CIMB Research Report

QUICK TAKES

11 July 2007

MALAYSIA

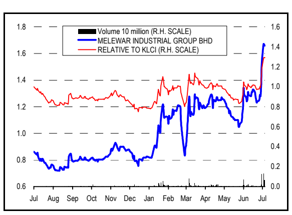
Melewar Industrial Group

Showing its mettle

NOT RATED

RM1.66	@10/7/07
	Mkt.Cap: RM627.2m
	Industrial (Steel)

MIG MK / MSTM.KL | **Sharifah Farah** + 60 (3) 2084-9965 – sharifah.jamalullil@cimb.com | KKDN PP 14048/11/2007



Background

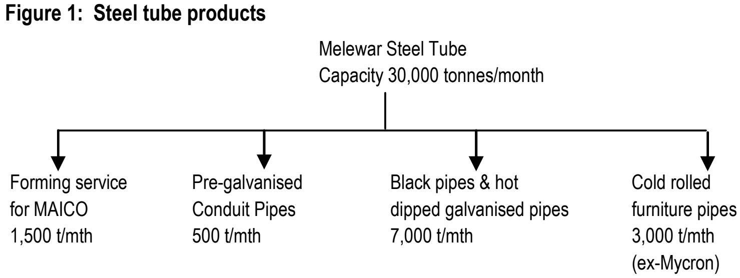
We recently visited Melewar Industrial Group (MIG), a diversified industrial conglomerate with three core divisions – iron and steel, engineering & power and oil & gas (see corporate structure in the appendix).

The iron & steel division makes long and flat products and is also involved in the mining of iron ore in Australia. The main companies in this division are 100%-owned Melewar Steel Tube (MST) which makes steel tubes under the brand names of MIG-Maruichi and Aurora, 100%-owned Melewar Steel Mill (MSM) and 54.5%-owned Mycron (MSB MK, Not Rated), the first cold rolled coil (CRC) manufacturer in Malaysia and one of only three CRC manufacturers locally.

MST has a capacity to produce up to 360k MT per annum (Figure 1). 50% of its sales goes to the engineering & construction sector, followed by the furniture and water industry (Figure 2). MSM is the manufacturer of high tensile deformed bars and steel billets. Its first steel billet plant with an annual capacity of 30,000 tonnes is in the final commissioning stage. Mycron Steel started operations in June 1990 and now has a rated capacity of 180k MT/year. It supplies about 28% of the CRC produced locally. CRC is used in office furniture, steel drums and pipes/tubes (Figure 3).

MIG's exposure to iron ore mining is through its 17% stake in Gindalbie Metals (GBG AU; Not Rated), an Australian listed company whose core activity is iron ore exploration and mining. The tenement area, which is north of Perth, has an estimated deposit of 1.2bn tonnes of magnetite iron ore and 100m tonnes of haematite iron ore.

Figure 1: Steel tube products



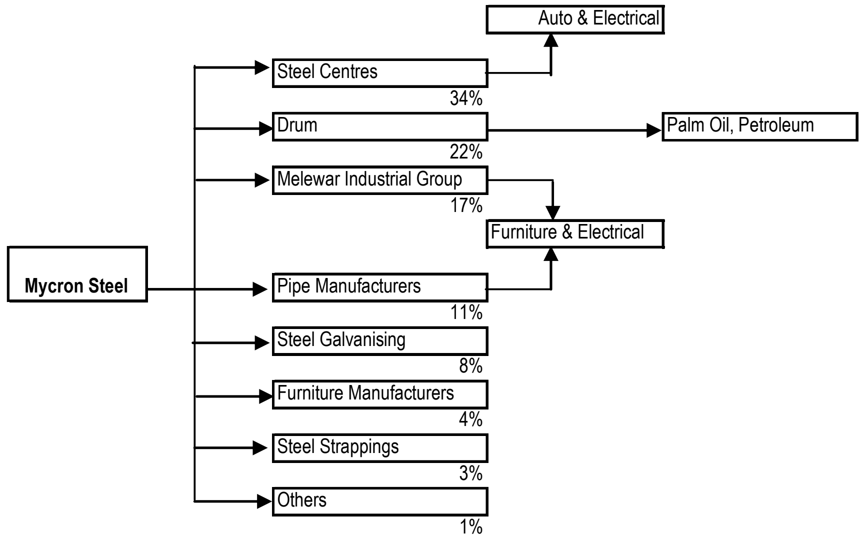
Source: Company

Figure 2: Customer mix for steel tubes

Sectors	Percentage
Engineering & construction industry	50%
Furniture industry	30%
Water supply industry	15%
Auto& electrical industry	5%

