

Eonmetall Group Bhd

December 18, 2006

RM0.935

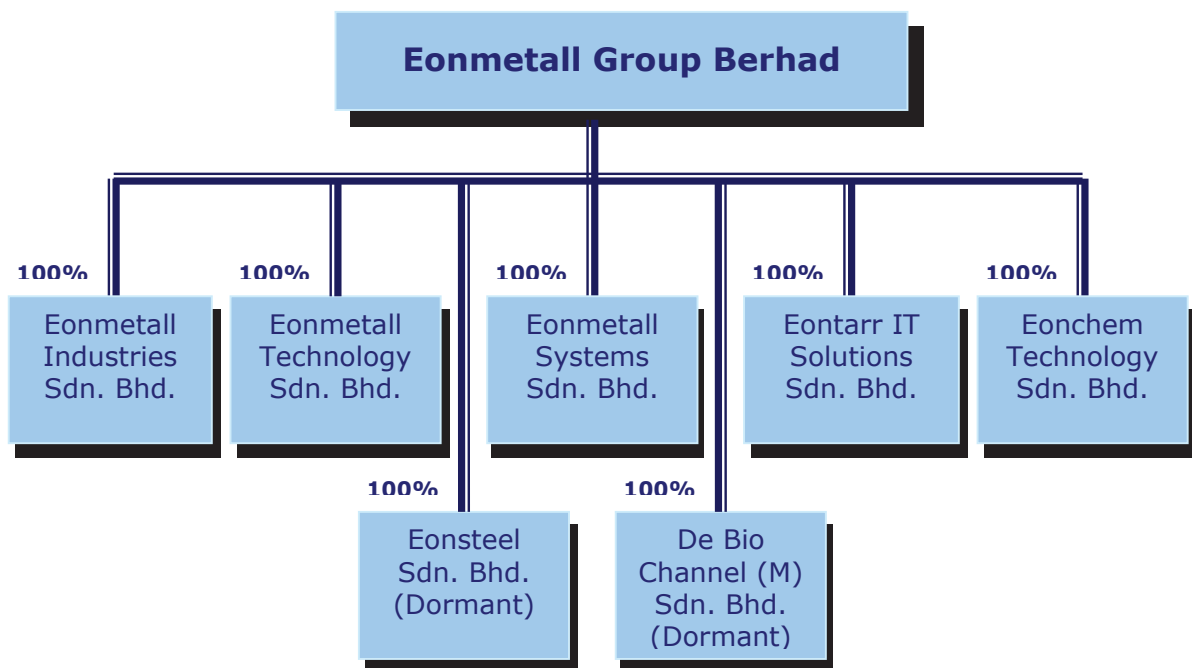
BUY

Analyst: Danny Ooi;

**Investment Summary**

- ***Established player in the iron & steel industry with a track record of more than 20 years.***
- ***Leading fabricator in the local metalwork machinery and equipment (MME) sector with a patent secured for manufacturing of steel products and apparatus.***
- ***In-house MME design and manufacturing capability secures higher profit margins compared to secondary flat metal products.***
- ***IT division provides one-stop 'front-end and back-end' solutions to enhance efficiency of MME products via real-time operational data.***
- ***Demand for steel products is expected to grow with commencement of projects under the 9MP and expansion of overseas market.***
- ***FY 12/2007 net profit is expected to grow by 20% y-o-y due to new MME products to be introduced and completion of a new and larger factory by 1Q 2007. Fair value of RM1.57 based on PEG of 0.70.***
- ***Received SC approval on December for transfer to Main Board.***

