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EVERGREEN FIBREBOARD BHD (draft)

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WOOD-BASED

BUY

KLCI	**917.25**
Share Price	**RM0.845**
New 12-mth Target	**RM1.11**
Prev. 12-mth Target	**-**
Prev. Rec.	**-**
Upside To Target	**31.3%**

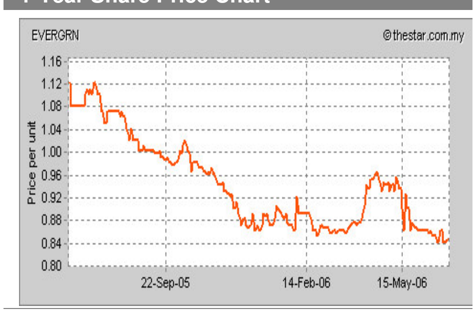
Stock Codes	
BMSB	EVERGRN/5101
Bloomberg	EVF MK

Stock and Market Data	
Listing	Main
Syariah compliance	Yes
Shares In Issue @ 25sen	480.0m
Market Cap	RM412.8m
3M Ave Daily Vol	269.4K
Est. Free Float	48.3%
52 Week High/Low	RM1.13/0.84

Fundamentals – FY06E	
ROA	9.9%
ROE	13.3%
Net gearing (x)	0.13
P/NTA (x)	1.0
Effective tax rates (%)	-

Shareholders	
Kuo Jen Chang	17.7%
Kuo Jen Chiu	15.2%

1-Year Share Price Chart



Source: Bloomberg

Share Performance	1M	3M	12M
Absolute (%)	-3.4%	-0.1%	-17.3%
Relative to CI (%)	-1.5%	0.91%	-22.1%

Capturing the cyclical recovery…

- **Buy for a 31.3% upside to RM1.11.** EFB should be a **BUY** for serious investors. Past experiences seem to signal that buying a globally competitive company compelling levels of valuation from all the three commonly used investment yardsticks - forward PER: 7.5x, net dividend yield: 8.1% and P/NTA: 0.91x – rarely disappoint. Our target price of RM1.15 or 10x PER06 is in line with 1-year trailing peak's PER. The company has also declared a 2sen tax-exempt dividend (ex-date on 6 July) for 1QFY06, to be payable on 8 Aug. The group paid 8.25sen tax-exempt dividend for FY12/05, equivalent of attractive yield of 9.6%.
- **A globally competitive company at Malaysian price**. Companies that survive the vagaries of the cyclical manufacturing environment are those that have the winning combination of greater range of quality products, excellent customer service, dynamic and savvy management, as well as solid financials. With over 30 years of experience in the engineered wood-based products industry, blending advanced technology with innovative thinking, Evergreen has the knowledge and expertise to run the world-class facilities at optimum efficiency, and is positioned to capitalise on the increase in demand for its products.
- Being the 2nd largest manufacturer in Malaysia, its main niche area is in the MDF segment, which contributes up to 84% of its revenue. Particleboard constitutes some 9% of revenue whilst the remainder 7% is from the furniture segment. The Group intends to focus on value-added MDF as these reap higher margins than plain MDF and particleboard.
- **Time to accumulate for a cyclical recovery play.** Despite falling from 52-week high of RM1.15 since making its debut on 10 Mar 05 (IPO price: RM1.14), we remain upbeat on EFB for its sound fundamentals & management, strong ROE and compelling valuations (average 2-year forward PER of 6.7x) and attractive dividend (7.7%). The group is also a recovery play from improving business environments due to the rising MDF and particleboard price (+10% y-o-y) lately, catching up with the rubber log and resin cost increase.
- **Commendable net earnings CAGR of 12.7% for 2005-07 despite rising raw material costs and intense competition.** We expect EFB to enjoy commendable 12.7% net earnings CAGR for FY05-07, benefiting from the higher MDF and particleboard prices, capacity expansion in Thailand, a change in product mix coupled with promising demand of wood-based panel products globally.

