



## Sector Update

# Small Caps

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## 2010 Jewels - A Good Sheen

2010 proved to be a decent year for OSK's Small Cap Jewels although their performance was eclipsed by the liquidity-infused rally, which benefited the bigger caps, particularly from 2H2010. Of the 50 stocks profiled in our handbook, half posted absolute returns in excess of 20%, with 49% outperforming the FBM Small Cap and FBM KLCI indices. While the smaller caps are expected to bask in the glory their larger cap peers in 2011, investors should not ignore names with good longer-term potential that are trading at unattractive valuations. We like small caps in the construction, property, oil & gas and consumer sectors as beneficiaries of the ETP, elections and earnings themes. Our current top small cap buy ideas are KIMLUN (TP: RM2.34), PLENITUDE (TP: RM2.78) and CI HOLDINGS (TP: RM4.37).

**A fair play.** In 2010, we attempted to balance the risks and rewards when selecting the stocks to be included in our OSK Jewels handbook given the anticipated market volatility. We were comforted in that our selection garnered a hit rate of 74% (defined as stocks with positive returns). Although this was below the 92% achieved in our 2009 edition - arguably the best year in terms of overall performance for this publication since inception - more than half (52%) of our picks actually outperformed the FBM KLCI (64% in 2009 edition). The major winners were from the consumer and construction sectors, which dominated the upper quartile in terms of ranked returns. The performance of our top 10 picks was mixed, with 8 of the 10 companies eking out positive returns. CI Holdings was the star performer (among our Top 5 picks) as its share price more than doubled in 2010. The other notable winners in the 2010 edition (in no particular order) were Sunway Holdings, Mamee, Zhulian, Delloyd, Help and Handal. Aside from Help, the other 5 stocks were featured for the first time in the handbook. Investors who bought into our top 5 picks would have chalked up an average return of 30% in 2010, a respectable gain and trumping the performance of both the FBM KLCI and FBM Small Cap indices.

**Table 1: OSK's Top 10 Jewels (2010 Edition)**

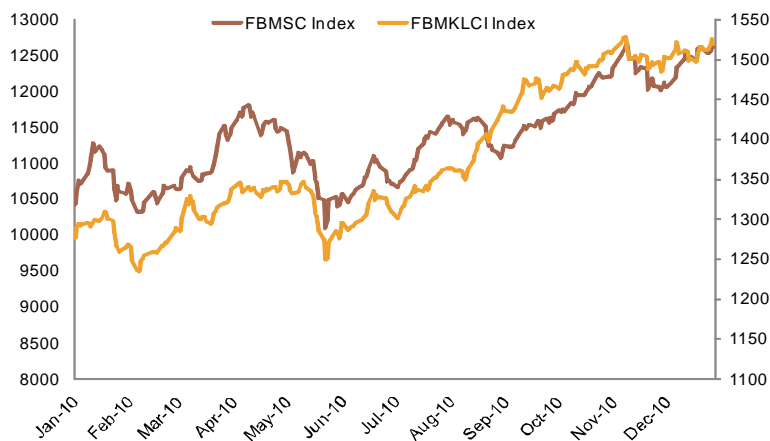
Companies	Sector	Share Price @ 2 Jan 2010 (RM)	Share Price @ 31 Dec 2010 (RM)	Return
Alam Maritim	Oil & Gas	1.26	0.99	-21.6%
CI Holdings	Consumer	1.62	3.65	125.3%
Faber Group	Conglomerate	1.61	2.54	57.8%
Freight Management	Logistics	0.80	0.97	21.1%
Glomac	Property	1.34	1.65	23.4%
HAI-O Enterprise	Consumer	3.54	2.65	-25.2%
KPJ Healthcare	Healthcare	2.50	3.72	48.6%
Leader Universal	Industrial Products	0.78	0.85	8.4%
Lion Industries	Steel	1.48	1.97	33.1%
Naim Holdings	Construction	2.89	3.37	16.8%

The overall performance of the 50 stocks and our views on the Top 5 companies in the 2010 edition are appended to this report.

