STANDARD & POOR'S

Minetech Resources

Recommendation: **BUY**

Stock Code: 7219 | Bloomberg: MINE MK | Price: MYR0.22 | 12-Month Target Price: MYR0.25 | Date: March 27, 2008

Board: Second

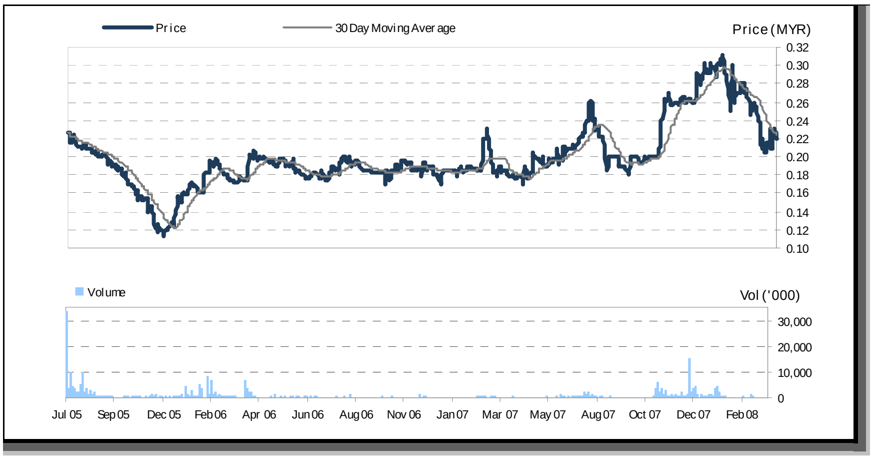
Sector: Trading/Services

GICS: Materials/Diversified Metals & Mining

Market Value - Total: MYR66.5 mln

Summary: Minetech Resources (Minetech) is Malaysia's second largest quarry operator with an estimated market share of 10% and production capacity of almost 15 mln tonnes per annum. It is also involved in the production of pre-mix, civil engineering and bituminous products.

Analyst: Su Peng Ng



Highlights

- We look for Minetech to post a net profit of MYR8.8 mln in 2008. Growth is anticipated to come from: (i) improved average selling prices of aggregates, (ii) renewal of contracts with inclusion of a diesel cost pass through clause (iii) additional revenue from two new premix plants and (iv) maiden revenue from its new bituminous plant.
- Average selling prices of aggregates have risen 10-15% YoY in 2008 driven by higher demand from new infrastructure projects. We expect average prices to remain higher than 2007 but may soften a little in the near term as larger infrastructure projects may see a delay in implementation after the unexpected general election results. However, 2008 should see an expansion in profit margins as several quarry contracts were re-negotiated to include a diesel cost pass through clause, a feature that was not in previous contracts.
- In addition to aggregates, Minetech is also banking on two new premix plants expected to come on-stream in mid-2008 to boost overall revenue. Furthermore, the group will also see maiden 2008 contribution from its bituminous products division which is produced under a joint venture with Korea Petroleum Industrial Co. Ltd. (004090 KS, KRW151,000, Not Ranked)

Investment Risks

- Risks to our recommendation and target price include slower-than-expected rollout of infrastructure projects, higher-than-expected operating costs and potential delays to commissioning of new premix plants.

Recommendation

- We initiate coverage on Minetech with a Buy recommendation and a 12-month target price of MYR0.25.
- Our target price is derived from using a relative valuation methodology. As Minetech does not have a direct listed peer, our target multiple is benchmarked our target PERs for small-to-mid-sized contractors within our coverage ranging from 10x-12x.
- Our target PER multiple of 8x is applied against 2008 EPS and we add our estimated 2008 net DPS of 1.5 sen to arrive at our 12-month target price. The target multiple is a 20% discount to the lower end of our PER range for small- to mid-sized contractors. The discount reflects Minetech's relatively small market capitalization and limited listing track record. The target multiple is also at the lower end of Minetech's historical PER trading range of between 6x-12x.
- We believe there is value to Minetech now after one-offs provisions for variation order to two contracts and its newly negotiated ability to pass on higher fuel costs for its fixed-price quarries. Looking ahead, Minetech should see margin expansion coupled with expectations of rising sales which should put the group in better standing with investors. As such we believe its share price should rise, reflecting the change in sentiment.
- From its latest 2006 annual report, we note that there was no mention of any corporate social responsibility (CSR) activities the group may have undertaken during the year.