EARNINGS & VALUATION PROFILE

FYE 31 Dec (RM'm)	2004	2005	2006F	2007F
Turnover	388.6	457.5	520.0	635.0
Growth	55.0%	17.7%	13.7%	22.1%
EBIT	64.6	56.4	57.2	76.3
Growth	188.5%	-12.6%	1.4%	33.3%
PBT	62.8	54.1	55.1	75.2
Growth	190.7%	-13.8%	1.8%	36.4%
Net Profit	45.0	54.5	54.7	69.1
Growth	107.1%	21.0%	0.4%	26.4%
EPS (sen)	9.4	11.3	11.4	14.4
DPS (sen)	0.0	8.3	6.5	7.5
PER (x)	7.4	7.4	7.4	5.9
PBV (x)	n/a	1.1	1.0	0.9
Yield	-	9.8%	7.7%	8.9%

Source: SBBSR

BACKGROUND

A leading worldwide producer of engineered wood-based products. Evergreen Fibreboard Bhd (EFB) had its beginnings in 1977, starting first as a laminator of veneer over medium density fibreboard (MDF). Over the years, it has successfully grown its business, diversifying its operations to venture into the manufacturing of MDF, particleboard and knocked-down wooden furniture. The Group has also broadened its geographical horizon, by expanding into Thailand through the acquisition of a 75% stake in Siam Fibreboard Company (SFC), a manufacturer of MDF in Feb 04.

Comprehensive range of upstream and downstream products. Today, EFB is an integrated producer of engineered wood-based products. The Group is active in the manufacturing of medium density fibreboard (MDF), knocked-down wooden furniture and doors, particleboard and fancy plywood. Being an integrated producer, EFB conducts both upstream and downstream activities, producing both plain and value-added MDF and particleboard. The value-added products have an overlay of either melamine, wood veneer, paper or PVC.

EFB's belief in conserving for the environment results in decisions to use sustainable plantation rubber wood instead of tropical timber. Understanding that the long-term growth of EFB is dependent on a sustainable source of raw materials and an enduring responsibility to the environment, EFB only manufacture its products from sustainable plantation wood, wood residues, slabs, and branches. With diminishing forests, the group believes in the need to introduce and promote engineered wood-based products to maximise the use of wood while simultaneously minimising waste materials. In line with the group’s concern for the environment, water treatment plants and dust filter bag systems are incorporated into its production process to eliminate negative effects on the delicate ecosystem.

The 2nd largest manufacturer in Malaysia. EFB prides itself on being one of the very few MDF manufacturers in this region to leverage on its state-of-the-art machinery and technology. Over the years, the group has enhanced its capabilities and embarked on a strategy of focusing on producing higher margins and quality products. Presently, EFB, headquartered in Johor has four manufacturing locations in Malaysia and one in Thailand. In Malaysia, the group operates out of two plants in Pasir Gudang and one in Segamat as well as at its headquarters in Parit Raja. The annual capacity of MDF production facilities is 280,000 cubic m and 324,000 cubic m in Malaysia and Thailand, respectively. While the utilisation rate is about 85% both in Malaysia and in Thailand. At present, EFB is the second largest manufacturer of MDF in Malaysia, with an estimated 16% market share.

TURNOVER AN PRODUCT BREAKDOWN						
FYE 31 Dec	**Revenue 2003**		**Revenue 2004**		**Revenue 2005**	
Business activities	**RM'000**	**%**	**RM'000**	**%**	**RM'000**	**%**
Plain MDF	136,850	54.6	235,698	60.7	305,262	66.7
Value added MDF	75,719	30.1	84,315	21.7	87,957	19.2
-coated MDF	*12,641*	*5.0*	*11,905*	*3.1*	*11,383*	*2.5*
-paper overlay MDF	*9,019*	*3.6*	*8,136*	*2.1*	*9,357*	*2.1*
-veneered MDF	*50,488*	*20.1*	*61,045*	*15.7*	*62,920*	*13.2*
-others	*3,571*	*1.4*	*3,229*	*0.8*	*4,297*	*0.9*
Plain particleboard	8,582	3.4	38,692	10.0	33,457	7.3
Knocked-down wooden furniture	24,116	9.6	26,634	6.8	28,459	6.2
Others	5,479	2.2	3,265	0.8	2,726	0.6
Total	250,748	100.0	389,604	100.0	457,861	100.0

OUTLOOK & COMMENTS

MDF is the earnings driver. EFB's main niche area is in the MDF segment, which contributes up to 85% of its revenue. Particleboard constitutes some 10% of revenue whilst the remainder 5% is from the furniture segment. The Group intends to focus on value-added MDF as these reap higher margins than plain MDF. EFB's products, particularly the MDF, are well-suited to be used in a wide range of applications from building interiors, profiling, joinery & millwork applications, household products, furniture & fixtures and automotives. The broad application of its products will mitigate the business risks.

