

Top Story

CYMAO HOLDINGS (RM1.51)

Beneficiary of robust plywood prices

BUY

Target Price: RM2.16

STOCK & SHAREHOLDERS' DATA

Bloomberg Code	: CYM.MK
Reuters Code	: CYMA.KL
KLCI	: 968.8
Market Capitalisation	: RM113.2m
Issued Capital	: 75.0m
Free Float (est)	: 16.1%
Range 12 mths	: RM0.94-RM2.39
Daily turnover (3 mth)	: RM0.24m
Relative Performance	: 1-mth +14.6%
	: 3-mth +38.9%
	: 6-mth +23.1%
Major Shareholders	:
Lin Tsai-Rong	28.1%
Tsay Chung Wen	6.6%
Hsu How Tong	5.5%

INITIATING COVERAGE

YE 31 Dec (RMm)	2003	2004	2005	2006F	2007F
Turnover (RMm)	162.8	195.1	245.8	294.6	339.0
Pretax Profit (RMm)	18.9	25.3	13.4	27.2	33.2
Net Profit (RMm)	16.1	21.0	16.3	23.2	28.2
Revision (%)				<i>new</i>	<i>new</i>
Consensus Profit (RMm)				<i>n/a</i>	<i>n/a</i>
EPS (sen)	21.5	28.0	21.7	30.9	37.7
EPS Growth (%)	12.2	30.0	(22.5)	42.5	21.9
CFPS (sen)	(0.2)	19.4	(7.9)	90.1	39.4
Gross DPS (sen)	0.0	12.5	7.5	8.0	8.5
NTA/share (RM)	1.01	1.49	1.65	1.87	2.15
PER (x) - basic	7.0	5.4	7.0	4.9	4.0
P/CF (x)	(823.4)	7.8	(19.0)	1.7	3.8
P/NTA (x)	1.5	1.0	0.9	0.8	0.7
Gross yield (%)	0.0	8.3	5.0	5.3	5.6
ROE (%)	21.3	18.8	13.2	16.5	17.5
EV/EBITDA	13.4	3.2	5.3	2.4	1.8

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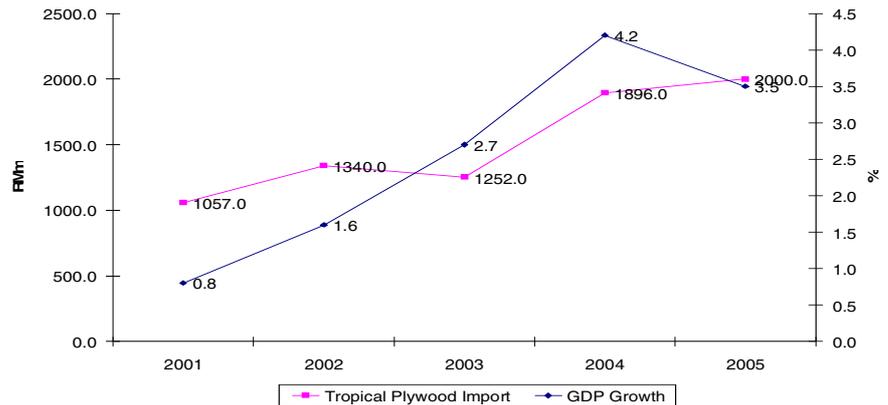
INVESTMENT HIGHLIGHTS

- **Beneficiary of high plywood prices...** Cymao has been recording plywood selling prices at all time high of US\$430 - US\$450/ cu m over the last 2 months. Prices are 50% higher compared to 2005.
- **... and expansion in capacity.** The Group's plywood production capacity for 2006 is estimated to hit 187,000 cu m per annum compared to 120,000 cu m in 2005. This was due to acquisition of Inovwood (an existing Sabah plywood manufacturer) and expansion of the acquired capacity.
- **Net profit to grow 43% to RM23.2m in FY06.** This would be underpinned by higher plywood prices and enlarged production capacity. We believe our forecast is conservative and there is room for further upgrade.
- **Sound track record.** Cymao's historical financial performance is a testimony of the Group's strong business fundamentals and capability. Cymao's average operating margin for the last 3 years was 10% while return on equity was 17%. Its net profit grew by an annual compounded growth rate of 21% over the last 8 years ended 2005 although it was only 4.5% over the last 5 years.
- **Good investment opportunity.** Cymao is trading at very attractive valuation, 4.9x FY06 EPS (65% discount to average PER of 13.2x FY06 EPS of timber companies) and 0.73x its price-to-book. This coupled with Cymao's promising earnings outlook in the coming quarters. We believe Cymao offers good potential upside. The stock is worth at least RM2.16 based on 7.0x FY06 EPS.

