

Stock Digest

Tuesday, 29 Mar, 2022

OM Holdings Ltd

Vertically integrated manganese ore and ferroalloy player

- **OM Holdings Ltd (OMH)** started off since 1994 and has now evolved into one of the largest vertically integrated manganese ore and ferroalloy player in South East Asia market.
- **Greenfield of expansion of Samalaju Smelting Complex is bearing fruit, placing OMH in the pole position against its peers in terms of competitive production cost over the long term.**
- **We initiate coverage on OMH with a BUY call and fair value of RM3.65, based on 9.0x P/E pegged to its forward FY23f EPS of 40.5 sen.**

Investment Highlights

- **Low-cost quartile smelter.** OMH embarked into a greenfield of expansion via a 75:25 joint venture with Cahya Mata Sarawak Bhd in 2013 through the construction of Samalaju Smelting Complex. We like OMH position as the low-cost quartile smelter that gives the group a competitive edge against its peers as the plant operates on renewable hydro-power over a 20-year power purchase agreement with Sarawak Energy that provides 350MW low-cost hydropower that comes. Electricity costs make up approximately 50.0% of total production costs
- **Furnaces conversion and capacity expansion.** OMH is currently undertaking the expansion of two 33.0 MVA furnaces to improve manganese production capability and efficiency. Apart from ramping up production capacity, OMH also plans to convert existing 2 FeSi furnaces into metallic silicon (Metsi) by end-2022 that offers better margins.
- **Improving steel demand.** Rapid urbanisation in South East Asia (SEA) countries will sustain the improving demand for steel bodes well for OMH as approximately 30.0% of OMH's ferroalloys are supplied to SEA market. According to the WorldSteel Association, global steel demand for finished steel is expected to grow to 1,924.6m mtpa (+2.7% YoY) in 2022.

Financial highlights

FYE Dec (RM m)	FY20	FY21	FY22f	FY23f	FY24f
Revenue	2,275.0	3,238.8	3,534.0	3,907.4	4,171.5
EBITDA	196.3	526.1	556.6	586.1	604.9
PATMI - Core	15.5	254.9	274.6	299.2	316.7
PATMI - Reported	(8.5)	340.2	366.2	399.0	422.2
Revenue growth (%)	-23.0%	42.4%	9.1%	10.6%	6.8%
Core PATMI growth (%)	-90.5%	1542.5%	7.8%	8.9%	5.8%
Core EPS (sen)	2.1	34.5	37.2	40.5	42.9
P/E (x)	129.9	7.9	7.3	6.7	6.4
DPS (sen)	-	6.0	7.0	7.5	8.0
Dividend yield (%)	0.0%	2.2%	2.6%	2.7%	2.9%
P/B (x)	1.4	1.1	1.2	1.1	0.9
ROE (%)	1.1%	13.8%	15.7%	16.2%	14.7%
Net Gearing (%)	75.5%	49.9%	48.1%	37.5%	17.0%

Source: OMH, M+ Online

Initiation Coverage

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BUY

Share price	RM2.73
Target price	RM3.65
Previous TP	-
Capital upside	33.6%
Dividend return	2.7%
Total return	36.3%

Company profile

Principally involved in the provision of engineering services, construction and general trading

Stock information

Bursa Code	5298
Bloomberg ticker	OMH MK
Listing market	MAIN
Share issued (m)	738.6
Market Cap (m)	2016.4
52W High/Low	4.69 / 2.18
Est. Free float	55.6
Beta	1.0
3-mth avg vol ('000)	154.2
Shariah compliant	No

Major shareholders

	%
Palace Star	21.1
Sun Lead International Ltd	6.2
Standard Life Aberdeen	5.9

Share price vs. KLCI (%)

	1M	3M	12M
Hist. return			
Absolute	-12.2	-6.8	-
Relative	-11.7	-9.9	-

Earnings snapshot

FYE (Dec)	FY21	FY22f	FY23f
PATMI (m)	254.9	274.6	299.2
EPS (sen)	34.5	37.2	40.5
P/E (x)	7.9	7.3	6.7

