

RHB Highlights

- ◆ **Evergreen Fibreboard Berhad : Initiation Of Coverage – Double-Digit EPS Growth With High Dividend**

OUTPERFORM**Evergreen Fibreboard Berhad (RM1.08)***Initiation Of Coverage – Double-Digit EPS Growth With High Dividend*

- ◆ **Expansion in MDF capacity to meet the growth in demand for MDF.** Evergreen is capitalising on the growing demand for MDF to expand its production capacity in Thailand, which is undertaken by Siam Fibreboard Ltd (SFCL) whereby a second line came into operation in April 2005 and a third line will be added in 2006, which will expand its total capacity to 742,000 m3 p.a.
- ◆ **Demand growth for MDF to sustain into 2008, with China and the Middle East being the growth markets.** Driving the growth in demand would be the continued growth in global economy as it will have positive implications on housing and thus, the furniture sector, which is the main end-user market for MDF. Stimulating the growth will be China, which consumes more MDF than particleboard for its growing furniture industry and flourishing housing and construction sectors. An emerging market is the Middle East whereby the booming real estate industry is spurring growth in the interior and furniture markets. China and the Middle East are among the main export destinations for Evergreen's MDF products.
- ◆ **EPS growing at a CAGR of 17% in FY12/05-07** driven by: (1) capacity expansion for its plant in Thailand; (2) sustained overall margins as rubberwood costs are generally cheaper in Thailand, providing better margins for its Thailand operations, which will be leading the growth for the group; and (3) low tax rates due to the extension of the pioneer status to Evergreen. We also expect the investment tax privileges for SFCL to be extended beyond June 2006.
- ◆ **Solid balance sheet with dividend payout of up to 50%.** Currently in a net cash position, we expect the group to have a low net gearing of 4.4% in FY12/06 due to capex requirements to add a third line for SFCL but the gearing level is miniscule when compared with the level of gearing for other panel board manufacturers. Evergreen has committed to distribute up to 60% of its net profit for FY12/05 as dividend and plans to maintain a payout of 50% for FY12/06-07. Based on our net profit projection, we expect Evergreen to pay an annual dividend of 8 sen per share.
- ◆ We initiate coverage on Evergreen with an **OUTPERFORM** rating with an indicative **fair value of RM1.30 per share**, which is based on FY12/06 PER of 8.0x. Together with the expected **7.4% gross yield**, the expected total return is close to 28%.

Investment Summary

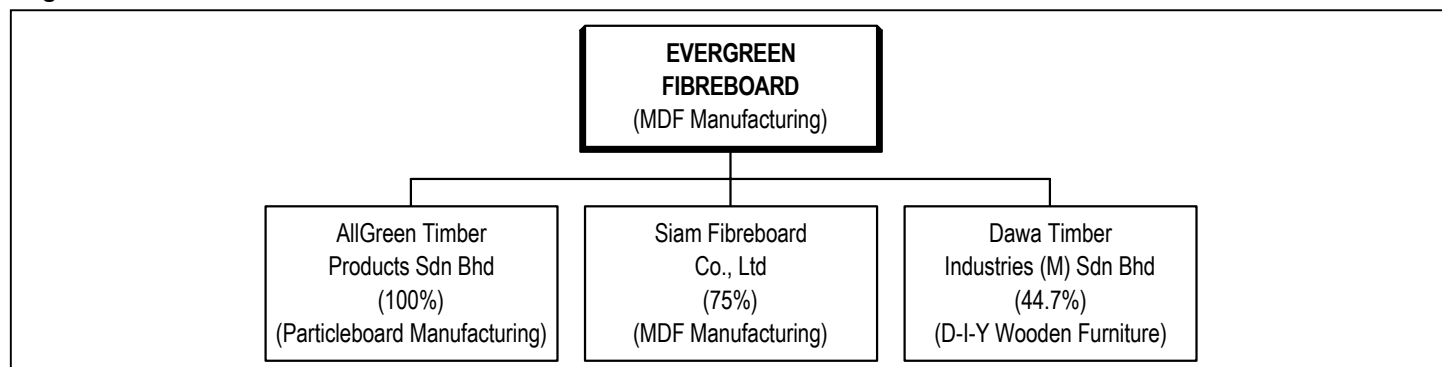
FYE 31 Dec	Turnover (RMm)	Pre-tax profit (RMm)	Net profit (RMm)	EPS (sen)	EPS Growth (%)	PER (x)	CFPS (sen)	P/CF (x)	Gross Div. (sen)	Div Yield (%)
2003a*	250.7	21.6	21.7	4.5	n.m.	23.9	n.m.	n.m.	0.0	0.0
2004a	388.6	62.8	45.0	11.6	157.3	9.3	3.1	35.3	0.0	0.0
2005f	517.0	80.6	63.9	13.8	18.8	7.8	14.2	7.6	8.0	7.4
2006f	646.7	101.5	78.2	16.3	17.8	6.6	20.9	5.2	8.0	7.4
2007f	758.5	118.8	89.9	18.7	15.0	5.8	25.7	4.2	8.0	7.4
Bloomberg Ticker			EVF MK							
Issued Shares (Par: RM0.25) (m)			480.0						48.5%	
Market Capitalisation (RMm)			518.4						51.8%	
Daily Trading Volume (m shares)			1.0							Main Board
52-week Price Range (RM)			0.89 - 1.15							Industrial (Wood-Based)

