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|---|-----------|--|--------|
| Name of PLC: Latitude Tree Holdings Berhad (LTHB) | | PLC Website: www.lattree.com | |
| Business Summary : Manufacturing of wooden furniture products and components | | | |
| Top Three Shareholders: Lin family | | 57.0% | |
| Yek Siew Liong | | 15.0% | |
| Tan Kit Pheng | | 4.1% | |
| Market / Sector: | Consumer | Stock Code: | 7006 |
| | | Bloomberg Ticker: | LAT:MK |
| Market Capitalisation: | RM 505.5m | Recommendation: | BUY |
| Target Price: | RM 7.20 | Expected Capital Gain: | 38.5% |
| Current Price: | RM 5.20 | Expected Div Yield: | 2.3% |
| | | Expected Total Return: | 40.8% |
| Analyst : Lim Boon Ngee Tel : +603 2163 3200; Email : bnlim@bcta.com.my | | | |

| Key Stock Statistics | 2016 | 2017F | 2018F | 2019F |
|---------------------------------|-------------|--------------|--------------|--------------|
| EPS (sen) | 74.8 | 71.0 | 71.7 | 79.0 |
| P/E (x) | 7.0 | 7.3 | 7.3 | 6.6 |
| Net Dividend/Share (sen) | 12.0 | 12.0 | 12.0 | 12.0 |
| NTA/Share (RM) | 4.99 | 5.77 | 6.36 | 7.03 |
| Book Value/Share (RM) | 4.99 | 5.77 | 6.36 | 7.03 |
| Issued Capital (mil shares) | 97.2 | 97.2 | 97.2 | 97.2 |
| 52-weeks Share Price Range (RM) | | | 4.62 - 6.00 | |
| Estimated free float | | | | 19% |
| Average volume (shares) | | | | 26,790 |

| Per Share Data | 2016 | 2017F | 2018F | 2019F |
|--------------------------|-------------|--------------|--------------|--------------|
| Year-end 30 Jun | | | | |
| Book Value/Share (RM) | 4.99 | 5.77 | 6.36 | 7.03 |
| Operating CF/Share (sen) | 87.2 | 43.7 | 121.1 | 69.4 |
| EPS (sen) | 74.8 | 71.0 | 71.7 | 79.0 |
| Net Dividend/Share (sen) | 12.0 | 12.0 | 12.0 | 12.0 |
| P/E (x) | 7.0 | 7.3 | 7.3 | 6.6 |
| P/Cash Flow (x) | 6.0 | 11.9 | 4.3 | 7.5 |
| P/Book Value (x) | 1.0 | 0.9 | 0.8 | 0.7 |
| Dividend Yield (%) | 2.3 | 2.3 | 2.3 | 2.3 |
| Payout Ratio (%) | 16.0 | 16.9 | 16.7 | 15.2 |
| ROE (%) | 16.3 | 13.2 | 11.8 | 11.8 |
| Net Gearing (%) | (29.8) | (26.7) | (37.3) | (39.0) |

| P&L Analysis (RM mil) | 2016 | 2017F | 2018F | 2019F |
|----------------------------------|-------------|--------------|--------------|--------------|
| Revenue | 770.60 | 786.03 | 817.32 | 863.42 |
| EBITDA | 115.23 | 109.33 | 111.02 | 117.63 |
| Depreciation & amort | (21.17) | (19.94) | (21.98) | (20.06) |
| Net interest income | (1.85) | (1.04) | (0.85) | (0.37) |
| Pre-tax Profit | 92.21 | 88.35 | 88.20 | 97.20 |
| Net Profit | 72.73 | 69.07 | 69.68 | 76.79 |
| EBITDA Margin (%) | 15.0 | 13.9 | 13.6 | 13.6 |
| Pre-tax Margin (%) | 12.0 | 11.2 | 10.8 | 11.3 |
| Net-Margin (%) | 9.4 | 8.8 | 8.5 | 8.9 |

1. 4QFY17 Results Highlight

| | 4Q FY17 | 4Q FY16 | Chg |
|----------------------|----------------|----------------|------------|
| | RMm | RMm | % |
| Revenue | 184.00 | 175.56 | 4.8 |
| Operating Profit | 15.28 | 19.88 | (23.1) |
| Finance cost | (0.72) | (0.68) | 5.4 |
| Pre-tax Profit | 14.57 | 19.21 | (24.2) |
| Net Profit | 4.46 | 9.81 | (54.5) |
| Operating Margin (%) | 8.3 | 11.3 | |
| Pre-tax Margin (%) | 7.9 | 10.9 | |
| Net-Margin (%) | 2.4 | 5.6 | |

- In 4QFY17, LTHB's turnover increased marginally by 4.8% to RM184.00m.
- PBT however declined by 24.2% to RM14.57m due to higher cost of raw materials and forex loss.
- Net profit dropped by a larger magnitude of 54.5% to RM4.46m. This was attributed mainly to higher effective tax rate of 69.4% (4QFY17) as compared with 48.9% (4QFY16).