Relative performance chart



Company Background

- **History dated back to 1994.** OM Holdings Ltd (OMH) was founded in 1994 by the current Executive Chairman, Mr. Low Ngee Tong and has successfully listed on the Australian Securities Exchange (ASX) in 1998.
- **Greenfield expansion.** OMH embarked into the next phase of expansion in 2013 via the construction of Salamaju Smelting Complex and first production was tapped in 2014. The 75.0%-owned plant (with 25.0% held by Cahya Mata Sarawak Bhd's subsidiary, Salamaju Industries Sdn Bhd) has a capacity to produce 250,000-300,000mtpa of Mn alloy, 200,000-210,000mtpa of Ferrosilicon (FeSi) and approximately 250,000mt/pa of Sinter ore. The plant is supported by low cost environmentally friendly hydro power from a 20-year power purchase agreement with Sarawak Energy and a 5-year tax holiday. OMH has been permitted to apply for another 5 years exemption on 70.0% of the statutory income, subject to the satisfaction of MIDA on pre-agreed criterion.
- **Qinzhou smelter.** OMH commenced the construction in-house smelting plant that is located next to Qinzhou port, at Guangxi, China in 2002. The plant currently operates 1 x 16.5 and 1 x 25.5 MVA furnaces with a production capacity of 80,000-95,000mt/pa of manganese alloys (Mn alloy) and 300,000 metric tonnes per annum (mtpa) of Sinter ore.
- **South Africa.** Elsewhere, OMH also holds 13.0% interest in the Tshipi Borwa mine through a strategic partnership with Ntsimbintle Mining, a leading South African miner and explorer. 49.9% of the Tshipi Borwa mine is held under the company Jupiter Mines (ASX: JMS). The manganese field is 35km long and 15km wide and is touted as the largest manganese bearing geological formation in the world. The mine is also equipped with a processing plant to crush and screen approximately 3.3-3.6m tonnes per annum of manganese ore.
- **Bootu Creek mine.** OMH started the exploration of Bootu Creek manganese ore mine in Northern Territory, Australia in 2001. Subsequently, the mining operations was commenced at end-2005 and delivered its first export shipment ore in 2006. After more than a decade of mining, Bootu Creek mining operations were ceased at end-2021 following the end of the mine's life and is no longer part of the main asset of OMH.
- **Dual Listing.** OM Holdings then completed its secondary listing on Bursa Malaysia, making its debut on the Main Market of Bursa Malaysia on 22nd June 2021. This also marks the first cross listing between Bursa Malaysia and the ASX.
- **Established market presence.** With over 20 years of operational history, OMH is now regarded as one of the world's leading suppliers of manganese ores and ferroalloys. Their products are distributed through their global trading network to top regional and global steel-makers around the world. Some of the key customers include Alliance Steel (Malaysia), China Steel Corporation (Taiwan), Eastern Steel (Malaysia), Erdemir (Turkey), Formosa Ha Tinh Steel (Vietnam), Hoa Phat Group (Vietnam), Hyundai Steel (South Korea), JFE Steel Corporation (Japan), Nucor (USA), POSCO (South Korea), and Tsingshan Stainless (Indonesia).

Business Model



Source: OMH, M+ Online

- **Smelting & Sintering.** Smelting involves the extraction of metal from raw ores through heating and melting into semi-finished alloys. Meanwhile, sintering involves the process of heating and fusing powdered ore into higher grade, semi-processed ores. OMH's wholly owned smelting and sintering plant through OM Materials (Qinzhou) Co. Ltd (OMQ) is located next to Qinzhou port, China. The plant is equipped with one 25.5 MVA and 16.5 MVA furnaces and two 36m² sinter lines that began operations in 2004. Following the upgrades in 2020, the plant now has a production capacity of 80,000-95,000mtpa of high carbon ferromanganese and 300,000mtpa of sintered ore.

OMH embarked into a greenfield of expansion via a 75:25 joint venture with Cahya Mata Sarawak Bhd in 2013 through the construction of Samalaju Smelting Complex and the first production was tapped in 2014. The plant consists of 8 main workshops, with 2 units of 25.5 MVA furnaces in each. Out of the 16 furnaces, 10 are allocated for the production of ferrosilicon, and 6 for the production of manganese alloys.

