

KINSTEEL BHD (210470-M)
(Incorporated in Malaysia)

NOTES TO THE INTERIM FINANCIAL REPORT FOR THE QUARTER AND SIX MONTHS ENDED 30 JUNE 2010

PART A – EXPLANATORY NOTES PURSUANT TO FRS 134

A1. Basis of Preparation

The interim financial statements are unaudited and have been prepared in accordance with the requirement of Financial Reporting Standards 134 (FRS134); “Interim Financial Reporting” and Paragraph 9.22 of the Main Market Listing Requirements of Bursa Malaysia Securities Berhad.

The interim financial statement should be read in conjunction with the audited financial statements for the year ended 31 December 2009. These explanatory notes attached to the interim financial statements provide an explanation of events and transactions that are significant to an understanding of the changes in the financial position and performance of the Group since the year ended 31 December 2009.

A2. Significant Accounting Policies

The significant accounting policies adopted are in consistent with those of the audited financial statements for the year ended 31 December 2009, except for the adoption of the following new Financial Reporting Standards (FRSs), Amendments to FRSs and Interpretations with effect from 1 January 2010:

| | |
|--|--|
| FRS 7 | Financial Instruments: Disclosures |
| FRS 8 | Operating Segments |
| FRS 101 | Presentation of Financial Statements (Revised 2009) |
| FRS 123 | Borrowing Costs |
| FRS 139 | Financial Instruments: Recognition and Measurement |
| Amendments to FRS 1 and FRS 127 | First-time Adoption of Financial Reporting standards and Consolidated and Separate Financial Statements: Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate |
| Amendments to FRS 2 | Share-based Payment: Vesting Conditions and Cancellations |
| Amendments to FRS 132 | Financial Instruments: Presentation |
| Amendments to FRS 139, FRS 7 and IC Interpretation 9 | Financial Instruments: Recognition and Measurement, Disclosure and Reassessment of Embedded Derivatives |
| Amendments to FRSs | Improvements to FRSs (2009) |
| IC Interpretation 9 | Reassessment of Embedded Derivatives |
| IC Interpretation 10 | Interim Financial Reporting and Impairment |
| IC Interpretation 11 | FRS 2: Group and Treasury Share Transactions |
| IC Interpretation 13 | Customer Loyalty Programmes |
| IC Interpretation 14 | FRS 119: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction |

The adoption of the above standards, amendments and interpretations do not have significant impact on the financial statements of the Group except as follows:

FRS 101, Presentation of Financial Statements (revised)

Prior to adoption of the revised FRS 101, the components of the financial statements presented consisted of a balance sheet, an income statement, a statement of changes in equity, a cash flow statement and notes to the financial statements. With the adoption of the revised FRS 101, the components of the interim financial statements presented consist of a statement of financial position, a statement of comprehensive income, a statement of changes in equity, a statement of cash flows and notes to the financial statements.

FRS 101 separates owner and non-owner changes in equity. Therefore, the current consolidated statement of changes in equity only includes details of transactions with owners. All non-owner changes in equity are presented as a single line labeled as total comprehensive income. Comparative information, with exception of the requirements under FRS 139, had been re-presented so that it is also in conformity with the revised standard.

The adoption of this revised standard will only impact the form and content of the presentation of the Group's financial statements.

FRS 139, Financial Instruments: Recognition and Measurement

FRS 139 sets out the new requirements for the recognition and measurement of the Group's financial instruments. Financial instruments are recorded initially at fair value. Subsequent measurement of the financial instruments at the balance sheet date reflects the designation of the financial instruments. The Group determines the classification at initial recognition and for the purpose of the first adoption of the standard, as at transitional date on 1 January 2010.

Financial assets

Financial assets are classified as financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, available-for-sale financial assets (AFS), or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group's financial assets include cash and short-term deposits, trade and other receivables and AFS investments.

(i) Loans and receivables

Prior to 1 January 2010, loans and receivables were stated at gross receivables less provision for doubtful debts. Under FRS 139, loans and receivables are initially measured at fair value and subsequently at amortised cost using the effective interest rate (EIR) method. Gains and losses arising from the derecognition of the loans and receivables, EIR amortisation and impairment losses are recognised in the income statement.

