



IRIS Corporation Berhad

Has the Capability to "Make An Island Habitable"

THIS REPORT IS STRICTLY FOR INTERNAL CIRCULATION ONLY*

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Dubbed "2014 Star Performer", IRIS Corporation (IRIS) has lived up to market expectations by far with the upsurge in share price last week from 29.0sen to 38.5sen. Importantly, the price rally is believed to be fundamentally-linked to the group's promising earnings prospect as well as the profound effect of the change in major shareholder list.

Key takeaways from a recent analyst and fund manager meeting are:

1. IRIS has a "complete" model and solution to key global concerns like poverty, pollution, food safety, employment and education;
2. IRIS holds a trump card after establishing business presence in 25 countries and having favourable relationship with top government officials; and
3. The importance of FELDA's support.

We raise our FY15-16 earnings projections by 11.2% and 12.2% after making some changes to our assumptions:

- We now assume more housing contracts from FELDA which is worth RM75mn each for FY15 and FY16;
- We raise FY15-16 capex requirement by additional RM20mn each year to RM50mn, and
- Drawdown RM100mn of borrowing in FY15 to fund capex.

IRIS' fair value is revised higher to 54sen/share (from 34sen/share previously) based on revised 15x CY15 earnings. We reiterate our **Buy** recommendation given the upside potential of 40%.

Earnings Summary (RM'mn)

FYE March 31 (RMmn)	FY12*	FY13	FY14F	FY15F	FY16F
Revenue	483.8	537.1	724.9	1,038.4	1,101.9
EBITDA	84.9	71.7	120.7	179.6	199.9
EBITDA margin (%)	17.5	13.4	16.6	17.3	18.1
Pretax profit	58.1	34.0	69.1	116.8	143.3
Net profit	43.7	21.1	31.4	60.6	74.9
Core net profit	43.7	21.1	31.4	60.6	74.9
EPS (sen)	2.9	1.1	1.6	3.1	3.8
Diluted EPS (sen)	2.3	1.1	1.6	3.1	3.8
EPS growth (%)	17.6	(54.1)	49.2	92.9	23.5
PER (x)	16.5	36.0	24.1	12.5	10.1
GDPS (sen)	0.5	0.5	0.5	0.5	0.5
Div yield (%)	1.2	1.2	1.2	1.2	1.2
Core ROE (%)	9.3	5.1	6.4	10.1	11.4

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

TP: RM0.54(+40.3%)

Last traded: RM0.385

BUY

Share Information

Bloomberg Code	ICB MK
Stock Code	0010
Listing	ACE Market
Share Cap (mn)	1970.5
Market Cap (RMmn)	758.6
Par Value	0.15
52-wk Hi/Lo (RM)	0.40/0.155
12-mth Avg Daily Vol ('000 shrs)	11646.0
Estimated Free Float (%)	62.3
Beta	0.94

Major Shareholders (%)

FELDA - 26.7
Datuk Tan Say Jim - 11.0

Forecast Revision

	FY14	FY15
Forecast Revision (%)	0.0	11.2
Net profit (RMmn)	31.4	60.6
Consensus	-	-
TA's / Consensus (%)	-	-
Previous Rating	Buy (Maintained)	

Financial Indicators

	FY14	FY15
Net Debt/Equity (%)	45.7	53.9
CFPS (sen)	(5.8)	(3.3)
Price/CFPS (x)	nm	nm
ROE (%)	6.4	10.1
NTA/Share (RM)	0.2	0.2
Price/NTA (x)	1.8	1.6

Share Performance (%)

Price Change	IRIS	FBM KLCI
1 mth	42.6	(0.7)
3 mth	51.0	2.3
6 mth	97.4	2.3
12 mth	120.0	8.6

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



Source: Bloomberg

Last Friday, there was a group of analysts and fund managers visited IRIS operating HQ in Technology Park Malaysia. Greeted by Datuk Tan Say Jim, the founder and Group Managing Director of IRIS, the management highlighted those critical success factors or intellectual properties (IPs) that IRIS possesses to grow its earnings base. Later, we had a tour to the roof top where management showcased IRIS' Aquaponics and AutoPot system. Also, we witness IRIS' capability to build a single-storey bungalow within 7 days, using IRIS KOTO industrialized building system (IBS).