- The plant operates on renewable hydro-power over a 20-year power purchase agreement with Sarawak Energy that provides 350MW low-cost hydropower to the complex that places OMH at a competitive edge against its peers, given that electricity costs make up approximately 40% of total production costs. The plant also enjoys a 5-year tax break. Meanwhile, OMH has been permitted to apply for another 5 years exemption on 70.0% of the statutory income, subject to the satisfaction of MIDA on pre-agreed criterion. The plant has a production capacity of 250,000-300,000mtpa of Mn alloy, 200,000-210,000mtpa of Ferrosilicon (FeSi) and approximately 250,000mt/pa of Sinter ore.

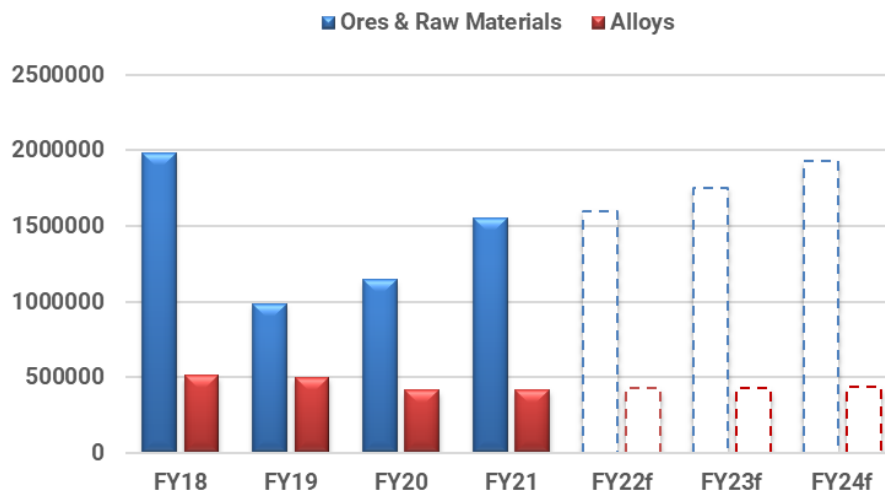
Salamaju Smelting Complex – Sarawak



Source: OMH, M+ Online

- **Marketing & Trading.** The marketing and trading segment operates in Singapore and has distribution channels located in China. Today, OMH products are sold to customers globally.

Sales Volumes of Ores & Raw Materials and Alloys



Source: OMH, M+ Online

- **Exploration & Mining.** The exploration and development of Bootu Creek manganese ore mine in Northern Territory, Australia started in 2001 and drilling was completed in 2004 with a joint-venture partner with the Groote Eylandt Mining Company (GEMCO). Since then, the mining operations commenced at end-2005 and the delivery of its first export shipment ore came in 2006. A year later in 2007, the mine became wholly-owned by OMH. In December 2021, mining operations stopped after reaching the end of mine life. In place of mining, an Ultra Fines Plant (UFP) was commissioned to reprocess reject material (or tailings), and is expected to yield an additional 250,000mtpa of fines for 7-8 years using a reflux classifier. Design rectification works are ongoing, with final trials conducted in H1 2022 for optimization before officially launching later.

