

21 June 2021

Basic Materials | Mining

OM Holdings (OMH MK)

Vertically Integrated Ferroalloy Producer

Fair Value: MYR3.07 (AUD0.99)

Listing Price: TBA

Reference Pricing Date: 21 June 2021

Indicative Listing Date: 22 June 2021

- **Fair value of MYR3.07 based on 1.7x FY22F P/BV.** OM Holdings (OMH), an Australian Stock Exchange (ASX)-listed mining and ferroalloy smelting company, is set to debut on Bursa Malaysia's Main Market on 22 Jun in a secondary listing exercise. At least 10m shares will be committed for trading liquidity on Bursa Malaysia, where the listing's reference price will be based on its ASX closing price on 21 Jun, converted at the prevailing AUD/MYR FX rate.
- **Vertically integrated manganese ore and ferroalloy producer.** With >20 years of operating track record, OMH is involved in the mining, smelting and trading of manganese ores and ferroalloys which are primarily fed into the steel industry's production process. Its mining assets are in Australia and South Africa, while smelting operations are in Sarawak and Qinzhou, China.
- **Prospects tied to regional steel sector.** The key earnings contributor lies in its primary ferroalloy smelting hub, OM Materials (Sarawak) or OMS, a 75%-owned business with Cahya Mata Sarawak (CMS MK, NEUTRAL, TP: MYR1.70). OMS has a rated capacity of around 500,000 tonnes pa comprising ferrosilicon (FeSi) and ferromanganese/silico-manganese (FeMn/SiMn) products, with key customers that include regional steelmakers such as POSCO, Nippon Steel, and JSW. The Samalaju-based smelter enjoys a relatively lower cost position, thanks to hydropower sourced from Sarawak Energy, in addition to its 10-year tax holiday period.
- **Earnings outlook.** Ferroalloy selling prices have surged YTD in tandem with the steel sector uptrend, while demand in the long run is seen to be supported by new steel capacity additions in South-East Asia. However, its Sarawak smelter has been affected by COVID-19, which resulted in partial idling of FeSi furnaces since 1H20, in addition to a full shutdown since end-May due to a recent outbreak amongst OMS employees. This is mitigated, to a certain extent, by forward sales agreements remaining in effect once production resumes. Management is anticipated to provide an update on the resumption of OMS at a later date.
- **Salient points.** Upon completion of the secondary listing, all shares quoted on both Bursa Malaysia and ASX will be fully fungible. At least 10m of the company's existing 738.62m share base shall be transferred from ASX to support trading liquidity on the Bursa Malaysia, while there is no new issuance of shares under the listing exercise. Note that earnings reporting will be done on a half-yearly basis in line with ASX's ruling, although this is supplemented by quarterly operational updates provided by the company.
- **Valuation and key risks.** Our MYR3.07 FV is based on 1.7x P/BV applied on FY22F BVPS and a AUD/MYR current FX rate of 3.10. Key risks are: Operational disruptions arising from COVID-19, fluctuations in regional ore and ferroalloy prices, as well as supply-demand imbalances.

Analyst

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Company Description

Incorporated in 1997 and listed on the Australian Stock Exchange in 1998, OM Holdings is a manganese and ferroalloy producer involved in upstream exploration and mining of manganese ore, as well as downstream processing and trading of manganese ore and ferroalloys.

Listing Details

Minimum share transfer	10m
Share base	738.6m
Current market cap	MYR1,990m

Major Shareholders

Huang Gang	14.0%
Marc Chan	13.6%
Low Ngee Tong	9.2%

Additional Info

Listing Market	MAIN
Stock Code	5298

Forecasts and Valuation	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
Total turnover (AUDm)	1,026.5	784.6	893.1	1,144.2	1,138.0
Recurring net profit (AUDm)	56.6	5.4	31.2	49.0	51.7
Recurring net profit growth (%)	-65.0	-90.6	483.8	56.9	5.5
Recurring EPS (AUD)	0.08	0.01	0.04	0.07	0.07
Recurring P/E (x)	11.3	120.1	20.6	13.1	12.4
P/BV (x)	1.6	1.7	1.6	1.5	1.4
P/CF (x)	-	-	15.4	12.6	16.0
Dividend Yield (%)	2.3	-	0.9	1.5	1.6
EV/EBITDA (x)	9.3	16.0	7.8	5.7	5.5
ROAE (%)	11.8	1.1	6.4	9.1	8.6
Net debt to equity (%)	81.0	75.3	57.4	38.7	25.7

