

Evergreen Fibreboard

Recommendation: **BUY**

Stock Code: 5101

Bloomberg: EVF MK

Price: MYR1.44

12-Month Target Price: MYR2.04

Date: May 30, 2008

Board: Main**Sector:** Industrial Products**GICS:** Materials/Forest Products**Market Value - Total:** MYR691.2 mln

Summary: The Group is a leading manufacturer of reconstituted wood-based panel boards and wood-based products in Malaysia.

Analyst: Ng Ai Lien**Highlights**

- Evergreen Fibreboard is Malaysia's second largest producer of medium-density fiberboard (MDF). The group's MDF production capacity is expected to increase by 34% to 1.07 mln cubic meters by the end of 2008. Its Indonesian MDF mill started production in April 2008 while the new line in Thailand is expected to commence operations at the end of 2008.
- The group has also embarked on integrating vertically its raw material production. With two new resin plants, in Malaysia and Indonesia, the group will have glue plants in all three manufacturing bases to meet its requirements. It has also acquired two subsidiaries in Thailand that will supply the group's full electricity requirement in Thailand.
- We forecast revenue to grow by 8% in 2008 to MYR789 mln but net profit to grow by a lesser 3% as the full impact from its Indonesian MDF and resin plant will not be felt until 2H08. Cost savings and higher production volume should be seen in 2009. We estimate revenue to grow by 16% and net profit by 21% in 2009.

Investment Risks

- Risks to our recommendation and target price include slower-than-expected demand for MDF; higher-than-expected prices of main raw materials, in particular, rubber wood logs; and weaker USD vis-à-vis MYR which will translate into lower sales values.

Recommendation

- We initiate coverage on Evergreen Fibreboard with a Buy call and a 12-month target price of MYR2.04.
- Our target price is derived from pegging Evergreen's 2008 EPS of 25.5 sen to a target PER of 8x, the average of its historical trading range since its listing in 2005 as well as a 15% discount to the average PERs for its peers. The discount is fair given Evergreen's high exposure to foreign currency fluctuations. We see the share price supported by a relatively attractive dividend yield of 4.9%.
- Its production expansion and raw material integration program should result in higher operating efficiencies for the group, with full year impact to be seen in 2009. Financial position is strong. Net gearing is likely to increase to 40% from 20% by end-2008 but should decline after this major expansion plan is completed.
- Evergreen's commitment to Corporate Social Responsibility (CSR) is demonstrated through its concern for the environment by only manufacturing its products from sustainable plantation wood and residues and cash donation to the community.

Key Stock Statistics

FY Dec.	2007	2008E
Reported EPS (sen)	24.7	25.5
PER (x)	5.8	5.7
Dividend/Share (sen)	7.0	7.0
NTA/Share (MYR)	1.14	1.29
Book Value/Share (MYR)	1.11	1.29
No. of Outstanding Shares (mln)	480.0	
52-week Share Price Range (MYR)	1.24 - 2.04	
Major Shareholders:	%	
Kuo Wen Chi & Family	42.3	
Lembaga Tabung Haji	8.7	
Alliancegroup Nominees (Tempatan) Sdn Bhd	2.3	

* Stock deemed Shariah compliant by the Securities Commission.

Per Share Data

FY Dec.	2005	2006	2007	2008E
Book Value (MYR)	0.82	0.89	1.11	1.29
Cash Flow (sen)	16.8	17.0	30.6	32.5
Reported Earnings (sen)	11.8	12.4	24.7	25.5
Dividend (sen)	8.3	5.0	7.0	7.0
Payout Ratio (%)	72.7	40.2	28.4	27.5
PER (x)	12.2	11.6	5.8	5.7
P/Cash Flow (x)	8.6	8.5	4.7	4.4
P/Book Value (x)	1.8	1.6	1.3	1.1
Dividend Yield (%)	5.7	3.5	4.9	4.9
ROE (%)	17.2	14.9	24.7	21.2
Net Gearing (%)	0.0	12.9	19.7	18.8

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Evergreen Fibreboard

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Price: **MYR1.44**

12-Month Target Price: **MYR2.04**

Date: **May 30, 2008**

Background

Corporate Profile

Evergreen Fibreboard Bhd. (Evergreen) group produces engineered wood-based products including medium-density fiberboard (MDF) and particleboard and value-added downstream products such as paper, veneer, printed and melamine board laminations and knock down furniture.

It is the second largest producer of medium-density fiberboard (MDF) in Malaysia and among the top five MDF producers in Asia.

