

**Cymao Resources Berhad (RM3.84)****NOT RATED***A Plywood Manufacturer With A Difference*

- ◆ Cymao, listed on the Main Board on 19 March 2004, is an investment holding company with its sole subsidiary, Cymao Plywood Sdn Bhd (CPSB), focusing on the manufacturing and marketing of processed downstream wood products such as veneer, plywood and decorative plywood.
- ◆ It manufactures and markets a wide range of plywood products, including veneer, conventional plywood or plain plywood, decorative plywood or fancy plywood, and specialty plywood comprising lay-on, engineered wood flooring, decorative medium density fibreboard, concrete forming panel and marine plywood. It aspires to be a one-stop centre in the marketing of plywood.
- ◆ Its competitive edge lies in its strong R&D capability. The team under the stewardship of its major shareholder, Lin Tsai Rong and his sons, undertakes R&D in all aspects ranging from product development, process enhancement to waste recycling. Its major shareholder, Lin Tsai Rong has a degree in Plant Pathology and has vast working experience of more than 40 years in the wood-based industry. The other key personnel in the R&D team is Lin Kai Hsuan who has a Master of Science in Forest Science and has extensive working experience in R&D. On average, the company spent about 1.0% of its turnover per annum on R&D over the past six years.
- ◆ Its venture into downstream higher value-added products, which demand skill and technology know-how, helps the company to weather steep competition, from both hardwood and softwood producers.
- ◆ Unlike major timber producers exporting to traditional market like Japan, Cymao's main export market centres on US. About 63% of its total sales were channel to the US in 2003, with Japan accounting for merely 0.1%. In the US market, its products are used in a wide spread of industries ranging from construction/housing, mobile homes, furniture, auto, yacht, musical instruments, and others. Its ability to penetrate a wide range of industries in the US helps to mitigate the risk of over dependence on one single country. Given its ability to penetrate the highly competitive US market, we believe the company is well placed to compete internationally.
- ◆ It is unique as it is able to operate successfully in Sandakan, Sabah without a timber concession since its inception in 1991. It weathered through the period of timber prices down-cycle in 2001-2002 and was able to turn in commendable earnings performance during these years, signaling its success in managing its timber business, without a concession, in trying condition.
- ◆ Given its established track record in managing timber business without a concession and its ability to market a wide range of downstream products to the competitive market like the US, we believe the company is well placed to benefit from the recovery in timber sector.
- ◆ In our earnings projections for FY04, we factor in similar quantum of increases in plywood prices and log cost, i.e. at +10%, respectively, despite the fact that plywood prices are growing at more rapid pace than logs. Based on higher sales volume and larger composition of premium plywood, it is able to turn in pre-tax profit and net profit growth of 42% and 28%, respectively in FY04. Assuming plywood prices stay unchanged into FY05, its earnings performance in FY05 will be underpinned largely by its increase in volume sales which is made possible by its capacity expansion, and higher composition of premium products sales. This will lead to a +11% growth in net profit. Based on share base of 60m, this will translate into net EPS of 35.2 sen in FY04 and 39.0 sen in FY05.
- ◆ Financially strong. Prior to its listing, it has merely a small borrowing of RM0.6m. Post IPO exercise in March, it reverted into net cash of RM12.1m. Given its underlying financial strength and management's indication of managing ROE to enhance shareholders' value, we believe the company is likely to provide good dividend pay-out going forward.
- ◆ It stands out when benchmark against its peers, particularly with the large timber players in Sarawak. Despite its lack of timber concession, it is able to weather through the timber trough in 2001-2002 in reporting higher earnings versus lower earnings and losses as reported by its peers. Going forward, we believe its prospects remain bright riding on the success of its marketing of downstream higher value-added products. Based on its successful track record of

profitability and underlying strength, we believe the company justifies to trade in line with the other timber stocks. We **fairly valued the stock at RM4.68 per share** by attaching a FY05 PER of 12x on its FY05 net EPS.