Source: Company data, RHB

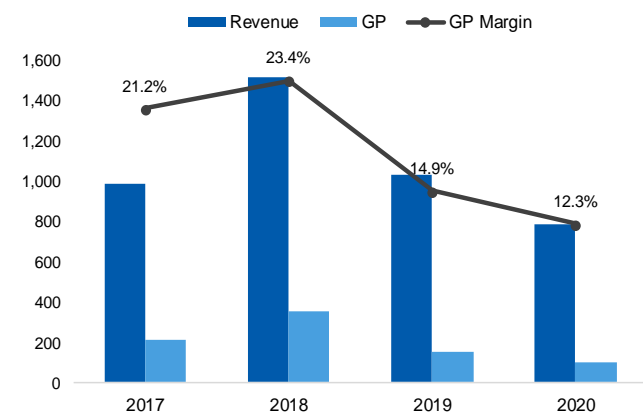
Note:

Small cap stocks are defined as companies with a market capitalization of less than USD1bn.

Financial Overview & Valuation

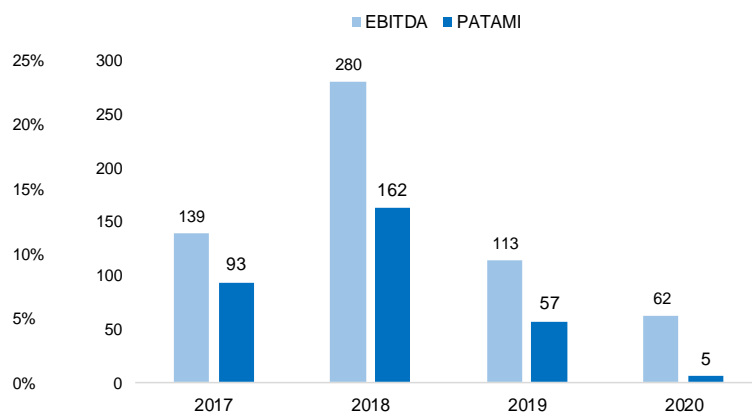
FY20 results review. Revenue fell 24% YoY to AUD784.6m, while group PATAMI tumbled 90% YoY to AUD5.4m as a result of the weak broader market during COVID-19, leading to ASP declines in addition to lower smelting production amid operational disruptions at OMS, which saw four out of 16 furnaces taken offline.

