



IRIS Corporation Berhad

A New Facelift

THIS REPORT IS STRICTLY FOR INTERNAL CIRCULATION ONLY*

Tan Kam Meng, CFA

+603-2072-1277 ext:1614

kmtan@ta.com.my

www.taonline.com.my

TP: RM0.285(+35.7%)

Last traded: RM0.21

BUY

The proposed private placement exercise. The recent offer made by Federal Land Development Authority (FELDA) to subscribe for 25% of new IRIS shares sprang a surprise as to why it is interested in IRIS, which earnings contribution is insignificant to FELDA. Also, the curiosity surrounding the premium pricing for non-controlling stake suggests that FELDA would have known something about IRIS that the market does not. Note that the offer price of RM0.28 per placement share represents 33% premium to IRIS' last closing price prior to the announcement of the private placement exercise.

Synergies. We think this is a win-win strategy after gaining further insights into the mutual benefits to both parties in our recent meeting. Banking on IRIS' established business exposure in the African region, it could help FELDA group to shorten the timing in identifying landbanking opportunity.

Numerous benefits for IRIS. By having FELDA to be IRIS' major customer-cum-shareholder will ensure steady flow of contracts in the future, we opine. Based on our rough estimation, the business opportunity is worth as much as RM375m per year over the next four years, assuming FELDA would launch 20,000 affordable homes for settlers. Meanwhile, there will also be a boost to IRIS' balance sheet quality. IRIS' net gearing and net current ratio would improve to 0.34x and 1.3x respectively from 0.51x and 1.1x as at end-FY13.

Valuation and recommendation. We raise our FY15-16 net profit by 14-22% respectively. In term of EPS, we downgrade our FY14/15/16 projections by 19.4%/9.9%/3.1% assuming the private placement exercise to be completed in FY14. Using a 3-year average CY14-16 EPS as a base and pegging an unchanged PE multiple of 12x, we derive a new target price of 28.5sen/share. Given the potential upside of 36%, we upgrade IRIS to **Buy** from hold.

Earnings Summary (RM'mn)

FYE March 31 (RMmn)	FY12*	FY13	FY14F	FY15F	FY16F
Revenue	483.8	537.1	629.9	735.5	811.7
EBITDA	84.9	71.7	116.5	133.7	142.4
EBITDA margin (%)	17.5	13.4	18.5	18.2	17.5
Pretax profit	58.1	34.0	68.5	88.5	107.7
Net profit	43.7	21.1	31.2	42.6	51.7
Core net profit	43.7	21.1	31.2	42.6	51.7
EPS (sen)	2.9	1.3	1.6	2.2	2.6
Diluted EPS (sen)	2.3	1.3	1.6	2.2	2.6
EPS growth (%)	17.6	(42.6)	18.6	36.4	21.5
PER (x)	9.0	15.7	13.3	9.7	8.0
GDPS (sen)	0.5	0.5	0.5	0.5	0.5
Div yield (%)	2.1	2.1	2.1	2.1	2.1
Core ROE (%)	9.3	5.1	6.5	7.6	8.7

* comprising 15-mopnth earnings from Jan-11 to March-12

Share Information

Bloomberg Code	ICB MK
Stock Code	0010
Listing	ACE Market
Share Cap (mn)	1576.4
Market Cap (RMmn)	331.0
Par Value	0.15
52-wk Hi/Lo (RM)	0.245/0.155
12-mth Avg Daily Vol ('000 shrs)	7733.0
Estimated Free Float (%)	83.6
Beta	0.92

Major Shareholders (%)

Datuk Tan Say Jim - 11.0
Perbadanan Nasional Bhd - 8.4

Forecast Revision

	FY14	FY15
Forecast Revision (%)	(19.4)	(9.9)
Net profit (RMm)	31.2	42.6
Consensus	-	-
TA's / Consensus (%)	-	-
Previous Rating	Hold (Upgraded)	

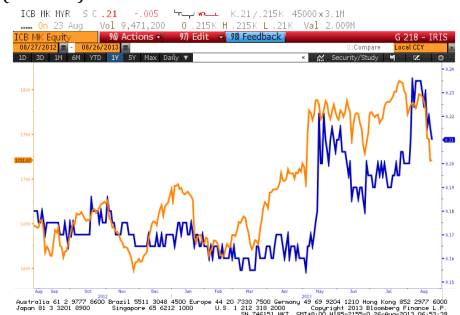
Financial Indicators

	FY14	FY15
Net Debt/Equity (%)	27.8	26.2
CFPS (sen)	(1.5)	0.4
Price/CFPS (x)	(14.1)	50.0
ROE (%)	6.5	7.6
NTA/Share (RM)	0.2	0.2
Price/NTA (x)	1.0	1.0