* Proforma

BACKGROUND

One of the leading MDF manufacturers in Malaysia and Thailand. The Evergreen group, which set up its first rubberwood-based medium density fibreboard (MDF) production line in 1991, is today the second largest manufacturer of MDF in the country with an estimated 16% market share of the country's production. Evergreen expanded its MDF manufacturing operations to Songkhla, Thailand in February 2004 through 75.0%-owned Siam Fibreboard Co Ltd (SFCL). Through another subsidiary and an associate, the group also produces particleboard and D-I-Y (Do-It-Yourself) wooden furniture. About 80% of group revenue of RM388.6m for FY12/04 came from exports, with MDF accounting for about 80% of total sales. Its market base is quite diversified, with China (including Hong Kong) contributing 20% to export revenue. Its other big markets are the Middle East, the US and Vietnam. Evergreen was listed on the Main Board of Bursa Malaysia in March 2005.

Organisation Structure



Evergreen's three MDF plants in Johor (one in Parit Raja, Batu Pahat and two in Pasir Gudang) have a total annual capacity of 280,000 m³. In Thailand, SFCL commenced operations of its second production line in early April 2005, which doubled its annual MDF manufacturing capacity to 322,000 m³, placing it as one of the leading MDF manufacturers in the country. The production of particleboard, which started in 2003, is basically to supplement the D-I-Y furniture division, which is capable of producing 1.8m sets of furniture a year. The particleboard plant in Segamat, Johor has an annual installed capacity of 144,000 m³. The group's specialty in D-I-Y furniture lies in its combination of thin MDF with thick particleboard as core frames. This method of production has substantially reduced the weight of the furniture compared with solid wood furniture and reduces material cost and wood content of the products.

Evergreen's Plant Production Capacity

FY12/04e	Annual capacity	Utilisation Rate
MDF		
Malaysia	280,000 m ³	85%
Thailand	322,000 m ³	85%*
D-I-Y wooden furniture	1,800,000 sets	66%
Particleboard	144,000 m ³	65%

* Utilisation rate of line 1, which has an annual capacity of 162,000 m³; Line 2 commenced operations only in April 2005

The group's future plans and strategies will centre on 3 key areas:

- Expansion of manufacturing facilities in Thailand.** Spearheading the group's future expansion will be SFCL. Evergreen is adding a new melamine lamination equipment for SFCL by the end of 2005 to add more value to its products. It also plans to add a third MDF line for SFCL to increase the plant's annual production capacity by 140,000 m³ p.a. in 2006 to support its plan to expand SFCL's market base outside Thailand and penetrate new export destinations in the future.
- Development of new value-added products for better margins.** Continuously involved in R&D of new products, it intends to develop high moisture resistant MDF and E1-grade MDF, which are in high demand in Japan and Europe, by the end of 2005. It has also set a target to launch new designs of D-I-Y furniture by the end of 2006.