Figure 1: Revenue and gross profitability



Source: Company data

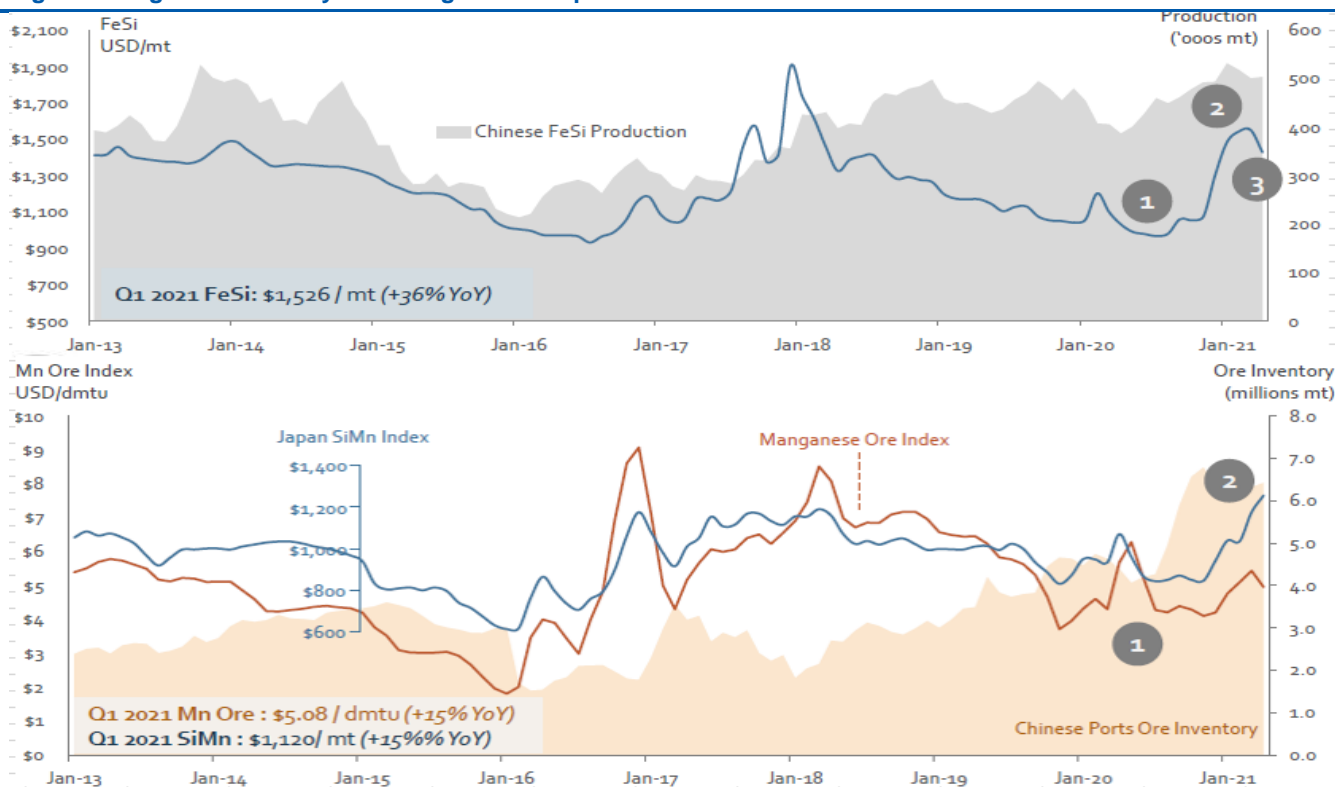
Figure 2: EBITDA and group PATAMI



Source: Company data

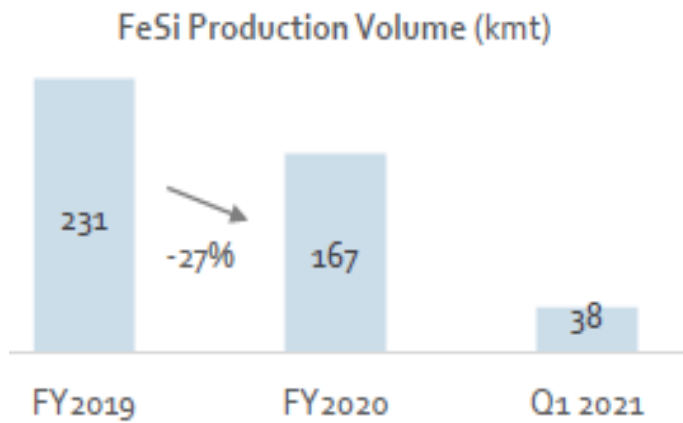
Market prices only began to recover towards end-2020, in tandem with the steel sector as demand from industrial sectors picked up once more. However, OMS continued to see a partial idling of its furnaces due to persistent labour constraints under MCO 3.0 in 1Q21, while operations have ground to a halt in May following a number of positive COVID-19 cases tested among its on-site employees. As such, OMS' production is likely to decline YoY in 1H21, while the resumption of works would require all employees at the plant to be tested negative for COVID-19. That said, OMS retains existing forward sales agreements with customers – which should help to smoothen its production planning process once operations are given the green light to recommence.

Figure 3: Regional ferroalloy and manganese ore prices



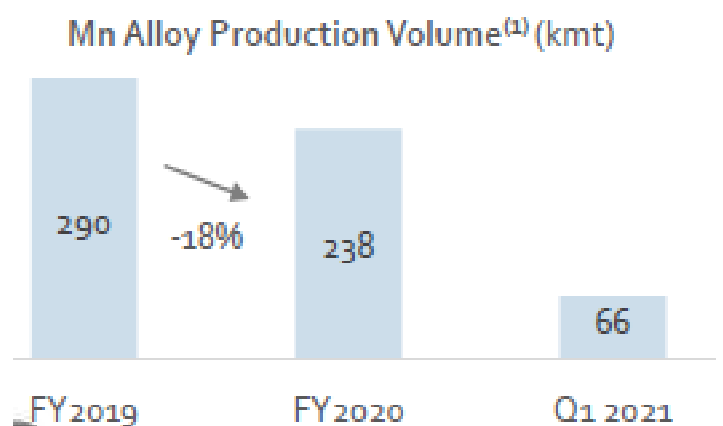
Source: Company data, Fastmarkets MB, Platts