Share Performance (%)

Price Change	IRIS	FBM KLCI
1 mth	2.4	(4.8)
3 mth	5.0	(2.9)
6 mth	31.3	6.0
12 mth	20.0	4.4

(12-Mth) Share Price relative to the FBM KLCI



Source: Bloomberg

Substantial change in shareholding structure. The recent offer made by Federal Land Development Authority (FELDA) to subscribe for 25% of new IRIS shares, if materializes, will result in substantial change in IRIS' shareholding structure. FELDA will emerge as a single largest shareholder with 20% stake in IRIS. Meanwhile, the group managing director's, Datuk Tan Say Jim, stake in IRIS will be diluted to 8.7% from 11.0% now.

Keeping the management team. Being the single largest shareholder, we believe FELDA will eventually ask for board seats to participate in IRIS' board decisions. As of whether there will be significant change in management team, we believe FELDA will keep the existing team given its lack of knowledge in this technology space.

Synergies

1) Connecting FELDA to Africa. Obviously, the long established presence that IRIS has in the African region is appealing to FELDA, we believe, after learning that FELDA group is exploring landbanking opportunities for its palm oil venture in African countries. Datuk Sabri Ahmad, managing director of Felda Global Ventures Holdings (FGV), a 20%-owned associate of FELDA, was quoted as saying that business expansion into Africa is crucial to FGV's eight-year plan to grow eight times by 2020. Meanwhile, the CEO of FGV, Mohd Emir Mavani Abdullah, said that the company has project teams in Cameroon and Nigeria now identifying suitable locations for palm oil plantations.

Nigeria has been one of IRIS' customers since 2003. Besides that, IRIS has other ongoing contracts to supply national ID cards or ePassport to Senegal, Tanzania and Egypt. The company is currently exploring job opportunities in Kenya, Congo, Ethiopia and Guinea too.

As these contracts will involve issues regarding national security, IRIS will usually have privileged access to countries' top ministries to ensure safety and protection to the nation with the implementation of new ID or ePassport programmes. For this reason, we believe IRIS is a best fit to FELDA as the latter is expected to venture into African counties in a big way.

Small investment cost to FELDA. Considering that IRIS is a strategic investment to FELDA to learn the ropes in Africa, and also the premium pricing, in absolute term (or RM110.3mn), is insignificant to FELDA after all, the subscription for IRIS' placement shares makes investment sense entirely.

2) Operational supports from a trusted solution provider. As a technology conglomerate, IRIS can be a solution provider to FELDA premised on its strong R&D and innovation skills. IRIS, being the inventor of world's ePassport and e-ID, has recently expanded its business beyond the digital identity space to cover other human basic needs, ie: shelter, food and energy.

Shelter (appendix A) - IRIS uses KOTO Industrialised Building System (IBS) in building affording homes, schools and staff quarters in Malaysia. This technology is a high speed, fully integrated building system with pre-fabricated lightweight panels for all parts of the building. IRIS has two manufacturing plants located in Subang and Kota Kinabalu. The company is constructing its third plant in Kuching, which is targeted for completion in 3Q13. The total output (pre-fabricated panels) from existing and new plants can cater for building of 500 houses per month. Currently, the Federal Government of Malaysia and FELDA are those existing customers to IRIS.

Food (appendix B) - The AutoPot system and the Aquaponics techniques are formulas to IRIS's Food and Agro technology, which could improve productivity and efficiency and enhance food security. Combining this with the IRIS KOTO homes, IRIS has designed a new concept of sustainable development, which will help to improve the living standard and creation of job opportunities. Currently, the Federal Government and FELDA are owners of Rimbulan Kaseh (RK) and Sentuhan Kasih (SK) projects respectively, comprising the food and agro and KOTO IBS homes.

Energy - The renewable energy segment is earnings-enhancing as this new unit has chalked up EBIT of RM3.1mn for first 6-month of operations ended FY13. Currently, this segment has only one power asset, which is the 700-tonnes/day Municipal Waste-to-Energy Plant in Phuket, Thailand. Other than the renewable energy plant, IRIS also owns a 300-tonnes/day Food Waste-to-Fertilizer plant in Weinan, China.

