

INITIATING COVERAGE

21 December 2007

SMR Technologies Berhad

Price : RM0.27

Market Capitalisation : RM27 m

Board : MESDAQ

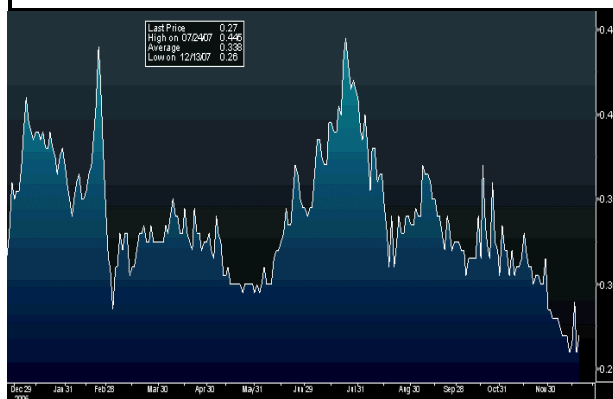
Sector : Technology

Recommendation : Initiate with Buy

Stock Code: 0117

Key Stock Statistics

FYE Dec	FY06	FY07f	
EPS (sen)	6.00	6.32	
P/E (x)	4.5	4.3	
Dividend/Share (sen)	1.0		
NTA/Share (sen)	24.70		
Book Value/Share (Sen)	31.40		
Issued Capital (m shares)	100.0		
52-week Hi-Low (RM)	0.26 - 0.494		
Major Shareholders:	%		
Special Flagship Holdings S/B	42.0		
Kumpulan Sentiasa Cemerlang S/B	13.2		
P&L Analysis (RM m)			
FYE DEC	FY05	FY06	FY07f
Revenue	7.9	12.2	16.4
EBITDA	4.8	7.5	8.6
Amort of dev cost & IP	-0.3	-0.5	-0.7
Depreciation	-0.8	-1.3	-1.6
Net Int Income/Exp	0.0	0.2	0.1
Pre-tax Profit	3.6	5.8	6.4
Eff. Tax Rate	0.0	-1.1%	-1.4%
Net Profit	3.6	5.7	6.3
EBITDA %	60.2%	61.3%	52.2%
Net Margin	45.7%	47.3%	38.5%
Sales Growth	89.0%	53.0%	35.0%



1. Investment Highlights / Summary

- SMRT is a human resource consultant and HR related software developer - specializing in human capital development.
- SMRT brings HR, IT, and consulting expertise together via a software system called - HRDPower™, which automates a comprehensive range of HR competency system and related services. The software can be customized to the specific objective of the client.
- SMRT position itself as a high value medium price provider of HR related software.
- SMRT also provide consultancy services and outsourcing services.
- Clients of SMRT include some leading corporations such as Maybank, Petronas, Exxon, DHL Singapore Airline, Shangri-la Hotel etc.
- Successfully penetrated into 31 countries, including US and Middle East. Oversea sales represent 66% and 40% of all sales in FY06 and 9 months of FY07, respectively.
- The current market price is trading at PER 4.3x of FY07f. This valuation does not take into account of its market penetration into 31 countries and its future prospect.
- We initiate coverage with a **buy** call, with **target price of RM0.504**. An upside potential of 87%.

2. Business overview

SMRT – a HR Consultant and HR related software developer

SMRT was listed in March 2006. It is an investment holding company and its 100% subsidiaries are involved in the following businesses;

(i) SMR HR Technologies Sdn Bhd - software development, specializing in human capital management and the provision of a comprehensive range of HR competency systems and related services;

(ii) SMR HR Services Sdn Bhd – provides HR related consultancy and outsourcing services; and

(iii) SMR USA Inc – provides technical and HR consulting services

Software Business

SMRT has developed a software system called **HRDPower™**. The HRDPower software system provides its clients with the ability to;

- assess the competency of its employees in relation to their designated post in the organization;
- identify any shortcomings from lack of employee competency;
- assess, identify and plan the relevant training required for every employee to address any competency shortfall;
- manage the performance management process; and
- manage the succession plans and talent pipelines for continued competitiveness of the organisation.

