Sino Hua-An to ride China's growth

| BY TONY C H GOH |

The recovery in the demand for steel in China may benefit Sino Hua-An International Bhd, which produces metallurgical coke in China. Sino Hua-An is the only Chinese company listed on Bursa Malaysia. Analysts and fund managers like its direct exposure to China's steel industry, which will benefit from the infrastructure boom under the Chinese government's RMB4 trillion (RM2 trillion), two-year economic stimulus programme.

The company is principally involved in the production of metallurgical coke and its by-products such as tar, crude benzene, ammonium sulphate and coal gas. Metallurgical coke, made from low sulphur bituminous coal, is a critical raw material used as an energy source for the smelting of iron ore in the manufacturing of steel.

OSK Research, in a recent report, highlighted Sino Hua-An's readiness to meet any potential uptick in demand in China, as the company recently upgraded its plant and equipments to comply with the country's ongoing efforts to curb pollution.

The research firm says the Chinese government's tighter environmental regulation has forced the closure of many smaller, inefficient coke producers on the mainland and promoted consolidation among them.

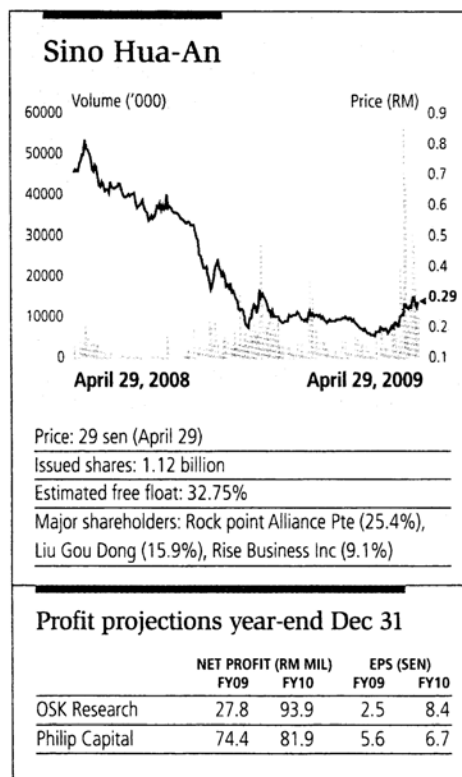
"Thus, as one of the largest independent coke producers in Shandong, Sino Hua-An stands to benefit from these closures," says OSK Research.

The recent increase in China's crude steel production is boosting the production of coke as well. For Sino Hua-An, it has increased its plant utilisation rate from below 50% in October 2008 to around 90% currently.

China's mammoth stimulus package has been the main catalyst for steel millers to resume operations and start replenishing their depleted inventory. As the stimulus package would revive construction activities, steel demand may surprise on the upside, thus directly benefiting coke producers such as Sino Hua-An.

The global economic slowdown has brought Sino Hua-An's valuation to an attractive level. The company's current market value of RM314.3 million (at 28 sen a share) is less than half its shareholders fund of RM763.8 million as at Dec 31, 2008.

While the challenging environment in 4Q2008 resulted in Sino Hua-An posting a RM83.7 million loss, and reduced the full year net profit to RM545,000 (from FY2007's RM127.5 million), a recovery could be in sight.



Price: 29 sen (April 29)
Issued shares: 1.12 billion
Estimated free float: 32.75%
Major shareholders: Rock point Alliance Pte (25.4%), Liu Gou Dong (15.9%), Rise Business Inc (9.1%)

Profit projections year-end Dec 31

	NET PROFIT (RM MIL)		EPS (SEN)	
	FY09	FY10	FY09	FY10
OSK Research	27.8	93.9	2.5	8.4
Philip Capital	74.4	81.9	5.6	6.7

Sino Hua-An is one of the largest independent coke producers in Shandong, China

In a recent report, Philip Capital Management Sdn Bhd forecasts Sino Hua-An to post a net profit of RM74.4 million this year. It expects Sino Hua-An to ride on the continued growth of China, which, despite the current global financial crisis, remains a favourite among analysts due to its vast economic potential.

"Despite the current global economic uncertainty, we believe that China's massive development potential remains strong in the long term," says Phillip Capital.

Sino Hua-An is currently in a net cash position, with a cash reserve of RM28 million as at Dec 31, 2008, and has no debts. Meanwhile, its management indicated that there will be no major capital expenditure over the next few years. Thus, there is a possibility that the company may distribute more surplus cash as dividends, going forward.

"The company is currently trading at 3.6 times FY2009 PER and a steep 65% discount from its NTA (net tangible asset) per share (of 58 sen per share)," says Philips Capital.

"With a strong operating cash flow, and a commitment for dividend payout of 20%, we expect the company will be able to better reward its shareholders," adds Philip Capital.

In a recent report, OSK advises investors to position themselves for the potential upsurge in steel demand, and hence coke demand, spurred by the various stimulus packages.

However, it also noted some of the key risks for Sino Huan-An. For instance, an increase in China's export tariff for steel will hurt steel production and hence, demand for coke. Meanwhile, a higher than expected coal price will erode coke producers' margins.

According to a report from RHB Research, lower contributions from higher-margin by-products and depreciation of the Chinese renminbi against the ringgit can also affect Sino Hua-An's earnings.

RHB, which has an "outperform" rating on Sino Hua-An, forecasts an indicative fair value for the stock at 37 sen per share, which is seven times the average FY2009-2010 estimated earnings per share of 5.3 sen. The research firm says the valuation is in line with the market capitalisation weighted historical one-year forward PER of seven times for the steel sector, which is the main consumer of metallurgical coke. ■