Acquiring the technology inventor. Given the capability of inventing new technology or business concept, it could be the skill that IRIS possesses that turns FELDA on, we believe.

Benefit to IRIS

1) A steady flow of contract. FELDA awarded the first Sentuhan Kasih project to IRIS for RM39.5mn in late 2012. IRIS has completed the project in 4-month period at a project site in Tenggaraoh near Mersing, Johor. Subsequently in 2Q2013, FELDA awarded the second SK project located in Chini, Pahang to IRIS for RM40mn. In addition, the company has also received a letter of award for building five blocks of staff quarters in the same location amounting to RM22.5mn in July-13. These projects will contribute to IRIS' FY14 earnings.

Enormous business opportunity. FELDA announced publicly that it will build 20,000 homes for settlers. Assuming FELDA will award 5,000 affordable houses for IRIS to build and each house would cost RM75,000/unit, this would potentially mean RM375mn business opportunity to IRIS per year over the next four years. Applying a blended margin of 15% for manufacture and construction of KOTO homes, the potential earnings could amount to RM56.25mn per annum, representing more than 2 times of IRIS' FY13 earnings.

FELDA to dish out projects soon. With the conclusion of 13th general election in May-13, we believe it is just a matter of time that FELDA will dish out more SK projects to lift the standard of living of settlers. Note that in 2012, the lack of SK and RK projects from FELDA and the government has resulted in the Agro and Food and IBS division posted its first operating losses of RM17.5mn for FY13. That being said, this division is expected to turn around in FY14 as we expect the government and FELDA to expedite the award of project post general election. In our model, we have conservatively assumed that IRIS would secure 2 RK and 3 SK projects worth total RM166mn as opposed to management guidance of 4 RK and 4 SK project win for FY14.

2) **A boost to IRIS' balance sheet quality.** Of the RM110.3mn placement proceeds, IRIS will allocate RM30mn for repayment of short term debt. This will improve the group's net gearing level to 0.34x from 0.51x as at end-FY13. Meanwhile, some RM47mn to be used as working capital would boost to the group's total amount of free cash flow. It will improve the net current ratio to 1.3x from 1.1x as at end-FY13.

Capacity expansion. The cash of RM25mn earmarked for capital expenditure will come in handy for capacity expansion. In our opinion, the cash is important as IRIS is expected to secure more RK and SK projects in the near future. The company could use the proceeds to expand the capacity of KOTO IBS panel.

Financial impact. The private placement exercise is expected to dilute IRIS' EPS by 19.4% with the effective 20% increase in share capital. However, by having a major customer becoming the largest shareholder not only would ensure sustainable long term business relationship, it will provide IRIS a facelift to attract investors' attention. As such, we are positive on the emergence of FELDA as a major shareholder of IRIS.

As far as earnings are concerned, we maintain our key assumptions of RM120mn worth of SK project from FELDA as opposed to management guidance of RM160mn for FY14. For FY15-16, we raise our job assumptions for SK project to RM160mn and RM200mn respectively from our previous assumptions of RM120mn. Also, we adjust the operating margin for SK project higher to 8-10% (from 5% previously) for FY15-16 given the expected improvement in operational efficiency. All in, we raise our FY15-16 net profit by 14-22% respectively. In term of EPS, we downgrade our FY14/15/16 projections by 19.4%/9.9%/3.1% assuming the issuance of new shares to be completed in FY14.

Valuation and recommendation. After weighing up the pros and cons, we strongly believe IRIS share price would play a catch up when the private placement proposal receives approvals from shareholders. Also, we see little risks that the proposal will be called off or not receiving shareholders' approval given the mutual benefit to both parties as discussed above.

We reiterate that IRIS' future earnings prospect is getting promising with the major customer turns to be the single largest shareholder. To capture this potential earnings growth, we fine-tune our valuation methodology. As we believe in "FELDA-effect" will kick in from FY15 onwards in term of contract award, we use a 3-year average CY14-16 EPS as a base to incorporate and smooth out the effect. Pegging an unchanged PE multiple of 12x, we derive a new target price of 28.5sen/share. Given the potential upside of 36%, we upgrade IRIS to **Buy** from hold.