(ii) AFS

Prior to 1 January 2010, AFS financial assets such as investments were accounted for at cost adjusted for amortisation of premium and accretion of discount less impairment or at the lower of cost and market value, determined on an aggregate basis. Under FRS 139, AFS financial asset is measured at fair value initially and subsequently with amortisation of premium with accretion of discount and other accrual of income recognised in income statement and with unrealised gains or losses recognised as other comprehensive income in the AFS reserve until the investment is derecognised, at which time the cumulative gain or loss is recognised in the income statement or determined to be impaired, at which time the cumulative loss is recognised in the income statement and removed from the AFS reserve.

Financial liabilities

Financial liabilities are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate.

The Group's financial liabilities include trade and other payables, short and long term borrowings and are carried at amortised cost.

Impact on opening balances

In accordance with the transitional provisions of FRS 139, the above changes are applied prospectively and the comparatives as at 31 December 2009 are not restated. Instead, the changes have been accounted for by restating the following opening balances in the balance sheet as at 1 January 2010:

| RM'000 | Previously reported | Effect of FRS 139 | As restated |
|----------------------|---------------------|-------------------|-------------|
| Assets:- | | | |
| Other investment | 4,000 | (515) | 3,485 |
| Receivables | 302,074 | (4,033) | 298,041 |
| Liabilities:- | | | |
| Long term borrowings | 491,334 | (27,691) | 463,643 |
| Equity:- | | | |
| Fair Value Reserve | - | (192) | (192) |
| Retained earnings | 587,826 | 8,834 | 596,660 |
| Minority interests | 922,036 | 14,501 | 936,537 |

In additions, these changes in accounting policies have the effect of decreasing the total comprehensive income for the current period by RM4.23 million as follow:

| | RM'000 |
|--|---------|
| AFS investments | 124 |
| Receivables | 666 |
| Long term borrowings | (5,017) |
| Net decrease in total comprehensive income | (4,227) |

FRS 117, Lease

FRS 117 clarifies that the default classification of the land element in a land and building lease is no longer an operating lease. As a result, leases of land should be classified as finance or operating, using the principles of FRS 117. The Group has reassessed and determined that all leasehold land of the Group are in substance finance leases and has reclassified the leasehold land to property, plant and equipment. This change in accounting policy has been made retrospectively in accordance with the transitional provisions of this FRS amendment. The following comparative figures have been restated following the adoption of the amendment to FRS 117:

| RM'000 | 31 December 2009 | |
|-------------------------------|---------------------|-------------|
| | Previously reported | As restated |
| Net Book Value | | |
| Property, plant and equipment | 2,311,419 | 2,350,568 |
| Prepaid lease payment | 39,149 | - |

Change of Accounting Policy

A subsidiary changed the accounting policy for inventories from first-in-first-out basis to weighted average basis to be in compliance with the basis used by the Group. The change in this accounting policy has no material impact on the prior year financial position and results of the Group. As a result, no adjustment has been made to prior year financial statement.

The effects of the change in accounting policy for inventories to the cost of goods sold in the current period and year to date were increased by approximately RM4.2 million and RM13.7 million respectively.

The effects of the change in accounting policy for inventories to the basic and diluted earnings per share (EPS) were as follow:

| | <u>Current quarter</u> | <u>Current year to date</u> |
|--------------------------------|------------------------|-----------------------------|
| Decrease in: - Basic EPS (sen) | (0.17) | (0.54) |
| - Diluted EPS (sen) | (0.15) | (0.50) |

A3. Auditors' Report

The preceding financial year's audit report was not qualified.

A4. Seasonal or Cyclical Factors

The business operation of the Group is generally affected by the demand in construction sector, commodities market condition and global economy, as well as the festive seasons.

A5. Items of Unusual Nature and Amount

There were no items affecting assets, liabilities, equity, net income or cash flow of the Group that are unusual because of their nature, size or incidence for the current quarter and financial year-to-date except for the effects arising from the adoption of FRS 139 as disclosed in Note A2.