**More than mere gems.** The devoted followers of our handbook would know that 2 particular companies, QL Resources and KPJ Healthcare, continued to be heavily promoted with the latter being among the top 10 stocks in the 2010 edition. The commendable gains they notched up in 2009 extended into 2010 as more investors warmed up to their strong longer-term prospects and better coverage by the investment community. Both stocks were first included in our 2005 and 2006 editions, with their market capitalizations soaring above RM2bn from under RM500m when they were first selected as our jewels. These two companies continue to be our choice picks for exposure to the consumer and healthcare sectors.

**Every dog has its day.** While we strove to pick winners within the 18 sectors profiled in the book, there was no guarantee that our stock picks would not disappoint. There were 2 disappointments last year, the first being Hai-O, a multi level marketing company which saw its share price nosedive after it dished out an earnings surprise in 2Q10. The other was Notion VTec, one of the few technology companies well liked for its exposure to the hard drive industry. In the case of Hai-O, more stringent recruitment policies imposed by the authorities affected the growth of its agency force, resulting in the poor earnings while Notion VTec's operations were impacted by issues affecting its 2.5" base plate designs. Subsequent to the findings, we took the unpopular decision to downgrade both the stocks to sells. In retrospect, it would not have been possible for us to predict the outcomes (the entire market was wrong) as both companies had fairly decent track records and were leaders in their respective industry segments. Hai-O was for a long time a preferred pick of OSK with a near-flawless record of consistently outperforming OSK and street estimates. The other stocks that saw their share prices fall were hit by a combination of sector-wide de-rating, poor demand outlook and stock specific challenges.

**Fig. 1: FBM KLCI and Small Cap Index performance 2010**



Source : OSK

**Small caps to bask in the glory of their larger peers in 2011.** While we expect the bigger cap companies to naturally be the winners of the liquidity infused rally, there remain investment opportunities within the small cap space as indirect and cheaper proxies which present good alpha strategies for investors. The selection of stocks to be included in the 2011 edition will be guided by our broader themes of Earnings, Elections and Easing (3Es), which form the basis of our 2011 investment strategy. That said, the overall selection process will continue to be based on our qualitative and quantitative benchmarks of good fundamental and operational standing. The key sectors that encapsulate these themes are construction, oil and gas, property and consumer, which we discuss in turn in the following paragraphs alongside our preferred picks. We had earlier included a teaser in our January monthly strategy report issued on 2 Jan entitled: 'Of Black Swans and Hidden Jewels', in which we highlighted some new small cap names that could potentially be included in the 2011 edition.

- **Construction and oil & gas remain key themes: KimLun our top pick**

With the economic transformation program (ETP) shifting to higher gear, we continue to see more goodies going the way of the local construction players. The Government recently announced 19 more entry point projects (EPP) valued at RM67bn, adding to the list of 18 projects announced earlier. The most ambitious of the projects unveiled to date is the RM36bn KL Mass Rapid Transit (MRT) development, for which Gamuda has been the appointed project delivery partner (PDP). While bigger cap contractors are natural beneficiaries of large scale infrastructure projects, small cap contractors with good execution track records and that have relevant expertise are also winners as they will also benefit from sub-contract works under the private finance initiatives (PFIs). Our top pick for small cap construction exposure is **KIM LUN (BUY, TP: RM2.34)**. We favour Sarawak construction players such as **NAIM (BUY, TP: RM5.10)** and **HOCK SENG LEE (BUY, TP: RM2.32)** which will be buoyed by the impending state election to be held by July. The oil and gas sector, which saw a paucity of contracts over the last 2 years, is also seeing a resurgence of interest due to new investments by major oil majors, which will indirectly benefit the likes of service providers, platform fabricators and ancillary vessel operators. Today, media reports said Petronas is expected to award 4 marginal oil fields in April. Our preferred exposure for the small cap oil and gas space remain **ALAM (BUY, TP: RM1.50)**, **PETRA ENERGY (BUY, TP:RM2.16)** and **COASTAL (BUY, TP: RM4.41)**.

