

INITIATING COVERAGE

08 April 2008

Zhulian Corporation Berhad

Stock Code: 5131

Price : RM1.03

Market Capitalisation : RM355.4m

Board : Main Board

Sector : Consumer Product

Recommendation : Buy

<u>Key Stock Statistics</u> <u>FYE Nov</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08f</u>
EPS (sen)	16.8	17.1	17.3
P/E (x)	6.1	6.0	5.9
Net dividend/Share	-	12.7	10.4
Book Value/Share		0.72	
Issued Cap. (m)		345.0	
52-week Hi-Low (RM)		1.50 - 1.00	
Major Shareholders:		%	
Zhulian Holdings S/B		35.0	
The Best Source Holdings Pte. Ltd.		17.31	
Teoh Beng Seng		10.98	

<u>Per Share Data</u> <u>FYE Nov</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08f</u>
Book Value (RM)	0.60	0.72	0.79
Cash Flow (RM)	0.2	0.2	0.2
Earnings (sen)	16.8	17.1	17.3
Net Dividend (sen)	-	12.7	10.4
Payout Ratio	0.0%	74.0%	60.0%
PER (x)	6.1	6.0	5.9
P/Cash Flow (x)	5.7	5.6	5.5
P/Book Value (x)	1.7	1.4	1.3
Net Dividend Yield	0.0%	12.3%	10.1%
ROE	28.0%	23.6%	21.9%
Net Gearing (x)	net cash	net cash	net cash

<u>P&L Analysis (RM m)</u> <u>FYE Nov</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08f</u>
Revenue	225.4	220.5	231.5
Operating Profit	63.6	59.1	58.8
Interest Exp	(0.2)	(0.0)	(0.0)
Pre-tax Profit	76.2	74.3	75.8
Eff Tax Rate	28.8%	26.1%	26.5%
Net Profit	57.9	58.9	60.2
Operating Margin	28.2%	26.8%	25.4%
Pre-tax Margin	33.8%	33.7%	32.7%
Net-Margin	25.7%	26.7%	26.0%

*FY06 figures are on proforma basis.

1. Investment Highlights / Summary

- **Direct selling with a niche in jewellery.** Zhulian is a multi-level marketing with a niche in costume jewellery, which is manufactured in-house.
- **Diverse product offerings.** Leveraging on its network, Zhulian expanded its product offerings to include home care, personal care, F&B, nutritional, baby care, water treatment and air purifier products. 84% of the products are produced in-house for design, quality and cost control.
- **Regional presence.** Zhulian has over 230 agencies and 365,000 independent distributors in Malaysia, Thailand, Singapore and Indonesia.
- **Financials.** While revenue growth appears stagnant in the last 3 years, net profit grew 7% p.a. due to contribution from its Thai associate, launch of higher margin products and better cost control. FY07 net cashflow from operations was RM37m, with zero borrowings.
- **Growth drivers.** Zhulian's planned product rollout includes new nutritional drinks and disposable pad, in addition to new jewellery collections. The group is also expanding its reach in East Malaysia, Indonesia and Singapore. New factory in 3Q08 will provide additional capacity to support growth.
- **Risks.** Direct selling companies' growth may reach a plateau after certain time, affected by drop in distributors or lack of new products. Rising opex cost is another concern. Success lies in ability to attract or retain distributors, having innovative products and manage cost.
- **Initiate coverage with Buy call and a fair value of RM1.26** by pegging EPS08f of 17.3sen against a PER multiple of 7.3x. Projected net dividend yield is attractive at 10%. Zhulian appeals to investors seeking a low PER stock with high dividend income.

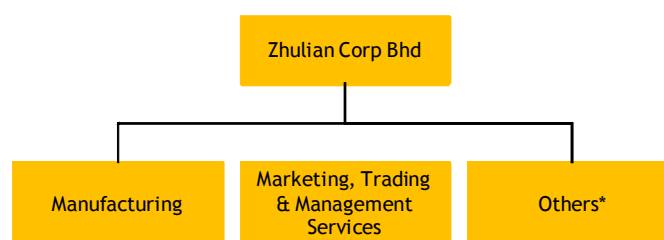
2. Background

MLM company with a niche in costume jewellery

Corporate profile. Zhulian Corporation Berhad (Zhulian) is an investment holding company while its subsidiaries are involved in the manufacture and direct selling of costume jewellery as well as a wide range of other consumer products via the multi-level marketing (MLM) concept. The Group holds the direct selling license under the Direct Selling Act.

