

PP7004/11/2006

Wednesday, 22 March 2006

MALAYSIAN AE MODELS HLDG.

STRONG BUY

AWAITING RECOGNITION

INVESTMENT HIGHLIGHTS

- **Solid track record.** Malaysian AE Models Holdings ("MAEMODE") boasts a 10-year net profit CAGR (FY1995-FY2005) of 12.6% p.a. despite a 21.3% net profit decline during the FY1999-FY2003-period when the technology bubble burst.
- **Rising earnings momentum.** Measures undertaken in the past few years to diversify earnings base are paying off. FY04 and FY05 net profit grew 12.2% and 14.6% y-y, respectively. We expect earnings growth to accelerate further over the next three years with a 3-year net profit CAGR (FY2005-FY2008) of 38.5%.
- **Key earnings drivers:** (1) Strong sales growth to China, Indonesia and other Asian markets; (2) Profit margins recovery due to greater focus on the higher value-added Automated Handling, Sorting & Retrieving-system and Bulk Materials Handling-system; (3) Lower group effective tax rate as three key subsidiaries will enjoy 5-10-year tax exemption (under Pioneer Status) from 2HFY06 onwards; and (4) Lower effective interest rate on the newly raised RM200m-Islamic Commercial Paper/Islamic Medium Term Notes.
- **Compelling valuations.** The stock is trading at a Basic (Fully Diluted) FY07 and FY08 P/E of 4.8x and 3.5x (6.1x and 4.6x), respectively. P/NTA stood at 0.6x as at May 31, 2005. We are not overly concerned about the low Gross Dividend Yield (0.6%) as MAEMODE needs to conserve cash to fund regional expansion.
- **BUY with a 12-month target price of RM1.90 based on a 3-year (FY05-FY08) PEG ratio of 0.6x.** The price behaviour of MAEMODE-WA (RM0.330. Ex. Price: RM1.00. Expiry Date: 19/9/2010. Premium: 50.3%. Gearing: 2.7x) seems to suggest an impending run-up in the underlying share price.

Share Price	RM0.885
Target Price	RM1.900
Par value	RM1.00
Issued Shares	95.1m
Market Capitalisation	RM84.2m
Board	Main
Sector	Industrial
BMCI	923.13
EMAS	212.12
Syariah-compliant	Yes
Stock Code	7075
Bloomberg	MAE MK

Major Shareholders (>5%)

Aemic Corp (M) S/B	33.86%
Atlantis Investment Management Limited	12.56%

Analyst

Teoh Cheng Guan	03-2166 6822
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Per Share Data

Y/E: May 31	2004	2005	2006E	2007F	2008F
Book Value (RM)	1.56	1.47	1.5E	1.76	2.01
Cash Flow (sen)	24.7	23.1	19.4	25.9	32.7
Earnings (sen)	13.4	12.9	12.0	18.4	25.0
Gross Dividend (sen)	0.5	0.5	0.5	0.5	0.5
Net Payout Ratio	2.7	2.8	3.0	2.0	1.4
P/E (x)	6.6	6.9	7.4	4.8	3.5
P/E (x) (Diluted)	0.0	0.0	9.2	6.1	4.6
P/CF	3.6	3.8	4.6	3.4	2.7
P/Book Value	0.6	0.6	0.6	0.5	0.4
Gross Dividend Yield (%)	0.6	0.6	0.6	0.6	0.6
ROE (%)	5.6	7.7	8.2	11.4	14.0
Net Gearing (%)	96.8	72.5	64.8	52.4	37.4

P&L Analysis (RMm)

