

## Leader Universal Holdings

Recommendation: **BUY**

Stock Code: 4529

Bloomberg: LUH MK

Price: MYR0.32

12-Month Target Price: MYR0.37

Date: October 17, 2005

Board: Main

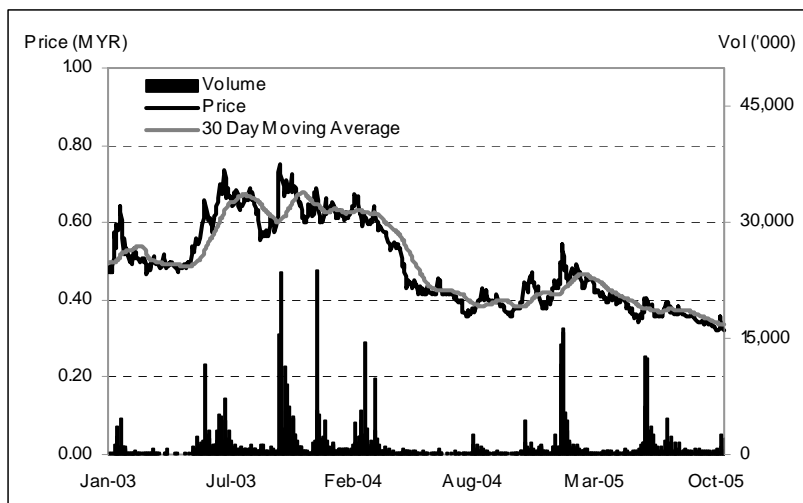
Sector: Industrial Products

GICS: Industrials / Electrical Components &amp; Equipment

Market Capitalization: MYR139.7 mln

**Summary:** Leader Universal Holdings (Leader) is an investment holding company, which, through its subsidiaries, is primarily engaged in the business of manufacturing and selling power and telecommunication cables and wires, power generation, and property development.

Analyst: Alexander Chia, ACA



## Highlights

- Leader is finally beginning to emerge from several years in the financial doldrums following the group's mistimed US\$100 mln Euro bond issue in 1997 and several failed overseas business forays.
- To its credit, Leader has met all debt obligations and the group in our opinion is now substantially leaner following a restructuring program involving a staff retrenchment exercise, disposals of non-core and under-performing business units and other substantial write-offs to rehabilitate its balance sheet, culminating in a MYR98 mln net loss in 2003. At end-1H05, net gearing was 133% and net interest cover a manageable 3.5x.
- Leader's re-focus on its core business has begun yielding dividends, with 1H05 revenues up 22% YoY and 10% HoH. Its cables and wires and power generation divisions will be the mainstay for earnings going forward.

## Investment Risks

- Risks to our recommendation and target price include the weakening of the MYR against the US\$, a higher interest rate environment, an unexpected slowdown in orders for cables and wires, the continued unfavorable investor perception of the company and the presence of stale bulls.

## Key Stock Statistics

FY Dec.	2004	2005F
EPS (sen)	3.5	4.6
PER (x)	9.2	6.9
Dividend/Share (sen)	0.0	0.0
NTA/Share (MYR)	0.77	0.82
Book Value/Share (MYR)	0.77	0.82
Issued Capital (mln shares)	436.5	
52-week Share Price Range (MYR)	0.32 - 0.545	
Major Shareholders:	%	
Zun Holdings Sdn Bhd	11.7	
Employees Provident Fund	5.4	
Dato' Chung Chin Fu	5.4	

## Recommendation

- We initiate coverage with a Buy recommendation on the basis of our 12-month target price of MYR0.37, which offers an upside of 15.6%.
- Our target price is calculated using the sum-of-parts method, by ascribing a 2006 PER of 8.0x to cable and wire division earnings and estimating the present value of earnings from its 60%-owned power generation business. We have conservatively not ascribed any value to its property division, which will not have any active projects after mid-2006.
- The worst appears to be over for Leader. Demand for power and telecommunication cables and wires is reported to be firm, buoyed by both local demand as well as export sales. It currently has a MYR500 mln order book excluding recurring orders and is in the running for a further MYR1.8 bln of orders.
- Leader's organizational restructuring has resulted in a more efficient entity enjoying lower production break-even levels. Additional kickers to future earnings could come from the expansion of its power generation business and the focus on developing higher value added products yielding better margins.
- Leader is a candidate for an injection of fresh equity although management admits that this will be difficult to achieve in the near term given unfavorable market conditions.

