KENANGA RESEARCH

Initiating Coverage

7 July 2008

HOLD
RM0.205

Target Price: RM0.19

Minetech Resources

Earnings recovery

Stock data

Market cap (RMm):	62.0
Issued shares (m):	302.5
52-week range:	RM0.18-RM0.338
3-mth avg daily volume:	215,208 shrs
Bloomberg code:	MINE MK
Syariah	No
YTD price chg:	-32.1%
YTD KLCI chg:	-22.1%
Est. free float:	48.94%
Major shareholders:	
Choy Sen @ Chin Kim Sang:	*29.14%*
Low Choon Lan:	*9.43%*
Datuk Lye Ek Seang:	*7.27%*
Dato' Hj Wan Zaki B. Hj Wan Muda:	*4.11%*

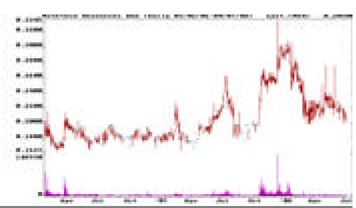
Consensus

FYE 31 Dec	2008E	2009E
Net profit (RMm):	9.1	13.9
EPS (sen):	3.0	4.6

Forecast revision

FYE 31 Dec	2008E	2009E
Revision (%)	-	-
Net profit (RMm):	5.6	6.9

Share price chart



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- **Minetech is a major player in the provision of turnkey quarry operation services, specialised services including drilling and blasting as well as civil engineering works.** With a 30 plus year track record, the Group has grown to become one of the largest aggregate players in the country with an estimated 10% market share;

- **Earnings expected to bounce back strongly into the black** after securing the fuel-cost pass though since the beginning of the year. With locked-in contracts and no avenue to pass on the increase in energy cost for the past 2 years have resulted in the Group chalking up losses and poor profitability. This should be now behind them.

- **Current uncertainty in the construction sector is unlikely to persist** as key developmental projects will continue to be rolled-out albeit at a lower scale. Demand for aggregates and turnkey quarry operations should be maintained underpinned by construction sector growth of 5.1% in 2008;

- **Increase demand for quarry products and services, rising capacity** and opening of new quarries in the medium to longer term should provide the necessary growth impetus. Increasing economies of scale should improve margins further.

- **We have a HOLD recommendation with a target price of RM0.19 based on 10x FY08 earnings**. This represent a discount to the construction average of 12x which we believe is fair given the company's smaller capitalisation and the near term head winds associated with the uncertain outlook for the construction sector.