### Investment Statistics

FYE Dec	Turnover (RMm)	PBT (RMm)	Net profit (RMm)	Net EPS (sen)	Growth (%)	PER (x)	NTA p.s (RM)	P/NTA (x)	DPS (sen)	Gr yield (%)
2002 (a)	139.6	15.3	14.4	24.0	(2.1)	16.0	-	-	-	-
2003 (a) *	165.2	19.3	16.5	27.6	15.1	13.9	1.97	1.9	-	-
2004 (f)	208.3	27.4	21.1	35.2	27.8	10.9	2.35	1.6	15.0	3.9
2005 (f)	229.8	30.4	23.4	39.0	10.8	9.8	2.39	1.6	15.0	3.9
Issued capital (m shares)			60 m			Listing			Main Board	
Par value			1.00			Market Capitalisation (RMm)			230.4	
Book NTA per share (FY04)			RM2.35			P/NTA (x)			1.63	
Major shareholders: Lin Tasi Rong : 28.13%; Tsay Chung-Wen : 11.0%; Hsu How Tong : 8.25%; Chang Huei-May : 4.4% Mendu (Bumi party) : 10.0%; Forum Timber (Bumi party) : 10.0%										

\* Inclusive of pre-acquisition profit

### Background

Cymao, listed on the Main Board on 19 March 2004, is an investment holding company with its sole subsidiary, Cymao Plywood Sdn Bhd (CPSB), focusing on the manufacturing and marketing of processed downstream wood products such as veneer, plywood and decorative plywood. It was set up by Taiwanese nationality led by Lin Tsai-Rong, in 1991 in Sandakan, Sabah. Initially, CPSB was involved in the production of sawn timber but this was phased out in 1992 when the company ventured into plywood manufacturing and secondary processing of plywood into more value-added products.

### Aspires To Be A One-Stop Centre In Downstream Plywood Products

The company manufactures and markets a wide range of plywood products including veneer, conventional plywood or plain plywood, decorative plywood or fancy plywood, and specialty plywood comprising lay-on, engineered wood flooring, decorative medium density fibreboard (MDF), concrete forming panel and marine plywood. The followings are products manufactured by the company:

- Veneer: It is a thin sheet of wood, which forms the building block for plywood. Its thickness varies from 0.5mm to 3.8mm.
- Conventional or plain plywood: The company produces conventional plywood mainly for general purposes, though some are for structural applications. Structural plywood is applied in construction of flood panels, wall panels, box beams, roof sheathing, concrete formwork and containers. General purpose plywood is used in interior decoration, sides of drawers, back of picture frames, wall partitions of temporary buildings, serves as the inner ply of decorative plywood and as substrate for paper overlay and other laminates.

It manufactures four grades of conventional plywood: i) top grade (for use as overlay and direct varnishing); ii) cosmetic grade-zero surface defect (for use in direct varnishing); iii) utility (for general purpose and for direct retail to consumers-minor surface defects); and iv) packing (for industrial use-reutilisation of wood waste).

The company mass-produces the 3-ply plywood while for other combinations, up to nine plies, are manufactured to order. The types of wood used for conventional plywood are all sourced locally.

- Decorative or fancy plywood: These products are made by laminating specially prepared decorative veneer with thickness ranging from 0.1mm to 0.9mm on the conventional plywood to transform the plywood into one with a highly attractive finish. The company used a variety of temperate woods for the decorative veneer. These products are used in paneling, furniture, fixture and interior decorating.
- Specialty plywood: These are plywood which have gone through additional processing to attain special properties or characteristics such as fire retarding, waterproof, scratch proof and low formaldehyde emission glue. The company manufactures specialty plywood made to specifications, which are of value-added and command a higher price and wider profit margin.

Meanwhile, the company places great emphasis on Research and Development (R&D) to further develop plywood into performance panels comprising: i) chemically-altered performance panels, which have corrosion resistance surface coating, fire retarding properties, and plasticised wood fibre i.e. wood fibre that has plastic-like properties; ii) mechanically-structured performance panels. It also intends to make hybrid performance panels, which are both chemically and mechanically altered. Examples of new products that will be launched over the next two years are:

**Table 1: New Products And Applications**

New Products	Applications	Benefits	Launch date
Fire-retarding plywood	Doors, walls and partitions, furniture in public area, mass transportation equipment and vehicle	New business segment, premium pricing	By 2005
Printed plywood	Outdoor advertising panels	Direct printing using laser printer, cost reduction, elimination of process to save time	By 2005
Oil palm core (use of oil palm trunk for the centre ply)	Low grade plywood	Reduce raw material cost, competitive pricing of plywood, plentiful and cheap supply of raw materials	By 2006
Polyester Plywood (scratch resistance)	Furniture, fixture, interior	New business segment, premium pricing	By 2006
Formica plywood	Furniture such as kitchen cabinets and tops, vanity tables, wardrobe, tables and shelves	Durable, comes in different colours to cater to consumer preference	By 2007

The company is also studying ways to recycle its wood waste into commercially viable products. One aspect is to turn the leftover core into activated carbon that can be used in filtration system. The product will be launched in 2007. It is also conducting feasibility study on the commercialising of composite materials, which is made from combining wood waste with resin. It is suitable for use as disposable in construction, temporary flooring and as packaging materials.