The history of Zhulian dates back to 1989 when founder and Chief Executive Officer, Teoh Beng Seng started the business of manufacturing costume jewellery and marketed the products via MLM. The group have since transformed from a small Penang-based direct selling company into a prominent group in the regional markets. Zhulian was listed on the Main Board of Bursa Malaysia Securities Bhd on 27 April 2007.

Business. Zhulian's key business divisions are as follows:-



* mainly consist of a property development subsidiary currently

From its base in costume jewellery and leveraging on its distribution channels, the Group has since expanded its product lines to include a wide range of consumer products which are listed as follows:-

Diversified into various consumer products

Category	Description
Costume Jewellery	Gold-plated, rhodium-plated , two-tone as well as sterling silver jewellery products under the brand name ZHULIAN.
Nutritional	Food supplements, nutritional supplements and sugar substitutes under brands such as B'YOUNG, Royalmix, Zhubee, Vegi-Vera, HOMSWEEP, Origrow, SSSolution and ISO.5.
Food & Beverage (F&B)	Coffee, cereal beverages and fruit juice concentrate.
Purifier	Water purification system known as Beyond Water Bio-Active Reforming System and air purifier system known as Beyond Microplasma Air Purifier.
Personal Care	Hygiene, grooming and skin care products such as shampoo, conditioners, hair gel, shower gel, lotion, skin whitening cream etc. under the brand names of DOLPHIN, EL'TINA, LAVITEEN, BabyCinta, SHISHEN, ASSAHO, SmileOn and Hinokoshiwa.
Home Care	Laundry, dishwashing and general purpose detergents, floor polish, air fresheners and fire extinguishers under the brands XTRA, JUNGLE FRESH and API TERMINATOR Dry Powder Fire Extinguishers.
Therapeutic products	Contiango Scientific Bolster, Contiango Scientific Pillow, Contiango Mattress Pads and M-belt bio-magnetic belts.

Revenue breakdown by product category

Product Category (RM m)	FY06		FY07	
	Revenue	%	Revenue	%
Jewellery	66.7	29.6%	60.4	27.4%
Home Care	10.5	4.6%	11.7	5.3%
Personal Care	20.5	9.1%	19.2	8.7%
F&B	34.3	15.2%	34.9	15.8%
Nutritional	41.2	18.3%	44.6	20.2%
Purifier	29.1	12.9%	28.2	12.8%
Baby care	0.6	0.2%	0.6	0.3%
Therapeutic	18.8	8.4%	17.4	7.9%
Others	3.8	1.7%	3.5	1.6%
Total	225.4	100.0%	220.5	100.0%

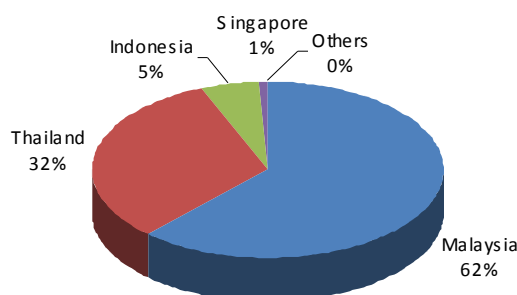
Jewellery remains key revenue contributor

Jewellery is the core product category since the Group's inception and remains as the largest contributor to revenue. Zhulian prides itself as having a wide range of designs that appeal to different age groups. In addition, it provides free electroplating services to its customers once a year.

Today, Zhulian has an extensive network presence in the South East Asian region, with over 230 agencies and approximately 365,000 independent distributors in Malaysia, Singapore, Thailand and Indonesia.

Country	Agency	Independent Distributors
Malaysia	76 agencies	~ 87,000
Thailand	130 agencies	~ 250,000
Indonesia	30 agencies	~ 27,000
Singapore	1 regional office	~ 1,500

Within Malaysia, the agencies are mostly in the northern region (24), trailed by southern region (18), central region (16), east cost (13) and east Malaysia (5).

