midf RESEARCH

25 May 2016 | 1QFY16 Results Review

Ann Joo Resources

Recent steel price rally not sustainable

***Maintain* SELL**

***Adjusted* Target Price (TP): RM0.85**
(*previously* RM)0.60)

INVESTMENT HIGHLIGHTS

- **The Group recorded a net profit of RM5.5m in 1QFY16 due to recovery in steel prices and reversal of inventories written down to NRV of RM18.47m**
- **The recent steel prices rally with more significant upward movement in Mar and Apr'16 was due to temporary shortage of steel which have started to correct with prices adjusting downwards**
- **Steel prices will continue to remain volatile**
- **Overcapacity of steel in China and the issue of high exports of China's steel persist**
- **Maintain SELL with an adjusted TP of RM0.85 pegged to a PB multiple of 0.5x on FY16 BVPS**

Marginal net profit of RM5.5m in 1QFY16 due to recovery in steel prices and reversal of inventories previously written down to NRV of RM18.47m. A marginal net profit of RM5.5m was recorded in 1QFY16 vs. 4QFY15's net loss of RM47.7m. This was largely due to a reversal in inventories previously written down of RM18.47m as steel prices recovered in 1QFY16. Steel prices moved up after Chinese New Year this year with a stronger price surge in March and April 2016. The upward movement was fuelled by a temporary shortage of steel as a result of restocking activities for a more active production. This was after lull period of production due to the earlier weaker selling prices. We believe that the surge was also contributed by speculative activities in futures trading. Hence, the upward price movement is not sustainable.

The higher steel prices seen earlier have started to ease towards the end of Apr'16 and the price correction has extended into May'16.

Revenue for its Manufacturing and Trading Division in 1QFY16 was higher sequentially but was lower on-year than 1QFY15. AJR's Manufacturing Division reported an operating profit of RM6.09m in 1QFY16 while its Trading Division recorded an operating profit of RM11.4m vs. RM15.53m and RM3.52m respectively in 1QFY15.

The Group's inventories declined 35.6%yoy to RM761.6m as at end 1QFY16 as the Group fully disposed off its pig iron and has even entered into forward selling for pig iron. Its net gearing ratio improved to 1.17x as of end 1QFY16 vs. 1.32x in 1QFY15.

RETURN STATS	
Price (24 May 2016)	RM1.03
Target Price	RM0.85
Expected Share Price Return	-17.5%
Expected Dividend Yield	-
Expected Total Return	**-17.5%**

STOCK INFO	
KLCI	1,625.84
Bursa / Bloomberg	6556 / AJR MK
Board / Sector	Main / Industrial Products
Syariah Compliant	No
Issued shares (mil)	500.6
Par Value (RM)	1.00
Market cap. (RM'm)	515.6
Price over NA	0.6x
52-wk price Range	0.62 – 1.26
Beta (against KLCI)	0.84
3-mth Avg Daily Vol	0.13m
3-mth Avg Daily Value	RM0.09m
Major Shareholders	
Ann Joo Corp	36.7%
Lim Seng Chee & Sons S/B	13.9%

With the planned early repayment of RM219m of its bonds in May'16, it is envisaged that its net gearing will improve to 0.93x.

The industry issue of overcapacity in China and high exports from China continue to persist. We understand that the recent recovery in steel prices has resulted in China suppliers cancelling their exports orders to the local steel mills resulting in temporary shortage which have caused domestic steel prices to surge. Steel prices are expected to remain volatile and price correction which has already started will continue into 2HCY16 until a stabilisation point where prices are supported by fundamentals of supply and demand.

Operating environment continues to be challenging. Although the China's government has announced its plan to remove the excess steel production capacity in China by 100 to 150 million tons of crude steelmaking capacity over 5 years, we expect the reduction of production capacity to be slow as it will have a socioeconomic impact (higher unemployment rate in China) if it is done swiftly. Until further measures have been implemented to curb the steel overcapacity in China and the strong imports of steel bars into Malaysia, we do not expect the higher steel prices to sustain.

The Group announced 3 corporate exercises. The Group has announced 3 corporate exercises; i) Rights issue of 1 Redeemable Cumulative Preference Shares (RCPS) for every 4 Ann Joo shares (Indicative terms: issue price for RCPS: RM0.50; Par value for RCPS: 0.01 per RCPS; tenure for RCPS: 8 years; conversion price: RM1.80 and conversion ratio: 1 RCPS for 1 Ann Joo shares), ii) Long term incentive (LTIP) to eventually reward key personnel and senior management with share grants and options where the issuance of new shares shall not exceed 15% of the issued and paid-capital of Ann Joo, and iii) Dividend Reinvestment Plan (DRP) which allows electable portion of any dividends paid together with a non electable portion to be reinvested into additional shares of Ann Joo. The DRP as we understand is for flexibility to allow portions of dividends (if any) to be reinvested back into the company.

