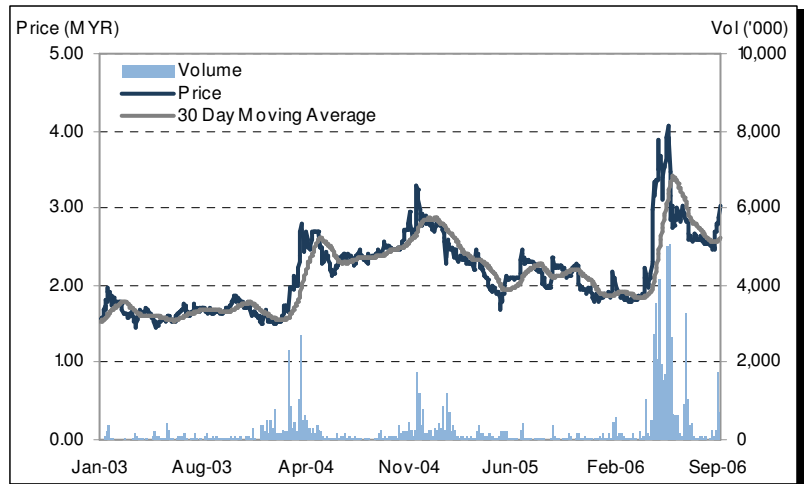


Lion Forest Industries

Recommendation: **HOLD**Stock Code: **8486**Bloomberg: **POS MK**Price: **MYR2.95**12-Month Target Price: **MYR3.00**Date: **September 21, 2006****Board:** Second**Sector:** Trading Services**GICS:** Materials / Forest Products**Market Capitalization:** MYR620.1 mln

Summary: Lion Forest Industries Bhd.'s (LFI) primary earnings contributor is 97.8%-owned Sabah Forest Industries (SFI). SFI owns Malaysia's only fully integrated natural pulp and paper mill, with an estimated 28% share of the Malaysian uncoated woodfree paper market in 2005.

Analyst: Desmond Ch'ng, ACA**Recent Developments**

- LFI has announced that it is raising its proposed capital distribution from MYR1.20 per LFI share to MYR2.00. This follows negotiations with creditors of the Lion Group on the utilization of proceeds from the impending sale of SFI. Of the proceeds of MYR944.8 mln from the impending sale, MYR420.3 mln will now be distributed to shareholders, versus MYR252.2 mln previously.
- The reason for the higher distribution, in our opinion, is to allow for a larger flow of funds up to LFI's immediate parent company, Lion Industries Corporation (LIC) (LLB MK, MYR0.88, Not Ranked), much of which will likely go towards debt repayment. LIC holds an effective 81% stake in LFI, and the LIC group had net debt of MYR2.28 bln at end-June 2006, or a net gearing of 1x.
- As for the balance of the proceeds, MYR104.4 mln (MYR134 mln previously) will be used as capex for the expansion of LFI's tyre operations in China, and MYR70 mln (MYR150 mln previously) will be used to develop 40,000 ha of oil palm plantation in Kalimantan.
- This leaves LFI with a further MYR344.6 mln (MYR403.1 mln previously) for either future businesses or as working capital for the group. Given that LFI's primary businesses following the disposal of SFI would be its tyre, plantation and building materials operations (for which no expansion is planned), we believe that the group would likely identify new businesses to inject into the group. This balance of MYR344.6 mln works out to be MYR1.64 per LFI share.

Key Stock Statistics

FY Jun.	2006	2007F
EPS (sen)	-111.3	9.5
PER (x)	NM	31.2
Dividend/Share (sen)	0.0	7.0
NTA/Share (MYR)	6.16	6.24
Book Value/Share (MYR)	6.16	6.24
Issued Capital (mln shares)	210.2	
52-week Share Price Range (MYR)	1.70 – 4.16	
Major Shareholders:	%	
Tan Sri William Cheng	81.2	

Recommendation & Investment Risks

- We maintain our Hold recommendation on LFI and our target price of MYR3.00.
- We estimate that LFI's FY07 book value post-disposal of SFI (but before the proposed capital repayment of MYR2.00 per share) would decline from MYR6.24 to MYR5.00. Our target price is based on a P/BV of 0.6x (unchanged) its post-disposal book value, in line with regional peer valuations.
- While the higher capital repayment is positive, we are overall neutral on the stock given the uncertainties on the eventual utilization of proceeds from the disposal of SFI and the potential returns, if any, if the proceeds are invested in existing or new businesses.

Earnings Outlook

- With the sale of SFI targeted to be completed by 1Q07, we could see a significant deviation from our FY08 numbers, given that SFI currently contributes to about 90% of group earnings. LFI's primary business thereafter would be the manufacture of tyres in China and the sale of building products. Its plantation remains greenfield and would likely only start yielding results 3-4 years after planting. Our forecasts have yet to reflect the earnings dilution from the sale of SFI.

Per Share Data

FY Jun.	2004	2005	2006	2007F
Book Value (MYR)	7.58	7.39	6.16	6.24
Cash Flow (sen)	48.6	45.9	-79.4	41.5
Earnings (sen)	16.5	14.0	-111.3	9.5
Dividend (sen)	17.5	16.0	0.0	7.0
Payout Ratio (%)	106.4	115.9	0.0	52.8
PER (x)	17.9	21.1	NM	31.2
P/Cash Flow (x)	6.1	6.4	NM	7.1
P/Book Value (x)	0.4	0.4	0.5	0.5
Dividend Yield (%)	5.9	5.4	0.0	2.4
ROE (%)	2.2	1.9	NM	1.5
Net Gearing (%)	0.0	0.0	1.4	2.4

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Lion Forest Industries

Recommendation: **HOLD**Stock Code: **8486** Bloomberg: **POS MK** Price: **MYR2.95** 12-Month Target Price: **MYR3.00** Date: **September 21, 2006****Profit & Loss**

FY Jun. / MYR mln	2005	2006	2007F	2008F
Revenue	590.4	559.8	684.1	677.2
Operating Profit (EBIT)	37.8	-72.4	28.2	24.2
Depreciation	-66.0	-66.9	-67.4	-66.7
Net Interest Income / (Expense)	-1.1	-3.7	-4.3	-4.3
Pre-tax Profit	36.1	-238.8	22.4	18.4
Effective Tax Rate (%)	17.5	-0.7	20.0	22.0
Net Profit	29.0	-233.9	19.9	14.1
Operating Margin (%)	6.4	-12.9	4.1	3.6
Pre-tax Margin (%)	6.1	-42.7	3.3	2.7
Net Margin (%)	4.9	-41.8	2.9	2.1

Source: Company data, S&P Equity Research

Standard & Poor's Equity Research Services

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Strong Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.

Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months, with shares rising in price on an absolute basis.

Hold: Total return is expected to closely approximate the total return of the KLCI or KL Emas Index respectively, over the coming 12 months with shares generally rising in price on an absolute basis.

Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months and share price is not anticipated to show a gain.

Strong Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months by a wide margin, with shares falling in price on an absolute basis.

S&P 12 Month Target Price – The S&P equity analyst's projection of the market price a given security will command 12 months hence, based on a combination of intrinsic, relative, and private market valuation metrics.

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