

## Malaysia Steel Works (KL)

Recommendation: **STRONG BUY**

Stock Code: 5098

Bloomberg: MSW MK

Price: MYR1.54

12-Month Target Price: MYR2.35

Date: March 3, 2008

Board: Main

Sector: Industrial Products

GICS: Materials/Steel

Market Value - Total: MYR224.8 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 &amp; Earnings Outlook

- Masteel delivered 2007 results that were better than our expectations. The group's 2007 net profit of MYR45.7 mln reached 110% of our forecast. The deviation came from our under-estimation of revenue and over-estimation of finance costs.
- Revenue was 41% higher YoY due to higher sales volume and selling prices. However, raw material prices rose at a faster pace, thereby squeezing 2007 operating margins down to 12.3% from 14.3% a year ago and resulting in a slower 21% YoY growth in operating profit.
- As expected, 4Q07's revenue declined by 11% QoQ as seasonal holiday and weather patterns led to lower sales volume. However, lower operating expenses helped expand operating margins to 12.3% from 10.3% in 3Q07 and EBIT to increase by 6.2% QoQ.
- We have adjusted our 2008 selling price assumptions to better reflect market prices for steel billets and bars. However, we have also increased our raw material cost assumption after an agreement reached between global steel millers and iron ore producers for a 65% YoY increase in iron ore prices. This would have a spill over effect on steel scrap prices which is the main raw material used by Masteel. As such, we look for a margin contraction in 2008 to 11% from 11.4% registered in 2007. Our 2008 net profit estimate is raised to MYR56.8 mln (from MYR48.2 mln). We also introduce our 2009 net profit estimate of MYR62.8 mln (+10.6% YoY).

## Recommendation &amp; Investment Risks

- We maintain our Strong Buy recommendation on Masteel with a higher 12-month target price of MYR2.35 (from MYR2.00) as a result of our higher 2008 net profit estimate.
- We have utilized a PER of 6x (unchanged) against our estimated 2008 EPS and added our estimated 2008 net DPS of 2.1 sen to derive our target price. Our revised target price remains at a discount to Masteel's BVPS of MYR2.44 as at Dec. 31, 2007.
- Masteel has proposed a private placement of up to 10% of its paid-up capital (or 14.6 mln new Masteel shares). The price has yet to be determined as the company will first need to obtain approvals from Securities Commission, shareholders and other relevant authorities. We understand the cash will be utilized to fund Masteel's expansion of its range of steel bar products which would require about MYR20 mln.
- Risks to our recommendation and target price include volatile steel and raw material prices arising from uncertainties in the global environment, slower rollout of the Ninth Malaysia Plan (9MP) projects, 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)	31.3	38.9
PER (x)	4.9	4.0
Dividend/Share (sen)	2.1	2.1
NTA/Share (MYR)	2.44	2.81
Book Value/Share (MYR)	2.44	2.81
No. of Outstanding Shares (mln)	146.0	
52-week Share Price Range (MYR)	0.98 - 1.91	
Major Shareholders:	%	
Soon Seng Company	28.9	
Lembaga Tabung Haji	5.8	
Ikhwan Salim bin Sujak	5.2	

## Per Share Data

FY Dec.	2005	2006	2007	2008E
Book Value (MYR)	2.05	2.27	2.44	2.81
Cash Flow (sen)	26.0	31.8	40.4	50.1
Reported Earnings (sen)	17.5	22.6	31.3	38.9
Dividend (sen)	0.0	2.1	2.1	2.1
Payout Ratio (%)	0.0	9.3	6.7	5.4
PER (x)	8.8	6.8	4.9	4.0
P/Cash Flow (x)	5.9	4.8	3.8	3.1
P/Book Value (x)	0.8	0.7	0.6	0.5
Dividend Yield (%)	0.0	1.4	1.4	1.4
ROE (%)	10.1	10.5	13.9	14.8
Net Gearing (%)	45.7	60.9	54.7	52.0

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**Quarterly Performance**

FY Dec. / MYR mln	4Q07	4Q06	% Change
Reported Revenue	137.4	97.3	41.2
Reported Operating Profit	16.9	13.9	21.1
Depreciation & Amortization	NA	NA	NA
Net Interest Income / (Expense)	-4.2	-5.4	-20.9
Reported Pre-tax Profit	12.6	8.6	47.3
Reported Net Profit	12.6	8.6	47.3
Reported Operating Margin (%)	12.3	14.3	-
Reported Pre-tax Margin (%)	9.2	8.8	-
Reported Net Margin (%)	9.2	8.8	-

Source: Company data

**Profit & Loss**

FY Dec. / MYR mln	2006	2007	2008E	2009E
Reported Revenue	362.2	548.0	672.8	723.2
Reported Operating Profit	44.5	62.4	74.0	79.5
Depreciation & Amortization	-8.3	-8.3	-10.3	-10.6
Net Interest Income / (Expense)	-14.5	-16.7	-17.2	-16.7
Reported Pre-tax Profit	30.0	45.7	56.8	62.8
Effective Tax Rate (%)	0.0	0.0	0.0	0.0
Reported Net Profit	30.0	45.7	56.8	62.8
Reported Operating Margin (%)	12.3	11.4	11.0	11.0
Reported Pre-tax Margin (%)	8.3	8.3	8.4	8.7
Reported Net Margin (%)	8.3	8.3	8.4	8.7

Source: Company data, S&amp;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	2.35
23-Nov-07	Strong Buy	2.00
5-Nov-07	Strong Buy	1.95
30-Aug-07	Strong Buy	2.15
23-Apr-07	Strong Buy	2.10
2-Mar-07	Strong Buy	1.50
18-Dec-06	Strong Buy	1.16
1-Dec-06	Strong Buy	1.19
13-Oct-06	Buy	0.86
31-Aug-06	Hold	0.83
5-Jun-06	Sell	0.71
8-Mar-06	Hold	0.66
27-Dec-05	Hold	0.62