INVESTMENT CASE

A beneficiary of high plywood prices. Cymao Holdings Bhd ("Cymao") manufactures and distributes plywood. Its' 2HFY06 net profit is expected to increase significantly from the RM9.0m recorded in 1HFY06. The Group's plywood were sold at between US\$430 - US\$450/ cu m in the July - September 2006 period. The prices are 51.7% higher than the average prices of US\$290/ cu m in FY05 and 37.5% higher than FY04's US\$320/ cu m.

US TROPICAL PLYWOOD IMPORT AND GDP GROWTH



Source: ITTO Annual Review 2005 and bloomberg

The high plywood prices (> US\$400/ cu m) is sustainable at least until 1QFY07. Cymao’s key export market, USA, imports most of its plywood from Malaysia (31% of total plywood imports in volume), Indonesia, China and Brazil (10%). In 2005, imports from Indonesia approximated 26.3% of USA’s total imports (volume, cu m).

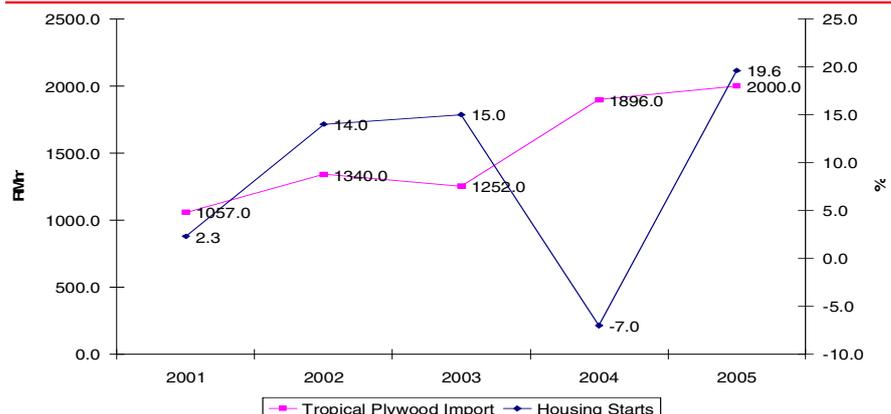
The Group sells more than 90% of its products overseas. Its main export markets are US (70%), United Kingdom (10%) and Middle East (5%).

With the huge vacuum in plywood exports arising from the fall in supply from Indonesia and Brazil, we opine that plywood prices are likely to stay above US\$400/ cu m at least until 1QFY07. Indonesia’s plywood exports have declined from its high of 10m cu m (85% of International Tropical Timber Organization, ITTO) in early 1990s to 3.1m cu m in 2005 and is estimated to contract to 1.5m cu m in 2006. Plywood manufacturers continue to face constraints in log supply. Besides clamp down on illegal logging and reduced logging quota over the past 12 months, recent forest fire and drought has worsened Indonesia’s log supply.

Brazil’s tropical plywood exports dropped to 0.9m cu m in 2005. The downtrend continues in 2006; Brazil’s tropical plywood exports for January and February 2006 were down by an average 45% YoY.

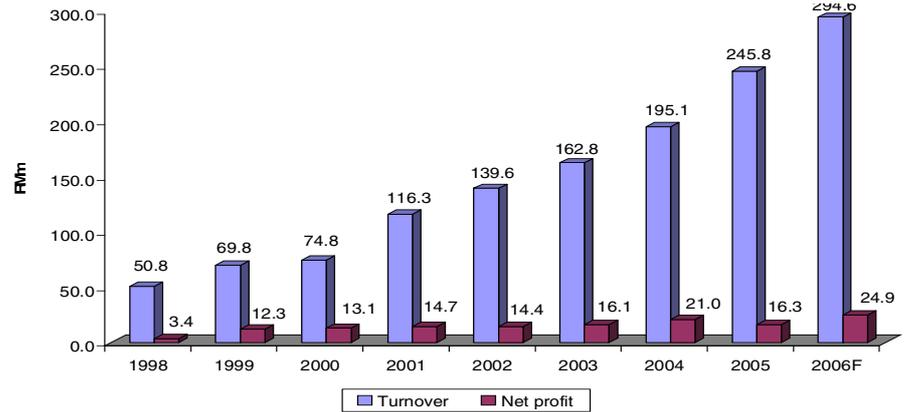
Stable plywood demand from US. Import of plywoods by US has been on a steady uptrend over the last 5 years, (Please refer chart above). We believe US’ plywood demand would remain firm going forward in line with its historical record. US’ easing housing starts should not have a significant impact on its plywood demand as plywood is used for many other applications such as for non-housing building construction and as panels for covered trucks. (Please refer chart above which indicates the little correlation between plywood import and housing starts)

