# Malaysian AE Models Holdings Berhad

**OVERWEIGHT**

## *Harvesting on manufacturing and retail booms in China and upcycle of commodity prices*

**Fair Value:**

**RM2.05 (+53.0%)**

| Stock Data | |
|---|---|
| Price (RM) | 1.34 |
| Stock code | 7075 |
| Bloomberg Ticker | MAE MK |
| Listing | Main Board |
| Share Cap (RM mn) | 95.12 |
| Market Cap (RM mn) | 129.22 |
| Par value (RM) | 1.00 |
| 52-wk high (RM) | 1.45 |
| 52-wk low (RM) | 0.90 |
| Major Shareholders | Datuk Dr.Lim Kee Sinn (32.3%) |

| Financial Data | |
|---|---|
| PER (x) | 10.7 |
| BV per share (RM) | 1.6 |
| P/BV (x) | 0.8 |
| ROE (%) | 8.2 |
| Beta (x) | 1.0 |
| Altman Z Score | 1.9 |
| Dividend yield (%) | 1.1 |

| Relative Performance | |
|---|---|
| 1-month (%) | -4.8 |
| 3-month (%) | -2.7 |
| 6-month (%) | -13.5 |
| 12-month (%) | 1.1 |
| YTD (%) | -7.8 |

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Our recent meeting with management of Malaysia AE Models Holdings Bhd (Maemode) has reaffirmed our positive conviction on the Group's prospect. Upon underperforming KLCI during the recent rally, we believe the Group is set for re-rating by the investors in view of its solid fundamentals, strong earnings growth and distressed valuation. We are maintaining our **OVERWEIGHT** recommendation with a target price of **RM2.05**. Our investment case is highlighted below:

***Harvesting on China's manufacturing & consumer booms.*** China, being the largest manufacturer in the world with speculator domestic consumption growth, has indirectly boosted the country's demand for logistics, sortation and warehousing systems. Maemode's venture to China since 1997 has opened up a highly lucrative market for the Group and is bearing fruits. We are optimistic that China market will be one of the key earnings drivers for the Group going forward. We expect China's contribution to the Group's total revenue to increase from 23% in FY06 to 38% by FY10.

***Riding on the thriving coal industry from its Indonesia's operations.*** We are also upbeat on Maemode's venture to Kalimantan, Indonesia. The upcycle of coal price has boosted the development of coal mining industry in Indonesia which increased the use of bulk-handling systems. Indonesia's coal exports are expected to exceed 180mn tons by 2010.

***Concerns about large debtor position and high gearing level largely unfounded.*** Some investors are concerned about the Group's and large debtor position and high gearing level which we believe are largely unfounded. We gather that more than RM100mn of its high project-based trade debtors are essentially contract work-in-progress (WIP). Furthermore, the Group has written off actual bad debt of less than RM90,000 over the past few years indicating that bad debt risk is low. Although Maemode's net gearing remained high at 97.2% as at 28th of February, its net interest coverage ratio was rather comfortable at 4.1x for FY07.

***Earnings delivery never disappoints.*** Since we started our coverage for Maemode in 2005, the Group has consistently delivered strong earnings growth that came above or within our expectations for the past seven quarters. With the expected strong growth from its overseas venture coupled with robust demand in the domestic market, we expect the Group to register 25%-35% growth in earnings over the next 3 years.

***Distressed valuation.*** The Group is trading at a single digit forward PER and discount to its forward NTA. We believe its current distressed valuation is unwarranted due to its strong earnings growth going forward.

*Harvesting time!!*

Our recent meeting with management of Malaysia AE Models Holdings Bhd (Maemode) has reaffirmed our positive conviction on the Group's prospect. After years of commitments and hard work in establishing its regional networks, we believe the Group will enjoy strong earnings growth from its overseas venture particularly in China and Indonesia which contributed 28% and 26% of the Group's orderbooks at present.

We believe the Group is set for re-rating by the investors in view of its solid fundamentals, strong earnings growth and distressed valuation.

