

Zhulian Corporation Bhd

Price : RM1.74

Market Capitalization : RM800.4 mln

Board : Main Market

Sector : CONSUMER

Recommendation : BUY

Bursa / Bloomberg Code: 5131 / ZHCB MK
Stock is Shariah-compliant.

Key Stock Statistics

FYE Nov	FY10	FY11f
EPS (sen)	18.9	19.8
P/E (x)	9.2	8.8
Net Div/Share (sen)	12.0	12.0
NTA/Share (RM)	0.76	0.84
Book Value/Share (RM)	0.77	0.84
Issued Capital (mln shares)	460.0	
52-week Hi-Low (RM)	1.46 - 2.21	
Major Shareholders:	%	
Zhulian Holdings Sdn Bhd	35.0	
The Best Source Holdings	17.3	
Teoh Beng Seng	11.6	
Lembaga Tabung Haji	6.2	
Teoh Meng Keat	5.8	

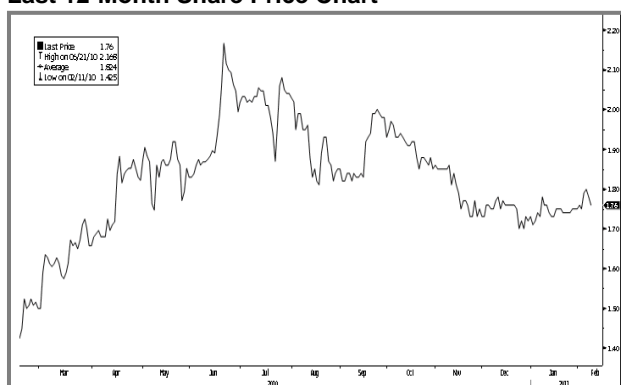
Figures adjusted for 1-for-3 bonus issue in July 2010.

Per Share Data

FYE Nov	FY09	FY10	FY11f
Book Value (RM)	0.70	0.77	0.84
Cash Flow (sen)	19.1	20.3	21.4
Earnings (sen)	17.8	18.9	19.8
Net Dividend (sen)	10.5	12.0	12.0
Payout Ratio (%)	58.9%	59.4%	60.0%
PER (x)	9.8	9.2	8.8
P/Cash Flow (x)	9.1	8.6	8.1
P/Book Value (x)	2.5	2.3	2.1
Dividend Yield (%)	6.0%	6.9%	6.9%
ROE (%)	25.6%	24.7%	23.5%

Figures adjusted for 1-for-3 bonus issue in July 2010.

Last 12-Month Share Price Chart



Investment Highlights / Summary

- **Regional multi-level marketing group** with circa 540,000 distributors in Malaysia, Thailand, Singapore and Indonesia. Diversified product offerings from gold-plated fashion jewellery to F&B, nutritional health, personal care, home care and therapeutic products.
- **Balanced revenue stream** with top three product categories (ie. jewellery, F&B and nutritional health products) each contributing one-fifth to turnover. In Malaysia, Zhulian also differentiates from competitors by focusing on Malay female market as its key distributor and customer segment.
- **Strong financials.** Zhulian achieved 3-year revenue and net profit CAGR of 14% since listing in 2007. Net profit margin is consistent at an average of 26%, which is superior to its peers. Net operating cashflow grew from RM38 mln in FY07 to RM81 mln in FY10. It has net cash per share of 29 sen with no borrowings.
- **Growth catalysts.** Zhulian's earnings growth is supported by continued rollout of new products, increase in distributor force from existing markets particularly Thailand and Indonesia, as well as expansion into new market such as Laos.
- **Risks** include adverse impact from strengthening RM due to its export sales in USD, and lower-than-expected earnings should distributor force growth becomes stagnant.
- **Maintain Buy recommendation with a fair value of RM2.18**, derived by pegging our FY11 EPS projection of 19.8 sen against a peer-benchmarked target PER of 11x. We like Zhulian for its i) resilient earnings delivery, ii) promising growth prospects, especially in the overseas markets, iii) superior net profit margin, and iv) undemanding valuation backed by attractive prospective net dividend yield of 6.9%. Zhulian offers a cheaper exposure into direct selling business by comparison to market leader, Amway Holdings.

