

# Euro Holdings

Recommendation: **HOLD**

Stock Code: 7208

Bloomberg: EUHO MK

Price: MYR0.63

12-Month Target Price: MYR0.70

Date: December 6, 2007

**Board:** Second

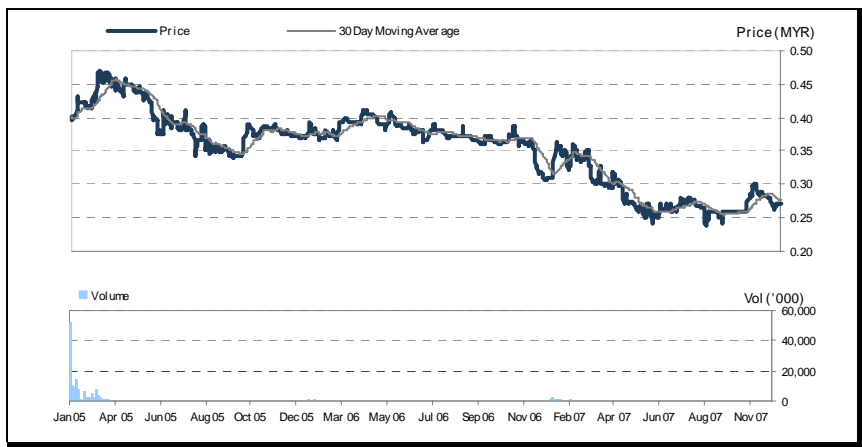
**Sector:** Consumer Products

**GICS:** Industrials/Office Services & Supplies

**Market Value - Total:** MYR50.6 mln

**Summary:** Listed on the Second Board of Bursa Malaysia in Jan. 2005, Euro Holdings (Euro) is principally a manufacturer of office furniture, focusing on office chairs and office system furniture that are sold under the brand names of 'Euro' and 'Euro Chairs'.

**Analyst:** Sharon Wong, CFA



## Highlights

- Euro is seeing good demand for its products and it is operating at relatively high utilization rates (averaging 80+% for the year). Following a weak 2006, we project a two-year net profit CAGR of 27% driven by revenue gains of 8% and a gradual recovery in margins.
- To help offset margin pressures, Euro raised selling prices (by about 5%) in mid 2007 and is looking at another round of price increases in 1Q08. In addition, it is focusing on improving productivity as well as introducing new products to cushion any negative impact on margins.
- While both its domestic and export markets have been increasing, we believe that export growth is likely to outpace domestic sales growth over the medium term given the group's continued overseas expansion drive. Exports accounted for 65% of revenue in 2006 and management targets them to increase to 80% over time.

## Investment Risks

- Risks to our recommendation and target price include escalating raw material prices and an appreciating MYR. In addition, future growth would hinge on Euro's ability to continue to secure new projects and replenish its order book.

## Recommendation

- We maintain our Hold recommendation with an unchanged 12-month target price of MYR0.70.
- Although Euro's earnings multiples are not demanding, raw material cost pressure concerns and the impact of the Ringgit appreciation on export margins could cap near-term price gains. Nonetheless, we find the dividend yields decent, which should offer share price support.
- Our target price continues to be based on relative valuation. We have maintained our target 2008 PER multiple of 7.5x and target 2007 P/NTA multiple of 0.8x and continue to attach a 10% discount to our relative valuation. The discount reflects the stock's low liquidity as well as earnings risks we see associated with raw material cost pressures and the appreciation in the MYR.

### Key Stock Statistics

FY Dec.	2006	2007E
Reported EPS (sen)	6.9	10.6
PER (x)	9.1	5.9
Dividend/Share (sen)	2.8	3.2
NTA/Share (MYR)	0.76	0.84
Book Value/Share (MYR)	0.76	0.84
No. of Outstanding Shares (mln)	81.0	
52-week Share Price Range (MYR)	0.55 - 0.84	
Major Shareholders:	%	
Lew Fatt Sin	22.2	
Dato' Mohd Haniff bin Abd Aziz	15.0	

### Per Share Data

FY Dec.	2004	2005	2006	2007E
Book Value (MYR)	0.61	0.71	0.76	0.84
Cash Flow (sen)	17.2	12.5	10.3	14.3
Reported Earnings (sen)	13.7	9.0	6.9	10.6
Dividend (sen)	0.0	3.5	2.8	3.2
Payout Ratio (%)	0.0	28.4	29.7	22.1
PER (x)	4.6	7.0	9.1	5.9
P/Cash Flow (x)	3.6	5.0	6.1	4.4
P/Book Value (x)	1.0	0.9	0.8	0.7
Dividend Yield (%)	0.0	5.6	4.5	5.1
ROE (%)	NA	15.2	9.4	13.2
Net Gearing (%)	0.0	0.0	2.0	0.0

\* 2004 is for the period from Mar. 24, 2004 to Dec. 31, 2004

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## Business

Euro manufactures ergonomic seating and office system furniture for the mid- to higher-end office furniture market segment. Its products can be placed into two broad categories – chairs and system furniture – and are mostly sold under its own brand names of 'Euro' and 'Euro Chairs'. Approximately 55%-60% of Euro's revenue is derived from office system furniture with the balance from office chairs.

