Sino Hua-An not immune to China risks

Its unit in Linyi city, Shandong province, is facing huge losses following a stoppage due to crackdown on environmental pollution

by Lim Cian Yai

IT is undeniable that companies doing business in China are often susceptible to regulatory, economic policy and political risks. However, the general perception is that local Chinese firms enjoy a greater measure of protection against such risks compared to foreign companies.

However, the reverse could well be true if the experience of Bursa Malaysia-listed Chinese metallurgical coke producer Sino Hua-An International Bhd is any indication. The Chinese company had recently been brought to its knees as a result of the China authorities' stepped-up enforcement of stiffer environmental regulations.

Sino Hua-An's key subsidiary, Linyi Yehua Coking Co Ltd in Linyi city in Shandong province, was forced to suspend operations since March following a crackdown by the local authority to improve air quality in light of public discontent over pollution.

Linyi Yehua contributes almost 100% of sales and earnings to Sino Hua-An, which was listed in 2007 via a reverse takeover of Antah Holdings Bhd. It was the first red-chip stock listed on Bursa Malaysia.

Sino Hua-An managing director Liu Guodong tells ***FocusM*** after its recent AGM that it could take six to nine months before the plant could restart operations.

"This situation is unprecedented. The closure has caused us a loss of RMB50-60 mil (RM29.4-35.29 mil) to repair the damaged coke ovens. Depending on the extent of damage, in the worst-case scenario, it would cost RMB300 mil (RM176.15 mil) to replace the impaired assets," he explains.

Double whammy

The company's problems were amplified when its coke ovens were damaged during the stoppage due to a drastic drop in oven temperature. Liu says the company is assessing the severity of the damage before deciding on the next step.

Apart from Linyi, Chengde in Hebei province was another key steel-producing city targeted by the authorities after Beijing recently toughened its stance against environmental pollution.

In Linyi alone, it was reported that over 400 companies from various sectors were forced to close pending clearance of all regulatory requirements.

Liu says it will take some time to restart Linyi Yehua's coke production as it needs to obtain the green light from the authorities.

"The authorities will assess our level of compliance once the ovens start producing again. It takes at least three months for the ovens to restart operation. The first month is to repair the damaged ovens, which then need to be fired up for approximately 50 days to achieve the optimal operating temperature of 1,300 degrees Celsius," he says. The average lifespan of a coke oven is 35 years.

In light of the closure, Sino Hua-An stresses its subsidiary "has always been able to meet the prescribed environmental standards since its incorporation".

"However with the advent of the said heightened 2015 new standards, we found ourselves falling short of meeting some elements of the revised standards," says the company.

Some of the rectification works needed are improvement of desulphurisation and dust-trapping equipment, installation of dust control in the coal- handling and sprinkler system, and connecting the company's management information system on emission data to China's Ministry of Environmental Protection.

The rectification work to meet the newly revised environmental protection standards was expected to be fully completed by last week. "Upon satisfactory assessment by the ministry, the suspension will be lifted," the company says.

On funding, Liu says Sino Hua-An has sufficient cash for the repairs and possible replacement.

"In the worst case (replacing the coke ovens), we may need bank borrowings. If we do not seek external funding, we may have inadequate cash flow to maintain future operations," says Liu, a China citizen.

He is one of the company's controlling shareholders with a direct interest of 10.16%. Negeri Sembilan royalty Tunku Naquiyuddin Tuanku Ja'afar has a 27.13% indirect and 1.08% direct interest.

Net cash generated from Sino Hua-An's operations for the first quarter ended March 31, 2015 stood at RM38.83 mil against RM4.81 mil a year earlier. Cash and cash equivalents were 61.42% higher at RM56.66 mil compared with the previous corresponding period.

Sino Hua-An says total losses arising from the shutdown could not be ascertained at the moment. "The loss (RMB50-60 mil) does not include loss of revenue from the sudden shutdown. It is very difficult to estimate as coke price is volatile and you may incur a loss for every tonne of coke you produce," explains Liu.

The company is bracing for the worst. Executive director Cedric Choo Sia Teik says the current financial year is "definitely going to be loss-making".

"We operated for only the first three months (of FY15), with production stopping for possibly the following six to nine months. Since the substantial portion of the year will be without production, it will definitely be a loss," says Choo.

Blessing in disguise

However, the shutdown may have a silver lining as current metallurgical coke prices are significantly lower than in 2012 when the company suffered a net loss of RM82.9 mil. In other words, if the plant were to operate at current prices till year-end, the company could well suffer a bigger loss than in 2012.

"If we do not have any operation till year-end, we can safely say that it will not be as bad as in 2012," says Choo.

He adds that production had continued to run in 2012. "The (metallurgical coke) price is even worse now than in 2012. To look at this positively, we are able to reduce the quantum of loss," he explains. FocusM

Choo (left) and Liu, who says the company has sufficient cash for the repair work

SINO HUA-AN INTERNATIONAL BHD

Key board members and management
Tunku Naquiyuddin Tuanku Ja'afar (chairman), Liu Guodong (managing director), Cedric Choo Sia Teik (executive director), Liu Xueqiang (executive director)

Major shareholders	
Rock Point Alliance Pte Ltd	**25.39%**
Liu Guodong	**10.16%**
Rise Business Inc	**9.09%**
Market cap (May 28)	**RM89.78m**
Share price (May 28)	**8 sen**
52-week high (Aug 8, 2014)	**17 sen**
52-week low (May 28, 2015)	**8 sen**
Financial results (Q1 ended March 31, 2015)	
Revenue	**RM154.74m**
Net loss attributable to shareholders	**RM11.21m**

Survival of the fittest

SINO Hua-An International Bhd is in a good position to weather the current low coke prices because of its strong balance sheet and zero borrowings.

Its executive director Cedric Choo Sia Teik says this puts the company in a better position to ride out the storm compared to other players. In fact, he sees this challenge as a restructuring cycle which will eliminate the smaller and financially weak players.

"At the moment, it is all about how to survive. Every coke player has the same problems and those which cannot withstand this will close permanently. So when the cycle is over, whoever is still standing will face less competition."

Choo points out that when there are fewer players in the market, oversupply will be addressed and coke prices will recover.

He believes prospects remain bleak for coke prices in the near term, as prices are influenced by the production of steel which is currently seeing a glut.

As of May 27, the price for first-grade metallurgical coke was quoted at RMB780 per tonne in Linyi, according to Bloomberg data. The commodity was traded at RMB980 a year ago.

Even before the closure of its subsidiary Linyi Yehua Coking Co Ltd's plant in Linyi city, Shandong province, Sino Hua-An's financials had shown signs of weakness.

Revenue for the first quarter ended March 31, 2015 slipped to RM154.74 mil from RM320.51 mil a year earlier. It suffered a RM11.21 mil net loss versus a net profit of RM599,000 a year earlier. In FY14, the company had posted a RM2 mil net profit on RM1.1 bil sales.

Before the closure, the Linyi plant was running at 90% of its annual capacity of 1.8 million tonnes.