19 February 2009

4QFYDec2008 Results

Malaysia Steel Works (KL)

- Sharp fall in 4Q08 sales and profits no surprise
- Outlook remains challenging in near term
- Expect profits to decline further in 2009
- But shares well below NTA of RM2.21

BUY

Key stock statistics	2008	2009E
EPS (sen)	40.7	13.8
P/E (x)	1.5	4.5
Net DPS (sen)	-	0.5
NTA/share (RM)	2.21	2.34
Issued capital (mil)	194.7	
52-week price range (RM)	0.50-1.59	

Major shareholders (%)	
Soon Seng Co.	38%

Price
RM0.62

Market capitalization
RM121 million

Board
Main

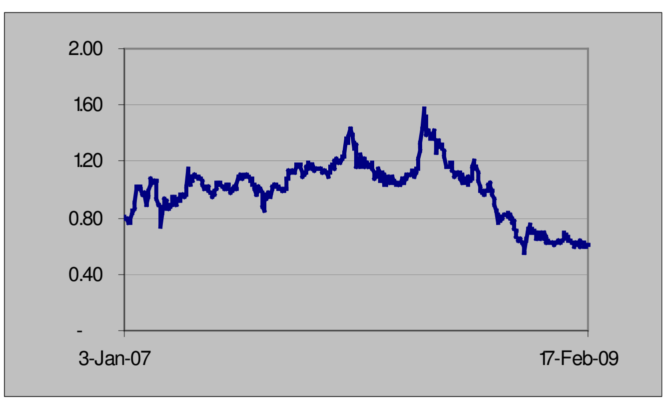
Indices
FBMS

Sector
Industrial Products

Stock code
5098

Analyst
Linda Koh

Share Price Chart



4QFYDec2008 Results Highlights:

Year end Dec (RM mil)	4Q08	4Q07	% chg
Turnover	161.7	137.4	17.6
Operating profit	13.2	20.6	(35.7)
Interest income/(exp)	(3.5)	(4.2)	nm
Extraordinary loss/(gain)	-	-	
Pre-tax profit	5.8	12.6	(53.8)
Tax	0.4	-	nm
Net profit	5.5	12.6	(56.7)
EPS (sen)	2.81	6.49	
Operating margin (%)	8.2	15.0	
Pre-tax margin (%)	3.6	9.2	
Net margin (%)	3.4	9.2	
Effective tax rate (%)	6.4	-	

Malaysia Steel Works (KL) (Masteel)'s sharply weaker results for 4QFYDec2008 came as no surprise. In fact, the company did slightly better than our expectations.

Turnover was 17.6% higher y-y but declined 38.8% q-q to RM161.7 million in 4Q08. The quarterly decline was due to slumping volume demand and selling prices.

Domestic consumption of steel bars and billets is estimated to have fallen by 30-40% during the last quarter of 2008 from peak levels in June-July 2008. Prices have also fallen precipitously since hitting record highs, declining by more than half as the global economic downturn gained traction.

Masteel's operating margin narrowed to about 8.2% in 4Q08, compared to 15% in the previous corresponding period and 9.5% in 3Q08. The company had reacted quickly by cutting back on new stock orders but its carrying cost of inventory remained high relative to rapidly falling selling prices.

Pre-tax profit fell 53.8% y-y to RM5.5 million in 4Q08. Net profit was 56.7% lower from the previous corresponding quarter and 67.3% down from 3Q08.

Year end Dec (RM mil)	2008	2007	% chg
Turnover	881.2	548.0	60.8
Operating profit	114.6	75.7	51.4
Interest income/(exp)	(13.8)	(16.7)	nm
Extraordinary loss/(gain)	-	-	
Pre-tax profit	85.7	45.7	87.6
Tax	6.4	-	nm
Net profit	79.3	45.7	73.6
EPS (sen)	40.73	23.47	
Operating margin (%)	13.0	13.8	
Pre-tax margin (%)	9.7	8.3	
Net margin (%)	9.0	8.3	
Effective tax rate (%)	0.1	-	

Despite weaker earnings in the last quarter of 2008, Masteel still managed to make record profits for the full-year, thanks to robust operating conditions in the first nine months, especially in 2Q08.

Turnover totaled RM881.2 million, up 60.8% y-y on the back of record demand and selling prices before the onset of the global financial and economic crisis.

Pre-tax profit grew 87.6% on the year to RM85.7 million while net profit was up by 73.6% to RM79.3 million. This was the best performance in Masteel's history.

Nevertheless, fortunes for the steel industry has turned sharply since September 2008. In view of the challenging operating conditions going forward, the company has not declared any dividend for the year.

Outlook and Recommendation

We are cautious on the outlook for the steel industry. Demand is likely to stay weak in the next one or two quarters, at the very least. The industry could turnaround in 2H09 but the pace of the recovery remains uncertain at this point.

On the positive note, global prices for steel products appear to be stabilising following the sharp decline in 4Q08. There are even some small price increases for select steel products in recent days.

The more upbeat sentiment is probably attributable to a combination of factors including expectations of greater demand as a result of massive stimulus packages announced by governments worldwide, production cutbacks by leading industry players and mild re-stocking activities.