Key takeaways

Datuk Tan kept mum about profit guidance during the whole presentation. However, he pointed out IRIS' various core competencies in growing and sustaining its business over the long run. 3 core competencies, which are worth mentioning include:

1. IRIS has a “complete” model and solution to key global concerns like poverty, pollution, food safety, employment and education;
2. IRIS holds a trump card after having business presence in 25 countries and having favourable relationship with top government officials; and
3. The importance of FELDA supports.

1. A “complete” model and solution to poverty, pollution, food safety, employment and education

What can IRIS do today? An amassing answer from Datuk Tan is that “IRIS can make an island habitable”. Rightly speaking, IRIS' involvement in 7 business segments provides a complete model and solution to the current global concerns like poverty, pollution, food safety, employment and education.



Source: IRIS & TA Research

i. Food & Agro technology and KOTO IBS

Importantly, this model has been tested with live examples of completed Rimbunan Kaseh (RK) projects implemented in Malaysia. RK project is not an ordinary housing project but a comprehensive township planning to supply affordable homes and employment opportunities for villagers. It involves the construction of 100 affordable homes using IRIS KOTO IBS, high-tech educational, training and recreational facilities and an integrated, sustainable farm designed to provide both food and supplementary income for villagers.

In 2012, a similar housing concept was successfully implemented in FELDA site in Tenggaroh, Johor. The project is named as Sentuhan Kasih (SK), which aims to build houses using the IRIS KOTO IBS for second and third generation FELDA settlers and enable them to venture into high-yield cash crop projects utilizing the IRIS integrated farming solution.

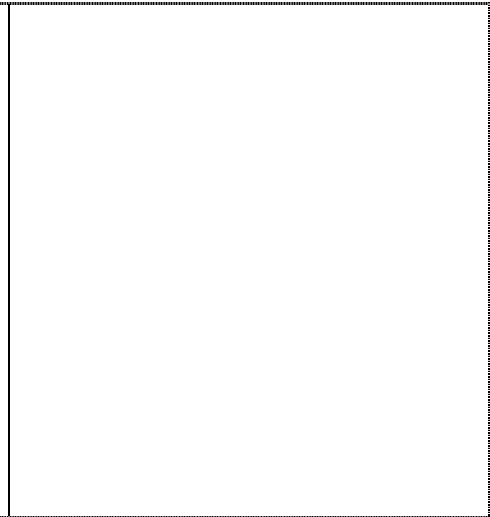


Figure 2: 1st Completed Rimbunan Kaseh project in Kuala Lipis, Pahang



Figure 3: 2nd completed Rimbunan Kaseh project in Serkam, Melaka



Figure 4: 1st completed Sentuhan Kasih project in Tenggara, Johor



Source: IRIS & TA Research

RK vs SK

RK is a government-funded project with contract sum of approximately RM23mn. The project duration is relative short within 4-6 months. As the project involves the implementation of integrated farming system, IRIS will provide farm management over the next 5 years. During this 5-year term, IRIS will employ a member from each family (from total 100 families in each RK site) to work in the farm, paying salary of RM1,000-1,500/month to each of them. In return, the foods produced in each farm are belong to IRIS. Based on a farm production forecast of 45,000 tons of produce over 5 years, IRIS projects each farm to generates sales of up to RM4.5-5mn per year. Working backward, this is based on a selling price assumption of RM0.50-0.56 per kilogram of produce, which we think is fair.

In contrast, SK project is funded by FELDA with contract sum of approximately RM39.5mn. Upon completion within 4-6 months, IRIS will hand-over all properties to FELDA and need not to employ FELDA settlers to work in the farm. However, it will provide consultancy services and guarantee offtake of food produced in the farm.

Results performance

IRIS started recognising the contribution from the Food & Agro and KOTO IBS segment in 3QFY13 (4QCY12). However, it failed to turn around the operation in the last 3 quarters due to: 1) low jobs volume for KOTO IBS division as job awards were sluggish during the General Election period; 2) the time lag for harvesting the first farm produce, resulting in mismatch of revenue and expenses (i.e. salaries paid to farm workers); 3) prudent accounting approach to charge out all R&D costs.

