Corporate Highlights

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

Results Note

30 September 2010

Hai-O Enterprise

MLM Division Slowdown Worse Than Expected

Share Price	:	RM3.26
Fair Value	:	RM2.84
Recom	:	**Underperform** (Maintained)

Table 1 : Investment Statistics (HAIO; Code: 7668) — Bloomberg: HAIO MK

FYE Apr	Revenue (RMm)	Net Profit (RMm)	EPS (sen)	Growth (%)	PER (x)	C. EPS * (sen)	P/NTA (x)	Net Gearing (x)	ROE (%)	GDY (%)
2010a	511.1	70.9	35.0	35.4	11.1	-	2.4	Net cash	38.7	6.2
2011f	432.2	56.5	27.9	-20.3	13.3	32.0	2.7	Net cash	26.3	5.0
2012f	435.5	57.9	28.6	2.5	12.9	36.0	3.1	Net cash	23.8	5.2
2013f	487.3	65.2	32.2	12.6	11.5	42.0	3.5	Net cash	23.7	5.8

Main Market Listing / Trustee Stock — ** Consensus Based On IBES Estimates*

- **Below expectations.** Hai-O's 1QFY04/11 net profit was below our and consensus estimates, accounting for only 11.2% and 12.2% of our and consensus full year net profit forecasts respectively. Earnings dropped significantly by 57.7% yoy and 45.3% qoq respectively. The drop was mainly attributed to its MLM division, which experienced a contraction in revenues of 73% yoy, while accounting for only 8% of our full year revenue estimate for the division.

- **MLM slowdown worse than expected.** Although we had already anticipated a decline in Hai-O's MLM membership recruitment drive and productivity per member, as reflected in our previous report dated 29 Jul, following the tighter rulings in the Direct Selling Act, we have underestimated the severity of the slowdown. Although we are confident that the division will bounce back over time, we doubt that it would revert to previous revenue highs of ~RM418m (FY10) in the medium term. We believe it would take some time for its membership drive to regain momentum after the setback. We are thus cutting our FY11-13 core distributor force (CDF) assumption by 8.1-15% to 122k, 110k, and 122k respectively. We are also cutting our revenue per member assumption for FY11 further to -25% (from -10% previously), while we are maintaining a 1% p.a. growth for FY12-13.

- **Prospects for FY04/11 bleak.** We believe that Hai-O's outlook for FY11 is bleak, driven mainly by its slowdown in the MLM division. Despite other divisions performing relatively in line, these divisions only contribute 36% and 41% of revenues and operating profit respectively, while the rest is derived from the MLM division. Thus, the slowdown in MLM will significantly affect the group's bottomline moving forward. The only exciting prospect now is Hai-O's venture in Indonesia for its MLM business model. However, the contribution from its Indonesia venture is currently not very significant.

- **Risks.** The risks include: 1) faster-than-expected recovery in its MLM division; 2) stronger-than-expected weakening of US$; and 3) stronger-than-expected pick-up in consumer spending.

- **Forecasts.** Our FY11-13 forecasts are reduced by 18.7-23.5% after adjusting our CDF and revenue per member assumptions.

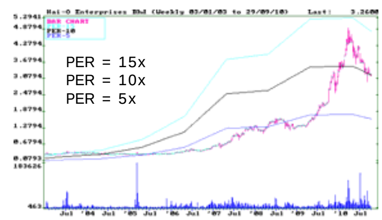
- **Investment case.** After our reduction in earnings, our fair value is thus reduced to RM2.84 (from RM3.63) previously. Our fair value is based on an unchanged target PER of 10x CY11 EPS. We are maintaining our **Underperform** call on the stock given Hai-O's bleak medium-term outlook.

RHBRI	Vs.	Consensus
	Above	
	In Line	
✓	Below	✓

Issued Capital (m shares)	202.2
Market Cap(RMm)	659.1
Daily Trading Vol (m shs)	0.13
52wk Price Range (RM)	2.27-4.93
Major Shareholders:	**(%)**
Tan Family	30.0

FYE Apr	FY11	FY12	FY13
EPS chg (%)	(18.7)	(23.5)	(22.5)
Var to Cons (%)	(12.8)	(20.6)	(23.3)

PE Band Chart



Relative Performance To FBM KLCI

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Please read important disclosures at the end of this report.