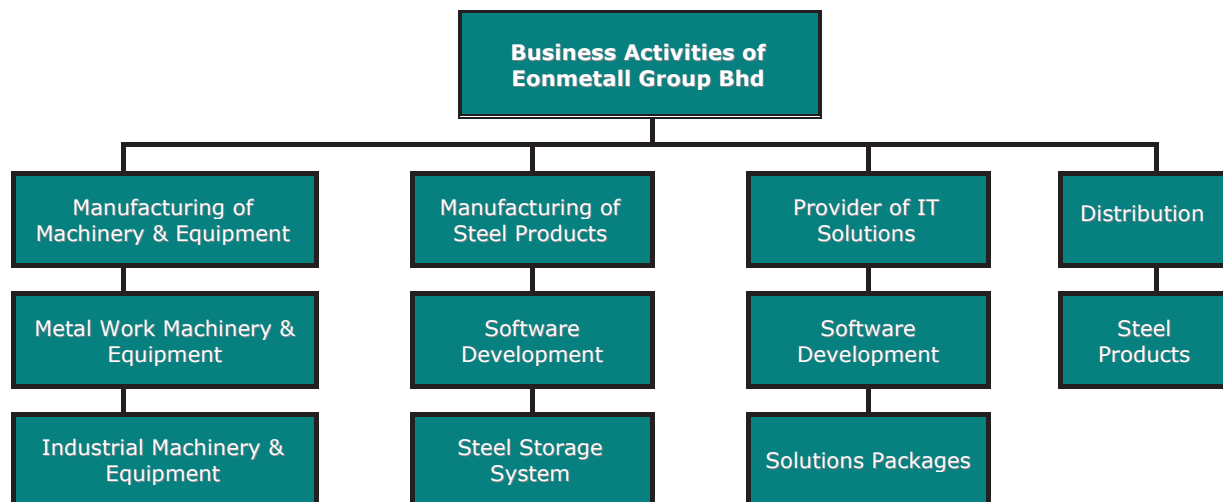
A. CORPORATE STRUCTURE



B. ESTABLISHED HISTORY

1. **Eonmetall Group Bhd** (Eonmetall) was listed on August 3, 2005 and carries with it more than 20 years of experience and expertise in the iron and steel industry via the company's founder and managing director, Dato' Goh Cheng Huat. The company's origins was established since the 1990s as a manufacturer of Secondary Flat Steel Products such as roofing sheets, slotted angles and expanded metals.
2. **An industry leader accredited with awards and patent.** Dato' Goh's invaluable skills in invention and enhancement of steel making machines and related processes have earned him the Young Entrepreneur Award in 1990. In 1999, his innovative skills led him to be awarded a patent for "Process For The Manufacturing OF Steel Products And Apparatus" and "4X2 High Cold Roll Angle Bar Machine". Today, Eonmetall is the leading fabricator in the local Metalwork Machinery and Equipment (MME) industry.
3. **Notable track record overseas.** Eonmetall's products are exported to USA, Saudi Arabia, Yemen, Sudan, Vietnam, Indonesia and etc. Notable achievements were 2 successful turnkey projects on a Design, Built, Operate and Transfer basis, i.e. the construction of a 120,000 sq.ft. steel factory in Sudan (1998) and a 220,000 sq.ft. steel factory in Yemen (1999).
4. **Diversification provides new growth avenues.** In 2000, they established the IT division with the objective to provide software development and incorporate IT solutions into its MME machines. In 2001, Eonmetall diversified into the Industrial Process Machinery and Equipment (IPME) sector, focussing on palm oil and oleochemical processing machinery.

C. SPEARHEADED BY 3 CORE BUSINESSES



1. Manufacturing of Machinery and Equipment

Niche MME fabricator with in-house R&D. Eonmetall is the leading MME fabricator in the country. They design all their machinery in-house, which in turn enables them to perform a wide range of metalwork functions including slitting, shearing and forming. The company's R&D team enables them to customise their MME products to suit customers' specifications.

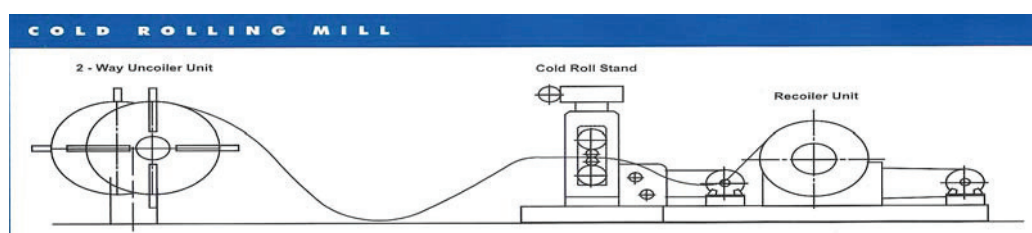
Patented technology. Eonmetall has been awarded a patent for their world-class cold-rolled forming machine that is able to form steel strap into various shapes, including angle bars, lip, 'C' and 'Z' channel products.