US TROPICAL PLYWOOD IMPORT AND HOUSING STARTS



Source: ITTO Annual Review 2005 and bloomberg

CYMAO'S TURNOVER AND NET PROFIT TREND



Source: Prospectus and annual report

Expanding production capacity. Cymao's topline growth in 2006 will also be boosted by higher production capacity or supply. Cymao had in February 2006 acquired 100% of Inovwood Sdn Bhd ("Inovwood") for RM16.0m. With this, the Group's production capacity was increased to 15,000 cu m per month from 10,000 cu m per month effective Feb 2006. In July 2006, the Group's capacity was increased further to 17,000 cu m per month (with expansion in Inovwood's plant). All in all, Cymao's production capacity for FY06 is estimated at 187,000 cu m per annum, 55% higher compared to 2005 (120,000 cu m per annum). While for FY07, production capacity is projected to increase to at least 222,000 cu m per annum or by 18% YoY.

Inovwood is principally involved in plywood manufacturing with its plant located at Jalan Batu Sapi, Sandakan. The Company generated net profit of RM0.7m for FYE 31 December 2004. Cymao's acquisition of Inovwood was purposed to meet the current strong demand and provide added supply to penetrate further into the UK, Europe and Middle East markets.

Inovwood's plant is located in the vicinity of Cymao's first plant which is also in Jalan Batu Sapi, Sandakan, Sabah. Cymao's existing factory has been running at 90% - 95% utilisation rate.

Sound track record. Cymao Group has about 14 years of experience in plywood manufacturing and distribution. The Group's net profit has been on an uptrend from as far back as 1998, except for 2005 where margins dipped on the back of lower plywood prices and higher log cost. Cymao's net profit and turnover grew by compounded rate of 21% over the last 8 years to 2005. Net profit CAGR for last 4 years to 2005 was however, only 4.5%. Ta Ann's net profit grew by a compounded rate of 14.2% for 8 years to 2005 and 13.7% for 5 years to 2005.

The Group's return on equity over last 3 years was commendable ranging from 13% to 21% while EBIT margin ranged between 8.0% - 16.0%. The Group's net gearing as at 30 June 2006 was only 9.5%.

An experienced Group. Cymao Group has been manufacturing plywood since 1992. The Group has the privilege of adopting skills and technology of producing plywood from its related company, Cyma Plywood and Lumber Co. Ltd. (common shareholders) in Taiwan. Cyma was one of Taiwan's major players in wood-based primary, secondary and further processing industry which include plywood and other value added products. With the closure of Cyma, experienced and highly skilled production personnel and technology were transferred from Taiwan to Malaysia.

Value buy! Cymao Group is trading at cheap valuations. Trading at only 4.9x FY06 EPS whilst PBV is only at 0.73x. Cymao's current earnings multiple is at a 65% discount to average 14.2x FY06 EPS of listed timber companies such as Ta Ann, WTK, Jaya Tiasa and Subur Tiasa.

Entering into China. Cymao has in July 2006 incorporated a wholly owned plywood manufacturing company in China, Xuzhou Richwood Co. Ltd. Cymao invested US\$1.4m or RM5.1m in Xuzhou. Xuzhou's current production is 18,000 cu m per annum but management targets to increase its capacity to 84,000 cu m or by 3x by end-2007.

Given the growing demand for China's plywood, the new plant in China would provide Cymao opportunity to expand its product range to include plywood made from China's logs. Key importers of these plywoods are European Union, Taiwan and Japan. The new investment is also strategic to Cymao Group as cost of production is cheaper in China and transportation cost to some customers is cheaper from China compared to Malaysia. The new venture should contribute positively to Cymao's bottomline from 2HFY07 onwards.

EARNINGS OUTLOOK

Net profit to grow by 42% to RM23.2m. We are expecting Cymao to deliver stellar net profit growth in 2HFY06 versus 1HFY06 and 2HFY05. This is on the back of rising plywood prices in 3QFY06 and increased in production capacity (+55% YoY).

Net profit for FY06 could reach RM23m compared to RM16.2m registered in FY05 and RM20.9m in FY04.

