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Struggle for survival

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SOME 40 kilometres from Klang lies Malaysia's only flat steel plant, Megasteel Sdn Bhd. The RM2.5 billion plant, which covers a length of 1.3 kilometres, holds the key to the survival of the Lion Group's supremo, Tan Sri William Cheng, 56.

Saddled with debts to the tune of RM10.4 billion, Cheng, in a bid to stall creditors, has proposed to issue zero-coupon bonds with a tenure of five to eight years and yields that could go as high as eight per cent. The scheme is not unique, considering that many others, including construction giant Renong Bhd, have issued papers to give them more time to set their books straight.

But creditors have frowned upon Lion's proposal. They have two main reasons for concern. The first is that about RM9 billion worth of bonds will be issued, making it even larger than Renong's RM8.4 billion scheme. According to a bond analyst from KAF Discount, the market should be able to absorb the bonds owing to the ample liquidity and low interest rates. 'But the yields must be high,' he says. 'This is because the bonds are zero coupon and it is a known fact that the Lion Group is under tremendous pressure. Only with high yields will the bonds be marketable in the secondary market.' (The Lion Group declined to respond to questions).

PLUS bonds, he adds, were an exception as it received favourable rating and was seen as reasonably safe. Thus, most local financial institutions and intermediaries gobbled it up, to the relief of the foreign lenders. 'As for Lion, the proposed bonds are seen to have more risk elements.'

They are perceived to be carrying these risks because of concerns surrounding their collateral and asset-backing. In Renong's case, the bonds are backed by cashflow from its lucrative North South Highway and a host of attractive assets, such as its 13 per cent stake in Bumiputra-Commerce Bank. In the case of Lion, the scheme draws its strength from the cashflow of the group's core business, which basically boils down to the production and sale of all kinds of steel - both long and flat products.

The volatility in the steel business is the second reason why creditors are viewing Lion's proposal with caution. Also, the group's assets are not deemed as attractive as Renong's. 'The highway operations of PLUS are akin to a utility with steady cashflow,' says a creditor. 'But in Lion's case, its cashflow is dependent on the highly cyclical steel industry.'

According to the Malaysian Iron and Steel Industries Federation 1999 report on the outlook for steel, the pre-crisis consumption high was at 8.4 million metric tonnes in 1996. At best, the report states, it may take another three years to attain that peak. But many observers feel it will take longer - something which does not augur well for the Lion Group.

The Lion Group is one of the largest conglomerates in Malaysia, with substantial interests in nine public-listed companies. According to its 1999 annual report, Cheng controls the flagship Lion Corporation Bhd with a 58.94 per cent stake. The other prominent shareholders are Lembaga Tabung Angkatan Tentera with a 20.64 per cent stake, and Mirzan Mahathir who has 15.98 per cent. Mirzan resigned from the board in August last year.

Like most other conglomerates, however, the depreciation of the ringgit has taken a toll on the group. Analysts estimate that at least half of the RM10.4 billion debts are in US dollars. The funds were taken for Lion's investments in China and the construction of the Megasteel plant in

Banting. Lion also had ventured into the stockbroking business with brokerages in Klang, Indonesia, Singapore and the Philippines. 'The stock market meltdown in the region coupled with the depreciation of the ringgit dealt a double blow for Cheng,' says an analyst with a rating firm.

Bogged down by pathetic demand for long products of steel, poor sales of its Suzuki vehicles and huge losses in its stockbroking activities, nearly all of the nine listed entities in the Lion Group drew blood in its profit and loss accounts last year. The exceptions were Posim Bhd and Malaysian British Assurance Bhd (MBA).

The timber operations of Sabah Forest Industries (SFI) kept Posim in the black while MBA recorded a pre-tax profit of RM72.49 million for the financial year ending June 30, 1999. The other companies, which include Lion Corporation Bhd, Amsteel Corporation Bhd and Lion Land Bhd, were in the red last year. Amsteel recorded losses of RM930 million as at June 30 last year, after a RM1.15 billion loss in 1998. Lion Corporation losses were RM341.89 million for 1998 and RM274.59 million last year. Lion Land, which owns 99 per cent of Amsteel Mills Sdn Bhd, has also recorded losses for the past two years.

The steel industry is largely broken up into two categories: long and flat products. Long products like rods, bars and wire mesh are essentially for the construction industry. In Malaysia, besides the Lion Group, the other major producers of long products are Southern Steel Bhd and Perwaja Steel. There are also many smaller producers like Malayawata Steel Bhd, Anshin Steel Industries and Antara Steel.

The competitive environment and grim outlook of the construction sector spell bad news for producers of long products. 'Demand for long products is unlikely to pick up until the second half of the year,' says Yap Yoke Keong, a council member of Master Builders Association of Malaysia. Industry sources say that business for long products is so bad that less efficient plants are running at only 50 per cent capacity. Just like all others in the industry, Lion is hit as well. In fact, the poor demand has scuttled the group's plans to build a second long products steel plant in Banting, next to its flat products plant. A visit to Banting reveals that only its bare structure exists.

But Lion's argument, says a creditor, is that its earnings stream is not dependent on long products alone. 'Megasteel's plant, by virtue of its being the only flat steel mill in the country and probably in the region, holds a dominant position,' says an official close to Cheng. 'Unlike the competitive long products industry, Lion holds a monopoly in the less volatile flat products market.'

Up to now, all of the flat steel which Malaysia requires is imported. In 1998, when the economy was in a recession, the import of flat steel was 1.12 million tonnes, costing about RM1.2 billion. During the boom years of 1996 and 1997, on the average Malaysia imported 2.25 million tonnes of flat steel that is used for various kinds of fabrication works, including making pipes and flat plates.