Malaysia is the largest market, contributing over 60% of revenue**FY07 revenue breakdown by geographical contribution**

Malaysia is the largest revenue contributing market to Zhulian at 62%, followed by Thailand (32%) and Indonesia (5%). The Group's presence in Thailand is via a 49%-owned associated company, which explains the smaller revenue contribution despite having the largest distribution network.

84% products are manufactured in-house.

In-house manufacturing. In order to better position itself, Zhulian has a strong manufacturing division, manufacturing roughly 84% of the Group's products in-house. Products manufactured in-house include the jewellery, nutritional, food & beverage, purifier and therapeutic categories. In-house production allows for exclusivity of designs, enhanced value-added services, proprietary formulation, as well as better control over cost and quality. Furthermore, Zhulian will also be more adept and swift in

adding or varying its product lines to cater to the ever-changing consumer preference.

**2 plants existingly,
with 3rd one coming
onstream in 3Q08**

Presently, the Group has two factories located in Bayan Lepas Industrial Estate, Penang with a combined built-up area of 225,000 sq ft. It is currently building a 3rd factory, also in the same industrial estate. The capex is approximately RM43.3m, inclusive of land, building and machinery cost. The factory, which provides an additional built up area of approximately 188,000 sq ft, is scheduled for completion by 3Q08.

The jewellery production is running at circa 90% capacity, while the F&B, nutritional, purifier products' production are between 50-60% utilization. The therapeutic products segment has plenty of room to grow with utilization currently at circa 30%. The new factory will add additional capacity especially on the nutritional and new pharmaceutical segments.

Zhulian uses a variety of raw materials due to its wide product range. These raw materials comprise gold, silver, other metals, synthetic stones, chemicals (for electroplating process), herbal extracts, food ingredients and additives, plastic moulded parts, minerals, filter material and jade stones. We estimate approximately 30% of total expenditure goes to manufacturing cost, while other major components are staff cost (est. 15%) and distributors' incentives (est. 25%).

Intense competition

Competition. The MLM segment in Malaysia is very competitive with a high numbers of players. While each company's product offerings are different, most revolve around F&B, nutritional, personal care, healthcare and household products. According to the Ministry of Domestic Trade and Consumer Affairs, there are 618 licensed direct selling companies locally as at December 2006, encompassing MLM, single-level marketing and mail order. Of these, 63% or 389 firms are MLM firms.

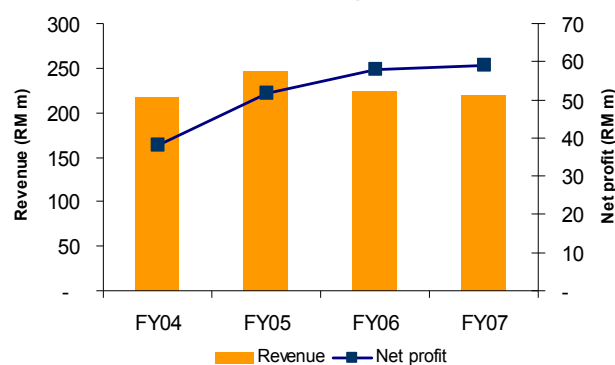
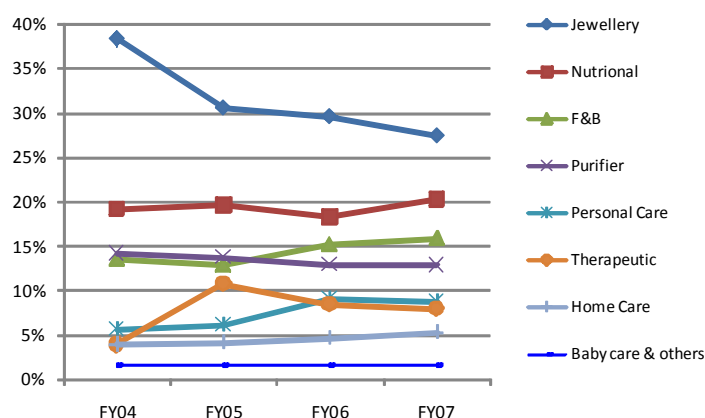
The listed MLM companies include Amway Holdings, CNI Holdings, Hai-O Enterprise, DXN Holdings, INS Bioscience, Liqua Health and Caely Holdings, while the unlisted names are Cosway, LeRoy, Elken, Neways, Nu Skin, Mary Kay, Totalife, and Herbalife.