The bulk (>80%) of its business is project-based. Major projects completed in 2006 include SAP Labs, Tata Consultancy Services and Satyam Computers Services in India and ConocoPhillips (COP US, US\$79.71, Buy) in Indonesia.

Exports accounted for 65% of revenue in 2006 and management targets to increase this to 80% over time. Although export margins are slightly lower than margins from domestic sales, payment terms are typically better for exports, resulting in better cash flow. Euro's export markets include India (~45% of exports), Singapore (~15%-16%), Japan, Indonesia, Philippines, Vietnam, Middle East, U.S. and Europe.

Euro recently clinched a distribution agreement with Rosemount Office Systems to design, supply and manufacture a range of system furniture and components for Rosemount. The agreement is for a period of five years with a minimum value of US\$12.5 mln. Rosemount is a registered supplier with the U.S. government and Euro's products are in the midst of being registered with the government. Management expects to commence delivery to Rosemount in March/April of 2008.

Meanwhile, its agreement to manufacture and supply a range of modular workstation for Godrej & Boyce in India is progressing well, in our opinion. The agreement has an estimated value of MYR12 mln to MYR24 mln p.a. and Euro is currently supplying above the minimum amount.

Euro's third plant in Rawang was completed at the end of 2006, and the first phase of this expansion raised production capacity by about 50%. With its plants currently operating at a high average utilization rate of 80+%, and 100% during peak periods, it is looking at the second phase of its expansion in the third plant. Construction of the second phase is expected to start in 2H08 with the new capacity coming on stream in 2009. Construction of the building is estimated to cost MYR4mln to MYR6 mln, with an additional MYR1 mln to MYR 2mln for machinery.

## Earnings Outlook

Euro's net profit contracted by 22.6% YoY in 2006 despite a 7.3% YoY growth in revenue due to: (i) higher raw material prices; (ii) stiffer competition; (iii) rework required for some of its orders during 3Q06; and (iv) a strengthening MYR.

Euro's main raw materials include steel, aluminum, fabric, wooden frames, chipboard, plastic components and foam. It is currently facing cost pressures from rising steel and aluminum cost. In addition, the appreciation in MYR impacts export revenue in MYR terms.

To help offset margin pressures, Euro raised selling prices (by about 5%) in mid 2007 and is looking at another round of price increase in 1Q08. In addition, it is focusing on improving productivity as well as introducing new products to cushion any negative impact on margins.

3Q07 was an extremely strong quarter for Euro, aided by contribution from major projects. 3Q07 revenue rose 34.5% YoY and 27.5% QoQ with strong performance from the export market. On a cumulative basis, 9M07 revenue was up 36.2% YoY on the back of a 40.3% and 34% growth in domestic and export sales respectively.

However, despite the mid-2007 price increase, gross margin declined QoQ to 24.2% in 3Q07 from 29.1% in 2Q07 due to contribution from major projects with lower margins in the quarter.

Euro is seeing good demand for its products and it is operating at relatively high utilization rates (averaging 80+% for the year). Following a weak 2006, we project a two-year net profit CAGR of 27% driven by revenue growth of 8% and a gradual recovery in margins. We expect the effective tax rate to increase to 21% in 2008 from 17% expected in 2007 as reinvestment allowances are utilized.

While both its domestic and export markets have been growing, we think that export growth is likely to outpace domestic sales growth over the medium term given the group's continued overseas expansion drive.

## Valuation

Our 12-month target price of MYR0.70 (unchanged) is based on a combination of PER and P/NTA multiples. We attach a 10% discount to reflect the stock's low liquidity as well as earnings risks we see associated with raw material cost pressures and the appreciation in the MYR. We apply a target 7.5x PER multiple to 2008 earnings and a target P/NTA multiple of 0.8x to 2007 NTA to arrive at our target price. Our target price also includes projected net DPS.

Recommendation: **HOLD**

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**Profit & Loss**

FY Dec. / MYR mln	2005	2006	2007E	2008E
Reported Revenue	88.0	94.5	118.6	128.1
Reported Operating Profit	9.4	7.4	10.9	11.9
Depreciation & Amortization	-2.8	-2.7	-3.0	-3.2
Net Interest Income / (Expense)	-0.4	-0.3	-0.5	-0.4
Reported Pre-tax Profit	8.8	6.9	10.3	11.3
Effective Tax Rate (%)	18.5	19.3	17.0	21.0
Reported Net Profit	7.2	5.6	8.6	8.9
Reported Operating Margin (%)	10.7	7.9	9.2	9.3
Reported Pre-tax Margin (%)	10.0	7.3	8.7	8.8
Reported Net Margin (%)	8.2	5.9	7.2	7.0

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

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**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.

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**Recommendation and Target Price History**

Date	Recommendation	Target Price
30-Nov-07	Hold	0.70
4-Sep-07	Hold	0.68
11-Jun-07	Hold	0.62
20-Mar-07	Hold	0.75
28-Feb-07	Hold	0.82
29-Nov-06	Sell	0.80
27-Jun-06	Sell	0.83
27-Feb-06	Sell	0.81
20-Dec-05	Sell	0.78