- **Consumer names still figure prominently: CI Holdings our top pick**

The consumer sector was featured most prominently in our handbook given that the sector had been relatively defensive in the face of the downturn in 2009 and performed well for most part of 2010 on the back of the improving consumer sentiment. With the strong spending propensity of Malaysians supported by the wealth effect from an rising stock market, the retailers generally performed better in 2010 on the back of a steady expansion in their topline. The food companies, on the other hand, have generally benefited from a stronger Ringgit and various cost-down initiatives, with indications of a better showing in FY11. For 2011, we see the Government's indirect efforts to promote consumption spending via the abolishment of import duties on goods announced during Budget 2011 being one of the indirect sweeteners for the sector. As the impact of reduced subsidies on flour and sugar has proven to be insignificant for most food companies under our coverage, we also see F&B companies faring reasonably well this year. The increasing number of consumer companies undertaking corporate proposals such as bonus issues, share splits (Padini, QL Resources) suggests that their managements are positive on the outlook of the economy and see further value creation from such exercises. This should boost sentiment in the sector. Our top pick consumer food and beverage (F&B) exposure remains **CI HLDGS (BUY, TP: RM4.37)** as there is room for the F&B segment in Malaysia to expand further. The other top pick within our small cap consumer universe is Bonia, as the company will benefit from stronger consumption spending and earnings accretion from the previous acquisition of Jeco.

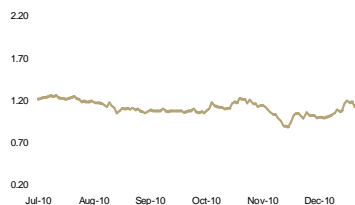
- **Property sector in the spotlight: Plenitude our top pick**

The property sector is back in the limelight, thanks to a flurry of positive news of late, in particular the mergers of UEM Land-Sunrise, MRCB- IJM Land (later aborted) and Sunway-SunCity, which will create key property groups with sizeable market capitalization, and the strong market liquidity fuelling appetite for mid to high end landed properties. We see the strong demand for landed properties to continue in 2011, thus bolstering the earnings of developers. While the larger cap players typically benefit first from the sector- wide rerating due to their exposure to good and strategic landbanks, we think it is only a matter of time when the smaller property outfits catch up due to their cheaper valuations. We see good value in a few small cap property stocks such as **PLENITUDE (BUY, TP: RM2.78)** and **BRDB (BUY, TP: RM3.00)**, which stand to benefit from the current upcycle in the sector. Look out for the inclusion of more property stocks in the next instalment of the OSK Jewels.

## APPENDIX

## OSK Top Malaysian Small Cap Companies – Top 5 Picks for 2010 Edition

## 6-month Share Price Performance



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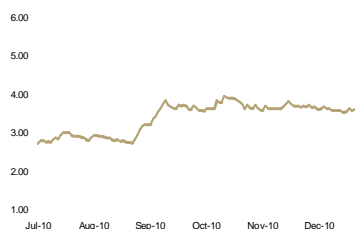
## ALAM MARITIM (BUY, TP: RM1.50)

The O&G sector has been a laggard sector over the past 2 years with a marginal recovery starting only at the end of 2010. Hence, we are not surprised that Alam did not perform up to our expectation as this was due to the sluggishness of the sector as a whole.

Alam's current vessel utilization rate is about 60%-70%. We understand that some of its vessels which have completed their contracts are now waiting for new contracts to be awarded by Petronas and its PSC contractors. There have been minimal contract renewals in the market in 2010. As for charter rates, these are still good at USD1.70-USD2.00/bhp for Alam's 5k bhp AHTS, which enables the company to fetch a gross margin of 30%-40%, depending on whether a vessel is chartered out as a package or as an individual charter.

Going forward, we believe the prospects of vessel players remain bright, especially starting from 2Q11. We think that after awarding our fabrication contracts, vessel services would be required to assist in the delivery of structures to oil platforms. Also, there will be more activities between the shore and the platforms once the platforms are up. Currently, we have a Neutral call on the company, with a target price of RM1.00 based on a PER of 10x FY11 EPS. We are in the mist of upgrading the stock's valuation in line with the brighter prospects for the O&G industry.

## 6-month Share Price Performance



## The Research Team

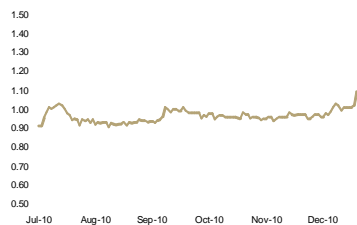
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## CI HOLDINGS (BUY, TP: RM4.37)

CI Holdings (CI)'s share price appreciated by ~120% (RM1.66 - RM3.52) in 2010, with the stock price hitting a high of RM3.98 in early Nov 2010. The strong performance of its share price was mainly driven by the company's turnaround story in 2007, its consistently strong earnings growth thereafter attributed to robust growth of its market leading brands such as Tropicana, Lipton and Revive Isotonic, as well as expansion of distribution coverage from 20,000 in 2007 to 43,000 currently. The share price was also boosted by its announcement on the further expansion of its non-carbonated production line, which was commissioned in September 2010 to cater for growing demand. The group also plans to invest further in its carbonated production line in FY12.