3. **Venturing into supporting activities to ensure continuous supply and save costs of raw materials.** Evergreen will be investing RM4.1m for a 25% stake in a joint-venture company that is currently constructing a world scale formaldehyde and resins plant in Hadyai. The venture will be led by Evergreen's current resins supplier, Dynea Chemicals which is one of the world's leading providers of industrial adhesive systems. Expected to commence operations at the end of 2005, the plant will cater to the growing wood panel industries in Asia Pacific. Evergreen also plans to embark on chipping operations in 2006 to provide in-house supply of wood chips, which are currently sourced from external parties.

THE MDF INDUSTRY

Made from wood waste, MDF's applications have developed from solely for furniture to building interiors. MDF and particleboard are reconstituted wood-based panel (RWP). The products are made from recycled wood, i.e. wood fibres (for MDF) or wood particles/chips (for particleboard). These feedstocks are bonded together with (urea formaldehyde) resins and other additives under high heat and pressure to form a flat dense sheet. In Malaysia, rubberwood is the primary feedstock for eight particleboard plants and 10 MDF mills (Malaysia has 14 MDF mills, producing around 1.5-1.6m m3 annually). Originally developed exclusively for furniture, which is still the main user market, MDF have found its applications in building materials (mainly for interior finishing and wood flooring), household products and interior parts of automotive, to name a few. MDF is also being recognised as an alternative to solid wood, plywood and even particleboards due to its finishing characteristics and better machineability. Meanwhile, rubberwood-based products have gained popularity because of the dwindling supply of timber from natural forest.

Major MDF Manufacturers In Malaysia

	Annual Capacity (m3)	Range Of Thickness (mm)	Wood specie	Location Of Plant
Merbok Hilir Group*	350,000	2.2 – 32.0	Rubberwood	Merbok, Kedah & Masai, Johor
Evergreen Group	280,000	2.5 – 18.0	Rubberwood	Parit Raja (Batu Pahat) & Pasir Gudang, Johor
Hume Fibreboard	200,000	8.0 – 24.0	Rubberwood	Nilai, Negri Sembilan
Robin Resources	175,000	3.0 – 25.0	Rubberwood	Mentakab, Pahang
Donghwa Fibreboard	130,000	n.a.	Rubberwood	Nilai, Negri Sembilan
Guthrie MDF	130,000	3.0 – 25.0	Rubberwood	Kulim, Kedah
Segamat Panel Boards	72,000	2.3 – 6.0	Rubberwood	Segamat, Johor
Samling Fibreboard	100,000	1.5 – 18.0	Natural forest wood	Miri, Sarawak

* Merbok MDF and Takeuchi MDF

Source: Respective companies

China is the world's top producer of MDF but will remain net importer. Global MDF capacity grew by a significant 16.9% in 2004 to reach 43.6m m3. Asia overtook Europe as the world's largest MDF-producing region in 2003 and widened its lead in 2004 with a total capacity of 18.9m m3 as compared to Europe's 13.8m m3 and North America's 5.1m m3. The majority of the increase in capacity since 2002 occurred in one country, i.e. China, which added over 7.8m m3 of capacity in 2002-2004 to elevate it as the largest MDF producing country in the world, accounting for almost one-third of global capacity. However, the expansion in capacity is still insufficient to meet the growing demand that China is expected to remain a net importer of MDF in the years to come.

Outside China, capacity expansion in Asia has been concentrated on particleboard. Malaysia is the largest producer of MDF in South-East Asia with an estimated annual production capacity of 1.5-1.6m m3. Thailand is currently in a second place but it is the No. 1 particleboard producer in the region. Within the RWP sector, most of the capacity expansion in recent years appears to have taken place in the particleboard segment. In Thailand, particleboard capacity doubled in 2004 to about 2.7m m3 while in Malaysia, Mico Chipboard recently increased its capacity by 3.1x to 940,000 m3 p.a. while Heveboard is setting up a second line, which will increase its annual production capacity by 4.4x to 525,000 m3 by 2Q 2006. As for MDF, there is no new capacity due to come on stream in Malaysia. In Thailand, SFCL's new capacity of 140,000 m3 is expected to come on stream in 2H2006 while the commencement of Vanachai Group's new MDF plant with a capacity of 250,000 m3 has been deferred from 4Q2006 to 1Q2007.