3. Financial Highlights

**Revenue affected by
declining jewellery
sales**

After reaching a high of RM246m in FY05, Zhulian's revenue has declined 8.4% yoy in FY06 and 2.1% yoy in FY07. The drop is attributed to intense competition, decline in jewellery sales and lower recruitment of new distributors.

Nonetheless, net profit surprisingly bucked the topline's trend by registering a CAGR of 7% between FY05 and FY07, largely due to contribution from its associate company in Thailand. In addition, management also attributed the achievement to introduction of new products which carry higher margins and higher operating efficiency. We note that the unaudited FY07 net profit of RM59m has fallen 7.7% short of the RM64m profit forecast given in its prospectus.

FY04 –FY07 Revenue and net profit record**FY04 – FY07 Revenue composition by product category**

From the chart above, the most significant observation appears to be the declining trend of the jewellery sales, averaging 10% p.a., confirming the revenue trend over the last 3 years.

Net cash position; net operating cashflow of RM37m; high ROE of 24% On balance sheet strength, the group is currently in net cash position and we expect it to remain so in the near future as it has a cash pile of RM120m, which is sufficient to finance its factory capex. NTA per share is at 72sen with high ROE of 24% in FY07. Inventory and receivables turnovers are healthy at 70 days and 55 days respectively. In addition, Zhulian generated a net cash from operation of RM37m in FY07.

4. Earnings Outlook

The growth catalysts for Zhulian going forward will be expansion of its geographical market and introduction of products.

New geographical markets. Zhulian has identified Indonesia, Singapore and East Malaysia as the growth markets. Currently, Indonesia and Singapore contributes 6% to revenue and management believes the growth potential is high at these markets. Meanwhile, there are only 5 agencies in East Malaysia currently out of the 76 in Malaysia. In our opinion, the lack of large departmental stores and shopping malls in Sabah and Sarawak should provide opportunities for Zhulian to market its variety of products.

Introduction of new products. Zhulian launched 2 new jewellery collections in June and August 2007 in conjunction with the past Hari

Raya festive season and response was said to be very encouraging. This year, new product pipeline includes 2 new nutritional beverages containing collagen and the herbal tea known as “Misai Kucing”. The R&D team is also working on introducing a new product this year which is the disposable pad. Zhulian also plans to increase its health supplement products (ie. vitamins) in view of the rising health consciousness amongst consumers.

Many MLM firms reach a plateau after a period of time, unable to break into the next level of growth due to market saturation in the respective product category, lack of product differentiation and inability to attract new or retain existing distributors. Therefore, we believe the critical success factors for Zhulian will be 1) its ability in recruiting new distributors, 2) keeping the existing distributors motivated to push sales, 3) introducing new or innovative products which attract customers, and 4) having the right pricing strategy.

Projects modest revenue and net profit growth of 5% and 1.5% respectively

We project Zhulian’s FY08 revenue to grow a modest 5% yoy to RM231.5m, driven by sales from the several planned new products. Meanwhile, we expect operating profit growth to remain flattish due to set-up cost at its new factory, marketing cost for product launches, higher depreciation and rising operating cost pressures. We estimate net profit at RM60m (+1.5% yoy, attributed to continued growth at its Thai associate), translating into EPS08 of 17.3sen.

5. Investment Risk

Stagnant in distributors’ growth. As mentioned earlier, the challenge for many MLM companies is to continue attracting new distributors while motivating the existing ones. A drastic drop in distributors or sales per active distributor will adversely affect company’s performance.

Lower consumer purchasing power. The jewellery, nutritional, water treatment and air purifier products are considered discretionary products and the rising cost of living may result in consumers cutting back their discretionary spending.

Execution risk. Any delay to the scheduled new products rollout, or commencement of the new plant may put a dent on earnings.