Y/E: May 31 (RM mil)	2004	2005	2006E	2007F	2008F
Revenue	159.5	186.0	218.8	257.7	301.2
EBITDA	24.7	28.2	30.8	37.8	45.4
Depreciation	7.1	7.1	7.1	7.2	7.3
Interest Expense	6.8	9.8	10.8	11.9	11.8
Pre-tax Profit	11.5	12.6	14.9	21.4	29.4
Effective tax rate (%)	29.8	26.6	20.0	15.0	15.0
Net Profit	8.3	9.0	11.4	17.5	23.8
Operating Margin (%)	11.5	11.8	13.1	12.7	13.5
Pre-tax Margin (%)	7.2	6.8	6.8	8.3	9.8
Net Margin (%)	5.2	4.8	5.2	6.8	7.9

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 801, 8th Floor, Kenanga International, Jalan Sultan Ismail, 50250 Kuala Lumpur, Malaysia
 Telephone: (603) 2166 6822 Facsimile: (603) 2166 6823 Website: www.kenangaresearch.com

 Head of Research



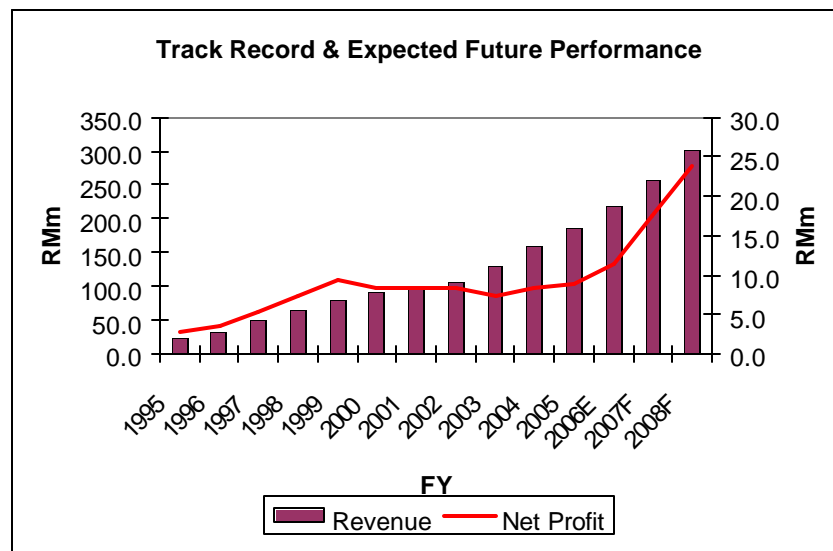
BACKGROUND & HISTORY

Malaysia AE Models Holdings ("MAEMODE") commenced operation in 1979 and was listed on the Second Board of Bursa Malaysia in 1999. MAEMODE transferred from Second Board to the Main Board of Bursa Malaysia in 2003.

MAEMODE group is principally involved in the provision of one-stop automated materials handling and factory automation system solutions. The group principally operates from its 9 blocks of 1 ½ storey factory buildings, of which 8 are located at Batu Pahat, Johor and one at Kluang, Johor with a total built-up area of 34,607 sq.m. The group also has factories in Indonesia and Suzhou, China.

MAEMODE boasts a solid long-term track record (See Figure 1). Note that MAEMODE's revenue and net profit continued to grow even during the height of the 1997-98 Asian Currency Crisis. Net profit declined 21.3% during the FY1999-FY2003-period after the technology bubble burst because of its over dependence on the Electrical and Electronics ("E&E") sector then.

FIGURE 1: TRACK RECORD AND EXPECTED FUTURE PERFORMANCE



Source: MAEMODE's annual reports, prospectus and Kenanga estimates

Over the past few years, MAEMODE has worked hard to reduce its dependence on the E&E sector. The following table serves as a good progress report on its diversification effort:

Table 1: Sales Breakdown by Industry Segment

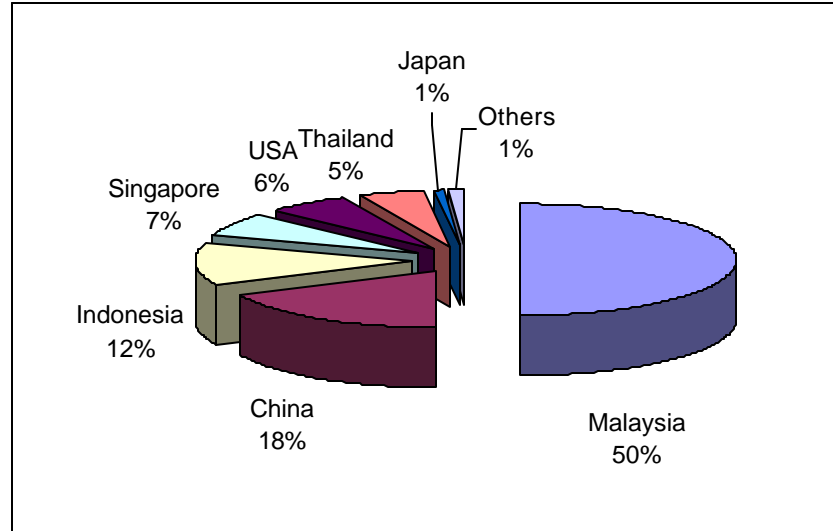
(%)	FY01	FY02	FY03	FY04	FY05
Automotive	5	4	7	1	1
Consumer Products	9	6	8	1	1
Coal Mines	0	0	3	13	13
Electrical & Electronics	55	46	23	31	32
Food Processing	1	2	1	1	4
Logistics/Warehousing	0	6	29	18	15
Plastic/Injection Moulding	6	3	3	1	1
Trading & Engineering	22	29	25	29	28
Others	2	4	1	5	5
	100	100	100	100	100

Source: MAEMODE

Apart from targeting more industries for its products, MAEMODE is also actively developing markets overseas. We expect export sales to grow faster than domestic sales.



FIGURE 2: SALES BREAKDOWN BY GEOGRAPHY



Source: MAEMODE

MAEMODE is not dependant on any single customer as the top 10 customers only account for approx. 28% of group sales and the biggest customer accounts for less than 6% of group sales.

Maemode has 4 key product categories:

- Unit Materials Handling System ("UMHS");
- Bulk Materials Handling System ("BMHS");
- Logistic, Sortation and Warehousing System ("LSWS"); and
- Contract Equipment Manufacturing ("CEM").

LSWS offers the highest operating profit margins and CEM the lowest.

MAEMODE focuses mainly on the medium-end product technology segment (average project value < US\$5m), as the lower-end is highly competitive. A few international players such as Siemens Diametic of Germany, Swisslog of Switzerland and Okura of Japan dominate the high-end product segment.

MAEMODE has signed 11 partnership agreements with the multinationals to market their technologies and products in the Asia Pacific region. For instance, the highly successful LSWS introduced to the Chinese market comes under the Exclusive Partnership Business Collaboration with Van Riet of the Netherlands. MAEMODE's LSWS can handle more than 9,000 parcels/hour vis-à-vis its Chinese competitors' 3,000 parcels/hour.

TABLE 2: COST ANALYSIS

	FY04	FY05	FY06E	FY07F	FY08F
Cost of sales	77.6%	77.4%	77.1%	79.5%	80.9%
Distribution expenses	2.6%	2.7%	2.6%	2.5%	2.4%
Administrative expenses	7.5%	7.3%	6.8%	6.6%	6.3%
Other operating expenses	7.6%	7.0%	6.6%	6.4%	6.1%
Finance cost	4.6%	5.5%	6.9%	5.0%	4.3%
	100.0%	100.0%	100.0%	100.0%	100.0%

Source: MAEMODE's annual reports and Kenanga estimates

Cost of sales can be further broken down as follows:

- Steels, parts and components such as belts and motors – 60% (30% imported);
- Labour – 10%; and
- Others – 30%

Note: Component prices have dropped by an average of 3-5% YTD.



Outlook – Rising Earnings Momentum

MAEMODE's revenue is project-driven. Outstanding order book stood at RM196m, of which RM70m is recurrent and comprises mainly of the higher margins services and maintenance jobs, as at January 31, 2006. The group is currently bidding for RM500m worth of new jobs and expects a 30-40% success rate.

