

13 August 2018 | Special Update

Steel Sector

More Headwind Coming So Recovery is Slower than Expected

SECTOR HIGHLIGHTS

- **More headwinds expected**
- **Negative reaction to news**
- **SST will give a breather to construction and steel sector**
- **FYE18/FYE19 will be negative for steel sector**

More headwinds expected. The Malaysian steel sector is expected to experience more headwinds from the trade wars. Currently, Street has priced-in the risk from trade wars such as tariff imposition and duty order from local steel exporter for products bound for the United States and Europe. On the other hand, China is demand for steel is shaky coupled with the slump in their construction industry. The demand from China manufacturing sector takes up to 360 million metric tons annually - close to 60 percent of its annual consumption. But, the demand is expected to shudder due further due to China's environmental health and occupational safety policies.

Negative reaction to news. Closer to home, in our observation Ann Joo Resources, Lysaght Galvanised Steel, Southern Steel, SC Steel, Mycron Steel and Choo Bee Metal has shown negative reaction to the announcements and influx of news regarding trade wars and tariff imposition by the United States and European Union. We reckon that this trend will persist as globally steel demand is expected to grow to 1,616.1 million metric ton (+1.8%YoY) in FYE18 and tepid growth will be plagued low demand for FYE19 - growing to 1,626.7 million metric ton (+0.7%YoY). This means less demand for export for the local steel mill. Most of the local companies are affected by unwavering overhead costs and operation expenditure making the sector unattractive. For example, total margin for the companies under observation for the past 5 years are (**Appendix 1**);

Companies	Net Margin
Southern Steel	-0.7%
Ann Joo	2.4%
CSC Steel	3.4%
Mycron Steel	2.1%
Choo Bee Metal	5.1
Total	2.5%
*Lysaght Galvanized Steel	20.6

