

Malaysia Steel Works (KL)

Recommendation: **STRONG BUY**

Stock Code: **5098**

Bloomberg: **MSW MK**

Price: **MYR1.02**

12-Month Target Price: **MYR1.40**

Date: **September 2, 2008**

Board: Main

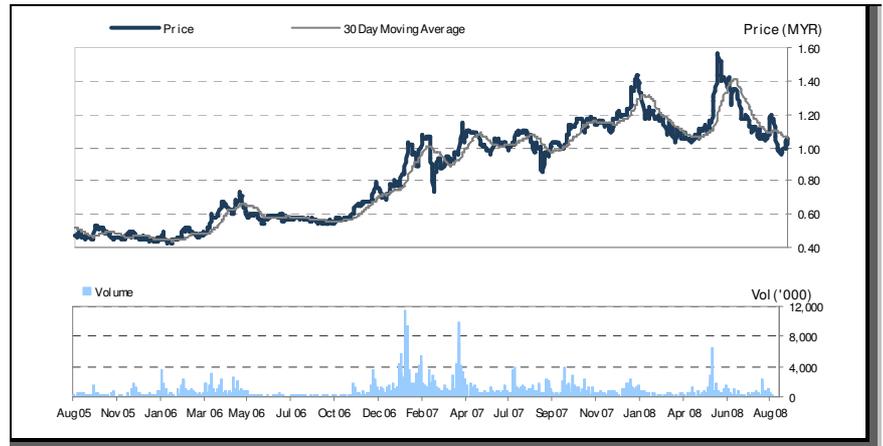
Sector: Industrial Products

GICS: Materials/Steel

Market Value - Total: MYR203.5 mln

Summary: Malaysia Steel Works (KL) (Masteel) is a steel producer with a capacity of 650,000 tonnes per annum (tpa). It produces steel billets and bars that are sold to downstream steel companies for the manufacturing of bars and other long products for the construction sector.

Analyst: Su Peng Ng



Results Review & Earnings Outlook

- Unsurprisingly, Masteel posted strong 1H08 net profit of MYR37.9 mln accounting for 70% of our previous full-year forecast, as the group's operating profit margin came in higher than we had earlier anticipated.
- 2Q08 revenue growth rose 61% QoQ on the back of higher volume sales and average selling price (ASP). The domestic steel industry was liberalized in May 2008, allowing the price gap to close between the domestic and international steel prices. Masteel was able to capitalize on the rise of local steel ASP during this period resulting in the expansion of its operating margin to 15.9% from 13.9% in 1Q08.
- Steel billet and bar ASP was raised three times in 2007 (April, June and December) before being liberalized in May 2008. These moves were the main drivers that helped pushed Masteel's 1H08 revenue growth by 77% YoY. The higher ASP filtered through to the group's profits with 1H08 operating profit rising by 132% YoY.
- Given the stronger-than-expected 1H08 results, we increase our 2008 net profit estimate to MYR98.8 mln (from MYR81.8 mln) by reducing our cost assumption. We leave our 2009 net profit estimate unchanged at MYR101.1 mln.

Recommendation & Investment Risks

- We maintain our Strong Buy recommendation on Masteel with a lower 12-month target price of MYR1.40 (from MYR1.95 ex-1-for-3 bonus issue completed on Aug. 14, 2008). The lower target price is a result of the lower target multiple.
- We have utilized a PER of 3x (from 6x) against our forecast 2009 (rolled over from 2008) EPS and added our estimated 12-month net DPS of 2.3 sen to derive our target price. The lower target multiple reflects lower peer average of 5x and discounted by 40% (unchanged) to reflect the group's smaller size, limited listing track record and higher risk profile following its proposed radiopharmaceutical venture.
- We remain positive on the local steel players, including Masteel, which have been enjoying strong ASP and margins in recent times. We think the recent softening of ASP and demand is due to seasonal factors - such as the severe summer heat in the Middle East, which reduces the pace of construction work - and the Beijing Olympics, which has required factories to shut down or reduce operating hours, thus reducing demand for steel. We expect prices and demand to increase toward the later part of the year but this could be mitigated by higher raw material costs. Share price catalysts may come from improving domestic steel consumption and potential M&A ventures for the group.
- Risks to our recommendation and target price include volatile steel and raw material prices, higher-than-expected costs at its radiopharmaceutical venture and the potential litigation charges of over MYR11 mln, the bulk of it for goods sold and delivered by a supplier.

