

SMR Technologies

Recommendation: **STRONG BUY**

Stock Code: 0117

Bloomberg: SMRT MK

Price: MYR0.28

12-Month Target Price: MYR0.41

Date: December 31, 2007

Board: Mesdaq

Sector: Technology

GICS: Information Technology/Application Software

Market Value - Total: MYR27.5 mln

Summary: SMR Technologies (SMRT) is primarily engaged in the business of designing, developing, consulting and implementing human capital or human development systems and solutions.

Analyst: Desmond Ch'ng, ACA



Highlights

- SMR's track record has thus far been impressive. From 2002 to 2006, revenue expanded at a CAGR of 82% while net profit grew at a CAGR of 65%.
- Fundamentals wise, margins are high (projected EBITDA margin of 48% in 2007 and 45% in 2008), given that SMR markets its own proprietary software. We expect average ROEs of 20% over the same period and the company continues to operate in a net cash position (net cash of MYR1.1 mln end-Sept. 2007).
- We forecast revenue growth of 34% in 2007 and 21% in 2008, riding on increasing market penetration. With potentially higher marketing and promotional costs as well as overheads, we are nevertheless, projecting slower net profit growth of 9% in 2007 and 14.4% in 2008.

Investment Risks

- Risks to our recommendation and target price include: (i) increasing competition from domestic and global peers, (ii) technological advancements and SMR's R&D capability in maintaining the relevance of its product; and (iii) higher-than-expected costs from new market penetration.

Recommendation

- We initiate coverage on SMR with a Strong Buy call and a 12-month target price of MYR0.41.
- Our target price is based on a forward 2008 PER of 5.7x, which represents a 30% discount to current valuations for Hexaware Technologies (Hexaware) (HEXW IN, INR83.05, Not Ranked). Hexaware is a Mumbai-based global provider of IT and process outsourcing services, with HR-IT services being part of the varied services it offers. The discount is to reflect SMR's smaller market capitalization relative to Hexaware's.
- What stands out for SMR is the fact that it operates in a market that offers much potential for growth, especially since it has built up credentials with large domestic companies and foreign multinationals in a wide range of industries. Bottomline growth going forward thus very much depends on just how quickly it can garner new clients while penetrating new markets e.g. the U.S. market through Smartha.

Key Stock Statistics

FY Dec.	2006	2007E
Reported EPS (sen)	5.7	6.3
PER (x)	4.8	4.4
Dividend/Share (sen)	1.0	1.0
NTA/Share (MYR)	0.19	0.26
Book Value/Share (MYR)	0.20	0.32
No. of Outstanding Shares (mln)	100.0	
52-week Share Price Range (MYR)	0.26 - 0.45	
Major Shareholders:	%	
Dr. Palaniappan a/l Ramanathan Chettiar	56.4	
Kumpulan Sentiasa Cemerlang	13.2	

Per Share Data

FY Dec.	NA	2005	2006	2007E
Book Value (MYR)	NA	0.02	0.20	0.32
Cash Flow (sen)	NA	4.1	7.1	7.8
Reported Earnings (sen)	NA	3.6	5.7	6.3
Dividend (sen)	NA	0.0	1.0	1.0
Payout Ratio (%)	NA	0.0	0.0	16.0
PER (x)	NA	7.6	4.8	4.4
P/Cash Flow (x)	NA	6.8	3.9	3.5
P/Book Value (x)	NA	11.4	1.4	0.9
Dividend Yield (%)	NA	0.0	3.6	3.6
ROE (%)	NA	NA	27.7	21.1
Net Gearing (%)	NA	0.0	0.0	0.0

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Background

Corporate Profile

Incorporated in Jul. 2004, SMR's primary objective is to provide a one-stop digital center for human capital development and its two key initiatives are:

- To develop human capital competency development and performance management software and a web-based on-line learning management system; and
- To provide related services such as implementation consultancy, web services and HR outsourcing.

Founder of the SMR group is Dr Palaniappan a/l Ramanathan Chettiar (Dr Palan) whose work experience over the past 29 years has been in the area of Human Resource Development (HRD) technology, having held various HRD positions in both a consultancy and project management capacity for large corporations and multi-nationals.

Products and Services

SMR's core product is its own proprietary software system, HRDPower™, a Human Resource (HR) competency and performance management solution, conceived and developed by Dr. Palan in Australia in 1998-1999. In 2001, Dr. Palan relocated the R&D functions to Malaysia and today, SMR operates out of Kuala Lumpur, with its R&D centre in Cybercity at Plaza Sentral.