**China**

***Welcome to China, the largest manufacturer in the world!***

China, being the largest manufacturer in the world with speculator domestic consumption growth, has indirectly boosted the country's demand for logistics, sortation and warehousing systems. Investment growth has been phenomenon in recent years especially in the manufacturing division. China has become the most favoured destination for Foreign Direct Investment (FDI) attributable to its low labour costs and a gigantic consumer market with estimated 1.2bn consumers. FDI to China has topped USD63.0bn in 2006 and the country is expected add another USD63.8bn FDI in 2007. Since logistic solutions form an integral part of most manufacturing process, the astonishing growth in manufacturing sector has boosted the demand for Maemode's products.

***Not to forget the power of this consumption giant!!***

The retail segment, which has contributed to nearly 40% of China's GDP, is expected to continue its sterling growth in tandem with the rise of economic prosperity in the country. Retail spending in China is expected to enjoy annual grow rate exceeding 11% to reach USD1.25tn in 2010. Many foreign based retail operations such as Carrefour, METRO, Tesco, Tricon, Wal-Mart and Parkson have flocked to China to capitalize on the stronger than ever consumption boom.

**China Retail Sales Value**


*Source: National Bureau of Statistic, Various*

## TOP 10 foreign retailers in China (2006)

| Company name | Sales USDbn | Home country | Y-o-y growth (%) |
|---|---|---|---|
| CR Vanguard | 4.92 | Hong Kong | 26 |
| Carrefour China | 3.23 | France | 53 |
| RT-MART | 2.55 | Taiwan | 25 |
| YUM Chin | 2.2 | USA | 27 |
| Wal-mart China | 1.96 | USA | 30 |
| Trust mart | 1.82* | Taiwan | Na |
| Lotus | 1.76* | Thailand | 34 |
| Metro | 1.22 | Germany | 24 |
| Hymall TESCO | 1.21 | UK | 17 |
| B&Q China | 0.81 | UK | 20 |

** = estimate*

*Source: CCFA, SJ*

***The accelerated development in the retail market has driven up the demand for Maemode's logistic solutions.***

Furthermore, the liberalization of direct selling market since 2005 has allowed the multi level marketing (MLM) operators such as Amway, Sunrider, Avon, Nu Skin and Mary Kay to tap into China's retail market. The accelerated development in the retail market has driven up the demand for Maemode's logistic solutions in order for companies to collect goods from suppliers to the distribution centre and redistribute them to supermarkets and hypermarkets. Management guided that its products with high sortation capacity up to 12,000 articles per hours have been very popular among the retailers in China.

## Logistic, Warehousing and Distribution

*Source: Company*

## Investment in China

| | 2003 USD bn | 2004 USD bn | 2005 USD bn | 2006 USD bn |
|---|---|---|---|---|
| Manufacturing | 191.1 | 254.8 | 345.8 | 343.4 |
| Transport, Storage & Post Services | 81.8 | 99.5 | 125.1 | 144.9 |
| Wholesale & Retail Trade | 12.0 | 16.6 | 22.3 | 24.5 |

*Source: China Statistical Data, National Bureau of Statistic China*

***China's logistic is expected grow at an annual growth rate of 20% to achieve USD149bn in 2010***

According to forecast from the Chinese authority, China's logistic is expected grow at an annual growth rate of 20% to achieve USD149bn in 2010,

***China…highly lucrative market for the Group and is bearing fruits.***

Therefore, Maemode's venture to China since 1997 has opened up a highly lucrative market for the Group and is bearing fruits. At present, the Group has 2 production facilities and 4 regional offices in China. We are optimistic that China market will be one of the key earnings drivers for the Group going forward. Management expects that capex for next 2 years to be approximately RM25mn with more than half will be invested in China to cater the growing demand. We expect China's contribution to the Group's total revenue to increase from 23% in FY06 to 38% by FY10.