ISSUES AND CONCERNS

Strengthening of RM. Cymao's export sales are transacted in US\$, hence appreciation in RM will have a negative impact on its turnover and correspondingly net profit. Our economist has forecast Ringgit to appreciate to RM3.65/US\$ (as at 2 October : RM3.69/US\$) by end-2006 and RM3.55 by ending-2007. Nevertheless, the negative impact will be mitigated by Cymao's log purchases' which about 33% is denominated in US\$ and the current high plywood prices.

No concession not an issue. Cymao sourced its main raw material logs from third parties as the Group does not have any timber concession. To avoid over-dependence on 1-2 suppliers and to ensure Cymao obtains the best price for its log supplies, Cymao has trading relationships with more than 10 log suppliers. These consist of 7 timber concession holders in Sabah and 4 overseas timber concessionaries. Approximately 66% of logs are sourced locally while overseas log suppliers are New Zealand, Canada and US.

RESULTS SUMMARY

YE 31 Dec (RMm)	1H05	1H06	% YoY	1Q06	2Q06	% QoQ
Turnover	105.0	122.7	16.9	49.9	72.9	46.1
EBIT	7.5	9.9	37.2	3.3	6.6	100.5
Interest income	0.0	0.1		0.0	0.1	
Interest expense	(0.1)	(1.1)		(0.6)	(0.4)	
Pre-tax profit	7.5	9.0	20.2	2.7	6.2	127.7
Taxation	2.4	0.5		0.6	(0.1)	
Net Profit	9.9	9.5	(4.2)	3.3	6.2	85.5
EPS (sen)	13.2	12.6		4.4	8.2	
Gross DPS (sen)	0.0	5.0		0.0	5.0	
NTA/Share (RM)	0.0	2.06		2.53	2.06	
EBIT margin (%)	7.2	8.1		6.6	9.1	
Pretax margin (%)	7.1	7.3		5.5	8.6	
Effective tax (%)	32.4	5.4		(21.1)	1.4	

To avoid supply interruption, Cymao has entered into log supply agreements with Country-Forests Industries Sdn Bhd and Sabah Forest Industries S/B. The agreements are perpetual and guarantee Cymao 200,000 cu m logs per annum. With the above preventive steps in place, Cymao is unlikely to face log supply problems.

Diesel price and glue cost minimal impact on bottomline. Cymao's consumption of diesel is insignificant to the Group's cost of production. The rise in diesel cost will only increase the Group's transportation cost. The Group's cost of production comprises of log cost (50%-60%), labour, consumable and packaging (15%-25%). Transportation cost is estimated to be less than 5% of Group's cost of production.

As for glue, the Group produces its own glue for in-house consumption. This has effectively protected Cymao's margins from rising glue cost as experienced by most plywood manufacturers. From what we understand, Cymao's in-house glue uses very little oil-based chemicals, hence cost has been contained despite higher crude oil price.

Competition from China's plywood. Demand for China's plywood is growing in dominance. Besides for domestic consumption, China's tropical plywood export volumes have been on a rising trend, hitting 1.0m cu m in 2005 versus 0.19m cu m in 2001. Cymao's new venture in China positions the Group to tap the burgeoning market.

The rising plywood exports from China is filling the decline in supply from Indonesia and is not expected to be a threat to Malaysian plywood in the near-to-medium term. Nevertheless, Cymao (main product is general plywood) is more susceptible to threat from China plywood compared to manufacturers of structural and floor-based plywood.

BUSINESS BACKGROUND

Sabah-based plywood manufacturer. Cymao is a Sabah-based timber company listed on the Main Board of Bursa Malaysia since 2004. The Group is involved in manufacturing and distribution of general plywood and decorative plywood products. Sales of general plywood make up to 70% of Group's turnover.

General plywood are used for building and construction (floor panels, wall panels, box beams, roof sheathing, concrete formwork & containers), packaging, consumer and industrial products. Whilst decorative plywood are known as fancy plywood made by laminating specially prepared decorative veneer on conventional plywood, this gives attractive finishing. Commonly used in panelling, furniture, fixture and interior decorating.

Controlled largely by experienced Taiwanese. Approximately 40% of Cymao shares are held by Taiwanese, namely Lim Tsai-Rong, Tsay Chung Wen and Hsu How Tong. They are in fact the founders of Cymao and were promoters of Cymao when the Group was applying for listing in 2004.

