

INITIATING COVERAGE

28 March 2008

Lysaght Galvanized Steel Berhad

Stock Code: 9199

Price : RM1.00

Market Capitalisation : RM41.6m

Board : Second Board

Sector : Industrial Product

Recommendation : BUY

<u>Key Stock Statistics</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08f</u>
<u>FYE Aug</u>			
EPS (sen)	13.9	19.7	18.5
P/E (x)	7.2	5.1	5.4
Dividend/Share (sen)	4.0	4.0	4.0
Book Value/Share		1.60	
Issued Cap. (m)		41.6	
52-week Hi-Low (RM)		1.32- 0.80	
Major Shareholders:			
		%	
Lysaght (M) S/B		55.1	
Ingli S/B		11.7	
Liew Swee Mio		0.8	

<u>Per Share Data</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08f</u>
<u>FYE Dec</u>			
Book Value (RM)	1.45	1.60	1.75
Cash Flow (RM)	0.2	0.2	0.2
Earnings (sen)	13.9	19.7	18.5
Dividend (sen)	4.0	4.0	4.0
Payout Ratio	28.9%	20.3%	21.6%
PER (x)	7.2	5.1	5.4
P/Cash Flow (x)	5.5	4.2	4.4
P/Book Value (x)	0.7	0.6	0.6
Dividend Yield	4.0%	4.0%	4.0%
ROE	9.6%	12.3%	0.0%
Net Gearing (x)	net cash	net cash	net cash

<u>P&L Analysis (RM m)</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08f</u>
<u>FYE Dec</u>			
Revenue	66.6	82.9	90.4
Operating Profit	7.7	11.2	10.4
Interest Exp	-	-	-
Pre-tax Profit	7.7	11.2	10.4
Eff Tax Rate	25.3%	26.5%	26.0%
Net Profit	5.8	8.2	7.7
Operating Margin	11.6%	13.5%	11.5%
Pre-tax Margin	11.6%	13.5%	11.5%
Net-Margin	8.7%	9.9%	8.5%

1. Investment Highlights / Summary

- Leading manufacturer of galvanized poles and masts.** Lysaght is one of the leading manufacturers of galvanized steel poles and masts in Asia, with current output at 18,000 mt per annum.
- Superior quality.** Lysaght uses premium quality zinc imported from Japan for its galvanizing process. In addition, it has in-house expertise to cater to custom requirements of customers. As a result, its products are found in some prominent stadiums and cities worldwide. 30% revenue comes from overseas.
- Growth markets.** Based on Lysaght's proven track record and quality products, we believe its overseas contribution will continue to grow. Meanwhile, demand locally should sustain in line with the infrastructure and construction activities.
- Good financials.** Revenue and net profit have been growing at double-digit over the last few years while keeping balance sheet lean with zero borrowings. Despite long cash cycle, net operating cashflow remains positive.
- Risks.** Lysaght's key raw materials are steel, zinc and fuel oil. With high volatility and increasing prices, earnings visibility is affected. In addition, with the recent changes in the political landscape locally post the general election, there could be some delays or slowdown in infrastructure and construction activities in the short term.
- Initiate coverage with Buy call and a fair value of RM1.17** by pegging Lysaght's EPS08f of 18.5sen against its peers' average PER of 6.3x (include a discount of 10% to reflect the risk factors above). This fair value is well supported by its NTA per share of RM1.60.

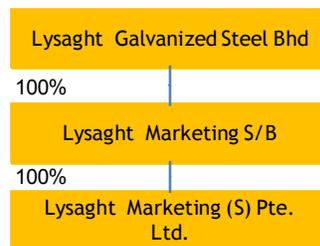
2. Background

Business in galvanized steel products

Corporate profile. Lysaght Galvanized Steel Berhad (Lysaght) and its subsidiaries are primarily involved in the manufacture and sale of galvanized steel products. It was listed on the Second Board of Bursa Malaysia Securities Berhad (then the Kuala Lumpur Stock Exchange) on 28 June 1994.