## Per Share Data

FY Dec.	2002	2003	2004	2005F
Book Value (MYR)	1.00	0.76	0.77	0.82
Cash Flow (sen)	15.7	-12.9	11.6	13.1
Earnings (sen)	5.7	-22.5	3.5	4.6
Dividend (sen)	0.0	0.0	0.0	0.0
Payout Ratio (%)	0.0	0.0	0.0	0.0
PER (x)	5.7	NM	9.2	6.9
P/Cash Flow (x)	2.0	NM	2.8	2.4
P/Book Value (x)	0.3	0.4	0.4	0.4
Dividend Yield (%)	0.0	0.0	0.0	0.0
ROE (%)	5.7	-29.7	4.5	5.6
Net Gearing (%)	109.6	134.3	128.8	126.1

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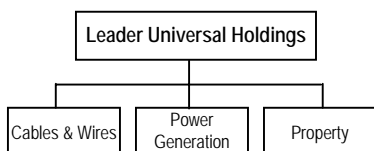
## Background

### Corporate Profile

Leader was established to implement a merger between Leader Cable and Universal Cable in 1990. Its core business is the manufacture of power and telecommunication cables, but branched out into power generation in 1997 after taking a 60% stake in an independent power producer (IPP) located in Cambodia. Leader also dabbles in property development on a small scale.

The H'ng Family owns an 11.7% stake in the company. Family patriarch Dato' Seri H'ng Bok San is Executive Deputy Chairman. His son Sean H'ng (CEO and MD) and daughter Jessica H'ng are members of the Board. The H'ng family also controls Bursa Malaysia Main Board-listed printed circuit board manufacturer GUH Holdings Bhd (GUH MK, Not Ranked).

### Corporate Structure

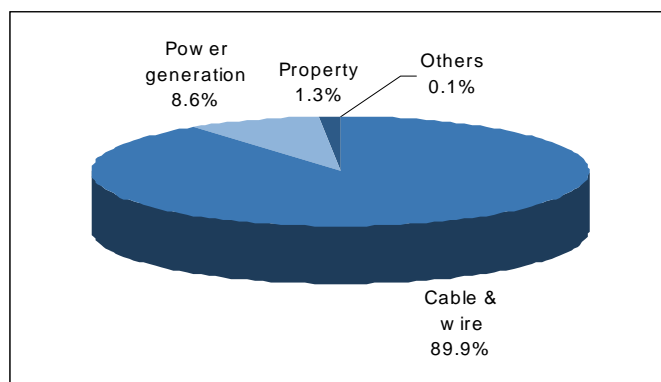


Source: Company data

### Business

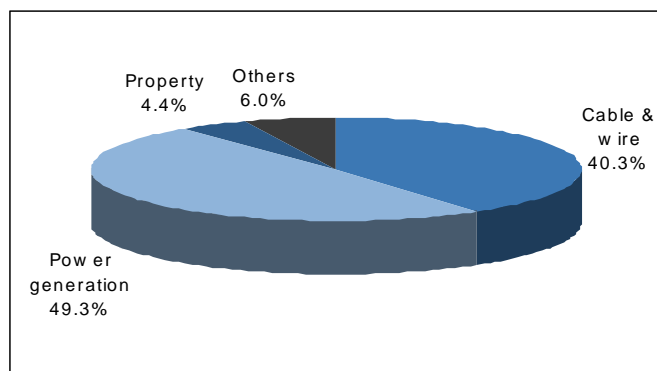
Leader has three main business divisions focused on the manufacture of cables and wires, power generation and property development.

### 1H05 Revenue Breakdown



Source: Company data

### 1H05 Operating Profit Breakdown



Source: Company data

### Cables and wires division

Leader is thought to be the largest integrated cable manufacturer in the Asean region. Leader operates four manufacturing plants in Penang, Kedah and Johor. It purchases base copper cathodes and aluminium ingots, which are melted and drawn into rods and then further into wires before being stranded into cables. In 1H05 approximately 56% of revenues were derived from the sale of intermediate products, in the form of aluminium and copper rods to other downstream cable and wire manufacturers. A wide variety of cables are manufactured for power and telecommunication applications containing aluminium as well as copper cores. Power cables comprised 29% of revenues in 1H05 while telecommunication cables made up 8%.

