

01 March 2012

Malaysia Steel Works

Hit by a narrowing spread margin

Malaysia Steel Works' (Masteel) FY11 core net earnings of RM28.5m (after adding back a one-off impairment of investment of RM4.0m) were way below ours and the consensus' expectations. The 4Q registered a net loss of RM13.3m, which fell by a significant 158% QoQ and 204% YoY. The quarter's results were hit by the decrease in the group's gross production margin (which is the spread between its raw material (i.e. scrap cost) prices and its finished steel product prices) as the latter drop faster during the quarter. We also expect 1Q12 to be challenging for Masteel given the current lacklustre international market demand as the long-drawn European crisis caused customers to delay their purchases. Given the lower margin and more challenging sales outlook, we have trimmed our earnings forecasts for FY12 by 25% to RM46m, and thus arrived at a new lower new TP of RM1.19 (from RM1.44 previously) based on 6.0x FY12 EPS. Given the current share price limited upside to our TP, we are downgrading our call on Masteel to Market Perform (from Outperform previously).

Below expectations. Masteel's FY11 core net earnings of RM28.5m (after excluding for a one-off impairment of investment of RM4m) were way below ours and the consensus' expectations, and accounted for only 61% and 67% of ours and the consensus forecasts respectively. This was mainly due to the decrease in the group's gross production margin (which is the spread between its raw material (i.e. scrap cost) prices and its finished steel product prices) as the latter's prices went down faster than the earlier during the quarter. The 4Q quarter registered a net loss of RM13.3m, which saw a significant dip of 158% QoQ and 204% YoY. As a result, the full year net earnings of RM28.5m were actually flat YoY.

Narrowing margins. 4Q11 revenue improved by 12% QoQ and 15% YoY. However, the quarter's EBIT margin fell from 7.1% to a -4.5% QoQ due to the jagged drop in steel prices towards the end of September, which narrowed the spread profit margin in the quarter.

Challenging 1Q seen. We expect 1Q12 to continue to be challenging for Masteel as we foresee a lacklustre demand in the international market as the long-drawn European crisis caused customers to delay their purchases. That said, we believe the spillover demand from potential projects such as KLIA 2, conveyor belt and jetty portion of the Vale site, the Manjung expansion as well as the Iskandar project in Johor Bahru should benefit Masteel going into 2H12.

First and final dividend of 1.35 sen. Masteel has announced a first and final dividend of 1.35 sen. This translates to a dividend yield of 2.4%, and is above our expectations as we did not project for any dividends for FY11 in our forecast.

Valuation. As we do not expect a strong quarter next year and given its lower spread margin, we have trimmed our earnings forecasts for FY12 by 25% to RM46m and thus arrived at a new lower TP of RM1.19 (from RM1.44 previously) based on 6.0x FY12 EPS. Given the current share price limited upside to our TP, we are downgrading our call on Masteel to a Market Perform now (from an Outperform rating previously).

MARKET PERFORM ↓

Price: RM1.09
Target Price: RM1.19 ↓

STOCK DATA

Bloomberg Ticker	MSW MK Equity	YTD price chg	-6.0%
Market Cap	229.8	YTD KLCI chg	2.5%
Issued shares	210.8	Beta	1.0
52-week range (H)	1.60	Major Shareholders	
52-week range (L)	0.92	TYT Resources SDN	31.9%
3-mth avg daily vol:	736,463	LTH	5.2%
Free Float	59.4%	Ikhwan bin Hj Sujak	3.5%
Altman Z-score	2.6		

AT A GLANCE

Target Price (RM):

Malaysia Steel Works (MASTEEL)
1.19 Downgrade

Valuation:

6x PER over FY12 EPS.

Current Price (RM):

1.09

Report Reason:

4Q11 results below expectation

Action:

Market Perform

Downgrade

Reason:

Lacklustre international demand

Basis of call:

-

Catalyst:

JV with KUB for the intercity rail transit and the >RM1 contracts for the KVMRT.

FYE31Dec RMm

2011A

2012F

2013F

Turnover

1253.4

1313.2

1284.1

Net Profit (NP)

28.5

45.9

45.4

Consensus (NP)

39.2

44.1

Earnings Revision:

+2%

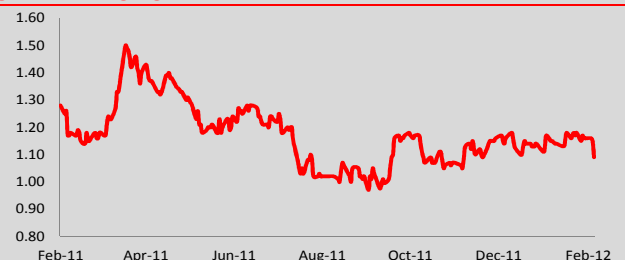
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Earnings Revision

Challenging year with lacklustre demand in the international market.