Figure 4: Ferrosilicon production volume



Source: Company data

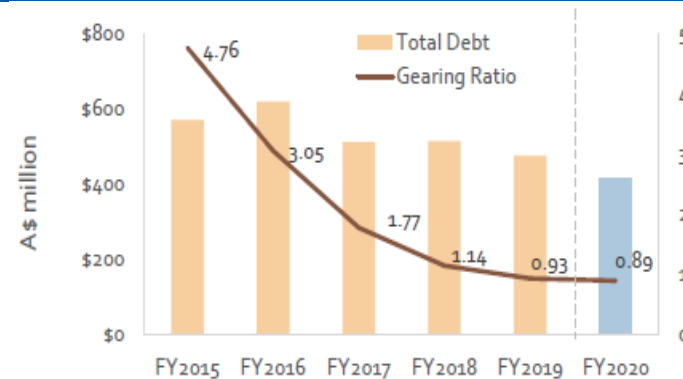
Figure 5: Manganese alloy production volume



Source: Company data

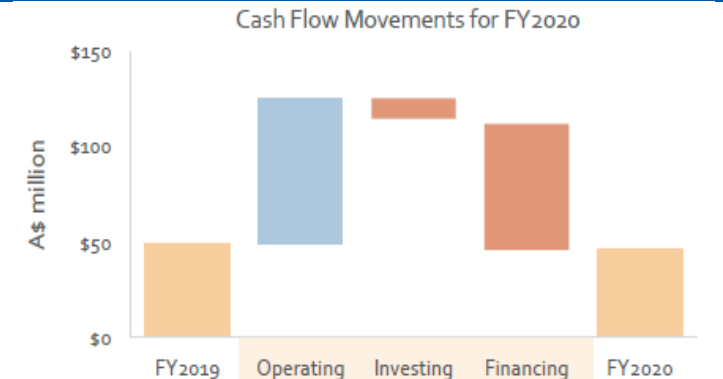
Focused on deleveraging balance sheet. Despite FY20's tough operating conditions, cash flow generation remained healthy – which allowed the group to continue paring down its debt. Certain capex-intensive projects were temporarily postponed last year, although these are expected to move further along from 2021F onwards.

Figure 6: Net gearing levels



Source: Company data

Figure 7: Cash flows prioritised to pare down debt levels

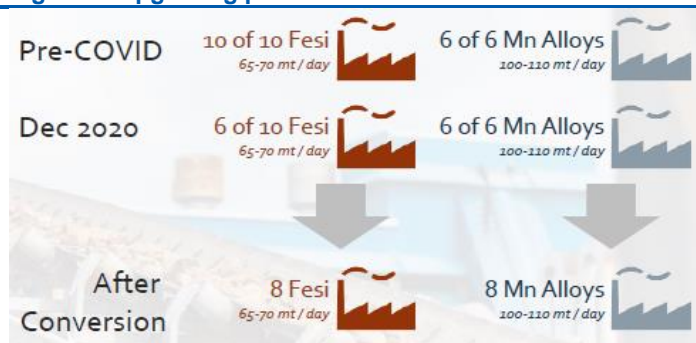


Source: Company data

Future plans. OMH's expansion plans are centred on expanding its smelting capabilities, namely with OMS. In the near term, the group will look to convert two of its ferrosilicon (FeSi) furnaces into manganese alloy production, giving a balanced 50-50 footprint of eight FeSi and eight ferro manganese (FeMn)/silico manganese (SiMn) furnaces subsequently. Production capacity, however, would expand by virtue of manganese alloy furnaces having a higher daily production output of 100-110 tonnes, vs 65-70 tonnes per day for FeSi furnaces.

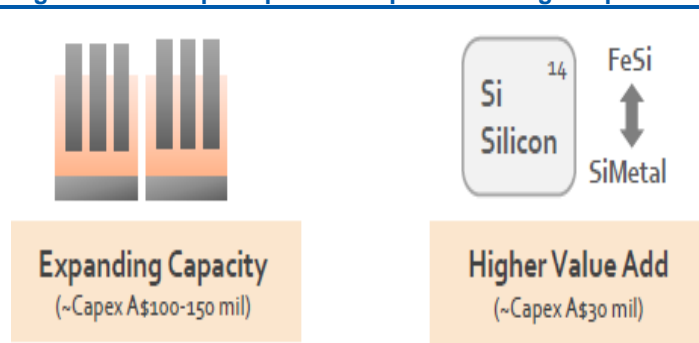
Beyond that, the group is also looking to set up additional smelting furnaces for the production of manganese alloys, slated for 2023F, while exploring potential opportunities to expand its manganese exposure across the entire value chain. At the same time, OMH is also seeking to tap into higher value-added products such as the production of metallic silicon, which garners healthy demand from the aluminium, chemicals and solar downstream industries.

