

Narra Industries

Recommendation: **HOLD**

Stock Code: **5000**

Bloomberg: **NARR MK**

Price: **MYR1.22**

12-Month Target Price: **MYR1.30**

Date: **October 14, 2005**

Board: Main

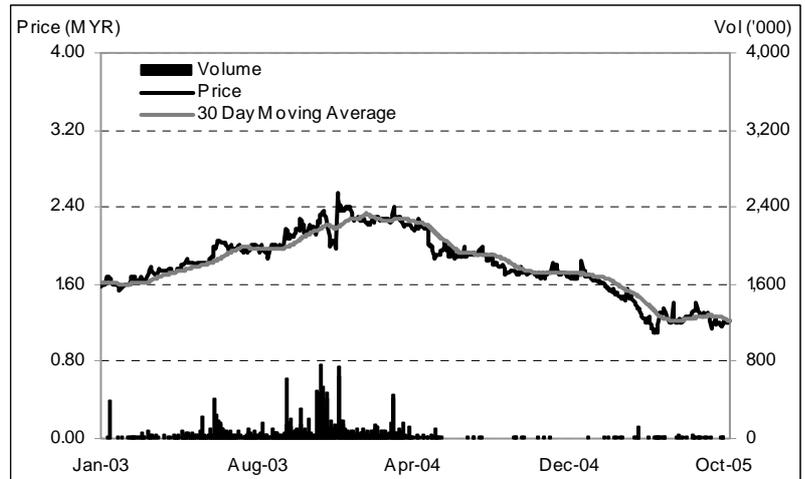
Sector: Industrial Products

GICS: Consumer Discretionary / Home Furnishings

Market Capitalization: MYR75.9 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



Highlights

- Narra is a niche player, focusing on product design, woodworking and finishing, and targeting the mid-to-high end market. Although the furniture industry is competitive, Narra's niche positioning has helped it achieve above industry average profitability and returns.
- We project net profit to grow at a CAGR of 14% over the next two years driven by steady orders from existing customers and new business from its recent foray into the hospitality furniture industry.

Investment Risks

- Risks to our recommendation and target price include cost pressures and increased competition from mass market producers moving up the value chain.
- The stock is extremely illiquid with an average daily volume of only 7,000 shares.
- As this is not a core business for the Hong Leong group, there is a risk that the major shareholder will not dedicate as much resources to the business.

Recommendation

- We initiate coverage on Narra with a Hold recommendation and a 12-month target price of MYR1.30.
- Our target price is derived from relative valuation analysis. We ascribe a fair FY06 PER of 8.4x to FY06 earnings based on a 20% premium to the historical PER of a basket of wooden furniture manufacturers.
- We believe a premium valuation for Narra is justified given Narra's focus on design and the mid-high end market where competition is less intense. This is also reflected in Narra's superior pretax margin of 9.1% and ROE of 11.7% compared to the industry median of 5% and 8% respectively.
- Narra's share price is supported by an attractive gross yield of 9.8% based on gross DPS of 12 sen. We believe that Narra should be able to maintain this level of DPS given its minimal capex requirements.

Key Stock Statistics

	2005	2006F
FY Jun.		
EPS (sen)	12.6	14.3
PER (x)	9.7	8.5
Dividend/Share (sen)	12.0	12.0
NTA/Share (MYR)	0.48	0.54
Book Value/Share (MYR)	1.08	1.12
Issued Capital (mln shares)	62.2	
52-week Share Price Range (MYR)	1.00 - 2.00	
Major Shareholders:	%	
Hume Industries (M) Berhad	61.6	

Per Share Data

	2003	2004	2005	2006F
FY Jun.				
Book Value (MYR)	NM	1.07	1.08	1.12
Cash Flow (sen)	NM	13.3	15.9	17.6
Earnings (sen)	NM	10.6	12.6	14.3
Dividend (sen)	NM	10.0	12.0	12.0
Payout Ratio (%)	NM	81.4	88.7	72.3
PER (x)	NM	11.6	9.7	8.5
P/Cash Flow (x)	NM	9.2	7.7	6.9
P/Book Value (x)	NM	1.1	1.1	1.1
Dividend Yield (%)	NM	8.2	9.8	9.8
ROE (%)	NM	NA	11.7	12.9
Net Gearing (%)	NM	0.0	0.0	0.0

All required disclosures appear on the last page of this report. Additional information is available upon request.

