

Malaysia Steel Works (KL)

Recommendation: **BUY**

Stock Code: **5098**

Bloomberg: **MSW MK**

Price: **MYR0.83**

12-Month Target Price: **MYR0.95**

Date: **May 6, 2009**

Board: Main

Sector: Industrial Products

GICS: Materials/Steel

Market Value - Total: MYR162.5 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 FBEMAS.

Analyst: Su Peng Ng



Recent Developments

- Despite an improvement from trough levels in 4Q08, Masteel warns of continuing price volatility and tepid demand in the steel market that will likely be a drag on 2009 earnings. Near-term uncertainties aside, we can extract some current positives - such as firmer pricing and increasing orders by end-users (and not traders or stockers), which indicate a firmer underlying demand for steel products - for a more optimistic medium-term outlook.
- Domestic demand for steel products is down 50% YoY on average but has picked up 15% MoM recently. Average selling prices (ASPs), meanwhile, have also fallen 50% YoY but have stabilized lately. Given the collapse in demand and ASP, we expect Masteel to report a net loss in 1Q09 and possibly in 2Q09 as well.
- Masteel also confirmed that its bio-tech venture is on the back burner for now, given the uncertain economic situation. The plant is ready but Masteel is not in a hurry to commence operations. We remove this project from our forecast but the impact to Masteel's bottomline is not material.
- 1H09 is unlikely to be a profitable one for Masteel and we look ahead to 4Q09 and onwards for a recovery in steel demand and improving ASPs. With a new political administration in place, we believe domestic infrastructure projects would be farmed out quickly and we should see positive impact of these project rollouts by 4Q09.

Recommendation & Investment Risks

- We maintain our Buy recommendation on Masteel with a higher 12-month target price of MYR0.95 (from MYR0.75). The higher target price is a result of a higher target PER. We maintain our valuation method of a blend of PER and P/BV methodology. We utilize a PER of 4x (from 2x) and P/B of 0.5x (unchanged) against our forecast 2010 (rolled over from 2009) EPS and BVPS to derive our target price. The target PER is derived from peer average while the target P/B is derived from the group's historical average.
- We think investors are currently focusing on steel companies' 2010 earnings potential in anticipation of improving demand and ASPs stemming from increased global pump-priming. In Masteel's case, share price catalysts could come from improving margins from 4Q09 onwards.
- Risks to our recommendation and target price include lower steel prices, higher-than-expected raw material prices and lower-than-expected demand.

Earnings Outlook

- We remove Masteel's biotech venture from our assumptions and reduce our steel sales volume projection to reflect slow demand pick-up for much of 2009. These factors reduce our Masteel 2009 and 2010 net profit estimates down to MYR10.3 mln (from MYR45.4 mln) and MYR39.9 mln (from MYR49.9 mln) respectively.

Key Stock Statistics

FY Dec.	2008	2009E
Reported EPS (sen)	48.2	5.3
PER (x)	1.7	15.8
Dividend/Share (sen)	2.3	2.3
NTA/Share (MYR)	2.21	2.04
Book Value/Share (MYR)	2.21	2.04
No. of Outstanding Shares (mln)	194.7	
52-week Share Price Range (MYR)	0.55 - 1.57	
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	2.04
Cash Flow (sen)	23.8	29.6	48.5	13.7
Reported Earnings (sen)	16.9	22.8	48.2	5.3
Dividend (sen)	1.6	2.3	2.3	2.3
Payout Ratio (%)	9.3	9.9	5.5	0.0
PER (x)	4.9	3.7	1.7	15.8
P/Cash Flow (x)	3.5	2.8	1.7	6.1
P/Book Value (x)	0.5	0.5	0.4	0.4
Dividend Yield (%)	1.9	2.7	2.7	2.7
ROE (%)	10.5	13.5	20.2	2.4
Net Gearing (%)	60.9	54.8	51.9	42.7

* Stock deemed Shariah compliant by the Securities Commission

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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	24.9	58.2
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	11.1	44.3
Effective Tax Rate (%)	4.0	7.5	7.5	10.0
Reported Net Profit	44.3	79.3	10.3	39.9
Reported Operating Margin (%)	11.3	11.3	4.4	8.7
Reported Pre-tax Margin (%)	8.4	9.7	2.0	6.6
Reported Net Margin (%)	8.1	9.0	1.8	6.0

Source: Company data, S&P Equity Research

Required Disclosures

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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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Recommendation and Target Price History

Date	Recommendation	Target Price
New	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
31-Aug-06	Hold	0.62
5-Jun-06	Sell	0.53