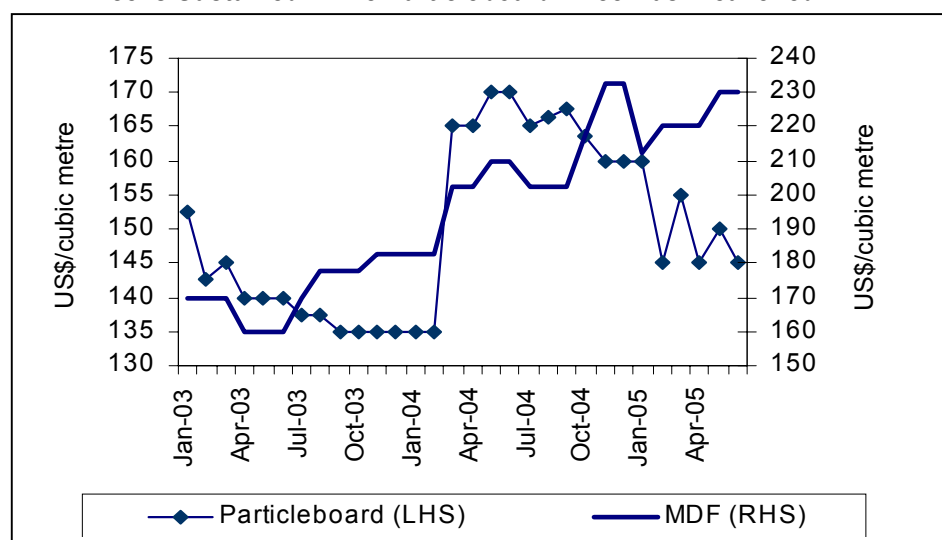
INVESTMENT CASE

Growth in global demand for MDF to sustain into 2008. An indicator of demand for wood products would be economic growth with implications for housing and thus, furniture and building interior industries. Global economic expansion and the worldwide fall in interest rates since 2001 have created the real estate boom almost across the globe. Along with it was the surge in global demand for panel products, particularly for MDF in China, which is one of Evergreen's main export markets. Driving the consumption in China is its booming domestic economy, the flourishing housing sector and the shift in furniture production from the US, Europe and other Asian countries, which has transformed China into the world's largest exporter of furniture. The Middle East, particularly the UAE, has also become an important growing market for Evergreen. Spurring the growth of the interior and furniture markets in the region is the on-going multi-billion equivalent ringgit worth of construction and real estate projects in the UAE and other Gulf countries. The Middle East was the second fastest growing region in the world after China in 2004. Closer to home, demand will emanate from 2,000-odd furniture producers in Malaysia and some 2,400 in Thailand.

The economic outlook for 2005-06 is for a more modest pace of expansion but the IMF's projected global economic growth of 4.3% for 2005 and 4.4% for 2006 is relatively robust in comparison with the growth achieved during much of the 1990s. Similarly, China's economy is expected to cool down but IMF is still projecting a strong growth of 8.5% in 2005 and 8.0% in 2006. With China leading the growth in demand, global MDF consumption is forecasted to grow by 9% p.a. until 2008 with demand from Asia Pacific projected to expand from 13.3m m³ in 2001 to 20.1m m³ in 2006 before expanding further to 30.8m m³ by 2008, according to a report by BIS Shrapnel. This forecast could turn out to be on the conservative side as demand for MDF in Asia Pacific was reported to have already surpassed 20.0m m³ in 2004.

Outlook for MDF is more favourable than particleboard given limited new supply. A notable increase in supply of particleboard from Thailand and Malaysia, which are the two main net exporters of particleboard in Asia, has resulted in particleboard supply currently exceeding demand, which are putting pressure on particleboard price. In the MDF segment, global supply/demand situation is more balance and price has been sustained at well above 2004's level. A continued growth in demand particularly from China amidst limited new supply will support the price of MDF for the rest of 2005 and 2006. An unusual point to note about consumption in China is that it consumes 2.3x more MDF than particleboard in 2004. This is in contrast with consumption pattern in most countries, such as Japan, the US and Europe, whereby particleboard consumption almost doubles that of MDF.