### **Competitive Edge Lies In Strong R&D Capability**

The company's ability to venture into higher value-added downstream products is backed largely by its strong capability in R&D. The team under the stewardship of its major shareholder, Lin Tsai Rong and his sons, undertakes R&D in : i) product development to create new products and to improve on existing products, ii) process improvement to enhance efficiency and reduce cost; iii) creation of proprietary consumables such as primer, wood putty and stabilised catalyst; and iv) waste recycling. Lin Tsai Rong has a degree in Plant Pathology and has vast working experience of more than 40 years in the wood-based industry. The other key personnel in the R&D team is Lin Kai Hsuan who has a Master of Science in Forest Science and has extensive working experience in R&D. On average, the company spent about 1.0% of its turnover per annum on R&D over the past six years.

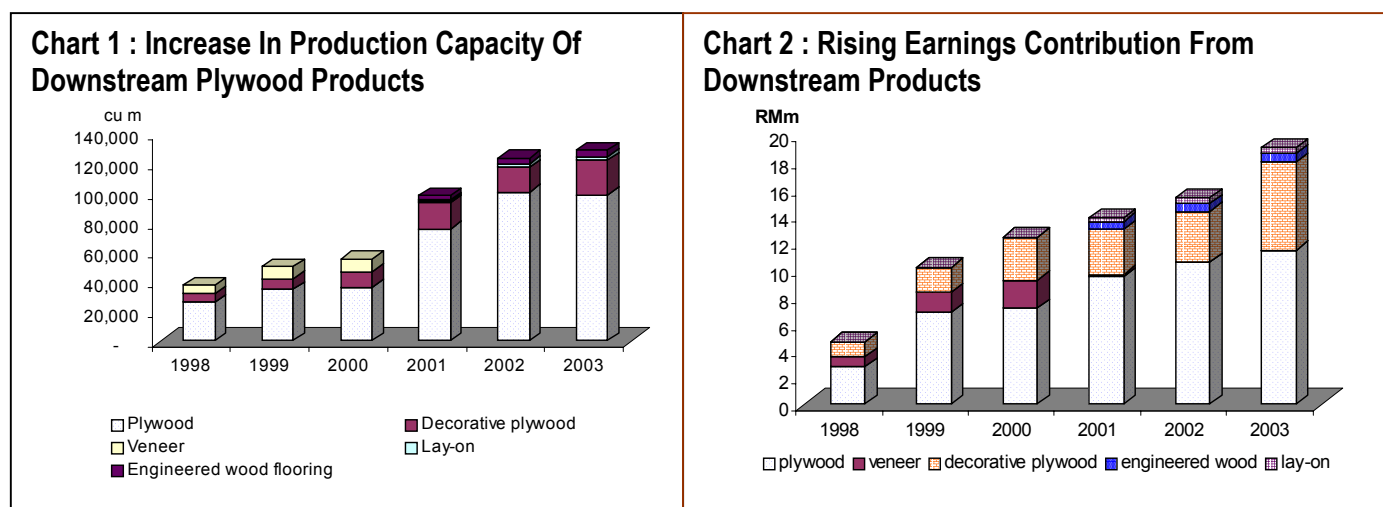
Aside from in-house expertise, the company also collaborated with organisations in undertaking R&D. These organisations are National Beijing University of China, South West Texas University of USA, Du Pont Chemicals of USA, Industrial Technology Research Institute of Taiwan, Forest Research Institute Malaysia and Sabah Forest Research Centre,

### **Rising Earnings Contribution From The Downstream Higher Value-Added Products**

The venture into downstream higher value-added products, which demand skill and technology know-how, helps the company to weather steep competition, from both hardwood and softwood producers. Competition is particularly steep in sale of conventional or plain plywood, which is considered more like commodities. In the case of decorative plywood and specialty plywood, there is strong requirement on skills to reduce wastage, to enhance quality, as well as R&D to provide technical know-how to cater to specialised demand.

