InsiderAsia
by Asia Analytica

1QFYDec2009 Results **29 May 2009**

Malaysia Steel Works (KL)

- Losses in 1Q09 on falling demand and prices
- Outlook remains challenging in the near term
- Expect turnaround in 4Q09 and stronger 2010
- Shares trading well below NTA of RM2.05

BUY

Price
RM0.89

Market capitalization
RM173.3 million

Board
Main

Indices
FBMS

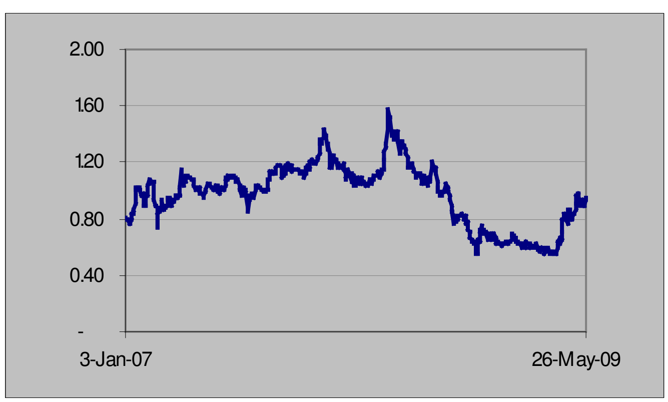
Sector
Industrial Products

Stock code
5098

Analyst
Linda Koh

Key stock statistics	2008	2009E
EPS (sen)	40.7	(22.0)
P/E (x)	2.2	nm
Net DPS (sen)	2.5	0.5
NTA/share (RM)	2.21	1.99
Issued capital (mil)	194.7	
52-week price range (RM)	0.50-1.59	
Major shareholders (%)		
Soon Seng Co.	38%	

Share Price Chart



1QFYDec2009 Results Highlights:

Year end Dec (RM mil)	1Q09	1Q08	% chg
Turnover	130.1	174.4	(25.4)
Operating profit	(22.9)	27.9	nm
Interest income/(exp)	(3.6)	(3.4)	nm
Extraordinary loss/(gain)	-	-	
Pre-tax profit	(30.4)	20.8	nm
Tax	-	1.6	nm
Net profit	(30.4)	19.1	nm
EPS (sen)	(15.6)	9.8	
Operating margin (%)	(17.6)	16.0	
Pre-tax margin (%)	(23.4)	11.9	
Net margin (%)	(23.4)	11.0	
Effective tax rate (%)	-	7.7	

Malaysia Steel Works (KL) (Masteel)'s results for 1QFYDec2009 were significantly weaker compared to the previous quarters on the back of sharp declines in both demand and selling prices for steel products.

Turnover dropped 25% y-y and 20% q-q to RM130.1 million in 1Q09. The company suffered in terms of falling volume sales as well as selling prices for its steel bars and billets.

Volume demand was severely affected by deteriorating economic conditions in 1Q09, which were compounded by a tightening credit market.

Given the sharp fall in end-user demand, most companies were saddled with high inventory levels. The uncertain outlook further deterred fresh purchases as most companies worked to keep stocks at minimal levels. Demand is estimated to have contracted by half from the average volume sales recorded in 2008.

We estimate steel bars prices fell to around RM1,800-RM1,900 per tonne during the quarter, well down from the peak of about RM3,800-RM4,000 per tonne in mid-2008.

Masteel was unable to cover its fixed overheads due to the sharply lower utilisation levels at its billet plant and rolling mill. The company recorded an operating loss before depreciation, interest and tax of RM22.9 million in 1Q09 – its first quarterly loss since listing in early-2005.

After taking into account depreciation and interest expenses, net loss widened to RM30.4 million for the first three months of the year.

Outlook and Recommendation

We remain cautious on the outlook for the steel sector in the near to medium term.

Globally, demand and prices for steel products are still weak. There was an encouraging uptick in prices for long steel products at the start of the year in anticipation of a demand recovery from the massive government stimulus packages. Some steel millers reacted by stepping up production but demand has not kept pace. And higher inventory levels sent prices drifting lower anew.

We suspect this environment will prevail for the better part of the year, with prices staying mostly range-bound. World crude steel production dropped 22.7% y-y in Jan-April 2009 and industry estimates production could fall by as much as 10-15% for the full-year.

Most of the global steel millers are currently producing at about half their capacity. This capacity overhang will keep a lid on price increases in the near to medium term. Price increases are also likely to be capped by lower raw material costs including iron ore and metallurgical coal.

Lower crude oil prices and freight costs have also lowered the barriers to trade between the different regions of the world. Steel prices in the global market are very competitive.

