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Company Update

Malaysia Steel Works (KL)

The Beauty of Being Small

TRADING BUY

Target RM1.22
Previous RM0.94
Price RM0.98

STEEL

Masteel is an integrated long steel manufacturer.

Stock Statistics

	MSW MK
Bloomberg Ticker	MSW MK
Share Capital (m)	210.8
Market Cap (RMm)	205.5
52 week H L Price (RM)	1.18 0.83
3mth Avg Vol ('000)	365.4
YTD Returns	-1.5
Beta (x)	1.28

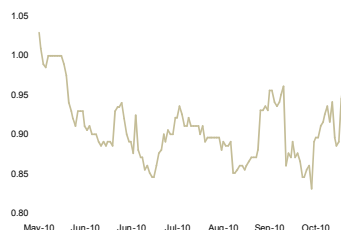
Major Shareholders (%)

TYT Resources	30.4
Lembaga Tabung Haji	9.19

Share Performance (%)

Month	Absolute	Relative
1m	8.0	8.4
3m	2.7	-3.4
6m	-8.1	-16.7
12m	-7.2	-22.2

6-month Share Price Performance



We visited Malaysia Steel Works (KL) (Masteel) last week and gather that Management is hopeful of riding on a long list of projects announced by the Government, especially with its expansion plans well under progress. We suspect Masteel may report a surprise surge in 2H, in tandem with its efforts to import cheaper scrap metal by containers and its smallish size enabling easier maneuvering of sales during a weak market. Therefore, we are upgrading our call to Trading BUY resulting from the higher earnings, with our new fair value tagged at RM1.22.

Dropping in on Masteel. We brought a small group of Institutional Investors to visit Masteel's office and rolling mill in Petaling Jaya last Friday. The company's MD cum CEO, Dato' Sri Tai Hean Leng, took opportunity to give an overview of Masteel's operation, and the company's and steel industry outlook.

Plant expansion well in progress. After spending some RM60m to RM70m over the past two years to modify its furnace and billet caster, management expect billet capacity to progressively increase from 450,000 tonne per year (tpy) to 650,000 tpy in FY12 by deploy in stages 130mm billets instead of the originally 120mm. The company has also identified a plant near its existing rolling mill to embark on its downstream expansion plan. As the said plant only requires minimum modification conversion to install a new rolling facility, the company has identified three machine suppliers from China to expedite the delivery of the required machines. Management is targeting to increase its rolling capacity to 500,000 tpy upon full commissioning in FY12m, hoping that this would be on time to ride on the string of public infrastructure and building projects announced by the Government recently.

Time to show that "small is beautiful". While we expect weak financial performance from steel mills in 2HFY10, Masteel's management suggests that the company's sales tonnage is encouraging. Dato' Sri Tai also said the company has been endeavoring to import containerized scrap metal after the liberalization of the scrap market since end-2008. Although we are surprised at the possible increase in sales volume, we think Masteel may have benefited from being centrally located in the catchment areas of steel demand. Also being a smaller mill, the volume it produces is way easier for the market to absorb. We also suspect that management may have accumulated enough experience in dealing with cheaper scrap imports by container, which are normally priced at about USD20 discount compared to bulk imports. Therefore, we are revising upwards our FY10 estimates by 62.7% to RM42.4m and FY11 numbers by 7% to RM47.5m. As its earnings may exceed market expectation, we upgrade our call to Trading BUY, with a new target price of RM1.22, derived from 5x PER and 0.59x P/NTA on rolling over to FY11 figures.

FYE Dec (RMm)	FY07	FY08	FY09	FY10f	FY11f
Revenue	548.0	881.2	687.3	931.2	1004.8
Net Profit	44.3	79.3	-8.5	42.4	47.5
% chg y-o-y	47.7	78.8	-110.7	-600.8	12.0
Consensus	-	-	17.2	41.4	-
EPS (sen)	22.8	40.7	-4.4	20.1	22.5
DPS (sen)	2.3	3.3	0.0	2.7	3.0
Dividend yield (%)	2.3	3.4	0.0	2.7	3.1
ROE (%)	13.5	20.2	-2.0	9.6	9.8
ROA (%)	7.3	11.5	-1.1	5.2	5.3
PER (x)	4.3	2.4	-22.5	4.9	4.3
BV/share (RM)	1.83	2.21	2.14	2.20	2.41
P/BV (x)	0.5	0.4	0.5	0.4	0.4
EV/ EBITDA (x)	5.4	3.7	19.6	5.5	5.0

Notes: Core Numbers

KEY HIGHLIGHT

Possible exceptional loss in 3Q? Masteel recently divested 5m ordinary shares of RM1.00 each in wholly-owned subsidiary, Bio Molecular Industries SB (BioM) (refer to our company update of 3 June 2010), for a cash consideration of RM1,000 to IBA Pharma SA (IBA). As the divestment was completed on 6 Aug 2010, we expect Masteel to incur a one-time disposal loss of some RM5.1m in 3QFY10 as the divestment was priced at a token sum of only RM1,000. Also, the maturity of the Collateralized Loan Obligation Bond (CLO) issued by CapOne Bhd on 20 Sept 2010 may also result in a RM5m investment loss. To recap, Masteel participated on the CLO programme for borrowings amounting to RM50m, and in return was required to reinvest 10% of the proceeds from CLO into the subordinated portion of the bond. Masteel has fully repaid its existing term loan facility with CapOne Bhd, but since more than 40% of borrowers have defaulted on the programme, this is likely lead to a complete loss for subordinated bond holders, including Masteel. Nonetheless, we think that since both losses are non-operational and non-recurring in nature, this may not impact on our core estimates.

EARNINGS FORECAST

FYE Dec (RMm)	FY07	FY08	FY09	FY10f	FY11f
Turnover	548.0	881.2	687.3	931.2	1004.8
EBITDA	74.9	115.4	21.8	75.9	81.3
Depreciation	-13.0	-15.1	-16.2	-14.2	-15.2
Net Interest Income	-15.7	-14.6	-14.1	-19.4	-18.8
Associate	0.0	0.0	0.0	0.0	0.0
PBT	46.2	85.7	-8.4	42.3	47.4
Net Profit	44.3	79.3	-8.5	42.4	47.5
EPS (sen)	22.8	40.7	-4.4	20.1	22.5
DPS (sen)	2.3	3.3	0.0	2.7	3.0
Margin					
EBITDA	13.7	13.1	3.2	8.1	8.1
PBT	8.4	9.7	-1.2	4.5	4.7
Net Profit	8.1	9.0	-1.2	4.6	4.7
ROE	13.5	20.2	-2.0	9.6	9.8
ROA	7.3	11.5	-1.1	5.2	5.3
Balance Sheet					
Fixed Assets	386.1	408.4	431.9	362.2	370.0
Current Assets	260.1	326.1	317.3	519.3	552.8
Total Assets	646.3	734.5	749.2	881.5	922.8
Current Liabilities	182.7	191.2	214.9	320.9	336.5
Net Current Assets	77.5	134.9	102.4	198.4	216.3
LT Liabilities	108.2	113.0	117.4	97.4	78.4
Shareholders Funds	355.4	430.3	416.9	463.2	507.9
Net Gearing (%)	54.8	51.9	53.0	45.9	39.1

OSK Research Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

Not Rated (NR): Stock is not within regular research coverage

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