High margins from in-house design and manufacturing capability. In view of their capability to design and customise MME products, Eonmetall is able to reap higher gross profit margins, hovering between 40% to 45%, as against gross profit margins of 10% to 12% derived from their secondary flat metal products.

a) Cold Rolling Mill Machine (top seller)

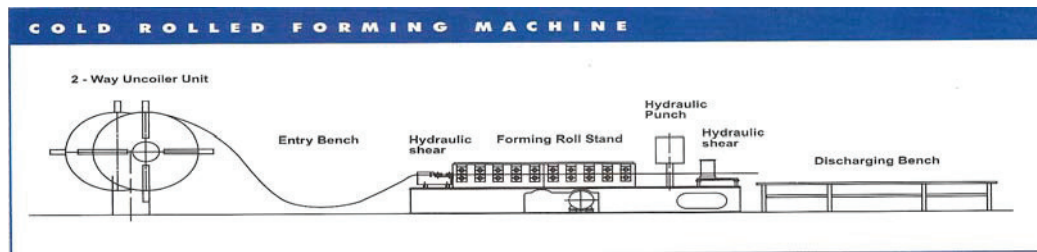
It has been their top seller since FY 12/2005 due to their ability to design and manufacture the machine in Malaysia.

It is used to reduce the thickness of low carbon pickled & oiled hot-rolled strip (not more than 3.0mm) to cold-rolled strip (0.5mm). After rolling and reducing, the cold-rolled strip can be used for production of steel tube, section, forming, etc.



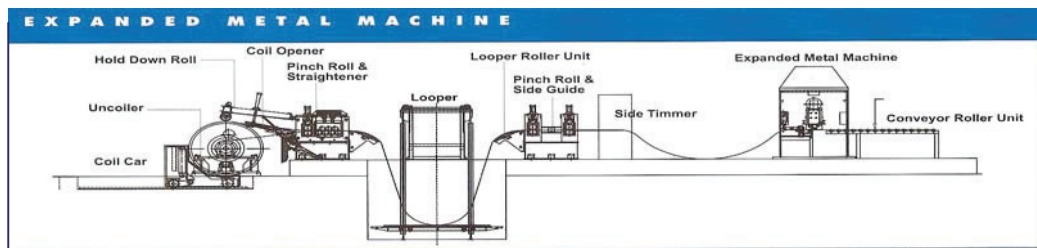
b) **Forming Machine**

It is used to form metal sheets or plates into required shapes and sizes for products such as channels, C-purlins, slotted angles, roll-forming as well as pipes and hollow sections.



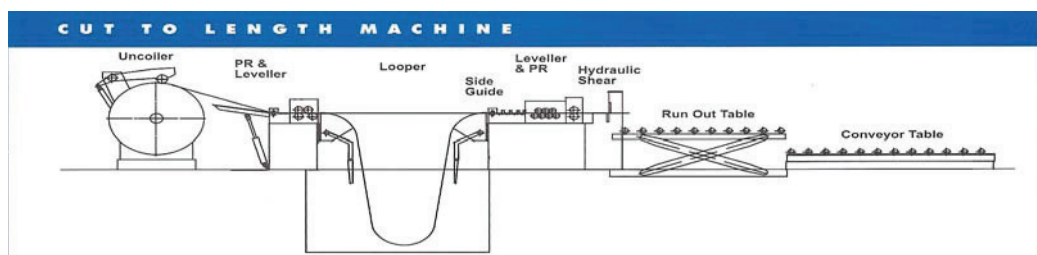
c) **Expanded Metal Machine**

A set of machinery to slit and expand or draw the resultant slit metal sheets into an open mesh pattern.



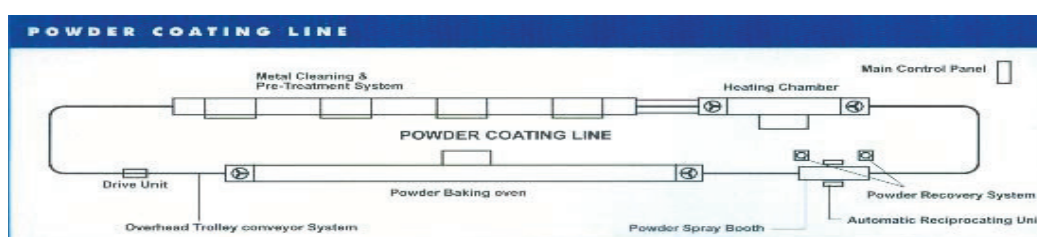
d) **Slitting and Shearing Machine**

Slitting is a process that cuts metal coils into desired widths whilst the shearing machine cuts straight lines across flat metal plates.



