CORPORATE

LTH ups exposure in Sino Hua-An

| BY ELLINA BADRI |

Lembaga Tabung Haji (LTH), whose choice of stock picks has sometimes raised eyebrows, has now set its sights on "M-chip" Sino Hua-An International Bhd (Hua-An).

The pilgrims fund has steadily been increasing its stake in Hua-An, whose principal business is the production and sale of metallurgical coke and its by-products, which are used to make steel. Hua-An's business operations are entirely carried out in China's Shandong Province.

Among LTH's past investments which attracted much interest was its acquisition of 21.56 million shares of Silver Bird Group Bhd from 3i Group plc, a London-based listed private equity firm, in August 2007. Silver Bird was already a loss-making company at the time, but LTH's emergence as a substantial shareholder, with a 15.18% stake, sparked talk of a general offer, although this did not materialise. The acquisition was also notable as it marked the pilgrim fund's entry into the food and beverage sector.

Filings show LTH had owned as much as 92.93 million shares in Silver Bird, equivalent to a 29.57% stake. A check on its holdings show, however, that it has trimmed its stake since February this year, and now holds 29.53%.

LTH also currently owns substantial stakes in Lityan Holdings Bhd and Ramunia Holdings Bhd, both ailing companies. Lityan's shares have been suspended since 2006 due to its poor financial results, while Ramunia's assets are set to be taken over by Sime Darby Bhd. Bloomberg data show LTH still owns 18.65% equity interest in Lityan and 29.68% in Ramunia.

Meanwhile, according to filings with Bursa Malaysia, LTH emerged as a substantial shareholder of Hua-An in April this year after it bought another 1.91 million shares in the company. The purchase raised its holdings in Hua-An to 56.12 million shares or a 5% stake, thus qualifying it as a substantial shareholder based on Bursa Malaysia's definition.

The purchases by LTH of Hua-An shares gathered pace in August, and in the latest filings dated Sept 8, the pilgrims' fund has upped its shareholding to 62.17 million shares, equivalent to a 5.54% stake.

At first glance, LTH's entry into Hua-An could be deemed as wrong timing, given that the coke maker posted a RM36.91 million loss in the first half ended June 30, 2009, as it fell victim to the downturn in the steel and metallurgical coke industries caused by the global recession.

The Shandong-based outfit also saw the average price of coke plunging 40% in 2QFY2009 compared with a year earlier, while the average price of coking coal, the raw material used by Hua-An to make coke, fell at a slower pace of 29%. This left the company facing compressed margins.

Hua-An's share price has, however, remained largely resilient amid the fall in coke prices. The stock has risen 112.24% year to date, ending last Thursday at 52 sen.

LTH was not available for comment on its recent purchases of Hua-An shares, but it is possible the pilgrim fund sees promising prospects, with anticipation of further recovery in the steel sector in the current half of the year.

Hua-An has halved its net loss in 2QFY2009 to RM13.3 million, compared with a loss of RM23.6 million in 1QFY2009. According to TA Securities, the improvement was attributed to the stabilisation of coke prices from 1Q to 2Q, at the RMB1,460 per tonne level, while the prices of coking coal tapered off to RMB1,036 per tonne.

"Looking forward, we expect the group to turn around in 2HFY2009, underpinned by an increase in sales volume, higher contributions from coke by-products as prices are expected to move higher in tandem with crude oil, favourable coke prices, and the stabilisation of coal prices.

"We expect such favourable operating environment to continue into FY2010, lifting FY2010 net profit higher," says TA in a recent report.

The research house also says its fair value for Hua-An, at 86 sen per share, represents a two times discount to its sector price-earnings ratio of 12 times for the steel sector, and the discount is sufficient to compensate investors for investing in the company.

OSK Research reckons the company's share price may soon play catch-up with the share prices of Chinese steel mills, which are trading at between 16.5 times and 22.9 times forward PER, and between 1.5 times and three times price-to-net tangible assets.

It also says while FY2009 will be a washout for Hua-An, its earnings in FY2010 could "spring a surprise", with the potentially strong earnings being supported by factors such as the recovery of crude oil prices — which would increase revenue contribution of the company's by-products — and the company's plans to increase capacity.

Meanwhile, Standard & Poor's says in a research note that the company's results will rebound significantly in the current half of the year, driven by the recovery in China's steel industry. In addition, the coke industry there is also expected to recover in the same period, boosted by the government's RMB4 trillion stimulus package.

Data from China's Iron and Steel Association (CISA) seem to indicate that the steel and coke industries are regaining their shine.

According to a recent CISA report, China produced 266 million tonnes of crude steel in the first six months of this year, registering a y-o-y growth of 1.2%. It also became a net steel importer in 2Q2009 for the first time since end-2005.

The Chinese government has also introduced various incentives for the export of steel products, such as providing export rebates.

Meanwhile, coke production grew 6.6% y-o-y in June and while exports of coke dropped 96% y-o-y to 230,000 tonnes in 1H2009, domestic demand for the product was able to absorb the excess export quantity. CISA also says coke prices in central China's Shanxi province had risen 20% to RMB1,700 from April to July this year.

With Hua-An representing a good proxy to China's growth story, in addition to the stock's undemanding valuations, LTH's accumulation of its shares could yield promising returns. Only time will tell, however, whether the pilgrims' fund will continue to be a substantial shareholder over the long term. E