

**Evergreen Fibreboard (BUY; NEW)**

INITIATION

April 7, 2015

Target Price: RM1.47

Share Price: RM1.13

**More Than US\$ Play**

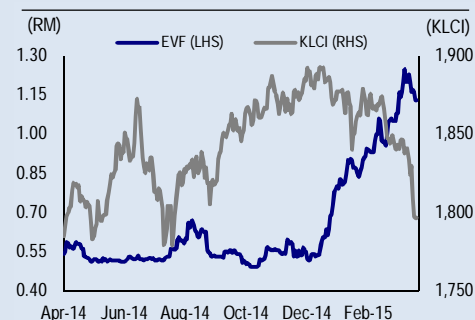
Highlights	<ul style="list-style-type: none"> <li>▪ Evergreen Fibreboard is one of the top 5 producers of engineered wood-based products in Asia, which main products consisting MDF and particleboard, with combined annual production capacity of more than 1.3m m<sup>3</sup>.</li> <li>▪ <b>A turnaround story...</b> Evergreen's earnings started deteriorating since 2012 and it recorded 7 consecutive quarters of net losses. Having undergone a series of internal restructuring activities (including writing off concession cost, broadening of customer base, and plant enhancements) as well as favourable external factors (in particularly lower log and adhesive prices, and a stronger US\$), Evergreen saw its performance improving and turned profitable since 3Q14</li> <li>▪ We believe <b>the strong share price performance has yet to fully reflect its true fundamentals</b>, as we anticipate Evergreen's earnings prospects to remain bright in the near to medium term, underpinned by several factors including:             <ol style="list-style-type: none"> <li>1. Management's ongoing efforts to improve operational efficiencies and financial performance will only be gradually reflected in the next 1-2 years;</li> <li>2. Lower raw material costs, in particularly, log and adhesive prices (which collectively account for 55-65% of the production cost of MDF); and</li> <li>3. Strong US\$, which is beneficial to Evergreen's bottomline as it derives 65-70% of its revenue from export sales.</li> </ol> </li> </ul>
Catalysts	<ul style="list-style-type: none"> <li>▪ Margin expansion from strengthening of US\$ and declining raw material prices (in particularly, rubber log wood and adhesive prices);</li> <li>▪ Turning around of other operations including the saw mill and particleboard operations.</li> <li>▪ Resumption of dividend policy.</li> </ul>
Risks	<ul style="list-style-type: none"> <li>▪ Escalating raw material prices and labour costs;</li> <li>▪ Slower-than-expected demand for MDF;</li> <li>▪ Fluctuating foreign currency movement (in particularly the US\$); and</li> <li>▪ Slower-than-expected turnaround at the saw mill and particleboard operations.</li> </ul>
Forecasts	<ul style="list-style-type: none"> <li>▪ We are projecting Evergreen's net profit in 2015 to multiply from RM0.2m in 2014, to RM64.5-83.2m in 2015 and 2016 respectively, underpinned by: (1) Higher selling prices (arising from a stronger US\$ against the RM); (2) Higher sales mix of value added products (which yield better profit margins); and (3) Management's ongoing efforts in streamlining its operations, which we believe will further improve its cost structure.</li> </ul>
Valuation	<ul style="list-style-type: none"> <li>▪ We initiate coverage on Evergreen with a BUY recommendation and TP of RM1.47 (based on 10x average 2015-2016 EPS of 14.7 sen), providing an upside of 30%.</li> </ul>

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KLCI	1,842.9
Expected share price return	30.1%
Expected dividend return	0.0%
Expected total return	30.1%

**Share Price**

**Information**

Bloomberg Ticker	EVF MK
Bursa Code	5101
Market cap (RMm)	513
3-mth avg volume ('000)	580
SC Shariah-compliant	Yes

<b>Price Performance</b>	<b>1M</b>	<b>3M</b>	<b>12M</b>
Absolute %	13.0	65.0	109.3
Relative %	10.8	53.0	111.5

