



MALAYSIA EQUITY
Investment Research
CBRS

AUTOMOTIVE

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Stock Profile/Statistics

	EPMB MK
Bloomberg Ticker	KLCI
Issued Share Capital (m)	124.45
Market Capitalisation (RMm)	56.00
52 week H L Price (RM)	0.61 0.42
Average Volume (3m) '000	31.24
YTD Returns (%)	-0.05
Net gearing (x)	1.22
Altman Z-Score	0.73
ROCE/WACC	0.48
Beta (x)	0.60
Book Value/share (RM)	0.42

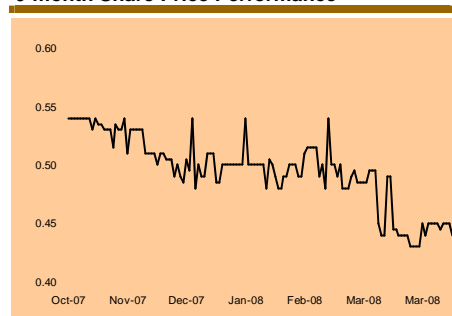
Major Shareholders (%)

Mutual Concept	21.93
Hamidon bin Abdullah	7.04
HSBC Holdings	5.39

Share Performance (%)

Month	Absolute	Relative
1m	-10.20	-11.81
3m	-12.00	8.92
6m	-18.52	-7.89
12m	-18.52	-12.38

6-month Share Price Performance



Initiating Coverage

Private Circulation Only

EP Manufacturing

NEUTRAL	Initiate
Price	RM0.45
Target	RM0.48

Light at the End of the Tunnel

Being one of the leading Tier-1 suppliers of Proton, EPMB's revenue is expected to further expand on the back of the positive growth of 5.6% in the automotive industry. Its autoparts sales should also jump with the recent breakthrough development of the IAFM module which is fitted into the Campro engines. Coupled with its new water meter business with a profit guarantee agreement, EPMB should be able to recover from its previous losses and maintain its growth momentum going forward. We initiate EPMB with a NEUTRAL and 12-months target price of RM0.48 derived from 7x FY08 EPS at a 15% discount given low liquidity.

Recovery in the automotive industry. After its past troubles, Proton made a come back with two new models: Proton Saga and Persona. This is highly evident in the monthly TIV over the last two quarters. We also foresee a 5.6% growth in the automotive industry going forward. This bodes well for EPMB sales as it is highly dependent on the sales of Proton and Perodua cars which dominate the automotive market share in the country. Apart from that, sales to Toyota have also doubled in 2007 from RM23m to RM46m.

Breakthrough collaboration with Bosch. EPMB's partnership with Bosch, the international power equipment manufacturing company has led to the development of the IAFM which forms the integral part of a car's powertrain. It is fitted into Proton Saga and Persona models. Delivery commenced in the last quarter of 2007 and the new IAFM would be one of its main components to its topline going forward. Being a Tier-1 vendor, Proton will partly finance EPMB on the capital expenditure spent on building the new platform for Proton's new model. This would be an advantage that EPMB has over its competitors.

The Smart meters. EPMB is tapping into new water meter business with the acquisition of Circle Ring Network (CRN). We believe this may be an opportunity to EPMB given the growing world demand for smart meters to reduce non-revenue water (NRW) losses with the average NRW across Asian countries at ~30% and Malaysia NRW of 39.3%. Currently, 30,000 pilot units have been delivered to Kedah and Malacca.

Valuation. We see a potential revenue growth of 51.2% in tandem with our forecasted growth of 5.6% in the automotive industry. Due to the net losses in EPMB and its peers, we value EPMB based on the historical PE band of 7x with a discount of 15%. We initiate coverage with a NEUTRAL recommendation based on a target price of RM0.48.

FYE Dec (RMm)	FY05	FY06	FY07	FY08f	FY09f
Turnover	300.1	228.5	303.0	458.2	473.7
Core Net Profit	21.2	2.9	-0.5	10.5	16.6
% chg YoY	16%	-86%	-	-	58%
Consensus	-	-	-	-	-
EPS (sen)	16.3	2.2	-0.4	8.0	12.6
DPS (sen)	8.0	3.7	0.0	0.0	0.2
Div Yield	18.5	8.6	0.0	0.0	0.5
ROE	10.9	1.4	-0.3	5.2	8.0
ROA	4.5	0.5	-0.1	1.5	2.3
PER (x)	2.6	19.7	-	5.4	3.4
P/BV (x)	0.3	0.3	0.3	0.3	0.3
EV/EBITDA (x)	4.5	11.7	10.5	6.4	5.5

