

KINSTEEL BHD (210470-M)

(Incorporated in Malaysia)

NOTES TO THE INTERIM FINANCIAL REPORT FOR THE QUARTER AND NINE MONTHS ENDED 30 SEPTEMBER 2011

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 2010. 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 2010.

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 2010, except for the adoption of the following new Amendments to Financial Reporting Standards (FRSs) and Interpretations with effect from 1 January 2011:

Amendments to FRS 1 (Revised)	Limited Exemptions from Comparative FRS 7 Disclosures for First-time Adopters
Amendments to FRS 1	Additional Exemptions for First-time Adopters
Amendments to FRS 2	Group Cash-settled Share-based Payment Transaction
Amendments to FRS 7	Improving Disclosures about Financial Instruments
IC Interpretation 4	Determining Whether An Arrangement Contains a Lease
IC Interpretation 18	Transfers of Assets from Customers
Amendments to IC Interpretation 13	Customer Loyalty Programmes
Amendments to FRSs	Annual Improvements to FRS (2010)

The adoption of the above standards, amendments and interpretations do not have significant impact on the financial statements of the Group.

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 outlook of the 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.

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

During the quarter under review, the Group has redeemed the third tranche of its Murabahah Medium Term Notes facility of RM10.0 million and RM50.0 million on 7 September 2011 and 25 September 2011 respectively.

Save for the disclosure above, 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 2010 was approved at the Annual General Meeting held on 16 June 2011 and paid on 19 August 2011 to Depositors registered in the Record of Depositors on 22 July 2011.

No dividends have been proposed nor paid for the financial period ended 30 September 2011.

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 RM186.9 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 quarter under review (3Q11), the Group recorded a 12.1% increase in revenue to RM403.8 million, from RM360.1 million in the corresponding quarter a year ago (3Q10) largely contributed by higher steel prices. The Group's pre-tax loss was narrowed to RM25.8 million as compared to a pre-tax loss of RM49.3 million in 3Q10.

Revenue for the period ended 30 September 2011 improved by RM169.7 million to RM1,444.8 million, as compared to RM1,275.2 million in the previous corresponding financial period. Despite improvement in the top line and improved pre-tax loss in 3Q11 as compared to 3Q10, pre-tax loss of the Group for the current period ended 30 September 2011 was higher at RM67.2 million, as compared to pre-tax profit of RM0.3 million in the corresponding financial period of 2010. This was because the increase in the price of raw materials substantially outpaced the increase in selling price in the first half of the financial year.

B2. Comparison with Preceding Quarter's Results

The Group recorded a pre-tax loss of RM25.8 million as compared to the preceding quarter's pre-tax loss of RM21.4 million. The Group cost management and containment strategies continue to cushion the effects of the rising cost of raw materials.

B3. Current Year Prospects

The group is cautious over its prospects for the 2011 financial year. While the rise in construction activity should help sustain steel prices for the rest of the year, the price of iron ore has also increased significantly and this is expected to take a toll on the overall performance of the Group.

Nevertheless, the Group will continue to find ways to reduce exposure to raw material price volatility to minimize the impact of the volatile steel market. This includes exploring the opportunity to acquire iron ore mines and sourcing local iron ore for further pelletizing for own consumption.

The Group has embarked on the construction of a concentration and pelletizing plant which when completed, will reduce the Group's reliance on imported pellets and the exposure to raw material price fluctuations when it is fully operational. The Group believes that the concentration and pelletizing plant will significantly reduce the Group's production cost, and hence enable it to position itself more competitively going forward.

B4. Profit Forecast

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

B5. Taxation

The Group's effective tax rate 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

The Company has on 25 July 2011 announced that it is proposing to undertake the following proposals:

- i) Proposed subscription of RM280,000,000 nominal value of Redeemable Convertible Unsecured Loan Stocks ("RCULS") issued by its subsidiary, Perwaja Holdings Berhad (PHB) at 100% of its nominal value; and
- ii) Proposed renounceable restricted offer for sale ("ROS") of such nominal value of the RCULS held by it to the entitled shareholders of PHB, other than the Company, on the basis of RM1.00 nominal value of RCULS for every two existing ordinary shares of RM1.00 each in PHB held on the entitlement date, upon completion of the proposed restricted issue.

Perwaja Holdings Berhad (PHB) has on 25 July 2011 announced that it is proposing to undertake the following proposals:

- i) Proposed restricted issue of RM280,000,000 nominal value of Redeemable Convertible Unsecured Loan Stocks ("RCULS") to Kinsteel Bhd at 100% of its nominal value;
- ii) Proposed issue of 280,000,000 free warrants on the basis of one free warrant for every two existing PHB shares held by the entitled shareholders on the entitlement date.

On 4 August 2011, Bank Negara Malaysia has granted its approval on the proposed issue of free warrants to non-resident shareholders of PHB.

On 26 August 2011, Securities Commission has granted its approval on the proposed issue of RCULS under the PDS Guidelines while the Proposed ROS is not subject to SC's approval.