**Major Shareholders (%)**

Kuo Jen Chang	18.5
UBS AG/Hong Kong	14.2
Lembaga Tabung Haji	7.5

**Summary Earnings Table**

<b>FY Dec (RMm)</b>	<b>2014A</b>	<b>2015F</b>	<b>2016F</b>	<b>2017F</b>
Revenue	938.9	934.3	963.4	966.7
EBITDA	96.8	157.2	189.8	191.9
PBT	25.2	85.7	116.6	116.9
Net profit	0.2	64.3	86.3	86.5
Core net profit	-3.2	64.3	86.3	86.5
Core EPS (sen)	-0.6	12.5	16.8	16.9
P/E (x)	NM	9.0	6.7	6.7
BVPS (RM)	1.57	1.69	1.86	2.03
P/B (x)	0.7	0.7	0.6	0.6
ROA (%)	NM	4.8	6.0	5.6
ROE (%)	NM	7.4	9.0	8.3

## Background

**Background.** Evergreen Fibreboard is one of the top 5 producers of engineered wood-based products in Asia, which products consisting mainly Medium Density Fibreboard (MDF) and particleboard, with combined annual production capacity of more than 1.3m m<sup>3</sup>.

In addition to its MDF and particle board production lines, Evergreen owns 2 resin plants in Malaysia (which manufactures glue for its own consumption) and 4,410 acres of rubber plantation land (more than 500 acres have already been planted with rubber trees) in Kahang, Johor.

Figure 1: Evergreen's Plant Location

	Location	Products/Activities	Annual Capacity
Evergreen Fibreboard (HQ)	Batu Pahat, Johor	MDF; valued added downstream products for lamination of paper/PVC; veneer; coated/emboss & direct print; knock down furniture	250k m <sup>3</sup>
Allgreen Fibreboard	Pasir Gudang, Johor	Particleboard	120k m <sup>3</sup>
Evergreen Adhesive & Chemicals	Batu Pahat, Johor	Resin/adhesive	96k mt
Evergreen Fibreboard	Pasir Gudang, Johor	Lamination of plywood and MDF with decorative faced veneer	100m sq ft
Dawa Timber Industries	Pasir Gudang, Johor	Lamination of plywood and MDF with decorative faced veneer	24m sq ft
Evergreen Fibreboard (JB)	Masai, Johor	MDF	120k m <sup>3</sup>
Evergreen Fibreboard (Nilai)	Nilai, Negeri Sembilan	MDF	250k m <sup>3</sup>
Siam Fibreboard	Hat Yai, Thailand	MDF	570k m <sup>3</sup>
Gre Energy Co	Hat Yai, Thailand	Biomass power plant	18 MW
PT Hijau Lestari Raya Fibreboard	Palembang, Indonesia	MDF Adhesive	120k m <sup>3</sup> 60k mt
Craft Master Timber Products	Batu Pahat, Johor	Sawn timber, kiln dry products & finger jointing	N/A
Evergreen Adhesive & Chemicals (Gurun)	Gurun Kedah	Resin/adhesive	96k mt
Asoan Oak Co. Ltd	Thailand	Sawn timber & kiln dry products	N/A
Jasa Wibawa	Kahang, Johor	Rubber plantation	4,410 acres