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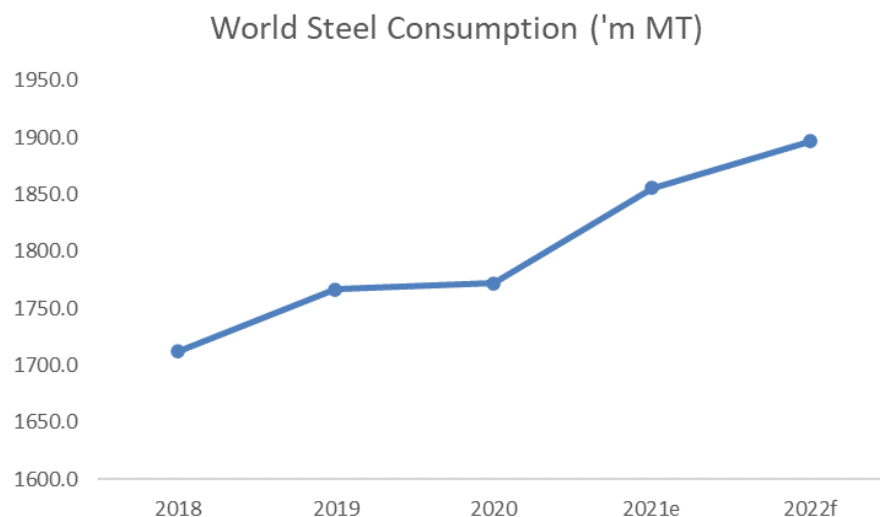
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Meanwhile, OMH also holds an effective 13.0% stake in the Tshipi Borwa mine via a joint venture partner with Ntsimbintle Mining. The mine operates on a simple drill, blast, haul operation. We note that the mine that began its operations since 2012 is equipped with a processing plant to crush and screen approximately 3.3-3.6m mtpa of manganese ore. 49.9% of the Tshipi Borwa mine is held under the company Jupiter Mines (ASX: JMS).

Outlook

- **Capacity expansion.** We like OMH for its on-going expansion plans of two 33.0 MVA furnaces to improve manganese production capability and efficiency. Upon completion, this will boost the production of Silico-manganese (SiMn) by additional 150,000 mtpa. Consequently, SiMn production capacity would increase to 450,000-470,000mtpa.
- **Furnaces conversion.** Apart from ramping up production capacity, OMH also plans to convert existing 2 FeSi furnaces into metallic silicon (Metsi) by end-2022 that offers better margins. Metsi are used in the aluminum, chemicals, and solar industries, marking OMH's move to diversify downstream industries. Post conversion, the furnaces have the flexibility to produce FeSi.
- **Rising consumption.** The rapid urbanisation in South East Asia (SEA) countries bodes well for OMH as approximately 30.0% of OMH's ferroalloys are supplied to SEA market to cater for the rising infrastructure, transportation, automobiles, shipbuilding, machinery and home appliances among others. According to the WorldSteel Association, global steel demand for finished steel is expected to grow to 1,896.4 mtpa (+2.2% YoY) in 2022. We reckon that strong manufacturing activity bolstered by pent-up demand would be the main contributor of the improvement.

World Steel Consumption



Source: WorldSteel Association

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SWOT Analysis

Strength	Weakness
<ul style="list-style-type: none"> Established position as one the largest leading suppliers of manganese ores and ferroalloys Low production cost advantage 	<ul style="list-style-type: none"> Labour shortages Fluctuation of ferrosilicon and silico manganese prices may affect margins
Opportunity	Threat
<ul style="list-style-type: none"> Production expansion and ramping up plants utilisation to capture robust demand Furnaces conversion into metallic silico may drive margins 	<ul style="list-style-type: none"> Fluctuation in foreign exchange rates, particularly between USD, AUD and RM

Source: M+ Online

Financials

- After a downturn in FY20 which only recorded RM15.5m in net profit that was largely affected by the softer manganese ore and ferroalloy prices amid the slowdown in demand following the Covid-19 pandemic, OMH has delivered a core net profit of RM254.9m in FY21, bolstered by the higher total manganese ore and manganese alloys, mainly SiMn as well as the surge on the ferroalloy prices as the average transacted prices for FeSi rose 59.1% YoY to an average AUD2,321/tonne.
- For FY22f, OMH will undergo a transition phase as the group planned a major maintenance for all furnaces and conversion of furnaces may only take place in 2H22. With production capacity hovering at 340,000-360,000 mtpa for FY22f (largely unchanged from FY21, we expect bottomline to only register mild improvement, rising 7.8% YoY to RM274.6m, alongside with an increase of 9.1% YoY to RM3.53bn in revenue. The improvement would be backed by the elevated ferroalloy prices, better utilisation smelting plant in Sarawak and slightly higher sales.
- We reckon that improvement in subsequent years (both FY23f and FY24f) will anchored by the conversion of furnaces into the production of MetSi and new Mn alloy plant that would boost production capacity to 610,000-640,000mtpa upon completion of their mid-term expansion plans. The upcoming supply stream would likely to be absorbed by the improvement demand for steel-related products.
- While the expansion plans are in place, we foresee OMH to remain in a lean balance sheet with net gearing below 0.5x level. Presently, OMH has allocated approximately AUD200.0m as CAPEX to cater for their expansion plans.

