

Malaysia Steel Works (KL)

Recommendation: **STRONG BUY**Stock Code: **5098**Bloomberg: **MSW MK**Price: **MYR0.93**12-Month Target Price: **MYR1.15**Date: **August 27, 2009****Board:** Main**Sector:** Industrial Products**GICS:** Materials/Steel**Market Value - Total:** MYR181.0 mln

Summary: Malaysia Steel Works (KL) (Masteel) is a steel producer with a capacity of 650,000 tons 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. The stock is a component of FBMEMAS.

Analyst: Su Peng Ng**Results Review & Earnings Outlook**

- Masteel reported a net loss of MYR32.4 mln for 1H09. We consider the results to be in line with our forecast as we expect an improved 2H09 performance.
- As expected, 1H09 revenue fell 34% YoY, pulled down by poor 1Q09 results when sales volume and average selling price (ASP) collapsed. The decline in revenues resulted in the company incurring an operating loss of 1H09 of MYR25.1 mln, down from an operating profit of MYR68.7 mln in 1H08.
- Judging by 2Q09 results, we note the industry is on the recovery compared to 1Q09. 2Q09 revenue jumped 31% QoQ, mainly on the back of rising sales volume. The improved revenue, together with a lower cost structure, resulted in a 2Q09 operating profit of MYR1.7 mln compared to a loss of MYR26.8 mln in 1Q09.
- The operating environment for the steel industry has improved, with demand picking up while ASP has stabilized. While we may experience some dip in demand and ASP in 3Q09 due to the Ramadan and summer season, we believe 2H09 will be profitable compared to 1H09. We look for a much better 4Q09 when we anticipate projects from both stimulus plans to kick-start in a meaningful way. We maintain our 2009-2010 earnings forecasts.

Recommendation & Investment Risks

- We upgrade Masteel to a Strong Buy (from Buy) with a higher 12-month target price of MYR1.15 (from MYR1.05).
- Our target price remains derived using a blend of PER and P/B methodology. We utilize a PER of 6.5x (from 5.5x) and P/B of 0.5x (unchanged) against our forecast 2010 EPS and BVPS respectively. The target PER is benchmarked to the peer average while target P/B is derived from the group's historical average. The higher target PER is due to higher peer average.
- Expectations for project rollouts to intensify from end-2009 onwards should continue to fuel investor interest in building material companies. As such, we believe Masteel is well positioned to out-perform, supported by strong 2010 earnings growth, a healthy balance sheet and attractive valuation multiples (2010 PER of 5x).
- Risks to our recommendation and target price include lower steel prices, higher-than-expected raw material prices and lower-than-expected demand.

Key Stock Statistics

FY Dec.	2008	2009E
Reported EPS (sen)	48.2	3.5
PER (x)	1.9	26.2
Dividend/Share (sen)	2.3	2.3
NTA/Share (MYR)	2.21	2.02
Book Value/Share (MYR)	2.21	2.02
No. of Outstanding Shares (mln)	194.7	
52-week Share Price Range (MYR)	0.55 - 1.05	
Major Shareholders:	%	
Soon Seng Company	21.7	
Lembaga Tabung Haji	5.8	
Ikhwan Salim bin Sujak	5.2	

Per Share Data

FY Dec.	2006	2007	2008	2009E
Book Value (MYR)	1.70	1.83	2.21	2.02
Cash Flow (sen)	23.8	29.6	48.5	12.0
Reported Earnings (sen)	16.9	22.8	48.2	3.5
Dividend (sen)	1.6	2.3	2.3	2.3
Payout Ratio (%)	9.3	9.9	5.5	0.0
PER (x)	5.5	4.1	1.9	26.2
P/Cash Flow (x)	3.9	3.1	1.9	7.8
P/Book Value (x)	0.5	0.5	0.4	0.5
Dividend Yield (%)	1.7	2.4	2.4	2.4
ROE (%)	10.5	13.5	20.2	1.6
Net Gearing (%)	60.9	54.8	51.9	47.3

* Stock deemed Shariah compliant by the Securities Commission

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FY Dec. / MYR mln	2Q09	2Q08	% Change
Reported Revenue	169.8	280.9	-39.6
Reported Operating Profit	1.7	44.6	-96.2
Depreciation & Amortization	NA	NA	NA
Net Interest Income / (Expense)	-3.7	-3.6	0.3
Reported Pre-tax Profit	-2.0	41.0	NM
Reported Net Profit	-2.0	37.9	NM
Reported Operating Margin (%)	1.0	15.9	-
Reported Pre-tax Margin (%)	-1.2	14.6	-
Reported Net Margin (%)	-1.2	13.5	-

Source: Company data

Profit & Loss

FY Dec. / MYR mln	2007	2008	2009E	2010E
Reported Revenue	548.0	881.2	560.8	669.7
Reported Operating Profit	61.9	99.7	21.3	58.3
Depreciation & Amortization	-8.3	-9.1	-9.4	-9.8
Net Interest Income / (Expense)	-15.7	-13.8	-13.8	-13.8
Reported Pre-tax Profit	46.2	85.7	7.5	44.5
Effective Tax Rate (%)	4.0	7.5	7.5	10.0
Reported Net Profit	44.3	79.3	6.9	40.0
Reported Operating Margin (%)	11.3	11.3	3.8	8.7
Reported Pre-tax Margin (%)	8.4	9.7	1.3	6.6
Reported Net Margin (%)	8.1	9.0	1.2	6.0

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.

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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	1.15
29-May-09	Buy	1.05
6-May-09	Buy	0.95
19-Feb-09	Buy	0.75
27-Nov-08	Hold	0.75
2-Sep-08	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