Although competition within the beverage is keener now, we believe CIH still has room to grow, riding on the enlarging beverage pie, particularly in the non-carbonated beverage space. While raw material prices are trending upwards, the stronger RM against USD would partially offset the negative impact. The progressive switch from non-carbonated and bottled drinks from carbonated and canned or packaged drinks would also help to sustain margins. We maintain our BUY call on CI Holdings at a TP of RM4.37, which is based on 15x revised FY11 EPS. The stock is currently trading at a forward 10.5x PE, which is still attractive.

**6-month Share Price Performance****The Research Team**

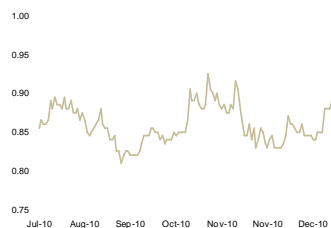
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**FREIGHT MANAGEMENT (BUY, TP: RM1.40)**

Freight Management's share price has outperformed the benchmark index, appreciating by 31% relative to the KLCI's 16.6% rise. Its shares got a boost in the first half of the year as its quarterly earnings continued to come in within our and consensus on the back of buoyant volume from stockpiling activities. While its 2H numbers were not as favorable due to moderating trade activities, Freight Management's margins and earnings have so far met our expectations.

Notable corporate developments in the mid-term are the potential contracts to be secured from a leading oil and gas MNC for its warehousing, clearance and forwarding services. Although the contract value has yet to be disclosed, management guided that it would be quite sizable as the storage portion alone may occupy as much as 50% of its current warehouse space in Klang. Taking the cue from last year's total revenue contribution of RM11m at 50%, the contract could boost warehousing revenue by as much as 30%. Due to space constraints, management has acquired a warehouse solely dedicated for a new client for a sum of RM14.5m using internally generated funds. On the tug and barge side, management is seeing more shipments of coal from Jambi, possibly due to the supply disruptions caused by the flooding in Queensland.

Freight Management's valuation remains undemanding, as the stock is trading at only 5.3x PE versus the sector average of 8-9x. Furthermore, we see container seaborne trade in South East Asia region remaining resilient despite moderating trade growth. Our TP of RM1.40 for Freight Management is premised on 9X PE, which is the peak valuation cycle.

**6-month Share Price Performance****The Research Team**

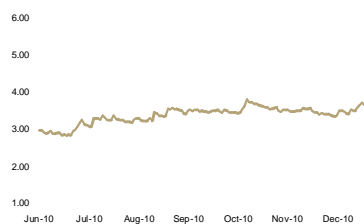
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**LEADER UNIVERSAL (BUY, TP: RM1.05)**

So far, revenue has increased by some 30% y-o-y. Despite that, Leader's profits were flattish YTD, mainly due to higher costs in 1Q2010, but this was offset subsequently by a better 2Q and 3Q. Gains at bottom line were limited as higher sales to foreign markets command lower selling margins as opposed to sales to the domestic market, which also remained flat. Looking at its share price, 2010 saw a growth of 8.4% y-o-y as we reckon a healthy 4Q has helped to lift overall earnings growth for the full year.

Going forward, we expect earnings growth to pick up via double digit as sales of cables and wires increase on higher global demand. Its bottom line earnings will also improve as we see the company incurring lower interest expenses as it pares down its borrowings. In the meantime, we look forward to Leader's power division, whereby a 100MW plant is scheduled to commence and contribute to earnings in 2012. Other than that, the group is also planning to jointly develop a 700MW power plant in Cambodia with the country's power provider, Electricite Du Cambodge.

For FY11 earnings, our SOP-derived target price for the stock is RM1.05, based on a PE of 9x on Leader's cable and wires division's earnings. The stock is currently trading at an undemanding forward P/E of 5.8x.