Lysaght's history dates back to 1972 when business began in the manufacturing of corrugated steel pipes and guardrails. The company later diversified into the design and manufacture of poles, masts, transmission poles, transmission/telecommunication towers and substation structures.

Corporate structure



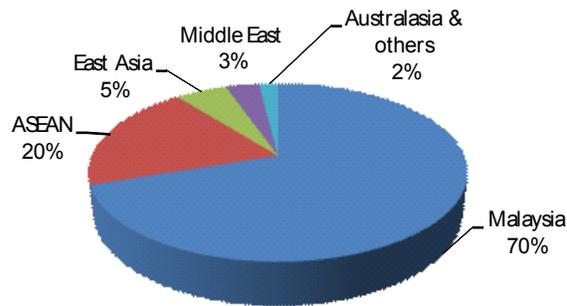
One of the leading manufacturers in Asia in galvanized steel products

Business. Today, Lysaght prides itself as one of the leading manufacturers of galvanized steel poles, masts, towers and guardrails in Asia. Some of its key products include:-

- Lighting poles
- Antenna poles
- Floodlighting poles
- Power transmission poles
- Flag masts
- High masts
- Stadium floodlighting masts
- Windmill masts
- Traffic signal masts
- Safety poles
- Mid-hinged poles
- Ski lift poles
- Distribution line poles
- Traffic sign gantry

30% overseas sales

Lysaght sells its products locally as well as abroad to over 30 countries worldwide. Local sales contributed 70% to revenue in FY07 while countries in the ASEAN, East Asia and Middle East made up the remaining 30%.

FY07 revenue breakdown by geographical contribution**Products used in various renowned structures/cities**

Some of the group's notable achievements abroad include installation of 61.7m stadium mast in Chidambaram Stadium, India which hosted the Cricket World Cup; installation of 30m and 40m floodlighting mast at Kranji Racecourse, Singapore; installation of stadium masts exceeding 40m at various stadiums in the UAE; and installation of 30m beacon mast in the Fremantle Port, Australia.

Meanwhile, locally, the group's products are seen nationwide – the street lighting poles and high lighting masts on the Penang Bridge; the 30m stadium mast at the Perak Hockey Stadium; the 25m high mast at the Kuala Lumpur International Airport; the 45m antenna monopole structure in Taman Tun Dr. Ismail Jaya, Shah Alam; and the decorative lighting poles in Putrajaya, to name a few. Some pictures of the products are enclosed for reference.

Currently at 72% utilization

Lysaght's manufacturing facility is located at the Tasek Industrial Estate, Ipoh, Perak with a built up area of approximately 315,000 sq. ft. The annual galvanizing production capacity is at 25,000 mt and the current output is estimated at 18,000 mt per annum, translating into 72% utilization rate.

Lysaght's plant is capable of galvanizing sections up to 14.0mm length and 1.8m width, and manufacture steel poles and masts of up to 32mm thick and a single length of up to 14m. In addition to standard products such as the normal street lighting poles, the group also boasts an in-house team capable of designing and custom manufacturing the poles and masts according to the specifications of customers. These are usually the higher-end products such as masts used in world-class stadiums.

Uses premium grade zinc imported from Japan for quality assurance

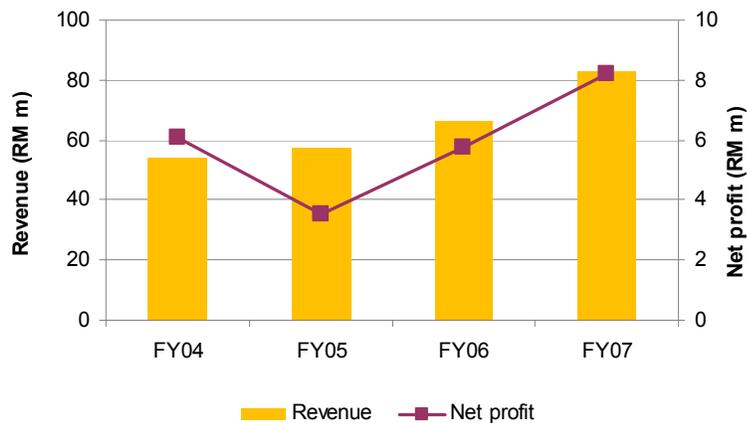
In addition, the group uses premium zinc imported from Japan for its galvanizing process. While this grade of zinc is more expensive, the output is superior in quality and is more durable.