HRDPower - a software that helps to improve HR's effectiveness

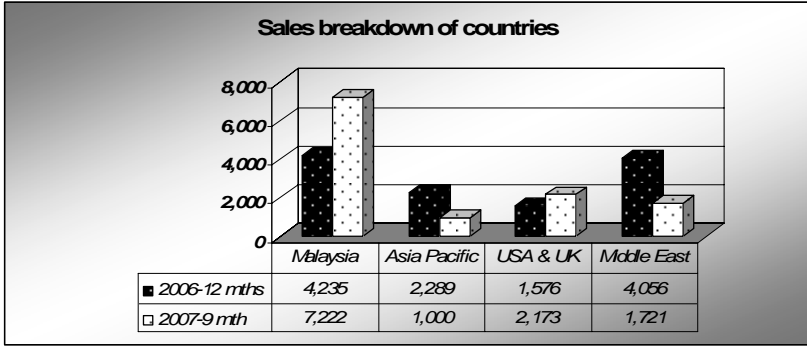
The software system automates various processes of competency development, performance management, training needs analysis, succession planning and eLearning facilities. The software is a management tool for an organization to improve the effectiveness of its human resources.

HRDPower software system can be customized to suit specific needs of an organisation. Further, SMRT has another product called eLearning. Elearning is a complementary product to the HRDPower software system. It is an additional module which deliver training over the internet.

SMRT has a good client base. Its clients include Maybank, Bank of Indonesia, Petronas, Exxon, National Drilling Company, Shangri-la hotel, Pan Pacific, Fedex, DHL, Singapore Airline, Tenaga Nasional Bhd, British American Tobacco, Carlsberg etc.

World is the market – overseas sales consist of 66% and 40% for the FY06 and 9 months of FY07, respectively

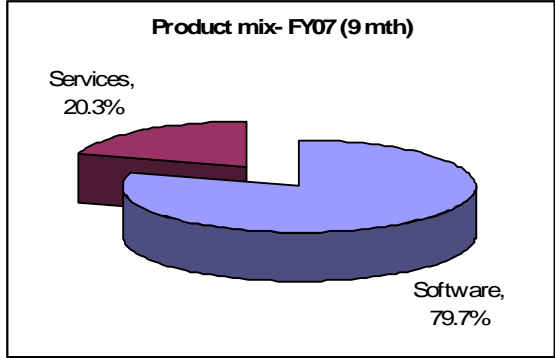
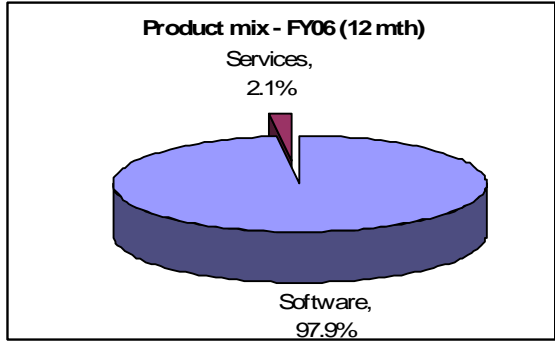
SMRT export its software system to 31 countries worldwide, including countries in South and East Asia, Middle East, USA, Australia, Africa and Asean countries. Oversea sales are mainly generated via its agents in oversea and referral from its customers. For FY06 and 9 months of FY07, oversea sales consist of 66% and 40% of total sales, respectively. Sales breakdown of geographical areas are as follows;



Other HR Related Services

Consultancy and outsourcing services are other services that spin-off from its software business. Consultancy services include helping its client to determine the skill-set needed for a job function and outsource services include helping client on personnel administration, training and skills audit.

Breakdown on products sales mix for FY06 and 9 months of FY07 are as follows;



Competitive strength

(i) Brand Recognition – “SMRT” and “Dr Palan” are recognizable brands in the HR industry. SMRT has won numerous awards, including Merit Award winner for MITI Brand Excellence Award in year 2007, Top 3 Finalists for Most Promising HR Award by Malaysian Institute of Human Resources Management in year 2006, Second position in the Enterprise 50 list, Golden Bull award by Nanyang Siang Pau, and Deloitte Technology Fast 500 Asia

Pacific in year 2005, amongst others.

Dr Palaniappan, who is the founder and largest shareholder of SMRT, is recognised for his speaking and training engagements, HRD consulting expertise and advisory services. He is also author of several books on HR related topics.

