InsiderAsia
by Asia Analytica

3QFYDec2011 Results **2 December 2011**

Malaysia Steel Works (KL) Bhd

- Profits continue to improve q-q in 3Q11
- Better margins despite lower volume sales
- Domestic demand for steel remains upbeat
- Attractive FD P/E valuation of just 6.1x for 2012

BUY

Key stock statistics	2010	2011E
FD EPS (sen)	13.4	15.2
FD /E (x)	9.1	7.2
Net DPS (sen)	1.35	1.5
NTA/share (RM)	2.27	2.47
Issued capital (mil)	210.8	
52-week price range (RM)	0.92-1.60	
Major shareholders (%)		
Soon Seng Co.	38%	

Price
RM1.09

Market capitalization
RM230 million

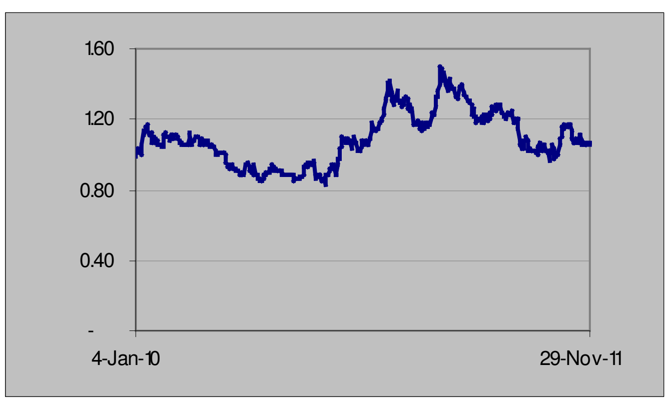
Board
Main

Sector
Industrial Products

Stock code
5098

By
The Research Team

Share Price Chart



3QFYDec2011 Results Highlights:

Year end Dec (RM mil)	3Q11	3Q10	% chg
Turnover	300.3	285.0	5.4
Operating profit	27.0	24.5	10.0
Interest income/(exp)	(4.0)	(4.9)	(18.5)
Extraordinary loss/(gain)	-	9.7	(100.0)
Pre-tax profit	17.5	5.4	221.4
Tax	1.3	0.7	89.1
Net profit	16.2	4.8	239.9
EPS (sen)	7.7	2.3	
Operating margin (%)	9.0	8.6	
Pre-tax margin (%)	5.8	1.9	
Net margin (%)	5.4	1.7	
Effective tax rate (%)	7.2	12.3	

Malaysia Steel Works (KL) (Masteel)'s earnings in 3QFYDec2011 were stronger than expected.

The company's turnover was 5.4% higher at RM300.3 million from the previous corresponding period due to higher average selling prices for steel products.

Turnover was, however, down 11.1% q-q as the result of lower volume sales. Nevertheless, earnings held up well. Masteel's operating margin improved from that registered in 3Q10 and the immediate preceding quarter. We attribute this, in part, to the company's relatively lean inventory holding policy that allows it to better match costs against selling prices.

The average selling price for steel bars increased to an estimated RM2,360 per tonne in 3Q11 from roughly RM2,240 per tonne in the immediate preceding quarter. Costs were also higher with the average scrap price estimated at over US$480 per tonne during this period.

Masteel reported net profit of RM16.2 million in 3Q11 – up slightly from RM15.5 million in 2Q11 and well above the RM4.8 million recorded in 3Q10.

Indeed, the company fared comparatively well in the latest quarter despite challenging conditions for the sector. Its larger peers such as Southern Steel, Ann Joo Resources and Kinsteel all reported weaker earnings q-q.

Gearing was fairly steady at about 49% while net assets stood at RM2.44 per share.

Outlook and Recommendation

We remain fairly upbeat on Masteel's prospects, taking into account expectations for improving steel demand from the domestic construction and infrastructure sectors over the next few years.

Rollout of projects under the various government initiatives, including the Economic Transformation Programme, is expected to gather traction going into 2012. For instance, the mega MRT project is expected to break ground by 1H12, driving up demand for steel bars. Masteel believes that it is in good position to supply this project based on the geographical advantage of its factories.

The company is in the midst of expanding capacity to cater to the forecasted volume demand growth.

The meltshop capacity will be gradually raised to 650,000 metric tonnes over the course of the next year, from the current 550,000 metric tonnes. Masteel is also planning to expand its rolling mill capacity, by about 150,000 metric tonnes. The new plant is expected to be operational sometime in 2013. Once operational, the company intends to divert part of its expanded billet capacity as feedstock to this plant – to extract better margins.