Market distribution by countries (Top 10)			
Country	**2005%**	**Country**	**2005%**
China	20.9	Korea	3.8
USA	11.5	Kuwait	3.4
Vietnam	7.3	Taiwan	3.2
Pakistan	5.7	UAE	3.2
Jordan	4.6	UK	2.0

Diversified export markets and customers'.
Over the past 30 years, EFB has signed up an impressive list of customers made up of a combination of MNCs and locals, which have been staying with the company for 5-15 years. These relationship have been cultivated, premised on its commitment to investment in resources, design capabilities and machinery during pre-mass production space are strong endorsement to its product quality, far-sighted management and price competitiveness. EFB has over 480 customers (from more than 40 countries over 5 continents), who are primarily retailers, furniture manufacturers and distributors who in turn sell directly to product manufacturers and end-consumers. They are serviced by both its internal

sales personnel (for local and major overseas markets) and agents (for certain export markets). The Group is not heavily dependent on any particular customer as its top customer accounted for only less than 10% of the Group's sales. Moreover, the group's top 10 customers accounted for about 30% of overall sales.

The up and coming Middle East markets. In a market where is very much subject to the cyclical nature of the manufacturing environment, EFB has to expand its reach globally, to maintain a strong presence in markets that are growing. Priority will be to expand its reach into the Middle east, where escalating wealth and an opening market are creating an increasingly wealthy and perhaps the largest middle-income population in the world, demanding a better lifestyle and the products to go with it. In terms of export exposure, EFB derives the bulk of its sales from overseas customers. In FY05, exports accounted for c.85% of the Group's revenue, with key markets being China (21%), US (11.5%), Vietnam (7.3%), Pakistan (5.7%), Jordan (4.6%) and Korea (3.8%). Based on the strong purchasing power from the Middle East countries, management indicates the Middle East markets would be the group's main bread and butter for the next three years. Overall, 90% of its top 10 customers have been with EFB for >5 years. Of this, 60% have been dealing with the group for about 10 years.

Healthy capacity utilisation rates. The Group operates out of four manufacturing plants, which are located in Johor, Malaysia and one plant that is based in Hatyai, Thailand. Currently, the Group is running at an average plant utilisation rate of between 65% and 85% for all three product divisions.

Production & Capacity breakdown

Products	Annual capacity	2003		2004	%	2005	%
		Output	Utilisation Rate %	Output	Utilisation Rate %	Output	Utilisation Rate %
MDF	Malaysia: 280,000 cu m3	246,391	88	235,115	84	237,932	85
	Thailand: 162,000 cu m3 for 2004 -extrapolated based on 10 months production			145,132	90		
	Thailand: 324,000 cu m3 for 2005 -extrapolated based on 8 months production					274,792	85
Plain particleboard	144,000 cubic m3	38,526	27	99,515	69	96,026	67
Knocked-down wooden furniture	1.2m sets for 2003	862,223	72				
	1.8m sets for 2004 and onwards			1.13m	63.0	909,971	51.0

Promising export growth bodes well for EFB. According to a study done by market research firm BIS Shrapnel, the global consumption of MDF is expected to grow by an average CAGR of 7-9% in 2005-2008. The same study forsees MDF use in the Asia-Pacific region to rise by 51.0% to 20.1m m3 by 2006 and 30.8m m3 by 2008. Malaysia is the third-largest exporter of MDF in the world, generating turnover of >RM16bn. On the other hand, particleboard global consumption is 100m m3. In the Asia-

Pacific region, particleboard demand stands at 12m m3, with China the biggest and fastest growing market, due to her position as the world's second biggest furniture exporter (closely behind Italy).

