Steel roaring back in earnings

Cut in China's steel capacity does not necessarily translate to lower production

Salient points:

> Local steel companies benefit from China policy to cut output.
> But China production could still rise.
> Local players protected by safeguard duties on imports.

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THE local steel industry is back in vogue.

A number of steel producers have reported strong earnings from higher steel prices, although some are still in the doldrums. The steel industry has been in a slump the last five years, beleaguered from the oversupply of steel products especially from China.

But things are turning the other way now. Since last year China has sought to reduce its steel production capacity as a means to reduce the glut and reduce pollution there. The effects are being felt here now. Among the local steel players which have recorded big gains in their earnings are Ann Joo Resources Bhd, Southern Steel Bhd and Hiap Teck Venture Bhd.

Southern Steel, for example, returned to the black in its financial year ended June 30. It reported a profit of RM93.3mil for FY2017 versus a loss of RM221.15mil for FY2016.

Hiap Teck, meanwhile, enjoyed a tripling of its profits to RM32mil for its third quarter ended April 30 from a year before.

The stock prices of these companies have also done very well. Since the beginning of the year, Ann Joo's stock gained 77.4% to RM3.68, while Southern Steel and Hiap Teck surged 107% and 54.2% to RM2.46 and 43.5 sen.

At current prices, Ann Joo is trading at an earnings multiple of 10.7 times, while Southern Steel is at 11.1 times and Hiap Teck at 13.1 times.

However, is this positive trend sustainable? It should be noted that in the last five years, the industry was hit by a plunge in steel prices due to an oversupply that saw some steel players like Megasteel and Perwaja shutting down operations.

Hence despite the good run for the year, industry experts reckon that the road for local steel millers will be bumpy.

For one, the price of steel is dependent on China's policies over its steel industry.

"The sustainability of (steel) prices are dependent on China's policies and demand as well as global demand," says Malaysian Iron and Steel Industry Federation president Datuk Soh Thian Lai.

He points out that although China last year pledged to cut 150 million tonnes of excess steel capacity by 2020, the republic would still have another 150 million of excess capacity.

"One key setback for the steel industry is the likelihood of China's mills increasing production to gain profits. Also the capacities that China are cutting are mainly from private mills. These mills are likely to restart their operations," he says.

According to the Organisation for Economic Co-operation and Development, the global steel capacity in 2016 was 2.38 billion tonnes, of which Chinese capacity stood at 1.17 billion tones, with rest of the world at 1.22 billion tonnes.

But although China is cutting its excess steel capacity, indication are that this does not necessarily lead to lower steel production there.

Last month, China based millers ramped up their production, posting a monthly record production. Their mills which include the world's top suppliers, increased output to take advantage of the rally in steel prices. They did this before the capacity cuts by the government which were to begin this month, Bloomberg reported.

The report said that steel output in China climbed to 74.59 million tonnes last month, up from 68.57 million in August 2016.

China is expected to cut more capacity starting this month as part of the country's winter anti-pollution curbs.

The Chinese government made a commitment last January to reducing its steel production capacity by between 100 million and 150 million tonnes.

Since last year, China has also been clamping down on illegal steel producers in efforts to curb pollution especially in the Beijing area.

Since China's pledge in 2016, steel prices have stabilised globally and, had given the much needed breathing space for local steel players.

"In general the steel industry in Malaysia is recovering from the worst scenario having been flooded with cheap imports especially from China," Soh says.

He expects steel prices to sustain its momentum on the back of steady demand, plant maintenance by major steel millers, as well as higher iron ore and coal prices.

The domestic price of long steel products to date has surged to about RM2,600 per tonne compared with RM2,200-RM2,400 per tonne in January this year.

Soh says demand for steel locally has been positive on the back of robust economic growth in the first half, which was boosted by construction projects.

Sustaining price increase

"Infrastructure developments in progress especially in the fourth quarter would sustain the increase in steel prices," he says.

In addition, the government's encouragement and promotion of the industrialised building system, a renewed push on the "buy Malaysian products first" policy, especially in the construction industry, and high-impact projects, will all help bolster the domestic steel industry.

Soh says that current local steel production capacities are sufficient to take up any surge of demand.

"The demand for steel is still not exceeding supply. Steel companies have enough capacities to overcome any upsurge of demand," he says.

Globally, he says that the demand of steel from China and globally is growing at 7% and 1.5 %, respectively.

"If the demand is still steady in China, the international price could be sustained until year end, and recently many big steel mills are having their yearly maintenance, which could put pressure on the supply side," Soh says.

Meanwhile, an analyst says that the recent rally in steel stocks are driven by lower steel output expected from China as the winter is coming.

"Capacity cuts especially for plants located in Beijing are expected to kick in as the winter heating season started in November," the analyst says.

The ongoing cuts in China steel production as well the imposition of safeguard duties by Malaysia for imports from China has shown positive sign to local steel players.

In April, the Malaysian government had decided to extend safeguard duties on several steel products by between 11.9% and 13.4% for three years.

"The safeguard measures on the steel sector has also led to lower China steel imports resulting in a stabilised price mechanism, which would helped local steel millers to sustain their profitability," points out the analyst.

The steel industry though is a tough one where only the strong survive. Consider this: between 2013 and 2015 when the domestic steel industry faced a global steel price slump as well as cheaper steel imports, local players incurred total losses of up to RM2bil. This is certainly food for thought for those betting on local steel millers riding on the current uptrend in the sector.