

**RESULTS – 2Q/FY10**

03 Sep 2010

For period Apr-Jun 2010

| | | | |
|-------------------------------------|----------|-------------------------------|------------------------|
| Chemical Company of Malaysia | | Price: | RM2.01 |
| | | Market Capitalisation: | RM813.5m |
| | | Board: | Main Board |
| Stock Code/Name: | 2879/CCM | FBM Index: | EMAS Shariah/Small Cap |
| Recommendation: | HOLD | Sector: | Industrial Products |

Analyst: Edmund Tham

| Key Stock Statistics | 2010E |
|-------------------------------|-------------|
| EPS (sen) | 1.6 |
| P/E (x) | 122.0 |
| Dividend/Share (sen) | 10.7 |
| NTA/Share (RM) | 0.98 |
| Book Value/Share (RM) | 1.76 |
| Issued Capital (mil shares) | 403.0 |
| 52-weeks share price (RM) | 2.00 – 2.74 |
| Major Shareholders: | % |
| Permodalan Nasional Bhd (PNB) | 69.3 |
| EPF Board | 9.6 |

| 2Q/ 30 Jun | 2Q10 | 2Q09 | yoy % | 1Q10 | qoq% |
|------------|-------|-------|-------|-------|-------|
| Rev (RMm) | 423.0 | 422.9 | 0.0 | 368.7 | 14.7 |
| EBIT (RMm) | 20.9 | 3.5 | 501.1 | 6.9 | 203.9 |
| NPAT (RMm) | 2.0 | (1.8) | 213.2 | 0.8 | 135.9 |
| EPS (sen) | 0.5 | (0.4) | 213.2 | 0.2 | 135.9 |

*NPAT here calculated after Minority Interest

| 1H/ 30 Jun | 1H10 | 1H09 | yoy % |
|------------|-------|-------|-------|
| Rev (RMm) | 791.7 | 766.0 | 3.3 |
| EBIT (RMm) | 27.8 | 16.3 | 70.8 |
| NPAT (RMm) | 2.8 | 0.5 | 470.7 |
| EPS (sen) | 0.7 | 0.1 | 470.7 |

*NPAT here calculated after Minority Interest

| Per Share Data | 2007 | 2008 | 2009 | 2010E |
|-------------------------|------|------|-------|-------|
| Book Value (RM) | 1.83 | 1.86 | 1.79 | 1.76 |
| Earnings (Losses) (sen) | 15.6 | 16.1 | (1.4) | 1.6 |
| Dividend (sen) | 16.0 | 16.3 | 10.7 | 10.7 |
| Payout Ratio (%) | 75.6 | 75.1 | N/A | 485.5 |
| PER (x) | 12.9 | 12.5 | N/A | 122.0 |
| P/Book Value (x) | 1.1 | 1.1 | 1.1 | 1.1 |
| Dividend Yield (%) | 8.0 | 8.1 | 5.3 | 5.3 |
| ROE (%) | 8.5 | 8.7 | N/A | 0.9 |
| Net Gearing (x) | 0.34 | 1.01 | 0.97 | 0.96 |

*N/A due to net losses

| P&L Analysis (RM mil) | 2007 | 2008 | 2009 | 2010E |
|-------------------------|--------|--------|--------|--------|
| Year end: Dec 31 | | | | |
| Revenue | 1397.3 | 2165.4 | 1571.8 | 1603.6 |
| Operating Profit | 112.1 | 141.2 | 45.9 | 65.2 |
| Depreciation | (36.0) | (42.9) | (49.7) | (56.5) |
| Interest Expenses | (15.7) | (25.7) | (33.9) | (40.0) |
| Pre-tax Profit | 105.6 | 120.3 | 15.6 | 31.7 |
| Effective Tax Rate (%) | 20.8 | 28.9 | 37.0 | 48.2 |
| NPATMI [^] | 62.7 | 65.0 | (5.8) | 6.6 |
| Operating Margin (%) | 8.0 | 6.5 | 2.9 | 4.1 |
| Pre-tax Margin (%) | 7.6 | 5.6 | 1.0 | 2.0 |
| Net Margin (%) | 4.5 | 3.0 | (0.4) | 0.4 |

* RM1.00 par value

[^]NPATMI = net profit after tax & minority interest**PERFORMANCE**

CCM's annualized 1H/FY10 revenue came in well within our earlier estimates. However, CCM's 2Q/FY10 net profit after tax and minority interest (NPATMI) was once again below our earlier expectations.

