

Malaysia Steel Works

Solid Steel Play

By the Kenanga Research Team | research@kenanga.com.my

OUTPERFORM ↔

Price: **RM1.00**

Target Price: **RM1.22** ↔

We recently visited Malaysia Steel Works (Masteel)'s meltshop at Bukit Raja, Klang and came away feeling positive on its growth prospects in the coming years, driven by: (i) improved billet production at the Bukit Raja meltshop, (ii) a boost in steel bar production from the upcoming rolling mill at Bukit Raja, (iii) potential trade actions to strengthen steel selling prices, and (iv) good construction outlook in the Klang Valley. No change to our earnings estimates. Maintain OUTPERFORM with a TP of RM1.22 based on Fwd. P/B of 0.43x to FY15 BVPS of RM2.81.

Recent meltshop upgrade to strengthen billet production. We recently visited Masteel's meltshop facility in Bukit Raja, Klang and came away feeling positive on its growth prospects in the coming years. Recall that Masteel is currently undergoing a capacity expansion in its billet production to increase billet production to 700k MT/yr (+8%) and steel bar production to 450k MT/yr (+13%) by end-FY14. During the visit, we gathered that the meltshop upgrade was completed as scheduled, and Masteel is now enjoying higher billet production levels at the Bukit Raja plant. We expect the recent upgrade to contribute positively to 4Q14 and FY15E earnings due to higher production volume and improved energy efficiency.

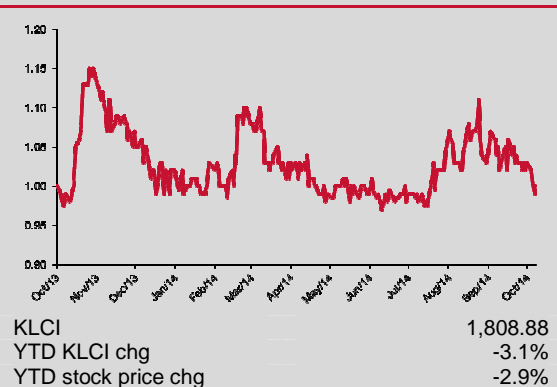
New rolling mill plant to boost steel bar capacity. Construction of the new 200k MT/year rolling mill adjacent to the existing meltshop is also progressing smoothly, with expected completion by mid-2015. We expect the new rolling mill to improve Masteel's production efficiency as feedstock will be immediately available for rolling with less reheating required. We are positive on the new plant addition which will bring Masteel's bar rolling capacity to a total of 650k MT/year in FY16, from 450k MT/year currently. Note that the smaller diameter steel bars to be produced at the new plant command a better margin of about 5% above standard bar prices (currently RM2,000/MT). Hence, we believe Masteel's recent meltshop upgrade and upcoming rolling mill should improve revenue growth which we estimate at 9% - 21% in FY14E-FY15E.

Potential trade actions should improve steel price environment. During the visit, we gathered that local steel players have been working with the government to resolve steel dumping issues and we expect some trade measures to be announced by 1Q15 which should improve local steel prices. Potential measures include anti-dumping duties, import licensing measures and export restrictions on steelmaking raw materials. Furthermore, on 6-Oct-14 Reuters reported that China steel export incentives (including tax rebates on certain steel products) have been cancelled, according to a China Iron Ore and Steel Association (CISA) official. Hence, CISA expects to see lower steel exports from China in 2015 despite unchanged output levels. With these developments, we are optimistic on local steel prices and estimate a 5-10% improvement in FY15E steel prices should trade actions be passed.

Construction growth in Klang Valley to be sustained post-Budget 2015. With all its manufacturing facilities in the Klang Valley, Masteel is poised to reap the benefits from the new and ongoing infrastructure projects announced under Budget 2015. We are positive on the announcement of new highways in the Klang Valley region due to the high usage of steel bars in road construction works. The confirmation of KVMRT Line 2 and LRT3 also bodes well for Masteel as the company already supplies steel bars for the current KVMRT project directly to MRT Corp as well as to stockists supplying the project. Hence, earnings visibility is good for the next 3-5 years as Masteel is likely to continue supplying steel bars for the current and upcoming construction projects in the Klang Valley.