(ii) Barrier of Entry – SMRT, via its founder Dr Palan, has many years of experience in the HR industry and has build up a comprehensive database of competency requirement for various industries, called “Competency Library”. This Competency Library is a key selling point as the client of SMRT needs such database to establish skill-set requirement for a job function and they can also compare their employees with the industry standard for evaluation purpose.

3. Industry

According to an industry research report, in Malaysia, the software license market for HR Management software alone (excluding payroll software which SMRT does not provide at the point when the report is published) is worth USD6.13 million in year 2004. In that year, SMRT rank second in the Malaysian market in terms of sales revenue of its HR related software.

The industry research report also stated that the HR competency market is at the beginning of its life cycle. It projects that the worldwide market can reach USD5.1 billion and the HR outsourcing market can reach USD19 billion by 2008.

4. Investment Risk

(i) Rapid technological changes - Technological advancement and changing industry standard will post a threat to the relevance of SMRT’s products and its R&D work. Product obsolescence due to inability to keep abreast of advances in IT architecture is a key risk.

(ii) Competition - The HR industry is highly competitive and many international players, some of the names like Peoplesoft, Oracle HR and SAP are also in the industry. These competitors have strong market reach and marketing capability.

(iii) Dependence on key personnel – The R&D and marketing of SMRT’s product rely significantly on a few key personnel. The lost of any personnel will have significant impact to the business operation.

5. Growth Prospect

(i) Introduce more products - SMRT is consistently developing new products and modify existing products. It has line up a few products to be role out in the next few quarters. The products are mainly for learning, knowledge management and eCommerce application.

SMRT has further enhanced the features of the HRDPower software to also include training and payroll processing. Management indicated that this newly upgraded HRDPower software will be launch in the 1QFY08.

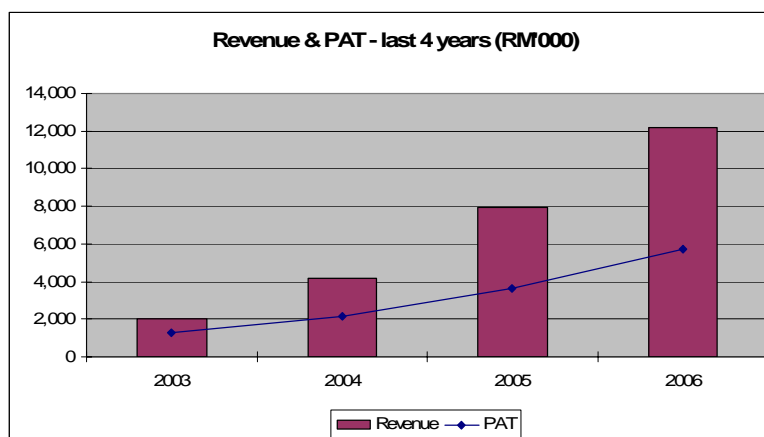
(ii) Growing US and Middle East Markets - SMRT has identified US and the

Middle East to be the sales growth driver in the next few years.

For US, SMRT entered into a strategic alliance on July 2007 with a HR practitioner in US, namely Improvement Incorporated USA, to form a company called Smartha Inc. Smartha Inc will be the exclusive distributor of SMRT's products in North America. SMRT has a 25% stake in Smartha Inc.

For the Middle East market, the management of SMRT intends to make a similar arrangement as what they did in US. SMRT also plan to establish a separate company or a branch in Middle East in the near future in order to serve the customers in Middle East better.

6. Financial Highlights



SMRT shows an impressive revenue and PAT growth in the last 3 years. Revenue and PAT were growing at an CAGR of 81% and 65% respectively during this period.

The improvement in revenue and PAT in the last 3 years are mainly attributable to (i) increasing awareness towards usage of technology to improve efficiency of work, monitoring and assessing staff performance. (ii) more products launch (iii) introduction of consultation services and maintenance charges.

SMRT also enjoy a healthy PAT margin of between 45%-50% for FY04-FY06. However, the margin for 9 months of FY07 is reduced to ~36% as the company incurred more depreciation expenses and administrative cost as SMRT needs the additional facility/support for the enlarged operation.