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**NAIM HOLDINGS (BUY, TP: RM5.10)**

Over the past 12 months, Naim's share price has only appreciated by 8.9%. On a relative basis, it has underperformed the KL Construction Index by 17.5% and also underperformed its closest peer, Hock Seng Lee (BUY, TP: RM2.32) by 45.3%. We feel that its underperformance is unjustified given its strong orderbook replenishment last year and positive prospects for Sarawak infrastructure.

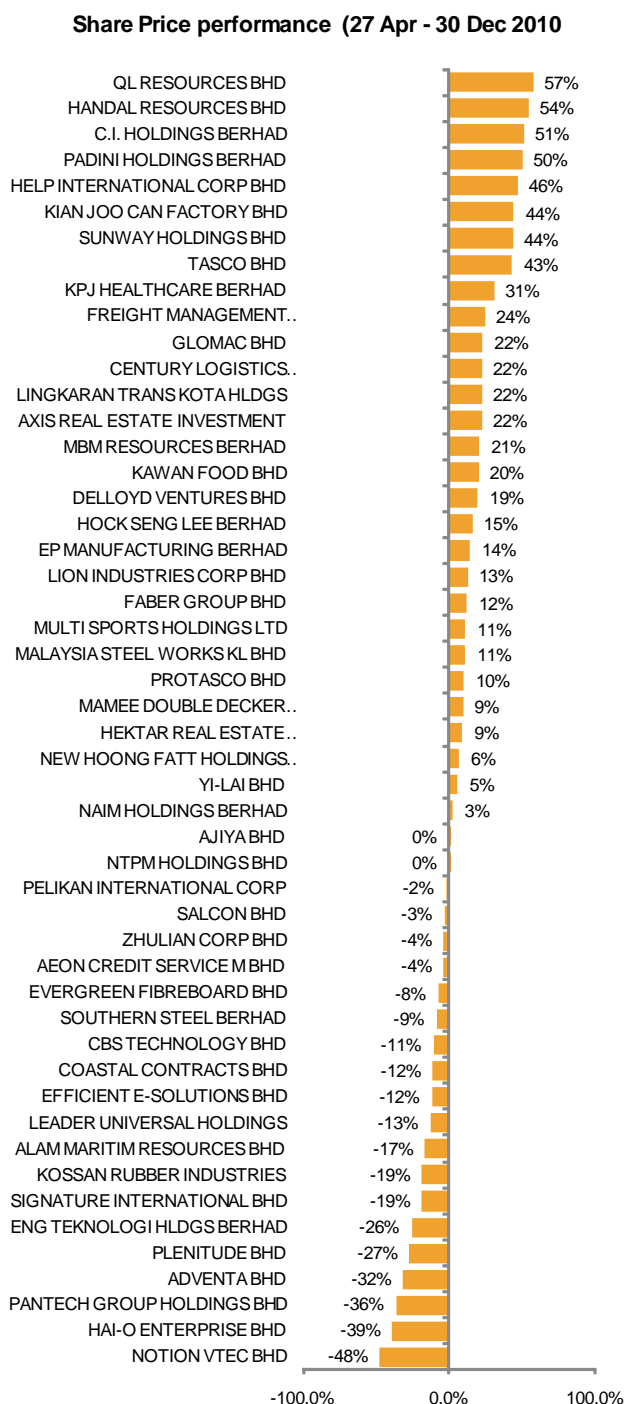
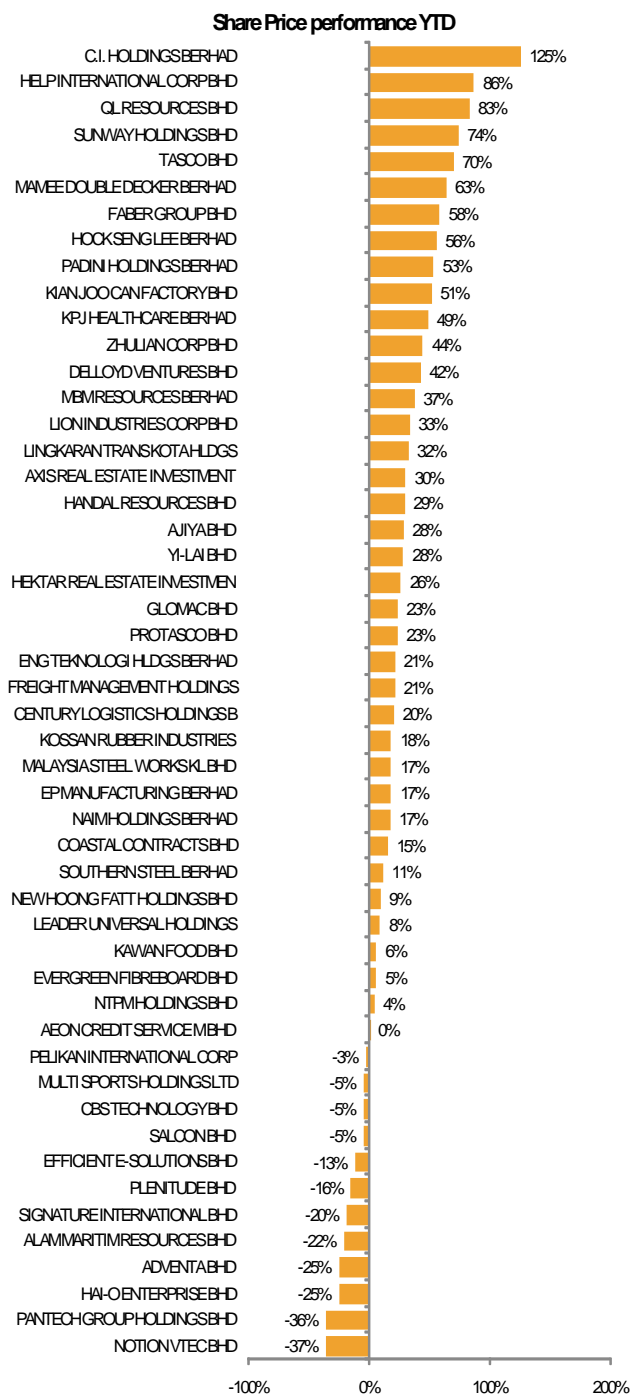
In Sept last year, the 70:30 Samsung-Naim JV announced that it had won the USD766.4m Sabah O&G Terminal (SOGT). Based on Naim's stake, we estimate that this had increased its orderbook by 70%. Work on the SOGT is expected to commence this year and will be led by its partner, Samsung Engineering. This project should be one of the key drivers for Naim's growth for FY11-12.