Table 1: Revenue and EBIT contribution from Food & Agro and KOTO IBS division

FYE March	3Q13	4Q13	1Q14	2Q14
Revenue	39.4	44.2	35.6	15.1
EBIT	4.7	(22.2)	(3.5)	(8.0)

Source: IRIS & TA Research

Opportunity

Subsequent to the completion of SK project in Johor, IRIS has entered into a memorandum of understanding (MoU) with FELDA for implementation of SK projects in several states in Peninsular Malaysia, including:

- 1) S.K Chini, Pahang,
- 2) S.K. Besut, Terengganu,
- 3) S.K. Palong, Negeri Sembilan,
- 4) S.K. Alor Setar, Kedah,
- 5) S.K. Gua Musang, Kelantan, and
- 6) S.K. Felda Jaya, Negeri Sembilan.

In relation to this, two letters of award have been given to IRIS to commence SK project in Chini, Pahang and Palong, Negeri Sembilan. The four remaining sites are under studied but the award could take a while due to related party transactions, after FELDA emerged as the single largest shareholder in IRIS.

As far as RK is concerned, we understand from management that there are 11 live and upcoming sites currently studied by management for the implementation of RK project. Research will be carried out on soil condition and weather study to decide the types of crops to be planted in these different locations.

Assuming the same respective value of RM23mn and RM39.5mn for each RK and SK site, the potential new jobs from the government and FELDA can amount to RM411mn in the immediate term. Further assuming RM5mn worth of farm produce in each farm, there will be some potential income of RM75mn recurring every year.

This is a conservative forecast, we believe, as opportunity could also come from South Africa as President Jacob Zuma has given the green light to IRIS to set up the like of Rimbunan Kaseh project in South African. We have not built this into our model until the company receives the letter of award.

Figure 5: Future Rimbunan Kaseh projects



Source: IRIS & TA Research

ii. Environment and Renewable energy

Given the technology invented and the IPs owned by IRIS, IRIS can do landfill and operate incinerators as part of waste management programme. The company is currently operating 2 incineration plants, ie: 1) 700-tonnes/day Municipal Waste-to-Energy Plant in Phuket, Thailand, which is capable of generating 10MW electricity. IRIS owns 51% interest in the plant; and 2) 450-tonnes/day food waste-to-fertiliser plant in Weinan, China, in which IRIS has 65% equity interest.

During the presentation, Datuk Tan is proud of the technology invented by Professor Chan and Dr. Zheng, who are partners and also the founders of Weinan plant. Professor Chan has discovered the use of enzyme and bio-bacteria to initiate the chemical reaction to convert organic fractions of food waste to organic fertilizer. According to management, the plant can convert 450-tonnes of food waste into 113-tonnes of fertilizer, or at a yield of 25%.

Results performance

Iris owns 51% stake in the new municipal waste-to-energy plant in Phuket, which made its maiden operating profit of RM2mn in 3QFY13 (4QCY12). The quarterly profit increased gradually to RM2.9mn in 1QFY14 and RM4.5mn in 2QFY12 after the successful ramp-up in the average energy supply. Looking forward, earnings from this division are expected to increase further as Weinan plant has commenced operation in 4Q13 (or 3QFY14). We expect the plant to be profitable in first year of operation as we understand that the tipping fee for handling food waste is sufficient to cover all operating expenses.

Table 2: Revenue and EBIT contribution from Environment and Renewable Energy division

FYE March	3Q13	4Q13	1Q14	2Q14
Revenue	18.2	9.4	10.5	11.0
EBIT	2.0	1.1	2.9	4.5

Opportunity

The management believes that IRIS has the cost advantage in building any food-waste-to-fertilizer plant as it possesses the IP. As such, IRIS is mulling over the idea of embarking the food waste-to-fertilizer project in Malaysia. We believe this project would receive overwhelming response from plantation companies if the fertilizer can be used in palm oil plantation.

iii. Education

To complete the model, IRIS believes education is a critical component to the whole sustainable rural development. As such, it has invested up to RM2.5mn to acquire 51% stake in Stamford College PJ and Stamford College Malacca. However, the acquisition is currently under litigation. We believe the litigation could be due to differences in realized values of net asset after IRIS conducted the due diligence process. Be that as it may, education is another business opportunity that IRIS can provide to cater for the need that FELDA will send 4,000 students to study in local colleges each year.