Financial statement (RM'mn)

P&L (FYE March)	2012*	2013	2014F	2015F	2016F
Revenue	483.8	537.1	629.9	735.5	811.7
COGS	(343.2)	(430.8)	(453.6)	(529.6)	(584.4)
Gross profit	140.6	106.3	176.4	205.9	227.3
EBITDA	84.9	71.7	116.5	133.7	142.4
Depreciation	(12.6)	(23.8)	(33.0)	(33.4)	(28.6)
EBIT	72.2	47.9	83.5	100.3	113.8
Finance cost	(14.1)	(13.3)	(14.3)	(11.2)	(5.4)
Associate	(2.2)	(0.7)	(0.7)	(0.7)	(0.7)
EI	0.0	0.0	0.0	0.0	0.0
PBT	58.1	34.0	68.5	88.5	107.7
Adj PBT	58.1	34.0	68.5	88.5	107.7
Tax	(17.2)	(15.6)	(19.2)	(26.5)	(36.6)
MI	2.8	2.6	(18.1)	(19.4)	(19.4)
Net profit	43.7	21.1	31.2	42.6	51.7
Adj net profit	43.7	21.1	31.2	42.6	51.7
EPS (sen)	2.9	1.3	1.6	2.2	2.6
DPS (sen)	0.5	0.5	0.5	0.5	0.5

Cash Flow (FYE March)	2012*	2013	2014F	2015F	2016F
PBT	58.1	34.0	68.5	88.5	107.7
Non- cash item	16.4	21.9	33.0	33.4	28.6
Chg in working capital	21.7	(44.6)	(77.2)	(77.7)	(56.1)
Tax	(22.5)	(16.5)	(19.2)	(26.5)	(36.6)
Others	36.9	22.6	0.7	0.7	0.7
CFO	110.6	17.4	5.7	18.3	44.3
Capex	(15.3)	(120.4)	(35.0)	(10.0)	(10.0)
Others	(1.4)	20.7	0.0	0.0	0.0
CFI	(16.7)	(99.7)	(35.0)	(10.0)	(10.0)
Net Addition/Rpmt	(27.9)	57.1	(90.0)	(10.0)	(10.0)
Dividend Paid	(7.1)	(7.1)	(8.9)	(8.9)	(8.9)
Others	18.3	0.2	102.0	0.0	0.0
CFF	(16.7)	50.3	3.1	(18.9)	(18.9)

Key Assumptions (RM'mn)	2012	2013	2014F	2015F	2016F
New contract secured					
---> Digital solution	210	207	180	180	180
---> Rimbunan Kaseh	-	46	46	69	69
---> Sentuhan Kasih	-	40	160	160	200

Balance Sheet (FYE March)	2012	2013	2014F	2015F	2016F
Fixed Assets	117.1	162.4	164.4	141.0	122.4
Intangibles	135.4	141.5	141.5	141.5	141.5
Others	60.8	201.7	201.0	200.4	199.7
LT Assets	313.3	505.5	506.9	482.9	463.6
Inventories	57.4	94.6	122.5	145.1	162.3
Trade & other receivables	277.2	333.9	391.6	457.2	504.6
Cash & Cash equivalent	88.8	58.9	32.7	22.1	37.5
Others	49.8	99.1	99.1	99.1	99.1
ST Assets	473.2	586.4	645.9	723.5	803.6
Total Assets	786.6	1092.0	1152.9	1206.4	1267.2
Trade and other payables	33.5	42.2	50.6	61.1	69.6
ST Borrowings	73.5	169.9	124.9	119.9	114.9
Others	188.9	305.9	305.9	305.9	305.9
ST Liabilities	295.9	518.0	481.4	486.9	490.5
LT Borrowings	75.7	102.8	57.8	52.8	47.8
Others	13.2	13.9	13.9	13.9	13.9
LT Liabilities	89.0	116.8	71.8	66.8	61.8
MI	(1.0)	41.1	59.3	78.6	98.0
Share Cap	236.3	236.5	295.6	295.6	295.6
Reserves	166.4	179.6	244.8	278.6	321.4
Shareholder's Funds	402.7	416.1	540.4	574.1	617.0
Liabilities + Equities	786.6	1092.0	1152.9	1206.4	1267.2

Ratios	2012#	2013	2014F	2015F	2016F
EPS Growth (%)	17.6	>100	18.6	36.4	21.5
PER (x)	9.0	15.7	13.3	9.7	8.0
Div Yield (%)	2.1	2.1	2.1	2.1	2.1
Net cash (RMm)	(60.4)	(213.9)	(150.0)	(150.6)	(125.2)
Net gearing (x)	0.2	0.5	0.3	0.3	0.2
ROE (%)	9.3	5.1	6.5	7.6	8.7
ROA (%)	4.8	2.2	2.8	3.6	4.2
NTA (RM)	0.17	0.17	0.20	0.22	0.24
P/NTA (x)	1.2	1.2	1.0	1.0	0.9
EV/EBITDA (x)	4.6	7.6	4.8	4.2	3.8