We forecast a 17.6% and 17.8% and 16.9% y-y growth in FY06, FY07 and FY08 revenue, respectively. MAEMODE will resort to selective outsourcing activities to handle the additional jobs. Sharing of profit margins with sub-contractors will not materially affect MAEMODE's overall operating profit margins, as it will be largely offset by reduced funding and shipping costs (From MAEMODE's Johor factories to overseas project sites).

We expect PBT margins to remain steady in FY06 mainly because of a one-off RM3.5m professional fee incurred in respect of the RM200m-Islamic Commercial Papers/Islamic Medium Term Notes ("ICP/IMTN"). We anticipate further PBT margins recovery in FY07 and FY08 due to:

- greater focus on the higher value-added Automated Handling, Sorting & Retrieving-system and Bulk Materials Handling -system; and
- Lower effective interest rate on the ICP/IMTN.

The FY06, FY07 and FY08 net profit will grow at a relatively faster 28.6%, 52.8% and 37.7% y-y because of tax exemption (under Pioneer Status) for the following 3 wholly owned subsidiaries:

- Vitontech (M) S/B – A manufacturer of automated conveyer systems and parts, automated sorting and lifting equipment, automated storage and retrieving equipments;
- Indusrol Technology S/B – A manufacturer of industrial rollers; and
- Matromatic Manufacturing (M) S/B – A provider of contract manufacturing services to the international Original Equipment Manufacturers ("OEMs").

FINANCIAL SUMMARY

TABLE 3 : EARNINGS ESTIMATES

Y/E: 31 May	FY04	FY05	FY06E	FY07F	FY08F
Turnover	159.5	186.0	218.8	257.7	301.2
Cost of sales	-116.2	-136.5	-159.7	-190.7	-222.9
Gross Profit	43.3	49.6	59.1	67.0	78.3
Other operating income	1.5	2.5	2.7	3.0	3.3
Distribution expenses	-3.8	-4.8	-5.3	-6.0	-6.6
Administrative expenses	-11.3	-12.8	-14.1	-15.8	-17.4
Other operating expenses	-11.4	-12.4	-13.7	-15.4	-16.9
Operating Profit	18.3	22.0	28.7	32.8	40.7
Finance Cost	-6.9	-9.8	-14.3	-11.9	-11.8
Share of results of associates	0.2	0.4	0.4	0.5	0.6
PBT	11.5	12.6	14.9	21.4	29.4
Taxation	-3.4	-3.4	-3.0	-3.2	-4.4
Profit after tax	8.1	9.2	11.9	18.2	25.0
MI	0.3	-0.3	-0.5	-0.7	-1.2
Net Profit after MI	8.3	9.0	11.4	17.5	23.8