Key Stock Statistics

FY Dec.	2007	2008E
Reported EPS (sen)	-1.9	2.9
PER (x)	NM	7.6
Dividend/Share (sen)	0.0	2.0
NTA/Share (MYR)	0.23	0.26
Book Value/Share (MYR)	0.23	0.26
No. of Outstanding Shares (mln)	302.5	
52-week Share Price Range (MYR)	0.17 - 0.31	
Major Shareholders:	%	
Choy Sen @ Chin Kim Sang	38.6	
Ek Seang Lye	7.4	
Dato Haji Wan Zaki bin Haji Wan Muda	5.2	

* This is a Syariah-compliant stock

Per Share Data

FY Dec.	2005	2006	2007	2008E
Book Value (MYR)	0.25	0.25	0.23	0.26
Cash Flow (sen)	4.5	3.8	1.1	6.6
Reported Earnings (sen)	1.8	0.9	-1.9	2.9
Dividend (sen)	5.0	2.0	0.0	2.0
Payout Ratio (%)	54.6	32.6	0.0	50.8
PER (x)	12.0	24.6	NM	7.6
P/Cash Flow (x)	4.8	5.8	19.5	3.3
P/Book Value (x)	0.9	0.9	1.0	0.9
Dividend Yield (%)	22.7	9.1	0.0	9.1
ROE (%)	8.9	3.6	-1.2	12.0
Net Gearing (%)	7.3	35.1	75.7	72.0

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Background

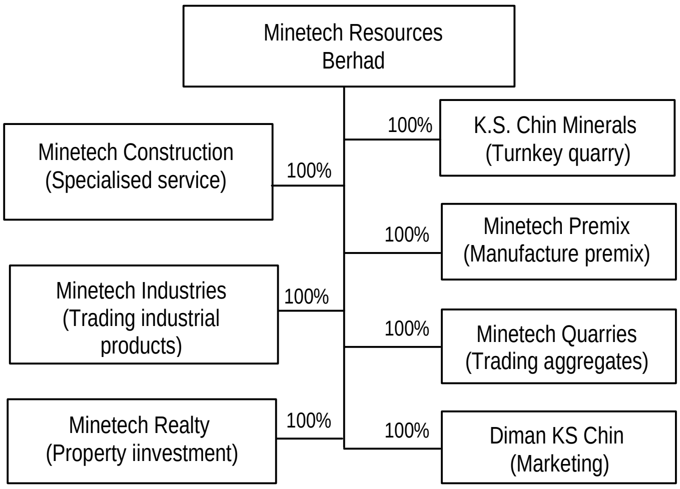
Corporate Profile

Minetech was incorporated as a private limited company in Mar. 2002 and later converted into a public limited company in May 2004. Minetech is an investment company with subsidiaries involved primarily in the provision of turnkey quarry operation services and the manufacturing and trading of premix products. The group was listed on Second Board of Bursa Malaysia on Jul. 22, 2005.

The group was founded by its Executive Chairman, Choy Sen @ Chin Kim Sang who has more than 30 years of experience in the industry. Mr Chin King Sang and his wife, Mdm Low Choon Lan, are currently Minetech's major shareholders with combined stakes of 38.6%.

Minetech's board of directors has seven members comprising the Executive Chairman, Group Managing Director, Executive Director, two Independent Non-Executive Directors and two Non-Independent Non-Executive Directors. The board composition meets the listing requirement set by Bursa Securities which requires at least two or one third of the board to be independent directors.

Corporate Structure



Source: Company data

Business

Minetech is involved in the upstream and downstream processes of production of aggregates. Its main business is in the provision of turnkey quarry operation services and all aspects involved in this process from drilling, blasting and crushing of rocks. In addition, it is also involved in the sales and marketing of aggregates as well as the manufacturing and trading of premix products. Other services within the group are the provision of specialised services for the quarrying industry and civil engineering works and trading of industrial machinery spare parts and rental of machinery. Its turnkey quarry division is the main contributor to 2007 revenue accounting for 60%. This is followed by civil engineering specialised services (28%).

