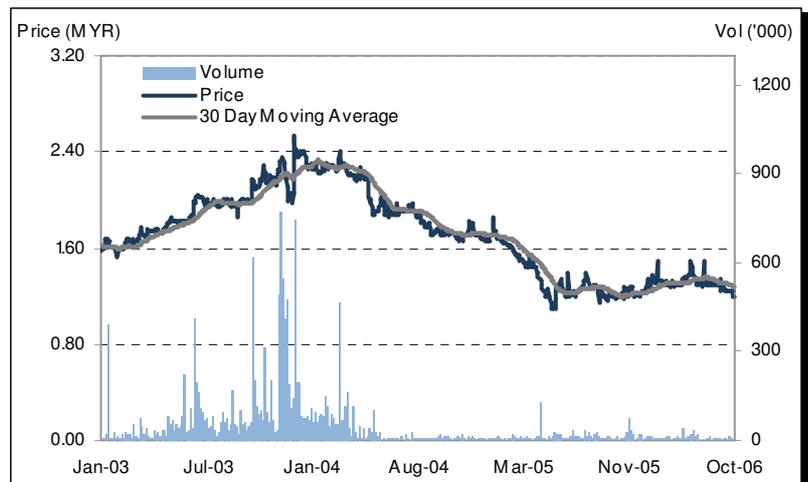


Recommendation: **SELL**Stock Code: **5000**Bloomberg: **NARR MK**Price: **MYR1.20**12-Month Target Price: **MYR1.12**Date: **October 11, 2006****Board:** Main**Sector:** Industrial Products**GICS:** Consumer Discretionary / Home Furnishings**Market Capitalization:** MYR74.6 mln

Summary: Narra Industries (Narra) is a manufacturer of mid- to high-end wood-based furniture for export. 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

Recent Developments

- Narra has made little headway in penetrating the hospitality sector. There has been little progress on potential work contracts for the Thistle Hotel group as refurbishment plans there have yet to be firmed up. Narra continues to work with Kimball Hospitality Inc for the hospitality sector in the US. It has a strategic cooperation with Kimball to gain a foothold and build a reputation in the hotel furniture industry. Kimball is one of the world's largest hotel room furniture suppliers. However, the strategic cooperation has yet to yield any major contracts. In addition, the Middle East market, which has been identified as a potential source of future growth, has yet to make any significant impact on earnings.
- Narra continues to position itself in the mid to high-end segment of the furniture market and Pottery Barn in the US remains its largest customer, accounting for about 60% of sales. However, product lifecycle has shortened and Narra will have to focus on furniture designs to remain competitive.
- Raw material prices (such as wood, lacquer oil) have been on the rise over the past year. With weaker demand from the US, Narra has not been able to raise prices, and this contributed to the margin contraction seen in FY06 (Jun.). However, the recent easing of oil and commodity prices could help to alleviate costs pressures.

Key Stock Statistics

FY Jun.	2006	2007F
EPS (sen)	6.5	9.1
PER (x)	18.4	13.1
Dividend/Share (sen)	12.0	12.0
NTA/Share (MYR)	0.46	0.47
Book Value/Share (MYR)	1.05	1.05
Issued Capital (mln shares)	62.2	
52-week Share Price Range (MYR)	1.10-1.72	
Major Shareholders:	%	
Hume Industries	61.6	

Recommendation & Investment Risks

- We maintain our Sell recommendation on Narra given uncertainty on when and whether the group will be successful in penetrating the hospitality sector. In our view, valuations are unattractive at current levels even after factoring in some success in securing major hospitality projects in 2HFY07. Although the 10% gross dividend yield is attractive, the sustainability of such a level of dividends over the medium term is dependent on a recovery in earnings.
- Our 12-month target price of MYR1.12 is unchanged. We continue to ascribe a fair CY07 PER of 9.5x to arrive at our target price. The target PER is based on a 20% premium to the historical PER of a basket of wooden furniture manufacturers. The premium reflects Narra's above-average margins and net cash position of 7 sen/share. We note that prolonged earnings weakness would render a premium valuation unjustifiable.
- Risk to our recommendation and target price includes overwhelming success in penetrating the hospitality sector that provides a significant boost to its orderbook.

Earnings Outlook

- Future prospects will depend largely on success in penetrating the hospitality sector. Management remains hopeful of penetrating this segment and our projections assume that Narra will have some success in securing and rolling out hospitality projects in 2HFY07.

Per Share Data

FY Jun.	2004	2005	2006	2007F
Book Value (MYR)	1.07	1.08	1.05	1.05
Cash Flow (sen)	13.3	15.9	9.6	10.4
Earnings (sen)	10.6	12.6	6.5	9.1
Dividend (sen)	10.0	12.0	12.0	12.0
Payout Ratio (%)	81.4	88.7	151.9	94.5
PER (x)	11.4	9.5	18.4	13.1
P/Cash Flow (x)	9.0	7.6	12.5	11.5
P/Book Value (x)	1.1	1.1	1.1	1.1
Dividend Yield (%)	8.3	10.0	10.0	10.0
ROE (%)	NA	11.7	6.1	8.7
Net Gearing (%)	0.0	0.0	0.0	0.0

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Narra Industries

Recommendation: **SELL**

Stock Code: 5000

Bloomberg: NARR MK

Price: MYR1.20

12-Month Target Price: MYR1.12

Date: October 11, 2006

Profit & Loss

FY Jun. / MYR mln	2005	2006	2007F	2008F
Revenue	109.1	71.2	92.5	111.0
Operating Profit (EBIT)	9.6	3.4	6.9	9.6
Depreciation	-1.1	-0.9	-0.8	-0.7
Net Interest Income / (Expense)	0.2	0.2	0.2	0.2
Pre-tax Profit	9.9	3.6	7.1	9.8
Effective Tax Rate (%)	20.8	-11.6	20.0	20.0
Net Profit	7.8	4.1	5.7	7.8
Operating Margin (%)	8.8	4.8	7.4	8.6
Pre-tax Margin (%)	9.1	5.1	7.7	8.8
Net Margin (%)	7.2	5.7	6.1	7.1

Source: Company data, S&P Equity Research

Standard & Poor's Equity Research Services

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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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