Background

Corporate profile

MLM business with a wide range of products – from gold-plated jewellery to health products

Penang-based Zhulian Corporation Bhd (Zhulian) and its group of companies are in the Multi-Level Marketing (MLM) business. The Group manufactures and distributes a wide range from products ranging from gold-plated fashion jewellery to health drinks and personal care products. Zhulian was listed on the Main Market (then known as the Main Board) of Bursa Malaysia on 27 April 2007.

Zhulian was founded in 1989 by Teoh Beng Seng, who believed there is a strong market for gold-plated fashion jewellery and brought the concept back to Malaysia from Europe. He chose direct selling as the distribution channel. Business flourished and the Group started to manufacture its own fashion jewellery at its plant in Penang. In 1996, Zhulian began to diversify its offerings into other categories such as food and beverages (F&B), home care, personal care, health drinks etc. It has also successfully ventured abroad and currently has a strong presence in Thailand, Singapore and Indonesia.

At present, Zhulian's board of directors is led by Independent Non-Executive Chairman, Haji Wan Mansoor Bin Wan Omar, while Teoh Beng Seng serves as the Group President and Chief Executive Officer. Teoh's three brothers are also on the board, with Teoh Meng Keat as the Group Managing Director, Teoh Meng Lee and Teoh Meng Soon as Executive Directors. Others on the eight-member board include one other Executive Director and two Independent Directors.

Corporate structure.



Note: Only direct subsidiaries are shown.

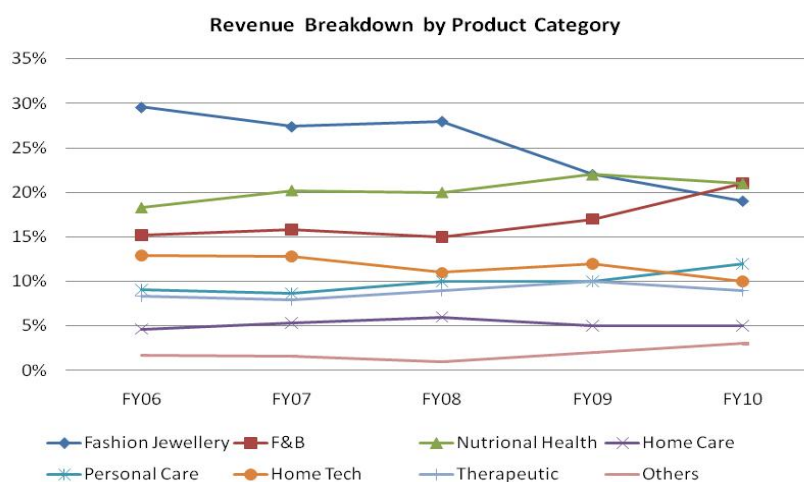
Business

From fashion jewellery alone, Zhulian's product offerings have since grown and it now offers a diversified range of consumer products as follows:-

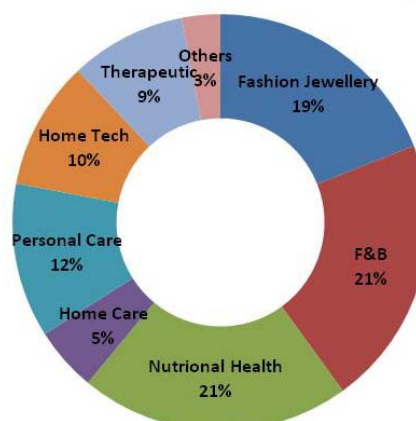
Category	Description
Fashion Jewellery	Over 2,000 designs of gold-plated, rhodium-plated and two-tone jewellery items such as rings, pendants, brooches, earrings, anklets, bangles, bracelets etc, under the brand ZHULIAN.
Food & Beverage (F&B)	Premix coffee, cereal drink, juice concentrate and premix cocoa.
Nutritional Health	Nutritional supplements and drinks under brands such as Dr. Africana's, Royalmix, B'Young, Vegi-Vera, Zhubee, Origrow, SS Solution, ISO.5, ISO.3, and ISO.7. Sugar substitutes under the brand Homsweet.
Home Care	Laundry, dishwashing and multi-purpose detergents as well as floor cleaner under the brand XTRA; and various air fresheners under the brand JUNGLE FRESH.
Personal Care	Personal hygiene products such as hair shampoo, conditioner, body shampoo, toothpaste, talcum powder, and foot care under the brands Smileon, Dolphin, Laviteen, Baby Cinta, Assaho, Hinokoshiwa and Eltina. Also, sanitary napkin under the brand Wanisa.
Beauty Care	Skin whitening, anti-ageing and body-shaping products under the brand Shishen. Lipsticks under the brand Nadra.
Home Tech	Water purification system known as Beyond Water. Air purifier system known as Beyond Microplasma Air Purifier.
Therapeutic	Bio-ion Therapeutic Mattress Pad, Scientific Pillow and Bolster under the brand of Contiago. Bio-magnetic therapeutic belt under the brand M-Belt.