MDF Price Is Sustained While Particleboard Price Has Weakened



Source: ITTO

A prudent but aggressive expansion. A case in point is Evergreen's expansion to southern Thailand. While Merbok Hilir ventured into Sri Lanka and Robin Resources went to China, Evergreen stays closer to home and near to the source of its main raw materials, i.e. rubberwood (Thailand is the world's largest producer of rubber) and glue resins. Meanwhile, its capacity expansion is concentrated on MDF, where demand turns out to be more resilient and price is sustained on lack of expansion by MDF producers in South-East Asia. SFCL also produces a wider thickness range of MDF and hence, it complements the range of MDF products offered by Evergreen's plants in Malaysia.

EPS growing at a CAGR of 17% to FY12/07. The main assumptions for our earnings projection are:

1. **Topline revenue growth will be driven by capacity expansion in Thailand.** The opening of the second line in April this year will boost topline revenue for FY12/05-06. We have factored in the planned addition of a third line for SFCL, which we assume to start in 2HFY12/06, into our forecasts. Meanwhile, continued growth in demand amidst limited additions in supply will support MDF price at the current price level (of US\$225-235/m³, using the benchmark FOB export price of Malaysian MDF) throughout our forecast period.
2. **Overall margins will be sustained** in spite of the current strength of rubberwood price (as an indicator, the domestic price of Malaysian rubberwood log has risen by over 20% over the past one year). The ban on the exports of sawn rubberwood should help to stabilise the domestic price of sawnwood and this should have a spill-over impact on prices of other types of rubberwood. In addition, rubberwood costs are generally cheaper in Thailand, providing better margins for SFCL, which is leading the growth for the group. Based on our projection, SFCL will contribute 45% to revenue and 64% to pre-tax profit by FY12/06 compared to 22% and 36%, respectively in FY12/04.
3. **Tax rates will remain low** due to the extension of the pioneer status to Evergreen by another five years from March 2005. Meanwhile SFCL, which will be exempted from tax up to 3 Jun 2006 due to investment tax privileges, will apply for an extension. The management is quite confident of receiving the extension from Thailand's Board of Investment and as such, we have not factored in tax charges for SFCL into our projections.

Solid financial position with dividend payout of at least 50% or 8 sen per share. Part of the proceeds of RM106.8m from its recent IPO exercise will be utilised to repay borrowings (RM32.0m) with the remaining amount set aside mainly for working capital (RM60.6m) and capex requirements (9.0m). Currently in a strong net cash position (net cash of RM92.8m as at March 2005), we expect the group to turn into a small net debtor in FY12/06 mainly due to an estimated capital spending of RM80-100m for the expansion of SFCL's capacity. However, our projected net gearing of 4.4% is miniscule when compared with the level of gearing for other panel board producers, i.e. Mico (102%), Heveaboard (29%) and Thailand's Vanachai Group (88%).

Evergreen has announced its commitment to distribute up to 60% of FY12/05 net profit as tax-exempt dividend (including the interim dividend of 3.125 sen per share, which will be paid on 10 July) and expects to maintain a payout of up to 50% of net profits for FY12/06-07. Based on these ratios and our projected net profits, we expect Evergreen to pay an annual dividend of 8 sen per share, which translates into an attractive yield of 7.4% at the current share price.

INVESTMENT RISK

Downside risks to our earnings forecast would be a delay in the opening of the third line for SFCL and a failure to receive an extension of investment tax privileges for SFCL. Without both, our projected EPS growth would be reduced to a low 2.8% for FY12/06 and negative 4.7% for FY12/07 (refer to table below). Drastic slowdown in the general economy would impact consumer spending and would accordingly affect demand for furniture, which is the main user market for Evergreen's MDF products. Concern about real-estate bubble following a period of feverish growth in the past few years may also slow down demand for wood products including MDF, which could delay Evergreen's plan to expand production capacity and penetrate into new markets.