The official contends that Lion enjoys protection from the government in the form of a 25 per cent tariff slapped on the import of flat steel products since April last year. The Megasteel plant, which was commissioned last June, has a capacity of 2.5 million tonnes. The creditors are told that even if Megasteel operates at 50 per cent of its capacity, it should be able to generate enough cashflow to redeem the bonds.

'At 50 per cent and assuming flat steel is sold at a conservative RM1,280 per tonne, Megasteel can generate tax-free profits of about RM400 million per annum,' says an advisor to the proposed bond issue. 'The earnings per share of Lion Corporation will rise by RM1. And steel prices

generally will increase, which in turn means the cashflow for the Lion Group will only improve.'

Nobody doubts the ability of Cheng in running efficient steel mills. His long products steel mill in Klang is one of the best - if not the best - in the country. But he will find his hands full in making sure the flat steel plant operates up to expectations. Assuming that RM9 billion zero-coupon bonds are issued at yields of about nine per cent, the Lion Group has to cough up some RM16 billion in seven years. To maintain credibility, Megasteel has to operate at 50 per cent capacity at the very least and hope that steel prices increase.

Can Megasteel operate at this level?

Although the flat steel plant is at present running in three shifts, its capacity is said to be well below 50 per cent and could be as low as 30 per cent. A check with several workers at the plant reveals that Megasteel, as expected, had problems in the first few months after it was commissioned. Now, though, its operations have improved.

Megasteel's low capacity, says a managing director of a public-listed construction company, is partly due to the lack of demand at the moment. In anticipation of the imposition of tariffs on imports of flat steel, many stockists had acquired a massive amount of it at the cheaper price of less than RM960 per tonne. Lion's price is RM1,280 per tonne. 'It will take another six months or so before the stocks are exhausted,' says the managing director. 'Until then, Megasteel will probably be running well below its capacity.'

Further, the flat steel products that Megasteel is manufacturing are of lower grade. Some companies like Maruichi Bhd are said to have received Approved Permits (APs) to import flat steel because they need higher quality products.

For the longer term, problems to consider are two-fold. Firstly, there is the implementation of the Asean Free Trade Area (Afta), come 2003. This policy is likely to result in the tariff for flat steel being lifted. And second, on the international scene, Russian mills have been churning out cheap steel, causing downward pressures on the international prices.

People who know Cheng, however, feel that the tycoon will not be intimidated by the challenges. 'Cheng is an entrepreneur who takes calculated risks,' says Tan Sri Soong Siew Hoong, a vice-president in the Chinese Chamber of Commerce Malaysia. 'An entrepreneur is a class above a businessman. A businessman goes to the karaoke to have a drink, but an entrepreneur uses it as intelligence gathering. His resources may be limited but his creativity is unlimited. Cheng will pull through.'

But did Cheng miscalculate with the Megasteel plant venture?

'No,' says an associate close to the magnate. 'Nobody expected the depreciation of the ringgit. In fact, the Lion Group wanted to start off the flat steel mill project years ago but efforts were stalled.'

The government, say sources, had wanted Perwaja to take the lead in the flat steel project. When that did not materialise, several investors from Taiwan showed keen interest. But they backed off because of the huge capital investments involved.

Close associates of Cheng say they are in the first year of operating Megasteel and are still on the learning curve. 'Once we get going, we will reduce cost and be as competitive as the international producers,' says one. 'With competitive prices, the demand will pick up.'

In the region, the only contest for Megasteel could come from the now defunct Nakornthai Strip Mill in Thailand. The plant, which is said to have the necessary equipment to produce high quality flat steel products, is not in operation owing to financial reasons. In 1998, international currency trader George Soros and a few other firms toyed with the idea of

injecting US\$650 million into the Nakornthai plant, but it did not come through. 'That leaves Megasteel as the only flat steel operator in the region,' says a Cheng associate.

Besides the flat steel plant, the Lion Group is also banking on the sale of several assets to fulfil its bond obligation. So far Lion has divested its retail supermarket chain, Parkson, to a Hong Kong group. A vast section of its building property in Jalan Ampang, Kuala Lumpur, has also been sold to Citibank. Assets that are up for sale are said to include Amsteel Corporations Bhd's 32.01 per cent stake in Malaysian British Assurance Bhd (MBA), Sabah Forest Industries Bhd (SFI) and Chocolate Products' brewery and motor parts manufacturing operations in China.

The sale of MBA is expected to net about RM55 million while analysts estimate Lion's operations in China at about RM600 million. The problem with China, however, is the tedious process in the repatriation of funds out of the country. As for SFI, sources say Cheng had taken some potential buyers on a helicopter tour over its vast timber concession area last year but nothing came out of it. The value of SFI, which has the country's largest integrated pulp and paper mill, is not known but the Lion Group had to assume a liability of about RM600 million when they took it over in August 1995. Since then, the group has turned SFI around. But the low prices of timber depress the value of the company as a whole.

Together with the bond issue, the Lion Group is set to undergo a restructuring exercise whereby Lion Corporation is likely to end up owning a larger portion of Megasteel. At the moment, Lion Corporation has a 50 per cent equity in Megasteel; Khazanah, 10 per cent; and Amsteel the rest. The Lion Group is said to be keen on divesting another 10 per cent to Khazanah, and the rest may go to Lion Corporation. 'At the end of the day,' says an analyst, 'the winner could well be Lion Corporation.' But before that, the Lion Group must hope that demand for flat and even long steel products pick up.

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