Top three revenue generators - fashion jewellery, F&B and nutritional health

Zhulian's top three revenue generators – fashion jewellery, F&B and nutritional health – each contributed approximately 20% to Group revenue in FY10. We note that up to FY08, fashion jewellery had always been the anchor revenue contributor. Nevertheless, the F&B and nutritional health segments have been growing swiftly and by FY10, revenues from the respective F&B and nutritional health category overtook fashion jewellery. We view the current revenue composition positively as it offers a more balanced mix without over-reliance on any particular product category.



FY10 Revenue Breakdown by Product Category



Source: Company, ZJ Research

A combined distributor force of approximately 540,000

As a MLM company, Zhulian's products are distributed through its vast network of independent distributors and agencies located in Malaysia, Thailand, Indonesia and Singapore. Its distributor force in these four countries has grown from 365,000 in 2008 to approximately 540,000 presently. Its largest distributors force is in Thailand (~439,000), followed by Malaysia (~88,000), Indonesia (~12,000) and Singapore (~1,000). Thailand appears to be the fastest growing market for Zhulian, with the number of distributors rising from 250,000 in 2008 to the current 439,000. Meanwhile, we believe Malaysia is a mature market for the Group with a relatively steady force of distributors.

GMP certification for its F&B manufacturing plant

Zhulian manufactures over 80% of its products in-house, and has three manufacturing plants in Penang Malaysia. In December 2009, the Group's manufacturing facility that produces F&B and nutritional products achieved the Good Manufacturing Practice (GMP) certification, which provides customers further assurance that Zhulian's products are manufactured in a hygienic manner and in accordance to the best practices in manufacturing. We understand the Group's current production capacity is sufficient to support the expected growth over the next three years. Meanwhile, across the borders, Zhulian also has offices in Thailand, Indonesia and Singapore.

427 licensed MLM companies in Malaysia

In terms of competition, the MLM landscape in Malaysia is competitive. According to the Ministry of Domestic Trade, Co-operatives and Consumerism website, there are 427 licensed MLM companies in Malaysia as at December 2008, being the latest available statistics. Nevertheless, well-known and active MLM companies are a much smaller number. Publicly-listed MLM companies include Amway Holdings, DXN Holdings, Hai-O Enterprise, CNI Holdings, INS Bioscience and Caely Holdings while the better known privately-held MLM companies include Cosway, Elken, Neways Worldwide and Nu Skin (Malaysia) to name just a few.

Differentiating factor: focus on Malay female market segment

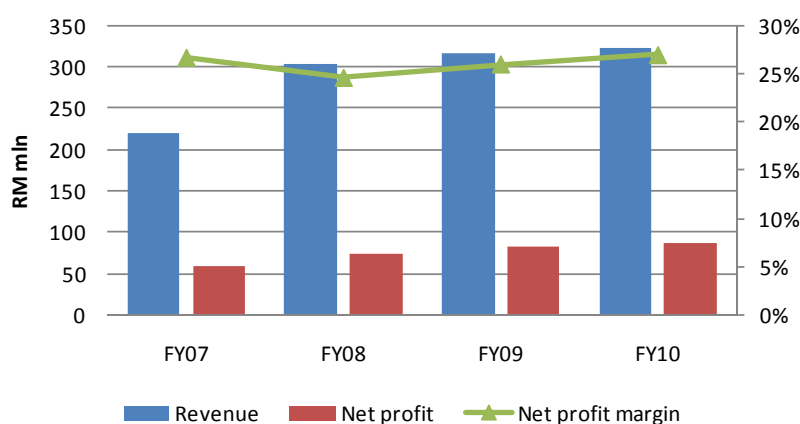
We note that most of the product offerings by these MLM companies revolve around F&B, nutritional, personal care, healthcare and household products. While Zhulian also sells these items, its fashion jewellery offerings remain a differentiation factor from its competitors. The Group further differentiates itself by focusing on the Malay female segment, which makes up 90% of its customer base in Malaysia.