Earnings Analysis

	Existing forecast: Addition of 3 rd line in 2HFY12/06 and extension of tax privileges for SFCL		Scenario 1: Addition of 3 rd line in 2HFY12/06 but no extension of tax privileges for SFCL		Scenario 2: No expansion of capacity but assume extension of tax privileges for SFCL		Scenario 3: No expansion of capacity and no extension of tax privileges for SFCL	
	EPS (sen)	Growth (%)	EPS (sen)	Growth (%)	EPS (sen)	Growth (%)	EPS (sen)	Growth (%)
FY06f	16.3	17.8	15.4	11.2	15.0	8.5	14.2	2.8
FY07f	18.7	15.0	15.8	2.7	15.8	5.2	13.5	(4.7)

SHAREHOLDERS AND MANAGEMENT

The family of Mr Kuo Wen Chi, who is the founder and Deputy Chairman, collectively holds 48.5% of the enlarged paid-up capital of the company. Other family members who sit on the board are Mr Kuo Jen Chang (Managing Director but is not involved in the day-to-day operations of Evergreen), Mr Kuo Jen Chin (Executive Director, who is more involved in operations of Evergreen) and Ms Kuo Huei Chen (Non-Executive Director).

VALUATION AND RECOMMENDATION

Evergreen was only listed recently and thus, it lacks the data points to provide a gauge of its long-term historical valuation. As a guide, we look at the rating of other listed particleboard manufacturers although Evergreen is the only listed RWP manufacturer in Bursa Malaysia that focuses on MDF. Mieco Chipboard and Heveaboard concentrate on particleboard while Thailand-listed Vanachai Group, which is the leading particleboard and MDF producer in the country, derives 60% of its revenue from particleboard.

Going forward, the RWP manufacturers under review will show a double-digit earnings growth for FY12/05-06 with the growth emanating mainly from capacity expansion (the plunge in FY12/05 EPS for Heveaboard is caused by an enlargement of share capital arising from its recent IPO while the drop for Vanachai is attributable to the fall in particleboard price). Yet, these companies are trading at single-digit PER rating, which reflects (1) the risks associated with the fluctuation in prices of rubberwood and glue resin and their consequence impact on earnings, and (2) concern about global economic slowdown, which would affect demand growth. Amidst these concerns, we expect Evergreen to continue to trade at single-digit PER going forward.

Carrying the current FY12/05 PER of about 8.0x to FY12/06, we arrive at an indicative fair value of RM1.30 per share for Evergreen. Together with the projected dividend yield of 7.4%, we initiate coverage on Evergreen with an **OUTPERFORM** recommendation.

Valuations of MDF/Particleboard Manufacturers

FYE Dec	Evergreen	Mieco*	Heveaboard*	Vanachai**
Currency	RM	RM	RM	THB
Share price @ 6 Jul 2005	1.08	2.06	1.40	5.00
Market capitalisation (m)	518.4	432.6	112.0	6,508.3
EPS (sen)				
FY05f	13.8	24.7	22.6	76.50
FY06f	16.3	28.5	36.4	85.00
EPS growth (%)				
FY05f	18.8	70.1	(15.0)	(11.6)
FY06f	17.8	15.4	60.9	11.1
PER (x)				
FY05f	7.8	8.3	6.2	6.5
FY06f	6.6	7.2	3.8	5.9
Balance sheet				
Net (debts)/cash (m)	92.8	(172.4)	(32.3)	(3,864.0)**
Net gearing (%)	net cash	102.2	28.9	87.9**