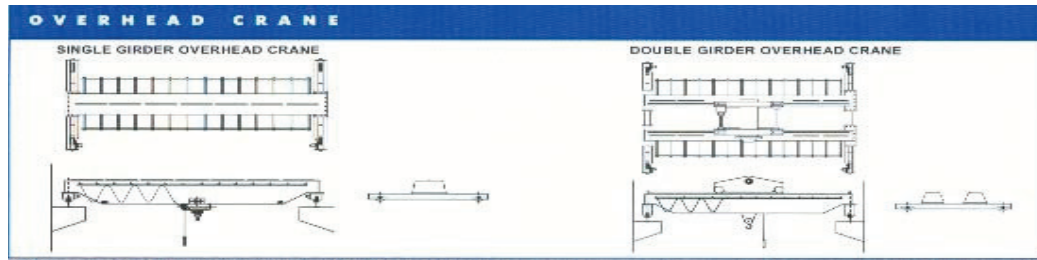
e) **Powder Coating Machine**

Comprise of 3 stages. First is to clean the parts to be coated. Second, is to apply the coat of powdered paint and finally is to cure the powdered paint via an oven.



f) **Overhead Crane**

It is used to hoist and move heavy objects within a limited area.



g) **Solvent Extraction Plant**

An Industrial Process Machinery and Equipment designed for palm oil and oleochemical sector. The plant uses a solvent to extract oil from initially processed palm fiber (wet palm fiber). It is capable of reducing oil content to about 0.5% from 10% (maximum) found in wet palm fiber. The oil extracted has various applications in the food industry.



2. Manufacturing of Steel Products

a) **Steel Storage Systems**

- **Drive-in & Drive-through Racking Systems**

The first shelf of the racking system is high enough to allow a forklift to drive in or through and stack loads onto the racking shelves.

- **Double Deep Racking Systems**

A racking system that can place 2 pallets in a single entry rack and 4 pallets in a double entry rack to accommodate more load space.

- **Selective Racking Systems**

The most common racking system where shelves are designed for single pallet depth with variable aisle width to accommodate forklifts, reach trucks and turret trucks.

- **Boltless Selective Racking Systems**

A common racking system using standardised "teardrop" shape connection design that makes the uprights and crossbeams slotted together with rivets.



- **Rack Supported Platform**

Accessible via staircases and loading gates, the shelves' can be decked with steel panels or plywood, whilst the floor with mesh grating, wood panels and steel plates.

- **DIY and 2-in-1 Racking Systems**

User-friendly design with easy to assemble instructions for the consumer market and sold through retail outlets such as DIY, hardware and department stores.

b) **Secondary Flat Metal Products**

Eonmetall utilises cold-rolled or hot-rolled coil, galvanised steel coils, plates and sheets as feedstock to produce a wide variety of products as mentioned below:

- **C-purlin**

Cold-formed high quality tensile zinc coated sheet that is used as a secondary support for roofing and cladding materials, including profile metal sheeting, slate, composite panel and tiles, with or without insulation.



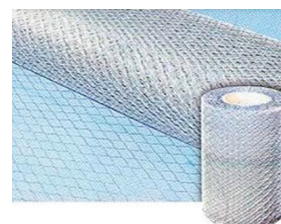
- **Roofing Sheets**

Made from galvanised and/or pre-painted steel, primarily used for roofing and wall claddings. Eonmetall uses roll-forming process, which entails taking metal sheets or coils to create profiles or shapes with identical cross-sections.



- **Expanded Metals**

Metal sheet or coil slitted and stretched into a non-raveling unit of uniformed sized diamond shaped openings. Among the end-products are air/fluid filters, grills, light diffusers, stationery, partitions, fencing, ventilation, satellite, radar antennas, shelves, racks, concrete reinforcement and etc.



