SECTOR UPDATE

Building Materials – Malaysia

Benefitting From Spillover Of Commodities Rally

Aluminum, ferroalloy and tin players are expected to post strong earnings in 2Q22, which offer an attractive trading catalyst. This is due to the improved production yoy after the lockdown and spillover of record-high prices from 1Q22, benefitting from structurally favourable supply-demand dynamics. We believe prices for the selected commodities have bottomed as current spot prices could be below some of the global producers' cash production costs. Maintain OVERWEIGHT. Top pick: Press Metal.

WHAT'S NEW

- **Expect robust performance in upcoming 2Q22 results.** We believe aluminum, ferroalloy and tin companies will post stellar 2Q22 earnings, which offer an attractive trading opportunity as the strong earnings may have yet to be fully reflected in their share prices. This is largely due to higher production yoy after the lockdown and the spillover effect of record-high commodity prices from 1Q22. Most of the companies under our coverage sell forward at least 2-3 months ahead so they managed to lock in the favourable prices before the prices trended downwards. Prices have eased entering into 2H22, mainly due to the weak market sentiment caused by the fear of recession. While sentiment may remain fragile in the near term, we believe this presents a good buying opportunity as China's gradual lifting of its lockdown will stimulate demand and support prices accordingly.

- **Rising energy prices...** Skyrocketing electricity costs and declining commodity prices amid the rising rates and fear of economic slowdown have led some global producers to cut or exit the market. Recently, the Ferroalloy Association in China asked its members to cut output by >60%, and over 40 producers agreed to do so. Ningxia in China, a major ferroalloy production hub, plans to reduce daily production by 67% to 1,450 mt/day. We noted that today's FeSi spot price of US$1,800/mt is below cash cost for some of these producers (vs OMH's cash cost: $1,200-1,400/mt). Producers in India also cut output by 40% in July. For tin, many major smelters in China decided to halt production in July too. Hence, around 13,500mt of refined tin (4% of global production) will not be produced in Jun-Jul 22. These production cuts will form a significant support for the commodity prices.

- **…give local smelters low-cost advantage over global peers.** Given the power-intensive nature of the smelting business, OMH and PMetal have significant advantage over global peers as they offer substantially lower costs, given their access to eco-friendly low-cost hydropower in Sarawak. For example, OMH is in the lowest quartile for production costs (fifth-largest FeSi producer, ex-China). Comparable smelters in China and Europe run at a cost that can be 2x or 3x higher. The use of hydropower, solar panels and waste heat recovery helps to reduce their carbon footprints too. China's strict environmental requirements will push more small producers to withdraw from the market. Hence, local smelters may fill the void left by some global players exiting the market. This was reflected as Malaysian smelters were the 2nd biggest suppliers to the US for FeSi in 4M22.

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 strong results this year due to: a) elevated ASPs, b) improved production, and c) healthy 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). Top pick: PMetal.

OVERWEIGHT

(Maintained)

TOP SECTOR PICKS

Company	Rec	Share Price 2 Aug 22 (RM)	Target Price (RM)
Press Metal	BUY	4.95	7.40

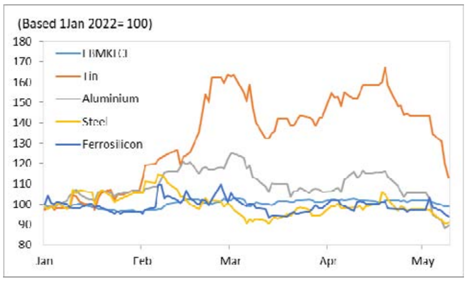
Source: UOB Kay Hian

KEY ASSUMPTIONS

	Average Ytd	2022F	2023F
Ferroalloy (US$/mt)			
ASP – FeSi Alloy	2,000	1,900	1,700
ASP – Mn Alloy	1,450	1,400	1,300
Tin (US$/mt)			
ASP	38,000	34,000	32,000
Aluminum (US$/mt)			
ASP - Aluminum	2,900	2,500	2,600

Source: UOB Kay Hian

EXPORTED BUILDING MATERIALS INDEX



Source: Bloomberg, UOB Kay Hian

KEY REGIONAL PRODUCTION CUTS

Ferroalloy	China: Cut output by >60% India: Slash production by 40%
Tin	China: Halt production in July impacting 13,500mt (4% global production)
Aluminium	Europe: Lost about half of its aluminium smelting capacity last year due to the high power prices

Source: Bloomberg, UOB Kay Hian

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PEER COMPARISON

Company	Tickers	Rec	Share Price 2 Aug 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	4.95	7.40	40,790	18.3	16.6	6.0	5.5	40.3	31.7
Malaysia Smelting Corp	SMELT MK	BUY	2.24	3.07	1,010	4.9	5.2	1.2	1.0	27.9	22.0
OM Holdings	OMH MK	NR	2.08	n.a.	1,450	5.2	4.1	n.a.	n.a.	12.3	17.1

Source: Bloomberg, UOB Kay Hian

- **Our preferred picks**:

  a) **Press Metal (PMAH MK/BUY/Target: RM7.40).** With a sixth consecutive quarter of record-high earnings in 1Q22, PMetal continues to be a prime beneficiary of strong aluminium prices backed by structural supply shortage and robust demand. The 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% at US$2,500/mt for 2023. Preference for low carbon and greener aluminium also lends further strength to current spot prices.

