STRATEGY – MALAYSIA

Commodities Rally Continues To Gain Momentum

Unwavering demand and ongoing supply constraints have pushed commodities prices to record-high levels. Strong prices may remain, at least in the near term, as power cuts across China have put further pressure on the global supply chain. Ferroalloy, aluminium and tin companies are among the prime beneficiaries. If the prices remain strong, this could result in 32%, 15% and 23% further upside to our target prices for OMH, PMetal and MSC respectively.

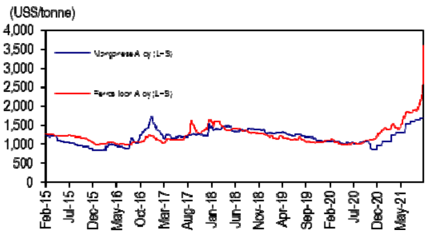
WHAT'S NEW

- **Commodities boom is alive and well.** Despite the record highs achieved in 1H21, commodity prices have continued to climb higher to reach new highs thus far in 2H21. As of 24 September, ferrosilicon (FeSi) alloy prices have jumped significantly to an all-time high of over US$3,500/mt (+72% mom, +217% yoy). Prices of manganese (Mn) alloy have also hit a 13-year high of about US$1,700/mt (+10% mom, +59% yoy). At the same time, LME aluminium and tin prices inched up to fresh highs of US$2,926/mt (+12% mom, +67% yoy) and US$37,499/mt (+14% mom, +116% yoy) respectively.
- **Favourable supply-demand dynamics…** The recent spike in prices is partly due to the ongoing intensified production constraint in China as power cuts across the country, due to power rationing amid high power demand, shortage of renewable power, and lower coal availability, has resulted in production uncertainty. In addition, the structural demand from robust industrial growth and a technological revolution also acts as a catalyst to provide strength to the prices.
- …**provide support to prices**. If prices continue to rise, based on our sensitivity analysis, every US$100/mt rise in our ferroalloy and aluminium price assumptions of US$1,700 and US$2,300 per mt in 2022 will boost OM Holdings (OMH) and Press Metal Aluminium's (PMetal) earnings by about 25% and 16% per year respectively. For OMH, if FeSi price remains at its current high of about US$3,000/mt in 2022, this could result in 32% upside to our target price of RM4.01 to RM5.30. For PMetal, assuming a similar PE of 30.0x (5-year forward PE mean) being ascribed, this could mean a 15% upside to our target price of RM6.90 to RM8.00. Every US$2,000/mt increase in our tin price assumption of US$25,000/mt in 2022 could raise MSC's earnings by about 20% annually. If tin price remains at its current high of about US$37,000/mt in 2022, this could result in 23% upside to our target price of RM3.02 to RM3.73.

ACTION

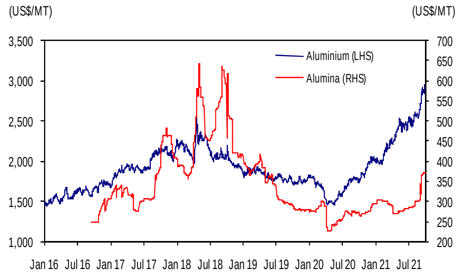
- **Upgrade the building materials sector to OVERWEIGHT** as the segment is poised to see a meaningful recovery, underpinned by the upswing in ASPs coupled with increasing structural demand amid the economic reopening. We like ferroalloy, aluminium and tin for exposure given their favourable supply-demand dynamics: a) structural demand from renewable energy, adoption of next-generation technologies such as electric vehicles (EVs) and greener metal, and b) structural tightness of supply with China's restrictive carbon policy.
- **Stock picks.** Our top pick is OM Holdings (OMH MK/BUY/RM3.18/Target: RM4.01). We like the company for its: a) growth potential as it is poised to benefit from the prolonged rally in ferroalloy prices on the back of favourable supply-demand dynamics, b) use of low-cost environmentally-friendly hydropower, putting it ahead of its global peers, and c) clear future plan to ensure earnings visibility. These factors will provide OMH with a strong 3-year net profit CAGR of 172% for 2020-23 on the back of a production recovery. We have not incorporated its planned capacity expansion into our valuation. The completion of those plans will prompt a valuation re-rating.

