

29 June 2015 | Sector update

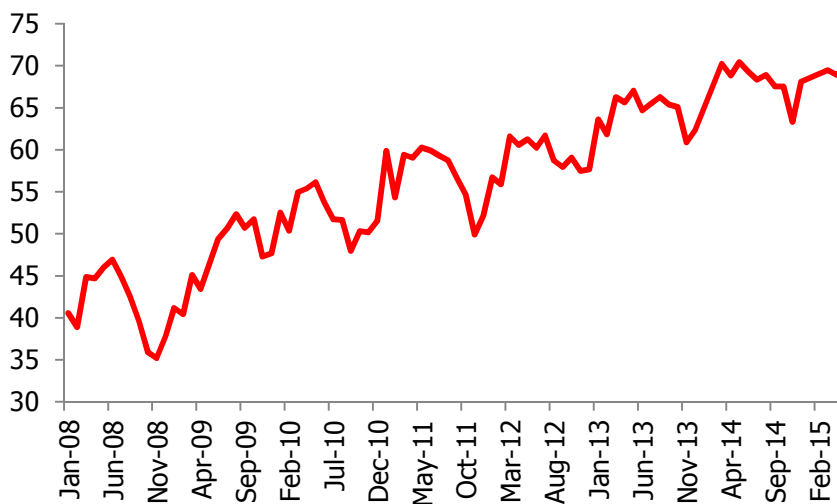
STEEL: China’s steel exports likely to continue to rise *Maintain NEGATIVE*

KEY HIGHLIGHTS

- **China’s steel production remained high leading to a rise in export volume of steel**
- **Export tonnages for Wire Rod and Rebars continue to be rampant**
- **Global steel production capacity utilization declined reflecting overcapacity in steel production worldwide**
- **Continue to expect rampant dumping activities of steel products in the local market**
- **Volatile raw material prices to continue to pose challenges to margins of steel players**
- **Maintain NEGATIVE on the sector**

China’s steel production remained high leading to a rise in export volume of steel. China’s steel production overcapacity continues to plague the industry. Chart 1 shows the continuation of high volumes of steel production by China. In 1Q15, China’s steel production was circa 200 million mt. This compares to 4Q14 and 3Q14 of 198 million mt and 205 million mt respectively. In April and May 2015, based on our tracking, China’s steel production continued to remain high at 69 million mt and 70 million mt respectively.

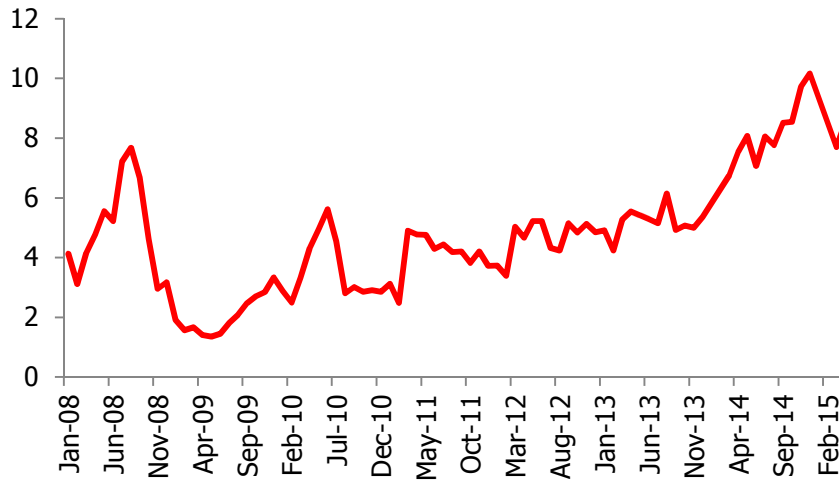
Chart 1: China steel production (in million mt)