The proposed RCPS is expected to raise RM42.2m (Min Scenario) to RM62.57m (Max Scenario) with RM1m utilised for defraying of expenses for the proposals and remaining to be used for working capital within a period of 12 months. This could lead to eventually an enlarged number of shares to 660m (Min Scenario) and 700.8m shares (Max Scenario) from the current 500.6m shares (after deduction of Treasury shares). Based on our estimates, the dilution to EPS could range from 31.8% (Min Scenario) to 40.0% (Max Scenario) while BVPS is expected to remain intact. In view that the details for the RCPS are only indicative as of now, we will only factor it into our estimates once the terms have been firmed up.

Forecast revised to reflect recovery in steel prices. In view of the 1Q recovery in steel prices, we have revised our net profit forecast for FY16 to RM14.1m from a loss of RM178.3m previously.

Maintain SELL with an adjusted TP of RM0.85. We maintain our SELL recommendation. We would advocate selling into strength from the earlier rise in share prices due to recovery in steel price. This is in view that the steel price correction has started and is expected to continue.

RESULTS SUMMARY

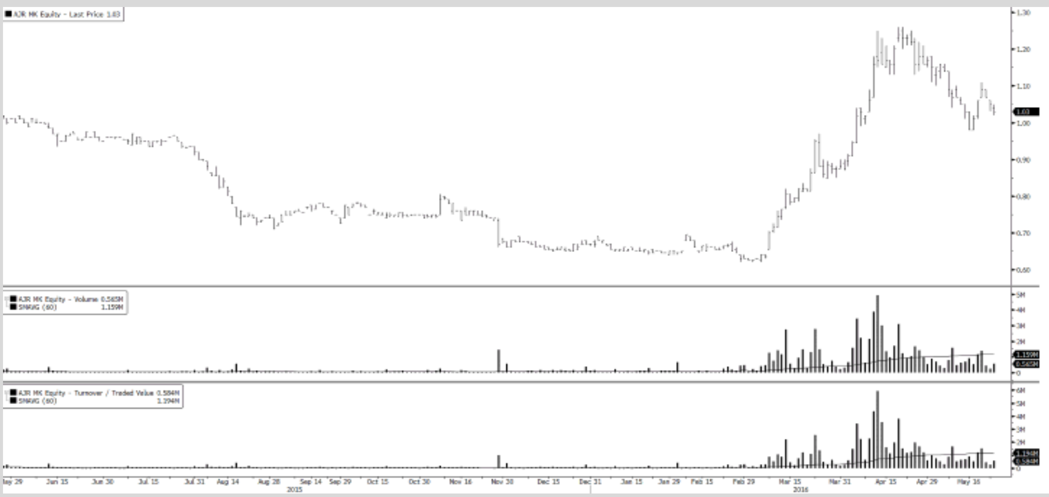
FYE Dec (RM m)	1Q16	4Q15	1Q15	%Qoq	%Yoy
Revenue	489.5	413.5	520.6	*-6.0%*	*-6.0%*
EBIT	21.3	-33.3	22.7	*-163.8%*	*-6.2%*
Pre-tax profit	7.4	-48.0	7.5	*-115.4%*	*-1.3%*
Net Profit	5.5	-47.7	5.3	*-111.6%*	*+3.6%*
				+/- ppts	**+/- ppts**
EBIT margin (%)	4.3%	-8.1%	4.4%	*+12.4%*	*-0.01%*
Pre-tax margin (%)	1.5%	-11.6%	1.4%	*+13.1%*	*+0.1%*
Net margin (%)	1.1%	-25.3%	1.0%	*+12.7%*	*+0.1%*

INVESTMENT STATISTICS

FYE Dec	FY13	FY14	FY15	FY16F
Revenue (RM 'm)	2,155.4	2,291.9	1,760.9	1,975.4
EBIT (RM'm)	62.7	81.3	-80.4	66.8
Pre-tax Profit (RM'm)	4.48	25.0	-140.5	18.8
Net Profit (RM'm)	12.3	23.4	-135.5	14.1
EPS (sen)	2.5	4.7	-27.1	2.7
EPS growth (%)	+164.1	+88.0	>-100	>100
PER(x)	25.8	13.7	n.m	n.m
Net Dividend (sen)	-	3.1	-	-
Net Dividend Yield (%)	-	3.1	-	-

Source: Company, MIDFR Forecast

DAILY PRICE CHART



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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by>15% within 3-months after a Trading Buy rating has been assigned due to positive news flow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative news flow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.