The turnkey quarry division provides services that are focused on the production of aggregates such as drilling, blasting and crushing of rocks before it is loaded as aggregates to trucks for its customers. The group currently operates 14 quarries with a total annual capacity of almost 15 mln tonnes. 13 of these quarries are located in Malaysia and one in Karimun, Indonesia. Clientele is varied and well known in the local mart such as YTL Corporation (YTL MK, MYR7.15, Not Ranked) and IJM Corporation (IJM MK, MYR5.40, Not Ranked). Of the 14 quarries that Minetech operates, seven are quarries with sales and marketing rights which allow the group to benefit from an increase in both pricing and volume (Minetech pays a fee to the quarry owner for the right to operate on the quarry). Length of contracts for these quarries normally ranges between 10-20 years. For the other seven quarries (fixed-price quarries), Minetech provides quarrying services and is paid a 'fixed' price for every tonne of aggregate produced. These fixed-price quarries limit Minetech to increases in volume only. Contracts for fixed-priced quarries are usually about 2-3 years. Many of these fixed-price quarries have had their contracts renewed recently with a diesel price pass-through clause to cater for potential of rising fuel costs.

Name of Quarry	Location of Quarry	Capacity (mln mt pa)	Customer
Without Sales and Marketing Rights			
Jaksa	Negeri Sembilan	1.50	YTL
Batu Berapit	Penang	0.75	YTL
Penanti 1	Penang	1.05	YTL
Tanming	Selangor	1.20	Tan Ming
Nusa Potensi	Kedah	1.20	Nusa Potensi
Kenneison	Selangor	2.25	YTL
Sg. Buloh	Selangor	1.50	YTL
With Sales and Marketing Rights			
Sg. Perangin	Perak	0.90	Kuari Sg Perangin
Mahkota Cheras	Selangor	0.60	Lion Group
Diman	Terengganu	0.75	Diman Kuari
Bidor	Perak	0.36	Bidor Rocks
Manjung	Perak	0.75	Sri Manjung Granite
Yasmin	Pahang	0.75	Yasmin Hayati
Batu Ayer	Indonesia	1.20	Batu Ayer
Total		14.76	

In the medium term, management is looking to add three more quarries; one in the southern region where it has no presence as yet, another in the northern region to better serve the Northern Corridor Economic Region (NCER) and another in the central region where construction activity is high. A quarry in the southern region would allow Minetech access to projects within the Iskandar Development Region (IDR). In addition, Minetech also has a 20-year sales and marketing contract with Huizhou City Xin Rong Gravel & Aggregates Engineering Ltd to operate Heng Li Quarry. It is expecting to obtain a permit from the authorities to operate the quarry within the next few months. Revenue contribution from China will only start in 2009 at the earliest. Our forecast does not include the Chinese venture as the group has yet to receive a permit to operate the quarry.

The domestic market for aggregates is approximately MYR700 mln in 2006. Minetech is ranked second in the domestic market with a 10% market share. Hanson Group (Unlisted) is the largest quarry operator with about a 15% market share. This value is expected to rise in view of increasing construction work from the Ninth Malaysia Plan (9MP). However, the growth may be constrained as some infrastructure projects may come under review following the recent general elections. Meanwhile, prices of aggregates have risen steadily over the past one year as 9MP projects are gradually implemented. Prices are currently around MYR16-18/ton presently, a rise of 10-15% YoY.

In the near term however, we believe aggregate pricing may soften slightly as the momentum of infrastructure projects rollout may slow but expect the overall 2008 prices to be 10% higher 2007 as demand from the construction industry is likely to intensify in 2H08.

Minetech has also ventured downstream to produce valued-added premix products. The group has three plants capable of blending up to a total of 1 mln tonnes per annum (tpa) of premix. These products are then sold to local construction outfits for their road work projects. The group is targeting another 700,000 tpa of capacity (via two new plants) to come on-stream by mid-2008 which should boost sales this year. Based on past experiences, these plants normally contribute profits from year one. Longer term, management plans to set up another two pre-mix plants in Malaysia as management believes demand will be stronger given expectations of rising construction activities.

In 2007, on a group basis, diesel and bitumen are the main raw materials accounting for 12% and 9% of COGS respectively. Per division, diesel normally accounts for 20% of total costs in the quarry business while bitumen accounts for about 60% of total cost in its pre-mix business. All raw materials are sourced domestically. The group is facing potential increases in diesel prices and has taken steps to address this issue by adding a cost pass through clause in its contracts. Otherwise, should diesel price increase by 10%, Minetech can expect net profit to decline by about 8% in the absence of any cost pass through.

