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Special Report: Small cap monitor: Small companies, big value

Tags: CIMB Research | Small cap

Written by CIMB Research

Friday, 17 September 2010 15:58

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Share price performance

FBM Small Cap Index an is underperformer since end-August. After outperforming the KLCI since the start of the year, the FBM Small Cap Index (FBMSC) began underperforming at end-Aug as interest shifted to the major index-linked stocks. Year-to-date (YTD), the FBMSC is up 10.4% compared to 12.7% for the KLCI.

The FBMSC has gradually recovered after hitting a trough at end-May following a sharp selloff in April-May. But its weekly charts show signs of at least a sideways consolidation for the index as the MACD turned negative recently. A break above the support-turned-resistance trend line at 11,700 points would signal that the bulls have taken charge again.

The key support level for the index is the 40-week SMA (equivalent to 200-day SMA) at 10,921. As long as this SMA support holds, the index will remain in a medium-term uptrend.

The performance of our small-cap stocks has been mixed YTD. Leading the pack are the consumer and packaging stocks, namely CI Holdings, Tomypak and Daibochi. Other performers include Jobstreet and Eksons. The biggest losers so far include RGB International (formerly Dreamgate) and Notion VTec. This is not a surprise as we rate both these stocks as underperforms. The surprise is the YTD underperformance of rubber glove stocks, Latexx and Adventa.

Plywood producer Eksons, port operator Suria Capital and Penang-based property developer, Hunza Properties are among the few top performers since end-June. The biggest losers since end-June are again Notion VTec, Latexx and Adventa.

Analysis of August results season

The results of the small caps in the August reporting season were not as solid as the previous quarter. Out of the 18 small caps that we cover, 33% failed to meet our expectations. This compares with only 16% in the previous quarter. On a more positive note, 17% topped our expectations compared to only 10% in the previous quarter.

Against consensus, the results trend was similar. In August, 14% of the 14 companies for which there are consensus numbers failed to meet expectations compared to none in the 1Q results period. However, 29% surpassed consensus expectations in August compared to only 23% in the previous quarter.

In August, there was only one major change in our recommendations. We downgraded Notion VTec from outperform to underperform as its 3QFY10 earnings tumbled 73% year-on-year (y-o-y) due to start-up losses for base plate manufacturing. We slashed our FY10-12 EPS estimates by 34%-45%, which pushed our target price down from RM4.05 to RM1.99, based on an unchanged target basis of 20% P/E discount to its peers.

In June, we downgraded Pelikan from trading buy to neutral as cost savings from the Herlitz acquisition could disappoint due to soft market conditions in Europe which contributes 80% of group revenue.

Small-cap stocks still offer value at current levels. The small caps under our coverage are trading at an average CY11 P/E of only 8.5 times, a 40% discount to the KLCI's 13.8 times P/E. Twelve of the 19 stocks that we cover are trading below eight times CY11 P/E and nine are below seven times CY11 P/E. These stocks include Xingquan, Eksons, Latexx, Tomypak Holdings and Notion VTec.

Investors looking for dividend yields can opt for Wellcall Holdings, Uchi, Asia File and Daibochi which offer gross dividends in excess of 7%. Wellcall's gross yield is above 12%, which is one of the highest in our overall coverage.



This month's top picks

Latexx Partners is now our top small-cap pick. With an annual production capacity of seven billion pieces of gloves, Latexx Partners is the fifth largest rubber glove manufacturer in Malaysia. It focuses on higher-quality powder-free natural rubber (NR) gloves and nitrile gloves.

The share prices of rubber glove companies including Latexx have taken a beating over the past few months, mainly because of concerns over rising latex prices, a stronger ringgit and a potential industry glut. We believe the concerns are overblown as demand for rubber gloves remains strong and this gives the rubber glove companies pricing power, which allows them to pass on rising costs to their customers.

Latexx's share price has been de-rated from nine times one-year forward P/E early this year to an attractive FD P/E of six times. Our technical chartist is looking for support at RM2.60-RM2.75 for the stock.

