Malaysia Steel

Target : RM1.03
Price : RM0.59

Small, But Has The Right Remedy

STEEL

Stock Profile/Statistics

Bloomberg Ticker	MSW MK
Issued Share Capital (m)	194.7
Market Capitalisation (RMm)	114.9
52 week H | L Price (RM)	1.59 | 0.5
3m Average Volume ('000)	73.0
YTD Returns (%)	-8.5
Net gearing (x)	0.52
Altman Z-Score	2.32
ROCE/WACC	1.3
Beta (x)	1.3
Book Value/share (RM)	2.21

Major Shareholders (%)

Soon Seng Company SB	29.4
Lembaga Tabung Haji	9.9
Rosly Bin Aziz	5.1

Share Performance (%)

Month	Absolute	Relative
1m	-5.6	-3.4
3m	-6.3	-9.7
6m	-36.9	-22.3
12m	-43.6	-17.2

6-month Share Price Performance

INVESTMENT MERITS

- **Although the smallest, Masteel is the only integrated long steel miller that managed to remain profitable throughout the various steel cycles**
- **On-going plant upgrade to increase capacity and improve efficiency**
- **Direct beneficiary of the potential stimulus packages worldwide**
- **Fair value of RM1.03 derived from an undemanding blended valuation of 5x FY09 EPS and 0.47x FY09 NTA/share**

COMPANY PROFILE

Malaysia Steel Works (Masteel) started in 1971 producing mild steel bars with an annual capacity of only 30,000 tonnes per year (tpy). In 1989, Masteel embarked on an extensive upgrading programme by replacing its old mill with a modern semi-continuous mill utilising technology from Germany and Britain, which improved capacity to 120,000 tpy. In 1997, the capacity of the rolling mill was further increased to 250,000 tpy. A thermo quenching line was also installed to produce grade 500 deformed bars. The mill obtained ISO 9002 certification towards end-1997. In line with the company's vision, a new billet plant in Bukit Raja went into commercial production in 1998, becoming one of the most modern meltshops in the region. The company was listed on Bursa Malaysia on Feb 7, 2005. In its quest to reduce costs, Masteel has implemented various cost cutting measures and upgraded its facilities.

KEY HIGHLIGHTS

A niche player. Masteel is the smallest integrated long steel manufacturer in Malaysia with a meltshop near Port Klang with a capacity of 450,000 tonnes per year (tpy) and operates a 350,000 tpy rolling mill in Petaling Jaya. It produces niche products that command better margins amid less intensified competition since there are no economies of scale to achieve, as opposed to the big mills. Its continuous upgrading exercises have helped to improve overall efficiency and increase capacity.

Right location, products and set-up. With its meltshop in proximity to Port Klang, Masteel enjoys easy access to steel scrap imports and billet exports. Its Petaling Jaya rolling mill is strategically located in the centre of the Klang Valley, where demand for steel is strong. The company produces niche products that command good margins, and that in an environment of less intense competition. Its integrated manufacturing set-up coupled with the continuous upgrading exercises help to improve overall efficiency and boost capacity, thus providing room for further improvement.

Quick in responding to market changes. We are impressed with the management's ability to identify changes in the steel cycle and to speedily liquidate its high cost inventory at the initial phase of the downtrend. The quick response has helped the company to escape from the two consecutive industry-wide impairment exercises in 2HFY08 as steel prices slumped more than 50% from the peak in July 2008. The fact that Masteel is among the smallest integrated mills and is prudent in keeping its inventory cycle short also helped in getting the stocks liquidated easily. Being a small player, the company also enjoys cheap local scrap prices. The strong earnings that it has built up over the years translate into a healthy net gearing ratio of less than 0.5x.

Direct beneficiary of stimulus packages. We are seeing encouraging inventory replenishment exercises generally as inventory across the value chain is almost exhausted after the aggressive de-stocking from September 2008. The recovery is more apparent in China as stockists turned bullish after policy makers there launched a RMB4trn stimulus package, prompting steel millers to resume operation and start purchasing iron ore, thus lifting the Baltic Dry Index to around 2,000 points. While the worst is behind us, we believe the real improvement in steel demand may only be seen from 2HFY09. As equity markets always price in a company's future outlook at least 6 months ahead, investors should position themselves for the potential upsurge in steel demand emanating from the stimulus packages.

COMPANY REPORT CARD

ROE. Masteel managed to weather the cyclical nature of the steel industry to remain profitable, largely thanks to good production management, low overheads and prudent inventory management. While we only project high single-digit ROEs of 8.1% and 8.6% for FY09 and FY10 respectively, these are nevertheless remarkable given the present tough operating environment.

Management. The management team comprises Managing Director Datuk Seri Tai Hean Leng @ Tek Hean Leng, who has more than 20 years of business experience and who successfully led the commissioning of the new meltshop in Klang.

Dividend. Being a young and growing company, Masteel has managed to pay reasonable dividends. We estimate a satisfactory gross dividend of 2.5 sen for FY09 and 2.9 sen for FY10.

RECOMMENDATION

With governments around the world announcing ever increasing pump priming measures, we suspect there could be an early recovery in steel demand. We are reiterating our **BUY** recommendation on Masteel for achieving another record profit for FY08. However, as real demand is only expected to kick in from the second half, we are maintaining our conservative earnings estimates, which translate into a 12-month target price of RM1.03. The stock's fair value is derived from a combination of 5x FY09 PER and 0.47x FY09 NTA/share.

Income Statement (RMm)

FYE 31 Dec	FY06	FY07	FY08	FY09f
Turnover	362.2	548.0	881.2	621.5
Growth (%)	18.2	51.3	60.8	-29.5
EBITDA	56.7	74.9	115.4	70.5
Pretax	30.0	46.2	85.7	39.2
Net Earnings	30.0	44.3	79.3	36.2
EPS (sen)	16.9	22.8	40.7	18.6
Growth (%)	28.8	34.6	78.8	-54.3
NTA/Share (RM)	1.70	1.83	2.21	2.38
Gross Div (sen)	2.1	3.0	0.0	2.5
Div Yield (%)	3.6	5.2	0.0	4.2
PER (x)	3.5	2.6	1.4	3.2
P/NTA (x)	0.3	0.3	0.3	0.2
Net Cash/ Share (sen)	-1.0	-1.0	-1.1	-0.5

Balance Sheet (RMm)

FYE 31 Dec	FY06	FY07	FY08
Fixed Assets	366.2	386.1	408.4
Current Assets	201.7	260.1	326.1
Current Liabilities	-212.8	-182.7	-191.2
Others	0.0	0.0	0.0
Total	355.1	463.6	543.3
Share capital	66.5	73.0	97.3
Reserves	234.8	282.4	333.0
Shareholders' Funds	301.3	355.4	430.3
LT Liabilities	53.8	108.2	113.0
Others	0.0	0.0	0.0
Total	355.1	463.6	543.3
Gross Debt	221.5	229.1	251.6
Net Cash/ (Debt)	-183.5	-194.6	-223.2

Cash Flow Statement (RMm)

FYE 31 Dec	FY06	FY07	FY08
Cash Flow from Ops	41.8	12.2	13.5
Cash Flow from Investing	-55.8	-33.2	-37.4
Cash Flow from Financing	15.7	26.8	17.8
Net Increase in Cash	1.7	5.9	-6.0
Cash at Beginning of Year	27.0	28.6	34.5
Other Changes	0.0	0.0	0.0
Cash at End of Year	28.6	34.5	28.5