- In terms of geographical contribution, its Vietnam operation, which accounted for 79.4% of group turnover in 4QFY17, grew marginally by 2.1% to RM146.05m in 4QFY17. Although turnover of the Malaysia and Thailand operations were each higher by 14.0% and 24.0% at RM29.81m and RM7.07m, their turnover base is much smaller as compared with the Vietnam operation.
- Although LTHB was faced with the rising rubberwood prices since the beginning of 2017, its gross margin was largely maintained at 17.0% (4QFY17) as compared with 17.5% (4QFY16). This could be due to stocking up of rubberwood timber at cheaper cost.
- However, it incurred higher administrative expenses due to one-off immigration expenses incurred for the hiring of new foreign workers. In addition, its net forex loss amounted to RM3.64m (4QFY17) as compared with net forex gain RM1.01m (4QFY16). Consequently, despite the stable gross margin, its PBT margin declined to 7.9% (4QFY17) from 10.9% (4QFY16).

FY17 Results Highlight

| | FY17 | FY16 | Chg |
|----------------------|-------------|-------------|------------|
| | RMm | RMm | % |
| Revenue | 786.03 | 770.60 | 2.0 |
| Operating Profit | 90.98 | 95.50 | (4.7) |
| Finance cost | (2.63) | (3.29) | (20.0) |
| Pre-tax Profit | 88.35 | 92.21 | (4.2) |
| Net Profit | 69.07 | 72.73 | (5.0) |
| Operating Margin (%) | 11.6 | 12.4 | |
| Pre-tax Margin (%) | 11.2 | 12.0 | |
| Net-Margin (%) | 8.8 | 9.4 | |

- For full year FY17, turnover was largely flat at RM786.03m due to a drop in orders. In US\$ term, turnover actually declined by 1.3% but it was helped by strengthening of US\$ against ringgit by 3.7%. Besides the slight softening in demand, LTHB’s factories in Malaysia and Vietnam were operating at optimum capacity with limited room for higher production output.
- In terms of geographical contribution, Malaysia experienced a 4.6% decline in turnover to RM126.03m in FY17. This was due to production rationalisation exercise arising from the consolidation of the downstream furniture making operations into one single factory in Kapar since Jun-17.
- The turnover of its Vietnam operations grew marginally by 2.0% to RM627.62m in FY17, as the operations were already running at optimum run-rate. Meanwhile, its Thailand operation (upstream production of saw milling, kiln dry sawn timber and furniture components) improved its turnover by 18.7% to RM27.26m in FY17.
- Gross margin at group level dipped to 16.8% (FY17) from 17.7% (FY16) due to the hike in the prices of rubberwood.
- Administrative expenses expanded by 23.3% in FY17. This was attributed to higher labour cost due to an increase in minimum wages in Vietnam since 1-Jan-17, as well as higher immigration expenses for its Malaysia operation. However, this was offset by a swing in net forex from a loss of RM1.19m (FY16) to a gain of RM3.18m (FY17). As such PBT margin only declined to 11.2% (FY17) from 12.0% (FY16).