- **Slotted Angles**

Roll-formed steel is perforated at specific spaces and can be overlapped to increase strength and stability. Used in building of a framing system such as carts, ladders, benches, shelving, cases, racks and other types of steel structures.



- **Others**

Other Secondary Flat Steel Products such as conduit pipes, blank mouth ring, header channel, vertical flange and etc.

3. Provider of IT Solutions

Provider of Integrated IT solutions for MME processes. Eonmetall's IT division capitalises on its expertise in manufacturing processes to develop a one-stop 'front-end and back-end' solutions to enhance operating efficiency. These solutions can be incorporated into Eonmetall's MME machines to provide real-time operational data.

a) EES Factory Automation (EES-FA).

A comprehensive framework that integrates, organises and synchronises information between shop floor devices and management systems to provide a unified real-time visibility of the manufacturing process via the Internet. Users are able to optimise shop floor controls such as alarm routing, sorting, filtering and blocking. The solution is expandable from a single computer node to a plant-wide monitoring system capable of:

- collecting data from a wide range of shop floor devices;
- visualise and aggregate data into valuable information for analysis; and
- share such information with 3rd parties.

b) EES Management Execution System (EES-MES)

Enhancement of enterprise planning systems via on-line integration with shop floor operations such as statistical process control, time and attendance, product data management, maintenance management and etc. EES-MES enhances management of manufacturing resources such as inventory, manpower and equipment by way of:

- shorter manufacturing life cycles;
- faster inventory turnover and reduce in-progress inventory;
- more on-time deliveries, higher quality and lower defects; and
- higher return on operational assets and improved margins.

D. FAVOURABLE INDUSTRY OUTLOOK WITH COMPETITIVE EDGE

1. **Competition remains subdued due to product-specific nature of business.** We see competition amongst the country's more than 130 secondary flat steel products manufacturers as rather muted because they are divided into product-specific groupings with each group producing their own niche products.
2. **MME sector entails higher barrier of entry.** Competition in the MME sector is moderate due to high barriers of entry. There are only 6 MME manufacturers in the country. But Eonmetall has the edge due to:
 - in-house technology and patents;
 - conform to international quality standards and accreditation;
 - good track record for products and services;
 - flexibility in meeting customers' requirements and specifications; and
 - spearhead continuous innovation and improvements via R&D.

3. **Overseas demand set to improve.** The International Iron and Steel Institute forecasts world steel demand will grow by 8.9% in 2006 and 5.2% in 2007 on the back of strong steel product consumption from China, Europe and the US. The recovery followed a protracted downcycle in the first 9 months of 2005, mainly caused by China's excessive capacity expansion that led to higher global inventories and players undercutting steel prices.
4. **13% p.a growth forecast for flat steel products.** The Malaysian Iron & Steel Industry Federation projects local demand for flat steel products to grow at a CAGR of about 13% annually from 2006 to 2010. We believe the bullish expectation is fuelled by initiatives under the 9th Malaysia Plan, which amongst others, focuses on the construction, infrastructure and manufacturing sectors. Catalysts such as the Iskandar Development Region in south Johor, the RM100 billion package to target key sectors such as rural and regional development, the RM3 billion 2nd Penang Bridge and others to come will entrench demand for secondary flat steel products due to their vast applications in user industries such as:
 - **Building, construction and infrastructure** – piping, roofing, wall-cladding, fencing, sections, beams, angles, reinforced concrete and etc.
 - **Consumer electronics** – expanded metal mesh for speaker grills, light diffusers, antennas and etc.
 - **Fabricated metal products** – racking systems, expanded metal mesh for industrial and consumer filters, metal furniture and etc.

D. TAX EXEMPTIONS BOOST PROFIT MARGINS

1. Eonmetall is currently enjoying various tax incentives granted by the government for its innovations in the manufacturing sector. They are:
 - Pioneer Status which exempts the company from tax for a full 10 years, applicable to its powder coating line, galvanising line, pre-painted galvanising line, rolling mill, solvent extraction plant, MDF machine and parts for the iron and steel industry.
 - A 70% tax exemption for the manufacturing of machinery and equipment for the edible oils, pharmaceuticals, chemical and oleochemical industries.
 - MSC status for wholly-owned subsidiary, i.e. Eontarr IT Solutions Sdn Bhd who enjoys a full tax exemption on IT solutions developed by the company.

