

Visit Note

Bloomberg Code MEHB.MK

INVESTMENT DATA

Recommendation Not rated
Price RM1.65
Target price -
Expected capital gain -
Expected yield -
Expected return -

Market capitalisation RM198m
Shares in issue @ 0.50 par 120m
52 week high/low RM1.72/RM1.28
3m average daily volume 0.3m

KLCI 1,397.48 pts

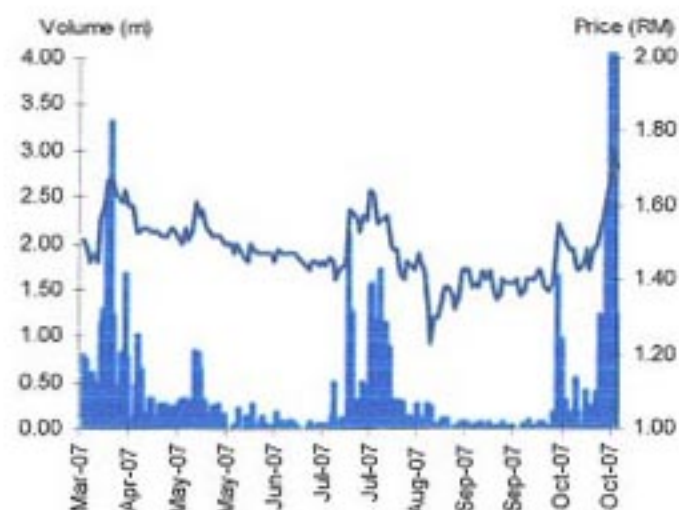
Major shareholders :

Alpine Equity (M) Sdn Bhd 23.6%
 Melati Ehsan Corporation Sdn Bhd 20.9%
 Desalink Sdn Bhd 11.6%
 Estimated Free Float 38.2%

Petite But Moving Up The Value Chain

- **We came out of Melati Ehsan (Melati) recently held analyst briefing feeling positive about the company's prospects going forward. In our opinion, Melati's appeal to investors lies in: 1) its strong earnings growth and visibility underpinned by a healthy unbilled order book of RM1.4bn; 2) its maiden foray into property development which should bolster earnings going forward; and 3) Melati's low PER multiple compared to peers. Assuming a 15% net profit growth in FY08/08, indicative fair value is RM2.34 based on 9x FY08/08 EPS, in line with peers average.**
- **Melati Ehsan is a niche small-cap construction company.** Melati has since 1990 undertaken construction projects totalling RM210m including the RM106m contract for the construction of 372 units of 2-storey link and semi-detached houses in Kota Damansara, Selangor, for Perbadanan Kemajuan Negeri Selangor (PKNS), and the RM52.7m link road at FTZ, Pusat Bandar Seaport in Damansara Jaya, Selangor, for Public Work Department (JKR). Its forte is in securing contracts from the government and government-related agencies on a negotiated basis which margins are higher compared to on a tender basis.
- **Melati is one of the key beneficiaries of the 9MP.** Compared to the 8MP, development expenditure in the 9MP is 17.6% higher at RM200bn, or 29.4% higher at RM220bn inclusive of the RM20bn under the private finance initiatives (PFI). We believe Melati Ehsan will stand a good chance of securing or at least playing a meaningful role in the 9MP projects on the back of its sound track record in government projects.
- **Strong earnings growth and visibility underpinned by a healthy unbilled order book of RM1.4bn.** Over the next two years, Melati's earnings are supported by both its construction and property profits, underpinned by its current combined unbilled order book of RM1.4bn (see Table 1). We gather that Melati has put in bids to tender for RM1.1bn infrastructure projects. With a historical success rate of 20-25%, total unbilled order book could swell from RM1.4bn to RM1.7bn.

DAILY CHART



Source: Bloomberg

INVESTMENT STATISTICS

FY Aug (RM m)	2004	2005	2006	2007
Turnover	81.3	133.3	144.2	173.4
EBITDA	20.3	23.1	31.8	35.4
Pretax Profit	20.1	22.9	31.6	36.6
Core Net Profit	14.5	16.2	22.7	27.1
EPS(sen)	12.1	13.5	18.9	22.6
EPS Growth (%)	NA	11.8	40.1	19.5
P/E (x)	13.6	12.2	8.7	7.3
Gross DPS (sen)	NA	NA	NA	7.5
Dividend Yield (%)	NA	NA	NA	4.7
Book value (RM)	NA	NA	NA	0.97
P/Book value (x)	NA	NA	NA	1.7