Earnings Estimates

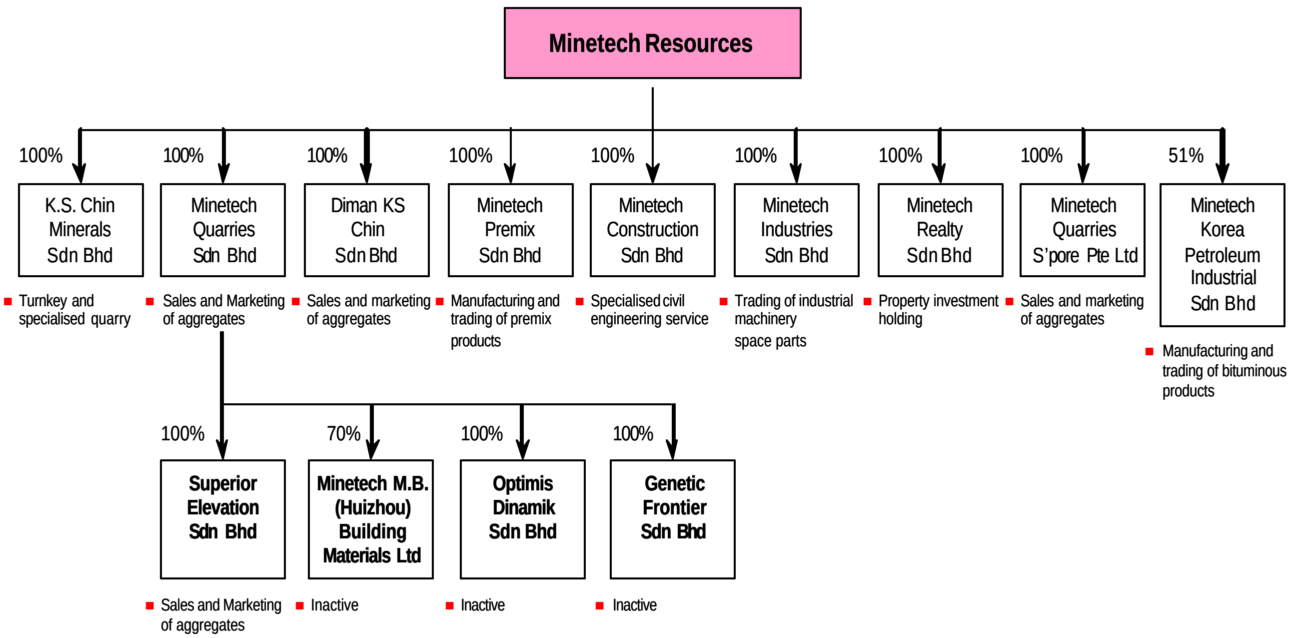
FYE 31 Dec	2006	2007	2008E	2009E	2010E
Revenue (RMm)	118.6	153.0	152.7	177.1	200.6
Pretax profit (RMm)	3.8	(6.9)	6.6	8.6	10.4
Net profit (RMm)	**2.4**	**(5.7)**	**5.6**	**6.9**	**8.4**
Net margin (%)	2.0%	-3.7%	3.7%	3.9%	4.2%
EPS (sen)	0.8	(1.9)	1.9	2.3	2.8
EPS growth (%)	-53.2%	n.m.	n.m.	22.6%	21.3%
DPS (sen)	0.4	0.4	0.5	0.6	0.7
NTA/share (RM)	0.23	0.23	0.24	0.26	0.28
PER (x)	26.3	n.m.	11.0	9.0	7.4
P/NTA (x)	0.9	0.9	0.9	0.8	0.7
Div. Yield (%)	2.0%	2.0%	2.4%	3.0%	3.6%
EV/EBITDA (x)	5.8	16.8	5.5	5.3	5.2
ROE (%)	3.4%	-8.4%	8.0%	9.1%	10.3%

Business Background

Core business includes the provision of turnkey quarry operation services, specialized services including drilling and blasting as well as civil engineering works. With an established track record of more than 30 years, the Group has grown to become one of the largest aggregate players with an estimated 10% share in the domestic market.

Group currently operates 14 quarries in total (13 Malaysia and 1 Indonesia) with a combined capacity of 14m tonnes per annum catering to key clients including the likes of YTL.

Group Structure



Source: Company

■ Quarry Operations

Quarries are situated close to infrastructural development sites

Group's 13 quarries in Malaysia are strategically located close to construction and infrastructure development sites which improve accessibility and market reach.

Currently, the company operates on a turnkey basis for 7 quarries with no marketing rights. Marketing risks in such cases rest solely with the quarry owners themselves. Usually, the production is earmarked for the quarry owner's own consumption mainly for their ready mix plants.

As pure contractor for half of the quarries while the rest comes with marketing rights

For the remaining 7 quarries including the one in Indonesia, marketing right is maintained with the group. Risk though naturally higher but so is the margin with selling prices estimated to be 100% higher.

Premix operation

Under subsidiary - Minetech Premix Sdn Bhd, the company undertakes the manufacturing and trading of premix products. Currently, it has 3 manufacturing plants located at Tanjung Malim, Perak and Terengganu, which blends different sizes of aggregates with a pre-determined amount of bitumen and filler or cement for asphalt premix production with a combined production capacity of 1,000,000 metric tonnes per year.

Premix operation to see 70% increase in capacity

By the end of this year, the division will be expanded with capacity increasing by 70% to 1.7m tonnes per annum when Diman Quarry (2) and Bidor Rock Quarry come on stream.

Specialised civil engineering

Services provided under this division include earth works, rock excavation, road construction and pavement projects. Currently with unbilled order book of RM15m which is expected to last till the year end, group has on tender RM180m worth of jobs with 20% strike rate.

New engine – bituminous products

Bituminous joint venture holds promise underpinned by rising demand for pipe coating

Under a joint venture with Korea Petroleum Industrial, a new manufacturing plant with 25,000 tonnes annual capacity had been set up to produce bituminous products specifically for pipe-coating in water-related and oil and gas industries. Currently, the domestic market for bituminous pipe coating products is estimated to be at 60,000 tonnes worth RM100m per annum which is expected to grow further on the back of rising demand for pipes and coating services.

