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KUALA LUMPUR: Many metal stocks have risen sharply of late, mainly due to improving sentiment for commodities in general, supported by China's commitment to tackle current excess capacity in its steel sector.

A check on 25 steel companies listed on Bursa Malaysia shows that more than half are trading at double-digit price-earnings ratios (PER), ranging from 10.33 times to as high as 74.32 times.

Among the big players, YKGI Holdings Bhd and FACB Industries Incorporated Bhd are trading at PERs of 74.32 times and 25.28 times, respectively.

In theory, the higher the PER ratio, the more expensive the stock. However, analysts see opportunity for investors to get into selective stocks for dividend play.

According to them, as steel prices continue to rally leading to some steel stocks' prices to triple over the past year, a valuation gap is seen emerging that may open the door for an opportunistic dividend play.

"If things remain status quo, the mid-tier stocks are bound to catch up eventually [in terms of PER valuation]," a senior industry executive told *The Edge Financial Daily*.

"There could be opportunities for dividend play [as the steel companies' earnings rebound following years of grappling with the surge of cheap Chinese imports into the local market], especially when a number of companies in the space are family controlled," he added. Traditionally, family-controlled firms are seen paying some of the highest dividend payouts.

But that's assuming these family-controlled steel companies whose valuation is lagging behind top-tier stocks, see a surge in profit and their share price continue to improve.

Taking away stocks with PERs at the extreme end such as YKGI and Tatt Giap Group Bhd's 0.6 times, there are currently four steel stocks trading at single-digit PERs comprising Mycron Steel Bhd (8.87 times), CSC Steel Holdings Bhd (8.56 times), Leon Fuat Bhd (7.99 times) and Eonmetall Group Bhd (5.99 times).

According to the Malaysian Iron and Steel Industry Federation, imports of steel products from China surged 281% to 3.44 million tonnes in 2015 from 904,000 tonnes in 2010 after the Asean China Free Trade Agreement took effect in January 2010.

When contacted, several fund managers and analysts concurred that there is an opportunity for dividend play among the steel stocks, although some remained sceptical due to the cyclical nature of the steel sector which makes dividend payouts not sustainable in the long run.

In February this year, China announced that it will work to cut steel output by up to 150 million tonnes although it did not specify a time frame. The move will cut 500,000 jobs in the steel sector alone, Bloomberg quoted China's human resources ministry as saying.

China has also committed 100 billion yuan over two years to aid retrenchment schemes, although this fund is also intended for job cuts in the coal sector.

These developments have helped steel prices in Malaysia to recover, alongside rising energy prices and local safeguard duties announced in September for rebar imports. The duties, which took effect for 200 days beginning Sept 26, 2016, are 13.9% for steel coils and 13.4% for reinforced bars respectively. The safeguard duties would be reviewed again in April, according to news reports.

"There were questions about whether China would really hurt its own steel production, but they have been cutting and seem to have the resolve to do this," said a senior analyst with a local bank-backed research house.

"If the steel production capacity continues to fall, then yes, the worst is over [for Malaysian steel players]," he added.

According to a monthly survey by the Construction Industry Development Board, mild steel round bars in Selangor averaged just under RM2,500 a tonne last December, compared with RM1,800 a tonne a year ago.

"For cyclical sectors such as steel, dividends would be a bonus," the senior analyst said.

However, two senior fund managers warned that this may not mean the sector is heading in the direction of recovery. They pointed to steel players' tight cash flow and compressed margins in a high-capital business environment.

For one fund manager, that casts doubt on dividend hopes in general, as any dividend would "depend on [the company's] cash flow. Their cash flow is very much affected by the commodity cycle and is very hard to predict."

Do steel stocks still have legs?

While a couple of market observers opined that the steel recovery prospects in general have not been fully priced in, they are of the view that the cheaper buys in the sector have all been taken.

"The lowest phase has clearly passed and every day the rally continues, the more uncertain it

becomes on where we are at the current upcycle,” noted one market observer. “Everyone is assuming things will recover and that things in the steel sector will remain the status quo. But the market is ignoring [possible risks] ahead.”

