SECTOR UPDATE

Building Materials – Malaysia

Low-cost Smelters Are The Clear Winners Amid The Global Power Crisis

We expect the aluminium, tin and ferroalloy segments to continue registering strong earnings ahead, supported by favourable prices despite the weak market sentiment. Commodity prices may stage a reversal once the lockdowns in China are eased, which will improve demand and support prices. OM Holdings and Press Metal are the clear winners against global peers, given their access to environmentally-friendly low-cost hydropower in Sarawak. Maintain OVERWEIGHT. Top pick: Press Metal.

WHAT'S NEW

- **Roller-coaster ride in 1H22**. After reaching new record-high prices in 1Q22, prices of exported commodities have retraced to a lower range in 2Q22. This is mainly due to the weak market sentiment caused by the fear of recession and global economic slowdown. The sentiment is expected to remain fragile in the near term given the lockdowns in China, prolonged war in Ukraine and the Fed's tightening that may dampen economic growth. Post-pandemic spending may be impacted by the higher borrowing costs as central banks around the world start to raise interest rates to combat the rising inflation pressure. Within our coverage, tin and aluminium prices were impacted the most, declining to US$36,700/mt (-15% mom, +18% yoy) and US$2,751/mt (-15% mom, +12% yoy) respectively.
- **Remain selective…** Despite the decline in commodity prices, it is still within our expectation as we had expected prices to ease this year, supported by production recovery and rising interest rates. Almost all commodity prices within our coverage still remain higher than our 2022 price assumptions. We believe prices will remain elevated (at well above pre-pandemic levels), supported by the favourable structural supply-demand. Despite the lockdowns in China, policymakers highlighted efforts to improve infrastructure in China, which reflects their commitment to stabilise the economy. This will help to support prices on the back of improved demand and healthy economic growth once the current tight COVID-19 restrictions are lifted and construction activity resumes in China from 2H22 onwards.
- **…amid the current economic landscape.** However, for some of the commodities, higher prices do not necessarily translate to higher earnings as margins are pressured by higher operating and raw material costs. In the midst of global power crisis and increase in electricity costs, we believe companies such as OM Holdings (OMH) and Press Metal (PMetal) have a significant advantage over their global peers given their access to an environmentally-friendly low-cost hydropower in Samalaju Smelting Complex in Sarawak.

ACTION

- **Maintain OVERWEIGHT** as we expect the favourable structural supply-demand to support the lofty commodity prices, especially after China gradually lifts its lockdown in 2H22. We favour the ferroalloy, tin and aluminium segments as they are poised to post another set of strong results in the upcoming quarter due to: a) strong ASPs, b) improved production, and c) higher demand. Most of our target prices imply close to -0.5SD from historical mean PE (vs current share prices trading between -1 to -1.5SD). We take the opportunity to upgrade MSC from HOLD to BUY (Target: RM4.45) as the recent fall in its share price provides an attractive buying opportunity given expected strong earnings ahead, including in 2023, as the ramp-up in production from its new smelter will help to support earnings, offsetting the decline in tin prices. Top pick: Press Metal (PMetal).

OVERWEIGHT

(Maintained)

TOP SECTOR PICKS

Company	Rec	Share Price 11 May 22 (RM)	Target Price (RM)
Press Metal	BUY	5.07	7.50

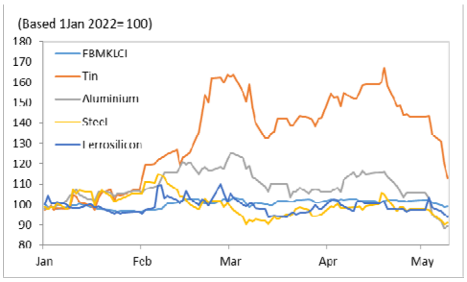
Source: UOB Kay Hian

KEY ASSUMPTIONS

	Current (May 22)	2022F	2023F
Cement (RM/mt)			
ASP – Bulk	340	280	260
Steel (RM/mt)			
ASP - Bars	3,525	2,800	2,600
Ferroalloy (US$/mt)			
ASP – FeSi Alloy	2,100	1,900	1,700
ASP – Mn Alloy	1,600	1,400	1,300
Tin (US$/mt)			
ASP	36,700	36,000	32,000
Aluminum (US$/mt)			
ASP - Aluminum	2,750	2,500	2,600
ASP – Alumina	378	388	403