We are also positive on the rollout of construction jobs in Sarawak given the impending state elections, which must be held by May. In 2010, contract wins in Sarawak totaled RM1.7bn (+50% y-o-y). Potential jobs to Naim include an equipment supply contract (RM100m) and resettlement village job (RM160m). We also expect Phase 2 of the Kuching Flood Mitigation Project to be awarded sometime this year. Naim holds the Letter of Intent for the entire job worth RM1.3-1.6bn.

In our view, Naim's laggard share price performance provides an excellent opportunity to accumulate. Our RM5.10 SOP based TP is based on 12x FY11 earnings (ex Dayang) and 9x its share in Dayang's earnings. We expect Naim's share price to catch up soon.

OSK Jewels absolute returns (2010)

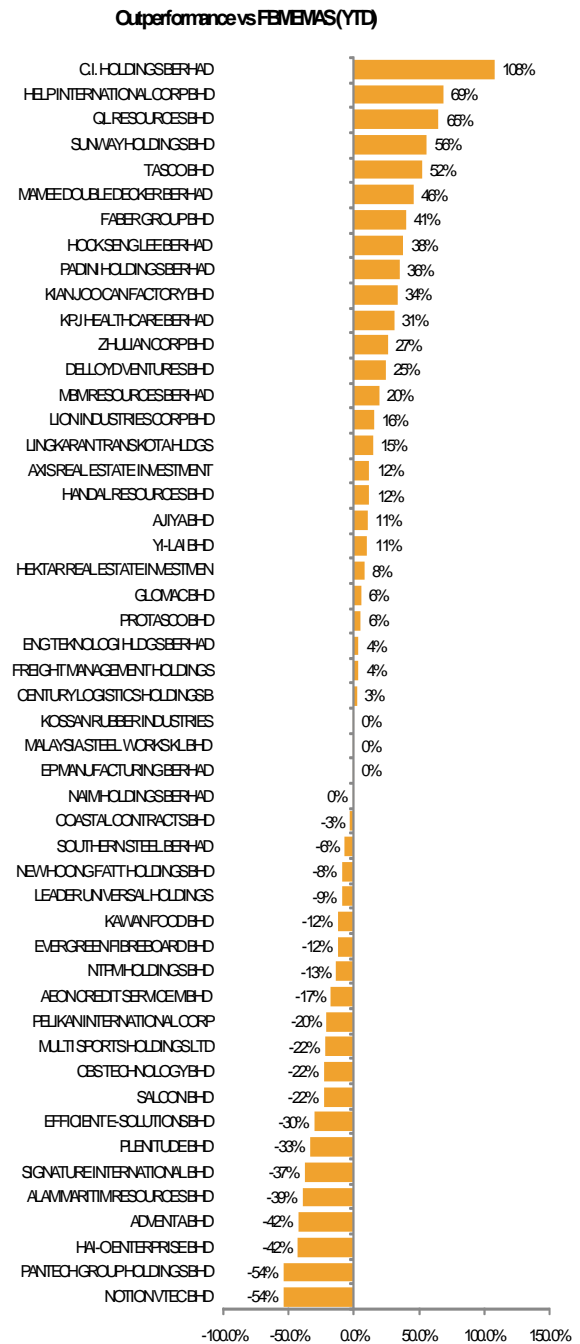
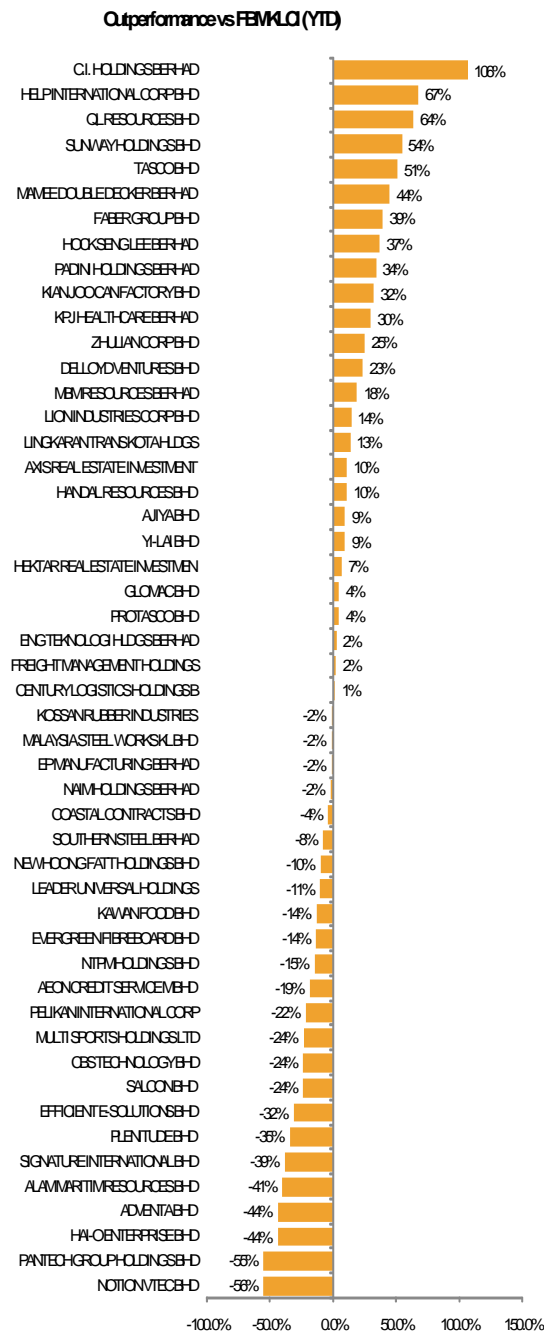
OSK Jewels absolute returns (27 April\* -31 Dec 2010)



\*Book launch date

OSK Jewels outperformance vs. FBM KLCI (2010)

OSK Jewels outperformance vs. FBM Small Cap (2010)



**OSK Research Guide to Investment Ratings****Buy:** Share price may exceed 10% over the next 12 months**Trading Buy:** Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain**Neutral:** Share price may fall within the range of +/- 10% over the next 12 months**Take Profit:** Target price has been attained. Look to accumulate at lower levels**Sell:** Share price may fall by more than 10% over the next 12 months**Not Rated (NR):** Stock is not within regular research coverage

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