Redistribution or reproduction is prohibited without written permission. Copyright © 2005 The McGraw-Hill Companies, Inc.

Page 1 of 4

Recommendation: **HOLD**

Stock Code: 5000

Bloomberg: NARR MK

Price: MYR1.22

12-Month Target Price: MYR1.30

Date: October 14, 2005

Background

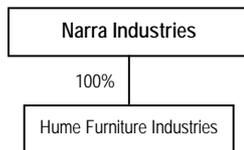
Corporate Profile

Narra, formerly known as Hume Cemboard, manufactures mid to high-end wood-based furniture for the export market. The group's previous business of manufacturing fibre cement products and particle cement boards was disposed of in Feb. 2003, and Hume Industries subsequently injected the furniture business into the listed entity in Oct. 2003 through a backdoor listing exercise.

Narra is part of the Hong Leong group of companies and Bursa Malaysia-listed Hume Industries is its major shareholder with a 61.6% stake.

In terms of corporate governance, the board composition is fair with a split in the Chairman and Managing Director roles, and half of its directors consisting of independent parties. In addition, two out of its three audit committee members are independent directors.

Corporate Structure



Source: Company data

Business

Narra produces mid to high-end wood-based furniture for the export market. Its main products are dining room furniture and occasional furniture in classical designs. The bulk of its products are exported to the US, UK and Middle East and its major customers include US-based Pottery Barn (which accounts for about 40% of revenue) and UK-based Morris Furniture. The OEM business accounts for 60+% of sales and the balance is derived from Narra's in-house brand, Theseira.

Unlike many of its listed peers that produce for the mass market, Narra is a niche player, focusing on product design, woodworking and finishing. Narra has its own production facilities but the bulk of the growth in output is met by outsourcing production of semi-finished products to sub-contractors. About half of output is currently outsourced. To ensure that quality is not compromised, Narra sources the raw material for its sub-contractors, sometimes stations its own technical staff at the sub-contractors' plants, and completes the finishing process in-house.

Narra is currently looking to penetrate the hospitality industry, namely hotels. It has a strategic cooperation with Kimball Hospitality Inc to gain a foothold and build a reputation in the hotel furniture industry. Kimball is one of the largest hotel room furniture suppliers in the world. In 4QFY04, it secured an initial order from Kimball to produce hotel room furniture. In addition to its cooperation with Kimball, Narra is also bidding for hotel projects on its own, including those of Thistle Hotels, which is part of the Hong Leong group of companies. The benefits of successfully penetrating the hospitality furniture business are that the business can be recurrent due to refurbishments and it is less competitive.

Given its niche focus, Narra is not investing in additional capacity but rather, is looking to expand its design capabilities. As such, capex requirements are currently not high.

Like any furniture producer in Malaysia, Narra's main competitors are from countries such as China and Vietnam. However, Narra is able to differentiate itself by focusing on the higher end market where quality and design are important, compared to mass-market producers that typically compete on pricing.

Earnings Outlook

As the group went through a corporate exercise which essentially resulted in the backdoor listing of the furniture business on Oct. 9, 2003, the results of the group prior to FY04 are not comparable. FY05 represents the first full year contribution from the furniture business.

From an earnings base of MYR4-5 mln p.a. for the furniture business in FY01-02, earnings have grown to almost MYR8 mln in FY05. FY05 earnings were boosted by the addition of a new customer, Pottery Barn but gross margin declined from 19.8% in FY04 to 17.4% in FY05 due to higher raw material costs (timber and oil-based materials such as lacquer).

Looking ahead, we project moderate growth of 12.5% in turnover and 13.5% in net profit in FY06. The cooperation with Kimball, while positive, has yet to have a significant impact on earnings. Nonetheless, FY06 revenue will be supported by steady orders from existing customers. Selling prices were raised by 5-10% in early 2005 and should take some pressure off gross margins. However, operating expenses will rise due to additional costs incurred to support the group's foray into the hospitality business.

We project turnover and net profit growth to accelerate to 15% in FY07 driven by new business from the hospitality furniture segment.

The effective tax rate is expected to remain at the 20-21% level, which is below the statutory rate due to reinvestment allowances and export incentives.