2. The presence in 25 countries and the favourable relationship with top government officials are the trump cards

IRIS has achieved the significant milestone after rendering services of Trusted Identification Solutions to 25 countries (refer to Figure 6). These solutions ranging from smart card production and ePassport inlay production, personalization and system integration to secure document management system, which ride on a patented technology known as Image Retrieval & Identification System invented by IRIS' founders. At present, there are 12 ongoing ePassport or Smart ID projects in countries including Malaysia, Nigeria, Tanzania, Senegal, Egypt, Bangladesh, Thailand, Canada, Bhutan, Afghanistan, Cambodia and Guinea.

By dealing with a nation's Smart ID or e-Passport project will provide the privilege to IRIS to have access to government officials in that particular country. Flipping through IRIS' 2013 annual report, we can list down those very important foreign visitors, who have visited IRIS in 2012-2013.

- Ministry of Agriculture, Irrigation and Livestock Afghanistan;
- Philippines President Office and Autonomous Region Governor;
- President of Guinea;
- Deputy Director of the Immigration Border Control, Ukraine;
- Ministry of Federal Capital Territory of Nigeria;
- The Honorable Mr. Omar Y. Mzee, Minister of Finance and Economic Affairs, Zanzibar;
- His Excellency Honorable Mr. Joang Molapo, Minister of Home Affairs, Republic of Lesotho;
- H.E. Dr. Emmanuel Nchimbi, Minister of Home Affairs, Tanzania;
- H.E. Mr. Mothetjoa Metsing, Deputy Prime Minister and Minister of Local Government Chieftainship and Parliamentary Affairs, Kingdom of Lesotho;
- H.E. Dr. Joomart Otorbaev, First Deputy Prime Minister of Kyrgyz Republic;
- Mr. Mohamoud A Nur, The Mayor of Mogadishu and Governor of Banadi Region, Somalia;
- Edward Nipake Natapei, Deputy Prime Minister/ Minister of Foreign Affairs, Republic of Vanuatu;
- The Right Honorable Mr. Rick Houenipwela, Minister of Finance, Government of Solomon Islands;
- Vice Minister and delegates of Papua New Guinea;
- Islamic Development Bank, Jeddah Saudi Arabia;
- Mr. Tony Moniaga & Mr. Ronald Simon, World Vision International; and
- HM King Mswati III, Kingdom of Swaziland.

The point of going through the name list above could sometime help in identifying future projects. For instance, IRIS secured an ePassport/Visa project worth USD250mn from the Government of Republic of Guinea in October last year after the President of Guinea visited IRIS in June-13.

It is needless to say that by having business presence in 25 countries and privileged access to government officials, IRIS has a strong brand equity, which is invaluable, we believe.