A6. Material Changes in Estimates

There were no changes in the estimates of amount relating to the prior financial years that have a material effect in the current quarter under review.

A7. Debt and Equity Securities

There were no issuance, cancellation, repurchases, resale and repayments of debt and equity securities during the financial year-to-date.

A8. Dividends Paid or Proposed

A final tax exempt dividend of 1 sen per ordinary share for the financial year ended 31 December 2009 was approved at the Annual General Meeting held on 17 June 2010 and paid on 20 August 2010 to Depositors registered in the Record of Depositors on 23 July 2010.

No dividends have been proposed nor paid for the financial period ended 30 June 2010.

A9. Segmental information

Segmental information is not provided as the Group's primary business segment is principally engaged in the manufacturing and trading of steel related products and its operation is principally located in Malaysia.

A10. Valuation of Property, Plant and Equipment

Property, plant and equipment are stated at cost or fair values less accumulated depreciation.

A11. Capital commitments

The total capital commitments being approved and contracted for as at the end of current quarter and financial year-to-date are amounting to RM36.0 million for the Group.

A12. Material Subsequent Events

There were no material subsequent events that have not been reflected at the date of issue of this announcement.

A13. Changes in the Composition of the Group

There were no changes in the current quarter and financial year-to-date in the composition of the Group.

A14. Contingent Liabilities and Contingent Assets

Save as disclosed in Note B11, there were no contingent liabilities or contingent assets, which upon becoming enforceable, may have a material effect on the net assets, profits or financial position of our Group.

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PART B: EXPLANATORY NOTES PURSUANT TO APPENDIX 9B OF THE LISTING REQUIREMENTS OF BURSA MALAYSIA SECURITIES BERHAD

B1. Review of Performance

For the current quarter under review, the Group recorded revenue of RM374.7 million and a pre-tax profit of RM12.8 million as compared to revenue of RM639.1 million and a pre-tax loss of RM74.0 million registered in the corresponding quarter a year ago.

Revenue and pre-tax profit for the 6 months ended 30 June 2010 were at RM915.1 million and RM49.6 million compared to revenue and pre-tax loss of RM1,079.5 million and RM167.3 million recorded in the corresponding financial period of 2009.

The increase in pre-tax profit was mainly due to higher steel prices.

B2. Comparison with Preceding Quarter's Results

The Group's pre-tax profit of RM12.8 million represent a decrease of approximately 65% or RM24 million, as compared to the preceding quarter's pre-tax profit of RM36.8 million. This was mainly due to lower turnover and higher cost of raw material purchased during quarter under review.

B3. Current Year Prospects

Financial performance during the first half of financial year 2010 has been satisfactory for the Group, attributed by healthy increase of steel prices and demand from local and surrounding region though hampered by increasing cost of raw materials. The Group however remains cautious of price volatility and will continue to be vigilant on its inventory stocking strategy to achieve reasonable margin for the year.

Barring unforeseen circumstances, the Group expects reasonable results for the year 2010.

B4. Profit Forecast

Not applicable as the Group did not issue any profit forecast/guarantee to the public.

B5. Taxation

Taxation comprises the following :-

| | Current quarter 30/06/2010 RM '000 | Current and year-to-date 30/06/2010 RM '000 |
|------------------|---|--|
| Current taxation | <u>(85)</u> | <u>(210)</u> |

The Group's effective tax rate for the current quarter and financial year to date is lower than the prevailing statutory tax rate of 25%, mainly due to the utilization of deferred tax assets not recognized in prior years.

B6. Sale of Unquoted Investments and/or Properties

There were no disposals of unquoted investments and/or properties for the current quarter and financial year-to-date.

B7. Purchase or Disposal of Quoted Securities

There was no investment in quoted securities as at the end of the quarter. There was no purchase and disposal of quoted securities for the current quarter and financial year-to-date.

B8. Status of Corporate Proposal

There were no corporate proposals announced but not completed as at the reporting date.