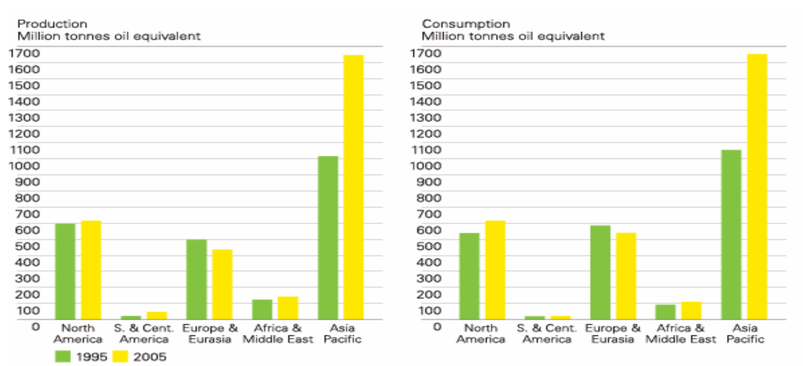
**<u>Indonesia</u>**

***Indonesia…the world's largest steam coal exporter!!!***

We are also upbeat on Maemode's venture to Kalimantan, Indonesia. The current upcycle of coal price has boosted the development of coal mining industry in Indonesia which we believe will in turn increase the use of bulk-handling systems.

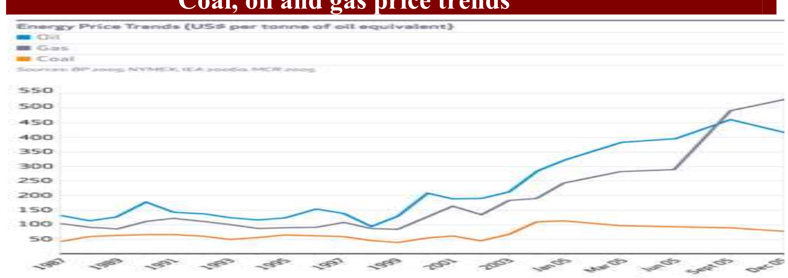
The rising global demand for electricity and power generations particularly in the emerging economies has increased the demand for coals which is one the most affordable fuels for power generation in view of the high oil and gas prices. The current upcycle in coal price has benefited Indonesia tremendously as the world's second largest exporter of coal after Australia and the world's largest steam coal exporter.

**Coal production and consumption**




*Source: BP Global*

**Coal, oil and gas price trends**

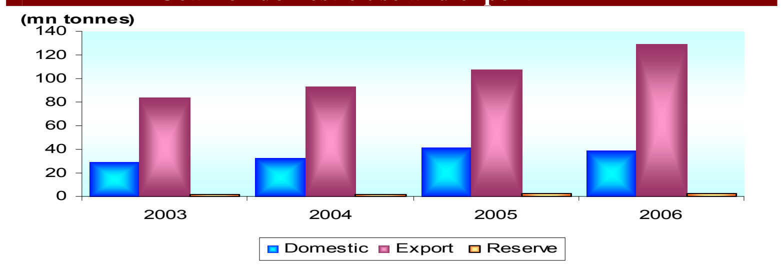



*Source: Various*

***Coal exports are expected to exceed 180mn tons by 2010.***

Indonesia's coal production has risen by 20 fold since 1990 to an estimated 167mn tons in 2006, at which 73% of it is exported overseas. Indonesia's coal exports are expected to exceed 180mn tons by 2010.

**Coal for domestic use and export**




*Source: DPPMB*

***Demand for bulk-handling solutions increased….***

This has boosted investment to develop and modernize the coal mining industry in Indonesia and in turn increased the demand for Maemode's bulk-handling solutions which could be used to transport the coal from coal plant to harbor as illustrated below:

**Photo of coal handling system**

*Source: Various*

***Maemode…well positioned to capitalize to develop and modernize the coal mining industry!!***

Maemode has recently secured a RM28.4mn contract to build a bulk-handling system for coal-fired power plant in East Kalimantan, Indonesia. With the Group's reputation as a reliable and leading service provider, we believe it is well positioned to capitalize on the increased demand for its bulk-handling solutions to develop and modernize the coal mining industry. At present, 26% of the Group's orderbook comes from Indonesia and we expect it to increase further going forward.