Maintain OUTPERFORM rating at Target Price of RM1.22. We make no changes to our earnings as much of the updates are inline with our assumptions. Our TP is based on Fwd. PB of 0.43x to FY15 BVPS of RM2.81, where the applied 0.43x Fwd. PB is based on +1.0SD over 5-year historical PBR. We believe the premium is justifiable due to the 8% and 44% production capacity expansions for billet and rebar coming online throughout FY14-FY15, and the improving operating environment in the domestic steel sector arising from robust construction demand. We also believe potential trade remedies could improve domestic steel prices in FY15. Maintain FY14E-FY15E earnings of RM30.7-36.1m as we have imputed the plant expansion potential into our earnings forecast previously.

Share Price Performance



Stock Information

Bloomberg Ticker	MSW MK Equity
Market Cap (RM m)	232.0
Issued shares	234.4
52-week range (H)	1.16
52-week range (L)	0.97
3-mth avg daily vol:	1,150,671
Free Float	60%
Beta	1.4

Major Shareholders

TYE RESOURCES SDN BH	30.4%
NG BENG HOO	5.3%
LEMBAGA TABUNG HAJI	4.7%

Summary Earnings Table

FY Dec (RM m)	2013A	2014E	2015E
Turnover	1,375	1,506	1,816
EBIT	44	49	55
PBT	29	32	37
Net Profit (NP)	27	31	36
Core NP	31	31	36
Consensus (NP)		31	38
Earnings Revision		-	-
Core EPS (sen)	14.1	14.1	16.6
Core EPS growth (%)	49.2	0.1	17.6
NDPS (sen)	1.0	1.4	1.6
BV/Share (RM)	2.5	2.7	2.8
Core PER	7.4	7.4	6.3
Price/BV (x)	0.4	0.4	0.4
Net Gearing (x)	0.4	0.4	0.5
Net Dvd Yield (%)	1.0	1.3	1.5