Capital expenditure is estimated to total roughly RM230 million for 2011-2013. The company's balance sheet is fairly healthy with 49% gearing at end-September 2011, which is well below the industry average.

Selling prices for steel products, on the other hand, are likely to remain within a tight range, at least for the near to medium term.

Prices for steel bars have fallen over the last two-three months and are hovering around RM2,200 per tonne at the moment. This is due, primarily, to growing uncertainties stemming from the financial turmoil in Europe and the global economic slowdown.

Even though domestic demand is expected to be relatively robust going forward, we expect competition from imports to keep prices relatively in line with that in the global market.

At the moment, outlook for the global steel market is one of caution. Demand growth is expected to slow in 2012 with sluggish economic growth in major developed countries and cooling emerging market economies.

The World Steel Association estimates global steel consumption growth at roughly 6.5% in 2011, after the strong 15.1% recovery in 2010. The pace of consumption increase is forecast to slow further to about 5.4% in 2012.

Indeed, some of the big steel millers, including those in China and Europe, have initiated production cutbacks in view of the uncertain economic conditions.

Raw material prices have also fallen well off their recent peaks. Major iron ore suppliers accepted lower selling prices for the raw material from the pre-determined 4Q11 contract prices, in recognition of weakened demand.

Prior to this, the comparative resilience in prices for iron ore and coking coal have resulted in a margin squeeze for global steel makers – even if they have kept a relative steady floor on prices for steel products. Having said that, few expect prices to go much lower for both key raw materials, taking into account the still rising demand, albeit at a slower pace of growth.

Most market observers currently believe that prices for iron ore will average around US$140-US$150 per tonne in 2012, compared with the peak of about nearly US$200 per tonne early this year. Prices for coking coal too are expected to be lower. Shipments for 1Q12 are priced around US$235 per tonne, down from about US$285 per tonne in 4Q11 and as high as US$330 per tonne in 2Q11.

Assuming steel prices will remain more or less at current levels and strengthening in volume sales, we forecast double-digit growth for Masteel for the next few years.

The earnings recovery, since hitting a trough in 2009, will continue to unfold. Net profit is estimated at RM46.1 million this year – up from RM28.2 million in 2010, conservatively assuming a weaker 4Q11. Net profit for 9M11 totaled RM37.9 million.

Earnings are forecast to expand to RM54.8 million and RM76.9 million in 2012-2013, respectively. Masteel's valuations remain attractive with P/Es of only 4.2 and 3 times for the two years – and 6.1 and 4.4 times on a fully diluted basis. As such, we maintain our **BUY** recommendation on the stock.

Profit & Loss Analysis

Year end Dec (RM mil)	2009	2010	2011E	2012E
Turnover	687.3	1,004.8	1,165.6	1,340.4
Operating profit	21.8	78.0	87.4	107.2
Depreciation	16.2	17.8	22.8	27.2
Interest inc/(exp)	(14.1)	(16.1)	(15.6)	(20.6)
EI loss/(gain)	-	14.1	-	-
Pre-tax profit	(8.4)	30.1	49.1	59.5
Tax	0.0	1.9	2.9	4.8
Minority Interests	-	-	-	-
Net profit	(8.5)	28.2	46.1	54.8
EBITDA margin (%)	3.2	7.8	7.5	8.0
Pre-tax margin (%)	(1.2)	3.0	4.2	4.4
Net margin (%)	(1.2)	2.8	4.0	4.1
Effective tax rate (%)	(0.3)	6.3	6.0	8.0

Per Share Data

Year end Dec	2009	2010	2011E	2012E
FD EPS (sen)	(4.4)	13.4	15.2	17.9
FD P/E (x)	nm	8.2	7.2	6.1
Dividend (sen)	1.0	1.4	1.5	2.0
Net yield (%)	0.9	1.2	1.4	1.8
Payout ratio (%)	(23.0)	10.1	6.9	7.7
NTA/share (RM)	2.14	2.27	2.47	2.71
Price/NTA (x)	0.5	0.5	0.4	0.4
Cashflow/share (RM)	0.02	0.39	0.33	0.39
Price/cash (x)	52.6	2.8	3.3	2.8
Net gearing (%)	53.0	43.8	48.3	58.6
ROE (%)	(2.0)	6.3	9.2	10.0

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