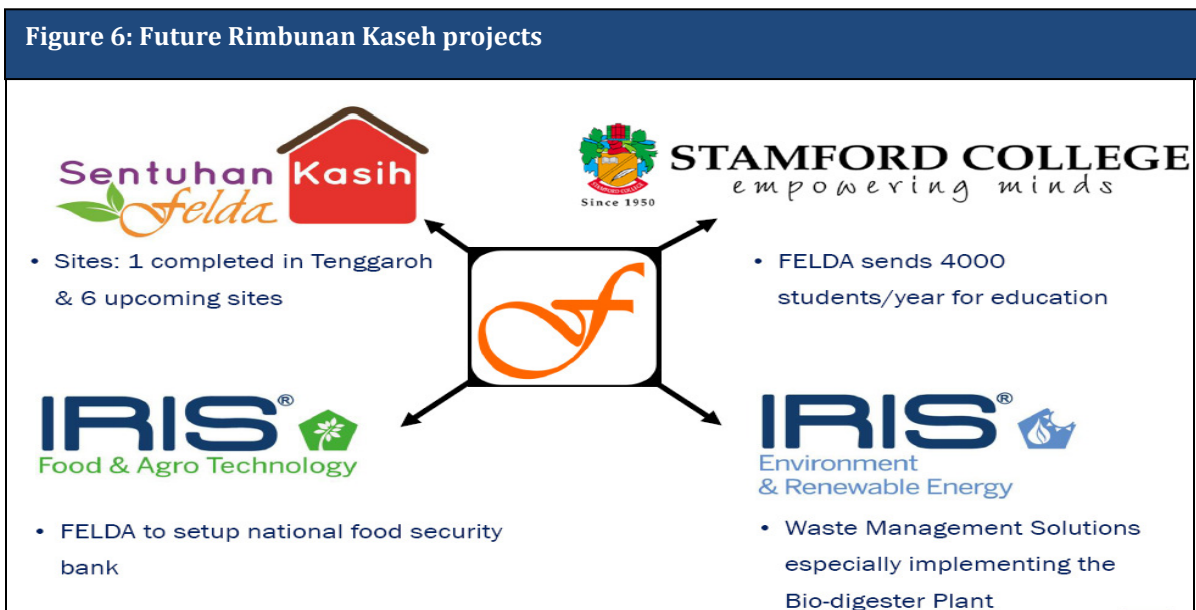


Source: IRIS & TA Research

3. The importance FELDA's supports

In our previous report dated 26 August 2013, we highlighted those possible synergies after FELDA subscribing for IRIS' share placement and becoming the single largest shareholder. We continue to believe this is a win-win solution to both companies, in which FELDA will technically have access to the technology know-how and IPs owned by IRIS as well as the privileged access to top government officials while IRIS can have operational and financial supports from FELDA.

In one of the presentation slides, IRIS believes future business opportunities could be extended from existing Sentuhan Kasih and other housing projects to education to bio-fertilizer project. Interestingly, management also believes the diagram below can be replicated in other countries and this will essentially mean more and more business opportunities for IRIS.



Source: IRIS & TA Research

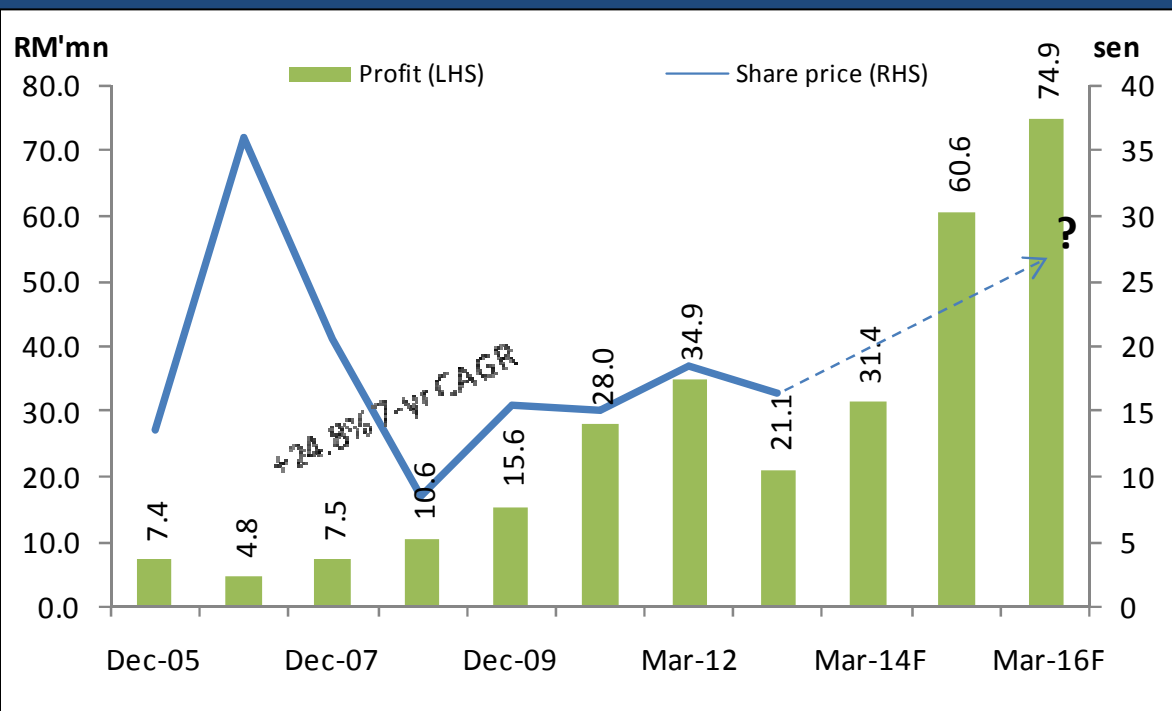
Financial highlights & Assumptions

We make some changes to our assumptions as below:

1. We now assume more housing contracts from FELDA worth RM75mn for FY15 and FY16. According to The Malay Mail, FELDA chairman, Tan Sri Mohd Isa Abdul Samad, was quoted as saying that Felda will build 4,000 units of houses annually for second and third generation settlers to bring the number to 20,000 units over the next five year. Here, we are assuming 1,000 units of the housing requirement each year to be awarded to IRIS as a price of RM75,000/unit.
2. We raise FY15-16 capex requirement by additional RM20mn each year to RM50mn. This is to factor in that IRIS would construct waste incineration plants in Malaysia to showcase to potential clients.
3. Drawdown RM100mn of borrowing to fund capex in FY15.

Following the change in assumptions, our FY15-16 earnings have increased by 11.2% and 12.2% respectively to RM60.6mn and RM74.9mn. This represents annual earnings growth of 93% in FY15 and 23% in FY16. The explosive growth in FY15 earnings is partly due to low base effect as FY13-FY14 earnings were affected by the mismatch of farm revenue and expenses. Also, the management has adopted prudent accounting policy by charging out R&D costs in FY13.

Figure 6: Future Rimbanan Kaseh projects



Valuing opportunity

Our FY14-16 earnings projections are premised on existing and pipeline contracts awarded to IRIS as well as latest news flows on the affordable housing in Malaysia. We have not factored in the tremendous growth opportunity below into our earnings model.

Opportunity 1: Of the 4,000 units of houses required by FELDA, we only assume 1,000 to be given to IRIS. In the case that FELDA were to give all 4,000 to IRIS, the contract value for each FY15 and FY16 could potentially be revised to RM300mn from our forecast of RM75mn.

Opportunity 2: The like of Sentuhan Kasih project called “Smart Village” could take off in South Africa since IRIS has been given the green light to commence the feasibility study.

Opportunity 3: FELDA may express interest in IRIS’ waste food-to-fertilizer technology and start investing in this area.

Opportunity 4: FELDA would send 4,000 students per year to Stamford College.

Opportunity 5: To capitalize on IRIS brand equity, IRIS and FELDA could further explore business opportunity in 25 countries, be it plantation, housing, food, waste management or education.

Recommendation

It is a daunting task to value each of these opportunities due to uncertainties in project timeline and contract values. Some of these opportunities may disappear for any reasons whatsoever. However, all these opportunities would not arise without IRIS’ intensive investment in technology (ie: KOTO IBS, waste management, Smart card) and product innovations. Hence, in our valuation approach, we take into account the near term earnings growth, long term business opportunities, and the technology and IPs invested by IRIS, we value IRIS at 54sen/share (from 34sen/share previously) based on revised 15x CY15 earnings.

There is no direct comparison given IRIS’ unique business model. However, if we make comparisons with Datasonic Group Berhad, which is involved in Smart card and Smart ID projects in Malaysia, our PE valuation is not excessive. Note that currently Datasonics is trading at 15x CY14 earnings. Besides, our PE multiple is much lower than the potential FY15-16 earnings growth of 93% and 24%.

We reiterate our **Buy** recommendation given the upside potential of 40%. We are confident that the recent rally in share price is fundamentally-linked to IRIS’ future earnings prospect as well as the profound effect of the change in major shareholder list. We believe the stock re-rating is on the cards as IRIS management is proactive in engaging with investment fraternity, showing confidence in FY15-16 earnings outlook.

Financial statement (FYE March)

<i>Profit and Loss (RM'mn)</i>	2012*	2013	2014F	2015F	2016F
Revenue	483.8	537.1	724.9	1038.4	1101.9
COGS	(343.2)	(430.8)	(522.0)	(747.6)	(793.3)
Gross profit	140.6	106.3	203.0	290.7	308.5
EBITDA	84.9	71.7	120.7	179.6	199.9
Depreciation	(12.6)	(23.8)	(33.0)	(41.1)	(42.9)
EBIT	72.2	47.9	87.7	138.6	157.0
Finance cost	(14.1)	(13.3)	(18.0)	(21.1)	(13.0)
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	69.1	116.8	143.3
Adj PBT	58.1	34.0	69.1	116.8	143.3
Tax	(17.2)	(15.6)	(19.3)	(36.4)	(48.7)
MI	2.8	2.6	(18.3)	(19.7)	(19.7)
Net profit	43.7	21.1	31.4	60.6	74.9
Adj net profit	43.7	21.1	31.4	60.6	74.9
EPS (sen)	2.9	1.1	1.6	3.1	3.8
DPS (sen)	0.5	0.5	0.5	0.5	0.5

