AB Capital Securities, Inc.

November 14, 2007

TKC Steel Corporation (T)

BUY

Strong Future Earnings

Price	9.68
Target	11.00
Market Cap (Pb)	10.398
52 week High	23.00
52 week Low	1.00

Strong Industry

The level of construction affects the demand for steel billets. With a stable level of construction in the past few years and with the 1st half of 2007 level up by 17% from 2006, there is a strong demand for steel billets. In fact, there are more steel consumers than producers in the Philippines, leading to a higher level of steel imports than local production. For the past five years, steel billet consumption in the Philippines has been around 1.5 million MT. On the other hand the total capacity of steel billet production is only 800,000 MT. TSC, a 96% owned subsidiary of TKC, accounts for 300,000 MT or 37.5%. Furthermore, steel prices have been steadily increasing since October of 2005. TKC also recently entered the welded pipes industry through ZZS Corporation, which was acquired by Billions in the first half of 2007. Billions, a wholly owned subsidiary of TKC owns 90% of ZZS. ZZS operates in China where the welded pipe consumption in 2006 was triple the consumption in 2000. ZZS in located near four provinces with strong pipe demand. TKC is the only listed steel company in the Philippine Stock Exchange. The fact that steel stocks abroad have been performing well for the past two years augurs a good future for TKC.

Expansion Plans

TKC is offering 235,000,000 new shares at the price of P9.68. The proceeds from the sale of these shares will be used primarily for Capital Expenditures. TKC has growth strategies on two fronts, namely TSC here in the Philippines and ZZS in China. Approximately 54% of the proceeds will be used for ZZS while 35% will be for TSC, the remaining portion will be used for Working Capital and the possible retirement of some debts. TKC plans to expand both TSC and ZZS in order to increase both capacity and production of steel billet and pipes.

Treasure Steel Corporation

TKC plans to install a blast furnace, the first of its kind in the Philippines, by the 4th quarter of 2008. The blast furnace will double the capacity of TSC's plant in Iligan City from 300,000 MT to 600,000 MT. There are also some plans to improve the plant's productivity as early as next year. Despite having a 300,000 MT capacity, TSC only produced 38,842 MT during 2005, this increased to 94,616 MT in 2006 and to 80,859 MT for the first half of 2007. With the improvements planned for next year, plant production will increase significantly due to a higher utilization rate.

Prince Anthony A. Yeung
Equities Analyst
898-7584

AB Capital Securities Inc.
8th Floor, Phinma Plaza
39 Plaza Drive, Rockwell Center,
Makati City, Philippines
Tel: 898-7555
Fax: 898-7595, 898-7597

email: abcsi@abcapital.com.ph
website: www.abcapitalonline.com

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This coupled with the increasing steel billet prices will fuel the strong revenue and income growth of TSC. TSC is the largest domestic steel billet producer. Their expansion plans will further emphasize this fact and will address the large gap between supply and demand of steel billets in the Philippines. TSC obtains its raw materials from scrap consolidators located in Visayas and Mindanao.

ZZ Stronghold

ZZS just recently started operations in June of 2007. It currently has a production capacity of 40,000 MT. This will increase to 80,000 MT by the end of November this year. The company also has expansion plans for 2008 and 2009. For the third quarters of 2008 and 2009, the company is expected to increase production capacity by 200,000 MT. Therefore, by the end of 2009, the production capacity of ZZS will be 440,000 MT. Since starting operations in June, ZZS has produced more than 7,000 MT. As with most start ups, this level is much lower than what ZZS is capable of especially with the numerous expansion plans. Next year, the company's first full year of operations, production can be expected to reach 100,000 MT. ZZS will make use of Korean technology and they will be the first to do so in China, giving them a distinct advantage. Furthermore, they are located in a Special Economic Zone and can source their raw materials domestically. ZZS is one of a few major steel pipe producers in Southern China. Their location also gives them easy access to ports. In terms of pipe diameter, ZZS offers the widest range, selling pipes with diameters ranging form 21 mm to 406 mm.

Risks

TKC's future growth is largely dependent on the expansion plans of TSC and ZZS. There is always the possibility that problems will arise, causing changes in the project timetables and project costs. Either a delay in the implementation of the expansion plans or an increase in costs will hurt the bottom line of TKC. Risks include changing economic conditions, unanticipated future regulatory requirements, flaws in design and construction and others. The efficient execution of the expansion plans will be the key to TKC's growth. Another risk is the strengthening Peso. With the Peso going higher, companies may find imported steel billets more preferable. This may lead to lower sales volumes or lower margins, both of which are undesirable.

Target Price

Expansion always entails risks. How a company handles these risks reflects on future performance. TKC is well equipped to handle the risks that they face in the coming future. TKC has been in the steel business for 40 years in the Philippines and Indonesia. Furthermore, TKC employs a very experienced management team. The heads of TKC, TSC, and ZZS collectively have over 40 years of experience in the steel industry. TKC is confident that their expertise and experience will allow them to handle the risks involved with expansion. Once the expansion plans are completed, TSC and ZZS will have significant competitive advantages. TSC will have the ability to produce far more steel billets than what other domestic companies are capable of producing. ZZS will be able to take advantage of its wide range of pipe offerings and its technology in order to tap its adjacent markets. Growth in the steel billet and pipe industries and TKC's expansion plans are the main reasons pointing to TKC having a breakout year in 2008. With a target price of P11.00, we believe that the shares of TKC are being offered at a discount. The offer price of P9.68 gives TKC an upside of 13.64% and is therefore a buy.