  b) **Malaysia Smelting Corp (SMELT MK/BUY/Target: RM3.07)** is on track for another strong year in 2022 backed by the ramp up in production and improvement in smelting margins from the full utilisation of its new eco-friendly smelting plant. Despite the volatile market sentiment that is pressuring tin prices, we still believe prices will remain firm in the long run as the structural supply issue will persist.

  c) **OM Holdings (OMH MK/NOT RATED/Current: RM2.05)** is in a sweet spot to benefit from elevated ferroalloy prices backed by structurally favourable supply-demand dynamics. Its use of low-cost eco-friendly hydropower, tax benefits and long-term earnings visibility via its capacity expansion and diversification plan, put it ahead of its global peers. The economic reopening helps OMH to resolve its manpower shortage issue and fully resume production going forward.

ESSENTIALS

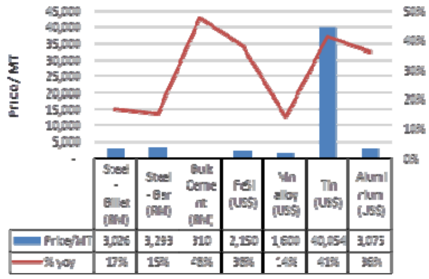
- **Stronger production amid economic reopening.** OMH's 2Q22 production volumes for FeSi and Mn alloy improved to 35,004mt (+52% yoy) and 60,767mt (+61% yoy), which brought 1H22 output to 68,929mt (+12% yoy) and 121,307mt (+28% yoy) respectively. This is mainly due to the absence of lockdown and border reopening. Sales volumes of FeSi and Mn alloys increased to 37,779mt (+25% yoy) and 52,172mt (+2% yoy), largely due to export bulk shipments that were delayed towards end 1Q22, which were brought forward to 2Q22. Due to its hedging practice, we believe OMH has locked in most of its sales in 1H22 at >US$2,000/mt for FeSi and >US$1,500/mt for Mn alloy.

- **Capacity expansion to boost earnings ahead.** The conversion of two of the idled FeSi furnaces to produce Mn alloys has recently been completed, targeting to produce an additional 100,000mt/year. With the new converted furnaces, OMH is running 14 out of 16 furnaces (6 FeSi and 8 Mn alloy). The remaining two idled furnaces are being converted into producing silicon metal (MetSi), which are expected to be completed in 4Q22 (24,000mt/year). With stable production output and elevated prices in 2022, OMH is expected to register strong profit for FY22. The company is trading at 3-4x 2022F PE. CMS' recent disposal of its 25% stake in OM Sarawak (OMS) is underway, expected to be completed by end-4Q22. Hence, from 2023 onwards, OMH will be able to recognise 100% profit from OMS.

- **Surge in power prices continues to disrupt production.** LME aluminium prices touched an all-time high at US$3,985/mt before retreating to the current level of around US$2,400/mt (ytd average: US$2,975/mt) which was affected by the frail sentiment on China's lockdowns. Besides favourable structural demand globally, electric vehicles (EV), renewable energy (RE) and infrastructure, LME aluminium prices are supported by supply tightness from partial plant shutdowns, power curtailment in China and Europe as well as supply disruption caused by the Russia-Ukraine war. Note that Europe has lost around half of its aluminum smelting capacity last year. Any further hikes in energy prices this coming winter could push more smelters to cut production.

- **Tin supply disruption continues.** LME inventory rose to 3,260mt due to weak demand from China's lockdown but inventory still remains low (three days' worth of global consumption vs historical average of >14 days or >15,000mt). Production in Indonesia (the world's largest tin exporter) has been declining in recent years due to changes in regulatory policies. It is considering raising the royalty rate on tin from 3% to a new progressive rate to increase the value extracted from its natural resources to boost its economy. It is also preparing a policy on a planned ban on processed tin exports.

COMMODITIES PRICES

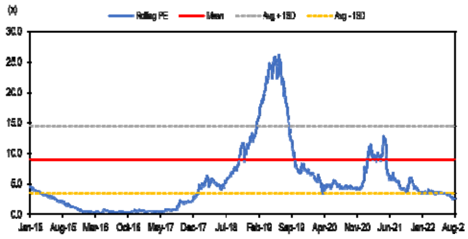


Source: MITI, Bloomberg, UOB Kay Hian

MSC HISTORICAL FORWARD PE

Source: UOB Kay Hian

OMH HISTORICAL FORWARD PE

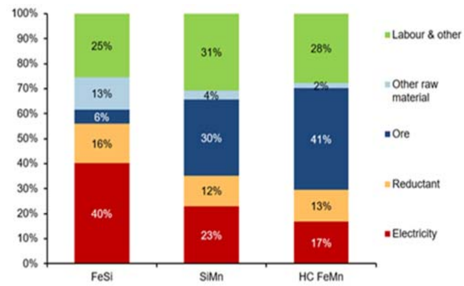


Source: UOB Kay Hian

PMETAL HISTORICAL FORWARD PE

Source: UOB Kay Hian

BREAKDOWN OF FERROALLOY PRODUCTION COSTS



Source: UOB Kay Hian

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