Valuations

- At RM2.73, OMH is trading at PERs for FY22f and FY23f of 7.3x and 6.7x, respectively. We assigned a P/E multiple of 9.0x to FY23f EPS of 40.5 sen, arriving at a fair value of RM3.65.
- We gather that OMH is trading below the local and global peers' average P/E multiple of 10.8x for 2022f. The assigned target P/E represents a slight discount to the average of 10.8x of selected mining and smelting companies listed on Bursa Malaysia as well as international scale. The discount is premised to OMH smaller market capitalisation.

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- We also gather that OMH does not have any formal dividend policy. Still, the group is committing to carve out approximately 20.0% pay-out from net profit as dividends, barring any unforeseen circumstances. For FY21, OMH has declared a total dividend of 6.0 sen per share. Moving forward, we have imputed an assumption pay out of 7.0-8.0 sen over the next 3 years, representing pay-out ratio of 18.0-19.0% from FY22f to FY24f.

Peers comparison

Company	Market Group	FYE	Price (RM)	Market Cap (RM 'm)	P/E (x)		Gross DY (%)	Revenue (RM 'm)	Net Income (RM 'm)
					FY21	FY22f			
OM Holdings Ltd	MAIN	Dec	2.73	2016.4	7.9	7.3	2.7	3238.8	254.9
Local									
Press Metal Holdings Bhd	MAIN	Dec	6.09	49183.8	47.7	23.4	1.8	10994.2	1030.5
Malaysia Smelting Group Bhd	MAIN	Dec	4.63	1944.6	16.5	10.0	2.6	1076.6	118.1
International									
South 32 Ltd	-	Jun	5.20	24214.4	-	7.9	5.8	7338.9	-261.3
Ferroglobe	-	Dec	7.86	1470.8	-	1.7	-	1778.9	-95.8
Avg ex-OM Holdings Ltd					32.1	10.8	3.4	5297.2	197.9

*South 32 Ltd metrics are based on AUD, while Ferroglobe Inc metrics are based on USD

Source: Bloomberg, M+ Online

Investment risks

- **Slowdown in demand for steel.** Given that OMH's sales are largely dependent on the demand for steel products, a downturn steel demand would hamper production volume as OMH is largely dependent on the manganese and ferrosilico markets.
- **Fluctuation in raw material prices.** Average selling prices are largely correlated with the raw material prices. Any fluctuation in raw material prices, namely ferrosilicon and manganese ore prices due to the demand-supply imbalances may trigger changes in revenue and margins assumption.
- **Exposure to currency risk.** Given that OMH has operations across 5 countries, the group runs the risk of volatility in foreign exchange markets. With most of the products are sold in USD, a stronger Greenback against the Ringgit would benefit OMH and vice versa.