On 25 October 2011, Bursa Securities has granted its approval for the admission of the RCULS and Free Warrants to the Official List of Bursa Securities and the listing of and quotation for the RCULS, Free Warrants and the new PHB Shares to be issued arising from the conversion of the RCULS and exercise of the Free Warrants on the Main Market of Bursa Securities.

On 4 November 2011, the Company and PHB have dispatched the Circular to the shareholders respectively informing on the Extraordinary General Meeting (EGM) to be held on 22 November 2011 to vote on the Proposals. At the EGM held on 22 November 2011, both the shareholders of the Company and PHB have approved the resolutions for the Proposals.

Barring unforeseen circumstances, subject to all requisite approvals being obtained, the Proposals are expected to be completed in end December 2011 while the Proposed ROS is expected to be completed in January 2012.

B9. Group Borrowings and Debt Securities

The Group's borrowings as at 30 September 2011 were as follows:-

	30/09/2011 RM'000
Secured	1,069,667
Unsecured	691,146
Total borrowings	<u>1,760,813</u>
<u>Short term borrowings:-</u>	
Bank Overdraft	20,530
Hire Purchases / Lease Creditors	18,300
Bankers' acceptance and trust receipts	1,211,045
Short Term Loans	19,486
Term Loans	40,000
Government Loan	14,696
Related Party Loan	504
Murabahah Commercial Papers/ Murabahah Medium Term Notes	110,000
	<u>1,434,561</u>
<u>Long Term borrowings:-</u>	
Government Loan	83,030
Related Party Loan	68,748
Hire Purchases / Lease Creditors	4,474
Murabahah Medium Term Notes	170,000
	<u>326,252</u>
Total borrowings	<u>1,760,813</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 September 2011, neither Kintsteel 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) 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 in respect of the sale and purchase of 170,000 mt of DRI in 2007. 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 inclusive of interest (“Outstanding Sum”) as at 6 November 2007 for the DRI supplied to Megasteel (“PSSB’s Counter-claim”).

Both parties had on 27 October 2011 reached a settlement and a Settlement Agreement was subsequently entered into by the parties on 28 October 2011 where Megasteel shall withdraw from Megasteel’s Claim while PSSB shall withdraw from PSSB’s Counter-claim.

**(ii) Kuala Lumpur High Court Suit No. D22-788-2009
Petroleum National 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. Petronas filed an application to strike out PSSB’s Defence and Counterclaim on 24 December 2009 which was dismissed with costs by the Judge on 30 July 2010.

After numerous rounds of mediation, the parties had on 14 October 2011 reached a settlement through a consent order where the parties shall withdraw from their respective claims with no liberty to file afresh.

The parties are now awaiting the extraction of the fair consent order from the court.

**(iii) Dubai Court of Cassation Appeal No.: 131/2011
PSSB v Star Steel International LLC (“Star Steel”)**

On 13 June 2011, PSSB issued a legal notice to Star Steel (an associate of ETA ASCON STAR Group) to recover the outstanding payment for the steel products being USD9,375,000. Star Steel has yet to reply to the legal notice.

Besides the above claim, PSSB has filed a claim against Star Steel for a sum of USD5,625,000 being payment for goods sold and delivered on 27 July 2010. Judgment was granted in favour of PSSB. Subsequently, Star Steel successfully appealed against PSSB on grounds that the dispute was subject to arbitration. PSSB is presently appealing against the decision. PSSB’s solicitors are of the opinion that PSSB has a good chance of succeeding against Star Steel.

PSSB is in the midst of negotiating with Starsteel with the view towards settlement for the above claims.

B12. Proposed Dividend

No dividend has been proposed, paid or declared by the Company since 31 December 2010 other than as stated in Note A8.

B13. Loss Per Share

(a) Basic loss per share

Basic loss per share is calculated by dividing the Group's net loss attributable to equity holders for the period by the weighted average number of ordinary shares in issue during the current quarter and the financial year to date.

	Current quarter 30/09/2011	Current year-to-date 30/09/2011
Net loss attributable to ordinary shareholders (RM'000)	(8,802)	(18,847)
Weighted average number of ordinary shares in issue including Treasury shares ('000)	968,196	967,041
Treasury shares ('000)	(7,754)	(7,754)
Weighted average number of ordinary shares in issue ('000)	960,442	959,287
Basic loss per share (sen)	(0.92)	(1.96)

Fully diluted loss per share has not been presented as the effect is anti-dilutive.

B14. Realised and Unrealised Profits Disclosure

The accumulated profits as at 30 September 2011 and 30 June 2011 is analysed as follows:

	Current Quarter RM'000	Immediate Preceding Quarter RM'000
Total accumulated profits of the Company and subsidiaries:		
- Realised profits	362,452	398,262
- Unrealised profits	177,652	177,177
	540,104	575,439
Less: Consolidated adjustments	(16,727)	(33,657)
Total group accumulated profits as per consolidated financial statements	523,377	541,782

By order of the Board,

Dato' Henry Pheng Chin Guan
Chief Executive Officer
Date: 25 November 2011