Its concerted efforts in developing downstream higher value-added products have led to an increase in production of decorative plywood and specialty plywood, which replaced veneer (see Chart 1). Its marketing of conventional or plain plywood has also gained mileage as seen from increasing production to cater to demand. Its success in marketing the downstream higher value-added products is also evidenced from rising earnings contribution from these products (see

Chart 2). In 1998 to 2000, earnings contribution from conventional plywood accounted for 60% of its profits; veneer, 15%; and decorative plywood, 25%. From 2001 onwards, earnings contribution of veneer were replaced by decorative plywood, engineered plywood and lay-on, while contribution from conventional plywood remained relatively stable at 60%. Going forward, earnings contributions from decorative plywood and specialty plywood are expected to gain momentum given a wider acceptance of these products and its ability to custom make these products to customers' requirements.



### Exports To The Highly Competitive US Market Exemplifies Its Ability To Compete

Unlike major timber producers exporting to traditional market like Japan, Cymao's main export market centres on US. About 63% of its total sales were channel to the US in 2003, with Japan accounting for merely 0.1%. Asian markets comprising Korean and Taiwan made up 4% of total sales. Local sales accounted for 22% of total sales in 2003.

In the US market, its products are used in a wide spread of industries ranging from construction/housing, mobile homes, furniture, auto, yacht, musical instruments, and others. Single customer exposure is limited to 10% or less per customer. Its ability to penetrate a wide range of industries in the US helps to mitigate the risk of over dependence on one single country. Given its ability to penetrate the highly competitive US market, we believe the company is well placed to compete internationally.

Going forward, it plans to widen its export exposures to Europe and Middle East. Its export efforts to Europe are greatly enhanced with its secured Forest Stewardship Council (FSC) certification, which acknowledged the company's production process that is environmentally friendly and usage of timber from renewable sources.

### Without A Timber Concession Posts No Hindrance

It operates successfully in Sandakan, Sabah without a timber concession since its inception in 1991. This is evidenced from its commendable profit margins in the past years (see Table 2). It weathered through the period of timber prices down-cycle in 2001-2002 and was able to turn in commendable earnings performance during these years, signaling its success in managing its timber business in trying condition.

To ensure consistent and adequate supply of logs, it has entered into long term contract with key log supplies such as Sapulut Forest Development Sdn Bhd (SFD) and Syarikat Hung Enterprise (SHE). It has also entered into long-term contract with suppliers of veneer and plywood to ensure consistent supplies of these products for secondary processing. Aside from these, it also has long-term contract with Gaintrade Ltd, Taiwan, Woodleader Enterprise Co Ltd, Taiwan, and China Timber Import and Export Corporation, China, to obtain consistent supply of temperate logs for processing. Temperate wood is used to enhance the finishing quality of decorative and specialty plywood. Despite dwindling in supply of hardwood in Sabah, the state's move to practise sustainable timber management, coupled with Cymao's ability to use smaller logs for plywood production and phasing out of less efficient producers will help to improve supply of raw materials to Cymao.

Despite its sourcing of logs from external parties at market prices, it is able to value-add on the wood produced and command premium pricing for its end products, particularly in the case of decorative and specialty plywood. This has in the way cushioned its earnings and enabled the company to enjoy healthy profit margin.

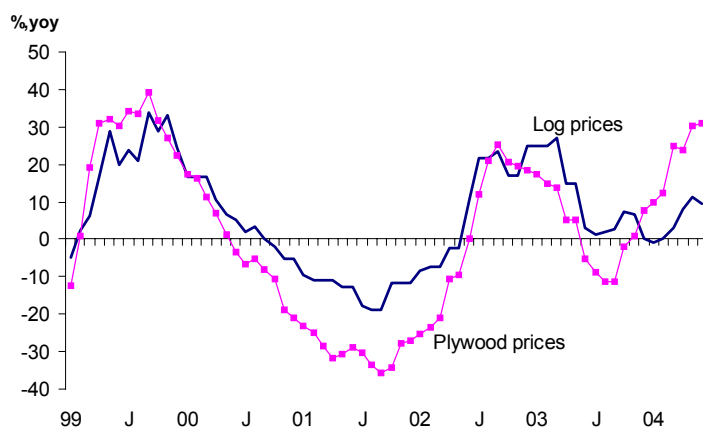
### Prospects: Growing From Strength To Strength

It has proven itself in successfully managing the timber business, as evidenced from the up-trend in profitability (see Table 2) despite the downtrend in timber prices in 2001-2002. Timber prices recovered towards end-2003 and trended higher in 1H2004 underpinning by tightening in supply, particularly with the reduction in log supply from Indonesia, and a nascent recovery in demand, particularly from Japan. With Japan showing firmer signs of economic growth and potentially registering stronger pick-up in housing starts going forward, this will help to underpin demand for timber and provide support to timber prices.