Source: Company

Figure 3: Mycron's CRC customers



Source: Company

Outlook

Long products

Positive outlook. Since its inception in 1970, the group has managed to stay profitable despite the construction slump in the past six years and weakness in steel prices. The outlook has brightened considerably over the past year given the recovery of the construction sector, increasing demand emanating from Ninth Malaysian Plan (9MP) projects and the strengthening of steel prices. According to the Malaysia Iron & Steel Industry Federation (MISIF), domestic steel consumption is projected to expand by 12% in 2007 and 15% in 2008. This is in tandem with the expected growth of the construction sector. After experiencing three years of negative growth, the sector is set to register 4.5% growth in 2007, followed by 5.5% growth in 2008.

We estimate that since end-2006, RM20.5bn worth of 9MP-related construction projects has been awarded and another RM77.1bn worth of potential projects could be awarded in the next one year. This would take the total amount to close to RM100bn, the highest in the country's history.

Both MST and MSM are operating at low utilisation rates of about 30-40% currently, leaving it sufficient room to raise output to tap into the expected increase in demand. Currently, MIG's steel pipe manufacturing segment has about 16-20% share of the local market.

Flat products

Demand and… Consumption of flat products tends to grow in tandem with the country's industrial outlook. According to MISIF, domestic consumption of flat steel products in 2010 will be up 50% from 2004's consumption of 1.6m tonnes.

… prices on the uptrend. When China became a net steel exporter in mid-2005, CRC prices corrected substantially from a high of US$720 per MT to a low of US$520 per MT at end-05. Prices have since rebounded to an average level of US$650 per MT in the past six months. Prices are expected to remain firm at the US$600-650 level.

Plant upgrade. Mycron is embarking on a plant upgrade and expansion which will increase its capacity from 180k MT/year to 260k MT/year. The expansion which is due for completion by end-2007 is estimated to add RM16.6m p.a. to the company's pretax and could increase Mycron's CRC market share to 40%.

Concerns. However, a constant concern is the requirement to purchase 40% of its raw material, hard rolled coil (HRC) from Megasteel whose pricing is about 5% higher than international prices even though its products are lower grade.

Mining

Rock-solid returns. MIG's investment in Gindalbie was only RM22.1m or A$0.10 per share. Over the past two weeks, Gindalbie's share price has shot up 40% to A$1.37, raising the value of MIG's investment to RM287m. The share price is expected to rise to A$1.50-2.00 once the company is fully operational.

Positive outlook. Gindalbie targets to produce 8m tonnes of magnetite a year for the next 30-40 years and 1.5m tonnes of haematite for the next seven years. The company intends to start mining haematite by 2008. Demand for iron ore is expected to stay strong, in lockstep with the uptick in steel demand. We gather that prices for iron ore are likely to increase by 15% over the next three years. For 2007, iron ore price has been fixed at US$0.72 per metric ton unit, an increase of 9.5%.

Others

MIG's engineering division has submitted a proposal to the Penang State Government for the Penang monorail project. It has proposed a 52km route, consisting of three single line inter-linked loops. The estimated project cost is RM1.6bn. We understand that Melewar is the only steel company bidding for this project.

Currently, the group has a pipeline of RM300m worth of engineering projects, comprising projects from Telaga Chip Mill in Sabah, the Mycron plant upgrade and expansion project and M3nergy's barite plant project in Labuan. MIG is bidding for a steel project worth a whopping RM3bn. Success in landing this project would mean significant upside to the group's earnings as we gather that the engineering division is able to generate net profit margins of between 15% and 20%.

Under its power and oil & gas division, MIG owns 70% of Siam Power Generation Company which operates and owns a 150MW combined cycle gas fired power plant in Rayong. It has a licence to expand up to 450MW and the site can accommodate up to 1,000MW of capacity.