E. POTENTIAL RISKS ARE SOMEWHAT MITIGATED

1. **Competitive risks.** Eonmetall's products such as racking systems, C-purlins and metal roofing systems are also manufactured by Main Board listed players namely, **Astino Bhd**, **Ajiya Bhd** and **Prestar Resources Bhd**. They are among the more than 130 manufacturers vying for a piece of the domestic secondary flat steel products market which exceeds 5 million tonnes annually, not to mention demand from the buoyant export market. We are confident that Eonmetall will sustain their niche market share as seen by the revenue growth of its secondary flat steel products at a CAGR of 36% from 2000 to 2005.

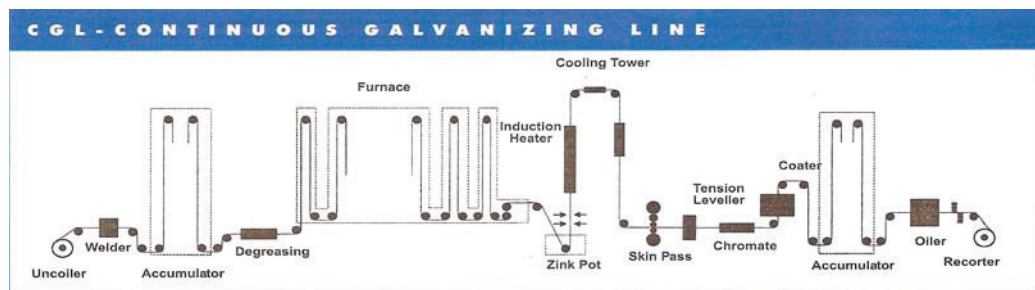
2. **Raw material prices.** Eonmetall uses hot-rolled coil (HRC), the feedstock for making cold-rolled coil (CRC), which will be further processed into secondary flat steel products. The prices of HRC and CRC have risen recently and will rise further, thus pressuring the profit margins. This is because not all products allow price hikes to be passed on to end-users. However, Eonmetall is able to mitigate the rise in raw material cost by converting HRC into CRC via its own developed Cold Roll Mill Machine. The in-house conversion limits Eonmetall's exposure to only HRC price fluctuations and significantly reduces total production cost.

F. BRIGHT PROSPECTS SEEN IN 2007

1. Expansion of Products Range

a) Galvanising line (end-2006)

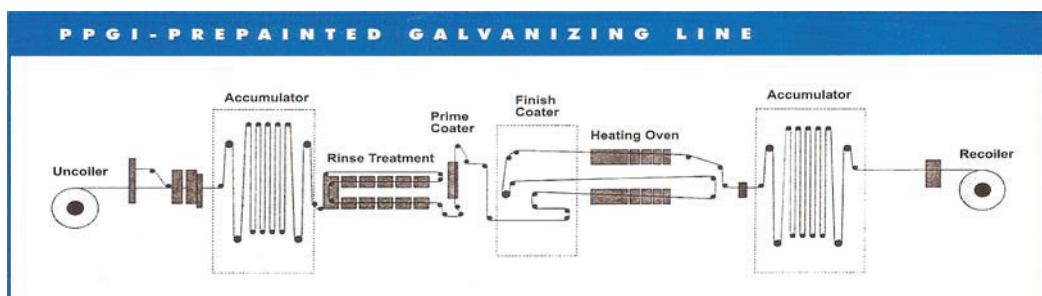
Slated for commercial launch by end FY 12/2006.



b) Enhanced Cold-Rolled Mill (end-2006)

Capable of rolling low carbon P&O and Hot-Rolled strips of 3.0mm and above and reducing them to a thickness of only 0.5mm. After rolling, these cold rolled strips can be used for production of steel tubes, sections & forming.

c) Prepainted Galvanizing Machine (2007)



d) Medium Density Fiberboard (MDF) Plant (2007)

The MDF plant utilizes oil palm empty fruit bunches as raw material to replace the traditional wood fiber in the manufacturing of MDF.

2. **Expansion of Facilities via New Factory (2007)**

- a) ***Eonmetall is constructing a new factory*** costing RM25 million near its current site to capture a larger chunk of the buoyant MME and secondary flat metal products market that is expanding significantly. About half of the cost will come from their IPO listing proceeds, and the balance via bank loans.