Minetech's civil engineering division is currently working on MYR54 mln worth of contracts, centred on road upgrading. The group is tendering for another MYR180 mln worth of contracts but we have not yet imputed any new projects into our earnings model. Going forward, Minetech will focus its resources on specialized contracts such as rock blasting and road pavement works where it has expertise.

Minetech has recently ventured into bituminous products partnering with Korea Petroleum Industrial Co. Ltd. Minetech has a 51% stake in the joint venture which has a manufacturing plant in Selangor with a capacity of 25,000 tpa. Minetech will be producing the bituminous paint coating that is used by pipe makers for the water and O&G industries. The domestic market for bituminous paint is estimated at 60,000 tpa or about MYR100 mln. The plant was commissioned in Feb. 2008 and thus far has been operating without major hitches. We do not anticipate a large net profit contribution from this venture at this juncture.

Earnings Outlook

Minetech's 2007 net earnings were disappointing despite a 30% growth in revenue. The group suffered from losses incurred from: (i) one-off provisions on two road projects due to disputes in variation orders (MYR4.9 mln), (ii) losses on fixed-price turnkey quarry operations due to high fuel costs (MYR0.6 mln) and (iii) expensed off pre-operating costs on new bituminous plant (MYR0.4 mln). Incorporating these expenses, Minetech registered a 2007 net loss of MYR5.2 mln compared to a net profit of MYR2.5 mln in 2006.

We are looking for a significant improvement in earnings for Minetech over the next two years after taking into consideration the following:-

i. Higher volume sales of aggregate from increased infrastructure works;
ii. Higher aggregate pricing and cost pass-through clause in its contracts which will expand margins from 2007;
iii. Contributions from its new bituminous plant which commenced operations in Feb. 2008;
iv. Contributions from two new premix plants expected in mid-2008;

We expect Minetech to achieve 2008 sales growth of around 13% YoY driven by higher sales volumes and selling prices. Minetech suffered from higher fuel costs in 2007 as its fixed-price quarries did not allow for a cost pass through. The bulk of these contracts were renegotiated in end-2007 to now include a fuel pass-through clause. As such, we anticipate Minetech's operating profit margin to expand in 2008 to 10.2% from 1.4% in 2007, and bottomline to register a profit of MYR8.8 mln.

2009 is expected to see revenue growth of 9% YoY. We expect all business segments to show YoY growth with the exception of civil construction in which we assume there will be no new contracts secured. Improving operational efficiencies and a lower tax rate (25%) should secure a 20% YoY growth at the net profit level to MYR10.6 mln in 2009.

Valuation

As Minetech does not have a direct listed peer, we have based our valuation on the group to our target PER for small to mid-sized contractors within our coverage, which ranges between 10x-12x.

Our target PER multiple of 8x stands at a 20% discount to the lower end of our PER range for small- to mid-sized contractors. The discount reflects Minetech's relatively small market capitalization and limited listing track record. Our target multiple is also below the group's historical average trading PER of 12.5x. After adding our estimated 2008 net DPS of 1.5 sen, we arrive at a 12-month target price of MYR0.25 for Minetech.

Recent Developments

Jan. 17, 2008: Minetech's shares underwent a 5 for 1 share split. Par value reduces to MYR0.20 from MYR1.00

Dec. 27, 2007: Minetech's additional 10% new shares were granted listing and quotation. The new shares were placed out at MYR1.17 per share (or MYR0.23 per share after share split)

Profit & Loss

FY Dec. / MYR mln	2006	2007	2008E	2009E
Reported Revenue	118.6	153.0	172.6	188.5
Reported Operating Profit	6.8	2.2	17.6	20.1
Depreciation & Amortization	-8.0	-9.1	-11.2	-11.9
Net Interest Income / (Expense)	-3.1	-4.1	-5.7	-6.0
Reported Pre-tax Profit	3.8	-6.9	11.9	14.1
Effective Tax Rate (%)	36.1	NM	26.0	25.0
Reported Net Profit	2.5	-5.7	8.8	10.6
Reported Operating Margin (%)	5.7	1.4	10.2	10.7
Reported Pre-tax Margin (%)	3.2	-4.5	6.9	7.5
Reported Net Margin (%)	2.1	-3.7	5.1	5.6

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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Recommendation and Target Price History

Date	Recommendation	Target Price
New	Buy	0.25