TABLE 4 : CASH FLOW

<u>Y/E: 31 May</u>	<u>FY04</u>	<u>FY05</u>	<u>FY06E</u>	<u>FY07F</u>	<u>FY08F</u>
PBT	11.5	12.6	14.9	21.4	29.4
Adjustments for:					
Depreciation	7.1	7.1	7.1	7.2	7.3
Interest income	-0.5	-0.9	-1.5	-2.2	-2.6
Interest expense	6.8	9.8	10.8	11.9	11.8
Share of results in associates	-0.2	-0.4	-0.4	-0.5	-0.6
Others	-0.5	-0.6	0.0	0.0	0.0
Operating CF before w/c charges	24.2	27.6	30.8	37.8	45.4
Inventories	0.5	-9.2	-2.0	-2.0	-2.0
Receivables	-14.8	-11.1	-10.0	-10.0	-10.0
Payables	4.4	2.1	5.0	5.0	5.0
Others	-14.1	-8.1	-5.0	-5.0	-5.0
Net CF from operations	0.3	1.3	18.8	25.8	33.4
Interest paid	-5.8	-7.9	-10.8	-11.9	-11.8
Income tax paid	-3.4	-4.6	-3.0	-3.2	-4.4
Interest received	0.5	0.9	1.5	2.2	2.6
Net Operating CF	-8.5	-10.4	6.6	12.9	19.8
Purchase of PP&E	-14.6	-21.8	-3.0	-3.0	-3.0
Proceeds from disposal of PP&E	5.8	1.4	0.0	0.0	0.0
Others	0.7	-0.7	0.0	0.0	0.0
Net Investing CF	-8.2	-21.1	-3.0	-3.0	-3.0
Proceeds from shares issued	3.1	31.5	0.0	0.0	0.0
Bonds	62.4	0.0	-65.0	0.0	0.0
Term loans	-5.7	-2.3	-8.0	-8.0	-8.0
HP	-1.4	-1.4	-1.4	0.0	0.0
Other borrowings	-16.6	3.6	100.0	0.0	0.0
Dividend paid	-0.2	-0.2	-0.3	-0.3	-0.3
Net Financing CF	41.6	31.2	25.3	-8.3	-8.3
Net Changes in Cash & cash equiv	24.9	-0.3	28.8	1.5	8.4
Cash and cash equiv (begin)	7.5	32.3	32.0	60.9	62.4
Effect of forex fluctuations	-0.1	0.0	0.0	0.0	0.0
Cash and cash equiv (end)	32.3	32.0	60.9	62.4	70.8
Cash and cash balance	32.9	32.2	61.9	63.4	71.8
Bank overdrafts	-0.6	-0.1	-1.0	-1.0	-1.0



TABLE 5 : BALANCE SHEET

Y/E: 31 May	FY04	FY05	FY06E	FY07F	FY08F
PP&E	64.1	80.0	75.9	71.7	67.4
Investments in associates	1.0	1.2	1.5	1.9	2.3
Others	4.2	4.4	2.0	2.0	2.0
<u>Fixed Asset</u>	<u>69.3</u>	<u>85.7</u>	<u>79.5</u>	<u>75.6</u>	<u>71.7</u>
Inventories	27.5	36.6	38.6	40.6	42.6
Trade & other Receivables	123.7	142.8	152.8	162.8	172.8
Taxrecoverable	0.0	0.6	0.0	0.0	0.0
Cash and bank balance	32.3	32.0	60.9	62.4	70.8
<u>Current Asset</u>	<u>183.5</u>	<u>212.1</u>	<u>252.3</u>	<u>265.9</u>	<u>286.3</u>
Trade & Other payables	15.5	17.1	12.1	7.1	2.1
ST bank borrowings	26.1	27.4	127.4	127.4	127.4
Provision for taxation	2.1	1.0	1.0	1.0	1.0
<u>Current Liabilities</u>	<u>43.7</u>	<u>45.5</u>	<u>140.5</u>	<u>135.5</u>	<u>130.5</u>
Net Current Asset/ (Liabilities)	139.8	166.6	111.8	130.4	155.8
	209.1	252.3	191.3	206.0	227.5
LT Loan	104.4	107.1	32.7	24.7	16.7
Others	3.4	3.9	5.4	10.0	15.0
<u>LT Liabilities</u>	<u>107.7</u>	<u>111.0</u>	<u>38.1</u>	<u>34.7</u>	<u>31.7</u>
Share capital	63.4	95.1	95.1	95.1	95.1
Reserves	3.3	3.1	3.1	3.1	3.1
Retained profit	32.5	41.2	52.3	69.4	92.9
<u>Shareholder's Funds</u>	<u>99.2</u>	<u>139.4</u>	<u>150.5</u>	<u>167.6</u>	<u>191.1</u>
<u>Minority Interest</u>	<u>2.2</u>	<u>1.9</u>	<u>2.7</u>	<u>3.7</u>	<u>4.8</u>
	209.1	252.3	191.3	206.0	227.6