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Financial Highlights

Income Statement						Balance Sheet					
FYE Dec (RM m)	FY20	FY21	FY22f	FY23f	FY24f	FYE Dec (RMm)	FY20	FY21	FY22f	FY23f	FY24f
Revenue	2,275.0	3,238.8	3,534.0	3,907.4	4,171.5	Cash	195.0	339.9	390.6	506.7	801.2
EBITDA	196.3	526.1	556.6	586.1	604.9	Receivables	194.9	170.5	184.0	203.4	205.7
EBIT	70.2	404.9	441.5	473.6	494.4	Inventories	669.1	1,069.0	1,016.6	1,043.8	1,114.3
Net finance income/ (cost)	(78.1)	(57.7)	(60.4)	(58.5)	(55.9)	PPE	1,989.7	1,919.2	1,874.7	1,840.4	1,813.4
Associates & JV	(47.9)	(16.8)	(17.7)	(19.5)	(20.9)	Others	457.5	432.5	389.3	353.3	320.6
Profit before tax	(13.5)	350.4	385.5	420.0	444.4	Assets	3,506.2	3,931.1	3,855.2	3,947.6	4,255.2
Tax	5.0	(10.2)	(19.3)	(21.0)	(22.2)	Debts	1,289.1	1,260.9	1,229.4	1,198.6	1,168.7
Net profit	(8.5)	340.2	366.2	399.0	422.2	Payables	502.0	560.9	629.4	647.8	670.3
Minority interest	(24.0)	85.3	91.5	99.7	105.6	Others	266.7	262.8	251.0	253.8	255.8
Core earnings	15.5	254.9	274.6	299.2	316.7	Liabilities	2,057.7	2,084.5	2,109.8	2,100.3	2,094.7
Exceptional items	-	-	-	-	-	Shareholder's equity	1,085.9	1,162.9	1,385.3	1,030.1	1,273.9
Reported earnings	15.5	254.9	274.6	299.2	316.7	Minority interest	212.2	317.8	571.9	429.9	485.5
						Equity	1,448.4	1,846.5	1,745.4	1,847.3	2,160.5
Cash Flow Statement						Valuation & Ratios					
FYE Dec (RM m)	FY20	FY21	FY22f	FY23f	FY24f	FYE Dec (RM m)	FY20	FY21	FY22f	FY23f	FY24f
Profit before taxation	15.5	254.9	274.6	299.2	316.7	Core EPS (sen)	2.1	34.5	37.2	40.5	42.9
Depreciation & amortisation	161.4	179.4	115.2	112.5	110.4	P/E (x)	129.9	7.9	7.3	6.7	6.4
Changes in working capital	50.2	(296.8)	14.7	47.0	94.0	DPS (sen)	-	6.0	7.0	7.5	8.0
Share of JV profits	-	-	-	-	-	Dividend yield	0.0%	2.2%	2.6%	2.7%	2.9%
Taxation	18.6	(3.6)	(3.9)	(5.1)	(8.0)	BVPS (RM)	1.96	2.50	2.36	2.50	2.92
Others	(90.1)	59.7	(200.0)	(200.0)	(150.0)	P/B (x)	1.4	1.1	1.2	1.1	0.9
Operating cash flow	137.0	197.3	204.5	258.7	371.1	EBITDA margin	8.6%	16.2%	15.8%	15.0%	14.5%
Net capex	(48.9)	(28.1)	(70.6)	(44.5)	(34.3)	EBIT margin	3.1%	12.5%	12.5%	12.1%	11.9%
Others	16.1	48.4	10.0	10.0	10.0	PBT margin	-0.6%	10.8%	10.9%	10.7%	10.7%
Investing cash flow	(32.8)	20.4	(60.6)	(34.5)	(24.3)	PAT margin	-0.4%	10.5%	10.4%	10.2%	10.1%
Changes in borrowings	(76.7)	(110.8)	(100.0)	(100.0)	(100.0)	Core PAT margin	0.7%	7.9%	7.8%	7.7%	7.6%
Issuance of shares	-	-	-	-	-	ROE	1.1%	13.8%	15.7%	16.2%	14.7%
Dividends paid	(21.4)	-	(51.7)	(55.4)	(59.1)	ROA	0.4%	6.5%	7.1%	7.6%	7.4%
Others	(6.6)	12.2	-	-	-	Net gearing	75.5%	49.9%	48.1%	37.5%	17.0%
Financing cash flow	(104.6)	(98.7)	(151.7)	(155.4)	(159.1)						
Net cash flow	(0.5)	119.0	(7.7)	68.8	187.7						
Forex	(8.1)	8.6	8.6	8.6	8.6						
Others	-	-	-	-	-						
Beginning cash	140.5	131.9	259.5	260.4	337.8						
Ending cash	131.9	259.5	260.4	337.8	534.1						