In terms of competition, there is no comparable listed peer locally. With the exception of one larger private competitor, Galvapole Industries Sdn. Bhd., others are mainly small and fragmented players. In the international arena, Lysaght competes mainly with companies from the USA, France, UK and Italy. The success in clinching the notable jobs as mentioned above is a testament to the group's quality and ability.

3. Financial Highlights

Lysaght's revenue soared from RM54.6m in FY04 to RM82.9m in FY07, recording a CAGR of 15%. Net profit, meanwhile, grew by a more modest CAGR of 11% from RM6.1m to RM8.2m during this period.

FY04-FY07 revenue and profit track record



Raw materials – steel, zinc and fuel oil Operationally, gross margin hovers at the low-20% level in the past 3 years. Lysaght's profitability is largely influenced by its raw materials prices, which make up approximately 80% of production cost. Its key raw materials are commodities such as steel, zinc and fuel oil which prices have been on the rising trend for the past several years. The group sources its steel supply locally from Megasteel while zinc is imported from Japan.

Clean balance sheet backed by NTA of RM1.60 per share Lysaght's balance sheet is lean. It has no borrowings, and is backed by NTA per share of RM1.60. Both FY07 ROE and ROA are healthy at 12.3% and 10.7% respectively. While the group is a manufacturing entity, its asset base is surprisingly light. Its property, plant and equipment stood at RM12.5m as at Dec 2007. We understand from management that this is due to the durability of its manufacturing and galvanizing equipment. And as it is running below full capacity now, there is no requirement for major capex in the next 2 years as it can ramp up production to meet any increase in demand.

Positive net operating cashflow despite long cash cycle Lysaght's cash cycle, as we understand it, is relatively long. The group buys the bulk of its raw materials in cash, which is the nature of the purchases for most commodities. After the production cycle, the products are sold to customers usually with a 90-day payment terms. However, in reality, some customers may stretch payment to perhaps even 150 days. Lysaght's FY07 collection days stand at 112 days. Despite this, it has been able to generate positive net cashflow from operations over the past several years, indicating prudent cash management practice.

4. Earnings Outlook

Overseas market growth. Contribution from overseas markets have doubled from RM12.4m in FY04 to RM25.1m in FY07, marking a CAGR of 26%. Going forward, we expect further growth in this segment, underpinned by rising demand owing to Lysaght's proven track record, high product quality and comparatively cheaper cost structure against its western peers.

Local market growth. On the local front, revenue too, recorded a CAGR of 11% from RM42.2m in FY04 to RM57.9m in FY07. As infrastructure development continues in our country, there will be demand for Lysaght's products. Simply put, there will be need for street lighting poles, power transmission poles, traffic signal masts etc almost in every corner of the country, both in new and replacement markets. However, in the lower-end product range (such as street lighting poles), we understand some

smaller players undercut price by compromising on quality, hence impeding growth at Lysaght.

Earnings visibility impacted by raw materials prices fluctuation

While revenue is expected to remain its uptrend, Lysaght's earnings visibility is clouded by the high volatility in the raw materials prices. This is largely due to 1) the lag time between price quotation to customers and placement of orders for raw materials, and 2) the inability to do cost pass-through to customers. For some larger scale projects, the time from quotation to award may take months to materialize and the group may be adversely impacted by the fluctuation in commodities prices. Although some buffer is built into the costing, the group also needs to be mindful of its competitiveness against other competitors.

