

Malaysia Steel Works (KL)

Recommendation: **HOLD**

Stock Code: 5098 Bloomberg: MSW MK Price: MYR0.66 12-Month Target Price: MYR0.75 Date: November 27, 2008

Board: Main

Sector: Industrial Products

GICS: Materials/Steel

Market Value - Total: MYR131.7 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

- Masteel's 9M08 results were within our expectations. After incorporating a small inventory writedown totaling MYR0.2 mln for 3Q08, 9M08 net profit of MYR74.0 mln accounted for 75% of our previous full-year estimate.
- 9M08 revenue was driven by higher average selling prices and sales volume. Operating margins expanded to 12.5% from 11.1% as production cost increases lagged ASP increases.
- Mirroring the trend shown by other steel manufacturers, Masteel's 3Q08 revenue fell 6% QoQ mainly as a result of lower sales volume. Demand for steel products started declining in 3Q08 firstly from seasonal factors (slower construction activities during the summer period) but later due to the widening global economic slowdown. Higher production costs (raw material and electricity) continued to burden Masteel, causing operating profit to decline 52% QoQ.
- 4Q08 will likely be more challenging for steel manufacturers. Global construction activities have dwindled while selling prices have plunged from 2008 highs (by -50% to -70%). Further inventory provisioning is unlikely in 4Q08. We have revised our 2008 and 2009 net profit estimates to reflect current prices and demand and our revised net profit estimates are MYR80.2 mln (from MYR98.8 mln) and MYR44.8 mln (from MYR101.1 mln), respectively.

Recommendation & Investment Risks

- We lower our recommendation on Masteel to Hold (from Strong Buy) with a lower 12-month target price of MYR0.75 (from MYR1.40). The lower target price is a result of the lower earnings estimate.
- We have switched our valuation method to a blend of PER and P/BV instead of just PER. This move would provide a fairer valuation of the company in an earnings down cycle, in our view. We utilize a PER of 2x (from 3x) and P/B of 0.5x against our forecast 2009 EPS and BVPS and added our estimated 12-month net DPS of 2.3 sen to derive our target price. The lower target PER reflects lower peer average while target P/B is derived from the group's historical average.
- While the substantial decline in Masteel's share price has likely discounted much of the potential near-term negative news, Masteel's earnings visibility remains cloudy. As such, we believe upside to its share price may be capped especially when investor sentiment towards cyclical stocks will likely be muted.
- Risks to our recommendation and target price include volatile steel prices, higher-than-expected raw material prices and lower-than-expected demand.

Key Stock Statistics

FY Dec.	2007	2008E
Reported EPS (sen)	22.8	40.2
PER (x)	2.9	1.6
Dividend/Share (sen)	2.3	2.3
NTA/Share (MYR)	1.83	2.16
Book Value/Share (MYR)	1.83	2.16
No. of Outstanding Shares (mln)	199.5	
52-week Share Price Range (MYR)	0.56 - 1.57	
Major Shareholders:	%	
Soon Seng Company	21.2	
Lembaga Tabung Haji	5.8	
Ikhwan Salim bin Sujak	5.2	

Per Share Data

FY Dec.	2005	2006	2007	2008E
Book Value (MYR)	1.54	1.70	1.83	2.16
Cash Flow (sen)	19.5	23.8	29.6	47.6
Reported Earnings (sen)	13.1	16.9	22.8	40.2
Dividend (sen)	0.0	1.6	2.3	2.3
Payout Ratio (%)	0.0	9.3	9.9	5.6
PER (x)	5.0	3.9	2.9	1.6
P/Cash Flow (x)	3.4	2.8	2.2	1.4
P/Book Value (x)	0.4	0.4	0.4	0.3
Dividend Yield (%)	0.0	2.4	3.4	3.4
ROE (%)	10.1	10.5	13.5	20.4
Net Gearing (%)	45.7	60.9	54.8	46.3

* Stock deemed Shariah compliant by the Securities Commission

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Quarterly Performance

FY Dec. / MYR mln	3Q08	3Q07	% Change
Reported Revenue	264.3	154.1	71.5
Reported Operating Profit	21.6	15.9	36.1
Depreciation & Amortization	NA	NA	NA
Net Interest Income / (Expense)	-3.3	-4.5	-26.9
Reported Pre-tax Profit	18.2	11.4	59.5
Reported Net Profit	16.7	11.4	46.9
Reported Operating Margin (%)	8.2	10.3	-
Reported Pre-tax Margin (%)	6.9	7.4	-
Reported Net Margin (%)	6.3	7.4	-

Source: Company data

Profit & Loss

FY Dec. / MYR mln	2006	2007	2008E	2009E
Reported Revenue	362.2	548.0	792.4	663.3
Reported Operating Profit	44.4	61.9	105.3	65.8
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	89.1	49.7
Effective Tax Rate (%)	0.0	4.0	10.0	10.0
Reported Net Profit	30.0	44.3	80.2	44.8
Reported Operating Margin (%)	12.3	11.3	13.3	9.9
Reported Pre-tax Margin (%)	8.3	8.4	11.2	7.5
Reported Net Margin (%)	8.3	8.1	10.1	6.7

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.

Shariah-compliant stock - As defined by the Shariah Advisory Council of Malaysia's Securities Commission

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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	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
31-Aug-06	Hold	0.62
5-Jun-06	Sell	0.53
8-Mar-06	Hold	0.50
27-Dec-05	Hold	0.47

