

Company Update

24 March 2016

Hai-O Enterprise Berhad

Bright outlook for MLM division

HOLD

Maintained

Share Price	RM2.49
Target Price	RM2.50

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 / HAO MK
Board / Sector	Industrial / Food & Drug Retailers
Syariah Compliant status	No
Issued shares (m)	193.32
Par Value (RM)	0.50
Market cap. (RMm)	481.37
52-week price Range	RM1.89– 2.50
Beta (against KLCI)	0.59
3-m Average Daily Volume	0.05m
3-m Average Daily Value [^]	RM0.11m

Share Performance

	1m	3m	12m
Absolute (%)	5.1	6.9	5.5
Relative (%-pts)	1.4	3.5	11.0

Major Shareholders

	%
KAI HEE TAN	10.06
AKINTAN SDN BHD	7.84
SIOU ENG TAN	6.97

Historical Chart



Source: Bloomberg

Team Coverage

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What's New

- **We maintain our positive stance on Hai'O's prospect following our company visit.** We acknowledge that the Group's resilient earnings growth still intact underpinned by impressive performance of its key revenue driver, MLM division (which contributes about respective 60% and 62% of the Group's topline and bottomline) with a net increase of over 1000 members/month to current total 4000-5000 members/month.

Comment

- **Signs of recovery in MLM division.** To recap, in FY14, the Group came out with the new marketing strategy by promoting more "small-ticket" items in order to buffer its diminishing sales and overreliance on "big-ticket" items as a result of sluggish consumer sentiment. The Group went through the transition period for the last 1-2 years and have finally reaped the fruits as evidenced by gradual segmental earnings recovery since 4QFY15 (4QFY15: +4.4% yoy, 1QFY16: +34.37% yoy, 2QFY16: +12.9% yoy and 3QFY16: +18.36% yoy). The MLM division posted stellar growth of 38.4 and 20.4% for its topline and bottomline respectively for 9MFY16.
- **MLM growth momentum is expected to be sustainable.** The rising of sales volume bucked the trend of anticipated drop in sales value (due to cheaper selling price of 'small-ticket' items) resulted in higher MLM's topline. The success of the strategic transformation was mainly attributable to: a) strong surge in MLM members pursuant to attractive commission scheme, incentive trips, member retention programme, as well as higher number of young entrepreneurs joining MLM force in view of rising cost of living and unemployment among fresh graduates; and b) high marketability and turnover of its 'small-ticket' items in the likes of health supplements and personal care products such as mineral coffee, collagen drink, garlic pill, and marine series toiletries which render recurring orders to the Group. As of todate, 'small-ticket' items contribute 70% of the MLM's topline as contrast to previous 30% contribution.
- **Overall margin expected to stabilise or improve slightly with Ringgit rebound.** Going forward, we envisage the Group's PBT margin to stabilise at current level of 20% as the Ringgit has strengthened against major currencies ytd. In fact, Hai-O initiated some proactive measures such as re-packaging, re-formulating, quality enhancement to its existing products with higher products selling prices and usage of Yuan for trade settlement during last year to tackle the higher import cost following the

severe fall in Ringgit.

- **A glimpse of hope in Indonesian venture.** Following past few years of unfruitful market penetration, Hai-O embarked on new strategy to revitalise its MLM expansion in Indonesia. It has engaged some new and strategic local partners in Jakarta to distribute its 'small-ticket' items, mainly targeting for low-to-middle income group of end consumers there. Management expects to see some positive results in FY17 with the growing number of members and products sales.
- **Potential share dividend in addition to current decent dividend yield.** The Group has allocated about RM2-3m for capital expenditures in FY17 mainly for the usage of system upgrade and a warehouse setup in Johor. The upgrade of IT system is for the convenience of MLM members to keep track their business and stock level through a sophisticated online system; whilst the new warehouse is to cater for the growing orders from Johor region. Anyhow, this shall not impact the Group's dividend payout with its existing dividend policy of minimum payout of 50%. Hence, we expect Hai-O to reward shareholders with 12 sen/share in FY16 and 14 sen/share in FY17, equivalent to dividend yield of 3-4%. Besides, we opine that the Group could distribute its treasury shares (the company's Share Buy-Back scheme is close to 5% of its issued and paid up share capital) in the form of share dividends to shareholders.

Earnings Outlook/Revision

- **We raised our earnings forecast for FY16F by 18% to RM35.5mill (previously: RM30.0mill)** as we foresee the Group to chalk up another better results for its MLM division in coming final quarter of FY16 amid continued growth in its recruited members coupled with positive response towards its best-selling products.

Valuation & Recommendation

- **Our call on Hai-O is kept at HOLD with an unchanged target price of RM2.50.** We pegged our target price at 11x FY2017F PE based on EPS of 23 sen.
- **MLM division as a core growth driver will continue to underpin Hai-O's earnings.** We believe the strong performance of MLM division would weather the softer consumer sentiment and cushion the negative impact towards its retail division. Furthermore, we reckon that the mild recovery of our Ringgit would mitigate the risk of unfavorable exchange rate and hence the higher import costs for its MLM, retail and wholesale divisions.

Figure 1: Financial Summary

Year to 30 April (RMm)	FY2013	FY2014	FY2015	FY2016F	FY2017F
Revenue	266.6	253.5	239.9	281.7	318.7
Operating profit	63.1	52.1	41.8	53.5	60.6
Net profit	47.2	40.3	29.8	35.5	44.3
EPS (sen)	24.4	20.8	15.4	18.4	22.9
P/E (x)	10.2	12.0	16.2	13.6	10.9
P/BV (x)	1.9	1.8	1.8	1.8	1.8
Dividend yield (%)	4.4%	4.3%	4.5%	3.4%	4.0%
PBT margin (%)	24.0%	21.0%	17.8%	21.0%	24.6%
Net Gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
ROE (%)	18.8%	15.2%	11.2%	13.1%	16.1%

Source: Company, JF Apex Estimates

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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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