* EPS for Mieco and Vanachai are average consensus' forecasts

** Listed On Stock Exchange of Thailand; Balance sheet figures as at 31 Dec 2004

Earnings Forecasts

FYE 31 Dec (RMm)	2003*	2004	2005f	2006f	2007f
Revenue	250.7	388.6	517.0	646.7	758.5
<i>Malaysia</i>	250.7	305.2	339.5	353.1	364.6
<i>Thailand</i>	0.0	83.5	177.5	293.6	394.0
EBITDA	35.8	80.1	104.9	131.2	152.7
Depreciation	(13.4)	(15.6)	(22.9)	(28.5)	(32.7)
Interest expense	(1.0)	(2.8)	(2.5)	(2.4)	(2.4)
Operating profit	21.4	61.7	79.5	100.3	117.7
Share of associate's profit	0.2	1.0	1.1	1.2	1.2
Pre-tax profit	21.6	62.8	80.6	101.5	118.8
<i>Malaysia</i>	21.6	43.2	39.9	36.5	34.9
<i>Thailand</i>	0.0	23.8	40.8	65.0	83.9
Taxation	0.1	(12.2)	(7.4)	(8.2)	(9.5)
Minority interests	0.0	(5.6)	(9.3)	(15.0)	(19.4)
Net profit	21.7	45.0	63.9	78.2	89.9
Issued shares - Par: RM0.25 (m)	480.0	480.0	480.0	480.0	480.0
Weighted shares (m)	480.0	386.3	461.8	480.0	480.0
EPS (sen)	4.5	11.6	13.8	16.3	18.7
Gross dividend (sen)	0.0	0.0	8.0	8.0	8.0
NTA per share (RM)	n.a.	0.66	0.80	0.89	1.00
Margins (%)					
EBIT	8.9	16.6	15.9	15.9	15.8
EBITDA	14.3	20.6	20.3	20.3	20.1
Pre-tax profit	8.6	16.2	15.6	15.7	15.7
Net profit	8.7	11.6	12.4	12.1	11.9
Effective tax rate	n.m.	19.5	9.2	8.1	8.0
Growth (%)					
Turnover	9.5	55.0	33.0	25.1	17.3
Pre-tax profit	(57.1)	190.7	28.4	25.8	17.1
Net profit	(55.5)	107.1	42.0	22.4	15.0
EPS	(55.5)	157.3	18.8	17.8	15.0
Key Assumptions - MDF					
Average Price (US\$/m3)			225	230	230
Exchange Rate					
RM/1US\$			3.80	3.80	3.80
RM/1THB			0.09	0.09	0.09
Evergreen Fibreboard					
Annual Production Capacity (m3)			280,000	280,000	280,000
Average Utilisation Rate (%)			89	92	95
Siam Fibreboard					
Annual Production Capacity (m3)			322,000	462,000	462,000
Average Utilisation Rate (%)			60	67	84

* Proforma

Balance Sheet

FYE 31 Dec (RMm)	2004	2005f	2006f	2007f
Fixed Asset	254.1	289.3	398.0	432.0
Other Investment	8.9	8.9	8.9	8.9
Goodwill	0.9	0.9	0.9	0.9
Current Assets	183.1	252.9	199.3	224.6
Current Liabilities	101.2	89.4	100.0	107.7
Net Current Asset/(liabilities)	81.8	163.6	99.4	116.9
Net Assets	345.6	462.6	507.1	558.6
Financed by:				
Share Capital (Par: RM0.25)	96.6	120.0	120.0	120.0
Reserves	159.7	265.6	310.2	361.8
Shareholders' Funds	256.2	385.7	430.2	481.7
Minority Interest	18.3	18.3	18.3	18.3
LT Borrowings	53.5	41.0	41.0	41.0
Deferred Taxation	17.6	17.6	17.6	17.6
SHF & LT Liabilities	345.6	462.6	507.1	558.6

Cash Flows

FYE 31 Dec (RMm)	2004	2005f	2006f	2007f
Pre-tax Profit	62.8	80.6	101.5	118.8
Non-Cash Adjustments	19.6	21.8	27.3	31.5
Tax Paid	(0.3)	(12.2)	(7.4)	(8.2)
Change In W/C	(67.4)	(22.0)	(21.0)	(18.7)
Operating Cash Flows	14.7	68.3	100.3	123.4
Capex	0.0	(25.0)	(80.0)	(20.0)
Investments	(50.7)	(5.0)	0.0	0.0
Others	0.0	2.0	2.0	2.0
Investing Cash Flows	(50.7)	(28.0)	(78.0)	(18.0)
Issue Of Shares	0.0	101.6	0.0	0.0
Dividend Paid	0.0	(38.3)	(38.4)	(38.4)
Repayment Of Term Loans	0.0	(22.0)	(1.0)	(1.0)
Financing Cash Flows	33.6	(60.3)	(39.4)	(39.4)
Net Cash Flows	(2.5)	(20.1)	(17.1)	66.0
Ending Cash	88.4	126.8	41.5	39.3

Analyst – Joshua CY Ng ☎ (603) 9280-2151 / joshuang@rhb.com.my

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