- b) ***A boost to production capacity.*** The new factory will boost Eonmetall's MME production capacity by 50%, secondary flat steel products (including Cold Rolled Coil but excluding steel racking systems) by 70% and act as main warehouse to store raw materials and finished goods. The new factory will benefit extensively from Eonmetall's vast expertise as a turnkey contractor in construction of steel factories in Sudan and Yemen. We believe Eonmetall will capitalise on their latest in-house designed MME and integrated IT solutions to maximise production efficiency and economies of scale.
- c) ***Expected to contribute positively to group earnings by FY 12/2007.*** Piling work has been completed on the 30-acre site and construction of the new factory building will commence by mid-November, followed by the office building in December. Scheduled to begin operation by 1Q 2007 to cater mainly for the export market, we can expect the new factory to positively contribute to Eonmetall's FY 12/2007 profits.

3. **Expansion of export market**

We noted that Eonmetall's exports have grown to 54.3% of the Group's revenue in FY 12/2005 from 41.6% in the previous year. The company exports their products to more than 50 customers in 27 countries and plans to further expand their export coverage, while at the same time, increase their sales turnover with existing overseas customers. The new MME products and additional capacity from the new factory that will come into operation by 2007 will give Eonmetall the edge to penetrate into new markets and cater for higher demand from foreign customers.

4. **Approval received for proposed bonus issue and transfer to Main Board**

Eonmetall has received approval on December 5, 2006 from the Securities Commission for their corporate exercise comprising:

- 1-for-2 bonus issue of up to 63.25 million new shares; and
- transfer of listing from 2nd Board to Main Board of Bursa Malaysia.

The above exercise is expected to be completed by early 2007.

G. INEXPENSIVE WITH UNTAPPED POTENTIAL

1. **Eonmetall is an undervalued stock** with a few interesting surprises under its sleeve:
 - The company's historical PER valuation is comparable with the lowest amongst its peers in the secondary flat steel industry. There is no listed competitor in MME manufacturing.
 - When completed, the new factory is expected to positively impact FY 12/2007 earnings via capacity expansion for both secondary flat metal products and MME products.
 - MME product mix is to expand with planned commercialisation of galvanizing and prepainted galvanizing lines as well as enhanced cold-rolled mill and MDF plant by 2007.
 - MME products are designed and developed in-house, providing a higher average pretax margin of 36%, compared to 12% for secondary flat metal products.
2. **Higher performance forecasted for FY 12/2007.** Going forward, we forecast Eonmetall's FY 12/2007 revenue and pretax profit to rise by 38% to RM130 million and 33% to RM22.59 million respectively compared to the previous year. The stronger performance is underpinned by additional capacity from the new factory as well as anticipated demand from overseas and locally to kick start projects under the 9MP.
3. **Lower 3Q 9/2006 results are not worrisome.** Lower sales of MME products was the main reason for the drop in 3Q 9/2006 pretax profit by 64.6% q-o-q to RM3.03 million. The reason being they yield a higher margin compared to secondary flat metal products. Revenue for the same period fell by 9.8% q-o-q to RM20.18 million. However, we are confident Eonmetall will achieve their FY 12/2006 forecast due to the outstanding orders for MME and secondary flat steel products worth RM12 million and RM18 million respectively.
4. **Fair value at RM1.57 based on PEG of 0.70.** Based on a 3-year (FY 12/2005 to 12/2007) net EPS CAGR of 11.45%, Eonmetall's PEG is attractively undervalued at 0.41. This is due to the anticipated earnings growth in FY 12/2007 contributed by the new factory. Using a conservative PEG of 0.70, we value Eonmetall at a fair value of RM1.57.

