ZJ advisory

Investment Research for CMDF – Bursa Research Scheme

INITIATING COVERAGE

1 June 2006

Leader Universal Holdings Bhd

Stock Code: 4529

Price :	**RM0.395**
Market Capitalisation :	**RM172.4m**
Board :	**Main**
Sector :	**Industrial Products**
Recommendation :	**HOLD**

Key Stock Statistics	**FY05**	**FY06F**
FYE Dec		
EPS (sen)	5.8	6.4
P/E (x)	6.8	6.3
Dividend/Share (sen)	-	
NTA/Share (RM)	0.81	
Book Value/Share (RM)	0.81	
Issued Capital (mil shares)	436.5	
52-week Hi-Low (RM)	0.295-0.47	

Major Shareholders:	**%**
Zun Holdings Sdn Bhd	11.7
Employee Provident Fund	5.4
Dato' Chung Chin Fu	5.4

Per Share Data	**FY03**	**FY04**	**FY05**
Book Value (RM)	0.76	0.77	0.79
Cash Flow (sen)	12.3	8.1	11.9
Earnings (sen)	(22.5)	3.5	5.0
Dividend (sen)	-	-	-
Payout Ratio (%)	-	-	-
PER (x)	n.a.	10.4	7.3
P/Cash Flow (x)	2.6	3.9	3.1
P/Book Value (x)	0.4	0.4	0.5
Dividend Yield (%)	-	-	-
ROE (%)	(29.7)	4.5	6.3
Net Gearing (%)	134.3	116.9	103.4

***P&L Analysis** (RM mil)*

FYE: Dec	**FY03**	**FY04**	**FY05**	**FY06F**
Revenue	1009.2	1267.7	1606.9	2182.2
Operating Profit	(70.8)	44.2	74.3	89.5
Depreciation	(41.4)	(34.9)	(33.1)	(25.0)
Interest Expenses	(21.4)	(23.2)	(28.2)	(36.2)
Pre-tax Profit	(92.2)	25.4	46.9	56.4
Effective Tax Rate (%)	3.6	-7.4	20.8	15.0
Net Profit	(98.1)	15.2	21.8	27.8
Operating Margin (%)	(7.0)	3.7	4.7	4.1
Pre-tax Margin (%)	(9.1)	2.0	2.9	2.6
Net-Margin (%)	(9.7)	1.2	1.4	1.3

1. Investment Highlights / Summary

- **Revenue and net profit showing steady upward trend.** We believe that Leader has emerged from its worse performing years. Its losses in year 2003 were mainly due to allowances/ impairments in relation to operating assets and other write-downs.
- **Higher margins from Cable and Wire division.** Operating margin rose from 3.7% to 4.7% between 2004 and 2005, implying improvements in revenue mix and pass-through of higher raw material costs. Better operational efficiencies also contributed to a YOY marginal improvement in net profit margin from 1.2% to 1.4%.
- **Highly experienced and capable management team steering Leader.** This is evident in the steady revenue growth especially in the cable and wire division - generally considered a highly competitive business. FY05 net profit improved by 44% from RM15.2m (FY04) to RM22.4m (FY05)
- **Predominantly exposed to local market which has little growth prospects.** Uninteresting growth prospects in Leader's commodity business of cables and wires, supplying to major local utility companies. Exports will be at the expense of margin erosion due to cost structures.
- **Initiating coverage with HOLD call.** With commodity-linked business, we believe margins will continue to be thin, and business growth will have to come from exports market. We are initiating our coverage with a hold call and fair value of RM0.43.

2. Background

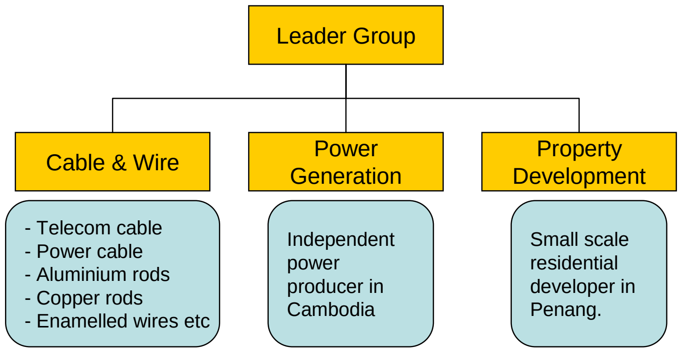
One of the largest integrated cable and wire players in the ASEAN region

Leader Universal Holdings Bhd (Leader) is the leader in wire and cable industry in Malaysia with the largest capacity and revenue in excess of RM1b every year. It is also one of the largest players in this segment in the ASEAN region. In addition, the Group has interest in power generation business (in Cambodia) and property development in Penang.

