

Grand-Flo Solution

Recommendation: **STRONG BUY**

Stock Code: 0056

Bloomberg: GFLO MK

Price: MYR0.54

12-Month Target Price: MYR0.70

Date: February 16, 2007

Board: Mesdaq

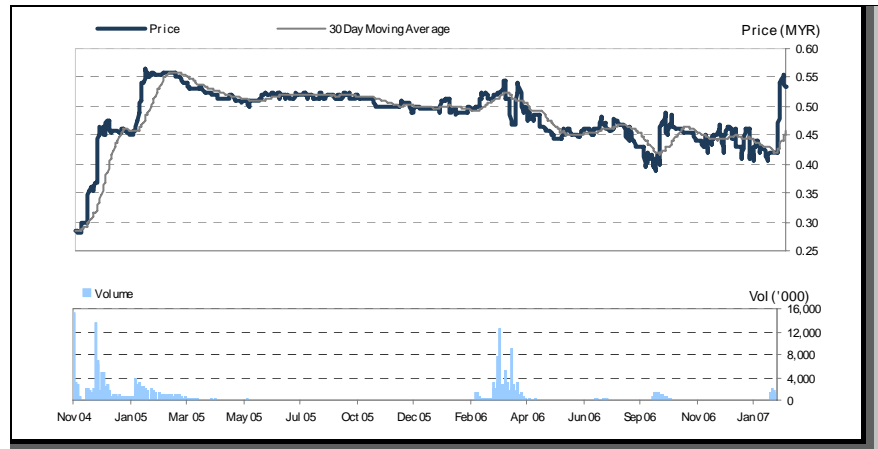
Sector: Technology

GICS: Information Technology/Data Processing & Outsourced Services

Market Value - Total: MYR65.2 mln

Summary: Listed in Nov. 2004, Grand-Flo Solution (Grand-Flo) is mainly engaged in enterprise data collection and collation system (EDCCS) related businesses in Malaysia and Southeast Asia.

Analyst: Joy Lee, CFA



Results Review & Earnings Outlook

- Grand-Flo's 4Q06 results were better than we expected. Net profit came in at MYR1.6 mln (up 98.8% QoQ) on revenue of MYR16.3 mln (up 26.2% QoQ), thanks to contribution from the newly acquired Spritvest and Data Centrix in Oct. 2006. The two new subsidiaries generated stronger-than-expected profit after tax of MYR0.8 mln (or 38% of their full-year PAT) during the quarter, while Grand-Flo's tax expense was also lower than our previous forecast.
- For the full year, net profit rose 58.3% YoY to MYR4.0 mln on revenue of MYR47.0 mln (up 55.4% YoY), compared with our original estimates of MYR3.5 mln and MYR4.6 mln, respectively. Although operating profit margin slid to 18% from 2005's 18.7% on higher costs, net profit margin improved to 8.5% from 2005's 8.3% on a lower effective tax rate and minority interests. As expected, Grand-Flo recommended a final gross dividend of MYR0.02 per share.
- For 2007, we expect the company's earnings outlook to remain robust given the full-year contribution from Spritvest and Data Centrix. We assume the two subsidiaries will continue to meet their profit guarantee of MYR2.5 mln in 2007. In addition, we believe Grand-Flo's Thailand operation will start to benefit from the tax break enjoyed by Simat Soft. We have raised our 2007 earnings forecast by 26% to MYR6.6 mln, reflecting stronger revenue growth and lower effective tax rate assumptions. We also introduce our 2008 earnings projection at MYR8.4 mln (up 27.7% YoY).

Recommendation & Investment Risks

- Following the upbeat 2006 results and revisions in our earnings forecasts, we maintain our Strong Buy recommendation on the stock with a revised 12-month target price of MYR0.70 (from MYR0.56 previously). Trading at a forward PER of 8.5x, we believe the stock's valuation remains attractive.
- Our new target price is based on a blend of PER, P/B and DCF valuations, plus a projected net DPS of 1.8 sen. We have ascribed 12.0x PER (unchanged) and 2.5x P/B (unchanged) on our estimated 2007 EPS and BVPS, respectively, which are at the lower end of the stock's historical trading ranges. In our DCF valuation, we have assumed a WACC of 9.9%, FCF CAGR of 15% for 2008-2011 and terminal growth rate of 3%.
- In the longer term, we believe Grand-Flo's earnings growth momentum will be driven by both organic growth at its existing presence in Malaysia, Thailand and Singapore, as well as its plan for expansion in other Asian markets including China, Vietnam and Indonesia.
- Risks to our recommendation and target price include a slowdown in the region's EDCCS market, intensifying competition, higher-than-expected cost of imported auto-ID equipment, and a weakening of the THB against the MYR. Meanwhile, its expansion in overseas markets may involve higher execution risk, in our view.

