

**2QFYDec2009 Results**

**26 August 2009**

## Malaysia Steel Works (KL)

- Net loss narrows to just RM2 million in 2Q09
- Turnaround in 2H09 on demand and price gains
- Outlook depends on pace of global economic recovery
- Shares very attractively valued for cyclical recovery

**BUY**

Price  
**RM0.92**

Market capitalization  
**RM179 million**

Board  
**Main**

Indices  
**FBMS**

Sector  
**Industrial Products**

Stock code  
**5098**

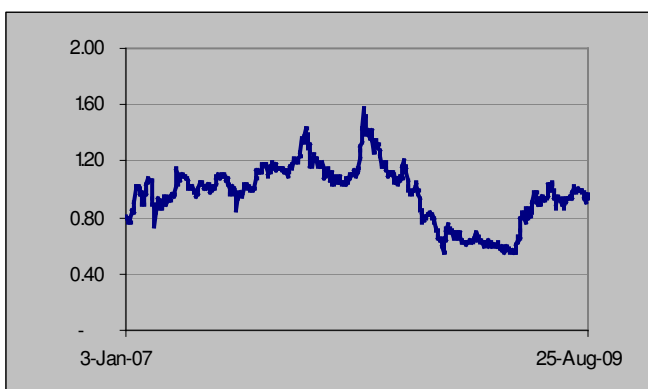
Analyst  
**Linda Koh**

Key stock statistics	2008	2009E
EPS (sen)	40.7	(8.8)
P/E (x)	2.2	nm
Net DPS (sen)	2.5	0.5
NTA/share (RM)	2.21	2.12
Issued capital (mil)	194.7	
52-week price range (RM)	0.50-1.06	

### Major shareholders (%)

Soon Seng Co. 38%

### Share Price Chart



### 2QFYDec2009 Results Highlights:

Year end Dec (RM mil)	2Q09	2Q08	% chg
Turnover	169.8	280.9	(39.6)
Operating profit	5.7	48.3	(88.1)
Interest income/(exp)	(3.7)	(3.6)	nm
Extraordinary loss/(gain)	-	-	
Pre-tax profit	(2.0)	41.0	nm
Tax	-	3.0	nm
Net profit	(2.0)	37.9	nm
EPS (sen)	(1.0)	19.5	
Operating margin (%)	3.4	17.2	
Pre-tax margin (%)	(1.2)	14.6	
Net margin (%)	(1.2)	13.5	
Effective tax rate (%)	-	7.4	

Malaysia Steel Works (KL) (Masteel)'s results for 2QFYDec2009 were better than we expected. Although the company remained in the red, losses narrowed significantly from the immediate preceding quarter.

Turnover dropped 39.6% y-y to RM169.8 million. This was due to record high steel prices and demand in the previous corresponding quarter. Selling prices hit a peak of around RM4,000 per tonne in mid-2008 before collapsing sharply in 2H08-1Q09, hitting a low of RM1,750 per tonne in April 2009, with the onset of the global credit crisis and economic downturn.

Positively, turnover was 31% higher q-q. Demand has picked up smartly after the sharp contraction in 1Q09, boosted by both inventory restocking as well as gradual recovery in underlying demand. We estimate utilisation rates at its billet plant and rolling mill improved to about 55% and 75%, respectively in June 2009 from as low as 40-50% previously.

Steel prices too have moved gradually higher on the back of stronger demand as well as rising cost of raw materials. We estimate steel bars sold for an average price of around RM1,900 per tonne in 2Q09, compared to as low as RM1,750 per tonne in early-April 2009.

Improved demand and plant utilisation as well as better selling prices helped raise operating margin for Masteel in 2Q09. The company made EBITDA (earnings before depreciation, interest and tax) of RM5.7 million in the latest quarter – a reversal from operating losses of RM22.9 million in 1Q09.

Net loss for the company narrowed to just RM2 million in 2Q09 compared to losses of RM30.4 million in 1Q09. Net loss totaled RM32.4 million in 1H09 compared to net profit of RM57.1 million in the previous corresponding period.

## Outlook and Recommendation

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Masteel's much better earnings results in 2Q09 underscored the improving outlook for the steel sector. Certainly, the worst appears to be over for the company.

Steel prices have been inching higher since hitting the lows in April 2009. The settlement of new iron ore contracts – priced 33% lower from last year but less than the discount initially demanded by steel millers – have offered support to steel prices in recent months, in addition to the gradual recovery in demand.