Financial Highlights

3-year revenue and net profit CAGR of 14%

Since its listing in 2007, Zhulian registered a healthy 3-year revenue and net profit CAGR of 14%. And despite the economic downturn in 2009, the Group managed to post a 4% and 10% yoy growth in revenue and net profit respectively, a testament to the resilience in its earnings delivery. Net profit margin, too, is commendable at an average of 26% over the past four years.

Historical Financial Performance



3-year NOCF CAGR of 29%

As a MLM Group, Zhulian's business generates a steady and healthy stream of cashflow. In fact, its net operating cashflow (NOCF) soared from RM37.5 mln in FY07 to RM80.8 mln in FY10, which translates into an impressive 3-year CAGR of 29%.

Net cash per share at 29 sen

The high net operating cashflow generation also resulted in the Group remaining in a net cash position with no borrowings. All its capex and opex needs have been sufficiently funded through internally-generated funds. As at end-January 2011, Zhulian's lean and strong balance sheet is backed by net cash per share of 29 sen and NTA per share of 76 sen.

Earnings Outlook

Going forward, we expect Zhulian's earnings growth to be underpinned by i) continued rollout of new or improved products, ii) growth in distributors in the existing markets, and iii) new geographical market expansion.

Growth catalysts: New products...

In order to sustain interest and excitement amongst its distributors and customers, Zhulian introduces new or improved products periodically, such as new jewellery designs during each Hari Raya celebration, new cosmetic products range, improved health drinks etc. FY11 product rollout pipeline includes new kitchenware, traditional herbal supplements, cosmetic products and fresh design of jewellery.

New recruits...

While Malaysia appears to be a mature market for the Group with a relatively steady pool of distributors, Zhulian is still attracting high number of new recruits in its fastest growing market – Thailand. Its distributor force in Thailand has grown from roughly 250,000 in early 2008 to the present 439,000. Meanwhile, Indonesia is expected to be another growth market for the Group. Prior to 2009, PT Zhulian was Zhulian's Master Agent in Indonesia but the Group did not have any stake in PT Zhulian. However, in May 2009, in order to strengthen its presence there, Zhulian has acquired a 60%-stake in PT Zhulian. With a majority stake in the latter, we expect to see more activities and active management in Indonesia.

And new markets... In terms of geographical expansion, Zhulian is eyeing to penetrate new markets in the South East Asia. Recently in January 2011, it incorporated a new subsidiary in Laos to be known as Zhulian Laos Co. Ltd. (ZLC) through its 80%-owned subsidiary, Zhulian Labuan Ltd (ZLL). ZLC, which is 95%-owned by ZLL, will be involved in direct selling business in the country.

For FY11, we project a modest 3% and 5% yoy growth in revenue and net profit to RM332.4 mln and RM91.3 mln respectively, assuming a 10% growth in distributor force from its existing markets. We have not factored in any contribution from Laos at this juncture pending availability of further details on the venture.

Investment Risks

Fluctuations in foreign exchange rate. Zhulian's export sales to Indonesia, Singapore and Thailand are denominated in USD. Meanwhile, the bulk of purchases are denominated in RM. As such, the strengthening of RM has an adverse impact on Zhulian's earnings. The Group mitigates the risk by maintaining accounts in USD for its imports and exports, as well as factoring in the forex fluctuations in its costing. Other measures include continuous efforts in improving productivity and efficiency.

Stagnant distributor growth. A key growth driver in the MLM business is the ability to recruit new distributors. As such, earnings would be adversely affected should Zhulian experience stagnating growth in distributor force. We note the growth in distributor force in Malaysia has been flat over the last few years but this has been more than compensated by the growth in Thailand. The challenge will be for Zhulian to continue to grow its distributor force in Thailand, Indonesia and Singapore, as well as establishing itself in the new markets.

Valuation

The table below lists the publicly-listed MLM companies in Malaysia (note: Caely Holdings Bhd was excluded from the list as it was loss-making in the latest financial year results).