H. FINANCIAL SUMMARY AND FORECAST TABLE

| Financial Summary & Forecast | | | | | | | | |
|------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| FY 31 Dec (RM'mil) | 2000 | 2001 | 2002 | 2003 | 2004 | *2005 | 2006F | ^2007F |
| Revenue | 21.45 | 25.95 | 37.94 | 49.36 | 78.45 | 79.56 | 94.06 | 130.00 |
| Operating Profit | 6.83 | 5.71 | 8.99 | 13.92 | 17.49 | 17.96 | 18.11 | 25.03 |
| Pretax Profit | 6.67 | 5.20 | 8.15 | 13.17 | 16.06 | 16.31 | 16.93 | 22.59 |
| Tax | -2.11 | -1.34 | -0.68 | -1.43 | -2.62 | -0.69 | -0.72 | -0.96 |
| Net Profit | 4.56 | 3.87 | 7.47 | 11.74 | 13.44 | 15.62 | 16.21 | 21.63 |
| EPS (sen) | 4.15 | 3.52 | 6.79 | 10.67 | 12.22 | 14.20 | 14.74 | 11.40 |
| Gross Dividend (sen) | - | - | - | - | - | 5.00 | 5.00 | 5.00 |
| Dividend Yield (%) | - | - | - | - | - | 5.35 | 5.35 | 8.02 |
| PER (X) | 22.55 | 26.58 | 13.77 | 8.76 | 7.65 | 6.58 | 6.34 | 5.47 |
| Total no. of shares | 110.00 | 110.00 | 110.00 | 110.00 | 110.00 | 110.00 | 110.00 | 189.75 |

* FY 12/2005 pretax profit includes negative goodwill of RM11.85 million

^ FY 12/2007 net EPS and PER adjusted for 1-for-2 bonus issue

I. PEER RANKING IN SECONDARY FLAT METAL PRODUCTS SECTOR

| Company | Business | Price (RM) Dec 18 | FY | Revenue (RM'mil) | PBT (RM'mil) | EPS (sen) | PER (X) |
|---|---|----------------------|---------|---------------------|-----------------|--------------|------------|
| Astino Bhd (Main Board) | Metal roofing sheets, C-purlin, capping, brackets and PVC doors. | 0.535 | July 06 | 243.7 | 13.7 | 8.19 | 6.3 |
| Ajiya Bhd (Main Board) | Metal roofing frames and structural products, light weight metal channels, metal ceiling and sun shades as well as safety glass products. | 1.07 | Nov 05 | 172.2 | 18.7 | 17.05 | 6.4 |
| Eonmetall (2 nd Board) | Metalworking Machinery and Equipment, Secondary Flat Metal Products and IT Solutions. | 0.935 | Dec 05 | 79.6 | 16.3 | 14.20 | 6.6 |
| Prestar Resources Bhd (Main Board) | Racking system, material handling equipment such as wheelbarrows, steel pipes, guardrails, slitted coils and steel sheets. | 0.625 | Dec 05 | 533.6 | 16.6 | 3.19 | 20.5 |
| SKB Shutters Corp Bhd (2 nd Board) | Metal racking system, metal roller shutters and steel doors. | 0.415 | June 06 | 40.7 | 1.0 | 1.08 | 38.4 |
| Yung Kong Galvanizing Industries Bhd (Main Board) | Galvanized roofing sheets, coil-to-coil galvanizing, shearing, roll forming and color coated steel sheets. | 0.835 | Dec 05 | 287.4 | 1.2 | 0.95 | 92.2 |

J. CORPORATE DATA

| Share Data | Major Shareholders as at May 11, 2006: | % |
|--------------------------------------|--|-------|
| Listing: 2 nd Board | • Eonmetall Corporation Sdn Bhd | 45.03 |
| Paid-up: RM55 million | • Variant Link Sdn Bhd | 13.46 |
| Par Value: 50 sen | • Dato' Goh Cheng Huat | 9.75 |
| NTA per share: 89 sen | • Bumiputra-Commerce Nominees | 5.91 |
| Price/Book: 1.05X | • LTAT | 3.57 |
| Board of Directors: | | |
| • Tan Sri Dato' Mohd Desa bin Pachi: | Chairman / Non-Executive Director | |
| • Dato' Goh Cheng Huat: | Managing Director | |
| • Yeoh Cheng Chye: | Executive Director | |
| • Tan Sri Dato' Soong Siew Hoong: | Non-Executive Director | |
| • Goh Kee Seng: | Non-Executive Director | |
| • Tan Yin Kham: | Independent Non-Executive Director | |
| • Ibrahim Mahdi Phee: | Independent Non-Executive Director | |



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INTER-PACIFIC RESEARCH SDN BHD

A handwritten signature in black ink, appearing to read "Tan Mun Choy".

Tan Mun Choy
(General Manager)

21st December, 2006

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