Source: CEIC, MIDFR

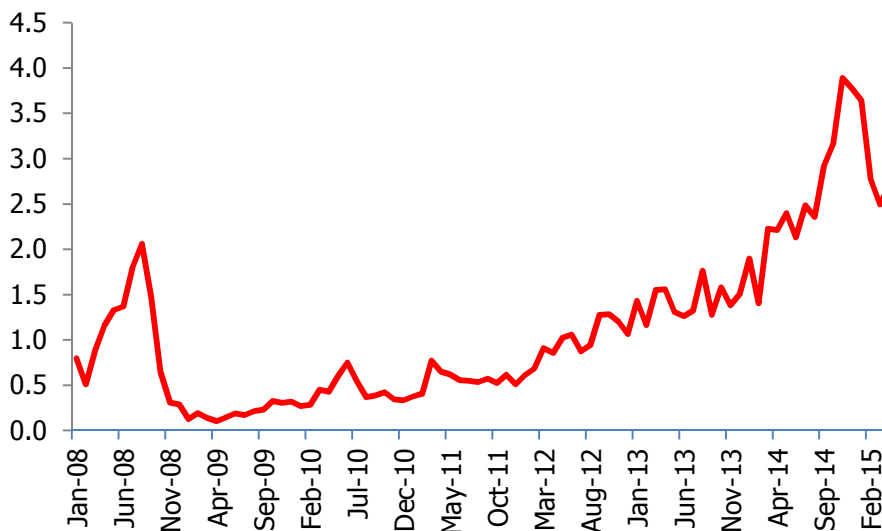
Export tonnages for Wire Rod and Rebars continue to be rampant. We continue to observe export volume of China’s steel trending up (refer Chart 2 above). Exports of billets and rebar continued to be on the rise as seen in Chart 3. Chart 4 shows that the percentage of steel produced by China exported overseas. In 1Q15, 13.0% of the steel produced by China of 200 million mt was exported overseas. In Apr’15, the percentage of China’s steel exported out remained high at 12.4%.

Chart 2: China steel exports (in million mt)



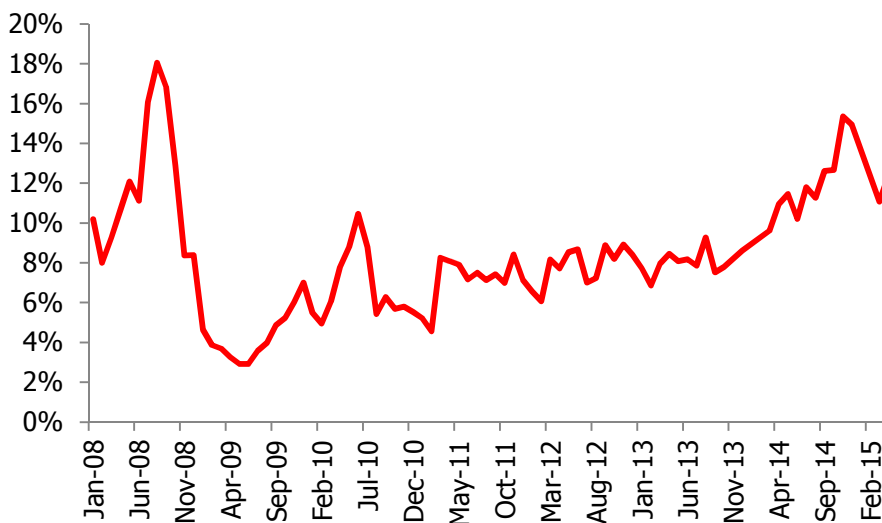
Source: CEIC, MIDFR

Chart 3: China exports of Rebar and Wire Rod (in million mt)



Source: CEIC, MIDFR

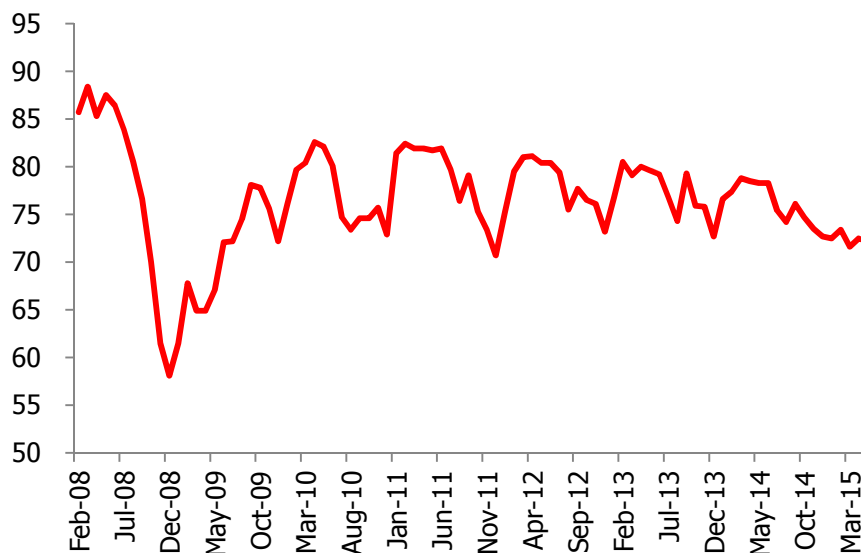
Chart 4: Percentage of steel produced by China exported overseas (%)