Small Cap monitor

Stock	Call	Price (RM)	Target price (RM)	Core P/E (x)		3-yr EPS CAGR (%)
				CY2010	CY2011	
Adventa	O	2.39	4.45	9.2	7.1	32.3
Asia File	O	4.31	5.80	7.6	6.7	11.5
C.I.Holdings	O	2.78	4.20	9.0	8.1	15.0
Daibochi	O	2.97	4.60	9.5	7.7	13.6
RGB	U	0.07	0.06	nm	11.4	165.6
Eksons	O	1.00	1.26	5.3	4.1	46.0
Ekovest	U	1.56	0.86	26.0	32.1	(15.0)
Hurza Prop	O	1.39	1.93	5.3	6.1	(16.7)
JobStreet	O	2.15	2.66	18.0	14.5	24.2
Latexx	O	2.86	5.44	6.2	4.8	43.9
MTD ACPI	U	0.45	0.32	nm	11.2	181.4
Noton	U	1.73	1.99	7.3	6.0	3.4
Petikan	N	1.11	1.19	8.8	6.6	58.0
Suria	N	1.56	1.77	6.9	6.6	9.9
Tomypak	O	1.27	1.98	6.6	5.4	8.9
Uchi	O	1.36	1.58	11.3	10.3	12.8
UM Land	O	1.54	2.11	12.1	9.2	13.3
Wellcall	O	1.24	1.82	9.8	7.9	18.5
Xingquan	O	1.44	3.12	3.5	2.8	21.3
Simple average				9.5	8.5	34.1

O=Outperform, N=Neutral and U=Underperform
 Source: CIMB Research, company

Investment highlights of our other small-cap stocks

Outperform recommendations

Adventa

We remain positive on the rubber glove sector in view of the sustainability of demand and manufacturers' ability to pass on cost increases. We like Adventa for its unique position as a player in the niche surgical glove market and its plans to further develop its OBM business segment. The company has also laid out long-term plans to grow its other business segments and become a significant healthcare products supplier in the region.

While gloves will remain its biggest earnings contributor, there are plans for other business segments to start contributing in 2013. Adventa remains firmly an outperform as the stock could enjoy a re-rating as a result of improving quarterly earnings coming from the capacity expansion and growing global demand. Our target price remains intact at RM4.45, still pegged to 13.2 times P/E or a 20% discount to Top Glove's target P/E of 16.5 times.

Asia File

Asia File has underperformed the market, which we think is unwarranted. Although revenue from its main market, Europe is flat, the group is still recording growth, thanks to expansion in the local, Asia and US markets. With Plastoreg coming under its umbrella since end-2007, Asia File has become the world's largest OEM producer of dividers and indices. This has helped the company make headway with major stationery suppliers in the US and Europe over the past one to two years.

We maintain our earnings forecasts and our target price basis of 30% discount to our regional sector P/E target of 13 times, giving us an unchanged target price of RM5.80. The stock remains an outperform. Potential re-rating catalysts include i) success in landing major orders from customers in the US and EU, ii) signs of economic recovery in Europe and iii) its attractive gross dividend yield of above 7%.

CI Holdings

Construction of CIH's RM45 million new production line at the Bangi plant will be completed this month as scheduled. The new line will be used to produce non-carbonated beverages, including the star performer Tropicana. The large investment and the recently renewed 10-year bottling agreement with PepsiCo demonstrate a strong, long-term partnership between CIH and PepsiCo.

We maintain our earnings forecasts and target price of RM4.20, pegged to an unchanged 10% discount to our 15 times target market P/E in view of the stock's relatively low liquidity. CIH remains firmly a buy, underpinned by the potential re-rating catalysts of 1) additional capacity, and 2) an increasingly marketable product line.

Daibochi

The last two quarters have been challenging for Daibochi as rising raw material prices, particularly for polyester, led to a squeeze in profit margin. Stable or declining raw material prices since July indicate profit margin recovery from 3Q onwards. It looks like the worst is over for the company. We remain excited about its venture into electronics packaging and potential major orders from PepsiCo in the near future. Earnings from these two ventures could be significant for Daibochi from 2011 onwards.

We continue to rate Daibochi an outperform and our top pick for the packaging sector. Our target price is unchanged at RM4.60, based on 12 times CY11 earnings or a 20% discount to our 15 times target P/E for the market. Factors that could catalyse the stock include i) margin recovery over the next few quarters, ii) contracts from major non-F&B companies and, iii) investors' increasing awareness of its generous gross dividend yield of 7%.

Eksons

Plywood earnings are stable, aided by strong demand from Middle East, Africa and Asia. Eksons is not directly affected by

the sluggish Japan and US housing markets. Sales of "The Atmosphere" property project have been strong over the past few months. The project has secured close to RM220 million bookings since its launch in August 2009. The take-up rate is 90%.

We maintain our earnings forecasts and target price of RM1.26 for Eksons, which is based on an unchanged three-year average P/NTA of 0.6 time. Eksons remains an outperform, with the potential share price triggers being i) a sales pick-up for its property project, ii) signs of recovery of US housing starts and iii) investors' increasing awareness of its attractive valuations of 0.4 time P/BV and four times CY11 P/E.