Peer comparison

Company	Share Price (RM)	PER (x)	P/BV (x)	Mkt Cap (mln)	Dividend yield	Net margin
Zhulian Corp	1.76	9.3	2.3	809.6	6.7%	27.0%
Amway Holdings	8.30	17.9	5.3	1,364.4	5.8%	10.9%
Hai-O Enterprise	2.62	11.3	2.4	529.7	8.6%	13.9%
DXN Holdings	1.44	8.3	1.5	346.7	2.4%	10.9%
INS Bioscience	0.56	9.3	0.5	388.3	2.1%	11.5%
CNI Holdings	0.20	57.1	1.4	144.0	6.9%	4.1%
Avg excl Zhulian & CNI		11.7				

Source: Bloomberg, Company data. Dividend yield calculated based on info from latest annual report.

From the table above, Zhulian's net profit margin is by far more superior than its peers. In terms of size, it ranks second behind Amway Holdings by market capitalization. From a dividend perspective, the yield is also commendable at approximately 6.9%. We note that Zhulian has been paying dividends on a quarterly basis since listing. The Group has a dividend policy to pay out 60% of net profit.

We have pegged a peer-benchmarked target PER of 11x against our FY11 net profit forecast of RM91.3 mln (which translates into FY11 EPS of 19.8 sen) to arrive at our fair value of RM2.18. (Note: we have excluded CNI Holdings from the computation of our peers' PER as we believe CNI's PER of 57x is stretched and not quite reflective of the valuation in our present equity market).

Recommendation

BUY recommendation with fair value of RM2.18 We maintain our **Buy** recommendation on Zhulian with a fair value of **RM2.18**, reflecting potential share price upside of 25%, backed by an attractive prospective net dividend yield of 6.9%.

We continue to like Zhulian for its i) resilience in earnings delivery, ii) earnings growth prospects, especially in the overseas markets, iii) higher-than-peers net profit margin, and iv) undemanding valuation with attractive dividend yield. In our opinion, Zhulian offers a cheaper exposure into the MLM business by comparison to market leader, Amway Holdings, which is trading at a PER of 17.9x.

Recent Developments

26 January 2011: Zhulian announced 4QFY10 results with revenue and net profit at RM84.9 mln (-2.7% yoy) and RM24.3 mln (-1.7% yoy) respectively. Full year revenue rose 2.3% yoy to RM322.6 mln while net profit was 6.2% higher yoy at RM87.1 mln.

26 January 2011: Zhulian incorporated a new subsidiary, Zhulian Laos Co. Ltd. (ZLC) through its 80%-owned subsidiary, Zhulian Labuan Ltd (ZLL). ZLL owns 95%-stake in ZLC.

18 October 2010: Zhulian announced 3QFY10 results with 9MFY10 revenue and net profit increased 4.2% and 9.4% yoy to RM237.7 mln and RM62.8 mln respectively.

22 July 2010: Zhulian completed its 1-for-3 bonus issue exercise, resulting in the listing and quotation of additional 115 mln ordinary shares on the Main Market. Post bonus issue, its issued capital is 460 mln ordinary shares.

P&L Summary

FYE Nov (RM m ln)	FY09	FY10	FY11f	FY12f
Revenue	315.3	322.6	332.4	346.2
Operating profit	85.7	75.5	79.8	83.8
Net Int Exp	-	-	-	-
Share of assc profit	17.0	30.4	31.9	34.2
Pre-tax Profit	102.7	105.9	111.7	117.9
Eff. Tax Rate	24.1%	25.5%	25.5%	25.5%
Net Profit	82.0	87.1	91.3	97.0
Operating Profit Margin (%)	27.2%	23.4%	24.0%	24.2%
Pre-tax Margin (%)	32.6%	32.8%	33.6%	34.1%
Net Margin (%)	26.0%	27.0%	27.5%	28.0%

Source: Company, ZJ Research

Balance Sheet Summary

FYE Nov (RM m ln)	FY09	FY10
Total Assets	373.3	405.6
Non-Current Assets	143.7	180.1
Current Assets	229.6	225.5
Current Liabilities	51.4	50.7
Long Term Liabilities	1.4	2.9
Share Capital	172.5	230.0
Shareholders' Equity	320.1	352.0

Source: Company, ZJ Research

Analyst: Nicole Tan Yoke Ping (nicole@zi.com.my)

RATING GUIDE

BUY	Price appreciation expected to exceed 10% within the next 12 months
SELL	Price depreciation expected to exceed 10% within the next 12 months
HOLD	Price movement expected to be between -10% and +10% over the next 12 months from current level

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