Valuation

Our target price for Narra is based on relative valuation, ascribing a fair FY06 PER of 8.4x to FY06 earnings. The target PER is based on a 20% premium to the historical 7x PER of a basket of Bursa Malaysia-listed wooden furniture makers. We believe that a premium is justified given Narra's niche focus on design and the mid-high end market where competition is less intense. This is also reflected in Narra's superior pretax margin of 9.1% and ROE of 11.7% compared to the industry median of 5.4% and 7.6% respectively. We have not included P/NTA analysis in our valuation of Narra given its emphasis on soft skills and its asset light strategy.

Based on PER-based valuation and projected FY06 DPS, we arrive at a 12-month target price of MYR1.30. Narra's share price will be supported by an attractive gross dividend yield of 9.8%.

All required disclosures appear on the last page of this report. Additional information is available upon request.

Redistribution or reproduction is prohibited without written permission. Copyright © 2005 The McGraw-Hill Companies, Inc.

Page 2 of 4

Narra Industries

Recommendation: **HOLD**

Stock Code: 5000 Bloomberg: NARR MK Price: MYR1.22 12-Month Target Price: MYR1.30 Date: October 14, 2005

Comparative Valuation

	Narra	Latitude	Kimble*	Lii Hen*
Share Price (MYR) @ Oct. 12, 05	1.22	1.90	0.68	0.75
Mkt. Cap (MYR mln)	75.9	122.7	75.6	44.7
Ave. Daily Vol. ('000)	7	28	1,794	348
PER FY04 (x)	11.6	10.9	4.8	37.3
PER FY05 (x)	9.7	8.6	6.8	15.5
P/NTA	2.5	0.9	0.5	0.5
Yield (%)	9.8	2.8	5.9	2.7

* Kimble & Lii Hen: FY03 (Dec.) & FY04 (Dec.)

Latitude Tree (LATI MK, Not Ranked), Kimble (KIMC MK, Not Ranked), Lii Hen (LHI MK, Not Ranked)

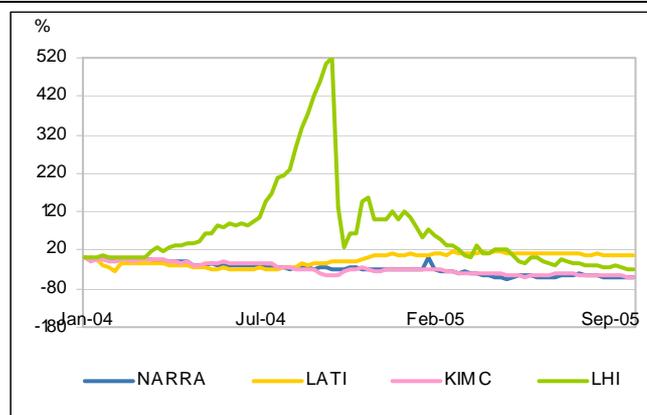
Source: Bloomberg, Company data

Profit & Loss

FY Jun. / MYR mln	2004	2005	2006F	2007F
Revenue	49.3	109.1	122.7	141.2
Operating Profit (EBIT)	4.3	9.6	10.9	12.6
Depreciation	-1.0	-1.1	-1.1	-1.1
Net Interest Income / (Expense)	4.0	0.2	0.2	0.2
Pretax Profit	8.2	9.9	11.1	12.9
Effective Tax Rate (%)	20.3	20.8	20.0	21.0
Net Profit	6.6	7.8	8.9	10.2
Operating Margin (%)	8.6	8.8	8.9	8.9
Pretax Margin (%)	16.7	9.1	9.0	9.1
Net Margin (%)	13.3	7.2	7.2	7.2

Source: Company data, S&P Equity Research

Relative Share Price Performance of Comparables



Source: Bloomberg, S&P Equity Research

Balance Sheet

FY Jun. / MYR mln	2003	2004	2005
Total Assets	NM	80.5	87.0
Fixed Assets	NM	12.4	13.6
Current Assets	NM	29.6	36.0
Other LT Assets	NM	38.4	37.4
Current Liabilities	NM	13.1	18.7
LT Liabilities	NM	0.9	1.0
Share Capital	NM	62.2	62.2
Shareholders' Funds	NM	66.5	67.4

Source: Company data, S&P Equity Research

Recent Developments

Aug. 2005: Reported a 121% increase in turnover and a 19% increase in net profit for FY05, which saw the first full year contribution from the furniture business.