Actively streamlining & rationalizing activities after the Asian financial crisis

The Group was hit by losses and huge debts (particularly the US100m Eurobond) during the 1997 Asian financial crisis. Over the next few years, the Group has actively rationalized its non-core and non-profitable businesses to consolidate and focus on its core operations. With the exception of losses in FY03 due to allowances and impairments in relation to operating assets and other write-downs, the Group has returned to black since FY00 and margins have been inching gradually. Since 2004, the Group has repaid as well as bought back partially its outstanding Eurobond to save on interest and additional premium payable. Current remaining exposure is approximately USD17.7m.

Business divisions



Source: Leader Universal Berhad

Leader's main divisions:-

<u>Cable and Wire division:</u>

- **Diversified products**. Leader manufactures and sells telecommunication and power cables, aluminium rods, copper rods, and optical fibre cables.

- **Strong local clientele.** Telekom and Tenaga Nasional are Leader's largest clients in Malaysia. Sales to Telekom and Tenaga constituted 15% of the RM1.6b revenue from the cable and wire division in FY05. The award of contracts by Tenaga is on a consortium basis, i.e. the grouping of cable companies into three groups or consortia. It is understood that the award of contracts are on an equitable basis amongst the three consortia. Total of 49% of revenue for FY05 came from the domestic private sector.

- **Overseas market penetration.** More than 30% of cable and wire division revenue comes from exports to over 30 countries in Europe, the Middle East, Africa, South India, ASEAN and the Asia Pacific region. However, the export business is generally more competitive, hence carries lower margins and higher volatility.

Power generation:

- **IPP in Cambodia.** Leader's 60%-owned subsidiary, Cambodia Utilities Pte. Ltd (CUPL) was incorporated in 1994 to develop a 35MW diesel engine heavy-fuel oil-fired power generating plant on a build-operate-transfer basis in Cambodia.

  The electricity generated is sold to Electricite du Cambodge (EDC), a department of the Ministry of Industry, Mines and Energy (MIME) in Cambodia. This is the first Independent Power Producer (IPP) contract to be awarded by the Government of Cambodia, which also makes CUPL the first Malaysian-owned company to successfully venture into the country's power industry. The contract is on a take-or-pay basis for a period of 18-year from 1997 to 2015.

Property development:

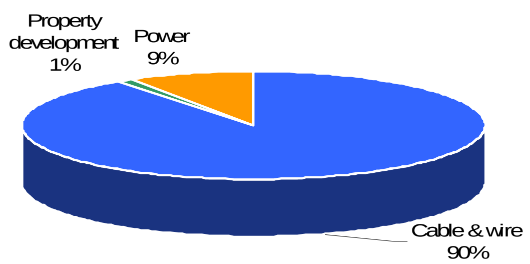
- **2 residential projects.** Leader has 2 ongoing property developments:

  Mayfair Supercondomiums located along Jalan Sultan Ahmad Shah (nicknamed the "Millionaires Row") in Penang with a Gross Development Value (GDV) of RM90m and a take-up rate of 60%.

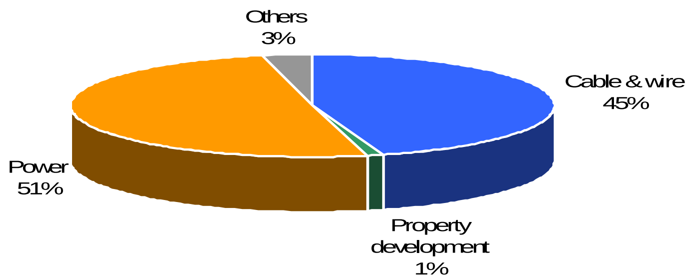
  Leader Garden Phase B in Tanjung Bungah, Penang with a GDV of RM40m comprising a mixture of landed properties such as terraced, semi-detached houses and bungalows.

  Both projects are scheduled for completion in 3Q 2006.