Company

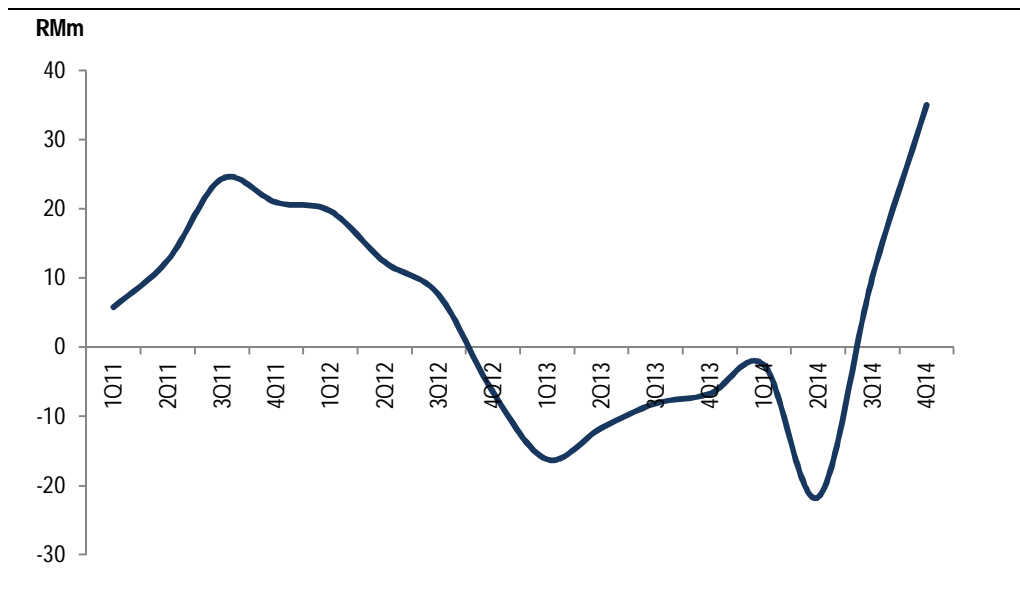
## Highlights

### A turnaround story

Evergreen's earnings started deteriorating since 2012 (and it recorded 7 consecutive quarters of net losses, see Figure 2), mainly due to several issues including: (1) Higher cost of log concessions; (2) Entrance of new MDF players and aggressive capacity expansion by existing MDF players, which have in turn resulted in oversupply of MDF in the ASEAN region; and (3) Higher crude oil prices, which have in turn resulted in high production cost (as glue is one of the major cost components in producing MDF).

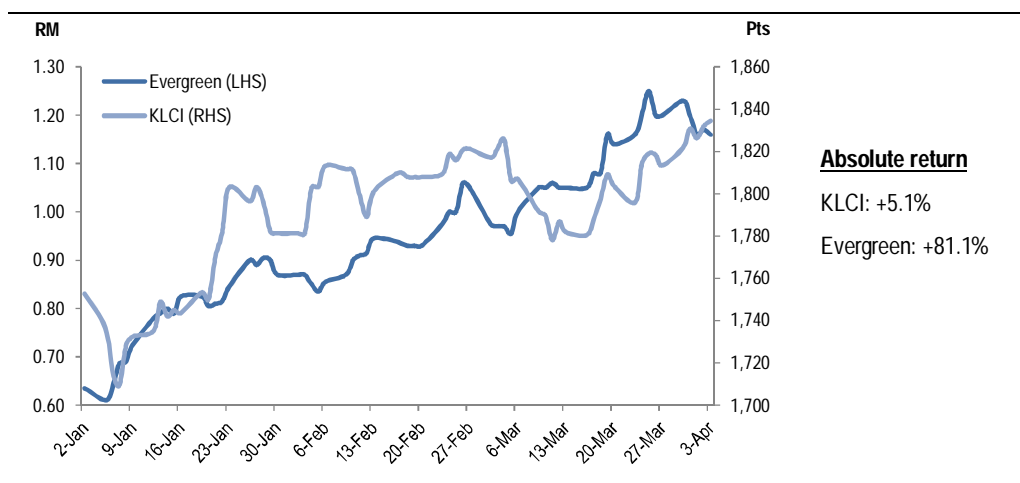
Having undergone a series of internal restructuring activities (including writing off concession cost, broadening of customer base, and plant enhancements) as well as favourable external factors (in particularly lower log and adhesive prices, and a stronger US\$), Evergreen saw its performance improving and turned profitable since 3Q14. The performance turnaround has also resulted in Evergreen's share price advancing more than 80% YTD, outperforming the market by 76%-pts (see Figure 3).

Figure 2: Evergreen's Historical Quarterly Earnings



Bursa Malaysia; HLIB

Figure 3: Evergreen's YTD Share Price Performance



Bloomberg

### **Share price performance has not fully reflected operational improvement**

We believe the strong share price performance has yet to fully reflect its true fundamentals, as we anticipate Evergreen's earnings prospects to remain bright in the near to medium term, underpinned by several factors including:

1. Management's ongoing efforts to improve operational efficiencies and financial performance will only be gradually reflected in the next 1-2 years;
2. Lower raw material costs, in particularly, log and adhesive prices (which collectively account for 55-65% of the production cost of MDF); and
3. Strong US\$, which is beneficial to Evergreen's bottomline as it derives 65-70% of its revenue from export sales.