B9. Group Borrowings and Debt Securities

The Group's borrowings as at 30 June 2010 were as follows:-

| | 30/06/2010 RM'000 |
|------------------|----------------------|
| Secured | 1,172,750 |
| Unsecured | 617,123 |
| Total borrowings | <u>1,789,873</u> |

Short term borrowing:-

| | |
|--|------------------|
| Bank Overdraft | 13,478 |
| Hire Purchases / Lease Creditors | 6,178 |
| Bankers' acceptance and trust receipts | 1,163,345 |
| Term Loan | 4,165 |
| Government Loan | 44,419 |
| Related Party Loan | 21,574 |
| Murabahah Commercial Papers/ Murabahah Medium Term Notes | 85,000 |
| | <u>1,338,159</u> |

| | 30/06/2010 RM'000 |
|----------------------------------|----------------------|
| <u>Long Term borrowings:-</u> | |
| Term Loan | 40,000 |
| Government Loan | 60,754 |
| Related Party Loan | 53,574 |
| Hire Purchases / Lease Creditors | 7,386 |
| Murabahah Medium Term Notes | 290,000 |
| | <u>451,714</u> |
| Total borrowings | <u>1,789,873</u> |

B10. Derivative Financial Instruments

There were no derivative financial instruments as at the reporting date.

B11. Material Litigation

Save as disclosed below, as at 30 June 2010, neither Kinsteel Bhd nor its Group is engaged in any material litigation and arbitration either as plaintiff or defendant, which has a material effect on the financial position of the Group and our Directors are not aware of any proceedings pending or threatened or of any facts likely to give rise to any proceedings which might materially and adversely affect the financial position or business of the Group.

**(i) Shah Alam High Court Civil Suit No. MT4-22-204-2002
Nesaga Technology Sdn Bhd (“Nesaga”) vs.
Perwaja Steel Sdn Bhd (“PSSB”)**

PSSB is alleged to have failed to adhere to 4 maintenance agreements in 1996 whereby Nesaga was to provide various services to PSSB. PSSB had entered into a settlement dated 28 June 1996 with various terms and conditions and PSSB allegedly agreed to all the terms in the settlement via a letter dated 1 July 1996.

On 22 March 2002, Nesaga filed a Writ of Summons and Statement of Claim at the High Court of Malaya at Shah Alam against PSSB. The claim was for LIRE356,996,800.00, RM404,180.00 and USD826,117.40 (approximate total claim is RM4,151,858.54 based on relevant conversion rate in year 2002) with interest calculated at the rate of 8% per annum from 1 July 1996 until date of judgment.

PSSB filed an application to amend its Defence and to include a Counter-claim which application was allowed on 10 December 2008 by the Registrar of the High Court. Nesaga filed an appeal on 16 December 2008 against the order dated 10 December 2008. The appeal was allowed on 7 January 2010 by the High Court Judge. PSSB then filed an appeal against the order dated 7 January 2010 at the Court of Appeal on 15 January 2010 and an application to stay the proceedings at the High Court pending appeal on 5 February 2010. The application for stay of proceedings was allowed with cost on 21 June 2010. The Court has fixed 3 September 2010 for mention of case management.

Meanwhile, PSSB's Appeal to the Court of Appeal against the dismissal of the amendment application is now fixed for hearing on 5 October 2010.

PSSB's solicitors are of the view that PSSB stands a fair chance of defending the case.

**(ii) Kuala Lumpur High Court Suit No. D8-22-1464-2007
Kuala Lumpur High Court Suit No. D2-22-1594-2007 (consolidated by the
Order of the Court of Appeal dated 17 January 2008)
Megasteel Sdn Bhd ("Megasteel") vs PSSB**

Megasteel filed a Writ of Summons and Statement of Claim for the sum of RM36,079,860.33 ("Megasteel's Claim") as damages for an alleged breach of contract against PSSB. On 17 December 2007, PSSB in its defence argued, *inter-alia*, that Megasteel has continued to accept the delivery of the goods unconditionally after the alleged stipulated time, causing time to be at large hence time is no longer of the essence. In addition there were variations to the contract causing time to be at large as well. PSSB also filed a Counter-Claim against Megasteel on 17 December 2007 for *inter-alia*, the outstanding sum of RM3,390,509.03 ("Outstanding Sum") as at 6 November 2007 for the DRI supplied to Megasteel.

