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1QFY10 Results Review

Malaysia Steel Works (KL)

Weak Start to the Year

Malaysia Steel Works (Masteel)'s 1QFY10 net profit of RM6.4m fell short of our and consensus forecasts. While management attributed the poor numbers to higher scrap cost and delivery of low margin products in 1Q, the scarce supply of local scrap metal may be another possible reason. As we are turning cautious on the mid-term outlook despite being bullish on 2Q, we are cutting our projections for the next two financial years. We also lower our PER multiple to 5x from 6x but retain our 0.59x NTA/share, which translates into a new TP of RM1.00. Reduce to NEUTRAL.

Below expectation. Masteel's 1QFY10 net profit of RM6.4m was way below our and street estimates. Revenue improved marginally by 0.2% but by an astounding 47.7% y-o-y on higher shipments and average selling prices (ASP). However, management attributed the weak showing to higher scrap cost and lower delivery of high margin products during the quarter. Being the smallest integrated local steel mill, Masteel was able to procure the bulk of its scrap metal requirement from local suppliers who normally set prices at a certain discount to international prices. Nonetheless, our market sources revealed the scarce supply of local scrap metal in the past months may have given rise to untimely procurement by the company in 1Q, thus squeezing overall margins.

2Q looking up but concerns lingers. Prices of all major raw materials and finished steel products have been on an uptrend, especially after the conclusion of 90% and 55% increases in iron ore and coking coal contracts respectively. Although the benchmark will only be valid from April to June 2010, we suspect the following quarter's contract prices are unlikely to fall in view of the robust price trend in the spot market, which may hold steel prices in the short term. The fact that Masteel's inventory of RM170.8m is likely to be at cheaper cost would certainly bolster its financial performance in 2Q as steel products delivered during the period are likely to be transacted at high levels due to time lag implications. Nevertheless, the attractive margin may be put to the test in 2H given that the expensive material may progressively lead to a higher average raw material cost, unless a surge in local and international steel demand pushes ASP to the next level.

Downgrade to NEUTRAL. With the uncertain 2H, we have decided to be prudent and lower our original estimates to RM31.1m for FY10 and RM44.4m for FY11, down 35.5% and 12.7% respectively. Together with the lower earnings, we also tone down our PER valuation from 6x to 5x EPS but retain 0.59x NTA/share, or +1 standard deviation of its historical trading band on FY10 numbers, from which we derive a new target price of RM1.00. We downgrade our recommendation to NEUTRAL.

NEUTRAL

Target **RM1.00**
Previous **RM1.45**
Price **RM0.94**

STEEL

Masteel is an integrated long steel manufacturer.

Stock Statistics

Bloomberg Ticker	MSW MK
Share Capital (m)	210.79
Market Cap (RMm)	198.14
52 week H L Price (RM)	1.18 0.86
3mth Avg Vol ('000)	233.2
YTD Returns	-5.1
Beta (x)	1.42

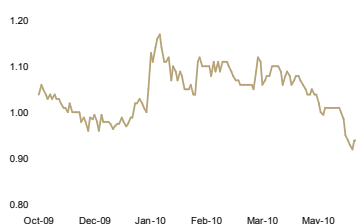
Major Shareholders (%)

Soon Seng Company SB	29.4
Lembaga Tabung Haji	10.0

Share Performance (%)

Month	Absolute	Relative
1m	-10.5	-7.1
3m	-13.0	-13.9
6m	-4.1	-3.2
12m	1.6	-17.2

6-month Share Price Performance



FYE Dec (RMm)	FY07	FY08	FY09	FY10f	FY11f
Revenue	548.0	881.2	687.3	809.5	872.9
Net Profit	44.3	79.3	-8.5	31.1	44.4
% chg y-o-y	47.7	78.8	-110.7	-467.6	42.5
Consensus	-	-	17.2	41.4	-
EPS (sen)	22.8	40.7	-4.4	14.8	21.1
DPS (sen)	2.3	3.3	0.0	2.0	2.8
Dividend yield (%)	2.4	3.5	0.0	2.1	3.0
ROE (%)	13.5	20.2	-2.0	7.2	9.4
ROA (%)	7.3	11.5	-1.1	3.9	5.2
PER (x)	4.1	2.3	-21.6	6.4	4.5
BV/share (RM)	1.83	2.21	2.14	2.15	2.35
P/BV (x)	0.5	0.4	0.4	0.4	0.4
EV/ EBITDA (x)	5.0	3.5	18.5	5.7	4.6