**<u>Solid order book and better margin</u>**

***Solid order book and better margin…***

Maemode's current order books stood at about RM285mn, with approximately 28% of the projects come from China and 26% from Indonesia. We are confident that the Group will able to secure more overseas contracts due to its ability to offer customized bulk handling solutions. Furthermore, the Group has always enjoyed higher profit margin compared with the industry average since Maemode is able to differentiate itself as a total systems provider instead of a simple automation system provider.

**<u>Sufficient capacity to meet higher demand</u>**

***Sufficient capacity to meet higher demand…***

Maemode's current capacity is at 76% meaning that the Group is still able to cope with further demand without incurring more capital expenditure. Maemode has anticipated its production to increase by 25% annually over the next three years.

## Financial Analysis

| Location | No of factory | Production Capacity (RMmn) | Production Output (RMmn) | Production Capacity (%) |
|---|---|---|---|---|
| **Batu Pahat** | 7 | 280 | 230 | 82 |
| **Kluang** | 1 | 10 | 6 | 60 |
| **Suzhou, China** | 2 | 60 | 30 | 50 |
| **Indonesia** | 1 | 5 | 3 | 6 |
| **Total** | 11 | 355 | 269 | 76% |

*Source: Company*

**Concerns about large debtor position and high gearing level largely unfounded.**

***Bad debt risk is low!!***

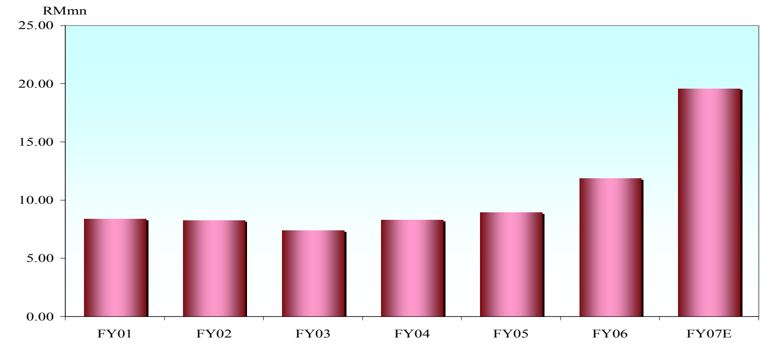
Some investors are concerned about the Group's and large debtor position and high gearing level which we believe are largely unfounded. We gather that more than RM100mn of its high project-based trade debtors are essentially contract work-in-progress (WIP). Furthermore, the Group has written off actual bad debt of less than RM90,000 over the past few years indicating that bad debt risk is low. Although Maemode's net gearing remained high at 97.2% as at 28th of February, its net interest coverage ratio was rather comfortable at 4.1x for FY07.

**Company that consistently delivers earnings growth**

***Consistently strong earnings growth!!***

Since we started our coverage for Maemode on the September 2005, the Group has consistently delivered strong earnings growth that came above or within our expected for the past seven quarters. With the expected strong growth from its overseas venture coupled with robust demand in the domestic market, we expect the Group to register 25%-35% y-o-y growth in earnings over the next 3 years.

## Net Profit




*Source: Company*

## Valuation

The Group is trading at a low single digit forward PER and discount to its forward NTA. We believe its current distressed valuation is unwarranted due to its strong earnings growth going forward. We are maintaining our target price for the Group to **RM2.05** pegging at a PER of 12x based on a prospective basic EPS for FY07 of 20.6sen. **Maintain OVERWEIGHT**