Megasteel filed a summary judgment application on Megasteel's Claim on 27 March 2008 and the same was dismissed on 14 January 2009. PSSB filed an application for judgment on admission of the Outstanding Sum on 30 March 2009 of which was dismissed on 26 October 2009. PSSB filed an appeal to the Court of Appeal against the dismissal of the application for judgment on admission on 20 November 2009. Meanwhile the matter was fixed for mediation on 27 July 2010. However, in view that the matter was not able to be resolved during mediation on 27 July 2010, the matter is now reverted to the Managing Judge Unit for further case management. The Court will write to parties to inform the case management date.

The solicitors of PSSB are of the opinion that PSSB stands a fair chance of success of defending Megasteel's claim and that Megasteel has no viable defence to the Outstanding Sum which Megasteel is seeking to set off the Outstanding Sum against Megasteel's Claim.

**(iii) Kuala Lumpur High Court Suit No. D22-788-2009
Petroliam Nasional Berhad ("Petronas") vs PSSB**

On 12 May 2009, PSSB was served with a writ of summons dated 27 April 2009, taken out by Petronas claiming the sum of RM85,795,957.50, being the alleged balance of the unpaid purchase price for the supply of gas to PSSB together with interest, on various bases. Both Petronas and PSSB have exchanged their respective pleadings. PSSB is disputing the claim.

By its Defence and Counterclaim dated 15 June 2009, PSSB is defending the claim and is counterclaiming for either a sum of RM105,258,714.45 or alternatively RM99,831,484.28, depending on the rate applicable. As the pre-trial steps have not been completed yet, there is no date for trial of the suit. Petronas filed an application to strike out PSSB's Defence and Counterclaim on 24 December 2009. On 30 July 2010, the Judge dismissed Petronas' application with costs.

As advised by PSSB's solicitors, the Board is of the opinion that PSSB has reasonable prospects of success. Nevertheless, it is still open to both parties to reach a negotiated settlement for this dispute.

B12. Proposed Dividend

No dividend has been proposed, paid or declared by the Company since 31 December 2009 other than as stated in Note A8.

B13. Earnings Per Share (“EPS”)**(a) Basic earnings per share**

Basic earnings per share is calculated by dividing the Group's net profit attributable to equity holders for the period by the weighted average number of ordinary shares in issue during the period.

| | Current quarter 30/06/2010 | Current year-to-date 30/06/2010 |
|--|----------------------------------|---------------------------------------|
| Net profit attributable to ordinary shareholders (RM'000) | 8,177 | 30,729 |
| Weighted average number of ordinary shares in issue including Treasury shares ('000) | 950,579 | 949,034 |
| Treasury shares ('000) | (7,754) | (7,754) |
| Weighted average number of ordinary shares in issue ('000) | 942,825 | 941,280 |
| Basic earnings per share (sen) | 0.87 | 3.26 |

(b) Diluted earnings per share

For the purpose of calculating diluted earnings per share, the weighted average number of ordinary shares in issue have been adjusted for the dilutive effects of all potential conversion of any convertible securities issued during the period as set out below:-

| | Current quarter 30/06/2010 | Current year-to-date 30/06/2010 |
|--|----------------------------------|---------------------------------------|
| Net profit attributable to ordinary shareholders (RM'000) | 8,177 | 30,729 |
| Weighted average number of ordinary shares in issue ('000) | 942,825 | 941,280 |
| Effects of dilution ('000) | 78,486 | 79,730 |
| Adjusted weighted average number of ordinary shares in issue and issuable ('000) | 1,021,311 | 1,021,010 |
| Diluted earnings per share (sen) | 0.80 | 3.01 |

By order of the Board,

Dato' Henry Pheng Chin Guan
Chief Executive Officer
 Date: 27 August 2010