Valuation and recommendation

Benchmark against other steel players. Given that majority of its earnings still comes from the steel division which is expected to be the main earnings contributor over the next few years, we use other steel players as a benchmark. In view of the positive outlook for the industry, we assume 10% revenue growth in FY08 and a slight net profit margin improvement from 8% in the past couple of years to 10%. Based on these assumptions, MIG is trading at 10x FY08 P/E, on par with other local steel bar players (Figure 4) but at a slight discount to the 11.5x average for steel pipe manufacturers (Figure 5). 11.5x P/E would imply a share price of RM1.90 for MIG, leading to upside of 14%. At RM1.90, the stock would still be below its NTA of RM2.25. The stock is under-researched though we gather that management have been seeing analysts and investors of late.

Figure 4: Comparison of steel bar and CRC manufacturers

	Bloomberg ticker	Recom.	Price (RM)	Mkt cap (RM m)	Core P/E (x) FY07	Core P/E (x) FY08	P/NTA (x) FY07	ROE (%) FY07	ROE (%) FY08	Div yield (%) FY07
Southern Steel	SSB MK	NR	1.79	699.5	9.6	8.8	1.0	11.0	11.4	2.8
Ann Joo Resources	AJR MK	NR	3.72	1,296.3	na	na	n/a	n/a	n/a	n/a
Kinsteel	KSB MK	NR	6.20	1,095.7	10.2	7.5	n/a	14.5	15.1	3.6
Ornasteel	ORNA MK	NR	1.55	589.0	6.7	6.2	n/a	14.1	14.5	9.2
Mycron	MSB MK	NR	0.92	164.7	na	na	n/a	n/a	n/a	n/a
Lion Industries	LLB MK	NR	1.88	1,326.5	na	na	n/a	n/a	n/a	n/a
Simple average					**9.9**	**8.2**	**1.0**	**13.2**	**13.7**	**3.2**

O = Outperform, N = Neutral, U = Underperform, NR = Not Rated, TB = Trading Buy and TS = Trading Sell
Source: Company, CIMB/CIMB-GK Research, Bloomberg, Reuters Estimates,

Figure 5: Comparison of pipe manufacturers

	Bloomberg ticker	Recom.	Price (RM)	Mkt cap (RM m)	Core P/E (x) CY07	Core P/E (x) CY08	3-yr EPS CAGR (%)	P/NTA (x) CY07	ROE (%) CY07	ROE (%) CY08	Div yield (%) CY07
Engtex Holdings	ENGT MK	NR	1.54	127.1	14.8	8.9	44.2	n/a	9.4	10.3	3.2
Hiap Teck Venture	HTVB MK	NR	2.09	684.3	13.1	8.0	40.2	1.5	n/a	n/a	1.4
YLI Holdings	YLI MK	NR	3.20	315.4	23.0	17.1	19.8	n/a	9.5	10.5	2.2
Simple average					**17.0**	**11.3**		**1.5**	**9.5**	**10.4**	**2.3**