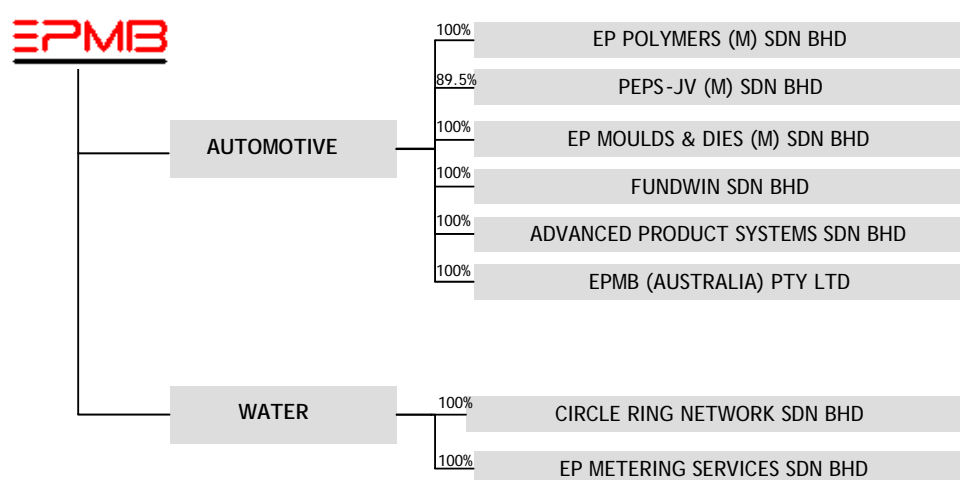
COMPANY OVERVIEW

A leading automotive solutions supplier. EP Manufacturing (EPMB) is one of the leading automotive systems solution suppliers. The company was incorporated in 1996 with key products including metal, modular assemblies, suspension, body and engine as well as plastic and lamp assemblies. EPMB has close partnerships and technical agreements with Bosch and Koito which offer full automotive systems solutions with world class leading edge technology to car makers. It has a vision to provide swift and efficient solutions throughout business functions from design and development to mass production, delivery and quality.

Access to technology via partnerships. EPMB has an agreement with Koito Manufacturing, a leading lighting equipment manufacturer, to acquire the license to manufacture and sell automotive lighting equipment using Koito's technical expertise. With Koito's guidance, EPMB was able to develop the technology and engineering skills to manufacture headlamps and other automotive lighting equipment. Strategic partnerships with Bosch, a leading global manufacturer of automotive and industrial technology, have allowed EPMB to supply brakes to Proton Holdings and other carmakers. Through its subsidiary, PEPS-JV, EPMB would manufacture its own components for the corner module and assemble it with Bosch's brake components. The Intake Air Fuel Module (IAFM) was a breakthrough jointly developed by Bosch and EPMB.

Moving into the water meter business. To broaden its earnings base, EPMB recently acquired Circle Ring Network Sdn Bhd (CRN) which is the sole exclusive manufacturer of Severn Trent. Plc patented Smart Water Meter. This acquisition has given EPMB the opportunity to also own the exclusive distributorship in Asia Pacific. EPMB is thus, made up of two core divisions catering to the automotive and water industry. Both segments operate in Malaysia while its Research and Development (R&D) is currently located in Australia to design and manufacture Toyota exterior fittings that are specially adapted for the Saudi market.

Figure 1: EPMB's Corporate Structure



Source: Company Data

Figure 2: Products Manufacture By EPMB



Source: Company Website, OSK Research

Production facilities. EPMB currently has 2 plants with a combined workforce of 1500 employees. The metal stamping facility is located in Ulu Yam, Batangkali which covers 428,000 sq ft including a new expansion of 198,000 sq ft. The new expansion includes a new assembly, stamping building and a new warehouse to enhance their capacity of production. As for the Shah Alam plant, it has a factory floor size of 15,480 sq ft with an occupied size of 13,858 sq ft which is mainly into plastic injection moulding that manufactures one of its new products, Intake Air Fuel Module (IAFM). Nonetheless, EPMB has excess land area to expand its capacity for IAFM and water meters which can increase production of IAFM by 30% while the production of water meters can be increased by 100%.

