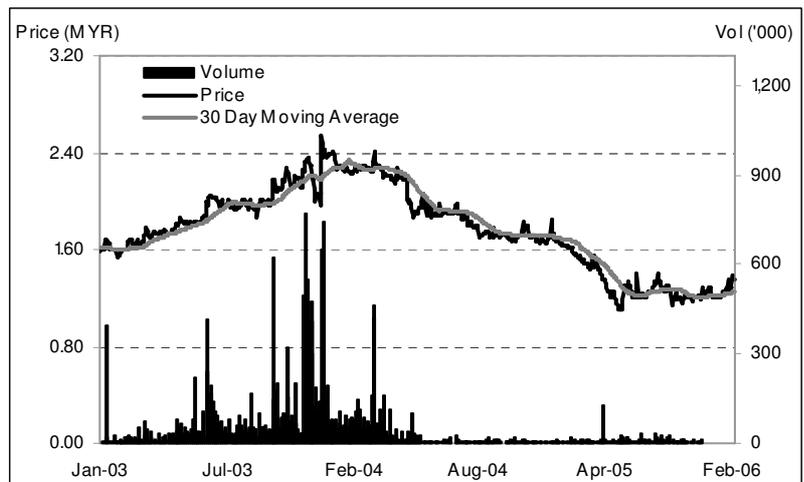


Recommendation: **HOLD**Stock Code: **5000**Bloomberg: **NARR MK**Price: **MYR1.35**12-Month Target Price: **MYR1.41**Date: **February 15, 2006****Board:** Main**Sector:** Industrial Products**GICS:** Consumer Discretionary / Home Furnishings**Market Capitalization:** MYR84.0 mln

Summary: Narra Industries (Narra) is a manufacturer of mid- to high-end wood-based furniture for the export market. It is part of the Hong Leong group of companies and its major shareholder is Bursa Malaysia-listed Hume Industries (HUM MK, Not Ranked).

Analyst: Sharon Wong, CFA

Results Review & Earnings Outlook

- Narra's results were below expectations due to delays in the hospitality projects that the group is pursuing.
- 2QFY06 (Jun.) revenue declined by 33.5% YoY while net profit declined by 39.8 YoY. The weak results reflect the competitive nature of the furniture business. Meanwhile, efforts to penetrate the hospitality industry have yet to bear fruit.
- Operating margin declined to 4.3% in 2QFY06 from 5.5% in 2QFY05, and was down sharply from 9.5% in 1QFY06. We believe that higher expenses could have been incurred to support the group's foray into the hospitality business.
- In our opinion future earnings will depend on Narra's success in securing hospitality projects. It has a strategic tieup with Kimball Hospitality Inc, one of the world's largest hotel room furniture suppliers. It is also bidding for hotel projects on its own, include those of sister company Thistle Hotels.
- Given the delays in the hospitality projects, we have lowered our net profit forecasts by 34% for FY06 and by 15% for FY07. We project net profit to decline 25% in FY06 before rebounding 47% in FY07.
- Narra's net cash position rose to MYR9 mln in Dec. 2005 from MYR3.9 mln in Jun. 2005. Given its strong balance sheet and low capex requirements, we believe that Narra will be able to maintain a gross DPS of 12 sen despite projections of lower earnings.

Key Stock Statistics

FY Jun.	2005	2006F
EPS (sen)	12.6	9.4
PER (x)	10.7	14.3
Dividend/Share (sen)	12.0	12.0
NTA/Share (MYR)	0.48	0.51
Book Value/Share (MYR)	1.08	1.09
Issued Capital (mln shares)	62.2	
52-week Share Price Range (MYR)	1.14 – 1.38	
Major Shareholders:	%	
Hume Industries	61.6	

Recommendation & Investment Risks

- Although we have lowered our near-term earnings outlook, we maintain our Hold recommendation on the stock. In our view, Narra's attractive gross dividend yield of 8.9%, and strong balance sheet will continue to offer support to the share price.
- We have raised our 12-month target price to MYR1.41 from MYR1.30 after rolling over our valuation period to FY07 from FY06. Our target price is based on a PER-based fair value of MYR1.32 and projected net DPS of 8.6 sen.
- We ascribe a fair FY07 PER of 9.5x (raised from 8.4x due to re-rating of peers) to FY07 earnings based on a 20% premium to the historical PER of a basket of wooden furniture manufacturers. In our view, a premium valuation is justified given Narra's superior ROE of 11.7% (vs. industry average of 9%), and strong net cash position of 14 sen/share.
- Risks to our recommendation and target price include further delays in hospitality projects, cost pressures and increased competition from mass-market producers moving up the value chain.

Per Share Data

FY Jun.	2003	2004	2005	2006F
Book Value (MYR)	NM	1.07	1.08	1.09
Cash Flow (sen)	NM	13.3	15.9	12.8
Earnings (sen)	NM	10.6	12.6	9.4
Dividend (sen)	NM	10.0	12.0	12.0
Payout Ratio (%)	NM	81.4	88.7	104.8
PER (x)	NM	12.8	10.7	14.3
P/Cash Flow (x)	NM	10.2	8.5	10.6
P/Book Value (x)	NM	1.3	1.2	1.2
Dividend Yield (%)	NM	7.4	8.9	8.9
ROE (%)	NM	NA	11.7	8.7
Net Gearing (%)	NM	0.0	0.0	0.0

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Narra Industries

Recommendation: **HOLD**

Stock Code: 5000

Bloomberg: NARR MK

Price: MYR1.35

12-Month Target Price: MYR1.41

Date: February 15, 2006

Quarterly Performance

FY Jun. / MYR mln	2QFY06	2QFY05	% Change
Revenue	19.1	28.7	-33.5
Operating Profit (EBIT)	0.8	1.6	-47.8
Depreciation	NA	NA	NM
Net Interest Income / (Expense)	0.1	0.1	-6.3
Pretax Profit	0.9	1.6	-46.0
Net Profit	0.7	1.2	-39.8
Operating Margin (%)	4.3	5.5	-
Pretax Margin (%)	4.6	5.7	-
Net Margin (%)	3.8	4.2	-

Source: Company data

Profit & Loss

FY Jun. / MYR mln	2004	2005	2006F	2007F
Revenue	49.3	109.1	98.2	127.7
Operating Profit (EBIT)	4.3	9.6	7.1	10.6
Depreciation	-1.0	-1.1	-1.1	-1.1
Net Interest Income / (Expense)	4.0	0.2	0.2	0.3
Pretax Profit	8.2	9.9	7.3	10.8
Effective Tax Rate (%)	20.3	20.8	20.0	20.0
Net Profit	6.6	7.8	5.9	8.7
Operating Margin (%)	8.6	8.8	7.2	8.3
Pretax Margin (%)	16.7	9.1	7.5	8.5
Net Margin (%)	13.3	7.2	6.0	6.8

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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