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3QFYDec2009 Results | **25 November 2009**

Malaysia Steel Works (KL)

- Returns to profitability on better demand and prices
- Demand expected to gradually improve in 2010
- Steel prices likely to stay relatively firm
- Shares very attractively valued for cyclical recovery

BUY

Price
RM0.98

Market capitalization
RM191 million

Board
Main

Indices
FBMS

Sector
Industrial Products

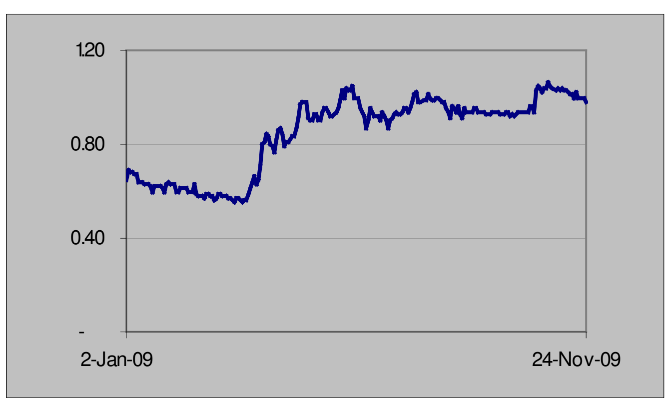
Stock code
5098

Analyst
Linda Koh

Key stock statistics	2008	2009E
EPS (sen)	40.7	(4.2)
P/E (x)	2.2	nm
Net DPS (sen)	2.5	1.0
NTA/share (RM)	2.21	2.16
Issued capital (mil)	194.7	
52-week price range (RM)	0.53-1.12	

Major shareholders (%)	
Soon Seng Co.	38%

Share Price Chart



3QFYDec2009 Results Highlights:

Year end Dec (RM mil)	3Q09	3Q08	% chg
Turnover	195.7	264.3	(25.9)
Operating profit	20.4	25.2	(19.0)
Interest income/(exp)	(3.0)	(3.3)	nm
Extraordinary loss/(gain)	-	-	
Pre-tax profit	13.4	18.2	(26.5)
Tax	-	1.4	nm
Net profit	13.4	16.7	(20.2)
EPS (sen)	6.9	8.6	
Operating margin (%)	10.4	9.5	
Pre-tax margin (%)	6.8	6.9	
Net margin (%)	6.8	6.3	
Effective tax rate (%)	-	7.9	

Malaysia Steel Works (KL) (Masteel) reported a strong turnaround in 3QFYDec2009, returning to profitability after two consecutive quarters of losses.

Turnover was still some 25.9% lower y-y at RM195.7 million, due to higher volume sales and selling prices in the previous corresponding quarter. Recall that steel prices were near record high levels early 3Q08, just before the onset of the global credit crisis.

However, turnover was 15% higher q-q as demand and prices gradually recovered from the lows in 4Q08-1Q09. This was the second straight quarter of higher turnover for Masteel.

Volume demand was boosted by inventory restocking as fears of the worst receded and user companies resumed purchases on expectations of better operating conditions ahead. Utilisation rates at its billet plant and rolling mill improved to about 65% and 75%, respectively, from as low as 40-50% in the earlier part of this year.

Steel prices also strengthened. We estimate selling prices for steel bars averaged at about RM2,000-RM2,100 per tonne in 3Q09, rebounding strongly from the low of about RM1,750 per tonne in April 2009 and average of about RM1,900 per tonne in 2Q09.

Masteel's operating margins improved on the back of both higher plant utilisation and selling prices.

Net profit stood at RM13.4 million in 3Q09, down some 20.2% y-y but sharply improved from the previous three quarters. The company's net profit slipped a high of RM37.9 million in 2Q08 to net loss of RM30.4 million and RM2 million in 1Q-2Q09, respectively. Profits in 3Q09 pared net loss for the year-to-date to about RM19.1 million.

Outlook and Recommendation

We expect operating conditions for the domestic steel sector will continue to improve going forward.

Demand for steel bars is expected to increase into 2010 with the rollout of projects under the government's pump priming activities. However, the pace of growth may be very gradual.

For starters, there is still ample surplus production capacity industry-wide following the sharp contraction over the past year. Also, whilst public construction activities are expected to pick up, the property sector will probably remain relatively lackluster. The government's latest proposal to implement a 5% real property gains tax and higher mortgage rates are expected to dampen demand.

Steel prices too have been more or less range-bound for the past few months. In the global market, prices hit the peak in August 2009 before giving back some gains with underlying real demand still relatively weak.

The short upturn in prices highlights the prevailing problem of huge excess capacity in the steel industry – rising prices had encouraged steelmakers to raise production, too much too soon.