Though Cymao's exports to Japan is insignificant, it is still able to reap the benefit from firming plywood prices worldwide, particularly given its ability to command premium pricing for its downstream higher value-added plywood products. With plywood prices rising at a faster rate than the increase in log prices (see Chart 3), it is well placed to enjoy wider profit margin despite its sourcing of logs from external parties at market prices. Aside from larger quantum of increase in prices of its end products versus raw material cost, it also benefits from increase in volume sales with wider acceptance of its products.

To be prudent, in our earnings projections for FY04, we factor in similar quantum of increase in plywood prices and log cost, i.e. at +10%, and based on volume sales as shown in Table 2, it is able to turn in pre-tax profit and net profit growth of 42% and 28%, respectively in FY04. Assuming prices stay unchanged into FY05, its earnings performance in FY05 will be underpinned largely by its increase in volume sales which is made possible by its capacity expansion, and higher composition of premium products sales. This will lead to a +11% growth in net profit. Based on share base of 60m, this will translate into net EPS of 35.2 sen in FY04 and 39.0 sen in FY05.

**Chart 3 : Plywood Prices Rising Faster Than Log Prices**



**Table 2: Earnings Review And Forecasts**

FYE Dec (RMm)	1998	1999	2000	2001	2002	2003	2004f	2005f
Turnover	50.8	69.8	74.8	116.3	139.6	165.2	208.3	229.8
EBITDA	9.6	14.3	16.8	18.6	20.3	24.6	34.3	38.8
Depreciation	(4.1)	(4.1)	(4.3)	(4.5)	(4.8)	(5.3)	(7.4)	(9.4)
Net interest	(0.9)	(0.0)	(0.2)	(0.2)	(0.2)	(0.0)	0.5	1.0
<b>Pre-tax profit</b>	<b>4.6</b>	<b>10.2</b>	<b>12.4</b>	<b>13.8</b>	<b>15.3</b>	<b>19.3</b>	<b>27.4</b>	<b>30.4</b>
Taxation	(1.2)	2.1	0.7	0.8	(0.9)	(2.7)	(6.3)	(7.0)
Pre-acquisition profits						(13.7)	-	
<b>Net profit</b>	<b>3.4</b>	<b>12.3</b>	<b>13.1</b>	<b>14.7</b>	<b>14.4</b>	<b>2.8</b>	<b>21.1</b>	<b>23.4</b>
<b>Normalised net profit *</b>	<b>3.4</b>	<b>12.3</b>	<b>13.1</b>	<b>14.7</b>	<b>14.4</b>	<b>16.5</b>	<b>21.1</b>	<b>23.4</b>
No of shares (m shrs)	60.0	60.0	60.0	60.0	60.0	60.0	60.0	60.0
<b>Net EPS (sen)</b>	<b>5.7</b>	<b>20.4</b>	<b>21.8</b>	<b>24.5</b>	<b>24.0</b>	<b>4.7</b>	<b>35.2</b>	<b>39.0</b>
<b>Normalised net EPS (sen)</b>	<b>5.7</b>	<b>20.4</b>	<b>21.8</b>	<b>24.5</b>	<b>24.0</b>	<b>27.6</b>	<b>35.2</b>	<b>39.0</b>
<b>Margins (%)</b>								
EBITDA	18.9	20.5	22.5	16.0	14.5	14.9	16.4	16.9
Pretax	9.1	14.6	16.6	11.9	11.0	11.7	13.2	13.2
Net profit	6.7	17.6	17.5	12.6	10.3	1.7	10.1	10.2
Normalised net profit *	6.7	17.6	17.5	12.6	10.3	10.0	10.1	10.2
Effective tax rate (%)	26.1	(20.7)	(5.5)	(6.0)	6.2	14.2	23.0	23.0
<b>Growth</b>								