Figure 8: Upgrading plans for OMS smelter



Source: Company data

Figure 9: Subsequent plans to expand smelting footprint



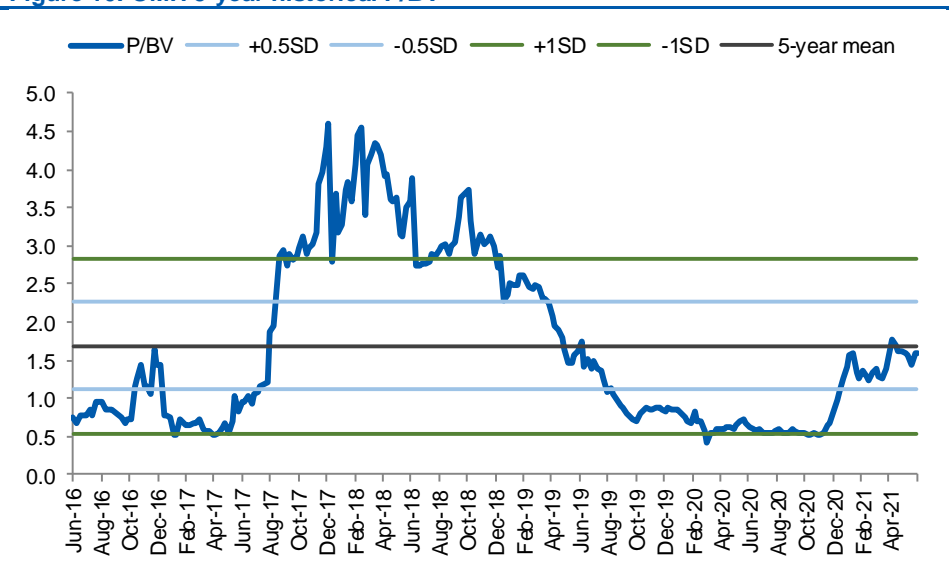
Source: Company data

Earnings forecast. OMH's 1H21 performance is expected to be impacted by the temporary suspension of OMS' operations, in addition to the persisting labour constraints affecting its smelting run-rates. The delicate operating environment amidst COVID-19 and labour movement restrictions may continue to pose downside risks to its 2H21 performance. On the other hand, this is expected to be somewhat mitigated by the lofty ferroalloy prices, in addition to higher output of manganese ore from its mining operations. We project FY21 earnings to rebound 484% YoY off FY20's low base to AUD31.2m, before rising 57% YoY further to AUD49m in FY22, as smelting utilisation rates normalise subsequently post-pandemic.

Valuation

Fair value of MYR3.07 based on 1.7x FY22F P/BV. Our target multiple is based on the group's historical 5-year mean P/BV. This is to reflect the balance of risks between the upcycle in ferroalloy prices and steel sector demand, vis-à-vis the current operational disruptions surrounding OMS. Direct listed peer comparisons are limited in view of the niche ferroalloy market, in addition to the differing asset bases between individual mining companies. Our MYR fair value is arrived at after converting our AUD0.99 FV based on current AUD/MYR rates of ~3.10.

Figure 10: OMH 5-year historical P/BV



Source: Bloomberg, RHB

Outlook

New regional steelmaking capacity additions to drive ferroalloy demand. According to Organisation for Economic Co-operation and Development's estimates, South-East Asia's steel industry is expected to grow at a healthy pace over the coming years to cater to rising urbanisation trends, with capacity additions of 61.5m tonnes pa based on identified projects touted for the region. As such, this is anticipated to drive the long-term growth in regional demand for ferroalloys and benefit OMH's ferroalloy smelting prospects down the road.

Near-term ASP support provided by China's decarbonisation policies. Similar to other industrial metals, Chinese production of ferroalloys may drop off subsequently as China's government moves to control greenhouse gas emissions by power-intensive industrials as such as steelmaking and also ferroalloy production. On 28 Apr, the country's administration raised the export tax rate for FeSi further to 25% from 20%, while power usage restrictions have been enacted on industrial metals producers, which could subsequently spill over to ferroalloy producers as well. As for manganese, the decoupling between manganese alloy vs manganese ore prices this year suggests that the smelting industry is facing relatively tight supply balances as compared to the ore miners. This bodes well for OMH's ferroalloy sales prospects in the current market cycle.

Key risks

Prolonged operational disruptions. Given OMH's reliance on OMS as a key earnings driver, a longer-than-expected suspension of operations due to recurring COVID-19 positive cases amongst employees, persisting labour movement restrictions, and/or delays in vaccinations may impact the group's performance beyond 1H21. This may also hold back OMS' plant upgrading works due to the need for foreign contractors to kick-start the commissioning of its manganese alloy furnace conversions.