FY05 Revenue breakdown by segment



FY05 Operating profit breakdown by segment



While Cable and Wire division contributed 90% of the Group revenue in FY05, the thin margin resulted in only 45% contribution to profit. Meanwhile, power division is the anchor earnings generator at 51% contribution despite making up only 9% of revenue. Impact from the property development business is minimal.

3. Financial Highlights

3-year revenue CAGR of 15%

Between FY02 to FY05, Leader recorded a 3-year revenue CAGR of 15%, largely arising from higher sales in the cable and wire division. The Group made a loss in FY03 mainly due to allowances and impairment made and performance has bounced back strongly thereafter. Net profit came in at RM15.2m in FY04 and further rose to RM22.7m in FY05 (+50% yoy) arising from higher margins in the cable and wire division. Power division generates the highest margin amongst the divisions. Meanwhile, net gearing stood at 1.2x, down from 1.3x in FY04.

Operating Profit Margin	FY04	FY05
Cable & wire	0.8%	2.4%
Property development	13.7%	3.8%
Power	28.1%	26.8%

1QFY06 results: revenue and profit up

In the recently announced 1QFY06 results, Leader's Group revenue soared 53.7% yoy to RM473.9m due to better performance across all division. The cable and wire division grew 57.6% yoy, power division (+25% yoy) and property (+16.7% yoy). Net profit attributable to shareholders (excluding minority interest) jumped from RM2.1m to RM8.0m (+276% yoy) due to higher contribution from associates and overall improvement in revenue.

Gearing down, continue to redeem and buy back Eurobond

Net gearing continue to descend, with 1QFY06 at 1.1x (against 1.2x in FY05). The Group is actively reducing its exposure by buying back and effecting early redemption of the Eurobond. Leader's latest exposure now stands at USD17.7m. Source of funds for redemption came from drawdown of its A_{ID}-rated RM150 Murabahah Medium Term Note (MMTN) and internally generated funds. To date, RM80m of its MMTN facility has been issued. Meanwhile, cash hoard stands at RM123.2m and the Group generates positive operating cashflow. As such, we are not too concerned over the Group's capability to redeem the remaining outstanding Eurobond.

4. Earnings Outlook

Development of new product range. Growth drivers include a new product range for aluminium and copper rods and potential growth in demand from the domestic oil & gas, and automobile industries.

Positive domestic and global outlook. According to the management, domestic outlook indicates strong demand especially in the telecommunications market, driven by the growth in demand for Streamyx broadband services.

Global outlook is positive, supported by a steady inflow of overseas contracts such as recently from a Qatar LNG company with current orderbook of approximately RM11.0m.

Sound order book value. Current order book of the cable and wire division is estimated to be c. RM600m with contracts scheduled over the next 1-2 years, of which RM200m is from abroad and RM400m domestic. It has also tendered for more than RM1bn worth of projects, with an estimated historical success rate of 20%.

Export contribution is projected to rise from a current 30% to 40% of total revenue over the next three years.

Minimal impact from 9MP expected. The recently announced 9th Malaysian Plan (9MP) will see combined spending allocation expenditure in the areas of electricity transmission, distribution and rural electrification totalling RM20.1b, an increase of 36% from 8MP. Leader should benefit from the allocation although we believe the impact would not be material.

5. Recent Developments

- Dec 2005: Disposal of Universal Pte. Ltd, a wholly-owned subsidiary of Univeral Cable (M) Berhad, for a cash consideration of SGD2.9m. No material impact on earnings expected. Disposal is part of the Group's ongoing rationalization effort.

- Apr/May 2006: Bought back USD10m nominal value of Eurobond; and further effected early redemption of USD25.2m of its Eurobond.

- May 2006: Disposal of Leader's effective 49% stake in Leader Realty Corporation Ltd (LRCL) to a related party for a cash consideration of USD350,000. LRCL is a property holding company. No material impact on earnings expected. Disposal is in line with the rationalization exercise.

6. Investment Risk

- **High prices of raw materials e.g.** copper, aluminium and PVC may threaten Leader's margins. Prices of both copper and aluminium have risen more than 70% since late last year. However, management indicated that there are cost pass-through clauses to enable Leader to pass on cost increases for both local and export contracts. This variation order or 'drawdown notice' is common practice with all major tendered contracts.