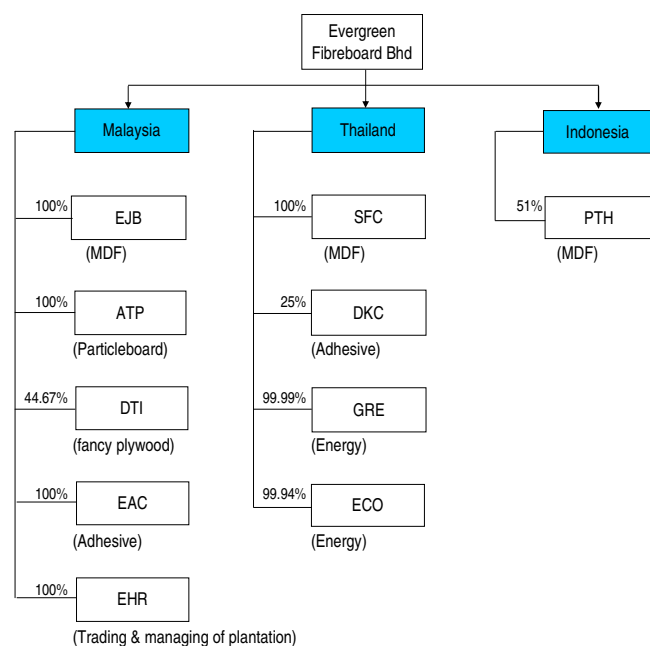
The company was founded by Mr Kuo Wen Chi, who is the Executive Deputy Chairman and with his two sons, Kuo Jen Chang and Kuo Jen Chiu, Chief Executive Officer and Chief Operating Officer respectively, the family holds 42.3% of the company.

Evergreen was listed on the Main Board of Bursa Malaysia in Mar. 2005.

Corporate Structure

MDF is the group's core product, contributing 91% of its revenue in 2007. Particleboard accounted for 4% and downstream wood-based products such as knocked down wooden furniture made up the balance 5%.

Evergreen has three manufacturing bases; Malaysia, Thailand and Indonesia. In Malaysia, the group has five manufacturing plants including two for MDF from its headquarter in Batu Pahat, Johor, and its subsidiary in Johor Baru, Evergreen Fibreboard (JB) Sdn. Bhd. (EJB). Allgreen Timber Products Sdn. Bhd. (ATP), located in Segamat, Johor, manufactures the group's single particleboard production line with annual capacity of 120,000 cubic meters. Its Thai subsidiary, Siam Fibreboard Co. Ltd. (SFC), produces plain MDF. In Sep. 07, Evergreen acquired the remaining 25% of SFC for MYR36.4 mln it didn't own, raising its interest to 100%. It has a 51% interest in the Indonesian subsidiary, P.T.Hijau Lestari Raya Fibreboard (PTH) which was acquired at the end of 2007.



Source: Company data

Business

Production Capacity of MDF products

	Annual Capacity (cu. meters)	Start Date
Malaysia	250,000 (Batu Pahat) 120,000 (Johor Baru)	Second line added in 2001 Feb 2007
Thailand	320,000 260,000 (New Line)	Mar 2004 End 2008
Indonesia	120,000	Apr 2008

Source: Company data

The group has a total production capacity of 800,000 cubic meters of MDF per annum as of end-2007. By the end of 2008, its annual capacity would have increased by 34% to 1.07 mln cubic meters. The expansion comes from the newly-acquired plant at PTH in Indonesia as well as the purchase of a state-of-the art manufacturing line for SFC in Thailand. The purchase price for the assets in PTH was US\$21 mln (MYR72.5 mln) and Evergreen's share of the cost was US\$10.7 mln (MYR36.9 mln). Another US\$2 mln was invested into upgrading and improving the efficiency of the plant which started operation in Apr. 2008. In Thailand, the group invested in new major machinery for a third line costing MYR120 mln. The new line has the capacity to produce 260,000 cubic meters of super thin high density fiberboard of 1100kg per cubic meter per year and is expected to be operational at the end of the year.

The main raw materials used are rubberwood logs and urea resin (UF glue) which are available locally. As the production of MDF can use a variety of raw materials such as wood off-cuts, shavings, sawdust in addition to wood fibers, essentially any type of plantation logs can be used as raw materials. UF glue is used extensively in the manufacturing of MDF and particleboard for bonding of wood fibers. The cost components of manufacturing MDF are: 30%-35% (Wood), 25%-28% (Glue), 10%-15% (Energy) and 30% (Labor and Overheads).