■ Industry Prospects

Longer term prospect for the construction industry remain intact despite the current uncertainty.

Overall prospect of the company is very much dependent on the construction sector which is likely to remain buoyant on the back of the 9MP rollout. Despite the current uncertainty surrounding the sector about projects being delayed especially after the surprising result from the recent General Election, we remain positive on the prospects for the sector as a whole, forecasting a growth of 5.1% in 2008 (2007 : 4.6%) as we see a positive end to the political impasse (if any) between the Federal and the various State Governments under opposition control eventually.

■ Cost of Production

For quarry operations, major costs include subcontracting costs estimated at circa 25% - 28% with fuel and lubricants accounting for 23% - 25%. Meanwhile, bitumen, cement and aggregates account for more than 70% of premix's cost of operations with direct fuel accounting for circa 10%.

■ Competitive Edge

Fully integrated operation backed up by a ready pool of equipment and skill-sets offer unparallel execution capability

Integrated provider of quarrying services and facilities. Being an integrated player will ensure that the group has the capability to control the entire value chain and hence offer better products and service delivery to the end customers.

Strong track record in the field should enable the group to secure new clients and quarry concessions.

Economies of scale. Being of a reasonable size does offer the advantage of scale which in turn allows for an efficient production of aggregates.

One of the largest fleet of quarry equipment in the country allows for unparallel execution capability. Due to the current mineral boom, mining equipment manufacturers are stretched to meet the overwhelming demand which has translated into long wait list of at least 2 years for certain equipment.

■ Competition

To our knowledge, there are approximately 10 providers of turnkey quarry operators in the country. In view of the relatively high number of quarries, the intensity of competition is reduced to a certain extent. Moreover, huge start-up costs and the need to get the necessary licensing and the necessary skill sets (short-firers for blasting) could prove too high for any aspiring entrants into the field.

Growth Drivers

New quarries. Two new quarries – Manjung in Perak and Yasmin in Kuantan is expected to come on stream in 2H08. The former with 750,000 tonnes annual capacity is already qualified and should start to export beginning August 2008. The Yasmin quarry however which is slated to be operational in 2H08 is still at the planning stage in terms of plant size and capacity. Earmarked to tap potential from the Kuantan Port developments, Yasmin quarry should be a contributor upon coming on-line. For conservative sake, we are only factoring 10% utilization for Manjung in 2008 but have not factored any contribution from Kuantan at the moment.

Premix operation to grow in support of its quarry division. Group is adding an additional 70% capacity to its existing 1m tonne capacity to 1.7m tonnes by end 2008 in anticipation of more road building and maintenance projects. We are projecting production to increase from 450,000 tonnes in 2007 to 850,000 in 2008.

New bituminous plant under the 51% joint venture with Korea Petroleum Industrial Co. Ltd is commissioned for commercial orders on Feb 08. Initially targeted at the local pipe-coating market, plans include exports to neighbouring countries including Singapore, Indonesia and Thailand. For FY08 and FY09, we are projecting a production utilization of 20% and 30% respectively.

Growing demand for quarry and related services on the back of a pick-up in construction activities across the region. Further rollout of 9MP projects as well as the huge integrated resort development activity that is taking place in Singapore should augment demand further.

Improved selling prices. Underpinned by a rise in demand, average selling prices for aggregates have improved by some 14% in 2007. By mid 2008, prices have continued to rise by an estimated 20% since end of 2007, in tandem with an overall rise in most commodities worldwide.

Repricing and adjustments to contracts to allow for cost pass through should provide additional impetus to earnings recovery after recent contract renewals with the necessary cost adjustment especially the quarries without marketing rights.

China venture. Group has entered into an MOU under 70% subsidiary – Minetech M.B. (Huizhou) Building Materials Ltd to venture into the Chinese quarry market. Given the vast infrastructural development that is currently taking place in China, prospects for the venture looks promising. For the immediate term however, we have not factored any contribution as it remains outside of our forecast horizon.