Source: UOB Kay Hian

EXPORTED BUILDING MATERIALS INDEX



Source: Bloomberg, UOB Kay Hian

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PEER COMPARISON

Company	Tickers	Rec	Share Price 11 May 22 (RM)	Target Price (RM)	Market Cap (RM)	PE FY22F (x)	PE FY23F (x)	P/B FY22F (x)	P/B FY23F (x)	ROE FY22F (%)	ROE FY23F (%)
Press Metal	PMAH MK	BUY	5.07	7.50	54,840	26.1	24.0	8.5	6.8	40.5	31.5
Malaysia Smelting Corp	SMELT MK	BUY	3.67	4.45	2,150	9.4	8.2	2.6	2.2	27.9	22.0
OM Holdings	OMH MK	NR	2.66	n.a.	2,067	7.9	6.5	1.1	1.0	12.6	18.2
Ann Joo Resources	AJR MK	HOLD	1.79	2.01	1,086	8.2	7.4	0.7	0.6	11.1	14.6

Source: UOB Kay Hian

- **Our top pick is PMetal.** With a fifth consecutive quarter of record-high earnings in 4Q21, PMetal continues to be a prime beneficiary of strong aluminium prices backed by structural supply shortage and robust demand. Its 42% additional smelting capacity is set to supercharge a two-year net profit CAGR of +43% from 2021. PMetal has hedged 60% of its aluminium sales volume at US$2,400/mt for 2022 and 35% of US$2,500/mt for 2023. Every US$100/mt increase to our aluminium price assumption of US$2,500/mt in 2022 would increase PMetal's earnings by 9% peryear. Assuming a similar PE of 29x 2022F PE (-0.5SD to its five-year mean) with a price assumption of US$2,600/mt in 2022, this would mean a 10% upside to our target price of RM7.50, at RM8.30.

ESSENTIALS

- **Clear cost price leader.** OMH's and PMetal's smelters in Sarawak offer significantly lower costs than their peers' mainly due to the >20-year take-or-pay power purchase agreement with Sarawak Energy. It provides them with 300MW of low-cost eco-friendly hydropower. Generally, electricity accounts for 40% of smelting cost. For OMH, we estimate electricity costs at US$0.04-0.06/kwhr, with a 1.5-2.5% p.a. escalation, placing OMH in the lowest quartile for production costs (fifth-largest FeSi producer, ex-China). A long-term low price for a key input places OMH at the bottom of the cost curve, giving it a significant advantage over its peers, enhancing its strategic position. Note that comparable smelters in China and Europe run at a cost that is at least 30% higher.

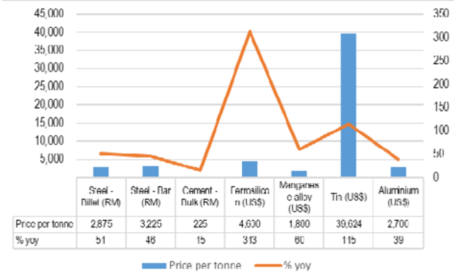
- **Ahead of global competitors.** For manganese (Mn) alloy, OMH is in the first quartile of the global cash cost curve. We believe that over time, higher-cost producers like India and South Korea will feel more pressure from the rising cost of domestic electricity. For China, its environmental policy will force non-compliant smelters to shut down, reducing supply further. Moving forward, low electricity cost will be the key differentiator and OMH together with PMetal stand to be the beneficiaries of this factor. They also enjoy a tax holiday until 2028. These benefits will ensure the sustainability of their margins vs peers.