The shareholders operated Cyma Plywood and Lumber Co. Ltd ("Cyma") in Taiwan for 30 years before cessation of operation in 1990. This was due to rising labour cost in Taiwan.

CONCLUSION

Operationally sound timber company... Cymao should post commendable earnings in the coming quarters on the back of high plywood prices and expanded production capacity. This, coupled with Cymao's undemanding valuation make the stock a good investment opportunity.

... trading at attractive valuations. Cymao is clearly undervalued, trading at 6.9x FY05 EPS and 4.9x FY06 EPS and 0.73x price-to-book. **We believe the stock should at least trade at 7.0x FY06 EPS, translating to target price of RM2.16.** Our valuation is at 50% discount to average 14.2x FY06 PER of listed timber companies such as Ta Ann, WTK, Jaya Tiasa and Subur Tiasa, FY07 PER of the listed peers is 11.9x while average PBV is 1.8x. The huge discount is to account for 1) Cymao's lack of its own concessions and 2) its main product being general plywood is more susceptible to substitution. Average FY07 PER of listed timber companies

Cymao's financial performance (operating margin and return on equity) for last 8 years is comparable to its listed peers industry average.

EARNINGS PROJECTION (RMm)

YE 31 Dec	2003	2004	2005	2006F	2007F
Turnover	162.8	195.1	245.8	294.6	339.0
EBITDA	24.4	31.8	21.3	36.5	44.3
Depreciation	(5.3)	(6.6)	(7.8)	(9.1)	(11.1)
EBIT	19.1	25.2	13.5	27.4	33.2
Interest income	-	0.2	0.2	0.2	0.2
Interest expense	(0.2)	(0.0)	(0.3)	(0.3)	(0.2)
Pretax profit	18.9	25.3	13.4	27.2	33.2
Taxation	(2.8)	(4.4)	2.9	(4.1)	(5.0)
Net profit	16.1	21.0	16.3	23.2	28.2
EPS (sen)	21.5	28.0	21.7	30.9	37.7
PER (x)	7.0	5.4	7.0	4.9	4.0
Actual share cap. (m)	75.0	75.0	75.0	75.0	75.0
Growth Rates (%)					
Turnover	16.6	19.9	26.0	19.8	15.1
EBIT	23.3	32.2	(46.4)	102.7	21.3
Profit before tax	23.5	34.0	(47.2)	103.5	21.9
Net profit	12.2	30.0	(22.5)	42.5	21.9
EPS	12.2	30.0	(22.5)	42.5	21.9
Ratios (%)					
EBIT margin	11.7	12.9	5.5	9.3	9.8
Profit before tax margin	11.6	13.0	5.4	9.3	9.8
Net profit margin	9.9	10.7	6.6	7.9	8.3
Tax rate	(14.8)	(17.3)	21.4	(15.0)	(15.0)

Source : Cymao Annual Report / Prospectus & AmResearch estimates

SUMMARISED BALANCE SHEET (RMm)

As at 31 Dec	2003A	2004A	2005A	2006F	2007F
Long Term Assets	43.1	49.9	45.2	72.5	75.3
Current Assets	77.4	96.6	122.3	115.4	133.7
Current Liabilities	20.1	9.8	13.0	18.8	20.5
Net Current Assets/(Liabilities)	57.4	86.7	109.4	96.6	113.2
Non-Current Liabilities	0.0	0.2	6.3	3.7	2.1
NET ASSETS/(LIABILITIES)	100.5	136.5	148.2	165.4	186.3
Share Capital	75.0	75.0	75.0	75.0	75.0
Share Premium	(2.1)	17.4	17.4	17.4	17.4
Retained Earnings	2.8	19.3	31.0	48.2	69.1
Negative goodwill	24.8	24.8	24.8	24.8	24.8
SHAREHOLDERS' EQUITY	100.5	136.5	148.2	165.4	186.3

Source : Cymao Annual Report & AmResearch

SUMMARISED CASH FLOW (RMm)

YE 31 Dec	2003	2004	2005	2006F	2007F
Operating cash flow	(0.1)	14.5	(5.9)	67.5	29.6
Investing cash flow	1.9	(20.8)	(0.2)	(36.4)	(13.9)
Financing cash flow	3.9	11.4	6.4	(10.5)	(10.0)
Net Increase/(Decrease) in cash	5.6	5.1	0.2	20.6	5.7
Cash and cash equivalents b/f	0.0	4.7	9.8	10.0	30.6
Cash and cash equivalents c/f	5.6	9.8	10.0	30.6	36.4

Source : Cymao Annual Report & AmResearch