For example, capacity utilisation at local steel millers has fallen to as low as 40-50% currently. The threat of cheap imports has also not materialized as most global steel makers too have stuck to sharp production cutbacks. The price over volume strategy has helped prevent a price-damaging build up in inventory.

The aggressive de-stocking activities witnessed in 4Q08, exacerbated by the global credit crunch, are likely to play out by end-1Q09. Thus, we should be some improvement in demand going forward.

Having said that, even assuming a gradual pickup in 2H09, a full recovery is more than likely a long way off.

Masteel has been running its plant at around 40% of capacity in the past few months. Exports have fallen sharply while domestic infrastructure and property projects are also drying up. Rollout of new projects under the government stimulus package has been slow. Domestic consumption of long steel products is currently estimated at half the pre-crisis levels.

Given the still weak demand outlook, prices are unlikely to revisit the highs of mid-2008 anytime soon. Steel bar prices are currently hovering around RM1,850-RM1,950 per tonne, far from last year's peak of RM3,800-RM4,000 per tonne. In fact, there could be further downside risks.

Global steel production fell 1.2% last year, the first decline since 1998 – and demand is expected to contract further in 2009. Some estimates global steel output could contract by up to 10% this year.

Any increase in demand for infrastructure projects under stimulus packages will likely be more than offset by the sharp fall in demand from other key end-user industries such as auto, consumer electronics and electrical and property.

Weak demand outlook is giving steel millers the upper hand in annual contract negotiations for iron ore and coking coal – the primarily feedstock for steel manufacturing – for the April 2009-March 2010 period.

The market currently expects benchmark prices for both iron ore and metallurgical coal to fall after rising for consecutive years. Current estimates for the reduction run from 15-20% to as much as 50% from last year's prices. Lower raw material costs would translate into lower selling prices for steel products, which are, in turn, hoped to rejuvenate demand growth.

But lower selling prices and volume demand will result in sharp declines in Masteel's revenue and earnings this year.

Sales are estimated to contract 45% to about RM485 million. Positively, margins should recover slightly from the 4Q08 lows with lower prices for new stock of raw materials such as scrap steel. The recent reduction in electricity tariff will also help lower operating costs.

Net profit is estimated at RM26.8 million or 13.8 sen share, down some 66% from last year's level before turning around in 2010.

Despite the weaker near-term outlook, we are keeping our **BUY** recommendation on the stock for its longer-term prospects and relatively modest valuations.

To be sure, investor interest may stay lackluster for some time, until there is greater clarity of a recovery. But Masteel shares are trading at modest valuations – 4.5 times forward earnings. The stock is also priced well below its net tangible assets of RM2.21 per share.

We are fairly comfortable with the company's balance sheet. It has not over-expanded in the last few years, only implementing plant upgrades and improved technology for greater efficiency processes.

Masteel's relatively small-sized operations will also allow it greater flexibility in terms of production runs and the manufacture of products for niche markets where the competition is less intense.

Gearing is manageable at about 52% with net debt of RM223 million at end-2008. Receivables are just slightly higher from end-2007 levels at RM134 million. Masteel has a fairly good track record on limiting bad debts in the past. Meanwhile, stock levels have fallen slightly from about RM176 million in 3Q08 to RM164 million at end-2008.

Profit & Loss Analysis

Year end Dec (RM mil)	2007	2008	2009E	2010E
Turnover	548.0	881.2	484.7	557.4
Operating profit	75.7	114.6	58.2	66.9
Depreciation	13.3	15.1	16.0	16.5
Interest inc/(exp)	(16.7)	(13.8)	(11.8)	(7.3)
EI loss/(gain)	-	-	-	-
Pre-tax profit	45.7	85.7	30.4	43.0
Tax	-	6.4	3.7	6.9
Minority Interests	-	-	-	-
Net profit	45.7	79.3	26.8	36.1
EBITDA margin (%)	13.8	13.0	12.0	12.0
Pre-tax margin (%)	8.3	9.7	6.3	7.7
Net margin (%)	8.3	9.0	5.5	6.5
Effective tax rate (%)	-	7.5	12.0	16.0

Per Share Data

Year end Dec	2007	2008	2009E	2010E
EPS (sen)	23.5	40.7	13.8	18.6
P/E (x)	2.6	1.5	4.5	3.3
Dividend (sen)	2.3	-	0.5	1.0
Net yield (%)	3.6	-	0.8	1.6
Payout ratio (%)	9.6	-	3.6	5.4
NTA/share (RM)	1.83	2.21	2.34	2.52
Price/NTA (x)	0.3	0.3	0.3	0.2
Cashflow/share (RM)	0.36	0.49	0.22	0.27
Price/cash (x)	1.7	1.3	2.8	2.3
Net gearing (%)	54.7	51.9	24.7	19.7
ROE (%)	13.9	20.1	6.0	7.6

Note: Figures have been adjusted for the company's one-for-three bonus issue implemented in August 2008

Comments & contact: info@insiderasia.com; Tel: 03-62015422 Fax: 03-62014906

Asia Analytica Sdn Bhd Suite 07-18, Level 7, Block E, Plaza Mont' Kiara, 2 Jln Kiara, Mont' Kiara, 50480 Kuala Lumpur, Malaysia