Figure 3: Capacity for the manufacturing plant in Batangkali



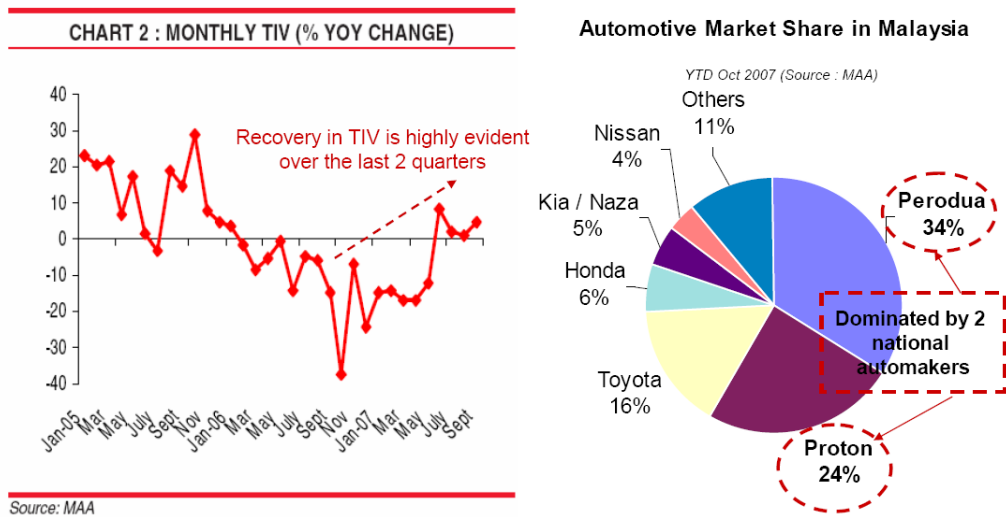
Source: Company data

KEY HIGHLIGHTS

Leading Tier-1 vendor. EPMB is one of the leading Tier-1 vendors for Malaysia’s two biggest national car manufacturers, namely Proton and Perodua. It has had a long term relationship with both car manufacturers since 1989. Being a Tier-1 vendor, Proton would partly finance EPMB on the capital expenditure spent on building new platforms for Proton’s new models. This would be an advantage to EPMB compared to its competitors as EPMB would not be tied with heavy debts for the construction of the platforms. EPMB is currently in talks with Proton on the new MPV model which is expected to launch beginning first quarter of 2009.

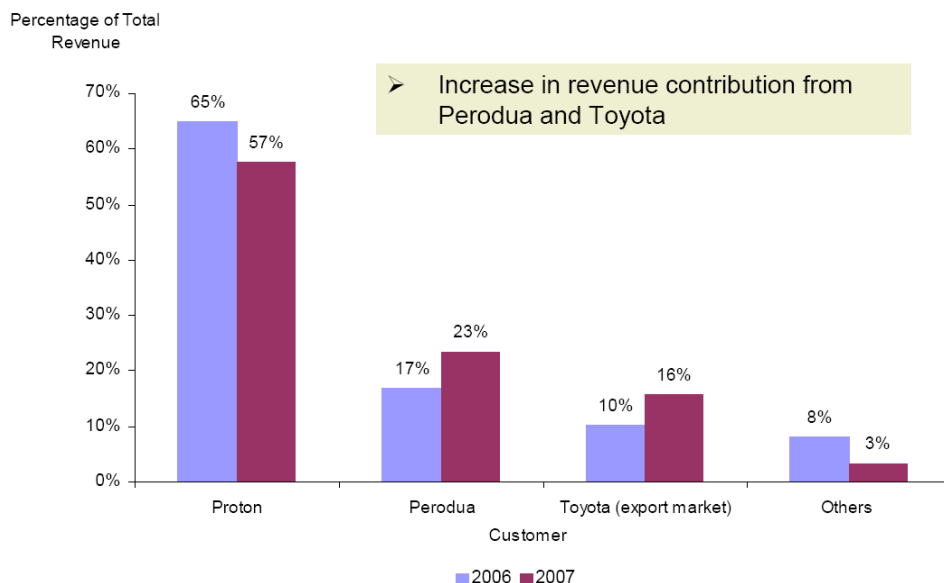
Automotive industry makes a come back... Following the recovery of the automotive industry which is evident over the last two quarters as shown by its monthly TIV (refer Figure 4) we foresee a 5.6% growth in the industry going forward. Furthermore, we see Proton and Perodua growing at a forecasted rate of 5.8% and 6.2%. Being a Tier-1 vendor, the recovery would bode well with EPMB sales as EPMB is highly dependent on the sales of Proton and Perodua which made up 58% of the total market share in the country. This can be seen from a stable growth in EPMB’s 2007 quarterly revenue from RM73m in Q2 to RM90m in Q4 in tandem with the launch of Viva in Q2 followed by Persona in Q3 and Saga in Q4. Apart from that, sales to Toyota have also doubled in 2007 from RM23m to RM46m with further contracts secured for the next few years.