FYE Dec	Year to date (9 months)			
	RM'000	FY2007	FY2006	% Change
Revenue		12,116	9,379	29.2%
EBITA		5,951	5,333	11.6%
Net Interest Income/Exp		19	(5)	
Amort of dev cost & IP rights		(413)	(362)	14.1%
Depreciation		(1,155)	(251)	360.2%
PBT		4,402	4,715	
Effective tax		-1.3%	0.0%	
Net Profit		4,343	4,715	-7.9%
EBITDA %		49.1%	56.9%	
Pre-tax %		36.3%	50.3%	
Net Margin		35.8%	50.3%	

For 9 months of FY07, despite reporting higher sales of 29%, net profit was lower by 7.9% as compare to the same period in FY06. The drop in profit is mainly due to higher administrative cost and depreciation charges for its enlarged operation. In FY06, SMRT purchased RM7 million worth of property, plant and equipment and hence, depreciation expense increased by 360% as compared with the same period in FY06. Management also indicated that there are some project implementation costs which have been incurred but has not reach the billing milestone. This timing issue also contributed to lower profit margin for this period.

Key Balance Sheet Items			
FYE Dec (RM'000)	Sep-07	Dec-06	% Change
Property Plant & Equip	7,500	7,263	3.3%
Goodwill on consolidation	6,634	6,633	
Intangible Assets	90	1,069	
Development cost	11,472	6,879	66.8%
Current Assets			
-Receivable	6,919	2,636	162.5%
-Other receivable	987	52	
-Cash & Fixed eposit	1,459	4,947	
Current Liability			
-Trade payable	1,181	97	
-Other payable	2,154	2,052	
Non Current Liability	326	278	
Equity			
Share Capital	10,000	10,000	
Reserve	21,400	17,052	
Shareholders' fund	31,400	27,052	
NA per share (RM)	0.314	0.271	
NTA per share (RM)	0.247	0.194	
Net gearing	Net cash	Net cash	

On balance sheet analysis, there is a large build up of development cost as SMRT is constantly upgrading its products and developing new products. As for the receivable, it is about 162% higher than Dec 2006. Management indicated that some of the projects involved 2 stages, i.e. software implementation and consultancy work. The customers will only make payment upon completion, i.e. delivery of both stages. Hence, the increased in receivable is in line with the trend that SMRT is billing more consultancy and outsourcing services in FY07 compare to FY06. On the recoverability, the management indicates that >90% of the receivable is below 150 days and they are monitoring the receivable closely.

SMRT is debt free and its ROE is at a respectable 21% in FY06. We forecast that ROE for FY07 can maintain at around this level.

7. Profit Forecast

We are forecasting sales to reach RM16.4 million in FY07f. Based on 3QFY07 result, 74% of the revenue forecast in FY07 has been achieved. This represent a growth of 35% from the revenue recorded in FY06.

On PAT margin, we believe the company's operating costs will be higher than last year to support a bigger business operation. Hence, we project that margin will be reduced from 47.3% in FY06 to 38.5% in FY07. Lower margin is estimated for FY07 by taking clue from the recent 3QFY07 result.

Thus for FY07f, we expect net profit to grow modestly by 10% to RM6.3 million (+59% achieved in FY06). Based on the FY07's 9 months net profit,

~70% of the forecast profit for FY07 has been achieved.

For FY08 we expect the momentum of the existing business to sustain a respectable growth in revenue and profits. We view the oversea venture into US and Middle East positively and believe that sales growth in FY08 will come mainly from this 2 markets, besides Malaysia.

8. Recommendation

Based on the current valuation of PER 4.3x of FY07f earnings, we believe the market does not take into account of SMRT's achievement in penetrating into 31 countries and its brand name. This valuation also did not take into account of its future prospect.

Nevertheless, we acknowledge that SMRT is a small cap company and it has a few new products that are still in the development stage. Naturally, company at this phase has a higher business risk than its established peers and the forward vision of its profitability at this stage is not certain. Hence, our valuation shall take into account of these factors.

**Initiate with a Buy call-
Target price RM0.504**

We initiate our coverage on SMRT with a PER of 8x and a fair value of RM0.504, an upside potential of 87%. Based on this valuation, we recommend a buy at this current price.

RATING GUIDE

BUY	Price appreciation expected to exceed 10% within the next 12 months
SELL	Price depreciation expected to exceed 10% within the next 12 months
HOLD	Price movement expected to be between -10% and +10% over the next 12 months from current level

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