### **Ongoing efforts to improve operational efficiencies and financial performance**

In respond to the increasingly competitive market, the management of Evergreen has undergone a series of plant enhancement projects and diversified its product range (to the downstream segment (which has better profit margins and less susceptible to price competition) since 2013. We note that several of these measures have yet to be reflected in its 2014 earnings and these include:

1. Consolidation of MDF operations, by relocating one of its operations in Johor to its plant in Indonesia, which will result in cost savings of RM6m p.a.;
2. Restructuring of its sawmill operations by shifting its focus from raw sawn to semi-finished products and rearranging the plant layout (which will result in output increasing by 300%); and
3. Upgrading its particleboard operations in Segamat, Johor.

### **Low raw material prices – a boon to Evergreen's cost structure**

We understand that the prices of rubber log wood and adhesives (the major cost components in producing MDF, accounting for 55-65% of the total production cost) are dependent on the price movements of rubber and crude oil.

Hidde Smit (former secretary general of the International Rubber Study Group) projects world demand for natural rubber to slow through 2016, on the back of subdued demand prospects in China (the world's largest rubber importer) and the surge in new planting between 2005 and 2011 (which will continue to boost world rubber supply). As for the crude oil price outlook, HLIB's oil and gas analyst projects that any rebound in crude oil price will likely be gradual (and will unlikely return back to US\$100/bbl level), given the structural change in supply.

Hence, we expect the prices of both rubber log wood and adhesive to remain stable (and lower vs. 2014) in the foreseeable future, which, in turn bodes well for Evergreen's cost structure.

### **A beneficiary of strong US\$**

We note that Evergreen is a beneficiary of a stronger US\$, as exports sales accounted for 65-70% of Evergreen's total revenue in 2014 (and majority of the export sales are denominated in US\$).

In our forecasts, we are using a US\$:RM assumption of RM3.50/US\$ for 2015-2016 (in line with HLIB's in-house assumption) vs. current exchange rate of RM3.63/US\$. This means a significant boost to its 2015 earnings. Our sensitivity analysis indicates that every RM0.10/US\$ appreciation will boost Evergreen's 2015 net profit by 9%.

## Risks

The risks include:

1. Escalating raw material prices and labour costs;
2. Slower-than-expected demand for MDF;
3. Fluctuating foreign currency movement (in particularly the US\$); and
4. Slower-than-expected turnaround at the sawmill and particleboard operations.

## Earnings Forecasts

We are projecting Evergreen's net profit in 2015 to multiply from RM0.2m in 2014, to RM64.5-83.2m in 2015 and 2016 respectively, underpinned by: (1) Higher selling prices (arising from a stronger US\$ against the RM); (2) Higher sales mix of value added products (which yield better profit margins); and (3) Management's ongoing efforts in streamlining its operations, which we believe will further improve its cost structure.

### Healthy balance sheet

As at 31 Dec 2014, Evergreen's net debt and net gearing stood at RM222.4m and 0.28x respectively, and we project its net gearing to stay below 0.3x over the next 2 years, underpinned by the absence of lumpy capex in the near future (as bulk of the lumpy capex has already been incurred over the past few years).

## Valuation & Recommendation

### Initiate coverage with BUY recommendation and TP of RM1.44

We initiate coverage on Evergreen with a **BUY** recommendation and TP of RM1.47 (based on 10x average 2015-2016 EPS of 14.7 sen), providing an upside of 30%. We note that our TP of RM1.47 has yet to reflect the value of its 4,410 acres of rubber plantation land, which could worth as much as RM40m (or 7.8 sen/share), assuming an estimated planted land bank of 500 acres is valued at RM42k/acre (in line with the current asking prices for such land in the similar area) and the remaining unplanted land bank is valued at RM5k/acre.

