Upbeat outlook on Sino Hua-An's diversification

Report: Downstream production will enhance overall profitability

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PETALING JAYA: Metallurgical coke producer China-based Sino Hua-An International Bhd's diversification into downstream production will enhance its overall profitability, says RHB Research.

In a latest update, the bank-backed brokerage said Sino Hua-An's plans for value-added products using by-products from metallurgical coke production was far more profitable than mergers or acquisitions as a means to expand capacity.

"Acquiring other existing metallurgical coke producers that are mostly inefficient would result in hefty investment costs and further capital expenditure in order to improve their (other producers') efficiency," the report said.

Sino Hua-An executive director Cedric Choo told *StarBiz* in an e-mail that the company was at the exploring stage and conducting viability studies on the by-products expansion plan and was unable to comment further on this matter.

Metallurgical coke is used as an energy source for the smelting of iron ore in the manufacturing of steel.

Earlier reports said Sino Hua-An had put on the backburner its plans to diversify downstream and become a steel player, in view of the financial crisis.

Instead, Sino Hua-An chose to ramp up its production to the maximum.

According to RHB Research, Sino Hua-An's plant utilisation rate had stabilised at about 90% since January while the price gap between metallurgical coal (input) and metallurgical coke (output) had normalised to the average of 450 renminbi per tonne since May.

"This was due to higher crude steel production in China, which boosted demand for metallurgical coke," the report said.

Coke processing at Sino Hua-An's plant in China. Cedric Choo (inset) says the company is at the exploring stage and conducting viability studies on the by-products expansion plan

The brokerage opined that both plant utilisation rate and price gap would sustain at current levels (if not increase further) in the medium term as global crude steel consumption was expected to recover in 2010, underpinned by stimulus package plans implemented by various economies that would translate to downstream demand.

Besides that, the Chinese government's ongoing efforts to consolidate the metallurgical coke industry in China by phasing out inefficient and small-scale metallurgical coke plants, would boost Chinese metallurgical coke producers' pricing power (including Sino Hua-An) over the longer term, it noted.

RHB Research added that although prices of Sino Hua-An's major by-products such as tar oil and crude benzene (that collectively contributed 5% to 8% of Sino Hua-An's total revenue), had started to ease this month, the pullback in these prices was likely to be temporary.

"We project crude oil prices to hover at US$50-US$70 per barrel for the second half of this year before rising to US$60-US$80 and US$80-US$100 in 2010 and 2011 respectively, underpinned by stabilising demand from the United States and a pick-up in China's manufacturing activities (which collectively contribute about 30% of global oil demand)," the brokerage said.

Sino Hua-An registered a net loss of RM23.63mil for the first quarter ended March 31 compared with a net profit of RM35.57mil in the previous corresponding period.

The decline was due to high prices of coking coal, which increased manufacturing costs.

Besides that, operating costs such as additional workforce and depreciation charge on new coking ovens, further inflated cost of sales in the first quarter.

Its revenue, however, increased 7% to RM310.95mil from RM290.8mil previously, mainly attributed to higher metallurgical coke prices.