Figure 4: Monthly TIV and automotive market in Malaysia



Source: MAA, Company data, OSK Research

Figure 5: Shift in revenue breakdown



Source: Company Data

IAFM – picking up. EPMB and Bosch have jointly developed the IAFM which was fitted into Proton Saga and Persona models. This has created a new income stream for EPMB as it forms an integral component of a car's powertrain that enhances the performance of Campro engines via better pick-up and smoother acceleration. Hence, with good booking rates from Persona and Saga, it signifies better sales volume for the IAFM modules.

“Win-win” tie-up with Teck See Plastics. EP Polymers, a subsidiary of EPMB signed a Shareholder's Agreement to form a joint venture with a similar-sized plastic competitor, Teck See Plastics. This JV is to develop expertise as a modular system supplier creating synergy to both parties. Both parties will cooperate to increase capacity and thus, achieve economies of scale to further strengthen their position in the industry. Through this partnership, it allows EPMB to secure new automotive business in both domestic and overseas markets.

Strategic location. Given the long term relationship with Proton and Perodua, EPMB's plant (no.1) is strategically located in between Proton and Perodua's plants as well as Bosch's plant. This facilitates the transportation of supplies to their customers. The Glenmarie, Shah Alam (no. 2) plant is also located nearby Port Klang and KLIA which gives EPMB easy transportation for exports to Middle East. This reduces transportation cost for both the car manufacturers (Toyota) and EPMB.

Figure 6: Locations of EPMB plants



Source: Company Data

Water meters – a new venture. With the acquisition of Circle Ring Network (CRN), EPMB is tapping into the less penetrated market of water meters. CRN is the sole exclusive manufacturer of patented electronic water meters (Smartmeters) for Severn Trent Metering Services Ltd, the largest water operator in the USA and UK. Unlike mechanical meters, Smartmeters is able to detect grit and sand which will affect the accuracy of the actual usage of water (refer Figure 7). Therefore, we believe this may be an opportunity for EPMB given the growing world demand for smart meters to reduce non-revenue water (NRW) losses to improve utility income and reduces inefficiencies of the water supply system. With average NRW across Asian countries at ~30% and Malaysia NRW of 39.3%, the smart meters stand a chance to prove their value with the Malaysian government aiming to reduce NRW to 30% by 2010. EPMB has thus far delivered 30,000 pilot units to Kedah and Malacca. Pilot projects have also been released in Putrajaya, Pahang and Sarawak with negotiations underway for several states. Orders from South Korea as well as extensive trials have been conducted in Australia, Vietnam, Jakarta and Thailand. Hence, we think EPMB stands a good chance to be a main beneficiary on the spending in the water sector. Apart from that, CRN was granted 100% pioneer status with tax exemption up till 2010.