Rubber wood log prices have remained relatively stable in 2007 and in 2008 thus far. To help the group mitigate the cost fluctuation, the group established Evergreen Hevea Resources Sdn. Bhd. (EHR), through which it buys rubber trees by concession, and fulfils 25%-30% of its rubber wood needs. However, glue cost has increased by 18.5% since the start of 2008, in tandem with the rising fuel cost (since the glue used is a petrochemical derivative).

Evergreen's subsidiaries that produce glue for the group are Evergreen Adhesive & Chemicals Sdn. Bhd. (EAC) in Malaysia and Dynea Krabi Company Ltd. (DKC) in Thailand. EAC's glue plant was commissioned in Apr. 2008. The Indonesian subsidiary, PTH, also owns a glue and resin manufacturing plant. All three glue plants are more than capable of meeting Evergreen's glue requirement as well as selling to external parties. Owning its own glue plants would ensure steady supply in the long run.

Electricity cost is not subsidized in Thailand, unlike in Malaysia and Indonesia. With escalating cost of electricity in Thailand, generating its own supply of electricity would reduce its overhead cost as well as ensuring continuous quality electricity supply. The recent acquisition of GRE Energy Company Ltd. (GRE) and ECO Generation Company Ltd. (ECO), which run on biomass, will supply the group's full electricity requirement in Thailand, including the new MDF line which is targeted to be operational at the end of 2008.

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Evergreen Fibreboard

Recommendation: **BUY**

Stock Code: **5101**

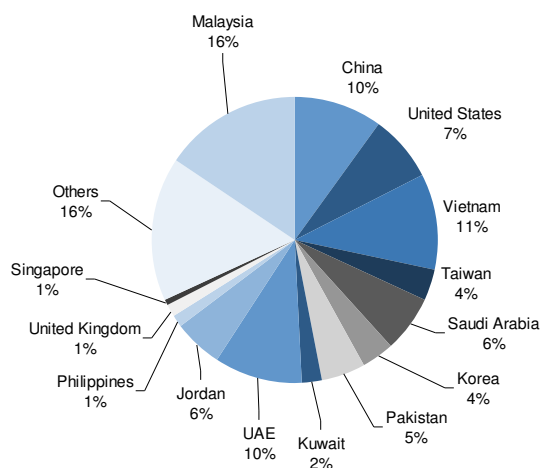
Bloomberg: **EVF MK**

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12-Month Target Price: **MYR2.04**

Date: **May 30, 2008**

Breakdown of 2007 Revenue by Countries



Source: Company data

The group exports its products to more than 40 countries, reflecting its preference for a well-diversified customer base. Overseas sales accounted for 84% of total revenue in 2007. Demand for engineered wood-based products in the last few years has grown at the rate of 7%-10% a year as a result of economic growth, product substitution growth (MDF is a cheaper and better substitute for solid wood and plywood) and population growth. The price of MDF has remained stable in 2007 and recent months, after having seen average increases of around 20% from 2006. Demand for particleboard in Asia Pacific has been strong, with China becoming the fastest growing market and this has helped push prices up further. The price of particleboard has risen by 19% since the start of 2008.

The group has achieved a CAGR of 23% in revenue and 38% in net profit over the past three years on the back of expansion in manufacturing capacities through acquisitions, as well as higher selling prices for its products. As prices for its core MDF products stabilize, the group is looking to integrate vertically by managing its own glue and power plants to have better control over its cost structure. This strategy will help the group weather the challenging market environment due to the slowdown in the global economy, in our opinion.

Earnings Outlook

A fire in EJB which occurred in Sep. 2007 affected one of the two lines in the Johor plant, reducing its output by 8%. The affected production line has been restored and operations resumed in Apr. 2008. The damages and consequential losses are fully covered by insurance. The disruption in production during the period from Sep. 07 to Mar. 08 has affected revenue and profits during 4Q07 and 1Q08. Insurance claims of MYR9.6 mln for loss of earnings during the two quarters have been included in the 1Q08 results. In the 1Q08, revenue grew by 7.5% and net profit declined by 11.4% YoY. Earnings were affected by the increase in raw material costs, higher freight charges as well as the write-off of the start-up cost of MYR1.13 mln by PTH and EAC. According to management, profit margin is stabilizing in 2Q08.

Plant utilization for the MDF lines is maintained at high levels of 86% in Malaysia and 99% in Thailand. Growth in revenue in 2008 should come from new contribution from the Indonesian joint-venture MDF mill and resin plant and increased contribution from SFC as a wholly-owned subsidiary (75%-owned previously). The Indonesian MDF plant, running at 50% currently, is expected to operate at 85% in a few months' time. As a result, profitability in 1H is likely to be lower than 2H because the plant will not have achieved breakeven rate during the period. With the view of improved sales (but lower profit in the 1H from continuing margin squeeze from higher operating costs) we forecast pretax profit for 2008 to contract by 7% but bottomline profit to benefit from lower tax charges. We are forecasting 16% growth in revenue and net profit to grow by 21% in 2009 as a result of full year impact from the new MDF line in Thailand as well as additional contribution from the new resin and power plants.