Steel traders, in particular, are believed to be rebuilding their inventory after allowing it to run down rapidly during the worst of the credit crisis. This effect though, would start to taper off in the coming months.

Positively, massive government stimulus packages should start to filter through in 2H09. Demand from the private sector has also shown encouraging improvement. There have been a few new property launches in recent months, even though the volume remains far below pre-crisis levels.

Looking further ahead, much depends on how quickly the rest of the world rebounds from its worst recession in decades. Also, excess global steel production capacity continues to pose a risk and would likely temper any material hike in steel prices in the near to medium term.

World crude steel output remains well below production capacity. Industry statistics indicate that global output fell 21.3% y-y in 1H09. This number would have been far worse if not for China, where output growth was marginally positive. Production in the US and Europe dropped by as much as 40-50% over the same period. Market analysts estimate world crude steel output will only return to last year's record level in 2011, at the earliest.

On the home front, industry demand have improved to an estimated 140,000 metric tonnes in June 2009 compared to 100,000-120,000 metric tonnes in the first five months of the year. Demand is, however, expected to turn down again in August-September 2009, ahead of the Hari Raya festive celebration before picking up momentum in 4Q09.

On the positive note, Masteel has been getting good orders from exports, which will offset the slowdown in domestic demand in 3Q09. Exports account for an estimated one-quarter of total sales. Its billet plant utilisation has improved to about 70% currently while production at the rolling mill is nearing 80%.

Meanwhile, steel prices have risen to about RM2,100 per tonne. There are indications that prices will gain another RM50 per tonne or so in September 2009.

Given the improved demand and selling prices, Masteel is expected to return to profitability in 3Q09, one quarter earlier than our previous forecast.

Nevertheless, we doubt the 2H09 recovery would be strong enough to offset losses in the first half of the year. We estimate Masteel will make a net loss of RM17.1 million in 2009.

The company should fare much better in 2010 as the global economic recovery gains traction.

We maintain our **BUY** recommendation on the stock. We expect Masteel's earnings to pick up sharply in 2010 with net profit estimated at RM43.9 million. This prices its shares at merely 4.1 times our estimated earnings in 2010.

Its share price should be well supported by net tangible assets of RM2.02 per share – more than twice the current share price. Masteel's balance sheet is in fairly good shape. The company has net debt of RM217.5 million at end-June 2009. Gearing, of about 55%, is below that of peers Southern Steel, Ann Joo Resources, Kinsteel and Perwaja.

Plus, we expect Masteel will continue to pay dividends this year despite its losses, albeit at a much lower level compared to the 2.5 sen in 2008. Dividends are estimated at just 0.5 sen per share in 2009 but should improve in 2010, in line with its earnings recovery.

#### Profit & Loss Analysis

Year end Dec (RM mil)	2007	2008	2009E	2010E
Turnover	548.0	881.2	678.5	780.3
Operating profit	75.7	114.6	13.6	85.8
Depreciation	13.3	15.1	16.0	16.5
Interest inc/(exp)	(16.7)	(13.8)	(14.7)	(14.5)
El loss/(gain)	-	-	-	-
Pre-tax profit	45.7	85.7	(17.1)	54.8
Tax	-	6.4	-	11.0
Minority Interests	-	-	-	-
Net profit	45.7	79.3	(17.1)	43.9
EBITDA margin (%)	13.8	13.0	2.0	11.0
Pre-tax margin (%)	8.3	9.7	(2.5)	7.0
Net margin (%)	8.3	9.0	(2.5)	5.6
Effective tax rate (%)	-	7.5	-	20.0

### Per Share Data

Year end Dec	2007	2008	2009E	2010E
EPS (sen)	23.5	40.7	(8.8)	22.5
P/E (x)	3.9	2.3	(10.5)	4.1
Dividend (sen)	2.3	2.5	0.5	2.0
Net yield (%)	2.4	2.7	0.5	2.2
Payout ratio (%)	9.6	6.1	(5.7)	8.9
NTA/share (RM)	1.83	2.21	2.12	2.32
Price/NTA (x)	0.5	0.4	0.4	0.4
Cashflow/share (RM)	0.36	0.49	(0.01)	0.31
Price/cash (x)	2.5	1.9	(157.8)	3.0
Net gearing (%)	54.7	51.9	55.6	47.7
ROE (%)	13.9	20.1	(4.1)	10.2

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



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