Billet Casting Process



Source: Kenanga Research

New Rolling Mill Plant Construction



Source: Kenanga Research

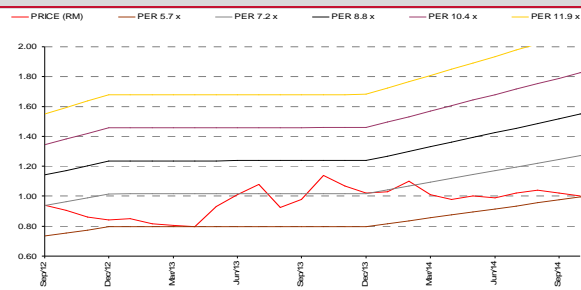
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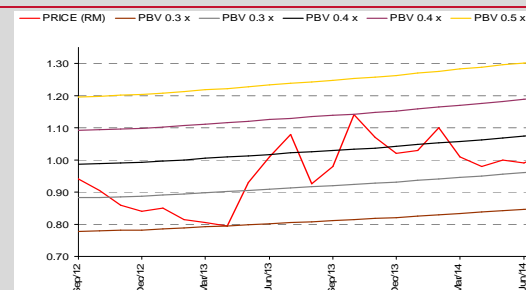
Income Statement						Financial Data & Ratios					
FY Dec (RM m)	2011A	2012A	2013A	2014E	2015E	FY Dec (RM m)	2011A	2012A	2013A	2014E	2015E
Revenue	1,253	1,312	1,375	1,506	1,816	Growth (%)					
EBITDA	62	62	66	72	78	Revenue	24.7	4.7	4.8	9.5	20.6
Depreciation	(21)	(22)	(22)	(23)	(24)	EBITDA	(0.9)	(0.3)	6.1	9.9	8.2
Operating Profit	41	40	44	49	55	Operating Profit	(9.0)	(1.8)	9.8	10.9	11.4
Total Fin. Costs	(16)	(15)	(15)	(17)	(17)	Pre-tax Income	(17.0)	0.2	16.4	9.9	17.0
Associate	(0)	(0)	(0)	(0)	(0)	Core Net Income	(25.0)	(11.2)	49.2	0.1	17.6
PBT	25	25	29	32	37	Profitability (%)					
Taxation	(1)	(1)	(2)	(1)	(1)	EBITDA Margin	5.0	4.7	4.8	4.8	4.3
Net Profit	24	24	27	31	36	Operating Margin	3.3	3.1	3.2	3.3	3.0
Core Net Profit	23	21	31	31	36	PBT Margin	2.0	1.9	2.1	2.1	2.1
						Core Net Margin	1.8	1.6	2.2	2.0	2.0
						Effective Tax Rate	2.2	2.2	6.7	3.5	3.0
						ROE	4.6	3.9	5.5	5.3	5.9
						ROA	2.6	2.2	3.0	2.9	3.1
						DuPont Analysis					
						Net Margin (%)	1.8	1.6	2.2	2.0	2.0
						Assets Turnover (x)	1.4	1.4	1.4	1.4	1.5
						Leverage Factor (x)	1.8	1.8	1.8	1.8	1.9
						ROE (%)	4.6	3.9	5.5	5.3	5.9
						Leverage					
						Debt/Asset (x)	32.7	30.5	28.5	30.5	31.7
						Debt/Equity (x)	58.2	54.0	52.3	55.1	60.8
						Net Cash/(Debt)	(247.1)	(229.1)	(228.8)	(253.0)	(306.7)
						Net Debt/Equity (x)	0.5	0.4	0.4	0.4	0.5
						Valuations					
						EPS (sen)	11.6	11.5	12.4	14.1	16.6
						Core EPS (sen)	11.0	9.7	14.1	14.1	16.6
						NDPS (sen)	1.0	1.5	1.0	1.4	1.6
						BVPS (RM)	2.4	2.5	2.5	2.7	2.8
						PER (x)	9.0	9.0	9.0	9.0	8.4
						Core PER (x)	9.5	10.7	7.4	7.4	6.3
						Net Div. Yield (%)	1.0	1.4	1.0	1.3	1.5
						P/BV (x)	0.4	0.4	0.4	0.4	0.4
						EV/EBITDA (x)	4.5	4.6	4.2	4.2	4.0

Source: Kenanga Research

Fwd PER Band



Fwd PBV Band



Source: Bloomberg, Kenanga Research

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Peer Comparison

Company Name	Price (13- Oct- 2014)	Mkt Cap	Core PER (x)			Est. Div. Yld.	Historical ROE	P/BV	Core Net Profit (RMm)			This Year Growth	Next Year Growth	Target Price	Rating
	(RM)		(RMm)	FY13/14A	FY14/15F				FY15/16F	(%)	(%)				
CORE COVERAGE															
ANN JOO RESOURCES BHD	1.15	576	15.8	15.0	11.6	3.9%	3.5%	0.5	36.5	38.5	49.4	6%	28%	1.47	OUTPERFORM
MALAYSIA STEEL WORKS KL BHD	1.00	210	7.1	7.1	6.0	1.4%	5.5%	0.4	30.7	30.7	36.1	0%	18%	1.22	OUTPERFORM MARKET PERFORM
LAFARGE MALAYSIA BHD	10.00	8,497	23.0	21.1	19.1	4.6%	11.5%	2.6	368.7	403.0	445.5	9%	11%	10.50	PERFORM
PRESS METAL BERHAD	5.06	2,779	20.3	12.0	8.0	2.6%	11.5%	2.0	126.8	215.2	322.2	70%	50%	8.87	OUTPERFORM

Source: Bloomberg, Kenanga Research

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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 sector'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 sector's Expected Total Return is WITHIN the range of 3% to 10%.
- UNDERWEIGHT : A particular sector'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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