Supply-demand imbalances. Ferroalloy market prices could be exposed to heavy fluctuations, depending on the state of supply-demand dynamics governing both the industry as well as the downstream steelmaking sector. For instance, an uneven cutback in steel producers' utilisation rates in China relative to ferroalloy production in the country amid the decarbonisation transition may lead to a temporary market dislocation affecting regional ferroalloy prices.

Raw material cost and forex fluctuations may impact margins. As the primary smelting cost component, the company is susceptible to unfavourable fluctuations in key raw material unit costs such as that of unprocessed ores and quartz, while FX volatility may also impact margins due to the group's operational exposure to various currencies including USD and AUD.

Cross-listing frictions. The trading and settlement of shares under Bursa Malaysia and ASX would be governed by different sets of rules, which may result in a share price divergence from time to time. Also, the transfer of shares between both exchanges is subject to time lag, which may take at least three market days or more. Variations in market liquidity may also arise between both exchanges.

Company Overview

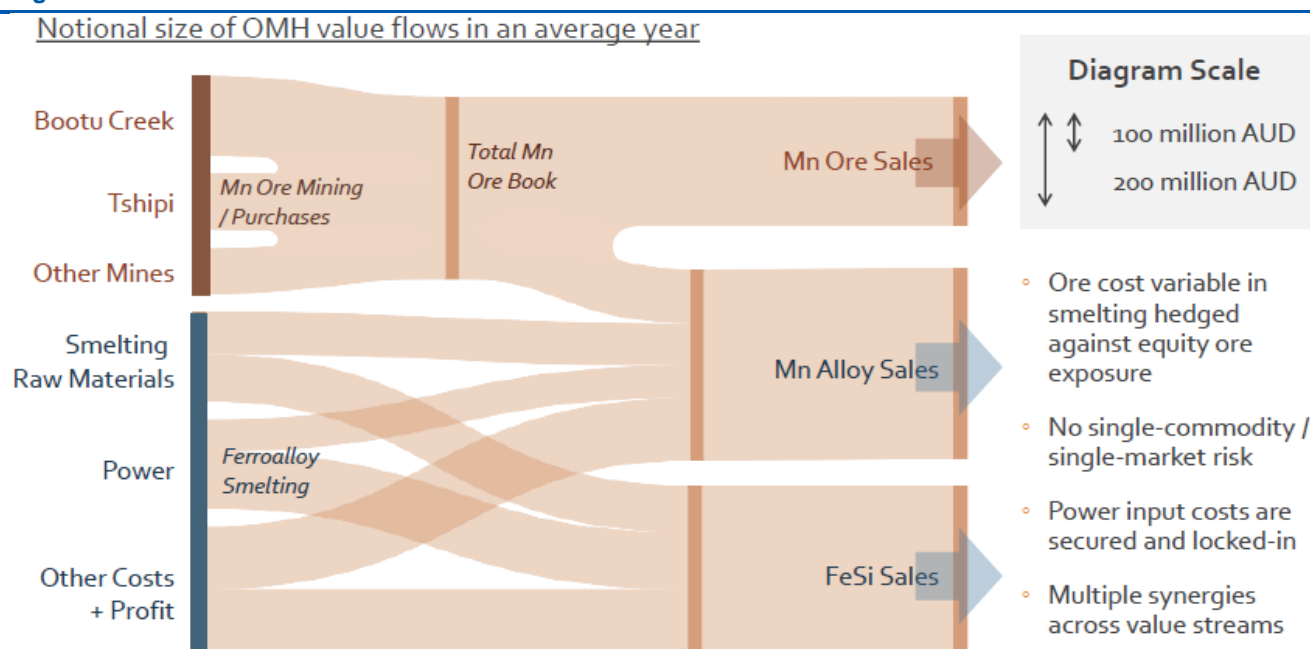
Background. OMH, together with its subsidiaries, is a vertically integrated manganese ore and ferroalloy producer. The group's business involves exploration, mining and trading of manganese ore, smelting and marketing of processed ferroalloys. With over 25 years in the industry, OMH was listed on the ASX in 1998, and has operations across Australia, China, Malaysia, Singapore, and South Africa. Today, the group supplies manganese ore, manganese ferroalloy and ferrosilicon, and seeks to be a major ferroalloy supply partner to major steel mills and other industries in the region and globally.