<i>Cash Flow (RM'mn)</i>	2012*	2013	2014F	2015F	2016F
PBT	58.1	34.0	69.1	116.8	143.3
Non- cash item	16.4	21.9	33.0	41.1	42.9
Chg in working capital	21.7	(44.6)	(163.5)	(137.8)	(42.0)
Tax	(22.5)	(16.5)	(19.3)	(36.4)	(48.7)
Others	36.9	22.6	0.7	0.7	0.7
CFO	110.6	17.4	(80.2)	(15.7)	96.1

Capex	(15.3)	(120.4)	(35.0)	(50.0)	(50.0)
Others	(1.4)	20.7	0.0	0.0	0.0
CFI	(16.7)	(99.7)	(35.0)	(50.0)	(50.0)
Net Addition/Rpmt	(27.9)	57.1	1.6	70.0	(50.0)
Dividend Paid	(7.1)	(8.9)	(8.9)	(8.9)	(8.9)
Others	18.3	0.2	102.0	0.0	0.0
CFF	(16.7)	48.5	94.7	61.1	(58.9)

<i>Key Assumptions (RM'mn)</i>	2012	2013	2014F	2015F	2016F
New contract secured					
---> Digital solution	210	207	900	180	180
---> Rimbulan Kaseh	-	46	46	69	69
---> Sentuhan Kasih	-	40	200	240	240
---> Felda 20k housing req	-	0	0	75	75

<i>Balance Sheet (RM'mn)</i>	2012	2013	2014F	2015F	2016F
Fixed Assets	117.1	162.4	202.4	211.3	218.4
Intangibles	135.4	141.5	155.1	155.1	155.1
Others	60.8	201.7	223.8	223.1	222.5
LT Assets	313.3	505.5	581.3	589.5	596.0
Inventories	57.4	94.6	149.3	204.8	220.4
Trade & other receivables	277.2	333.9	472.6	569.0	603.8
Cash & Cash equivalent	88.8	58.9	39.7	35.1	22.4
Others	49.8	99.1	101.7	101.7	101.7
ST Assets	473.2	586.4	763.3	910.6	948.2
Total Assets	786.6	1092.0	1344.6	1500.2	1544.2
Trade and other payables	33.5	42.2	72.1	86.2	94.5
ST Borrowings	73.5	169.9	195.3	180.3	155.3
Others	188.9	305.9	305.9	305.9	305.9
ST Liabilities	295.9	518.0	573.3	572.4	555.7
LT Borrowings	75.7	102.8	106.0	191.0	166.0
Others	13.2	13.9	17.6	17.6	17.6
LT Liabilities	89.0	116.8	123.6	208.6	183.6
MI	(1.0)	41.1	75.4	95.1	114.8
Share Cap	236.3	236.5	295.6	295.6	295.6
Reserves	166.4	179.6	276.7	328.5	394.5
Shareholder's Funds	402.7	416.1	572.3	624.1	690.1
Liabilities + Equities	786.6	1092.0	1344.6	1500.2	1544.2

<i>Ratios</i>	2012#	2013	2014F	2015F	2016F
EPS Growth (%)	17.6	>100	49.2	92.9	23.5
PER (x)	16.5	36.0	24.1	12.5	10.1
Div Yield (%)	1.2	1.2	1.2	1.2	1.2
Net cash (RMm)	(60.4)	(213.9)	(261.6)	(336.2)	(298.9)
Net gearing (x)	0.2	0.5	0.5	0.5	0.4
ROE (%)	9.3	5.1	6.4	10.1	11.4
ROA (%)	4.8	2.2	2.6	4.3	4.9
NTA (RM)	0.17	0.17	0.21	0.24	0.27
P/NTA (x)	2.3	2.2	1.8	1.6	1.4
EV/EBITDA (x)	7.9	11.4	8.5	6.1	5.3

* 15 months contribution

Based on annualised 12-month earnings

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