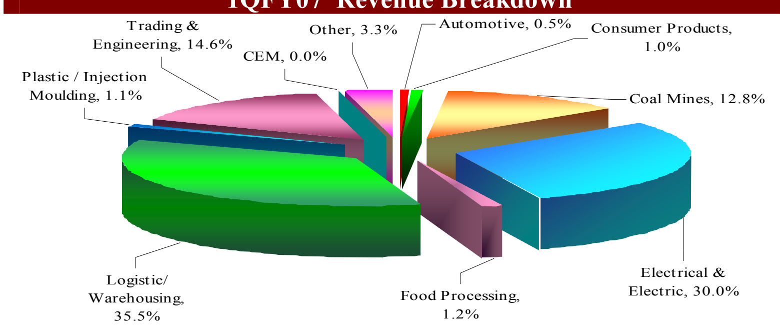
**Financial Analysis**

| ***P&L Analysis (RMmn)*** **Year-end: 31st May** | **2004** | **2005** | **2006** | **2007E** |
|---|---|---|---|---|
| Revenue | 159.5 | 186.0 | 286.8 | 352.7 |
| EBITDA | 25.3 | 29.9 | 38.4 | 51.5 |
| Depreciation | (7.1) | (7.5) | (9.8) | (12.2) |
| Interest Expenses | (6.8) | (9.8) | (9.9) | (12.6) |
| Profit before Tax | 11.5 | 12.6 | 18.6 | 26.7 |
| Taxation | (3.4) | (3.4) | (6.5) | (6.8) |
| Minority Interest | 0.3 | (0.3) | (0.2) | (0.3) |
| Net Profit | 8.3 | 9.0 | 11.9 | 19.6 |
| EBITDA Margin (%) | 15.9 | 16.1 | 13.4 | 14.6 |
| Pre-tax Margin (%) | 7.2 | 6.8 | 6.5 | 7.6 |
| Net-Margin (%) | 5.2 | 4.8 | 4.1 | 5.6 |

**Per Share Data**

| ***Per Share Data*** | **2004** | **2005** | **2006** | **2007E** |
|---|---|---|---|---|
| Book Value (RM) | 1.6 | 2.0 | 1.6 | 1.8 |
| Cash Flow (sen) | (13.2) | (14.9) | (14.1) | (16.2) |
| Earnings (sen) | 13.3 | 12.9 | 12.5 | 20.6 |
| Dividend (sen) | 0.5 | 0.5 | 1.5 | 3.0 |
| Payout ratio (%) | 3.8 | 3.9 | 12.0 | 14.6 |
| PER (x) | 8.5 | 5.7 | 7.4 | 6.4 |
| P/Cash Flow (sen) | (8.6) | (4.9) | (6.6) | (8.1) |
| P/Book Value (sen) | 0.7 | 0.4 | 0.6 | 0.7 |
| Dividend yield (%) | 0.4 | 0.7 | 1.6 | 2.3 |
| ROE (%) | 8.8 | 8.4 | 12.8 | 15.7 |
| Net Gearing (%) | 96.8 | 72.5 | 91.9 | 117.3 |