Sales to the public sector, which includes Telekom (T MK, Not Ranked) and Tenaga Nasional (TNB MK, Buy) formed 13% of 1H05 revenues, while exports made up 26%. Key local customers include Telekom and Tenaga, while top export customers include CEB of Sri Lanka and Olex of Australia. Management estimates that Leader currently enjoys a 30% share of the domestic power cable market and between 30-35% share of the market for telecommunications cables.

Leader's cable manufacturing facilities currently operate around the clock on three shifts daily, and management estimates overall utilization rates at between 70-80%. Pricing is typically on a cost plus basis given the volatility of base metal prices recently. Leader has managed to pass through higher raw material costs, given the sharp 66% and 22% rise in LME copper and aluminium prices respectively since Jan. 2004.

Management reports an existing order book of MYR500 mln and is bidding for a further MYR1.8 bln of new contracts.

### Power generation division

Leader owns a 60% stake in Cambodia Utilities Pte Ltd, which operates a 35MW diesel / distillate-fired plant. The electricity generated by the IPP is sold to Electricite du Cambodge (EDC), a government energy utility, via an 18-year Power Purchase Agreement (PPA) expiring in 2015, on a "take or pay" basis. It enjoys a fuel pass-through clause insulating it from the recent oil price increases.

### Property development

Leader is currently undertaking two property development projects located on Penang Island:

**Leader Garden Phase B:** This comprises 67 units of 2 and 3 storey terraced, semi-detached and bungalow homes, located in Tanjung

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Bungah. The estimated gross development value (GDV) is MYR40 mln. Completion is scheduled for Jun. 2006. Its landbank in this area has been exhausted.

**Mayfair Super Condominium:** Located along Penang's "Millionaire Row", this 29-storey, single block of 49 super premium condominium units averages 5,000 sf in size with selling prices starting from MYR2 mln per unit. The GDV is estimated at MYR90 mln with 60% sold to date. The development is also scheduled for completion by Jun. 2006.

**Other:** Leader owns 89 acres of freehold development land on the mainland in Prai for which no firm development plans have yet been announced.

### Earnings Outlook

Going forward, demand will be supported by Leader's position as a supplier of intermediate products to downstream cable and wire manufacturers. We understand from management that Tenaga's cable purchases are awarded on a negotiated basis, split equally between three consortia, one of which Leader is leading, claiming about 70% of that consortium's share of orders from Tenaga. Given that Tenaga spends an average of MYR4 bln on capex annually, of which it is estimated that MYR500-600 mln is on power cables, we estimate that Leader will enjoy recurring annual power cable orders from Tenaga alone amounting to between MYR117-140 mln.

Although domestic fixed line subscriber growth has stagnated recently as a result of cannibalization from cellular services, new residential neighborhoods continue to be developed which will eventually need to be served by fixed line telephone services requiring laying of new cable. Other demand drivers include the government's emphasis on improving broadband penetration, which according to the Malaysian Communications and Multimedia Commission (MCMC) stands at just 1.35% as at mid-2005, could lead to increased demand for xDSL compatible copper cables given that the bulk of the broadband access technology in Malaysia is xDSL over copper.

Going forward, management is looking to raise exports to 40% of revenues from 26% currently. Management is also looking at options to expand the generating capacity of its Cambodian IPP, which could be put in place in less than 12 months given the existing plant infrastructure.

We are forecasting revenue growth of 19% and 6% in 2005 and 2006 respectively driven by its cable division. Power generation's revenue increase of 11.6% for 2005 reflects fuel cost pass through.

Operating margins are expected to expand to 4.8% and 5% in 2005 and 2006 respectively (from 3.7% in 2004) on the back of economies of scale and higher operating leverage couple with an overall improvement in Leader's cost structure and organizational efficiencies. Finance costs continue to be a drag on earnings at over MYR28 mln pa for the next two years. Effective tax rates are estimated to be in the low 20's.

Net profit is forecast at MYR20.1 mln and MYR22.8 mln for the two forecast years.

### Valuation

Our 12-month target price of MYR0.37 has been derived using the sum of parts method, by ascribing a 2006 PER of 8.0x to cable and wire division earnings and estimating the present value of earnings from its 60%-owned power generation business. We have conservatively not ascribed any value to its property division, given that its two existing projects will be completed by mid-2006 with no plans announced for the development of its remaining landbank.