Hunza Prop

We expect Infinity and Gurney Paragon to be Hunza Properties' primary earnings drivers in the next two to three years. The group has about RM80 million worth of unsold units for Infinity and about RM200 million for Gurney Paragon condos. Since construction of Infinity has been completed, any sales clinched should flow directly to the bottomline. As for Gurney Paragon, unbilled sales stood at RM103 million as at end-June 2010, which should be recognised over the next one to two years.

Over the mid-to longer-term, contribution from Alila 2 and the steady stream of rental income from the Gurney Paragon mall should help support earnings. We maintain our outperform recommendation. Potential rerating catalysts include 1) stronger property sales, 2) better-than-expected construction progress, and 3) increasing investor interest in the Penang property market. Our target price stays at RM1.93, still based on a 40% discount to its fully diluted RNAV.

Jobstreet

Jobstreet is a beneficiary of the recovering economy. It has seen fairly strong growth in both Malaysia and Singapore. Conditions in the Philippines remain soft but should improve now that the elections are over. Jobstreet is taking a strategic move to boost its marketing expenditure this year in a bid to capture more market share, especially within Singapore.

Jobstreet remains an outperform on the back of the potential rerating catalysts of continued earnings momentum, margin expansion, improving business conditions and the strong 2Q10 results. Our target price remains intact at RM2.66, which we continue to base on a 20% premium over our target market P/E of 15 times.

Tomypak

Tomypak and its MNC customers review the selling prices every quarter for changes in raw materials and forex fluctuations. Although 2QCY10 results saw a margin squeeze due to rising raw material costs, this quarter should experience a strong margin recovery as overall raw material prices have fallen since early July.

Tomypak remains an outperform with an unchanged target price of RM4.96, which is based on a 30% discount to our 12 times target P/E for Daibochi. Factors that could catalyse the stock include margin recovery and stronger-than-expected revenue growth in the next few quarters as well as the recently completed share split and bonus issue, which should improve trading liquidity.

Uchi

Uchi's fortunes are beginning to improve as the conversion to the new energy-saving devices is behind it. We are seeing a pick-up in order flows and higher utilisation rates, thanks to the recovering economy, stronger demand and the completion of the conversion process. Uchi has also seen in 2Q an improvement in margins arising from increased contribution from higher-end, higher-margin products. The order book remains full until year-end and has even started to flow in for Jan/Feb.

However, it will be affected by the appreciating ringgit and rising labour and raw material costs. But we continue to rate it an outperform on the back of the catalysts of stronger-than-expected demand recovery and rising contribution from higher-end, higher-margin products. Our target price remains intact at RM1.58, still based on a 20% discount to our target market P/E.

Wellcall

Demand for Wellcall's mandrel and extrusion hoses continues to pick up. The order backlog is four to five months for extrusion hoses and around two months for mandrel. Wellcall is already running on two shifts to meet demand. Although it can do 24-hour shifts, this is not sustainable in the long term. We believe that management is looking at a major expansion. Our target price stays at RM1.82 as we continue to value the stock at a 30% discount to Top Glove's 16.5 times target CY11 P/E.

Wellcall remains an outperform given the potential re-rating catalysts of i) stronger-than-expected demand recovery, ii) its hard-to-beat net dividend yields of 8%-9% and iii) potential expansion in the next few quarters. Furthermore, the share price is supported by its net cash of 30 sen per share, equivalent to 23% of its current share price.

UM Land

We remain positive about the property sector and UM Land given the postponement of the IFRIC 15 accounting policy which would have led to excessive earnings volatility on a quarterly basis as it requires developers to recognise profits on handover of property. We are not overly concerned about potential measures by the government to cool down property price appreciation as we believe that it will be targeted at higher-end landed properties for which buyers can afford to come up with bigger downpayments.

We make no changes to our buy recommendation or RM2.11 target price for UM Land, which we continue to base on a 50% discount to its RNAV. The share price could be catalysed by 1) more land acquisitions and 2) a good response to its two upcoming new condo project in 4Q10.

Xingquan International

In our small cap universe, Xingquan offers the cheapest CY11 P/E of 2.8 times, which is just a fraction of the average small-cap sector P/E of 8.4 times. We expect order value growth for Xingquan to remain strong on the back on improving brand equity. The new factory is expected to start production in 1Q11 and will expand the group's annual production capacity to 10 million pairs of shoes and 28 million pairs of shoe soles. We continue to like Xingquan for its niche in outdoor shoes, which is a less saturated market than the performance sports shoe segment.

Our target price remains at RM3.12, still based on six times CY11 P/E, a 50% discount to the average of the peers under our coverage in view of Xingquan's smaller size. We reiterate our outperform recommendation. Potential re-rating catalysts include better-than-expected trade fair order value.

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