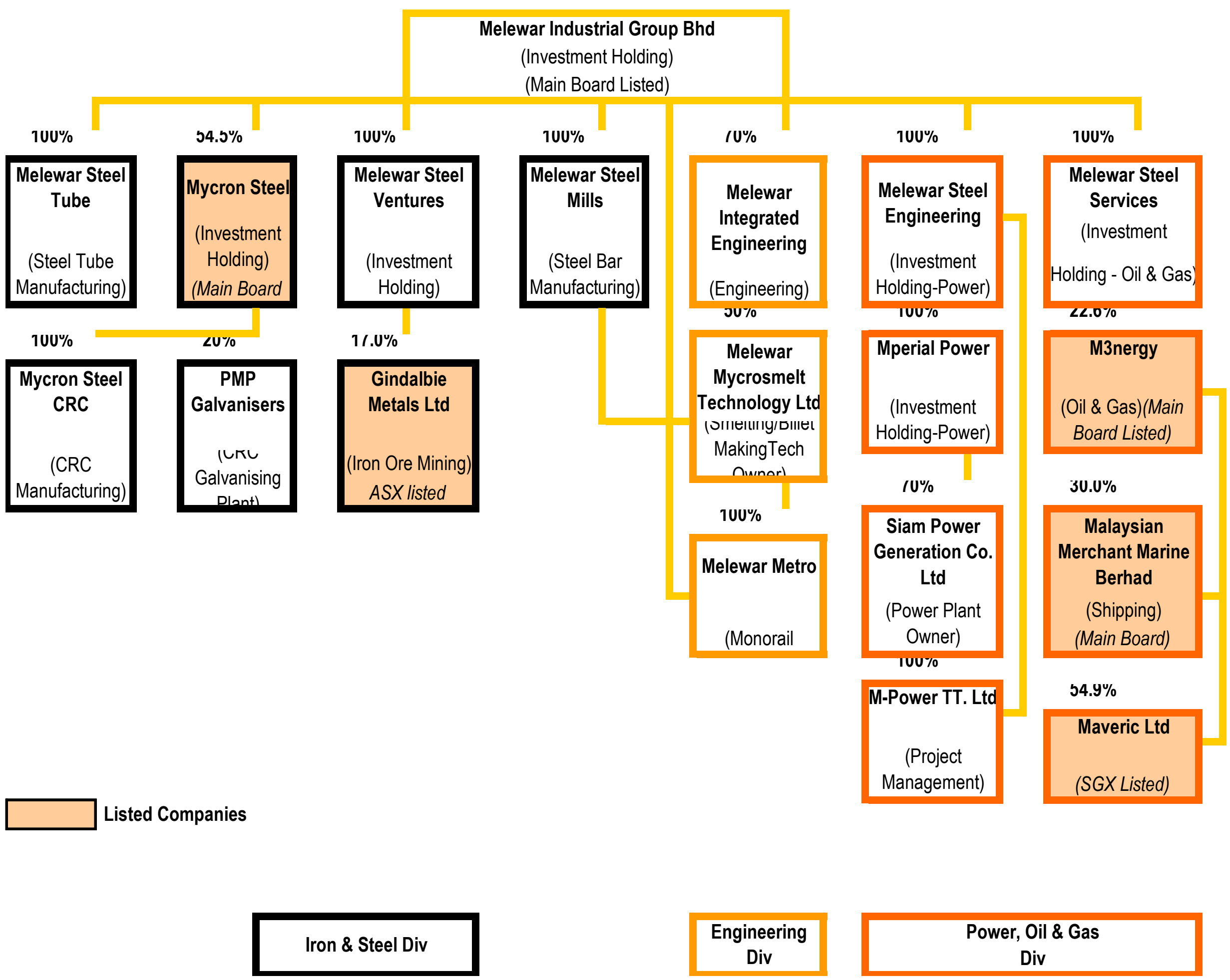
O = Outperform, N = Neutral, U = Underperform, NR = Not Rated, TB = Trading Buy and TS = Trading Sell
Source: Company, CIMB/CIMB-GK Research, Bloomberg, Reuters Estimates,

Financial summary

FYE Jan/Mar	2003	2004	2005	2006	2007^
Revenue (RM m)	390.8	462.2	598.7	566.9	652.2
EBITDA (RM m)	95.5	98.7	91.0	51.8	83.4
EBITDA margins (%)	24.4	21.4	15.2	9.1	12.8
Pretax profit (RM m)	77.5	80.6	72.7	35.5	57.0
Net profit (RM m)	56.6	64.4	46.5	46.9	46.4
EPS (sen)	26.9	30.5	21.8	21.7	16.46*
EPS growth (%)	+5%	+13%	-29%	-0%	-24%
P/E (x)	6.2	5.4	7.6	7.6	10.1
Gross DPS (sen)	7.5	157.2	7.0	2.3	-
Dividend yield (%)	4.5	94.7	4.2	1.4	-
P/NTA (x)	0.4	0.7	0.8	0.6	0.7
ROE (%)	8.9	12.8	13.1	9.9	9.1
Net gearing (%)	5.0	29.0	38.0	41.0	25.0

Source: Company, CIMB/CIMB-GK estimates, Reuters Estimates
^ 14 months ended 31 March due to change in FYE from Jan to Mar
** The group proposed a 1:3 bonus issue and an additional 7.7m warrants in Feb 07.*

Appendix: MIG's corporate structure



Source: Company

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UNDERPERFORM: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.

TRADING BUY: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 months.

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OVERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

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