

# Narra Industries

Recommendation: **STRONG SELL**

Stock Code: **5000**

Bloomberg: **NARR MK**

Price: **MYR0.89**

12-Month Target Price: **MYR0.69**

Date: **December 22, 2006**

**Board:** Main

**Sector:** Industrial Products

**GICS:** Consumer Discretionary/Home Furnishings

**Market Value - Total:** MYR55.3 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, MYR3.18, Not Ranked).

**Analyst:** Sharon Wong, CFA



## Results Review & Earnings Outlook

- Narra's quarterly results were again disappointing. There was no sign of a pick-up in demand and the group was in the red in 1QFY07 (Jun.). In addition, unlike previous years, Narra did not declare an interim dividend this time.
- Turnover declined by 27% YoY due to "lower sales orders from new products and poor retail sales experienced by major customers". Pottery Barn in the U.S. is Narra's largest customer.
- With lower turnover and higher raw material costs, Narra made a net loss of MYR0.3 mln in 1QFY07 from a net profit of MYR1.8 mln in 1QFY06. Raw material prices (such as wood and lacquer oil) have been on the rise, while Narra has not been able to pass on the higher costs to customers due to weak demand.
- Narra's future prospects will depend largely on its success in penetrating the hospitality sector. There has been little progress on this front but management remains hopeful.
- Management expects the company to remain profitable for the full year despite the losses in 1QFY07. Nonetheless, given the weak 1Q, we have lowered our FY07-FY08 net profit projections by 24%-28%. Our projections assume that Narra will have some success in securing and rolling out hospitality projects in 2HFY07. Our projected dividends for FY07 and FY08 are reduced to 5 sen and 8 sen per share, respectively (from 12 sen).

## Recommendation & Investment Risks

- We downgrade our recommendation to Strong Sell from Sell following the weaker-than-expected 1QFY07 results and poor earnings visibility, which do not justify its premium valuation, in our view. Narra currently trades at a premium to both the median 2007 multiple of 10x for our universe of small-cap stocks and the historical PER of 7.9x for a basket of wooden furniture manufacturers.
- Our 12-month target price is revised down to MYR0.69 (from MYR1.12) following the earnings downgrade. We accord a lower PER of 7.9x to CY07 earnings (from 9.5x after removing our previously assigned 20% premium to the peer's average). The target price includes our projected CY07 net dividend of 5.8 sen per share.
- The lower multiple reflects the uncertainty of the group's ability to successfully penetrate the hospitality sector. Dividend yields are still decent in spite of a reduction in our projected dividends, but the sustainability of such a level of dividends over the medium term is dependent on a recovery in earnings.
- Risk to our recommendation and target price includes overwhelming success in penetrating the hospitality sector that provides a significant boost to its order book.

### Key Stock Statistics

FY Jun.	2006	2007E
Reported EPS (sen)	6.5	6.6
PER (x)	13.7	13.5
Dividend/Share (sen)	12.0	5.0
NTA/Share (MYR)	0.46	0.49
Book Value/Share (MYR)	1.05	1.08
No. of Outstanding Shares (mln)	62.2	
52-week Share Price Range (MYR)	0.89 - 1.50	
Major Shareholders:	%	
Hume Industries	61.6	

### Per Share Data

FY Jun.	2004	2005	2006	2007E
Book Value (MYR)	1.07	1.08	1.05	1.08
Cash Flow (sen)	13.3	15.9	9.6	7.9
Reported Earnings (sen)	10.6	12.6	6.5	6.6
Dividend (sen)	10.0	12.0	12.0	5.0
Payout Ratio (%)	81.4	88.7	151.9	54.6
PER (x)	8.4	7.1	13.7	13.5
P/Cash Flow (x)	6.7	5.6	9.3	11.3
P/Book Value (x)	0.8	0.8	0.8	0.8
Dividend Yield (%)	11.2	13.5	13.5	5.6
ROE (%)	NA	11.7	6.1	6.2
Net Gearing (%)	0.0	0.0	0.0	0.0

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**Quarterly Performance**

FY Jun. / MYR mln	1Q07	1Q06	% Change
Reported Revenue	17.5	24.1	-27.4
Reported Operating Profit	-0.3	2.3	NM
Depreciation & Amortization	-0.3	-0.5	-46.3
Net Interest Income / (Expense)	0.0	0.0	17.9
Reported Pre-tax Profit	-0.3	2.3	NM
Reported Net Profit	-0.3	1.8	NM
Reported Operating Margin (%)	-1.9	9.5	-
Reported Pre-tax Margin (%)	-1.7	9.6	-
Reported Net Margin (%)	-1.8	7.5	-

Source: Company data

**Profit & Loss**

FY Jun. / MYR mln	2005	2006	2007E	2008E
Reported Revenue	109.1	71.2	79.7	95.6
Reported Operating Profit	9.6	3.4	4.9	7.2
Depreciation & Amortization	-2.0	-1.9	-0.8	-0.7
Net Interest Income / (Expense)	0.2	0.2	0.2	0.2
Reported Pre-tax Profit	9.9	3.6	5.1	7.4
Effective Tax Rate (%)	20.8	NM	20.0	20.0
Reported Net Profit	7.8	4.1	4.1	5.9
Reported Operating Margin (%)	8.8	4.8	6.2	7.5
Reported Pre-tax Margin (%)	9.1	5.1	6.4	7.7
Reported Net Margin (%)	7.2	5.7	5.1	6.2

Source: Company data, S&amp;P Equity Research

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**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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For residents of Malaysia. All queries in relation to this report should be referred to Alexander Chia, Lee Leng Hoe or Ching Wah Tam.

**Recommendation and Target Price History**

Date	Recommendation	Target Price
New	Strong Sell	0.69
9-Oct-06	Sell	1.12
30-May-06	Hold	1.34
15-Feb-06	Hold	1.41
14-Oct-05	Hold	1.30