FERROSILICON AND MANGANESE ALLOY PRICES



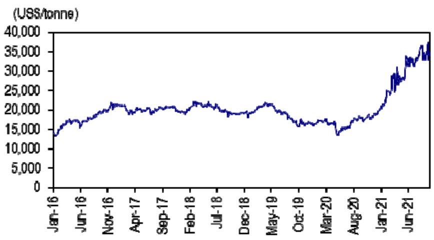
Source: Bloomberg, UOB Kay Hian

LME ALUMINIUM SPOT PRICES



Source: Bloomberg, UOB Kay Hian

TIN PRICES



Source: Bloomberg, UOB Kay Hian

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PEER COMPARISON

Company	Tickers	Rating	Share Price 27 Sep 21 (RM)	Target Price (RM)	Market Cap (US$m)	PE 2020 (x)	PE 2021F (x)	PE 2022F (x)	EV/EBITDA 2020 (x)	EV/EBITDA 2021F (x)	P/BV 2021F (x)	Dividend Yield 2020 (%)	Dividend Yield 2021F (%)
OM Holdings	OMH MK	BUY	3.18	4.01	559.4	54.1	9.3	5.8	17.7	8.7	1.1	0.0	1.4
Press Metal Aluminium	PMAH MK	BUY	5.60	6.90	10,794	91.4	37.6	24.4	11.2	5.4	7.9	0.3	1.1
Malaysia Smelting Corporation	SMELT MK	BUY	2.32	3.02	221.6	61.6	14.4	9.9	20.2	8.9	2.0	0.4	1.6

Source: UOB Kay Hian

ESSENTIALS

- **Power shortage severely disrupts ferroalloy production**. In order to achieve carbon neutrality by 2060, China has stepped up enforcement to rein in emissions entering 2H21 after it found out that only 10 out of 30 mainland regions managed to reach their energy goals in 1H21. Although the new stricter measures have reduced China's power generation by 2.7% mom in Aug 21 to 738.3b kwh, it was still the second-highest month on record as power requirements remain high to support the economic recovery. The electricity outages and production restrictions in main production areas intensified as more plants were shut down in places like Guangxi, Ningxia and Yunnan.

- **Strong FeSi prices may remain for the rest of the year.** We believe FeSi prices may remain high (US$2,000-3,000 per mt), at least in the short term, as the winter season in northern China that starts in October will push power consumption higher, further exacerbating the power shortage. While Beijing's top economic planner, the National Development and Reform Commission (NDRC), plans to resolve the power issues in the near term, some industry players do not foresee any significant reversal in China's commitment in reducing emissions. With the Beijing Winter Olympics coming up in Feb 22, we believe the strict enforcement of environmental regulations may persist. As the world's lowest cost quartile manganese smelter, OMH is set to achieve record earnings ahead as it benefits from the strong ferroalloy prices and production recovery.

- **Still ample upside in structural demand and preference for greener aluminium.** LME aluminium prices have continued to rise steadily to hover at c.US$2,900-2,920/mt (ytd average: US$2,380/mt) despite price-curbing efforts by China. We believe this is all on the back of favourable structural catalysts with: a) strong demand from China, EV and infrastructure, b) a shortage of supply on top of the partial shutdown of plants, and c) preference for low carbon and greener aluminium that lend further strength to the current spot prices. Meanwhile, political unrest in Guinea has fuelled further concerns over supply of raw materials. Moreover, PMetal (using mostly hydro power as an energy source instead of coal power) is also registering its product under the green aluminium categorisation, which we believe could result in PMetal becoming the preferred ESG investing target.

- **A prolonged upswing in tin prices**. Tin prices have surged to all-time highs (US$37,499/mt) as inventories in exchange warehouses dwindled. We believe this is mainly due to: a) increasing demand for tin solders, mainly from automobiles and electronics, and b) ongoing supply shortage caused by logistics disruptions and capacity resumption after lockdowns and productions cuts in tin-producing countries amid the pandemic and political turmoil. While prices may ease gradually entering 2022, we believe prices will remain firm in the long run, albeit not at the current high, as supply cannot catch up with increasing demand. Note that tin inventories in LME warehouses fell 79% yoy to 1,180mt on 22 September. According to the International Tin Association (ITA), the global tin market deficit is expected to rise 24.5% yoy to 12,700mt in 2022.

