

Deep discount to intrinsic value**Asia Resources****China Asean Res. (8186 HK, HK\$0.34) STRONG BUY (unchanged)****Target price: HK\$2.09 (+514.7%)**

International agreement. The members of the International Tropical Timber Organization (ITTO) signed in 2006 the International Tropical Timber Agreement to promote the expansion of international trade in tropical timber from sustainable and legally harvested forests, increase employment opportunities in member countries and their export earnings. As an ITTO member, Cambodia has been encouraging the export of secondary processed wood products (SPWPs), to fully utilize its dwindling timber resources and create jobs. In line with this direction, China Asean Resources plans to step up the development of its downstream processing capacity.

Downstream development plan. To launch its sawn timber production as soon as possible, the company is developing a sawn timber processing plant with annual production capacity of 12,000.0m³, to be expanded to 80,000.0m³ within two years of coming on stream by end-1Q FY12/08F. The company also plans to set up a semi-finished and finished floor decking plants with annual production capacities of 50,000.0m³/annum and 500,000.0m³/annum each. We expect the semi-finished floor decking plant to start production in July 2008 and floor decking plant to be operational at the beginning of 2009. To utilize large amounts of wood residuals produced during the manufacturing of sawn timber and floor decking, the company will build a particle board plant with annual production capacity of 50,000.0m³, which should commence operation in FY12/09F.

Value from deep processing. The group plans to make sawn timber, semi-finished floor decking and floor decking. The value of its timber is expected to increase substantially after deep processing and reach US\$854.0/m³ (for floor decking) from US\$165.0/m³.

Sawn timber. The production yield of sawn timber processing is estimated at 70.0%, implying it takes 1.4m³ of raw timber to produce 1.0m³ of sawn timber. Since log extraction is estimated to cost US\$10.0/m³, we estimate the raw material cost of sawn timber at US\$14.3/m³. The ASP of sawn timber made from low-grade logs is estimated at US\$165.0/m³. The value of logs increases 11.5x after they are processed into sawn timber.

Semi-finished floor decking. The production yield of sawn timber processed into semi-finished floor decking is estimated at 70.0%, implying it takes 1.4m³ of sawn timber to produce 1.0m³ of semi-finished floor decking. Assuming the group uses only low-grade sawn timber (with the ASP of US\$165.0/m³), the raw material cost per cubic meter of semi-finished floor decking would be US\$235.7. The ASP of semi-finished floor decking is projected at US\$440.0/m³. The conversion of sawn timber into semi-finished floor decking doubles its value.

Finished floor decking. We estimate the production yield of sawn timber processed into finished floor decking at 55.0%. It requires 1.8m³ of sawn timber to produce 55 pieces of floor decking (1.0m³ of 1.8cm thick deck). Under the same assumption as for semi-finished floor decking, the raw material cost per 55 pieces of floor decking is estimated at US\$300.0m³. We project the ASP per 55 pieces of floor decking at US\$880.0 or US\$16.0/m². The processing of sawn timber into floor decking raises its value more than three-fold.

Profit squeeze from residual wood. We estimate that 0.6m³ of wood residue will be created from the production of 1.0m³ of sawn timber and 0.2m³ from the production of 55.0 sheets of floor decking.

Table 1: Cash margin estimates

Product	Unit	Raw material	Production yield	ASP (US\$/unit)	Cash profit (US\$/unit)	Cash margin (%)
Sawn timber	m ³	Round log	70%	165.0	65.7	39.8%
Semi-finished floor decking	m ³	Swan timber	70%	440.0	184.3	41.9%
Floor decking	m ²	Swan timber	55%	16.0	232.4	26.4%

Source: SBI E2-Capital

Cash margin projection. The cash margin of sawn timber and semi-finished floor decking is estimated at 39.8% and 41.9%, respectively. Although floor decking commands the lowest cash margin of 26.4%, it has the highest ASP and this highest cash profit in absolute terms. The company's total capital expenditure on downstream processing expansion is currently estimated at US\$9.5m.

Second forest. The group is acquiring its second forest, which is adjacent to its forest in Kratie province, Cambodia, and covers about 10,000.0 hectares. Its vegetation is similar to the group's forest and timber reserves of about 3.0m m³. Transaction details are not yet available.

Bridging the gap. The new forest acquisition will help smooth the company's earnings between FY12/12F and FY12/14F and beef up its resources. We originally expected net profit to fall 77.8% YoY in FY12/12F because of shrinking timber resources and still immature latex operations. Between FY12/12F and FY12/13F, we expected earnings growth to be sluggish and to pick up only in FY12/14F with latex production in full swing. Further, we expected the timber resources of the first forest to be exhausted in FY12/12F, forcing the company to buy raw materials. However, the new forest will give it sufficient resources to either expand production downstream or continue with its vertically integrated model (from tree extraction to product manufacturing) until FY12/17F. Since the two forests are contiguous, the group can develop them in a cost-efficient and timely manner.

Re-rating expected. BMI Appraisals valued the group's forest at US\$360.0m. We put its value at US\$703.4m. Since the forest is similar to the target forest, China ASEAN Resources' intrinsic value should double upon the completion of the acquisition. Based on a simple P/E multiple approach, the company is attractively valued at P/E of 2.3x for FY12/08F, representing a substantial discount to the peer group's average one-year forward P/E of 24.9x. We estimate that the group cash in hand at HK\$160.5m, cash per share at HK\$0.157 and cash per share on a fully-diluted basis at HK\$0.094. STRONG BUY call reiterated.

Table 2: Peer group comparison

Company name	Ticker	Year End	Currency	Price	Market Cap (US\$m)	P/E (x) 1-yr forward	P/E (x) 2-yr forward
Ta Ann Holdings	TAH MK	Dec	MYR	7.0	453.3	11.5	9.5
Jaya Tiasa Holdings	JT MK	Apr	MYR	3.7	312.0	14.4	11.9
WTK Holdings	WTKH MK	Dec	MYR	2.4	316.3	12.3	10.3
Evergreen Fibreboard	EVF MK	Dec	MYR	1.6	234.6	7.3	5.6
Timberwest Forest	TWF-U CN	Dec	CAD	14.3	1,094.6	12.5	9.0
Sino-Forest	TRE CN	Dec	CAD	20.6	3,705.1	20.1	16.3
Weyerhaeuser	WY US	Dec	USD	73.9	15,607.1	45.6	31.7
International Paper	IP US	Dec	USD	33.2	14,201.3	15.2	12.0
Rayonier Inc	RYN US	Dec	USD	45.7	3,566.6	19.8	21.7
Plum Creek Timber	PCL US	Dec	USD	46.1	7,935.0	33.8	31.3
Fletcher Building	FBU NZ	Jun	NZD	11.2	4,388.6	11.9	10.5
Gunns Ltd	GNS AU	Jun	AUD	3.9	1,384.1	17.0	16.0
UPM-Kymmene Oyj	UPM1V FH	Dec	EUR	14.5	11,299.4	15.0	14.1
Samling Global	3938 HK	Jun	HKD	1.7	921.0	11.9	10.7
<i>Average</i>	<i>Average</i>					<i>24.9</i>	<i>20.0</i>

Source: Bloomberg

Disclosure of interests: SBI E2-Capital Securities Ltd. acted as the Sole Bookrunner and Joint Placing Agent for China Asean Resources (233m Top-up shares and 167m new shares at HK\$0.60) on Jul, 2007.