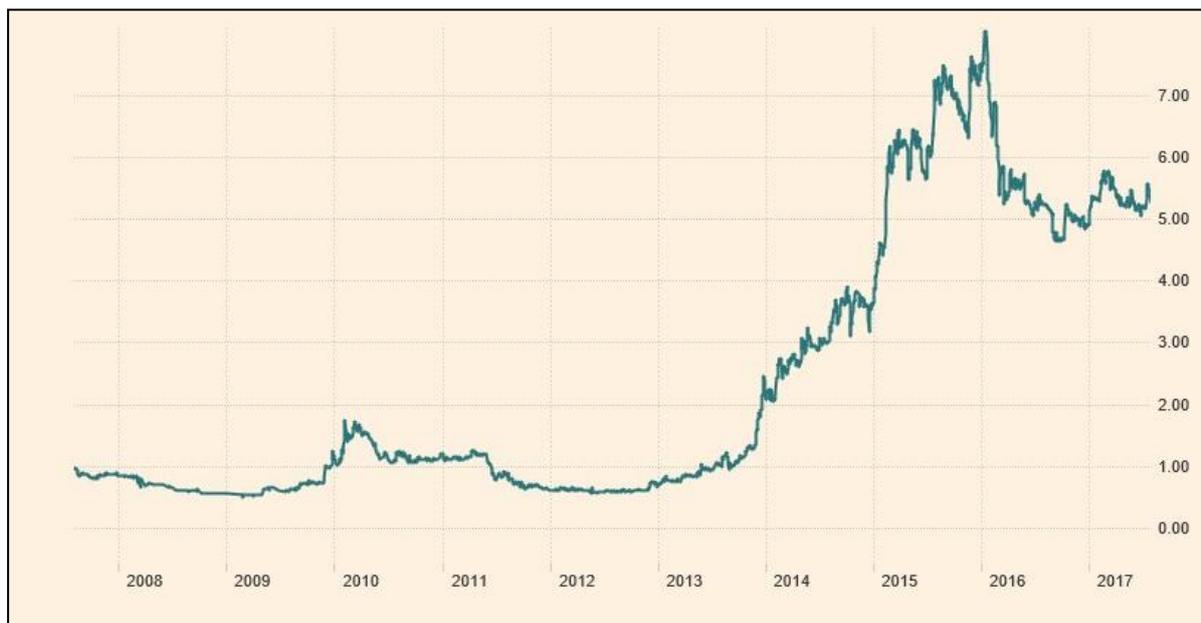
2. Earnings Outlook

- LTHB is involved in the manufacturing of wooden furniture products and components, in particular high quality rubberwood furniture targeted for the export markets. About 99% of its revenue is derived from export markets, primarily the US, Canada, Europe, South Africa, Australia and the Middle East. Amongst its export markets, sales to the US accounts for 93% of its group revenue.

- LTHB is expected to experience slower turnover growth going forward due to limited capacity expansion and optimum run-rate at its furniture making operations in Kapar (Malaysia) and Vietnam. Its only expansion in downstream operation is on a new high-end production line (Line F) and design centre in Vietnam to cater for production of small quantity high-value products. It is focusing on ODM products, which fetches higher profit margin. It is currently in developing new product prototype to customers.
- Against the backdrop of higher rubberwood prices, its profitability in FY18 will be under pressure. Effective 1-Jul-17, the government has banned the export of rubberwood to ensure adequate supply of the raw material for the local furniture industry. This should alleviate the issue of shortage of rubberwood supply and the rising price of sawn rubberwood timber. The rising cost can be mitigated by increase in selling prices and improvement in operational efficiency.
- The key strategic initiative is to expand its upstream operation in order to ensure the stability of raw materials supply and reduce cost of raw materials. The construction of an additional saw milling plant in Terengganu is scheduled to be completed by end-Aug-17. The full production is expected to commence towards 2QFY18. Upon the full production, its Terengganu will be able to source 100% (from 50% currently) of the wet timbers requirement internally.

3. Valuation and Recommendation

- The reported FY17's net profit is slightly below our earnings forecast due mainly to a swing in net forex loss, lower margins and higher effective tax rate. We have lowered our earnings forecast by 4% to account for a slight drop in profitability.
- LTHB is uniquely positioned given its exposure to the production base in both Malaysia (availability of rubberwood and established cluster of sub-contractors) and Vietnam (competitive cost of production).
- We like LTHB for its unique value proposition in terms of a sizeable integrated operation ranging from upstream manufacturing of sawn timber and furniture components to downstream manufacturing of end furniture products. The integrated synergies and economies of scale position the group in a competitive position in terms of reliability in sourcing of rubberwood supply, better cost control and quality products on a timely delivery basis to its international customers.
- Over FY17-18, LTHB is expected to post flattish net profit performance due to the lack of new capacity expansion on its downstream furniture making operations and cost pressure arising from rubberwood prices.
- We are maintaining our BUY recommendation. Based on our EPS forecast of 71.7 sen for FY18, the stock is currently trading at a P/E of 7.3x for FY18. We have reduced our fair value to RM7.20 from RM7.50 upon ascribing a target P/E of 10x. Excluding net cash per share of RM1.54 sen, its P/E ex-cash reduces to 5.1x.

Share price chart of LTHB**Disclosures/Disclaimer**

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)

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