- **Low growth propects for local cable and wires market.** This is linked to Tenaga and Telekom's flat annual capex of RM4.0bn and RM1.14 bn respectively for 2006 and 2007 (Source: 2004 annual reports and analyst briefings of Telekom and Tenaga) as well as absence of major infrastructure developments in Malaysia. This is exacerbated by domestic excess capacity for copper wires, with the high number of players in the cable industry which makes this a highly competitive market with razor-thin net margins. However, Leader has successfully tapped into and continues to expand its export markets of Middle East, Australia and New Zealand amongst others. Exports currently account for approximately 35% of Leader's turnover.

- **Competition from use of fibre-optic lines and wireless technology.** However, demand growth for fixed line telephone services remains stable, albeit at a lower rate than for mobile services. In addition, the high demand growth for broadband services which require installation of copper cables should also support demand for Leader's products in the foreseeable future.

7. Balance Sheet

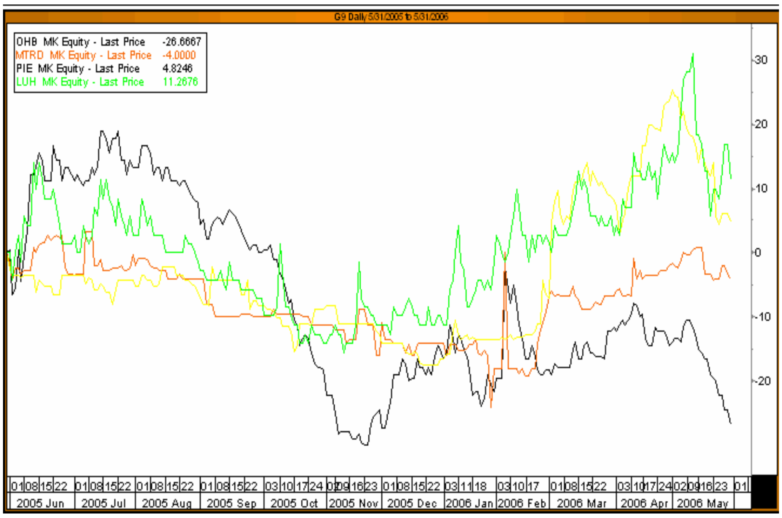
FYE Dec (RM m)	**FY05**
Total Assets	1250.0
Current Asset	770.0
Non-Current Assets	480.0
Current Liabilities	522.9
Non-Current Liabilities	273.6
Share Capital	436.5
Shareholders Funds	453.5

8. Valuation

We have used current average PER of 6.7x based on industry peer comparison comprising Metrod, PIE Industrial and Opcom, to arrive at a fair value for Leader. We have chosen to exclude Wonderful Wire & Cable due to its much smaller operations and small market capitalization.

Comparative Valuation	**Metrod**	**PIE Ind.**	**Opcom**	**Avg.**
Share Price (RM)	2.40	2.42	0.68	
Mkt. Cap (RM mil)	60.0	152.7	87.7	
Ave. Daily Vol. ('000 shares)	15.3	57.6	117.9	
P/E FY04 (x)	8.3	13.2	6.4	**10.3**
P/E FY05 (x)	6.5	8.7	4.9	**6.7**
P/BV (x)	0.9	1.0	1.5	**1.1**
Yield (%)	4.6	5.0	4.8	**4.8**

Historical relative share price performance (in %) of Leader, and peers Opcom Holdings Berhad, Metrod Berhad (MTRD MK) and Pie Industrial Berhad.



(Source from Bloomberg)

9. Recommendation

We recommend a HOLD based on our 12-month fair value of RM0.43.

Analyst: Nicole Tan Yoke Ping (nicole@zj.com.my)

RATING GUIDE

BUY	Price appreciation expected to exceed 10% within the next 12 months
SELL	Price depreciation expected to exceed 10% within the next 12 months
HOLD	Price movement expected to be between -10% and +10% over the next 12 months from current level

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ZJ Advisory Sdn Bhd (Co No: 645449-V)
(An investment adviser licensed by the Securities Commission)
Suite 22B, 22nd Floor, Wisma Denmark,
No 86, Jalan Ampang, 50450 Kuala Lumpur
Tel (603) 2032 2328 Facsimile (603) 2032 1328