Standard & Poor's Equity Research Services

Standard & Poor's Equity Research Services U.S. includes Standard & Poor's Investment Advisory Services LLC; Standard & Poor's Equity Research Services Europe includes Standard & Poor's LLC- London and Standard & Poor's AB (Sweden); Standard & Poor's Equity Research Services Asia includes Standard & Poor's LLC's offices in Hong Kong, Singapore and Tokyo, Standard & Poor's Malaysia Sdn Bhd and Standard & Poor's Information Services (Australia) Pty Ltd.

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.

Required Disclosures

All of the views expressed in this research report accurately reflect the research analyst's personal views regarding any and all of the subject securities or issuers. No part of analyst compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Additional information is available upon request.

Other Disclosures

This report has been prepared and issued by Standard & Poor's and/or one of its affiliates. In the United States, research reports are prepared by Standard & Poor's Investment Advisory Services LLC ("SPIAS"). In the United States, research reports are issued by Standard & Poor's ("S&P"), in the United Kingdom by Standard & Poor's LLC ("S&P LLC"), which is authorized and regulated by the Financial Services Authority; in Hong Kong by Standard & Poor's LLC which is regulated by the Hong Kong Securities Futures Commission, in Singapore by Standard & Poor's LLC, which is regulated by the Monetary Authority of Singapore; in Japan by Standard & Poor's LLC, which is regulated by the Kanto Financial Bureau; in Sweden by Standard & Poor's AB ("S&P AB"), in Malaysia by Standard & Poor's Malaysia Sdn Bhd ("S&PM") which is regulated by the Securities Commission and in Australia by Standard & Poor's Information Services (Australia) Pty Ltd ("SPIS") which is regulated by the Australian Securities & Investments Commission.

The research and analytical services performed by SPIAS, S&P LLC, S&P AB, S&PM and SPIS are each conducted separately from any other analytical activity of Standard & Poor's.

C MDF-Bursa Research Scheme ("CBRS")

This report has been prepared by S&PM for purposes of CBRS administered by Bursa Malaysia Berhad, independent from any influence from CBRS or the subject company. S&P will receive total compensation of MYR15,000 each year for each company covered by it under CBRS. For more information about CBRS, please visit Bursa Malaysia's website at:

<http://www.bursamalaysia.com/website/listing/cbrs.htm>

Disclaimers

This material is based upon information that we consider to be reliable, but neither S&P nor its affiliates warrant its completeness, accuracy or adequacy and it should not be relied upon as such. With respect to reports issued by S&P LLC-Japan and in the case of inconsistencies between the English and Japanese version of a report, the English version prevails. Neither S&P LLC nor S&P guarantees the accuracy of the translation. Assumptions, opinions and estimates constitute our judgment as of the date of this material and are subject to change without notice. Neither S&P nor its affiliates are responsible for any errors or omissions or for results obtained from the use of this information. Past performance is not necessarily indicative of future results.

This material is not intended as an offer or solicitation for the purchase or sale of any security or other financial instrument. Securities, financial instruments or strategies mentioned herein may not be suitable for all investors. Any opinions expressed herein are given in good faith, are subject to change without notice, and are only correct as of the stated date of their issue. Prices, values, or income from any securities or investments mentioned in this report may fall against the interests of the investor and the investor may get back less than the amount invested. Where an investment is described as being likely to yield income, please note that the amount of income that the investor will receive from such an investment may fluctuate. Where an investment or security is denominated in a different currency to the investor's currency of reference, changes in rates of exchange may have an adverse effect on the value, price or income of or from that investment to the investor. The information contained in this report does not constitute advice on the tax consequences of making any particular investment decision. This material does not take into account your particular investment objectives, financial situations or needs and is not intended as a recommendation of particular securities, financial instruments or strategies to you. Before acting on any recommendation in this material, you should consider whether it is suitable for your particular circumstances and, if necessary, seek professional advice.

For residents of the U.K. This report is only directed at and should only be relied on by persons outside of the United Kingdom or persons who are inside the United Kingdom and who have professional experience in matters relating to investments or who are high net worth persons, as defined in Article 19(5) or Article 49(2) (a) to (d) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001, respectively.