As sales are mainly denominated in USD, and although the management tries to hedge up to 50% of its USD revenue, the weakness in USD poses some risks in translating its USD sales into local currency.

Tax rates are expected to remain low because of tax incentives granted to Evergreen and subsidiaries EJB, GRE and SFC. The pioneer status granted to Evergreen allows 70% of its income to be tax-exempt for a 5-year period until Dec 2009. EJB has obtained Investment Tax allowance, GRE and SFC's new third production line were granted tax exemption for eight years ending in 2014.

Valuation

We initiate coverage on Evergreen Fibreboard Board with a Buy call and a 12-month target price of MYR2.04.

The target price is derived from pegging Evergreen's 2008 EPS of 25.5 sen to a target PER of 8x, the average of its historical trading range since its listing in 2005 as well as a 15% discount to the average PERs for its peers of 9.5x. The discount is fair given Evergreen's high exposure to the weak USD.

Comparative Valuations

	Evergreen Fibreboard	WTK Holdings	Subur Tiasa	Java Inc	Vanachai Group
Bloomberg code	EVF MK	WTKH MK	STH MK	JAVA MK	VNG TB
Share Price @ May 28, 2008	1.44	2.42	3.16	1.9	3.46
Currency	MYR	MYR	MYR	MYR	THB
Mkt. Cap (mln)	691.20	1,059.99	663.60	329.44	4,518.20
PER FY07 (x)	5.83	16.06	7.93	3.82	10.18
PER FY08 (x)	5.63	12.41	NA	9.50	6.48
P/NTA	1.30	1.02	1.02	1.32	0.84
Yield (%)	4.86	1.24	0.95	5.26	5.78

Source: Bloomberg, Company data

The group has a healthy balance sheet. Net gearing stood at 19.6% as at end of Mar 08. Capital commitments for the rest of 2008 are estimated to be MYR142 mln, which would bring net gearing to around 40% by the end of 2008. Its financial position should improve after the expansion plan is completed by end-08 when capex returns to MYR7 mln-MYR8 mln a year.

Evergreen paid a tax-exempt dividend rate of 7 sen per share in 2007, which we believe can be maintained in the current year and which translates into attractive dividend yield of 4.9%. The company does not have a specified payout policy but we see few cash flow constraints at this stage that would curtail dividend payments.

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FY Dec. / MYR mln	2006	2007	2008E	2009E
Reported Revenue	528.1	731.6	789.0	913.0
Reported Operating Profit	68.3	144.1	135.9	166.4
Depreciation & Amortization	-22.2	-28.3	-33.9	-37.3
Net Interest Income / (Expense)	-0.7	-4.4	-5.5	-6.7
Reported Pre-tax Profit	67.7	140.4	130.1	159.3
Effective Tax Rate (%)	3.8	6.7	2.5	4.0
Reported Net Profit	59.7	118.5	122.2	147.7
Reported Operating Margin (%)	12.9	19.7	17.2	18.2
Reported Pre-tax Margin (%)	12.8	19.2	16.5	17.5
Reported Net Margin (%)	11.3	16.2	15.5	16.2

Source: Company data, S&P Equity Research

Balance Sheet

FY Dec. / MYR mln	2006	2007
Total Assets	667.5	908.0
Fixed Assets	371.5	527.8
Current Assets	267.2	347.8
Other LT Assets	28.7	32.5
Current Liabilities	70.1	211.4
LT Liabilities	145.8	157.2
Share Capital	120.0	120.0
Shareholders' Funds	426.0	532.7

Source: Company data, S&P Equity Research

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Glossary

Strong Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.

Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months, with shares rising in price on an absolute basis.

Hold: Total return is expected to closely approximate the total return of the KLCI or KL Emas Index respectively, over the coming 12 months with shares generally rising in price on an absolute basis.

Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months and share price is not anticipated to show a gain.

Strong Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months by a wide margin, with shares falling in price on an absolute basis.

S&P 12 Month Target Price – The S&P equity analyst's projection of the market price a given security will command 12 months hence, based on a combination of intrinsic, relative, and private market valuation metrics.

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Recommendation and Target Price History

Date	Recommendation	Target Price
New	Buy	2.04

