Inet research

FY06 2Q Result Update

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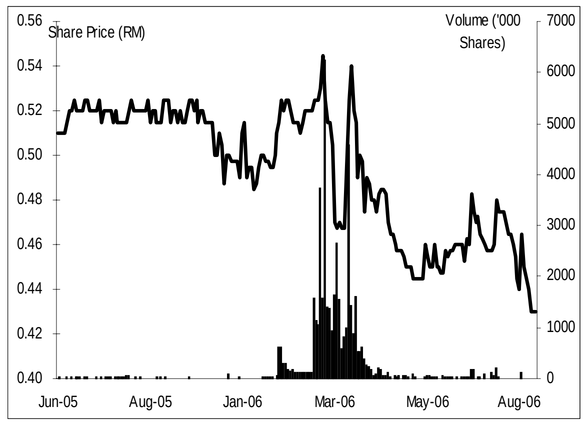
Grand-Flo Solution Berhad		***Price:***	*RM0.43*
		Market Capitalisation:	*RM53.1m*
		Board:	*Mesdaq*
		Sector:	*Technology*
Stock Code:	*0056*	***Recommendation:***	*BUY*

Key Stock Statistics	FY05	FY06F	FY07F
EPS (sen)	2.7	3.2	5.8
P/E on EPS	16.2	13.4	7.4
Dividend/Share	0.0	1.6	1.8
NTA/Share (sen)	20.3	12.7	19.7
Book Value/Share (sen)	27.1	24.1	30.9
Issued Capital (m shares)	50.0	123.6	123.6
52-weeks price range (RM)	0.43 – 0.58		

Note: Historical EPS adjusted for proposed bonus issue for comparison purposes

Major Shareholders:	%
Tan Bak Hong and Yap Li Li	29.8%
Tan Bak Leng	12.3%
Tan Chuan Hock	8.0%

Share Price Chart



Per Share Data	2004	2005	2006F	2007F
Book Value (RM)	0.11	0.14	0.24	0.31
Cash Flow (sen)	22.2	3.8	3.7	7.4
Earnings (sen)	2.0	2.7	3.2	5.8
Dividend (sen)	0.0	0.0	1.6	1.8
Payout Ratio (%)	0.0	0.0	50.0	30.0
PER (x)	21.5	16.2	13.4	7.4
P/Cash Flow (x)	1.9	11.4	11.7	5.8
P/Book Value (x)	3.9	3.2	1.8	1.4
Dividend Yield (%)	0.0	0.0	3.7	4.1
ROE (%)	15.8	20.1	13.4	18.9
Net Gearing (%)	n.c.	n.c.	n.c.	n.c.

n.c. – net cash

P&L Analysis (RM mil) Year-end: 31 Dec	2004	2005	2006F	2007F
Revenue	13.3	30.2	45.3	69.9
Operating Profit	2.4	6.6	9.0	14.5
Depreciation	-0.2	-0.9	-1.0	-1.3
Interest Expenses	-0.1	-0.1	0.1	0.2
Pre-tax Profit	2.2	5.6	8.1	13.4
Effective Tax Rate	20%	27%	27%	25%
Net Profit	1.7	2.7	4.0	7.2
Operating Margin	18%	22%	20%	21%
Pre-tax Margin	16%	19%	18%	19%
Net-Margin	13%	9%	9%	10%

1. 2QFY06 results highlights and review:

(RM million)	2QFY06	2QFY05	% Change
Revenue	8.9	8.2	9.3%
Operating Profit	2.0	1.7	11.9%
Depreciation	-0.3	-0.2	51.5%
Interest Expense	0.0	0.0	5.4%
Pre-tax Profit	1.6	1.5	6.5%
Net Profit	0.7	0.8	-11.9%
Operating Margin	21.8%	21.3%	0.5%
Pre-tax Margin	17.7%	18.2%	-0.5%
Net-Margin	7.9%	9.8%	-1.9%

- The 2Q results of Grand-Flo Solution (GF) were in line with our top line estimate, but the profits came in lower than expected. The group's revenue increased by 9.3% and PBT by 6.5% y-o-y respectively, but net profit dropped by 11.9%. This was mainly due to higher foreign income tax (30% for current quarter) and minority interest share of Simat Mobile Computer Co Ltd (SMC)'s earnings as sales in its Thai subsidiary improved.

- GF's PBT margin fell slightly because of higher depreciation and its net margin declined from 9.8% to 7.9% y-o-y due to reasons mentioned above.