Results Table (RMm)

FYE Dec	1Q10	4Q09	Q-o-Q chg	YTD FY10	YTD FY09	Y-o-Y chg	Comments
Revenue	192.1	191.7	0.2%	192.1	130.1	47.7%	Higher ASP and shipments resulted in higher revenue
EBITDA	12.1	17.5	-31.1%	12.1	-22.9	-152.7%	Higher scrap cost and lower shipment of high margin products eroded margins q-o-q despite a sharp turnaround y-o-y
Depreciation	-2.8	-4.2	-32.6%	-2.8	-3.9	-28.2%	
Net interest expense	-3.0	-3.4	-10.9%	-3.0	-3.6	-16.1%	
Associates	0.0	0.0	0.0%	0.0	0.0	0.0%	
PBT	6.7	10.6	-36.9%	6.7	-30.4	-122.0%	Higher scrap cost and lower shipment of high margin products eroded margins q-o-q despite a sharp turnaround y-o-y
Tax	-0.3	0.0	1472.7%	-0.3	0.0	n.m.	
MI	0.0	0.0	0.0%	0.0	0.0	0.0%	
Net profit	6.4	10.6	-40.0%	6.4	-30.4	-120.9%	Lower margin translate into lower PAT q-o-q, thus the numbers came below of ours and street estimates
EPS (sen)	3.3	5.4		3.3	-15.6		
DPS (sen)	0.0	0.0		0.0	0.0		No dividend declared
EBITDA margin	6.3%	9.1%		6.3%	-17.6%		Margin was impacted higher scrap metal cost and delivery of lower margin steel products.
NTA/share (RM)	2.12	2.14		2.12	2.05		

EARNINGS FORECAST

FYE Dec (RMm)	FY07	FY08	FY09	FY10f	FY11f
Turnover	548.0	881.2	687.3	809.5	872.9
EBITDA	74.9	115.4	21.8	63.7	76.4
Depreciation	-13.0	-15.1	-16.2	-14.2	-15.2
Net Interest Income	-15.7	-14.6	-14.1	-18.5	-16.9
Associate	0.0	0.0	0.0	0.0	0.0
PBT	46.2	85.7	-8.4	31.0	44.3
Net Profit	44.3	79.3	-8.5	31.1	44.4
EPS (sen)	22.8	40.7	-4.4	14.8	21.1
DPS (sen)	2.3	3.3	0.0	2.0	2.8
Margin					
EBITDA (%)	13.7	13.1	3.2	7.9	8.7
PBT (%)	8.4	9.7	-1.2	3.8	5.1
Net Profit (%)	8.1	9.0	-1.2	3.8	5.1
ROE	13.5	20.2	-2.0	7.2	9.4
ROA	7.3	11.5	-1.1	3.9	5.2
Balance Sheet					
Fixed Assets	386.1	408.4	431.9	362.2	370.0
Current Assets	260.1	326.1	317.3	467.2	494.3
Total Assets	646.3	734.5	749.2	829.4	864.3
Current Liabilities	182.7	191.2	214.9	279.0	290.9
Net Current Assets	77.5	134.9	102.4	188.3	203.3
LT Liabilities	108.2	113.0	117.4	97.4	78.4
Shareholders Funds	355.4	430.3	416.9	453.1	495.0
Net Gearing (%)	54.8	51.9	53.0	40.1	33.6

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