* 15 months contribution

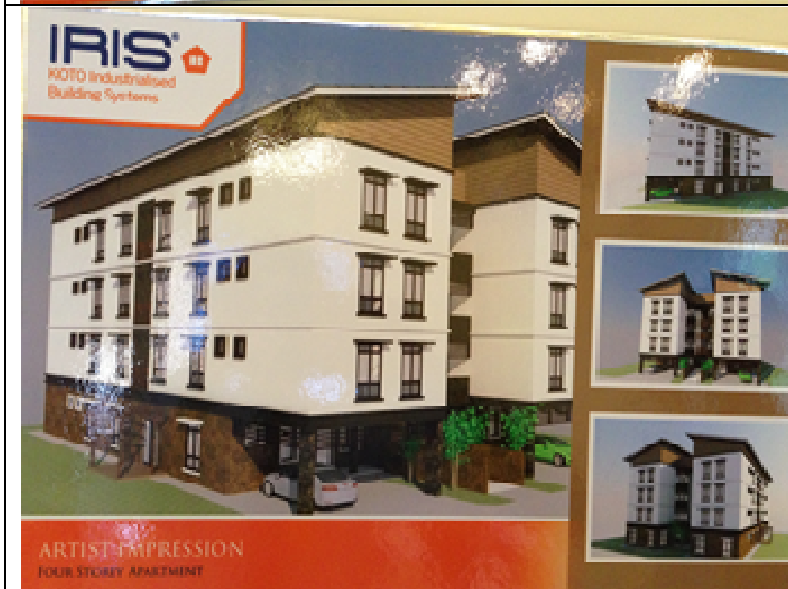
Based on annualised 12-month earnings

Appendix A: IRIS KOTO IBS

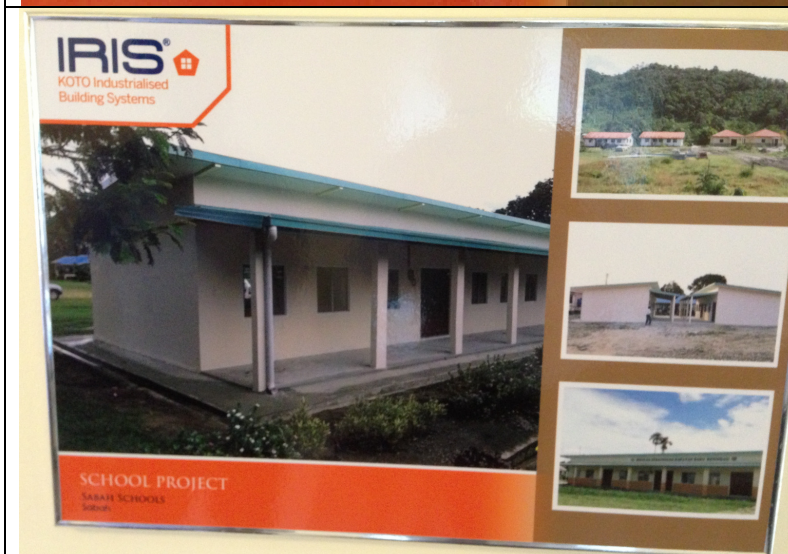
	<p>IRIS KOTO IBS Pre-fabricated panels can be used in all parts of building, including the foundation, walls ceiling, roofing, columns and beams. It is made from fire retardant, rigid cellular insulation, and fibre-reinforced mineral composite that provide great insulation for maintaining indoor temperatures.</p>
	<p>A completed Federal Government's Rimbunan Kaseh project using IRIS KOTO IBS in building semi-detached houses.</p>
	<p>A completed FELDA's Sentuhan Kasih project using IRIS KOTO IBS in building single-storey houses.</p>



A double-storey house using IRIS KOTO IBS.