Figure 11: Overview of operating assets

Exploration & Mining	Smelting & Sintering	Marketing & Trading
Bootu Creek - Australia (100%) Manganese ore: 0.8 Mtpa Tshipi Borwa - South Africa (13%*) Manganese ore: 3.0-3.6 Mtpa <i>* Effective interest held via J/V with Ntsimbintle (a BEE group)</i>	Qinzhou - China (100%) Mn alloy: 80-95ktpa Sinter ore: 300ktpa Sarawak - Malaysia (75%*) Mn alloy: 250-300ktpa Ferrosilicon: 200-210ktpa Sinter ore: 250ktpa (estimated production capacity) <i>* J/V with conglomerate Cahya Mata Sarawak, listed on Bursa Malaysia</i>	Singapore/China (100%) Global sales and procurement Manganese ore, Ferrosilicon, Silicomanganese, Ferromanganese, Quartz, Reductants (coke, coal), Fe units

Source: Company data

Figure 12: Value chain illustration

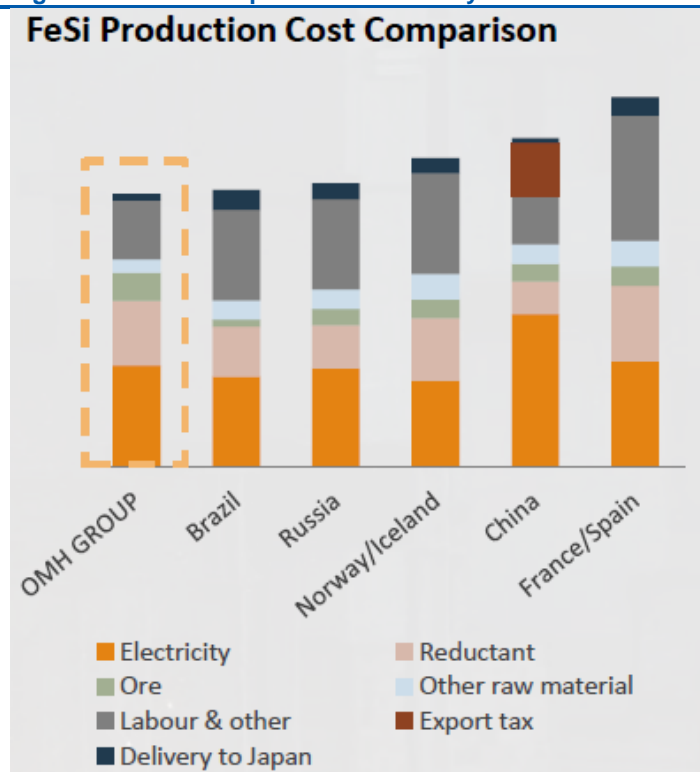


Source: Company data

Cost-competitive ferroalloy smelting operations. OMS is the group's primary smelting hub and major earnings contributor, residing at the lower end of the industry's cost curve while benefitting off a 20-year power purchase agreement for environmentally friendly hydropower supply from Sarawak Energy, in addition to being eligible for a 10-year tax-exemption period until 2027. OMS has a rated capacity of approximately 500,000 tonnes pa comprising FeSi, SiMn as well as FeMn alloy production.

Figure 13: Indicative position on industry cost curve

Figure 14: OMS smelting cost structure



Source: Company data



Source: Company data

Figure 15: Overview of product applications

Critical alloying element to steel - a product essential to basic industries and modern infrastructure

**Manganese Ore**

Manganese is the 4th most consumed metal behind iron, aluminium and copper.

Steel accounts for over 90% of manganese ore consumption, with batteries a small but growing market.

Products: **Manganese Ore**

**Manganese Alloys**

Main alloying element – **Manganese**

- Deoxidises and desulphurises steel
- Acts as a hardening agent
- No known substitute and cannot be recycled
- 6 manganese alloys furnaces

Products: **Ferro-manganese, Silico-manganese**

**Silicon Alloys**

Main alloying element – **Silicon**

- Deoxidises steel
- Used in specialty electrical steels for transformers
- No known substitute and cannot be recycled
- 10 ferrosilicon furnaces

