

Malaysia Steel Works (KL)

Recommendation: **STRONG BUY**

Stock Code: 5098

Bloomberg: MSW MK

Price: MYR1.69

12-Month Target Price: MYR2.60

Date: June 6, 2008

Board: Main

Sector: Industrial Products

GICS: Materials/Steel

Market Value - Total: MYR246.7 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



Recent Developments

- Masteel is poised to post significantly better results due to a surge in average selling prices of steel billets and bars after the liberalization of the domestic long steel sector on May 12, 2008.
- Prior to the liberalization, we understand that steel bars were already trading at significant premiums to the ceiling price of MYR2,278/ton. After the government lifted price controls over the long steel industry, steel billet and bar prices have risen higher and presently trade around MYR3,300/ton and MYR3,500/ton, respectively. At these levels, it is about 12% higher than ASP prior to the liberalization.
- To take advantage of the higher steel prices and continued strong demand within the ASEAN region, the group is embarking on further improvements in its steel production processes and human capital training in order to increase average production capacity by 12% to 500,000 tpa for billets and 400,000 tpa for bars in 2009.
- Its bio-tech venture (production of radiopharmaceuticals for the treatment of cancer) is progressing well. It expects to begin production by 1Q09 but net earnings contribution will be dwarfed by earnings from its steel manufacturing arm.
- Masteel is exploring the possibility of diversifying into other steel related ventures, which could materialize within the next six months.

Key Stock Statistics

FY Dec.	2007	2008E
Reported EPS (sen)	30.4	50.9
PER (x)	5.6	3.3
Dividend/Share (sen)	3.0	3.0
NTA/Share (MYR)	2.43	2.74
Book Value/Share (MYR)	2.43	2.74
No. of Outstanding Shares (mln)	146.0	
52-week Share Price Range (MYR)	1.14 - 2.09	
Major Shareholders:	%	
Soon Seng Company	28.9	
Lembaga Tabung Haji	5.8	
Ikhwan Salim bin Sujak	5.2	

* Stock deemed Shariah compliant by the Securities Commission

Recommendation & Investment Risks

- We maintain our Strong Buy recommendation on Masteel with a higher 12-month target price of MYR2.60 (MYR2.50). The higher target price is a result of the increase in our 2008 net profit forecast.
- We have utilized a PER of 5x (from 6x) against our forecast 2008 EPS and added our estimated 12-month net DPS of 3 sen to derive our target price. The lower target multiple reflects lower peer average. We see potential share price catalyst coming from continued uptrend in steel prices and announcements by the group on potential steel-related ventures.
- 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 and higher-than-expected costs at its radiopharmaceutical venture.

Earnings Outlook

- We have adjusted our model to reflect the significantly higher ASP and higher capacity. Our ASP assumptions are still at large discounts to current trading prices, signaling that there could be upgrades to our net profit forecasts later in the year. Our revised net profit estimate is MYR81.8 mln (from MYR66.7 mln) in 2008 and MYR101.2 mln (from MYR67 mln) in 2009.

Per Share Data

FY Dec.	2005	2006	2007	2008E
Book Value (MYR)	2.05	2.27	2.43	2.74
Cash Flow (sen)	26.0	31.8	39.5	60.0
Reported Earnings (sen)	17.5	22.6	30.4	50.9
Dividend (sen)	0.0	2.1	3.0	3.0
Payout Ratio (%)	0.0	9.3	9.9	5.9
PER (x)	9.6	7.5	5.6	3.3
P/Cash Flow (x)	6.5	5.3	4.3	2.8
P/Book Value (x)	0.8	0.7	0.7	0.6
Dividend Yield (%)	0.0	1.2	1.8	1.8
ROE (%)	10.1	10.5	13.5	20.6
Net Gearing (%)	45.7	60.9	54.8	48.5

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Profit & Loss

FY Dec. / MYR mln	2006	2007	2008E	2009E
Reported Revenue	362.2	548.0	864.8	1,140.5
Reported Operating Profit	44.4	61.9	106.9	128.4
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	90.8	112.4
Effective Tax Rate (%)	0.0	4.0	10.0	10.0
Reported Net Profit	30.0	44.3	81.8	101.2
Reported Operating Margin (%)	12.3	11.3	12.4	11.3
Reported Pre-tax Margin (%)	8.3	8.4	10.5	9.9
Reported Net Margin (%)	8.3	8.1	9.5	8.9

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	Strong Buy	2.60
2-Jun-08	Strong Buy	2.50
3-Mar-08	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