**1QFY07 Revenue Breakdown**

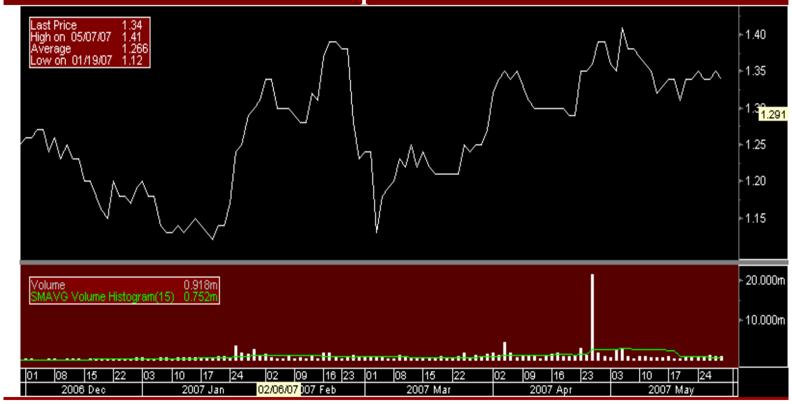



*Source: Company*

## Balance Sheet

| Balance Sheet as at May | 2004A | 2005A | 2006A |
|---|---|---|---|
| **FIXED ASSETS** | | | |
| Tangible fixed assets | 64.1 | 80.0 | 97.5 |
| Intangible assets | n/a | n/a | n/a |
| Investments: associates | 1.0 | 1.2 | 5.6 |
| Others | 4.2 | 4.4 | 0.2 |
| **Total Fixed Assets** | **69.3** | **85.7** | **103.3** |
| | | | |
| **CURRENT ASSETS** | | | |
| Inventories | 27.5 | 36.6 | 20.4 |
| Receivables | 123.7 | 142.8 | 204.2 |
| Other current assets | n/a | 0.6 | 0.2 |
| Cash and near cash | 32.3 | 32.0 | 31.2 |
| **Total Current Assets** | **183.5** | **212.1** | **256.1** |
| | | | |
| **CURRENT LIABILITIES** | | | |
| Trade and other creditors | 15.5 | 17.1 | 27.0 |
| Short-term borrowings | 26.1 | 27.4 | 129.1 |
| Other current liabilities | 2.1 | 1.0 | 3.35 |
| **Total Current Liabilities** | **43.7** | **45.5** | **159.4** |
| | | | |
| Net Current Asset/(Liabilities) | 139.8 | 166.6 | 96.7 |
| | | | |
| **LONG TERM LIABILITIES** | | | |
| Long term borrowings | 104.4 | 107.1 | 42.7 |
| Other long term liabilities | 3.4 | 3.9 | 4.2 |
| **Total Long Term Liabilities** | **107.7** | **111.0** | **47.0** |
| | | | |
| Net Asset/(Liabilities) | 101.4 | 141.3 | 153.0 |
| | | | |
| **SHAREHOLDERS EQUITY** | | | |
| Share Capital | 63.4 | 95.1 | 95.1 |
| Share Premium | 0.2 | n/a | n/a |
| Non-Distributable Reserves | 3.0 | 3.1 | 2.9 |
| Reserves/Retained Profit | 32.5 | 41.2 | 52.8 |
| Minority interest | 2.2 | 1.9 | 2.1 |
| **Total Shareholders Funds** | **101.4** | **141.3** | **153.0** |

## Share performance




## Appendix I: Malaysian AE Models Holdings Berhad profile

Malaysian AE Models Holdings Berhad, (Maemode) is a Malaysia-based company that is principally engaged in investment holding. The Company operates in Malaysia, Singapore, Indonesia and The People's Republic of China. Maemode's range of unit handling equipment and systems consists of belt conveyor, roller conveyor, chain conveyor, free-flow conveyor, curve conveyor, magnetic driven conveyor and printed circuit board (PCB) conveyor. It provides consultancy, design, manufacture, installation, commission, maintenance and procurement of bulk materials handling solution. The Group builds and integrates logistics, sorting and warehousing system, including sorting conveyor, merging conveyor, palletizing system (with robot), spiral conveyor, telescopic conveyor, automated storage and retrieval system, software and control system, and supervisory control and data acquisition system. It also provides a range of offshore manufacturing solutions to industrial companies and product creators.

*Source: Company*

## Appendix II: Customer Range

- Electrical and electronic,
- Food processing and bottling,
- Packaging,
- Automotive,
- Logistic , warehousing and distribution,
- Metal related,
- Plastic injection moulding ,
- Pharmaceutical,
- Mining, and
- Other general industries

Some of the Group's major customers include Sony, Matsushita, Sharp-Roxy, Seagate, Flextronic, Acer, Samsung, Nokia, Michelin, Proton, Toyota, Nestle, Tesco-Lotus, DHL, Siemens, Sumitomo, Maruyasu Kikai, Komatsu, Yamatake, Malaysian Port Authority, Petronas, Asean Bintulu Fertilizer, ABB, and Lafarge Group.

*Source: Company*