They include uncertainty over what US President Donald Trump might do amid signals of increasing protectionism from the world’s largest economy.

“The very obvious risk is what would Trump do? If he puts a border tax across the board on imports, a lot of our steel exports can’t get into the US. Our steel exports are not big, but it would impact global steel prices and that would spill over into our steel sector,” said one analyst.

In addition, while steel product prices have recovered, demand outlook is mixed.

A fund manager opined that while major infrastructure projects announced by the government may support demand, that boost is offset by a slowdown in the housing sector, another primary driver.

Such infrastructure works include the Mass Rapid Transit project and the upcoming RM55 billion new East Coast Rail Line that will connect the Klang Valley to the East Coast via 600km of rail tracks.

The Malaysian Steel Institute (MSI), an agency under the ministry of international trade and industry (Miti), estimates a full-year steel products consumption of at least 10.4 million tonnes in 2017, slightly higher than the expected figure for 2016 which will only be confirmed after December’s data is released in early March.

It is understood that MSI and Miti have been pushing to promote the use of local steel products in construction works to boost consumption of the local steel sector’s output.

For investors looking at value buys amid the ongoing rally in the steel sector, a key factor to watch out for is the cost structure, said several fund managers.

This means examining the sub-niches of each player, their type of facilities and comparing them against direct peers. In addition, a look at major shareholdings may add another dimension of interest for those looking to bet on dividends from a potential year of earnings recovery.

“The more efficient players would have a higher net profit margin,” said another analyst. “Also look at how good the management are and how new is their steel milling facilities — newer usually means more efficient.”

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Comparison of 25 steel companies

COMPANY	PRICE (RM)*	MARKET CAP (RM MIL)	PER	1Y TOTAL RETURN (%)	TOTAL RETURN YTD (%)	REVENUE 12M^ (RM MIL)	EPS 12M^ (SEN)
Ann Joo Resources Bhd	2.450	1,227.36	16.758	266.05	12.90	1,811.46	0.146
CSC Steel Holdings Bhd	2.120	782.94	8.559	77.65	-1.40	990.82	0.244
Southern Steel Bhd	1.360	574.86	-	80.00	12.40	2,393.81	-0.357
Hiap Teck Venture Bhd	0.330	423.88	-	71.76	16.99	1,099.81	-0.012
WZ Satu Bhd	1.170	408.17	14.506	41.58	9.35	493.21	0.080
Malaysia Smelting Corp Bhd	3.940	394.	16.000	74.34	0.25	1,482.45	0.245
Pantech Group Holdings Bhd	0.465	343.48	12.697	3.35	4.49	435.93	0.037
Tong Herr Resources Bhd	2.120	327.84	13.275	20.35	3.92	571.99	0.160
Lion Industries Corp Bhd	0.475	323.39	-	115.56	17.28	2,456.16	-1.107
Mycron Steel Bhd	0.985	279.14	8.866	310.42	-2.48	602.45	0.111
Malaysia Steel Works KL Bhd	0.855	208.02	13.710	123.68	3.01	1,136.48	0.062
Leon Fuat Bhd	0.550	170.5	7.991	21.11	18.28	492.17	0.068
Lysaght Galvanized Steel Bhd	3.500	145.53	10.542	0.34	0.00	61.69	0.332
Eonmetall Group Bhd	0.640	107.94	5.994	149.53	8.47	97.26	0.108
YKGI Holdings Bhd	0.280	97.53	74.324	52.78	24.44	401.56	0.004
FACB Industries Inc Bhd	1.120	93.95	25.282	12.18	6.13	50.83	0.044
Melewar Industrial Group Bhd	0.395	89.08	-	85.71	5.33	658.39	-0.007
Perwaja Holdings Bhd	0.100	56.	-	-36.36	5.26	55	-0.678
Leader Steel Holdings Bhd	0.430	54.3	12.536	177.42	7.50	152.68	0.034
Amalgamated Industrial Steel Bhd	0.430	53.78	-	43.33	-1.15	58.29	-0.033

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