Risks

Increase in owner operated quarries will be a negative as constricts the level of demand for the group's services. While always a threat with quarry owners looking to operate on their own, Minetech's strong execution track record couple with the high level of equipment and machineries that they own should provide them with the necessary edge.

Rising fuel cost. A direct concern with fuel and lubricants accounting for at least 25% of cost of production. Previous bad experience was due to a lock-in clause which prevented the group from passing on higher energy costs to the end clients but since the beginning of the year, group had managed to rework their previous arrangement with energy cost now fully borne by the end clients. While not entirely insulated from the rising energy costs, the new arrangement should mitigate at least a large chunk of the cost pressures that the group had to face during the past two years.

Slowdown in the construction sector. While uncertainty in the sector had heightened after the recent General Election, the sector is still expected to register growth in 2008 with major projects already in the implementation stages.

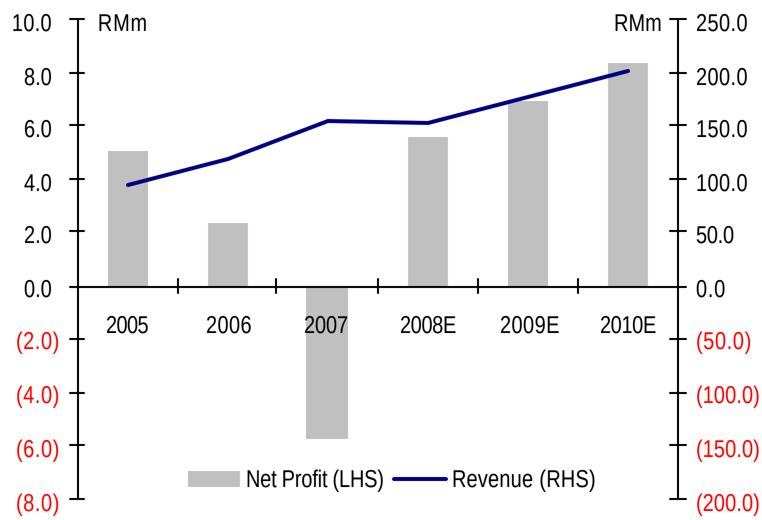
Non renewal of leases. While certain quarries might have short tenures or leases which are expiring soon, management is however confident that the leases will be renewed upon expiry given the good working relationship built over the years. For example, the short 3 month lease with Tan Ming in Puchong has been operated by Minetech since 1998 without interruptions while the soon to expiry quarries in Seberang Prai under YTL Group in end 2009 has an automatic 2-year extension.

Financials

Track record has been quite patchy during the past two years, affected by both a general slow uptick in the construction sector as well as rise in energy costs which had an overall negative impact on the earnings. Additional provisioning for disputed variation orders, higher energy cost without the associated pass through couple with additional pre-operating expenses for the bituminous product division had dragged 2007 numbers leading to a net loss of RM5.7m.

Excluding the one-offs and the losses associated with the fixed quarry contracts with no cost pass through, 2008 had started off positively with the group chalking up RM2.2m net profit during 1Q08. Barring the unforeseeable, 2008 is expected to be profitable.

Financial track record of Revenue and Net Profit



Source: Company; Kenanga estimates

Investment Case

Earnings recovery. Group is poised for a healthy turnaround after a dismal two years on the back of newly negotiated contracts which allows for a cost pass through as well as a more profound recovery of the construction sector as a whole.

Strong track record with strategically located quarries. Being one of the largest in the industry has accorded the group with unparallel advantages including scale and strong execution capabilities with the necessary skill sets and equipment. Strategically located quarries that are near large township development areas help to not only improve accessibility but at an effective cost as well.

Additional catalysts from possible new quarry acquisitions and regional expansion. Successful execution of the China operation as well as possible venture into the Southern part of the country where there is minimal group presence offer further potential for earnings growth.