SMR's software and web-based systems have essentially evolved around HRDPower™, and they include:

Name of product	Description	Launch date
HRD Power Access	HRD system with Competency and Performance Module incorporating Key Performance Indicators (KPI) with Access backend.	2001
HRDPower SQL Server	Human Resource Development system with Competency and Performance Module and KPI with SQL server backend and network version.	1Q04
Training Power	Training Management system with Access backend.	4Q03
HRDPower.Net	An online portal for licensed users of HRDPower™ software system with easy access to information, resources, products and services required for HRD.	3Q06
HRDWebvarsity	A complete web-based Learning Management system.	1Q07
TrainersVirtualCampus	An online university for trainers specializing on Training the Trainers.	1Q07
Competency Power	Competency based HRD system with functional competency classification.	1Q07

Source: SMR

As a one-stop HR solutions provider, SMR also provides complementary HR-related services such as: (i) consultancy, (ii) design and implementation of knowledge management, eLearning, performance management and succession planning systems and processes and (iii) outsourcing of HR services such as training management processes, and training needs analysis.

About HRDPower™

HRDPower™ is a system which is designed to monitor and manage the development and competency of employees, as well as the impact on a company's investment into human capital development. As such, what the system does is it enables employers to:

- Assess the competency of their employees in relation to their designated posts in the organization;
- Identify any shortcomings of their employees or areas lacking competency;
- Assess, identify and plan for the relevant training to address competency shortfalls;
- Manage the performance management process;
- Manage the succession plans and talent pipelines for continued competitiveness of the organization; and
- Manage the budget and training requirement of the organization.

What differentiates HRDPower™ from most other HR software systems is that it focuses on strategic HR competency and performance, as opposed to operational HR issues such as payroll and time-keeping. As such, the system complements, rather than competes with, other HR management (HRM) products.

HRDPower™'s uniqueness is its flexibility. Supported by intensive technical and functional R&D, HRD is web-based, is connectible to just about any device and available in multiple languages. Moreover, given that the software is supported by a readily accessible database, it typically takes SMR just about 90 days to customize and fully install the system for its clients, as opposed to about 12-18 months for other software providers. That HRDPower™ is today used by organizations in 32 countries worldwide, is testimony to the vast acceptance of this system.

Barriers to Entry

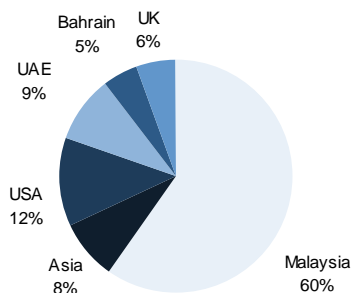
While there are many other competitors in the HR software solutions sphere, what makes SMR unique, we believe, are the following factors:

The product's focus. As mentioned before, where HRDPower™ differs from most other software is that it focuses on competency management rather than operational HR issues, and as such, has fewer competitors in this field. Moreover, while there are many HR consultants in the industry, most do not have their own proprietary software.

The product's origins. Most HR solutions have typically been developed by IT specialists with little knowledge of HR functions. HRDPower™, on the other hand, was developed by a HR consultant, Dr. Palan, who has close to 30 years of experience in this field. Moreover, the product continues to be supported by an international think tank of HRD experts, thus ensuring the ongoing shelf life and relevance of the product.

Expertise & track record. With experience in over 32 countries, SMR is a global service provider. SMR today has customers in South, East and West Asia, Australia, USA, Europe, Africa and ASEAN countries.

Revenue breakdown by geographical location (9M07)



Source: SMR

Competency libraries. What is also positive is that SMR's customers are in industries that are deemed to be of high value e.g. oil & gas, healthcare, hospitality, aviation and consumer electronics, thus lending credibility to and enhancing the profile for its products. What therefore cannot be duplicated overnight is the knowledge database and competency libraries that the group has built up over the years over a wide range of industries.

An established brand name. SMR is company which is fairly well-known amongst the HR community given that: (i) Dr. Palan and the company have published various books on HR-related topics, (ii) the company organizes a HRD Congress every year with over 1,000 registered participants from more than 30 countries, and (iii) SMR offers accredited certification HR programs. Since 1978, the company has certified more than 1,000 HR trainers and consultants.

Ongoing R&D. R&D remains a key to the success of the organization and the aim is to increase the number of R&D personnel from about 40 presently to 54 in 2008 (30 in 2006). SMR also plans to collaborate in joint R&D with industry partners such as eLearning developers, content developers, institutions of higher learning.

A Growing Market for Competency Management

With the rapid evolution and growth of businesses today, there is increasing awareness amongst companies for the need to more ably and effectively assess employees' performance and competency levels, given that this has a significant bearing on a company's efficiency, productivity and ultimately, bottom line.

Moreover, several other developments have paved the way for greater competency management requirements. The restructuring of Government-Linked Companies in Malaysia, for instance, has resulted in the need for such performance measures to be in place. The availability of competency and performance management systems is also a prerequisite for certain certifications such as ISO9000 and ISO14000. Insurance companies have also made this a determinant of the level of premiums imposed on certain high-risk industries e.g. oil & gas.

Recent Developments

In Jul. 2007, SMR entered into an MOU with Improvements Incorporated USA (Impin) for the exclusive distributorship of its IT and related products in North America via a new set-up company called Smartha Inc. SMR holds a 25% stake in Smartha, Impin 33.3%, while the balance is held by Dr Palan (15%), Ajay Arya (10%) and Michael Janowiak (16.7%).