“Chemicals and Pharmaceuticals segments reported higher sales”

CCM's group revenue for 2Q/FY10 ended 30th June 2010 had increased very marginally by RM67,000 as compared to the corresponding 2Q/FY09 as its Chemicals and Pharmaceuticals segments reported higher sales. CCM's group profit before tax (PBT) for 2Q/FY10 was higher by around RM14 million compared to 2Q/FY09. The improvement in profit before tax was primarily due to the better metals raw material pricing, lower overhead costs, lower provision for doubtful debts and higher share of associated company results of its Chemicals segment.

In 2Q/FY10, CCM's group revenue had increased by 14.7% q-o-q from the preceding 2Q/FY10 while its group profit before tax had improved by 347.7% from RM3.1 million to RM13.7 million.

All information, views and advice are given in good faith but without legal responsibility. Mercury Securities Sdn. Bhd. or companies or individuals connected with it may have used research material before publication and may have positions in or may be materially interested in any stocks in the markets mentioned.

This report has been prepared by Mercury Securities Sdn Bhd for purposes of CMDF-Bursa Research Scheme ("CBRS") administered by Bursa Malaysia Berhad and has been compensated to undertake the scheme. Mercury Securities Sdn Bhd has produced this report independent of any influence from 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/website/bm/listed_companies/cmdf_bursa_research_scheme/



OUTLOOK/CORP. UPDATES

With the anticipated improvement in the domestic and regional economies, we expect CCM to have a more favourable performance for the remainder of its FY10. In April 2010, The International Monetary Fund (IMF) said that the global economy will grow at a faster-than-expected rate this year as it continues to rebound from a financial crisis. In its World Economic Outlook report, the IMF had forecast global economic growth of 4.2% for 2010 and 4.3% for 2011. During its 1H/FY10, CCM's Chemicals and Pharmaceuticals segments performed reasonably well while its Fertilizers segment's performance have been impaired by stiff competition in the sector.

“Better overall performance expected in FY10”

Malaysia had reported a solid 2Q/2010 GDP growth of +8.9%. Meanwhile in July 2010, Bank Negara Malaysia (BNM) had increased its overnight policy rate (OPR) to 2.75%, given that domestic economic conditions have improved. This move is meant to stifle inflationary pressures and to correct other imbalances in the economy. The latest available CPI of +1.9% y-o-y was reported for the month of July 2010. Economic recovery would also lead to better business optimism and hence assist to raise demand for various industries, including fertilizers, chemicals and pharmaceuticals.

“Fertilizers segment still faces issues”

The revenue from CCM's **Fertilizers segment** for 1H/FY10 ended 30th June 2010 was 2% lower than the corresponding 1H/FY09. The segment profit before tax (PBT) recorded a loss of RM4.6 million compared to a PBT of RM1.5 million reported in 1H/FY09. The severe price competition from lower quality NPK (Nitrogen, Phosphorous and Potassium) compounds had continued to adversely affect the sales margin performance of the segment. Going forward, we are not expecting this situation to improve much in the near term.

Meanwhile, the usage and application of fertilizers by plantation companies depend also on CPO (crude palm oil prices) and weather conditions. CCM plans to penetrate the market for smaller plantations after establishing a strong foothold supplying fertiliser to the big plantations in Malaysia. CCM commands 30% of the domestic fertiliser market, catering to the larger oil palm plantation companies such as Sime Darby Bhd.

CCM's new RM60mil fertiliser plant in Lahad Datu that would be operational in the first quarter of 2011 would also enhance the group's position as the largest compound fertiliser in Malaysia and expand its capability in Sabah and East Kalimantan. The new plant will raise CCM's fertilizer output to 670,000 tonnes annually.