Profit & Loss

FYE 31 Dec (RMm)	2006	2007	2008E	2009E	2010E
Revenue	118.6	153.0	152.7	177.1	200.6
Cost of Sales	(102.5)	(144.8)	(131.2)	(152.1)	(172.3)
GP Profit	16.1	8.3	21.5	25.0	28.3
GP %	13.6%	5.4%	14.1%	14.1%	14.1%
EBITDA	14.9	6.8	21.0	24.0	27.0
EBITDA %	12.5%	4.4%	13.7%	13.6%	13.5%
Pretax	3.8	-6.9	6.6	8.6	10.4
Tax	(1.39)	0.89	(0.99)	(1.72)	(2.09)
MI	(0.0)	0.2	0.0	0.0	0.0
Net Profit	2.4	-5.7	5.6	6.9	8.4
EPS	0.8	(1.9)	1.9	2.3	2.8
EPS Growth	-53.2%	n.m.	n.m.	22.6%	21.3%
PER (x)	26.3	n.m.	11.0	9.0	7.4
EV/EBITDA(x)	5.8	16.8	5.5	5.3	5.2
CFS (sen)	3.3	-1.0	4.6	3.1	4.1
P/CFS (x)	6.2	-20.1	4.5	6.6	5.0
Gross DPS	0.4	0.4	0.5	0.6	0.7
Div Yield %	2.0%	2.0%	2.4%	3.0%	3.6%

Cash Flow Statement

FYE 31 Dec (RMm)	2006	2007	2008E	2009E	2010E
Pretax Profit	3.8	(6.9)	6.6	8.6	10.4
Deprn & Non Cash Adj	8.0	9.5	9.6	10.6	11.8
Working Cap Chgs	(2.6)	(8.5)	(1.4)	(8.0)	(7.8)
Cash Tax Paid	(1.5)	(0.4)	(1.0)	(1.7)	(2.1)
Others	2.3	3.1	0.0	0.0	0.0
CF from Op	**10.0**	**(3.1)**	**13.8**	**9.4**	**12.4**
Capex	(15.4)	(19.0)	(17.6)	(20.3)	(22.1)
Net Inv & Sale of FA	0.0	2.4	0.0	0.0	0.0
Others	(3.2)	(5.8)	0.0	0.0	0.0
CF from Investment	**(18.6)**	**(22.4)**	**(17.6)**	**(20.3)**	**(22.1)**
Debt Raised/(Repaid)	20.2	23.8	15.0	15.0	15.0
Equity Raised/(Repaid)	0.0	6.3	0.0	0.0	0.0
Div Paid	(2.7)	(0.8)	(1.1)	(1.4)	(1.7)
Cash Int & Others	(2.0)	(2.3)	0.0	0.0	0.0
CF from Financing	**15.5**	**27.1**	**13.9**	**13.6**	**13.3**
Change in Cash	6.8	1.6	10.1	2.8	3.6
Cash C/F	(1.2)	5.6	7.2	17.3	20.1
Forex Diff on Open Bal	0.0	0.0	0.0	0.0	0.0
Ending Net Cash / (Debt)	5.6	7.2	17.3	20.1	23.8

Balance Sheet

As of 31 Dec (RMm)	2006	2007	2008E	2009E	2010E
Fixed Asset	65.3	77.3	85.3	95.0	105.3
Intangibles	0.0	0.0	0.0	0.0	0.0
Other LT Assets	10.3	14.9	14.9	14.9	14.9
Total Non Current Asset	**75.5**	**92.2**	**100.2**	**109.9**	**120.2**
Cash & Equivalents	7.6	10.7	17.3	20.1	23.8
Stocks	12.2	12.7	12.2	14.2	16.0
Trade Debtors	53.5	66.4	68.7	79.7	90.3
Other Current Assets	7.8	10.7	8.0	8.0	8.0
Total Current Assets	**81.1**	**100.3**	**106.3**	**122.0**	**138.1**
Trade Creditors	21.7	30.0	30.5	35.4	40.1
ST Borrowings	31.2	60.6	50.0	50.0	50.0
Other Current Liab	16.4	16.8	18.0	18.0	18.0
Total Current Liab	**69.3**	**107.4**	**98.5**	**103.4**	**108.1**
LT Borrowings	0.6	2.2	20.4	36.4	51.4
Other LT Liab	17.6	14.9	15.0	14.0	14.0
Total LT Liab	**18.1**	**17.0**	**35.4**	**50.4**	**65.4**
M I	0.0	0.0	0.0	0.0	0.0
Share Cap	55.0	60.5	60.5	60.5	60.5
Reserves	14.1	7.6	12.1	17.6	24.3
Dividend	0.0	0.0	0.0	0.0	0.0
S/H Fund	69.1	68.1	72.6	78.1	84.8

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