# Challenging times for Sino Hua-An

| BY GAN YEN KUAN |

In just two months or so, China has seen a sharp reversal in the price of metallurgical coke, a raw material used as fuel in steel production. As global demand for steel contracts, steel prices have dropped resulting in cutbacks in production. That means lower demand for coke. Add to that the crowded marketplace, and it is inevitable that most coke producers in China are now grappling with declining margins.

Main Board-listed Sino Hua-An International Bhd, whose coke production business is based in Shandong province in China, has not been spared as well. Industry observers warn that the company's profit figures in the remaining two quarters may not be as rosy as those it recorded in 1H2008.

"Moving forward, Sino Hua-An's profit is likely to be squeezed, which is very much in line with its peers and major steel makers in China, which are also facing a margin squeeze," says an observer.

"It should be able to make money in 3Q2008, although profits may be lower, given that the fall in coke prices began only in late August. However, if the steel market remains sluggish for the next few months, there will be a lot of uncertainties in its future earnings," he adds.

In Shandong, where Sino Hua-An sells 80% of its coke, the price of coke fell from its peak of RMB3,095 (about RM1,620) per tonne in July to RMB2,940 per tonne in August, and to RMB2,500 per tonne in September. Coke was sold at between RMB2,000 and RMB2,200 per tonne last month.

The coke price fell 20% from July to September. It remains to be seen if the coke price will continue to retreat and offset all the gains recorded in the first seven months of the year.

Sino Hua-An executive director Cedric Choo admits that margins have been squeezed due to the narrowing price gap between coking coal (the raw material used in coke production) and coke.

In February, the price gap was RMB917. This had narrowed to RMB763 in September, he says. While the price of coking coal has also been going down, it has not been as steep, otherwise it would have helped cut the company's costs.

"The coking coal price for July was RMB1,767 and in September, it dropped by only 1.7% to RMB1,737," says Choo.

However, he is optimistic that demand for steel will pick up towards the end of the year or early next year. He says the oversupply situation is expected to persist until the end of the year, although it will ease as demand gradually creeps up. "This is because steel stocks would have been run down by then and the users of steel worldwide would have to start to restock," he notes.

"Infrastructure projects, property development and construction will not vanish overnight as once started or launched, they will need to be completed within a timeframe — although the said timeframe may be stretched out a little longer in view of the prevailing economic condition. As such, these users should begin to restock, if not by the end of the year, in 1Q2009. This is where demand for steel will slowly recover and thus, that of coke," adds Choo.

Sino Hua-an, which added production capacity of 600,000 tonnes in May, now operates at about 75% of its total capacity of 1.8 million tonnes per year. It had earlier expected to hit capacity utilisation of 90% in August and to 100% soon after that.

For 1H2008, the company posted a net profit of RM72.48 million, up 44% from RM50.2 million in the previous corresponding period. The company, which rose from the ashes of Antah Holdings Bhd under a successful restructuring scheme, has been able to deliver robust earnings since its listing on March 26, 2007.

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# PER much lower than peers

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However, the recent development in the steel and coke industries caused the company's share price to fall to its historic low of 20.5 sen last Wednesday before rebounding to 23.5 sen the following day. Year-to-date, it has fallen by a hefty 69.7%, steeply underperforming the Kuala Lumpur Composite Index which saw a 40.9% decline in the same period.

The sharp plunge was partly due to a selldown by foreign funds. The foreign shareholding level in the company had fallen to about 10% in September from more than 20% in August last year.

Aseambankers has downgraded Sino Hua-An to a "hold" from a "buy". "We have turned more cautious for 2009, expecting China's steel industry dynamics to improve only towards 2010, noting the deeper-than-expected production and price cuts by Chinese steel millers of late. The impact of the global financial crisis and economic slowdown could remain profound for some time, and this will subdue stock valuations across the board, especially for small-mid caps," the research house notes.

However, HLG Research, in an Oct 13 report, believes Sino Hua-An shares have been oversold.

Fundamentally, the company is considered a steady outfit, with a cash hoard of RM75.74 million as at June 30, and no gearing. Based on its closing price of 23.5 sen last Thursday and Aseambankers' projected FY2008 earnings per share of 9.8 sen, Sino Hua-An is now trading at a price-earnings ratio (PER) of 2.4 times, much lower than those of its Chinese peers, most of which traded at a PER of more than 10 times.

Although Sino Hua-An is traded at a sharp discount to its peers and may seem attractive, the crash in global equity markets has put investors on the sidelines. Unless there are positive signals, they are unlikely to start picking up stocks. It may take a long while for Sino Hua-An's share price to return to a level that reflects its fundamentals. ■