Source: CEIC, MIDFR

Global steel production capacity utilization declined reflecting overcapacity of steel production worldwide. Global world steel production capacity utilization continues to slip to 72.0% as of end May 2015, down from 73.0% as of December 2014. The lower utilization rate of global production capacity of below 80% has been persistent in 1st 5 months of CY15. This reflects the continuation of overcapacity in steel production worldwide.

Chart 5: Global world capacity utilization rate (%)



Source: WSA

Continue to expect rampant dumping activities of steel products in the local market. With high global overcapacity coupled with slower economic growth in China, export volume of China's steel products to overseas has been evidenced. We continue to expect rampant dumping activities of steel products in the local market. Recall that the earlier petition to MITI by local steel company for trade remedies against the anti-dumping of steel bars by China Mills was unsuccessful. As a result of this, no anti-dumping duties were imposed on the imports of Rebars. Operating environment continues to be challenging for domestic steel companies. We continue to expect operating margins to be affected by the flooding of cheap steel from China without any anti-dumping duties imposed on Wire Rods and Rebars.

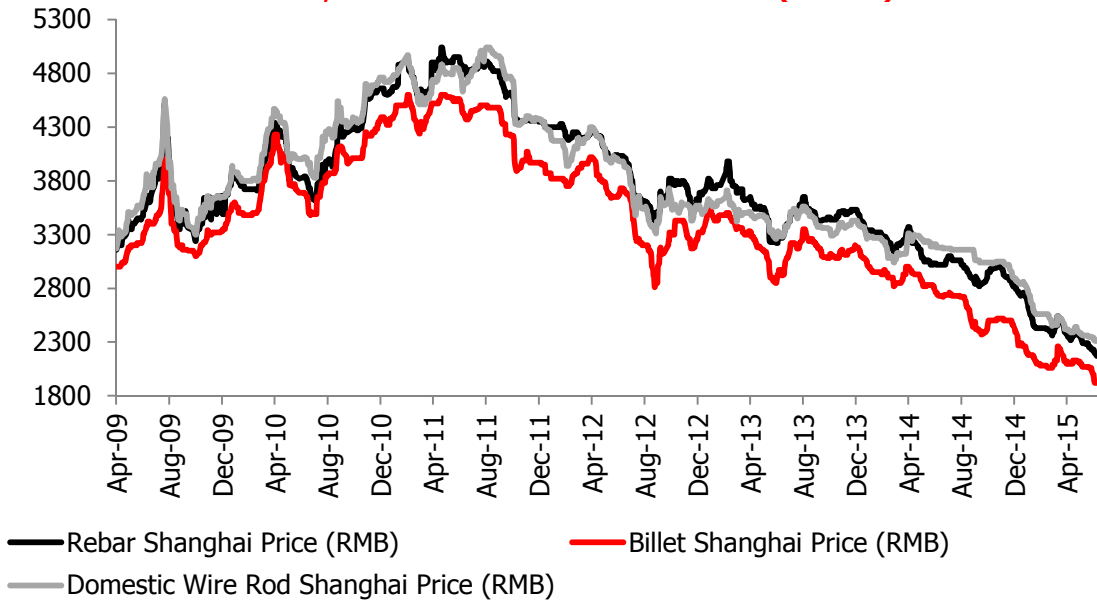
Prices of long steel, Billets, Rebars and Wire Rods continued to decline. In 2Q15, Billets, Rebars and Steel Bars prices drop to an average of RMB2,083, RMB2,323 and RMB2,389 per metric tonne respectively. This was lower compared to average price of RMB2,143, RMB2,499 and RMB2,600 respectively in 1Q15 (see Table 1 and Chart 6). Spread between Billet and Steel Bar price remained narrow as seen in Chart 7, hence reflecting weakness in the pricing of long steel products. Meanwhile, Chart 8 shows the volatility of the spread between Rebars and Wire Rods.