On the local front, demand has started to pick up slightly in April following the sharp drop in 1Q09 but will probably remain muted in the near term until the impact from the government's stimulus packages filters down in 2H09. Export demand has also fallen sharply and margins are very thin for the reasons mentioned above.

Hence, despite sharp production cutbacks, we believe inventory levels for the sector may not normalize until the later part of the year. On a positive note, there has been no further write-down on stocks in 1Q09.

Prices for steel bars have been pretty much range-bound year-to-date, trading between RM1,750 to RM2,000 per tonne. We suspect this may well remain so for at least the next one to two quarters.

Buyers are still very cautious at the moment. Most are buying just enough for their immediate consumption. This could be attributed, in part, to the still tight credit market, de-stocking as well as clouded outlook, albeit improved from 1Q09.

Masteel has reacted quickly to the downturn, slowing its raw material purchase since 4Q08 and keeping stocks at manageable levels. It avoided any major stock write down, which hurt earnings for all the other local steel millers last year.

Nevertheless, the company is not escaping unscathed, falling into the red in 1Q09 on the back of the sharp demand contraction. The outlook for the next one to two quarters is somewhat uncertain at this point.

Positively, Masteel has greater flexibility in terms of production runs given its relatively smaller size. The company completed some upgrading works at the end of last year that enabled it to manufacture smaller sized bars, which is less competitive. It also has had some success in the export markets in recent weeks.

Whilst utilisation at its billets plant remains at roughly 50%, higher exports have allowed it to step up production at the steel bars plant to about 70-75% currently. This will help bolster margins in 2Q-3Q09.

Masteel has no major expansion plans for the year with capital expenditure estimated at roughly RM10 million. The company's balance is relatively solid with gearing of 60% at end-March 2009.

Gearing is expected to fall with the gradual reversal in working capital in the next few months. Working capital dropped to about RM200 million at end-1Q09, down from RM247 million at end-2008.

The company is likely to remain in the red in 2Q09 and perhaps even in 3Q09. Some price recovery is expected in 4Q09 and into 2010 as the global economic recovery gains traction.

Masteel should return to profitability in the last quarter of the year but earnings will not be sufficient to offset earlier losses. We estimate Masteel to report a net loss of RM42.9 million in 2009. The company is, however, expected to turnaround in 2010 – net profit is estimated at RM24.2 million.

Despite the less rosy short-term outlook, we are still upbeat on the company's longer-term prospects. Masteel shares are trading well below its net tangible assets of RM2.05 per share. Hence, we do see good upside potential for the stock come the next up-cycle. We maintain our **BUY** recommendation on the stock.

The company declared a first and final dividend of 2.5 sen per share for the last financial year ended December 2008. That translates into a net yield of 2.8% at the current share price. The ex-entitlement date has yet to be decided. Despite losses forecasted in the current year, we believe the company will continue to pay dividends, albeit at much lower levels. We assume net dividend of 0.5 sen per share this year.

Profit & Loss Analysis

Year end Dec (RM mil)	2007	2008	2009E	2010E
Turnover	548.0	881.2	572.8	658.7
Operating profit	75.7	114.6	(11.5)	56.0
Depreciation	13.3	15.1	16.0	16.5
Interest inc/(exp)	(16.7)	(13.8)	(15.4)	(15.3)
EI loss/(gain)	-	-	-	-
Pre-tax profit	45.7	85.7	(42.9)	24.2
Tax	-	6.4	-	-
Minority Interests	-	-	-	-
Net profit	45.7	79.3	(42.9)	24.2
EBITDA margin (%)	13.8	13.0	(2.0)	8.5
Pre-tax margin (%)	8.3	9.7	(7.5)	3.7
Net margin (%)	8.3	9.0	(7.5)	3.7
Effective tax rate (%)	-	7.5	-	-

Per Share Data

Year end Dec	2007	2008	2009E	2010E
EPS (sen)	23.5	40.7	(22.0)	12.4
P/E (x)	3.8	2.2	(4.0)	7.2
Dividend (sen)	2.3	2.5	0.5	1.0
Net yield (%)	2.5	2.8	0.6	1.1
Payout ratio (%)	9.6	6.1	(2.3)	8.1
NTA/share (RM)	1.83	2.21	1.99	2.10
Price/NTA (x)	0.5	0.4	0.4	0.4
Cashflow/share (RM)	0.36	0.49	(0.14)	0.21
Price/cash (x)	2.5	1.8	(6.4)	4.3
Net gearing (%)	54.7	51.9	56.4	53.4
ROE (%)	13.9	20.1	(10.5)	6.1

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

.

Comments & contact: info@insiderasia.com   Tel: 03-6201 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.