Products: **Ferrosilicon**

Source: Company data

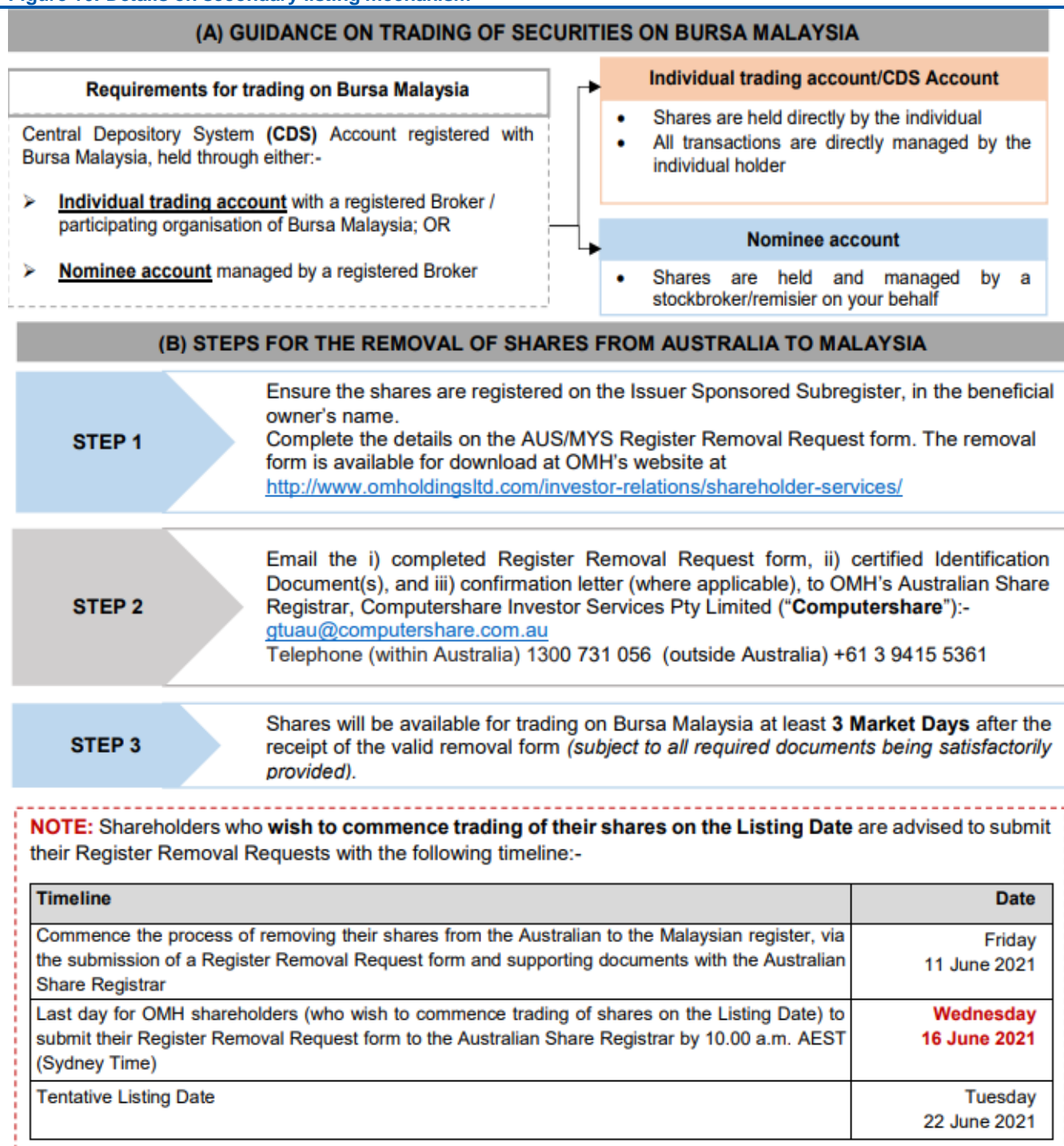
ESG profile. OMH's environmental credentials are anchored by its energy-intensive smelting operations' primary reliance on renewable hydropower, resulting in a lower carbon footprint relative to industry peers that are running on fossil fuels such as coal. Social exposure is more pronounced, given that the group is culpable to operational hazards – as highlighted by a fatal accident occurring at its Bootu Creek mine on Aug 2019, which led to a 4-month production suspension. As for the governance factor, OMH's board comprises five out of seven independent non-executive directors, whereas management provides quarterly updates on the group's operations to supplement its semi-annual reporting intervals under ASX rules.

Management team. The group's senior management includes long-standing co-founders, Low Ngee Tong which serves as Executive Chairman, and Heng Siow Kee as the group's human resources director and also Managing Director of OMS. Other key personnel also includes industry veterans fulfilling various operational and financial roles within the group's business functions.

Salient details of OMS' secondary listing are on the next page.

Secondary Listing Salient Details

Figure 16: Details on secondary listing mechanism



Source: Company

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
Take Profit:	Target price has been attained. Look to accumulate at lower levels
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Not Rated:	Stock is not within regular research coverage

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