Table 1: Average price of Billets and Steel Bars by quarters

Average Price (RMB per metric tonne)	Billets	Rebars	Wire Rods
2Q15*	2,083	2,323	2,389
1Q15	2,143	2,499	2,600
4Q14	2,459	2,897	2,986

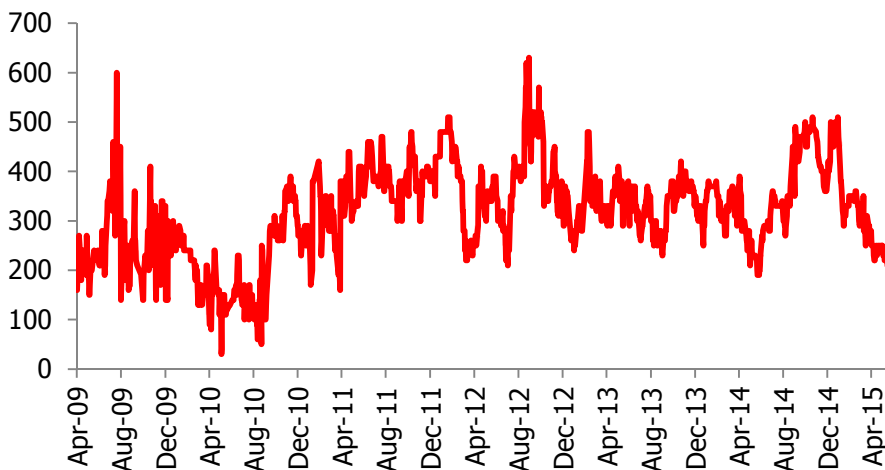
*Denotes average from 1/4/15 to 24/6/15 Source: Bloomberg

Chart 6: Billets, Rebar and Wire Rod Price Trend (in RMB)



Source: Bloomberg, MIDFR

Chart 7: Spread between Billets and Rebars (in RMB)



Source: Bloomberg, MIDFR

Chart 8: Spread between Rebars and Wire Rod (in RMB)

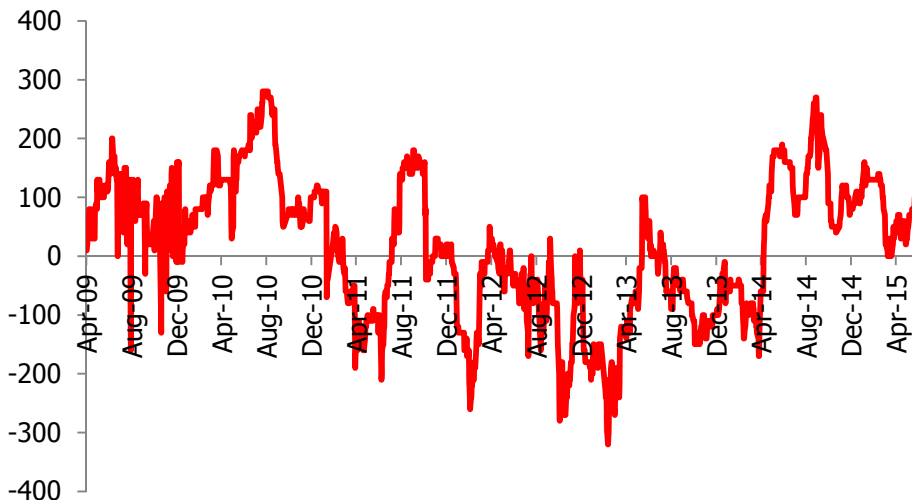
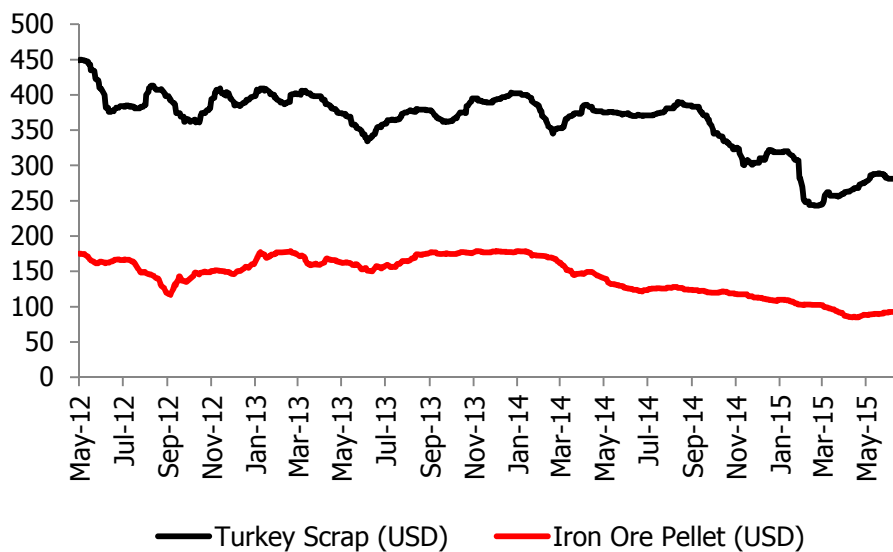