GREEN POLICIES BY SUPER COUNTRIES - 1

Topic	US	EU
Economy-wide Net-Zero Goals	Carbon neutrality by 2050	Carbon neutrality by 2050
Known Policy Tactics	• Net-zero emissions power sector by 2035 • Tax credits for clean energy • Carbon tax and Carbon border tax (CBT) expected under Biden administration	• 55% reduction of carbon emissions below 1990 levels by 2030 • Green Deal Stimulus • European Carbon Trading Scheme • CBT is expected
Expected Role of Gas & Coal	Coal phase out and gas as bridge fuel in 2020s	

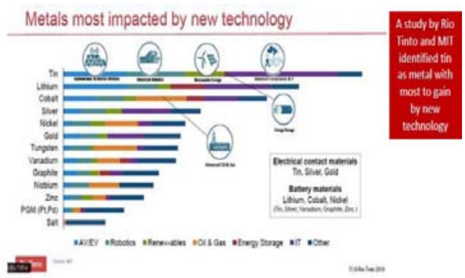
Sources: Transition Economist and Berkeley Research

GREEN POLICIES BY SUPER COUNTRIES - 2

Topic	East Asia	China and India
Economy-wide Net-Zero Goals	Carbon neutrality by 2050 for Japan and South Korea	Carbon neutrality by 2060 for China. No carbon neutrality goal yet for India
Known Policy Tactics	• Retirement of inefficient coal plants and replacement of some with natural gas plants • Increase usage of clean fuels, such as hydrogen and ammonia	• Renewable Electricity Quota • Reduction of carbon intensity across sectors
Expected Role of Gas & Coal	Coal phase out in 2030s and gas as bridge fuel in 2020s-30s	

Sources: Transition Economist and Berkeley Research

METALS USAGE FOR NEW TECHNOLOGY



Source: MIT

PREFERRED PICKS AND FEATURED STOCKS

Company	Rating	Target Price (RM)	Share Price 27 Sep 21 (RM)	Investment Merits
OM Holdings (OMH)	BUY	4.01	3.18	• We raise our 2021-23 earnings forecasts by 41%, 52% and 37% respectively as we increase our ASP assumptions of FeSi and Mn alloy to US$2,000/US$1,700/US$1,500 and US$1,500/US$1,400/US$1,300 per mt for 2021-23. We increase our target price to RM4.01 (previously RM3.46) accordingly. If prices continue to rise, based on our sensitivity analysis, every US$100/mt rise in our FeSi and Mn alloy price assumptions will boost earnings by about 25% per year. • As an eco-friendly and the world's lowest cost quartile manganese smelter, OMH is expected to post a 3-year net profit CAGR of +172% from 2020, supported by production recovery and robust ferroalloy prices due to favourable supply-demand dynamics.
Press Metal (PMetal)	BUY	6.90	5.60	• With P3 Samalaju plant's expected completion in Oct 21, we believe the additional 42% smelting capacity and our current aluminium spot price assumption of US$2,300 for 2022 could lead to a 2-year net profit CAGR of 101% in 2022. • Its clean energy source via hydraulic power and products registration for green categorisation could carry a higher price premium for its products, alongside the preferred ESG investing target. • Sensitivity analysis: Every US$100/tonne increase to our assumption of US$2,300/tonne in 2022 would increase earnings by 16% annually, assuming alumina cost of US$360/mt (implies about.15% cost) and carbon anode prices of Rmb4,140/mt.
Malaysia Smelting Corporation (MSC)	BUY	3.02	2.32	• As the world's third-largest refined tin producer, MSC is expected to post a 3-year (2021- 23F) 97% earnings CAGR as it is poised to benefit from strong tin prices, its new eco-friendly smelter, robust structural demand and exploration of new mines. • Our tin price assumptions are US$30,000/mt, US$25,000/mt and US$24,000/mt for 2021-23 respectively. Based on our sensitivity analysis, every US$2,000/mt rise in our tin price assumptions would boost earnings by about 20% a year. Our blue-sky earnings scenario suggests a higher target price of RM4.03.

Source: UOB Kay Hian

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