Table 2: Earnings Reviews (YoY Cumulative)						
FYE Apr (RMm)	**1Q10**	**4Q10**	**1Q11**	**QoQ (%)**	**YoY (%)**	**Comments**
Revenue	148.6	98.8	54.8	(44.6)	(63.1)	Lower revenue due to significant drop in MLM division of 73% yoy.
- Wholesale & retail	*16.8*	*24.5*	*18.0*	(26.6)	7.2	Qoq declined as 4Q was stronger due to Chinese New Year festivities
- MLM	*130.3*	*72.6*	*35.2*	(51.4)	(73.0)	Significant decline as a result of applying more stringent rules on new member recruitment and tightening of stock management
- Others	*1.5*	*1.7*	*1.5*	(13.3)	3.3	
EBIT	26.3	15.8	10.8	(31.5)	(58.9)	Filtered down from revenue and higher margin (refer to EBIT margin).
Interest income/(expense)	(0.0)	(0.0)	(0.0)	600.0	(38.2)	
PBT	26.3	15.8	10.8	(31.6)	(59.0)	Filtered down from EBIT.
Taxation	(7.8)	(0.8)	(2.9)	277.1	(62.5)	Refer to effective tax rate.
MI	(0.1)	(0.7)	(0.1)	(90.6)	25.0	
Net profit	18.5	14.3	7.8	(45.3)	(57.7)	Filtered down from PBT and lower effective tax rate.
EPS (sen)	9.1	7.0	3.9	(44.4)	(57.1)	
Gross dividend (sen)	0.0	16.0	0.0	(100.0)	-	
EBIT margin (%)	17.7	16.0	19.7	3.8	2.0	Improved operating margin as a result of better product mix and weakening of USD
PBT margin (%)	17.7	16.0	19.7	3.7	2.0	
Net profit margin (%)	12.4	14.4	14.3	(0.2)	1.8	
Effective tax rate (%)	29.6	4.9	27.0	22.1	(2.6)	Higher than statutory tax rate due to certain non-deductible expenses and losses from certain subsidiaries which cannot be set off against profits

Source: Company; RHBRI

Table 3. Earnings Forecasts				
FYE Apr (RMm)	**FY10a**	**FY11F**	**FY12F**	**FY13F**
Turnover	**511.1**	**432.2**	**435.5**	**487.3**
Wholesale	43.9	46.1	48.4	50.8
MLM	418.1	334.8	333.4	380.3
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	(15.4)	0.8	11.9
Cost of Sales	(311.7)	(269.7)	(271.1)	(297.7)
Gross Profit	199.3	162.4	164.4	189.6
EBITDA	100.4	80.3	81.5	90.9
EBITDA margin (%)	19.6	18.6	18.7	18.7
Depreciation	(4.3)	(4.4)	(4.4)	(4.4)
Net Interest	(0.1)	1.1	1.5	2.1
Associates	0.0	0.0	0.0	0.0
Pretax Profit	**95.9**	**77.0**	**78.6**	**88.5**
Tax	(23.8)	(19.2)	(19.7)	(22.1)
Minorities	(1.3)	(1.2)	(1.0)	(1.2)
Net Profit	**70.9**	**56.5**	**57.9**	**65.2**

Table 4. Forecast Assumptions			
FYE Apr	**FY11F**	**FY12F**	**FY13F**
Core distributor force (CDF)	122,000	110,000	122,000
Distributor productivity (RM/CDF)	15,370	15,523	15,678
Opening of new retail outlets	3	3	3
Revenue per outlet (RM'000)	643	649	656

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Stock Ratings

Outperform = The stock return is expected to exceed the FBM KLCI benchmark by greater than five percentage points over the next 6-12 months.

Trading Buy = Short-term positive development on the stock that could lead to a re-rating in the share price and translate into an absolute return of 15% or more over a period of three months, but fundamentals are not strong enough to warrant an Outperform call. It is generally for investors who are willing to take on higher risks.

Market Perform = The stock return is expected to be in line with the FBM KLCI benchmark (+/- five percentage points) over the next 6-12 months.

Underperform = The stock return is expected to underperform the FBM KLCI benchmark by more than five percentage points over the next 6-12 months.

Industry/Sector Ratings

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

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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