

**RESULTS REPORT**

16 May 2011

Yung Kong Galvanising Industries Berhad		Market Price:	RM0.52
		Market Capitalisation:	RM105.9m
		Board:	Main Market
Recommendation:	HOLD	Sector:	Industrial Products
Target Price:	RM0.52	Stock Code/Name:	7020 / YUNKONG

Analyst: Edmund Tham

KEY FINANCIALS

Key Stock Statistics	2011E
Earnings/Share (sen)	3.1
P/E Ratio (x)	16.9
Dividend/Share (sen)	1.3
NTA/Share (RM)	0.86
Book Value/Share (RM)	0.87
Issued Capital (mil shares)	203.6
52-weeks share price (RM)	0.475 – 0.655
Major Shareholders:	%
.Yung Kong Co Bhd /	
Dato' Dr Hii Wi Sing	39.9
.Marubeni-Itochu Steel Inc	18.4

*RM0.50 par value

Ratios Analysis	2008	2009	2010	2011E
Book Value/Sh. (RM)	0.80	0.85	0.84	0.87
Earnings/Sh. (sen)	0.7	5.5	4.7	3.1
Dividend/Sh. (sen)	0.8	3.3	1.7	1.3
Div. Payout Ratio (%)	82.1	45.7	26.6	32.5
P/E Ratio (x)	76.9	9.5	11.1	16.9
P/Book Value (x)	0.6	0.6	0.6	0.6
Dividend Yield (%)	1.4	6.4	3.2	2.6
ROE (%)	0.8	6.4	5.6	3.6
Net Gearing (or Cash)(x)	1.75	1.72	1.62	1.70

*Dividend figures reflect ordinary shares only

P&L Analysis (RM mil)	2008	2009	2010	2011E
Year end: Dec 31				
Revenue	479.3	341.5	466.4	478.1
Operating Profit	19.6	26.4	30.8	25.9
Depreciation	(17.6)	(18.5)	(18.9)	(19.2)
Interest Expenses	(14.8)	(10.8)	(13.5)	(13.8)
Pre-tax Profit	4.8	15.6	17.3	12.1
Effective Tax Rate (%)	44.1	33.5	27.5	19.3
Net Profit	1.2	9.9	9.6	6.3
Operating Margin (%)	4.1	7.7	6.6	5.4
Pre-tax Margin (%)	1.0	4.6	3.7	2.5
Net Margin (%)	0.3	2.9	2.0	1.3

*2011 figures are our estimates

PERFORMANCE – 1Q/FY11

1Q/ 31 Mar	1Q11	1Q10	yoy %	4Q10	qoq%
Rev (RMm)	111.8	117.5	(4.9)	119.1	(6.2)
EBIT (RMm)	0.7	10.4	(92.9)	0.8	(2.6)
NPAT*(RMm)	(3.3)	5.2	(163.2)	(2.3)	(40.0)
EPS (sen)^	(1.6)	2.5	(163.2)	(1.1)	(40.0)

^based on share base of 203.6 million

*NPATMI

Yung Kong's 1Q/FY11 (quarter ended 31st March 2011) results basically came in below our earlier expectations.

“Weak Q1 performance”

The group's 1Q/FY11 revenue of 111.8% had declined by 4.9% from the revenue in 1Q/FY10. The group reported a loss before tax (LBT) of RM2.9 million as compared to a profit before tax (PBT) of RM8.0 million reported in the corresponding 1Q/FY10. The decrease in revenue was due to the group's lower average selling prices (ASPs), whereas the LBT resulted from the higher raw material (Hot Rolled Coil/HRC) costs and also the lower ASPs of its steel products.

“Twin headaches - higher raw material costs & lower ASPs”

Comparing q-o-q, the group recorded a LBT of RM2.9 million in 1Q/FY11 versus a LBT of RM1.0 million reported in the preceding 4Q/FY10. The decline in profitability was mainly due to the higher raw material costs and also the higher maintenance costs incurred by the group during 1Q/FY11.

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OUTLOOK/CORP. UPDATES

The volatility in the movement of steel prices is a concern to the steel product industry. The impact of the current diversion of prices between YKGI's raw material, Hot Rolled Coil (HRC) and its finished products is troubling indeed. The situation is causing the group's clients to limit their purchasing to meet just immediate needs. The situation is made worse by the rampant availability of imported materials of lower prices in the market.

“Troubling HRC situation”

Following the recent filing of a petition requesting for safeguard investigation pursuant to Section 10 of the Safeguards Act 2006 (Act 657) by Megasteel Sdn Bhd to MITI for HRC (the first case since the Act was implemented), the future of the domestic steel industry may become very uncertain should a safeguard be granted. The mid-stream and downstream steel industries may be greatly impaired and rendered uncompetitive.

The reversal of the general price diversion situation shall slowly be effected when the market is able to accept the increased cost of the production to be passed on to customers. YKGI alleviates this situation by having a “cost plus” clause in its contracts with clients. In the meantime, YKGI's management plans to proceed cautiously in deciding the procurement the timing and quantity of HRC, which is on an upward price trend. YKGI's current production expansion plans involve a “Trimming & Slitting Line” (operational by 2Q/2011) and a “Continuous Colour Coating Line” (to be commissioned by 2012).

