities since last financial year. As such, the division is actively retaining and recruiting new members to increase sales. Hence, we foresee that MLM division will continue perform poorly for FY20F as compared to FY19.
- **Wholesale division – continues focusing on core products.** The Wholesale division will continue focusing on its core products (i.e. Chinese medicated tonic and other health and wellness products) due to higher sales achieved from its core products. On top of that, the division will continue to secure agencies for more food and beverage products.
- **Retail division – more sales campaign ahead.** Looking forward, the Group will continue to launch extensive sales

promotion as the division received good response from its loyalty friendship members. Therefore, we believe that the retail division will achieve a better revenue for the 2QFY20 as compare to 1QFY20.

- **Unattractive outlook ahead.** We foresee that Hai-O's business performance will not recover in the immediate term and might be further bogged down by MLM division on the back of lower new member recruitment coupled with lower member renewal.
- **Risks include:** 1) Higher-than-expected operating expenses (i.e. higher marketing and branding expenses) and 2) Lower-than-expected domestic spending due to higher cost of living.

Earnings Outlook/Revision

- **We adjust downwards our earnings forecasts for FY20F and FY21F by 14.4% and 4.8% to RM41.7m and RM47.4m respectively,** after lowering our sales assumptions for MLM division to better reflect its lower new member recruitment and lower PBT margin pursuant to higher marketing and branding expenses.

Valuation & Recommendation

- **Downgrade to SELL from HOLD with a lower target price of RM2.20** (previous target price: RM2.24) following our earnings cut and recent rally in share price against our target price. Our revised target price is now based on P/E multiple of 15.8x FY20F EPS (from 13.5x), which is at its 3-year historical mean P/E.
- Looking forward, we also expect the Group to declare a lower dividend per share of 11sen/share in FY20F vs. 13sen/share in FY19, which translates into a dividend yield of 4.1% based on current share price.

Figure 1: Quarterly Figures

Year ended 30 April	1QFY20	4QFY19	1QFY19	QoQ	YoY
	RM'm	RM'm	RM'm	%	%
Revenue	66.1	69.9	80.1	-5.5%	-17.5%
Gross profit	25.2	25.5	32.2	-1.2%	-21.7%
Operating profit	10.0	13.6	14.2	-26.3%	-29.5%
PBT	10.2	13.9	14.4	-26.5%	-29.4%
PAT	7.5	9.8	10.7	-23.4%	-29.4%
Net profit	7.7	10.0	11.0	-22.7%	-29.6%
Margin (%)				ppts	ppts
Gross profit margin	38.1%	36.4%	40.2%	1.7	-2.1
EBIT margin	15.1%	19.4%	17.7%	-4.3	-2.6
PBT margin	15.4%	19.8%	18.0%	-4.4	-2.6
PAT margin	11.4%	14.1%	13.3%	-2.7	-1.9
Net profit margin	11.7%	14.3%	13.7%	-2.6	-2.0

Source: Company, JF Apex

Figure 2: Revenue and PBT by division

Year ended 30 April	1QFY20	4QFY19	1QFY19	QoQ	YoY
	RM'm	RM'm	RM'm	%	%
MLM division	42.1	47.4	58.0	-11.2%	-27.4%
Wholesale division	14.8	12.0	13.6	23.3%	8.8%
Retail division	8.1	10.1	7.6	-19.8%	6.6%
Total Revenue	65.0	69.5	79.2	-6.5%	-17.9%
MLM division	7.3	10.4	10.3	-29.8%	-29.1%
Wholesale division	1.7	2.0	3.7	-15.0%	-54.1%
Retail division	(0.3)	0.4	(0.6)	N/A	N/A
Total PBT	8.7	12.8	13.4	-32.0%	-35.1%
PBT margin (%)				ppts	ppts
MLM division	17.3%	21.9%	17.8%	-4.6	-0.4
Wholesale division	11.5%	16.7%	27.2%	-5.2	-15.7
Retail division	N/A	4.0%	N/A	N/A	N/A

Source: Company, JF Apex

Figure 3: Peer Comparison

Company	Price	Recom	T.price	P/E		P/B	PBT margin	Div Yield
	RM		RM	19'	20'		%	%
Hai-O	4.0	SELL	2.19	17.2	16.4	2.6	19.3	4.8
Amway	5.9	-	-	16.2	16.9	4.5	7.2	4.7

Source: Company, JF Apex

Figure 4: Financial Summary

Year ended 30 April	FY16	FY17	FY18	FY19	FY20F	FY21F
	RMm	RMm	RMm	RMm	RMm	RMm
Revenue	297.6	404.0	461.8	328.4	336.0	351.5
Gross profit	101.4	132.9	162.2	125.9	122.9	126.5
Operating profit	48.3	77.3	97.6	62.4	55.0	61.0
PBT	49.1	78.1	99.0	63.5	55.9	62.1
PAT	36.6	59.2	75.1	47.1	41.9	47.6
Net profit	36.3	59.3	75.4	47.4	41.7	47.4
Margin (%)						
Gross profit margin	34.1%	32.9%	35.1%	38.4%	36.6%	36.0%
Operating profit	16.2%	19.1%	21.1%	19.0%	16.4%	17.3%
PBT margin	16.5%	19.3%	21.4%	19.3%	16.6%	17.7%
PAT margin	12.3%	14.7%	16.3%	14.4%	12.5%	13.5%
Net profit margin	12.2%	14.7%	16.3%	14.4%	12.4%	13.5%
Growth (%)						
Revenue growth	24.1%	35.7%	14.3%	-28.9%	2.3%	4.6%
Gross Profit growth	18.5%	31.0%	22.1%	-22.3%	-2.4%	2.9%
PBT growth	14.0%	59.2%	26.8%	-35.9%	-12.0%	11.0%
PAT growth	18.9%	61.9%	26.9%	-37.2%	-11.1%	13.5%
Net profit growth	20.8%	63.1%	27.2%	-37.1%	-12.0%	13.6%
Net gearing	Net cash	Net cash	Net cash	Net cash	Net cash	Net cash
ROA	11.3%	16.3%	19.0%	14.0%	13.9%	15.5%
ROE	13.5%	20.0%	23.6%	16.5%	16.2%	18.7%
EPS (sen)	12.1	19.7	25.1	15.8	13.9	15.8
P/E	22.1	13.6	10.7	17.0	19.3	17.0
DPS (sen)	10.0	16.0	20.0	13.0	11.0	11.0
Dividend Payout	82.6%	81.1%	79.7%	82.3%	79.2%	69.7%
Dividend yield (%)	3.7%	6.0%	7.5%	4.9%	4.1%	4.1%

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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Published & Printed By:
JF Apex Securities Berhad (47680-X)
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