Key Stock Statistics

| FY Dec. | 2006 | 2007E |
|---------------------------------|-------------|-------|
| Reported EPS (sen) | 3.8 | 6.3 |
| PER (x) | 14.1 | 8.5 |
| Dividend/Share (sen) | 2.0 | 2.5 |
| NTA/Share (MYR) | 0.12 | 0.23 |
| Book Value/Share (MYR) | 0.23 | 0.35 |
| No. of Outstanding Shares (mln) | 121.8 | |
| 52-week Share Price Range (MYR) | 0.39 - 0.56 | |
| Major Shareholders: | % | |
| Grand-Flo Corporation Sdn Bhd | 20.0 | |
| Tan Bak Leng | 12.3 | |

Per Share Data

| FY Dec. | 2004 | 2005 | 2006 | 2007E |
|-------------------------|------|------|------|-------|
| Book Value (MYR) | 0.11 | 0.13 | 0.23 | 0.35 |
| Cash Flow (sen) | 3.4 | 3.6 | 5.3 | 8.1 |
| Reported Earnings (sen) | 2.3 | 2.5 | 3.8 | 6.3 |
| Dividend (sen) | 0.0 | 0.0 | 2.0 | 2.5 |
| Payout Ratio (%) | 0.0 | 0.0 | 44.1 | 33.2 |
| PER (x) | 23.7 | 21.3 | 14.1 | 8.5 |
| P/Cash Flow (x) | 15.9 | 14.9 | 10.1 | 6.6 |
| P/Book Value (x) | 4.9 | 4.0 | 2.3 | 1.5 |
| Dividend Yield (%) | 0.0 | 0.0 | 3.7 | 4.7 |
| ROE (%) | NA | 20.7 | 19.4 | 18.9 |
| Net Gearing (%) | 0.0 | 0.0 | 0.0 | 0.0 |

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Quarterly Performance

| FY Dec. / MYR mln | 4Q06 | 4Q05 | % Change |
|---------------------------------|------|------|----------|
| Reported Revenue | 16.3 | 7.8 | >100 |
| Reported Operating Profit | 2.5 | 1.2 | >100 |
| Depreciation & Amortization | NA | NA | NA |
| Net Interest Income / (Expense) | -0.1 | -0.1 | 4.2 |
| Reported Pre-tax Profit | 2.5 | 1.2 | >100 |
| Reported Net Profit | 1.6 | 0.5 | >100 |
| Reported Operating Margin (%) | 15.5 | 15.6 | - |
| Reported Pre-tax Margin (%) | 15.0 | 14.8 | - |
| Reported Net Margin (%) | 9.8 | 6.3 | - |

Source: Company data

Profit & Loss

| FY Dec. / MYR mln | 2005 | 2006 | 2007E | 2008E |
|---------------------------------|------|------|-------|-------|
| Reported Revenue | 30.2 | 47.0 | 70.8 | 84.5 |
| Reported Operating Profit | 5.7 | 8.4 | 12.7 | 15.8 |
| Depreciation & Amortization | -1.1 | -1.6 | -1.9 | -2.2 |
| Net Interest Income / (Expense) | -0.1 | -0.1 | -0.2 | -0.2 |
| Reported Pre-tax Profit | 5.5 | 8.3 | 12.5 | 15.6 |
| Effective Tax Rate (%) | 29.2 | 26.8 | 18.9 | 17.0 |
| Reported Net Profit | 2.5 | 4.0 | 6.6 | 8.4 |
| Reported Operating Margin (%) | 18.7 | 18.0 | 18.0 | 18.7 |
| Reported Pre-tax Margin (%) | 18.1 | 17.6 | 17.7 | 18.5 |
| Reported Net Margin (%) | 8.3 | 8.5 | 9.3 | 10.0 |

Source: Company data, S&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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Recommendation and Target Price History

| Date | Recommendation | Target Price |
|-----------|----------------|--------------|
| New | Strong Buy | 0.70 |
| 6-Sep-06 | Strong Buy | 0.56 |
| 18-May-06 | Buy | 1.08 |
| 29-Mar-06 | Buy | 1.15 |
| 3-Mar-06 | Hold | 1.04 |
| 7-Dec-05 | Hold | 1.01 |