The earnings catalyst-expansion of new MDF line in Thailand. Currently, the Group has a maximum production capacity of approximately 604,000 m3 for MDF. With the introduction of the 3rd new MDF line in SFC (capex RM120m), capacity for MDF will increase by 268,000 m3 or another 44% to 872,000m3 by 2007. The state-of-the-art plant has the latest technology of world's fastest speed ar over 100m/min and the world 1st super thin High Density Fibreboard (HDF) of up to 1100kg/m3 (normal HDF is 900/kg/m3). It is also capable of producing normal MDF with thickness ranging from 1.5mm-25mm. Management is optimistic that this new line (only fewer than 20 players worldwide has this kind of facilities) will contribute about 10% to topline in 2007. Currently, super thin HDF prices ($245/m3) is about 25% higher than normal MDF ($195/m3).

EFB's products exceed major international standards. As EFB's products are mainly exported, quality certification is extremely important. Since 2002, EFB has been ISO 9001:2000 certified and obtained the Chain-of-Custody (CoC) accredited by the Forest Stewardship Council (FSC) in 2003. The formaldehyde content in EFB's products meets the international standards where the level of Urea Formaldehyde emission complies with BS EN622-1:1997 standards for a Class A MDF. EFB is now working to develop MDF with E1 standard (emission _ 0.124 milligrams per m3 air) which complies with European emission standards. This would ease the Group's efforts to penetrate more markets worldwide.

High barriers to entry into market. The small number of producers of reconstituted wood-based panel board manufacturers (below 30 producers) attests to the high barriers to entry. The barriers to entry into the reconstituted wood-based panel board production in Malaysia is high due to these factors:

- *Government policies*—stringent licensing requirements for certain wood-based activities and installations and the handling of radioactive material used in x-ray gauging activities
- *High capital set-up costs*—entrants require at least RM150m in start-up costs
- *Technical skills and expertise*—strong know-how required in R&D and production processes
- *Track record*—the need to gain customers' confidence in quality and supply reliability

Reliance on good supply of rubberwood logs and UF glue. The industry is reliant on two major input materials: rubberwood logs and UF glue. In Malaysia, the supply of rubberwood logs from rubber plantations is slowly declining given areas planted with rubber trees have declined an average of 2.7% in 1999-2003. However the risk of supply shortage is mitigated by the rise in areas of rubber tree replanting by an average of 1.0%. Having said, the production of MDF is not dependent on rubberwood only. MDF can be produced from any sort of wood and can utilise twigs or shavings and other by-parts of wood. Alternatively, material such as hemp, straw, palm tree waste and bamboo are being considered in the manufacture of MDF.

Broadening its product range. Management believes prospects for EFB are favourable, given the Group's strong position in the domestic and export markets. In light of its future growth potential. In order to maintain its position as a leader in the MDF business segment in Malaysia, EFB is diversifying its product range. The Group plans to undertake R&D activities targeted at developing new categories of MDF, including high moisture resistant MDF (HMR MDF) and E1Grade MDF. The development of HMR MDF, which the Group hopes to launch in 2005, will widen the applications of its MDF such as external doors, bathrooms and window frames, whereas the development of E1 Grade MDF will strengthen the Group's position in export markets, particularly in Japan and the EU. In its downstream activities, the Group is looking to develop new designs for its knocked-down line of wooden furniture, and expects this initiative to take off by 2H06.

Expansion into glue resin plant. Malaysia is a producer of UF glue, with an estimated production capacity of 600,000 tonnes yearly. However, EFB procures UF glue from Singapore, mainly due to reliability of supply. In fact, EFB is setting up a glue resin plant via a JV (holding a 25% stake and JV agreement had been signed in May 05) with existing glue resin producers (Dynea Krabi Co Ltd) to ensure continuous supply for MDF production. Glue resin, particularly UF glue made up the bulk of Group purchases of approximately 32%%; hence the importance of a reliable and timely supply. EFB expects the new plant to be build in Thailand will be up and running by 2007. With the glue resin plant, EFB will utilise 50% of production and sell out the remaining half. By having its own glue resin plant on site, EFB would also save on freight costs.