In our view risks could include a weakening of the MYR against the US\$ and higher interest rates which could affect Leader's ability to repay and service its Euro bond obligation of which US\$62 mln remains outstanding. Leader should have sufficient funds and capital lines in place to fully redeem the Euro bonds by 2007. Other risks to our share price and recommendation include weak investor perception and the possible presence of stale bulls.

We think Leader is a candidate for an injection of fresh equity to recapitalize its balance sheet and remove or reduce its existing debt burden. However, this may not be achieved in the near term as a result of unfavorable market conditions and its share price discount to par value.

At our target price, Leader's implied 2006 PER is 7.1x, which we are comfortable with, considering its healthy 2004-2006 net profit CAGR of 23% on the one hand and its fragile balance sheet on the other.

### Comparative Valuation

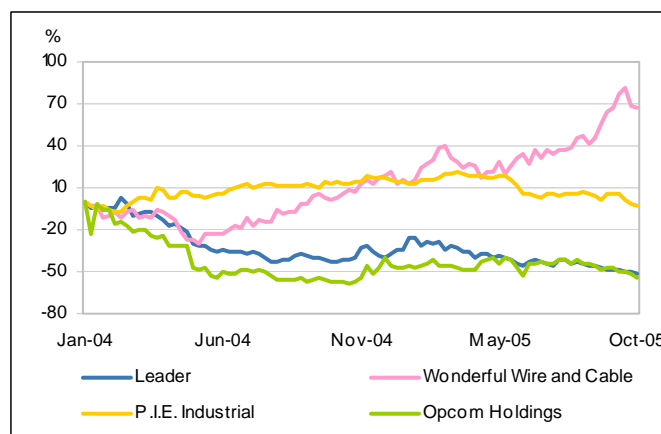
	Leader	WWC	PIE	Opcom*
Share Price (MYR) @ Oct. 11, 05	0.345	0.650	2.02	0.865
Mkt. Cap (MYR mln)	150.6	28.4	125.3	111.6
Ave. Daily Vol. ('000)	635	11	4	81
PER FY03 (x)	NM	70.6	16.3	5.6
PER FY04 (x)	9.9	6.2	11.1	4.3
P/NTA	0.5	0.4	0.9	1.3
Yield (%)	0.0	0.0	5.9	9.3

\* OPCOM PER is for FY04 (Mar.) and FY05 (Mar.)

WWC = Wonderful Wire and Cable (WWC MK, Not Ranked), PIE = P.I.E. Industrial (PIE MK, Not Ranked), Opcom = Opcom Holdings (OHB MK, Buy)

Source: Bloomberg, Company data

### Relative Share Price Performance of Comparables



Source: Bloomberg, S&P Equity Research

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**Recent Developments**

Aug. 2005: Leader announces 1H05 results with revenues rising 22% YoY to MYR733.3 mln, pretax profits 51% higher at MYR21.1 mln and net profit 5% lower YoY to MYR9.0 mln. Net profits were lower as a result of a deferred tax write back and lower effective tax rates in 1H04.

Jun. 2005: Leader announces the sale of a combined 70% stake in 75% subsidiary Leader Optic Fibre Cable Sdn Bhd (LOFC) to Bumiputra shareholders for a total of MYR2.6 mln.

**Profit & Loss**

FY Dec. / MYR mln	2003	2004	2005F	2006F
Revenue	1,009.2	1,267.7	1,508.0	1,595.0
Operating Profit (EBIT)	-70.8	46.4	71.9	80.2
Depreciation	-42.0	-35.4	-37.0	-34.7
Net Interest Income / (Expense)	-21.4	-23.2	-29.7	-28.8
Pretax Profit	-92.2	25.4	45.4	54.2
Effective Tax Rate (%)	3.1	-7.4	20.8	22.1
Net Profit	-98.1	15.2	20.1	22.8
Operating Margin (%)	-7.0	3.7	4.8	5.0
Pretax Margin (%)	-9.1	2.0	3.0	3.4
Net Margin (%)	-9.7	1.2	1.3	1.4

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

**Balance Sheet**

FY Dec. / MYR mln	2002	2003	2004
Total Assets	1,422.4	1,183.1	1,216.5
Fixed Assets	601.9	500.1	454.9
Current Assets	693.0	599.6	705.2
Other LT Assets	127.5	83.4	56.4
Current Liabilities	442.6	425.7	493.5
LT Liabilities	422.6	336.7	290.8
Share Capital	436.5	436.5	436.5
Shareholders' Funds	436.0	330.1	336.6

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

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**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.

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