In terms of HRC, YKGI is able to procure locally from Megasteel and also overseas. YKGI has relative ease in obtaining steel raw material from Nippon Steel Corporation (NSC) of Japan, via its substantial shareholder Marubeni-Itochu Steel Inc of Japan. Furthermore in 2010, YKGI had forged a strategic partnership with Nippon Steel Corp (NSC), which will guarantee it with a steady long-term supply of raw materials at very

competitive prices. NSC would supply up to 50% of HRC required by YKGI and this tie-up will also enable YKGI to get technical assistance by tapping into NSC's R&D capabilities.

“Steady economic growth”

The latest available Malaysian economic data (March 2011) revealed reasonably positive growth rates in y-o-y percentage terms, for instance: IPI (+2.4 y-o-y), Manufacturing Sales (+14.1% y-o-y), Exports (+7.8% y-o-y) and Imports (+12.1% y-o-y). Malaysia had reported a very respectable 4Q/2010 GDP growth of +4.8% (+7.2% for full year 2010 GDP), stable 4Q/2010 unemployment rate of 3.2% and CPI of 3.0% (March 2011). Meanwhile, Bank Negara Malaysia (BNM) had raised its overnight policy rate (OPR) of 2.75% to 3.0% and the statutory reserve requirement (SRR) of 2% to 3%.

“Demand not an issue”

Since most of YKGI's steel products are sold locally, the local steel product demand situation in Malaysia is crucial for its prospects. In tandem with the improving domestic economy (in GDP terms), the **local building and construction sector is expected to do well**. Local demand for steel products will be supported by the Malaysian government's large infrastructure and industrial projects under the 10th Malaysian Plan (10MP), NKEA (National Key Economic Areas) and also The Sarawak Corridor of Renewable Energy (SCORE).

“Group reorganization”

In March 2011, YKGI, through its 65% owned subsidiary, **Star Shine Marketing S/B (SSM)** had entered into share sale agreements for the acquisitions of the remaining equity stakes in Star Shine Steel Products S/B (SSP), Star Shine Global Trading S/B (SSGT) and Star Shine Industries S/B (SSI) that were not already owned by SSM. These acquisitions valued at around RM5.6 million were to be satisfied by the issuance of new around 3.5 million SSM shares at an issue price of RM1.60 per share.

Results Report

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YKGI had also entered into a Share Swap Reorganisation Agreement with **Starshine Holdings Bhd** (SHB), SSM and various individuals (including members of the Hii family) (the Swap Vendors), whereby SHB agreed to acquire from the Swap Vendors all the 21.5 million SSM shares held (representing the entire equity of SSM after the Acquisitions) for a total consideration of around RM36.5 million to be satisfied by the issuance of 364,999,980 ordinary shares of RM0.10 each in SHB at an issue price of RM0.10 per SHB share. SHB will then be a 54.5%-owned subsidiary of YKGI.

In April 2011, YKGI announced its **proposal to list SHB Group on the ACE Market** of Bursa Malaysia. The Acquisition, Reorganisation and Proposed Listing were subject to YKGI shareholders' approval. These proposals were duly passed at an EGM convened on 13th May 2011. The Acquisition and the Reorganisation are expected to be completed within second quarter of 2011 whereby the Proposed Listing (once approved by the authorities) is expected to be completed by third quarter of 2011.

VALUATION/CONCLUSION

Yung Kong's BOD had proposed a first and final dividend of 1.25 sen per ordinary share tax exempt, and also a first and final dividend of 1.375 sen per RCPS tax exempt for its FY10. The dividends have just been approved at the group's AGM and will be paid on 31st May 2011. In recent years, Yung Kong's dividend payout ratios have been quite varied but we expect that Yung Kong would be able to maintain a reasonable dividend payout ratio of around 30% of its NPATMI for its FY11.

Even with an adjusted beta (correlation factor) of 1.19 to the KLCI, Yung Kong (-2.8%) has slightly underperformed the KLCI (+1.5%) this year. Market conditions have also been volatile in recent months, impacted by the political uprisings in the Middle East/North Africa, public debt issue in Europe and major Tohoku tsunami/earthquake in Japan. Nevertheless, as Yung Kong is not an especially large market-cap

stock, this may put a dampener on its market visibility and trading volume.

“Maintain Hold Call”

Based on our forecast of Yung Kong's FY11 BV/Share and an estimated P/BV of 0.6 times (within its historical range), we set a FY11-end **Target Price (TP) of RM0.52**. This TP equals its current market price. Our TP for Yung Kong reflects a P/E of 16.9 times over its FY11F EPS. Meanwhile, the local “Iron and Steel” sector's average P/E and P/BV is 15.8 times and 0.71 times, respectively.

We find that Yung Kong's FY11F P/BV valuation is not pricey, while it has reasonable dividend yields. The group's net gearing levels appear to be quite steady. Yung Kong is in a cyclical industry, and we would like to see Yung Kong achieve a more apparent and consistent earnings growth in the near term. Currently, the group is facing the twin problems of rising costs and dwindling ASPs. If the group reports net losses for its Q2 results, this may lead to a downward bias in our subsequent forecasts.

Meanwhile, Yung Kong also face routine business risks such as a possible slower rate of economic growth, slow implementation pace of major infrastructure projects, weak demand for steel products, foreign exchange fluctuations, future hike in cost of fuel/utilities (oil, electricity, gas), shortage of gas supply, slim net profit margins, weak ASPs and also the rising costs of raw materials (HRC).

YUNKONG: Share Price



Source: NextView

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