1H06 results comparison

(RM million)	1H06	1H05	% Change
Revenue	18.7	13.9	34.6%
Operating Profit	4.2	3.3	29.1%
Depreciation	-0.5	-0.4	21.8%
Interest Income	-0.1	-0.1	4.3%
Pre-tax Profit	3.6	2.8	31.1%
Net Profit	1.6	1.4	9.9%
Operating Margin	22.6%	23.6%	-1.0%
Pre-tax Margin	19.4%	19.9%	-0.5%
Net-Margin	8.3%	10.2%	-1.9%

- For 1H06 results, the profits were lower than expected despite higher revenue that was in line with our forecast. The revenue was higher by 34.6% y-o-y due to the improved contribution from SMC, and its profits rose as a result. However, note that the group's operating and PBT margins fell slightly as its operational expenses increased.

- In view of the lower than expected margins to date, we have reduced our FY06 PBT (from RM10.5m to RM8.1m) and net profit (from RM5.1m to RM4.0m) forecasts. For FY07, we have also reduced our PBT and net profit estimates accordingly, assuming the group is able to maintain its margins at current levels as it expands.

Segmental breakdown (RM million)	2Q06	2Q05	Change y-o-y %	1Q06	*Change q-o-q %	1H06	1H05	Change y-o-y %
Turnover								
- Malaysia	4.1	4.3	-4.8%	4.5	-9.8%	8.6	8.0	8.0%
- Other countries	4.8	3.9	22.8%	5.2	-7.9%	10.0	5.9	70.8%
Total	8.9	8.2	8.4%	9.7	-8.8%	18.7	13.9	34.6%
Pre-tax profit								
- Malaysia	0.3	0.5	-37.0%	0.3	-0.6%	0.7	0.9	-22.8%
- Other countries	1.3	1.0	29.7%	1.8	-28.7%	2.9	1.9	56.0%
Total	1.6	1.5	5.9%	2.1	-24.2%	3.6	2.8	31.1%
Net profit								
- Malaysia	0.3	0.5	-42.4%	0.2	12.9%	0.5	0.8	-33.4%
- Other countries	0.5	0.3	37.7%	0.6	-24.1%	1.0	0.6	61.9%
Total	0.7	0.8	-9.3%	0.8	-13.5%	1.6	1.4	9.9%
Pre-tax margin	*17.9%*	*18.3%*		*21.5%*		*19.4%*	*19.9%*	

* *Refers to 2Q06/1Q06*

- The revenue and PBT decline of 8.8% and 24.2% q-o-q respectively was mainly caused by the delays in implementation of expected projects in Malaysia. Out of the 1H06 RM18.7m revenue, Malaysia contributed RM8.6m (46%) while the other countries, mainly Thailand (from SMC), contributed RM10.0m (54%). However, on the profit side, the overseas income made up most of the group's PBT (80.6% or RM2.9m) and net profit (62.5% or RM1.0m), significantly higher than that of Malaysia. Nonetheless, GF's acquisition of 100% of Spritvest Sdn Bhd and 100% of Data Centrix Sdn Bhd (Spritvest's R&D arm) will boost the profit contribution from the Malaysian segment in the coming quarters.

2. Recommendation

- GF's balance sheet remains healthy with projected net cash positions for FY06 and FY07. The key revenue driver will be the group's local operations (especially with the new acquisition) and also likely new overseas expansion (probably in Indonesia and China). This is in addition to the growth in its existing Thailand market.

We expect the group's profit margin to also improve on the back of synergy within the group and a likely increase in new clients that will utilise its higher-margin software package solutions. We believe that given the low usage rate of bar coding technology in the Asian region, GF continues to enjoy significant growth potential if it is able to leverage on the success of its overseas ventures.

- At the current price level, despite our lower revised forecasts, GF is still trading at an attractive PER of 13.4x based on a revised prospective FY06 EPS of 3.2 sen, way below that of the entire Mesdaq market's historical FY05 weighted average PE multiple of around 32x. With a full year contribution from the new acquisition, the PE multiple will decline to 7.4x for FY07.

- With strong growth prospects, underpinned by its dominant niche position in a growing bar code industry and its successful overseas market breakthrough, we believe the stock deserves to trade at a PE multiple of at least 10x – 15x (at a PE to growth ratio of 1.0x), which is very likely to be its sustainable growth rate over the longer term. We are maintaining a BUY recommendation on GF with a new target price of RM0.58 or a 35% upside from its current share price of RM0.43, ascribing a 10x multiple for its FY07 EPS of 5.8 sen. The stock has surprisingly come under selling pressure in the last few months but we believe GF's prospects remain intact and its profits are likely to improve in subsequent quarters.

Investment ratings:
Buy (generally >10% upside over the next 12 months)
Hold (generally negative 10% downside to positive 10% upside over the next 12 months)
Sell (generally >10% downside over the next 12 months)