Meanwhile, CCM's Fertilizer division had also established a strategic alliance with the Malaysian Agricultural Research and Development Institute (MARDI) to undertake research and development (R&D) activities to promote the commercialization of Nitro Humic Acid (NHA), a crop booster foliar fertilizer. NHA has been proven to be effective in enhancing the plant crop yield of paddy, chillies, tomatoes and citrus by increasing the size and quantity of harvested fruits.

This project is funded under the Ministry of Science, Technology and Innovation (MOSTI)'s TechnoFund scheme. Under this strategic alliance, MARDI is providing its technological expertise to carry out R&D while CCM Fertilizers will be involved in the commercial production, marketing, sales and distribution of NHA and crop booster fertilizers.

“Steady growth expected from Chemicals and Pharmaceuticals segments”

Revenue for CCM's **Chemicals segment** for 1H/FY10 had increased by 9% against the corresponding 1H/FY09 while its segment PBT had contributed a profit of RM8.9 million compared to a loss of RM5.5 million during 1H/FY09. The segment turnover had increased due to the better metals raw material pricing coupled with the improvement on the overall performance of Chemicals segment. Meanwhile, the higher segmental profit achieved during the quarter was mainly contributed by the lower overhead costs, lower provision for doubtful debts and higher share of associated company results.

We expect that the results for CCM's Chemicals segment to remain positive during its FY10. Furthermore, we anticipate that its Chemicals segment would stand to benefit from the strength of the rubber glove sector via its investment in the specialty polymer coatings business, which caters for the medical/examination rubber gloves sector.

CCM's **Pharmaceuticals segment** had recorded a higher turnover of 2.7% during 1H/FY10 compared to the corresponding 1H/FY09. However, the segmental profit before tax was 24.5% lower as

Results Coverage

This report has been prepared by Mercury Securities Sdn Bhd for purposes of CMDF-Bursa Research Scheme ("CBRS") administered by Bursa Malaysia Berhad and has been compensated to undertake the scheme. Mercury Securities Sdn Bhd has produced this report independent of any influence from 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/website/bm/listed_companies/cmdf_bursa_research_scheme/



compared to the same period last year. The decrease was due to unavailability of certain controlled drugs due to the quota limitation in raw material imposed by the Malaysian authorities and also the higher finance cost as a result of the effects from the FRS139 (Financial Reporting Standards 139 - Financial Instrument: Recognition and Measurement) implementation.

CCM's 72.3%-owned CCM Duopharma Biotech Bhd (CCMDBIO) had also faced challenges to procure its normal import permits for psychotropic and dangerous drugs. The Pharmaceuticals segment has been performing creditably with strong resilience even during the last recent recessionary period and we expect steady growth during FY10 as well.

As Malaysia's largest generic pharmaceutical manufacturer, CCM is well poised to capture a bigger share of the local market and it aims to aggressively strengthen its presence regionally. CCM is already present in ASEAN, with Indonesia as its biggest market. The group is also looking beyond ASEAN and hopes to venture into new markets in the Middle East and Australasia.

CCM also plans to develop more innovative halal products and expand its market reach to both Muslim nations and countries with a substantial population of Muslim communities. This is in line with CCM's determination to drive the halal initiative forward and to realize Malaysia's ambition of becoming an international halal hub. Meanwhile, this year CCM is also launching 10 or 11 new over-the-counter (OTC) and prescription products that are targeted to boost its pharmaceutical market share to 23% by year-end from 20% currently.

CCM Duopharma's RM35 million new warehouse (next to its current site in Klang) is expected to be completed by end of the 3rd quarter in 2010. Its business plans include the new warehouse, a water treatment plant, and the remodelling and upgrading of its small volume injectables plant (which includes the first inert vaccines fill-and-finish facility in the country).

In July 2010, AKN Technology Bhd had served a lawsuit on CCM in relation to the shares sales agreement (SSA) between Paramount Discovery SB and CCM, and the conditional profit guarantee agreement (CPGA) executed by AKN in favour of CCM. AKN is claiming that CCM has breached conditions stated in the CPGA and as such AKN seeks to get discharged from its obligations under the CPGA. Alternately, AKN is seeking compensation

for CCM's purported breach in conduct. During the case management on 4th August 2010, the Court had fixed the matter for hearing on 6th October 2010. Currently we are unable to assess the full impact of this lawsuit on CCM's financials. However, we do not foresee the impact to be particularly substantial.