Chart 9: Iron Ore and Scraps Price Trend (in USD)



Source: Bloomberg, MIDFR

Table 2: Average price of Iron Ore and Scrap by quarters


Average Price (USD per metric tonne)	Iron Ore Pellet (Spot)	Scrap
2Q15*	89	278
1Q15	102	272
4Q14	115	320

*Denotes average from 1/4/15 to 24/6/15 Source: Bloomberg

Volatile raw material prices to continue to pose challenges to margins of steel players. Chart 9 shows volatility in the prices Iron Ore and Scrap. Average prices of Iron Ore in 2Q15 slipped to USD89 and USD278 per mt from USD102 while scrap prices was slightly higher at USD278 per mt in 2Q15 compared to USD272 per mt in 1Q15.

Maintain NEGATIVE on the sector. The sector continues to be faced by the overcapacity of steel production as well as slowdown in China's economy. With the slowdown of China's economic and steel consumption by China, part of the steel produced by Chinese mills had to be exported out. This has resulted in the rampant dumping of cheap steel products in Southeast Asia market. We gather that in the 1Q15, China's steel products have flooded the Southeast Asia market reaching 7.18 million mt, an increase of +63.0%yoy. Arising from this, margins of steel players have been impacted and this requires greater value added in steel production as well as cost competitiveness to compete with China's cheaper steel products. While the Chinese government has removed the export tax rebate on certain boron added steel products, we understand that there are still steel producers in China that continue to benefit from the export tax rebate by switching to add other alloy elements to qualify for rebate under the 'Other alloy steel' classification. Hence, dumping activities of China's steel products continue to impact demand and margins of local long steel players. On flat products, MITI is now investigating into the alleged dumping of three grades of colour-coated steel coils from Vietnam and China.

Effective, 1st July, Gas prices will be higher by RM2.03 per million British thermal unit (MMBtu) or circa 10% from RM19.77 MMBtu to RM21.80 MMBtu for industrial users. The hike in gas prices will also impact steel producers in Peninsular Malaysia and this is likely to result greater challenges to the earnings to steel players.

Despite of maintaining our NEGATIVE stance on the sector, we are still NEUTRAL on Ann Joo (TP: RM1.06) and Lion Industries Corp (LICB) (TP: RM0.36). This is in view that the weaker fundamentals of the steel operations have already been reflected in the share prices of the stocks. Base on the current share prices, AJR and LICB have already traded well below their book values. 

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	Rec.	Price @ 26/6	Target Price	EPS (sen)		EPS chg (%)		PER		Net DPS		Net DivYield	
				FY14	FY15	FY14	FY15	FY14	FY15	FY14	FY15	FY14	FY15
AJR	NEUTRAL	0.96	1.06	4.7	2.3	+88.0	-51.1	20.4	41.7	2.0	-	2.1	-
Lion Industries	NEUTRAL	0.36	0.36	5.5	-14.4	-16.7	n.m	6.5	n.m	-	1.0	-	2.8

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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 <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	<i>Negative</i> total return is expected, by -15% or more, over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% 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.