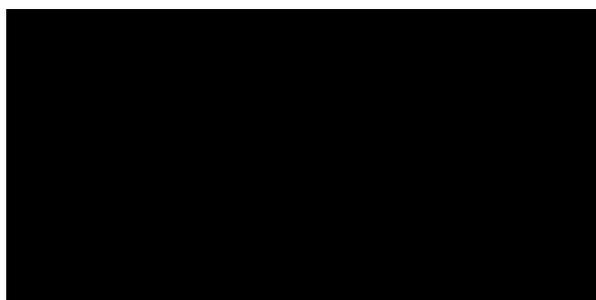
Thus, given the prevailing high volatility in steel, zinc and oil prices, we forecast Lysaght's FY08 revenue to increase 9% to RM90.4m, accompanied by a moderate net profit of RM7.7m, translating into an EPS08 of 18.5 sen.

5. Investment Risk

Commodity fluctuation. Fluctuation in steel, zinc and oil prices is a major risk factor as earnings visibility is impacted by the volatility in these 3 commodities which make up 80% of production cost. Mitigation therefore, lies in the management ability to manage raw materials supply against potential workflow.

Timing of implementing various infrastructure projects. There are many projects from the 9th Malaysia plan and the 5 growth corridors that Lysaght can benefit from. However, with the recent 12th general election results, we are concern about the timing of implementing the infrastructure and construction projects in those states. Notwithstanding the above, we believe this uncertainty is short term in nature and clearer direction will be make know in the later stage.

6. Balance Sheet



7. Valuation

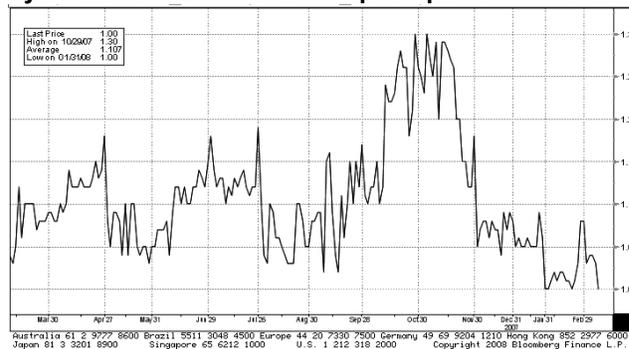
Currently trading at PER5.4x

Based on our EPS08 of 18.5 sen, Lysaght is currently trading at an undemanding PER08 of 5.4x. For peers comparison, we have chosen manufacturers with galvanizing line in Malaysia for comparison. The average PER for this peer group is 7.0x.

We decided to take a more conservative stance in valuation for now considering that at this juncture, Lysaght earnings visibility is low. The fluctuation of raw materials price and uncertainty in the timing of implementing the 9th Malaysia Plan may affect both the top line and the margin of Lysaght in FY08. Hence, we included a discount of 10% of the above PER for our valuation purpose. We will monitor the situation and

may revise the valuation at a later date when the above conditions improve.

Lysaght's last 12-month share price performance



8. Recommendation

**Initiate with
Buy call and fair value
of RM1.17**

We initiate our coverage on Lysaght with a **Buy** recommendation and a fair value of **RM1.17** based on PER of 6.3x. The fair value is well supported by its NTA per share of RM1.60 and at current price, dividend yield is about 4%.

We like Lysaght for its 1) prudent management, 2) focus on quality delivery, 3) lean balance sheet and 4) potential growth both in Malaysia and overseas. Nonetheless, moderating factors would be the investment risks mentioned earlier as well as the stock's relatively illiquid trading volume (historical 12-month average daily volume of approximately 65,000 shares).

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Appendix – Selected projects of Lysaght



Installation of stadium masts in Guam, USA



Proton City Stadium, Tg Malim



30m beacon mast, Fremantle Port, Australia



Kranji Race Course, Singapore



Guthrie Corridor Expressway 1



Kuala Lumpur International Airport



High mast lighting on Penang Bridge, Penang



45m stadium masts at Al-Ahli Football Stadium, UAE



47m stadium masts at Sharjah Cricket Stadium, UAE

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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