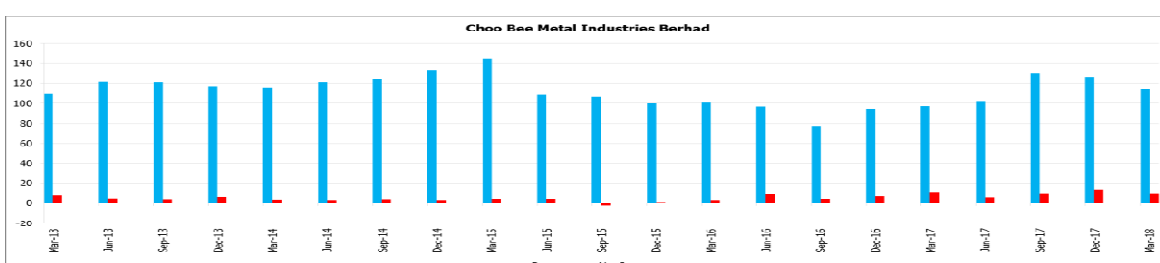
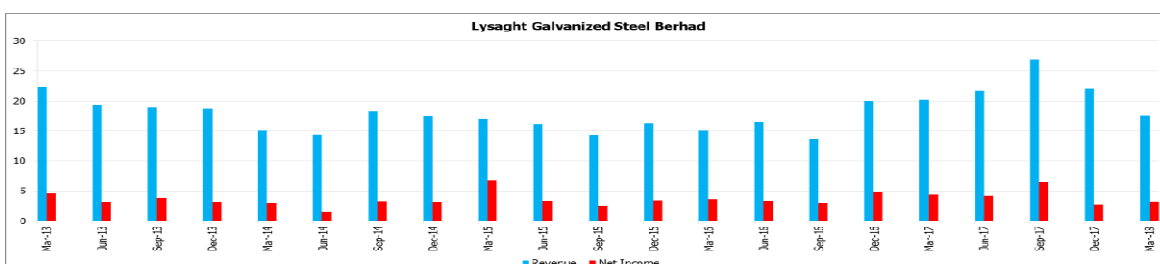
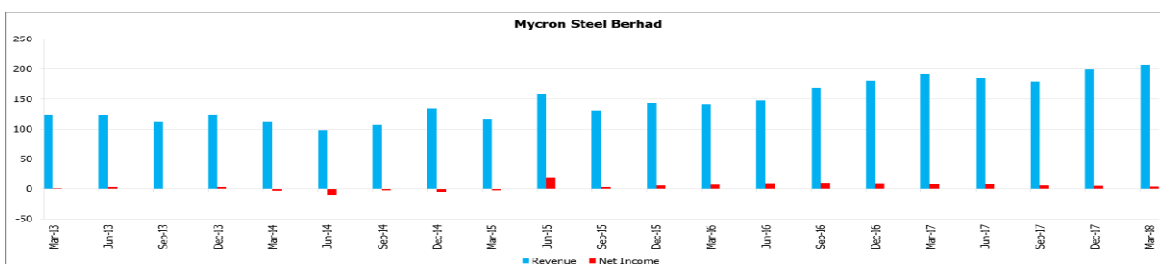
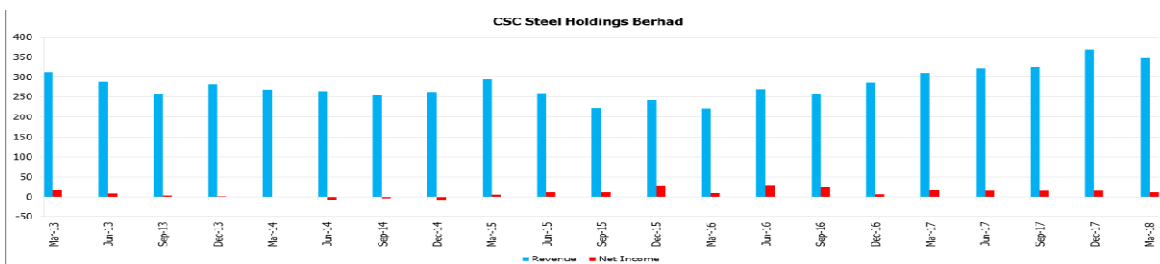
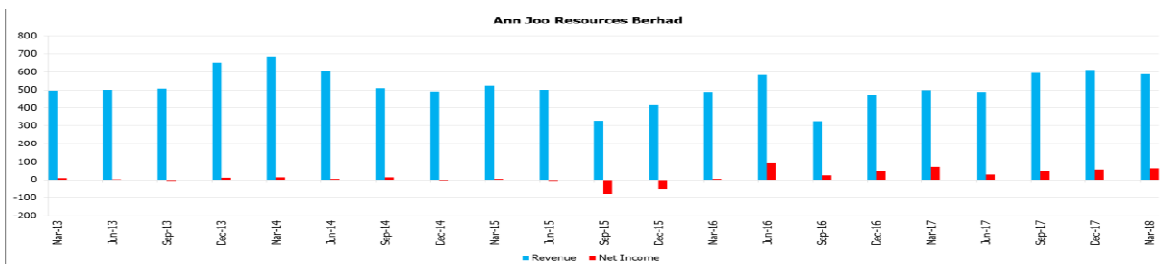
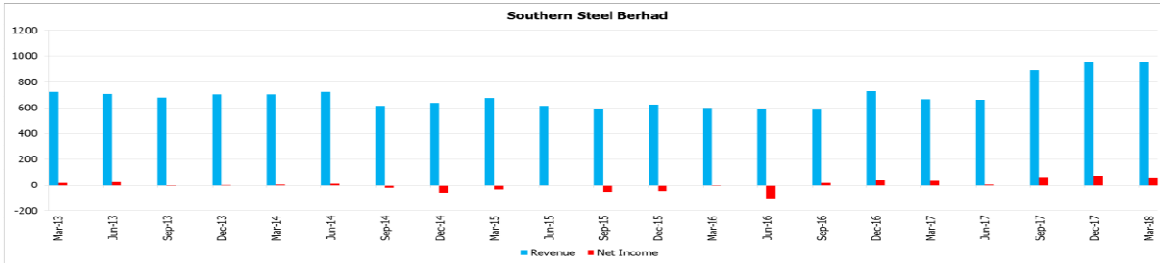
*We exclude Lysaght as it is not really a pure play steel mill; the company manufactures steel pole and masts. Hence, the slide in the share price due to news on tariffs and insipid demand works is unjustified to Lysaght's as the cost structure is expected to improve further.

SST will give a breather to construction and steel sector. Furthermore, the government has announced the exclusion of Sales and Services Tax (SST) for building materials and construction services. If it takes place, the construction sector is expected to take a breather from the grim outlook that impacts the industry from project cuts. The steel and construction sector are interconnected as the former relies heavily from the building material demand from the latter's project activities. SST will enable steel sector to maintain its product supply to construction sector without any additional cost.

FYE18/FYE19 will be negative for steel sector. We believe that the steel mill are still operating at more than >70.0% of capacity. Changes in global trade policies, tepid global demand as well as the local steel mill cost structure will continue to impede any positive demand for the companies under our observation. We view that the steel sector will be affected negatively in for FYE18 and FYE19.

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APPENDIX 1



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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

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.