Source: Prospectus, Alliance Research

Visit Note

05 November 2007

Table 1 : Outstanding construction unbilled orderbook as at 31 August 2007

Project	Project period	RM m
Mixed development comprising 501 residential houses and 320 shop lots	Dec 2007 - Nov 2012	500.0
Turnkey construction - Taman Aman Putra	Oct 2004 - Oct 2010	424.5
Highway project "Trans Eastern Kedah Interland"	Sept 2005 - Aug 2008	231.7
Flood mitigation project	Jan 2005 - Dec 2009	147.8
Mixed development projects	Sept 2009 - Aug 2014	55.0
Main construction - Carrefour	Jan 2008 - Aug 2008	50.0
Turnkey construction - Bayu Perdana	Sept 2006 - Dec 2007	30.3
Construction - 4 block 3-storey	May 2007 - Nov 2008	8.5
Construction - 113 units double storey terrace house	Sept 2006 - Apr 2008	5.2
Construction - 281 units double storey terrace house, TNB substation	May 2006 - Apr 2008	4.1
Construction - Infrastructure works	Nov 2005 - Nov 2007	1.4
Turnkey construction - Bayu Perdana (Phase 1) - 63 units of double storey terrace house and 12 units of semi-detached houses	Jan 2005 - Dec 2007	0.7
Total Unbilled order book as at 31 August 2007		1,459.2

Source : Company, Alliance Research

Table 2 : Potential future projects

Project	RM m
Infrastructure consisting of water works and flood mitigation	600.0
Building consisting of government facility as well as for mixed development	527.4
Upgrading of existing roads and bridges	6.7
Total	1134.1

Source : Prospectus

□ **Maiden foray into property development**

In its bid to diversify its earnings base, Melati is moving into property development. Leveraging on its expertise in building works, Melati is moving up the value chain from being purely a building works contractor to becoming the project owner of a property development project via acquiring 7 parcels of land approximately 99.3 acres in Pandamaran, Klang for RM32m from TPPT Sdn Bhd (a subsidiary of Bank Negara).

- The acquisition price implies an average land cost of RM7.36/psf which is attractive as we understand land values around these areas are currently between RM5-10/psf. We gathered, layout plans, earthworks and pre-commencement plans has already been approved by the local municipal. The project has an estimated gross development value (GDV) of RM500m and expected to be launched in 1Q 2008 and completed by 2012. The development will include 501 gated link houses, 320 low-rise shop lots, 3.6ha commercial units and 2.8ha of industrial units. Potential profit from this project is RM150-200m or an average RM30m-40m PBT per annum over the next five years. As such, average net profit annually is between RM22.5m (EPS = 18.8 sen/share) and RM30m (EPS = 25 sen/share).
- The property venture makes strategic and commercial sense as this helps to: 1) broaden Melati's earnings base into property development; and 2) also, unlike typical property developers that sub-contract out building works, Melati Ehsan keeps the jobs, and therefore the construction margins to itself as well.

- **At 8x-10x FY08/07 EPS, Melati's share price could be worth between RM2.08 and RM2.34.** Assuming a conservative net profit growth of 15% in FY08/08, Melati's indicative fair value is RM2.33/share based on 9x FY08/08 EPS of 26 sen which is the sector average for small market capitalisation construction stocks (see Table 1).
- Since listing on the Main Board of Bursa Malaysia in March 2007 with an IPO price of RM1.28/share, Melati share price has risen by 26% but still lagged the KL Construction index (+56% YTD). We expect its better earnings visibility and growth to generate interest and lead to a potential re-rating for the stock. The stock is currently trading at undemanding valuations of 7.3x and 6.3x FY08/07 EPS and based on our on-the-back of the envelope FY08/08 EPS of 26.0 sen.

Table 3 : Selected small cap construction stocks

Company	Price	Market Cap (RM m)	EPS (sen)		PER (x)		Rating	Target price (RM)
			FY07	FY08	FY07	FY08		
TSR Capital	1.94	200.85	12.4	29.7	15.6	6.5	Trading Buy	2.98
Crest Builder Holdings	1.18	142.50	25.4	30.7	4.6	3.8	NR	NR
Prinsiptek Corporation	0.93	120.40	16.5	21.0	5.6	4.4	NR	NR
Ekovest [^]	2.28	337.92	18.7	11.4	12.2	20.0	NR	NR
Protasco	1.00	303.00	10.1	11.0	9.9	9.1	NR	NR
Melati Ehsan*	1.65	198.00	22.6	26.0	7.3	6.3	NR	NR
Average excluding Melati Ehsan					9.6	8.8		

[^] refer to FY08 and FY09

*Assuming a net profit growth of 15% in FY08

Sources: Bloomberg Consensus, Alliance Research

□ Background.