## Financial Projections

## Income Statement

FY Dec (RMm)	2013A	2014A	2015F	2016F	2017F
Revenue	938.7	938.9	934.3	963.4	966.7
EBITDA	19.3	96.8	157.2	189.8	191.9
PBT	-49.0	25.2	85.7	116.6	116.9
Taxation	3.9	-2.9	-15.4	-23.3	-23.4
PAT	-45.2	22.3	70.3	93.3	93.5
Minority interests	2.4	-1.5	-6.0	-7.0	-7.0
Reported net profit	-42.8	0.2	64.3	86.3	86.5
Core net profit	-42.1	-3.2	64.3	86.3	86.5
Issued shares (m)	513.0	513.0	513.0	513.0	513.0
Basic EPS (sen)	-8.3	0.0	12.5	16.8	16.9
Core EPS (sen)	-8.2	-0.6	12.5	16.8	16.9

## Balance Sheet

FY Dec (RMm)	2013A	2014A	2015F	2016F	2017F
Non-current assets	875.6	850.9	814.5	776.3	736.3
Current assets	411.2	408.2	524.3	660.0	793.9
Assets held for sale	0.0	4.1	4.1	4.1	4.1
Total assets	1,286.8	1,263.3	1,342.9	1,440.4	1,534.4
Current liabilities	399.8	380.7	390.0	394.2	394.6
Non-current liabilities	78.4	49.0	49.0	49.0	49.0
Liabilities held for sale	0.0	0.2	0.2	0.2	0.2
Equity	786.2	804.7	869.0	955.3	1,041.8
Minority interests	22.4	28.7	34.7	41.7	48.7
Equity & liabilities	1,286.8	1,263.3	1,342.9	1,440.4	1,534.4

## Quarterly Financial Summary

FY Dec (RMm)	4Q13	1Q14	2Q14	3Q14	4Q14
Revenue	252.0	239.5	215.8	234.5	249.1
Gross profit	35.4	38.1	20.3	56.6	72.1
PBT	-8.1	-2.9	-21.6	12.0	37.7
Taxation	4.9	-0.3	-0.4	-1.4	-0.7
Minority interests	-3.5	0.6	0.3	-0.5	-2.0
Reported net profit	-6.7	-2.6	-21.7	10.1	35.0
Effective tax rate (%)	0.6	-0.1	0.0	0.1	0.0
Reported EPS (sen)	-1.3	-0.5	-4.2	2.0	6.8

## Valuation Ratios

FY Dec (RMm)	2013A	2014A	2015F	2016F	2017F
Core EPS (sen)	-8.2	-0.6	12.5	16.8	16.9
P/E (x)	NM	NM	9.0	6.7	6.7
BVPS (RM)	1.53	1.57	1.69	1.86	2.03
P/Book (x)	0.7	0.7	0.7	0.6	0.6
Net gearing (x)	0.36	0.28	0.16	0.01	-
EBITDA margin (%)	2.1	10.3	16.8	19.7	19.8
PBT margin (%)	NM	2.7	9.2	12.1	12.1
Core net margin (%)	NM	NM	6.9	9.0	9.0
ROA (%)	NM	NM	4.8	6.0	5.6
ROE (%)	NM	NM	7.4	9.0	8.3
Effective tax rate (%)	7.9	11.4	18.0	20.0	20.0

## Cash Flow

FY Dec (RMm)	2013A	2014A	2015F	2016F	2017F
Operating cash flow	46.1	84.9	122.1	159.2	167.7
Investing cash flow	-37.3	-15.9	-35.0	-35.0	-35.0
Financing cash flow	-41.1	-54.0	0.0	0.0	0.0
Cash at begin	79.6	55.5	70.1	157.2	281.4
Cash at end	52.5	70.6	157.2	281.4	414.0
OCF/share (sen)	9.0	16.6	23.8	31.0	32.7
FCF/share (sen)	1.7	13.5	17.0	24.2	25.9

## Key Assumptions

	2015F	2016F	2017F
RM:US\$	3.5	3.5	3.5
MDF production capacity ('000 tonnes)	1,270.0	1,270.0	1,270.0
MDF utilisation rate (%)	77.1	79.8	80.2

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<b>TRADING BUY</b>	Positive recommendation of stock not under coverage. Expected absolute return of more than +10% over 6-months. Situational or arbitrage trading opportunity.
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<b>NEUTRAL</b>	The sector, based on weighted market capitalization, is expected to have absolute return between -5% and +5% over 12-months.
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