Key Stock Statistics

FY Dec.	2007	2008E
Reported EPS (sen)	22.8	49.5
PER (x)	4.5	2.1
Dividend/Share (sen)	2.3	2.3
NTA/Share (MYR)	1.83	2.25
Book Value/Share (MYR)	1.83	2.25
No. of Outstanding Shares (mln)	199.5	
52-week Share Price Range (MYR)	0.96 - 1.57	
Major Shareholders:	%	
Soon Seng Company	21.2	
Lembaga Tabung Haji	5.8	
Ikhwan Salim bin Sujak	5.2	

* Stock deemed Shariah compliant by the Securities Commission

Per Share Data

FY Dec.	2005	2006	2007	2008E
Book Value (MYR)	1.54	1.70	1.83	2.25
Cash Flow (sen)	19.5	23.8	29.6	56.9
Reported Earnings (sen)	13.1	16.9	22.8	49.5
Dividend (sen)	0.0	1.6	2.3	2.3
Payout Ratio (%)	0.0	9.3	9.9	4.5
PER (x)	7.8	6.0	4.5	2.1
P/Cash Flow (x)	5.2	4.3	3.4	1.8
P/Book Value (x)	0.7	0.6	0.6	0.5
Dividend Yield (%)	0.0	1.5	2.2	2.2
ROE (%)	10.1	10.5	13.5	24.5
Net Gearing (%)	45.7	60.9	54.8	44.9

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FY Dec. / MYR mln	2Q08	2Q07	% Change
Reported Revenue	280.9	148.4	89.3
Reported Operating Profit	44.6	18.7	>100
Depreciation & Amortization	NA	NA	NA
Net Interest Income / (Expense)	-3.6	-3.8	-3.8
Reported Pre-tax Profit	41.0	14.9	>100
Reported Net Profit	37.9	14.9	>100
Reported Operating Margin (%)	15.9	12.6	-
Reported Pre-tax Margin (%)	14.6	10.1	-
Reported Net Margin (%)	13.5	10.1	-

Source: Company data

Profit & Loss

FY Dec. / MYR mln	2006	2007	2008E	2009E
Reported Revenue	362.2	548.0	864.8	989.7
Reported Operating Profit	44.4	61.9	125.8	128.3
Depreciation & Amortization	-8.3	-8.3	-8.7	-11.0
Net Interest Income / (Expense)	-14.4	-15.7	-16.0	-16.0
Reported Pre-tax Profit	30.0	46.2	109.8	112.3
Effective Tax Rate (%)	0.0	4.0	10.0	10.0
Reported Net Profit	30.0	44.3	98.8	101.1
Reported Operating Margin (%)	12.3	11.3	14.6	13.0
Reported Pre-tax Margin (%)	8.3	8.4	12.7	11.3
Reported Net Margin (%)	8.3	8.1	11.4	10.2

Source: Company data, S&P Equity Research

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Glossary

Strong Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.

Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months, with shares rising in price on an absolute basis.

Hold: Total return is expected to closely approximate the total return of the KLCI or KL Emas Index respectively, over the coming 12 months with shares generally rising in price on an absolute basis.

Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months and share price is not anticipated to show a gain.

Strong Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months by a wide margin, with shares falling in price on an absolute basis.

S&P 12 Month Target Price – The S&P equity analyst's projection of the market price a given security will command 12 months hence, based on a combination of intrinsic, relative, and private market valuation metrics.

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For residents of Malaysia. All queries in relation to this report should be referred to Alexander Chia, Desmond Ch'ng or Ching Wah Tam.

Recommendation and Target Price History

Date	Recommendation	Target Price
New	Strong Buy	1.40
6-Jun-08	Strong Buy	1.95
2-Jun-08	Strong Buy	1.88
3-Mar-08	Strong Buy	1.76
23-Nov-07	Strong Buy	1.50
5-Nov-07	Strong Buy	1.46
30-Aug-07	Strong Buy	1.61
23-Apr-07	Strong Buy	1.58
2-Mar-07	Strong Buy	1.13
18-Dec-06	Strong Buy	0.87
1-Dec-06	Strong Buy	0.89
13-Oct-06	Buy	0.65
31-Aug-06	Hold	0.62
5-Jun-06	Sell	0.53
8-Mar-06	Hold	0.50
27-Dec-05	Hold	0.47