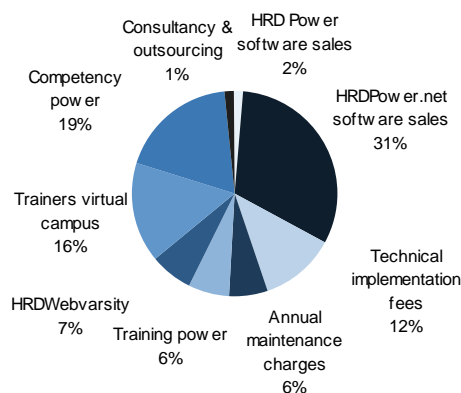
SMR and Smartha entered into a distribution agreement for the exclusive distributorship of SMR Group's software in North America. SMR will bill Smartha for product licensing fees, implementation and sale of products and services and Smartha is allowed to leverage and mark-up the price of such services to their clients.

Earnings Outlook

SMR's track record has thus far been impressive. From 2002 to 2006, revenue expanded at a CAGR of 82% while net profit grew at a CAGR of 65%.

For 9M07, revenue expanded by a further 29% YoY, with HRDPower.Net sales accounting for 31% of total turnover. Gross profit margins remained healthy, improving further to 64% versus 62% in 9M06.

Revenue breakdown by product/service (9M07)



Source: SMR

Net profit, however, contracted 8% YoY, given the build-up in expenses due to: i) higher depreciation on its new office premise, (ii) higher amortization of products, (iii) start-up costs for unbilled projects and (iv) higher A&P for greater market reach.

Despite this, however, the pipeline remains healthy with outsourcing contracts worth about MYR8.7 mln in hand, which should support earnings coming in higher YoY. We are forecasting revenue growth of 34% YoY in 2007, and a net profit of MYR6.3 mln i.e. 9% higher YoY.

SMR Technologies

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With greater awareness and acceptance for SMR's products and services, given increasing marketing efforts, we project revenue growth of 21% in 2008. With increased marketing efforts, we are projecting higher costs ahead. Nevertheless, we still expect EBITDA margins to remain healthy at about 45% in 2008 (48% in 2007).

The group's subsidiary, SMR HR Technologies, was awarded MSC status on Jan. 29, 2001 and currently enjoys tax-free incentives for up to 10 years, or an investment tax allowance for up to five years and no duties on the importation of multimedia equipment. As such, we expect the group's effective tax rate to remain negligible over the next few years. All in, we project a YoY net profit growth of 14.4% for 2008.

What stands out for SMR is the fact that it operates in a market that offers much potential for growth, especially since it has built up credentials with large domestic companies and foreign multinationals in a wide range of industries. Moreover, fundamentals wise, margins are high, given that the company markets its own proprietary software.

We expect average ROEs of 20% over the same period and the company continues to operate in a net cash position (net cash of MYR1.1 mln end-Sep. 2007). Bottomline growth thus very much depends on just how quickly it can garner new clients while penetrating new markets e.g. the U.S. market through Smartha.

Valuation

Current valuations are undemanding, with the stock trading at a prospective 2008 PER of just 3.8x. We have tagged on a 12-month target price of MYR0.41 to the stock, which represents an upside of 49%.

Our target price is based on a forward 2008 PER of 5.7x, which represents a 30% discount to current valuations for Hexaware Technologies (Hexaware). Hexaware is a Mumbai-based global provider of IT and process outsourcing services, with HR-IT services being part of the varied services on offer. The discount is to reflect SMR's much smaller market capitalization.

Profit & Loss

FY Dec. / MYR mln	2005	2006	2007E	2008E
Reported Revenue	7.9	12.2	16.3	19.7
Reported Operating Profit	3.6	5.8	6.3	7.3
Depreciation & Amortization	-0.4	-1.4	-1.6	-1.7
Net Interest Income / (Expense)	0.0	0.2	0.2	0.3
Reported Pre-tax Profit	3.6	5.8	6.3	7.3
Effective Tax Rate (%)	0.0	1.1	1.3	1.3
Reported Net Profit	3.6	5.7	6.3	7.2
Reported Operating Margin (%)	45.8	47.9	39.0	36.9
Reported Pre-tax Margin (%)	45.7	47.8	39.0	36.9
Reported Net Margin (%)	45.7	47.3	38.5	36.4

Source: Company data, S&P Equity Research

Balance Sheet

FY Dec. / MYR mln	2005	2006
Total Assets	15.1	29.5
Fixed Assets	1.4	7.3
Current Assets	3.1	7.6
Other LT Assets	10.6	14.6
Current Liabilities	0.6	2.1
LT Liabilities	0.1	0.3
Share Capital	7.0	10.0
Shareholders' Funds	14.4	27.1

Source: Company data, S&P Equity Research

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Glossary

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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For residents of Malaysia. All queries in relation to this report should be referred to Alexander Chia, Desmond Ch'ng or Ching Wah Tam.

Recommendation and Target Price History

Date	Recommendation	Target Price
New	Strong Buy	0.41