6. Balance Sheet

Balance Sheet (RM m)	FY06	FY07
Total Assets	249.3	283.5
Fixed Assets	55.7	46.9
Current Assets	160.6	195.8
LT Assets	33.0	40.8
Current Liability	41.6	33.7
LT Liability	0.6	0.0
Share Capital	142.2	172.5
Shareholders’ Fund	206.9	249.7

7. Valuation

Currently trading at PER5.9x with estimated 10% net dividend yield Based on our EPS08f of 17.3sen, Zhulian is currently trading at an undemanding PER08 of 5.9x. We have included the following companies as peer comparison:

Company	Share price (RM)	Market Cap (RM m)	Trailing PER (x)	P/BV (x)	FYE	Gross Yield (%)
Amway Holdings	6.50	1,068.5	12.1	4.7	Dec	4.9
CNI Holdings	0.35	248.4	11.9	2.5	Dec	6.7
Hai-O Enterprise	3.22	267.5	9.9	2.1	Apr	6.6
DXN Holdings	0.51	121.6	5.1	0.8	Feb	2.5
Average PER			9.7			
Zhulian Corp	1.03	355.4	6.0	1.4	Nov	15.0

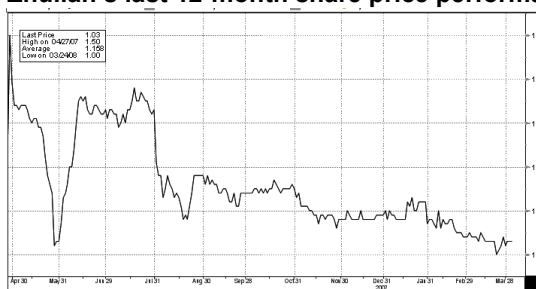
Source: Bloomberg, Company data

We have excluded INS Bioscience as it is trading at over 100x PER, while Liqua Health and Caely Holdings are currently loss-making.

Pegging Zhulian's EPS08f of 17.3sen against our target PER multiple of 7.3x yields a fair value of RM1.30. The target PER is 25% discount to the average 9.7x PER, to reflect our cautious view given the uncertain outlook in consumer spending in light of rising cost of living.

A key attractive point is Zhulian's above average dividend yield. The group has a dividend policy to pay out 60% of net profit in dividends. In FY07, it paid out 74% of its earnings, translating into a net yield of 12.7%. Based on a conservative 60% payout in FY08, the net yield is potentially at 10.4%.

Zhulian's last 12-month share price performance



Source: Bloomberg

8. Recommendation

Initiate with Buy call and fair value of RM1.26 We initiate our coverage on Zhulian with a **Buy** recommendation and a fair value of **RM1.26**. With its clear dividend policy, it provides a very attractive potential net yield of 10%. This company appeals to investors looking for low PER stock with high dividend yield.

Analyst: Ng Kok Ken (kokken@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

DISCLAIMER

This report is for information purposes only and has been prepared by ZJ Advisory based on sources believed to be reliable at the time of issue of this report. We however do not give any guarantee as to the accuracy or completeness of the information provided. Any opinions or estimates in this report are that of ZJ Advisory as of this date and are subject to change without notice. ZJ Advisory has no obligation to update its opinion or the information in this report beyond the scope of participation under the CMDF-Bursa Research Scheme. ZJ Advisory and/or its directors and staff may have an interest in the securities mentioned.

This report is under no circumstances to be construed as an offer to sell or a solicitation of an offer to buy any securities. Investors should seek financial regarding the appropriateness of investing in any securities discussed or opined in this report. Investors should understand that statements regarding future prospects may not materialize. This report may contain forward looking statement and forecasts, which are based on assumptions that are subject to uncertainties. Any deviation from the expectations may have adverse effect on the projections and prospects contained herein. ZJ Advisory accepts no liability for any direct, indirect or consequential loss arising from the use of this report.

ZJ Advisory is a participant in the CMDF-Bursa Research Scheme and will receive compensation for the participation. For more information on the CMDF-Bursa Research Scheme, please visit <http://www.bursamalaysia.com/website/listing/cbrs.htm>.

ZJ Advisory Sdn Bhd (Co No: 645449-V)
(An investment adviser licensed by the Securities Commission)

Suite 22B, 22nd Floor, Wisma Denmark,
No 86, Jalan Ampang, 50450 Kuala Lumpur
Tel (603) 2032 2328 Facsimile (603) 2032 1328