CCM is committed towards good **corporate social responsibility (CSR)** practices in healthcare, education, sports and the environment. The company has contributed towards the betterment of healthcare (lifestyle campaign, pharmaceutical donations), education (donations, scholarships, school-adoption), sports (sponsorship) and the environment (responsible care programme), among others.

VALUATION

Despite of the tough operating environment and tight profit margin levels, CCM's management had declared a final dividend per share (DPS) of 8 sen tax exempt (equivalent to 10.7 sen gross DPS) for its FY09. This is probably in part due to the obligation to pay dividends to its institutional shareholders (including PNB, its controlling stakeholder). The dividend was paid to shareholders in July 2010. For CCM's FY10, in absence of guidance from CCM's management, we have tentatively assumed the same gross DPS of 10.7 sen would be proposed.

CCM has an adjusted beta (correlation factor) of 0.65 to the KLCI. Year-to-date (YTD) in 2010, CCM is lower by 11.8%, underperforming the KLCI (+12.6 YTD). Due to CCM's current weak earnings, its P/E valuations would prove to be too high and unreliable. Based on our forecast of CCM's FY10 book value/share and an estimated P/BV of 1.2 times, we set a FY10-end **target price of RM2.11**, which is a meagre 5.2% above its current market price.

“Limited price downside”

Currently, we are **maintaining our Hold Call** on CCM. This is on the basis that while its earnings growth prospects still appears weak, any further stock price downside is limited by its trading volume illiquidity. From our observation, CCM's stock price has not retreated below RM2.00 since August 2004. Additionally, we expect CCM to be able to return to profitability in its FY10, given the overall recovery in the global economy.

“Maintain Hold Call”

CCM is a GLC (government-linked company) under PNB's stable and we foresee - given that CCM's

All information, views and advice are given in good faith but without legal responsibility. Mercury Securities Sdn. Bhd. or companies or individuals connected with it may have used research material before publication and may have positions in or may be materially interested in any stocks in the markets mentioned.

This report has been prepared by Mercury Securities Sdn Bhd for purposes of CMDF-Bursa Research Scheme ("CBRS") administered by Bursa Malaysia Berhad and has been compensated to undertake the scheme. Mercury Securities Sdn Bhd has produced this report independent of any influence from 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/website/bm/listed_companies/cmdf_bursa_research_scheme/

management already has a financial restructuring plan in place, the shape of its balance sheet ought to improve, given appropriate time and effort. Meanwhile, CCM's operations also face risk factors such as possible foreign exchange translation losses, stiff price competition from rival companies, regulatory restrictions and also market fluctuations in selling prices or costs of raw materials arising from demand and supply disequilibrium.

“Interim period - search for new MD”

Meanwhile, CCM's group Managing Director (MD) Dato' Dr Mohamad Hashim Ahmad Tajudin had decided to retire from CCM and all Board directorships within the group to pursue his personal interests upon expiry of his contract at the end of June 2010. Dato' Dr Mohamad Hashim was appointed in May 2004 and had served 2 terms with the group.

CCM's Nomination and Remuneration Committee is in the process of finalizing its recommendation to the Board of Directors on the appointment of a new Group MD. In the interim, an Executive Committee comprising Mr E Sreesanthan (Chairman), Tan Sri Dato' Dr Abu Bakar bin Suleiman and Dato' Mohd Nizam bin Zainordin will be responsible for the operations of the group. Nevertheless, we do not foresee any adverse effects on the group's operations and performance during this interim period. The Board of Directors ought to be able to seek out suitable candidates among the qualified senior management personnel of the numerous GLC (government-linked companies) locally, especially those under PNB's stable and control.

CCM: 6-month Share Price



Source: NextView

Results Coverage

This report has been prepared by Mercury Securities Sdn Bhd for purposes of CMDF-Bursa Research Scheme ("CBRS") administered by Bursa Malaysia Berhad and has been compensated to undertake the scheme. Mercury Securities Sdn Bhd has produced this report independent of any influence from 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/website/bm/listed_companies/cmdf_bursa_research_scheme/