Minimal impact from strengthening of RM vs USD. the As the Group's products are mainly for the export market, EFB is susceptible to foreign exchange fluctuations. In addition to this, 55-60% of EFB's raw materials are imported. These sales and purchases are mainly denominated in the Euro and USD. To mitigate some of its foreign exchange risk, EFB hedges 6-months forward for its Malaysian operations. Its Thailand operations are not hedged but the Group intends to change the transaction currency of SFC from Euro or US Dollar to the Thai Baht to localise the trading currency and divest itself from the said foreign exchange risk. Having said, the effect of strengthening RM is always built into the quotation to customers, albeit on a laggard basis. As such, the impact on the bottom line is expected to be minimal, provided there is a gradual appreciation from RM movement and the Ringgit will not breach the RM3.50 level.

Strong competitive edge and execution skill. EFB has higher net margin (around 11%) compared to other players such as Heavea (7%) and Mieco (-2%). The strong margins are mainly due to the use of state-of-the-art equipment in the production process, which will enhance productivity and efficiency. Amongst its peers, we believe EFB possesses the strongest position to absorb the high input costs and can afford to be more aggressive in its marketing strategies to enhance topline growth. Also, the group has a healthy balance sheet with net cash of RM69m as at end March 06 against its peers (mostly are in net debt).

Still attractive payout in 2006/07. After paying almost 70% (equivalent to 8.25sen or 9.8% yield) from net profit to shareholders in 2005, we expect a lower dividend payout of 6.5sen (7.7% yield) in 2006 and 7sen (8.9%) in 2007, on the back of heavy capex for these periods. We believe the attractive payout is still much superior compared with its peers or some blue-chip companies.

A stronger turnaround in 2H06 and 2007. Going forward, the Group is anticipating a strong surge in revenue, up 13.7% y-o-y to RM520m in FY06 and 22.1% y-o-y to RM635m in FY07, driven by the increased contribution from SFC (after facing teething problems in 4Q05) and promising MDF demand. But owing to rapid cost increases in some of the primary inputs like wood, resin and fuel, coupled with slower cost pass-on to the clients, FY06's bottomline is likely to remain flat against 2005. Nevertheless, as product pricing are recovering, coupled with expanded capacity and product range, we would see a more prominent improvement in FY07 margins and earnings (+26.4%).

VALUATION

The success of EFB is largely attributed to the insight and the vision of the management. With over 30 years of experience in the engineered wood-based products industry, the team has the knowledge and expertise to run the world-class facilities at optimum efficiency. EFB's hands-on management approach solves challenges quickly and efficiently, and maximises employee performance.

Going forward and with the completion of its new factory, it is poised to continue its journey on its impressive, uninterrupted growth trajectory. Its financial position and attractive yield are the best among its peers. That the management is prepared and willing to share the fruits of its success with the shareholders demonstrates a high degree of corporate governance and transparency.

Room for re-rating. At a 7.4xPER06 and 5.9x PER07, EFB valuations are cheap, supported by attractive tax-exempt dividend yield of 7.7% for 2006, commendable net profit CAGR of 12.7%, net margins and ROEs. We initiate a BUY recommendation, with **12-month target price of RM1.11** (ascribing 9.8x PER06). Our target price is also in line with its 1-year historical peak to trough PER of 7-9.9x and industry average of 10x.

We like EFB for the following reasons:

- Core expertise and competencies as an efficient and globally competitive MDF & particleboard manufacturer, with strong PAT margins of 11% (vs peers' –3% to 6%), superior ROE of 14% (vs peers' –2% to 7.7%) and balance sheet with netcash RM67m (vs peers in netdebt).
- Promising prospects of CAGR of 9% till 2008.
- A commendable 12.7% net earnings CAGR for FY05-07 despite escalating raw material price and intense competition.
- Undemanding valuation at 5.9xPER07, supported by attractive EPS07 growth of 26.4%.
- Attractive tax-exempt dividend yield of 7.7% for 2006.

Definition of Investment Ratings

Stocks ratings used in this report are defined as follows:

BUY Share price expected to appreciate 10% or move over a 12-month period
HOLD Share price expected to be between 0% and 10% over a 12-month period
SELL Share price expected to depreciate over a 12-month period

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