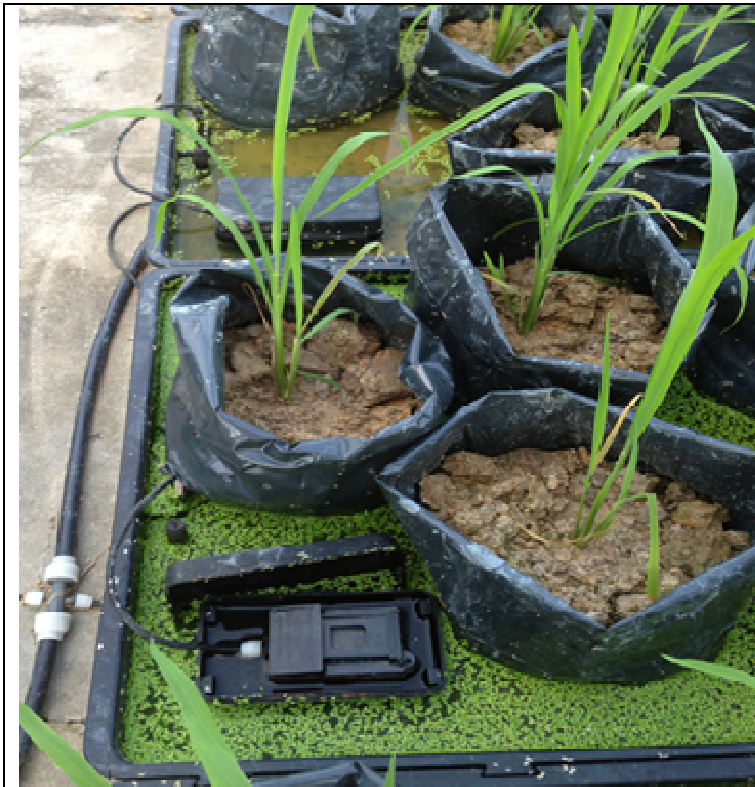
A four-storey apartment block using IRIS KOTO IBS.



A completed school project in Sabah using IRIS KOTO IBS.

Appendix B: IRIS Food & Agro Technology

	<p>IRIS Aquaponics technology is part of IRIS integrated farming system.</p>
	<p>Cultivating Tilapia using IRIS Aquaponics technology.</p>
	<p>A study is carried out on cultivating Empurau (忘不了) using the Aquaponics technology.</p>



IRIS AutoPot System has devices installed in pots to draw water from reservoir/water tank. This system, invented by Jim Far, is premised on "Plant Driven Concept" in which each plant would determine its own water and feed requirement. The system will provides consistent crop yields and quantity of premium grade.



Example of padi plantation using IRIS AutoPot systems.



Another advantage of using AutoPot is that it allows zero contact with common plant diseases, which are found on ground level.



Another example of Golden Melons cultivated using IRIS AutoPot Systems.



Synsepalum dulcificum, or commonly known as miracle fruit, can be planted using IRIS AutoPot System. Note that this typical fruit is hard to grow in Malaysia due to temperature and watering issue. Some tips I discover about planting miracle fruit and the process is certainly tedious and complicated.

1. Use soil mixtures of 60% peat moss to 40% perlite with a pH of between 4.5 and 6.
2. Keep the soil moist, but avoid letting the plant stand in water.
3. 80% humidity is a good goal to shoot for, but a little lower won't be deadly.
4. Don't use tap water, as its pH tends to be too high. Using rain water is much preferred.
5. Don't fertilize unless one knows what they are doing. Many plants have died from unnecessary fertilization.
6. Keep the plant warm. Good temperatures are 70-85 degrees Fahrenheit, and bad temperatures are below 50 degrees Fahrenheit.
7. Avoid direct sunlight if possible. Filtered sunlight works great.

Disclaimer

The information in this report has been obtained from sources believed to be reliable. Its accuracy and/ or completeness are not guaranteed and opinions are subject to change without notice. This report is for information only and not to be construed as a solicitation for contracts. We accept no liability for any direct or indirect loss arising from the use of this document. We, our associates, directors, employees may have an interest in the securities and/or companies mentioned herein.

This report has been prepared by TA SECURITIES HOLDINGS BERHAD for purposes of CMDF-Bursa Research Scheme ("CBRS") administered by Bursa Malaysia Berhad and will be compensated to undertake the scheme. TA SECURITIES HOLDINGS BERHAD has produced this report independent of any influence from the CBRS or the subject company.

For more information about CBRS and other research reports, please visit Bursa Malaysia's website at: <http://www.bursamalaysia.com/market/listed-companies/research-repository/research-reports>

for TA SECURITIES HOLDINGS BERHAD^(14948-M)
(A Participating Organisation of Bursa Malaysia Securities Berhad)
Kaladher Govindan – Head of Research