Figure 7: Water usage reading will be less due to grit and sand



Source: Malaysian Water Association, Company data

Figure 8: Malaysia NRW

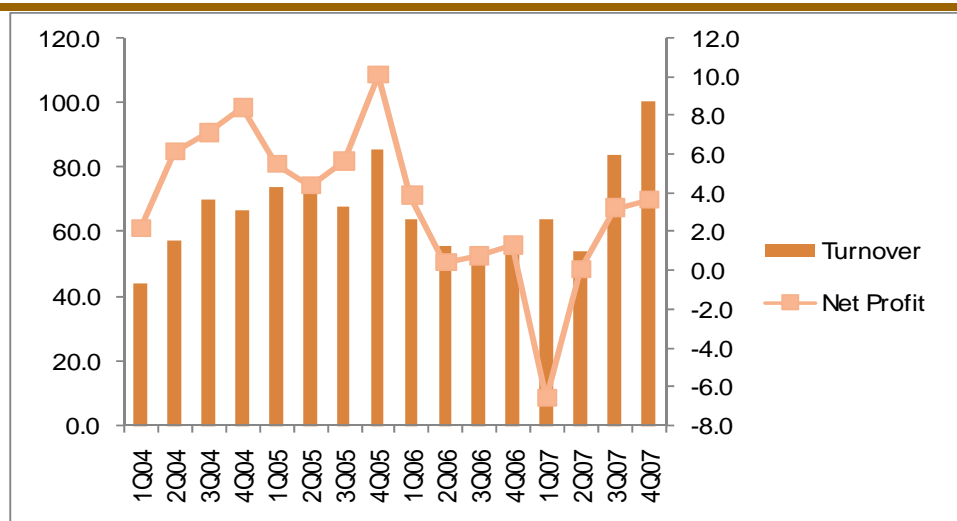
Percentage of Non-Revenue Water (%)		
Water supply entities	2003	2004
Pulau Pinang	19.4	21.4
Sarawak*	24.7	27.2
Labuan	23.8	28.7
Terengganu	29.2	29.3
Perak	33.2	31.7
Melaka	20.9	33.3
Johor	35.8	36.3
Perlis	41.6	36.7
Kelantan	43.4	40.8
Selangor**	43.9	42.7
Kedah	43.6	42.8
Pahang	48.2	48.2
Negeri Sembilan	54.2	54.7
Sabah	65.4	58.0
National Average	40.0	39.3

Source: Malaysian Water Association, Company data

FINANCIAL REVIEW

Bouncing back with auto industry. As EPMB's sales is highly dependent on Proton's car sales (55% of total revenue contribution), it reported a declining profit from RM21.2m in 2005 to RM2.9m in 2006 and henceforth to a net loss of RM0.5m in 2007. This is in line with Proton's sales decline of 8% in 2006 and 37% in 2007. However, with Proton's new launchings in the second half of last year, we foresee a recovering growth in the automotive industry of 5.6%. Hence, EPMB is set to recover from its losses. Proton's recovering sales from its two latest models, namely the Proton Saga and Persona have improved EPMB's profit and has driven the sales of its IAFM modules (refer Figure 9). EPMB is recovering from losses which can be seen from the last two quarters, with a net profit of RM3.0m in 2006 and RM2.9m in 2007 in tandem with higher sales that made up 60% of the total sales in the year. Furthermore, the sales of Saga in the fourth quarter would continue to contribute to EPMB's revenue as delivery takes 6-8 months' time due to its initial production to manufacture 100 units of the model per month.

Figure 9: EPMB's Revenue and Net Profit Track Record



Source: Company Data, OSK Research Estimates

“Smartmeter” provide new income stream. With the expansion into the new water business, we should see both topline and bottomline growth in this area as the water meter business comes with a profit guarantee of RM24m over 3 years. Delivery started in the last quarter of 2007 and with a production capacity of 70%, we foresee that its revenue would continue to grow given the ongoing contracts for US, Mideast, Europe as well as orders from South Korea. Currently, EPMB had delivered 30,000 pilot units to Kedah, Malacca, Putrajaya, Pahang and Sarawak.

Going forward. Hence, we project its revenue to reach RM458.2m in 2008 due to better sales in the automotive segment and better sales in the water meter business. Net income on the other hand, is forecasted to be RM10.9m in 2008 as we factor in the profit guarantee of RM7.5m. Nevertheless, due to the change in the political environment, we expect growth from its local sales division to slowdown in FY08.

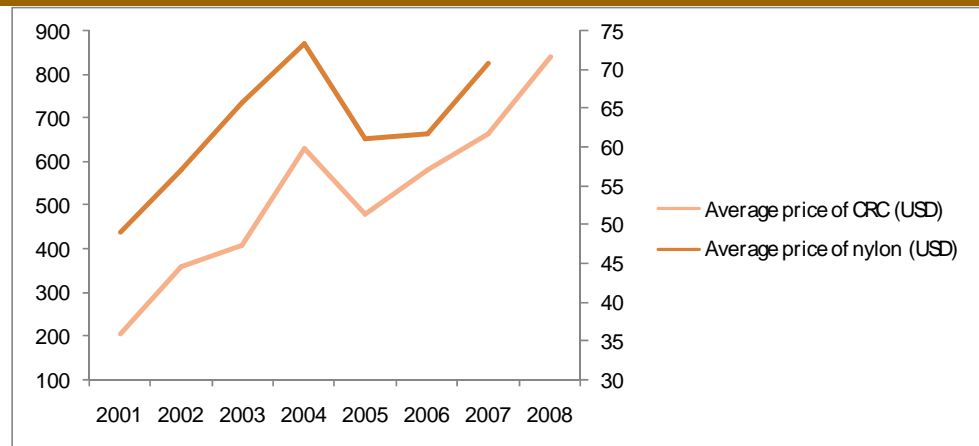
A bag full of tax incentives. EPMB enjoys tax incentives from its subsidiary, Peps-JV, EP Polymers (EPP), Circle Ring Network and Fundwin through its investments to improve in its business. With that, EPMB does not foresee any tax payable in the coming years. The bag of tax incentives includes:

- 1) Peps-JV: 100% pioneer status from 2004 to 2009 & 100% ITA on investment for 2006 onwards on major projects & Reinvestment Allowance brought forward from pre Pioneer period
- 2) EPP: Tax loss brought forward and possible 100% pioneer status on IAFM
- 3) CRN: 100% pioneer status from 2005 to 2010 on its water meter business
- 4) Fundwin: Tax allowance

INVESTMENT RISKS

Escalating raw material costs. The current 65% price hike in iron ore prices has resulted in the higher cost of cold rolled coils (CRC) to about US\$800/MT. The escalating price of raw materials would squeeze the margins for the automotive parts industry as car manufacturers have the bargaining power. Furthermore, with the price hike in consumer goods lately, consumer spending may be affected. The demand for cars could be dampened as higher oil prices would deter potential buyers from purchasing a car.

Figure 10: EPMB's Revenue and Net Profit Track Record



Source: Bloomberg

Lack of experience in water meter business? Diversifying into the new business of water meters would pose a risk as EPMB specialises in the automotive industry. Though electronic water meters record actual usage and reduce NRW, the cost of electronic water meter (selling price at RM100+) is more expensive compared to mechanical water meters. Thus, the cost to change to electronic water meters would be substantial.

VALUATION & RECOMMENDATION

NEUTRAL with a target price of RM0.48. Given its new income contribution from IAFM and water meters, we believe that the revenue and net profit will remain positive. Nonetheless, its high dependence on the local car industry and lack of experience in the water meter business may cast doubts on the sustainability of the business, thus the income stream. Given the losses among its industry peers last year (refer Figure 11), we value EPMB based on a historical PE band of 7x at a 15% discount due to (1) net loss from EPMB and its peers in FY07 (2) diversification into new unrelated business (3) poor liquidity. Hence, we initiate coverage with a NEUTRAL recommendation based on a target price of RM0.48.

Figure 11: Peers comparison

Automotive parts peers (Year 2007)					
	Net Income	EPS	PER	P/BV	Last Price
Ingress	(10.96)	-	-	0.30	0.56
Autoair	(4.49)	-	-	0.35	0.51
Tracoma	(4.08)	-	-	0.22	0.51
Mintye	7.52	-	7.25	0.66	0.87
Delloyd Ventures	13.42	0.12	12.72	0.69	1.92
EPMB	(0.51)	(0.39)	-	0.30	0.46

Source: Bloomberg

FYE Dec (RMm)	FY05	FY06	FY07	FY08f	FY09f
Turnover	300.1	228.5	303.0	458.2	473.7
EBITDA	46.9	27.6	30.1	45.6	52.5
PBT	27.7	6.4	0.4	13.4	20.2
Net Profit	21.2	2.9	-0.5	10.5	16.6
EPS (sen)	16.3	2.2	-0.4	8.0	12.6
DPS (sen)	8.0	3.7	0.0	0.0	0.2
Margin					
EBITDA	15.6%	12.1%	9.9%	10.0%	11.1%
PBT	9.2%	2.8%	0.1%	2.9%	4.3%
Net Profit	7.1%	1.3%	-0.2%	2.3%	3.5%
ROE	10.9%	1.4%	-0.3%	5.2%	8.0%
ROA	4.5%	0.5%	-0.1%	1.5%	2.3%
Balance Sheet					
Fixed Assets	307.2	399.3	497.7	515.1	509.7
Current Assets	159.0	136.4	134.4	202.3	214.7
Total Assets	466.3	535.7	632.1	717.4	724.5
Current Liabilities	125.4	144.3	217.9	318.6	323.8
Net Current Assets	33.6	-7.9	-83.5	-116.3	-109.1
LT Liabilities	116.6	179.2	203.3	186.8	181.5
Shareholders Funds	224.2	212.2	210.9	212.0	219.1

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