Turnover	37.3	7.2	55.5	20.0	18.3	26.1	10.3
Pretax profit	119.1	21.9	11.8	10.7	25.8	42.3	10.8
Normalised net profit	258.1	6.5	12.4	(2.1)	15.1	27.8	10.8
Normalised net EPS (sen)	258.1	6.5	12.4	(2.1)	15.1	27.8	10.8
ROE (%)						22.0	19.9
<b>Sales volume (cu m)</b>							
Plywood					96,620	102,100	111,800
Decorative plywood					28,620	31,800	34,980
Engineered wood flooring					4,460	7,080	8,142
Polyester plywood					-	2,000	2,300
Lay-on					2,450	5,270	6,060.50
Total					132,150	148,250	163,282
<b>Sales prices (RM per cu m)</b>							
Plywood					1,026	1,129	1,129
Decorative plywood					1,938	2,132	2,132
Engineered wood flooring					1,406	1,547	1,547
Polyester plywood					-	2,090	2,090
Lay-on					1,748	1,923	1,923
<b>Log cost (RM per cu m)</b>							
Veneer					300	330	330
Sliced veneer					760	836	836
Lay-on					380	418	418

\* Inclusive of pre-acquisition profit

### Financially Strong

Prior to its listing, the company has merely a small borrowing of RM0.6m. Post IPO exercise in March, it reverted into net cash of RM12.1m. The IPO exercise enabled the company to raise gross proceeds of RM22.5m (see Table 3) Out of this, RM7.8m has been earmarked for capital expenditure including land acquisition and construction of new factory and warehouse. Given its underlying financial strength and management's indication of managing ROE to enhance shareholders' value, we believe the company is likely to provide good dividend pay-out going forward.

### Fairly Valued At RM4.68

The company stands out when benchmark against its peers, particularly with the large timber players in Sarawak. Despite its lack of timber concession, it is able to weather through the timber trough in 2001-2002 in reporting higher earnings versus lower earnings and losses as reported by its peers (see Table 4). Going forward, we believe its prospects remain bright riding on the success of its marketing of downstream higher value-added products. Based on its successful track record of profitability and underlying strength, we believe the company justifies to trade in line with the other timber stocks. We fairly valued the stock at RM4.68 per share by attaching a FY05 PER of 12x on its FY05 net EPS.

**Table 3 : Utilisation Of IPO Proceeds**

	RMm
Capital expenditure	4.1
Acquisition of land	1.2
Construction of new factory & warehouse	2.5
Working capital	12.7
Estimated listing expenses	2.0
<b>Total</b>	<b>22.5</b>

**Table 4 : Peer Comparison**

	FYE	Price	EPS Growth (%)				PER (x)			Div Yd	P/NTA	ROE	Net gearing (x)
		RM	2002	2003	2004	2005	2003	2004	2005	2004	2004	FY04	last reported
Jaya Tiasa	Apr	3.84	->100.0	+>100.0	-14.9	29.5	17.2	20.2	15.6	1.3	1.46	7.6	0.2
Lingui	Jun	1.04	->100.0	+>100.0	+>100.0	50.0	31.6	14.6	9.7	0.5	0.66	4.5	0.7
Ta Ann	Dec	7.05	31.8	-4.1	34.1	23.3	17.3	12.9	10.5	3.5	2.85	23.2	net cash
Cymao	Dec	3.84	-2.1 *	15.1	27.8	10.8	13.9	10.9	9.8	3.9	1.63	22.0	net cash

\* Negative growth due to exhaustion of tax credit in 2002, stripping out tax credit in previous year, growth is positive

**Analyst – Tan Hui Gek ☎ (603) (603) 9280-2175 / hgtan@rhb.com.my**

This report is for private circulation only and shall not be reproduced either in part or otherwise without the prior written consent of RHB Research Institute Sdn Bhd (RHBRI). The opinions and information contained herein are based on available data believed to be reliable. It is not to be construed as an offer, invitation or solicitation to buy or sell the securities covered by this report. RHBRI does not warrant the accuracy of anything stated herein in any manner whatsoever and no reliance upon such statement by anyone shall give rise to any claim whatsoever against RHBRI. RHBRI and/or its associated persons may from time to time have an interest in the securities mentioned by this report. Specific details of such interest will be provided upon request. This report may not be reproduced, copied or circulated without the prior written approval of RHBRI.