Rationale:

SHARE PRICE CHART



The Research Team

research@kenanga.com.my

Tel: 603-2713 2292

Income Statement

FY 31 Dec (RMm)	4Q FY10	1Q FY11	2Q FY11	3Q FY11	4Q FY11	QoQ Chg	YoY Chg	YTD10	YTD11	YTD Chg
Revenue	292.0	278.4	338.0	300.3	336.7	12%	15%	1004.8	1253.4	25%
EBIT	14.0	9.6	19.5	21.4	-15.1	-170%	-208%	44.4	35.4	-20%
Pretax profit	9.7	6.8	15.4	17.5	-14.5	-183%	-250%	30.1	25.1	-17%
Taxation	-0.7	-0.6	0.1	-1.3	1.2	-196%	-274%	-1.9	-0.5	-71%
Minority Interest	0.0	0.0	0.0	0.0	0.0	-	-	0.0	0.0	-
Core Net Profit	9.0	6.2	15.5	16.2	-9.3	-158%	-204%	28.2	28.5	1%
EPS (sen)	4.3	2.9	7.3	7.7	-6.3			13.4	11.6	
GDPS (sen)	1.4	0.0	0.0	0.0	1.4			0.0	1.4	
EBIT margin (%)	4.8%	3.5%	5.8%	7.1%	-4.5%			4.4%	2.8%	
PBT margin (%)	3.3%	2.4%	4.6%	5.8%	-4.3%			3.0%	2.0%	
Net profit margin (%)	3.1%	2.2%	4.6%	5.4%	-2.8%			2.8%	2.3%	
Effective tax rate (%)	7%	9%	-1%	7%	-8%			6%	-2%	

Source: Company

Earnings Estimates

FYE 31Dec (RMm)	2009A	2010A	2011A	2012E	2013E
Turnover	687.3	1004.8	1253.4	1313.2	1284.1
EBIT	5.6	32.2	37.6	67.1	68.0
Pretax profit	-8.4	30.1	25.1	46.9	46.4
Net Profit	-8.5	42.2	28.5	45.9	45.4
EBIT margin	0.6%	3.7%	4.3%	7.6%	7.7%
Pretax margin	-1.0%	3.4%	2.8%	5.3%	5.3%
Effective tax rate	-0.3%	6.3%	2.2%	2.2%	2.2%
Growth ratios					
Turnover	-22%	46%	25%	5%	-2%
EBIT	-94%	474%	17%	79%	1%
Pretax profit	-110%	-456%	-17%	87%	-1%
Net profit	-111%	-598%	-32%	61%	-1%
ROE	-2.0%	9.4%	5.8%	8.7%	7.9%
ROA	-1.1%	5.4%	3.3%	5.0%	4.6%
Net Gearing (x)	0.5	0.4	0.5	0.5	0.6
Per share data					
EPS (sen)	-4.4	20.0	13.5	19.8	17.9
EPS growth (%)	-110.7%	-560.0%	-32.3%	46.3%	-9.4%
PER (x)	-25.3	5.5	8.1	5.6	6.1
EV/EBITDA (x)	20.0	8.9	7.8	5.4	6.5
Gross DPS (sen)	0.0	-1.3	-1.4	-2.0	-2.4
Div. Yield (%)	0.0%	-1.2%	-1.2%	-1.8%	-2.2%
NTA/share (RM)	2.1	2.3	2.4	2.4	2.4
P/NTA (x)	0.5	0.5	0.5	0.5	0.5
Historical Price Ratio	2006	2007	2008	2009	2010
PER (x)	1.9	-29.0	3.2	4.9	4.8
PBV (x)	0.3	0.6	0.3	0.4	0.5

Source: Kenanga Research

Balance Sheet

FYE 31Dec (RMm)	2009A	2010A	2011A	2012E	2013E
Non Current Assets	431.9	448.3	478.5	521.6	522.0
Current Assets	317.7	378.2	410.3	424.6	508.1
Total Assets	749.6	826.5	888.8	946.2	1030.2
Current Liabilities	214.9	261.5	334.2	339.3	374.9
Non Current Liabilities	117.4	86.3	54.5	54.5	54.5
Shareholders' Fund	417.3	478.6	500.0	552.4	600.7
Minority Interest	0.0	0.0	0.0	0.0	0.0
Equity & Liabilities	749.5	826.5	888.8	946.2	1030.2

Source: Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

- OUTPERFORM : A particular stock's Expected Total Return is MORE than 10% (an approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%).
- MARKET PERFORM: A particular stock's Expected Total Return is WITHIN the range of 3% to 10%.
- UNDERPERFORM : A particular stock's Expected Total Return is LESS than 3% (an approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate).

Sector Recommendations***

- OVERWEIGHT : A particular stock's Expected Total Return is MORE than 10% (an approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%).
- NEUTRAL : A particular stock's Expected Total Return is WITHIN the range of 3% to 10%.
- UNDERWEIGHT : A particular stock's Expected Total Return is LESS than 3% (an approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate).

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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KENANGA INVESTMENT BANK BERHAD (15678-H)

8th Floor, Kenanga International, Jalan Sultan Ismail, 50250 Kuala Lumpur, Malaysia
Telephone: (603) 2166 6822 Facsimile: (603) 2166 6823 Website: www.kenangaresearch.com



Chan Ken Yew
Associate Director