There are concerns that underlying real demand will stay weak and the rebound seen in 2Q-3Q09 was spurred by inventory replenishing and government stimulus policy.

For instance, the US government's cash-for-clunkers rebate programme gave car sales a huge boost in 3Q09. But sales have fallen off once the programme ended. Similarly, the US property sector is being propped up by tax credit for first time homebuyers. The tax break, to a certain degree, have "borrowed" from future demand. Sales may drop again once the rebate programme expires, in April 2010.

China's massive stimulus spending has helped stave off an even bigger drop in global steel production this year. The country's steel production is forecast to grow a strong 19% in 2009, partially offsetting double-digit declines in the US and Europe. But demand may weaken in 2010 amid government plans to clamp down on industry overcapacity and waning stimulus policies.

Indeed, pressures of over-production have already seen Chinese steel prices fall by as much as 25%, on average, from the peak in early-August 2009. China accounts for just under half of the world's total steel consumption. Hence, weakness in the domestic Chinese market – and resulting rise in steel exports – will have significant impact on the global steel industry.

At this point, the outlook for steel is still somewhat hazy although prices have rebounded in recent weeks and most market observers expect prices to stay firm next year. On the other hand, few are overly bullish pending further clarity on the pace of the global economic recovery.

Recent news reports suggest miners are looking to raise iron ore prices for 2010-2011 supply contracts after the 33% cut this year. Spot iron ore prices are back above US$100 per tonne currently, up from as low as US$60 per tonne in March 2009. Still, much depends on how upcoming economic data and demand pans out in the coming months.

On balance, we expect Masteel will enjoy better volume demand in 2010 but prices could remain range bound. Liberalization of the domestic steel sector will keep prices in line with global prices. We estimate steel bar prices will hover between RM1,900 and RM2,100 per tonne.

As mentioned, domestic demand for steel will be boosted by government pump priming projects but sales growth to the private sector, including property developers, are likely to be modest. Meanwhile, export markets are expected to be very competitive, especially if the glut in China persists.

On the positive note, Masteel recently secured a steel bars off-take agreement with Australia's Stemcor Australia worth RM120 million over the next two years. The company has also started exporting to New Zealand. Its products have received Certification of Product Compliance from the Australian Certification Authority for Reinforcing Steels (ACRS), an accreditation accepted in both countries. Exports currently account for more than one-third of Masteel's sales.

We estimate the company's sales and earnings will remain fairly firm in 4Q09, although net profit could be lower due to weaker selling prices, but are likely insufficient to completely overturn losses suffered in 1H09. Net loss is estimated at RM8.2 million for 2009.

Masteel is expected to return to profitability in 2010. We forecast net profit at RM44.8 million or 23 sen per share. Thus, its shares are trading at an attractive 4.3 times 2010 earnings.

The stock is also priced well below its book value, which stood at RM2.09 per share at end-September 2009. We maintain our **BUY** recommendation.

Profit & Loss Analysis

Year end Dec (RM mil)	2007	2008	2009E	2010E
Turnover	548.0	881.2	705.0	810.7
Operating profit	75.7	114.6	21.1	85.1
Depreciation	13.3	15.1	16.2	16.9
Interest inc/(exp)	(16.7)	(13.8)	(13.1)	(12.2)
EI loss/(gain)	-	-	-	-
Pre-tax profit	45.7	85.7	(8.2)	56.0
Tax	-	6.4	-	11.2
Minority Interests	-	-	-	-
Net profit	45.7	79.3	(8.2)	44.8
EBITDA margin (%)	13.8	13.0	3.0	10.5
Pre-tax margin (%)	8.3	9.7	(1.2)	6.9
Net margin (%)	8.3	9.0	(1.2)	5.5
Effective tax rate (%)	-	7.5	-	20.0

Per Share Data

Year end Dec	2007	2008	2009E	2010E
EPS (sen)	23.5	40.7	(4.2)	23.0
P/E (x)	4.2	2.4	(23.4)	4.3
Dividend (sen)	2.3	2.5	1.0	2.0
Net yield (%)	2.3	2.6	1.0	2.0
Payout ratio (%)	9.6	6.1	(23.8)	8.7
NTA/share (RM)	1.83	2.21	2.16	2.37
Price/NTA (x)	0.5	0.4	0.5	0.4
Cashflow/share (RM)	0.36	0.49	0.04	0.32
Price/cash (x)	2.7	2.0	23.8	3.1
Net gearing (%)	54.7	51.9	46.2	39.3
ROE (%)	13.9	20.1	(1.9)	10.2

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

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Comments & contact: info@insiderasia.com *Tel: 03-6201 5422* *Fax: 03-6201 4906*

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