- **Positive prospects for the only listed ferroalloy company in Malaysia.** Last week, OMH announced that it has entered into a binding letter of offer with Cahya Mata Sarawak (CMS) for CMS to sell its 25% stake in OM Sarawak to OMH for US$120m (RM525m). We believe it is a win-win deal for both CMS and OMH. The proceeds can be reinvested by CMS to capture the growing opportunities within its core businesses in Sarawak. For OMH, the completion of this deal will allow it to have full control (100% stake) of its smelting business in Sarawak and this will enhance its earnings further going forward. This deal will be earnings accretive over the long term and will solidify OMH's position as a major ferroalloy player in the region. Due to its hedging practice, OMH has managed to lock most of its sales volume in 1H22 at above US$2,000/mt.

- **Future expansion…** 1Q22 production volumes of FeSi and Mn alloy have slightly decreased to 33,925mt (-6% qoq) and 60,540mt (-3% qoq). This is within expectation mainly due to the ongoing conversion works coupled with the employee home leave rotations. Sales volumes of FeSi and Mn alloys were 30,718mt (-11% qoq) and 57,632mt (-1% qoq) due to export bulk shipments that were delayed towards end-March 22. OMH plans to expand its smelting capacity significantly, yielding an additional 150,000mt/year of Mn alloys by end-23 via a bigger 2-4 33MVA furnaces. Currently, 12 out of 16 furnaces are in operation (six FeSi and six Mn alloy) while the remaining four are idle. OMH plans to convert two of the idle furnaces to produce Mn alloys, as it pivots towards Mn alloy production since these alloys offer: a) higher average returns, b) improved hedging ratio with ore, c) better supply-demand, and d) higher efficiency.

- **Diversification of product offerings to capture further growth potential.** OMH is converting the remaining two idle furnaces to produce silicon metal in order to deliver higher value-added products, which offer better margins. Silicon metal is used for manufacturing microchips, steel and solar cells. This marks OMH's first step in diversifying into the aluminium, chemicals and solar downstream industries. The silicon metal furnaces are expected to also be able to produce FeSi for more flexibility in terms of product mix. The conversion of all four idle furnaces is currently taking place with the hot commissioning and testing works expected to commence in 4Q22. With the gradual arrival of contractors from China amid the border reopening, we expect the furnaces to be on track for commissioning by end-22.

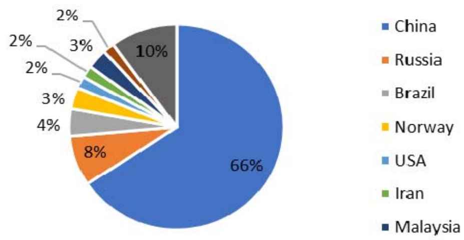
COMMODITY PRICES



	Steel - Billet (RM)	Steel - Bar (RM)	Cement - Bulk (RM)	Ferrosilicon (US$)	Manganese alloy (US$)	Tin (US$)	Aluminium (US$)
Price per tonne	2,875	3,225	225	4,600	1,800	39,624	2,700
% yoy	51	46	15	313	60	115	39

Source: MITI, Bloomberg, UOB Kay Hian

TOP FERROSILICON ALLOY-PRODUCING COUNTRIES

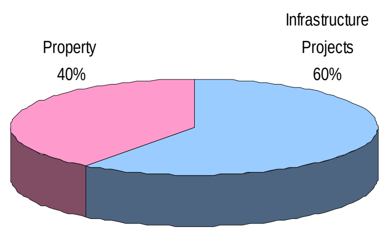


Source: AlloyConsult

TIN INVENTORIES IN LME WAREHOUSES

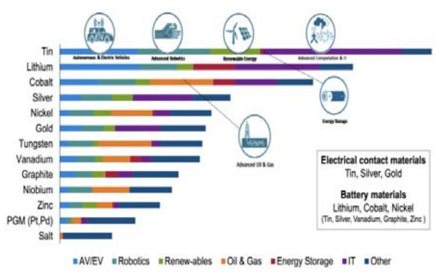
Source: LME

CEMENT CONSUMPTION



Source: UOB Kay Hian

METALS MOST IMPACTED BY NEW TECHNOLOGIES



Source: MIT, Rio Tinto

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