Melati is principally involved in infrastructure and building construction works. Melati pride itself of being a turnkey contractor, which provides from planning, design, engineering, and procurement and up to construction stage. Its wholly-owned subsidiary Pembinaan Kerry Sdn Bhd, is a registered Class 'A' and Grade 7 contractor; put simply, this allows Melati to undertake construction projects of unlimited value. At the helm of the company is founder and managing director Dato' Yap Suan Chee who has had more than 20 years of experience in the construction and property sectors. As at 31 August 2007, Melati is in a net cash of RM17.6m or 14.7sen/share.

Recommendation Framework

STOCK RECOMMENDATIONS

- OUTPERFORM** : The stock's total return is expected to exceed KLCI's total return by 5% or more in the next 12 months.
- MARKET PERFORM** : The stock's total return is expected to be within +5% or - 5% of KLCI's total return.
- UNDER PERFORM** : The stock's total return is expected to be below KLCI's total return by 5% or more in the next 12 months.
- TRADING BUY** : The stock's total return is expected to exceed KLCI's total return by 5% or more within the next 3 months. Fundamentals are not strong enough to call an Outperform rating and investors are willing to assume higher risks.
- TRADING SELL** : The stock's total return is expected to be below KLCI's total return by 5% or more within the next 3 months.
- NOT RATED** : Stock is not within our regular coverage

SECTOR RECOMMENDATIONS

- OVERWEIGHT** : The industry as defined by the analyst is expected to outperform the KLCI over the 12 months.
- NEUTRAL** : The industry as defined by the analyst is expected to perform in line with KLCI over the 12 months.
- UNDERWEIGHT** : The industry as defined by the analyst is expected to underperform the KLCI over the next 12 months.

total return = capital gain + dividend yield

Common Abbreviation

Adex = Advertising Expenditure	1QFY12/07 = 1 st Quarter for FY Dec 07	PE = Price Earnings Ratio
bn = billion	2HFY12/07 = 2 nd Half for FY Dec 07	PEG = PE ratio to growth
BV = Book Value	FCF = Free Cashflow	PER = PE ratio
CF = Cashflow	FV = Fair Value	QoQ = Quarter on Quarter
CAGR = Compounded Annual Growth rate	FY = Financial Year	RM = Ringgit
Capex = Capital Expenditure	KLCI = Kuala Lumpur Composite Index	RM bn = RM billion
CY = Calendar Year	m = million	RM m = RM million
Div yld = Dividend Yield	MoM = month on month	ROA = Return on Assets
DCF = Discounted Cashflow	NAV = Net Assets Value	ROE = Return on Equity
DPS = Dividend Per Share	NTA = Net Tangible Assets	ROSF = Return on shareholders funds
EBIT = Earnings Before Interest & Tax	NR = Not Rated	TP = Target Price
EBITDA = EBIT before Depreciation and Amortisation	p.a. = per annum	WACC = Weighted Average Cost of Capital
EPS = Earnings per share	PAT = Profit after tax	YoY = Year on Year
EV = Enterprise Value	Pretax profit = Profit before tax	YTD = Year to date

DISCLAIMER

The report is for information purposes and has been prepared by Alliance Research Sdn. Bhd. (Alliance Research) based on sources believed to be reliable. No liability can be accepted by Alliance Research for its completeness or accuracy. Opinions expressed are subject to change without notice. The company and its directors, representatives and employees may have an interest in the securities mentioned. Issuance of the report by Alliance Research is not an offer to sell or a solicitation to buy the securities of the company covered in the report and Alliance Research shall not be responsible for any consequential loss or damage, whether direct or indirect.



Soh Meng Hui
Head of Research

Published and Printed by
ALLIANCE RESEARCH SDN BHD (290395-D)
Level 18, Menara Multi-Purpose
Capital Square
8, Jalan Munshi Abdullah
50100 Kuala Lumpur, Malaysia
Tel: +60(3) 2692 7788
Fax: +60(3) 2717 6522
Email: Allianceresearch@allianceinvestment.com.my