

INITIATE COVERAGE

OM Holdings (OMH MK)

Gearing Up To Capture Price Rebound Effect In 2023

Reinitiate coverage with BUY. OMH is set to achieve a multi-year profit bonanza with expanded capacity, as hydro-powered smelters' cost advantage has significantly widened vs fossil-fuel dependent global competitors. We believe ferroalloy prices have bottomed, currently standing below some global producers' cash costs. Note that 1H22 core earnings surged over fourfold mainly due to strong ferroalloy prices, backed by a structural supply shortage amid global decarbonisation. Target price: RM3.53.

WHAT'S NEW

- **The favourable structural supply-demand dynamics** have yet to be reflected in OM Holdings' (OMH) share price, as the rising global energy prices have widened the cost differential gap between the company and fossil-fuel dependent smelters. This gives OMH significant low-cost advantage due to its long-term access to 300MW of inexpensive hydropower in Sarawak. 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. This places OMH in the lowest quartile for production costs (fifth-largest FeSi producer, ex-China). Comparable global smelters run at a cost that can be 2x or 3x higher.
- **1H22 results review.** OMH's 1H22 post-provision net profit came in above street expectations at RM216m or US\$48m (+136% yoy), representing >70% of its 2021 earnings. 1H22 revenue rose 35% yoy to RM2.1b or US\$467m. The improvement was mainly due to the spillover of elevated ferroalloy prices in 1H22 (refer to overleaf RHS price chart) and higher ferroalloy production, partially offsetting the inflationary headwinds and lower tonnages of ores sold in 1H22 amid the unfavourable macro environment. Despite the volatile market, we believe OMH will be able to sustain strong earnings ahead, backed by elevated ferroalloy prices, higher production output and expanded capacity.
- **Improved ferroalloy production...** 2Q22 production volumes of ferrosilicon (FeSi) and manganese (Mn) alloy improved to 35,004mt (+3% qoq, +52% yoy) and 60,767mt (+0.4% qoq, +61% yoy) respectively. The improvement was largely due to the better production with the absence of COVID-19-related lockdowns. This brought 1H22 production volumes of FeSi and Mn alloy to 68,929mt (+12% yoy) and 121,307mt (+28% yoy) respectively, forming close to 60% of OMH's full-year guidance.
- **...with expanded capacity ahead.** The conversion of two idle FeSi furnaces to produce Mn alloys has recently been completed, targeting to produce an additional 100,000mt/year. The furnaces have been hot commissioned and are currently in the midst of ramping up production. With the new converted furnaces, OMH is currently running 14 out of 16 furnaces (six FeSi and eight Mn alloy). The remaining two idle furnaces are currently being converted into producing silicon metal (MetSi), which is expected to be completed in 4Q22 (24,000mt/year). Demolition works have been completed, with civil modification works currently underway. The smelter equipment fabrication has been completed and delivered to the smelting plant in batches for installation.

KEY FINANCIALS

Year to 31 Dec (RMm)	2020	2021	2022F	2023F	2024F
Net turnover	2,275.4	3,164.1	3,468.7	3,801.1	4,060.9
EBITDA	164.1	559.0	636.5	723.1	763.2
Operating profit	22.2	386.0	498.8	573.5	602.6
Net profit (rep./act.)	15.5	249.0	340.5	445.6	482.4
Net profit (adj.)	14.0	306.8	340.5	445.6	482.4
EPS (sen)	1.9	41.5	46.1	60.3	65.3
PE (x)	101.2	4.8	4.4	3.3	3.1
P/B (x)	1.0	0.8	0.7	0.6	0.5
EV/EBITDA (x)	15.6	4.8	3.6	2.7	2.1
Dividend yield (%)	-	3.2	3.5	4.6	5.0
Net margin (%)	0.6	9.7	9.8	11.7	11.9
Net debt/(cash) to equity (%)	47.8	43.2	38.9	28.2	28.2
Interest cover (x)	0.3	6.4	6.6	8.7	10.7
ROE (%)	1.2	20.0	18.6	20.2	18.4

Source: OM Holdings Limited, Bloomberg, UOB Kay Hian

BUY

Share Price	RM1.84
Target Price	RM3.53
Upside	+91.8%

COMPANY DESCRIPTION

OM Holdings Limited operates as a holding company. The Company, through its subsidiaries, mines and refines manganese ore and ferro alloys and silicon. OM Holdings markets its products worldwide.

STOCK DATA

GICS sector	Materials
Bloomberg ticker:	OMH MK
Shares issued (m):	738.6
Market cap (RMm):	1,322.1
Market cap (US\$m):	293.6
3-mth avg daily t'over (US\$m):	0.0

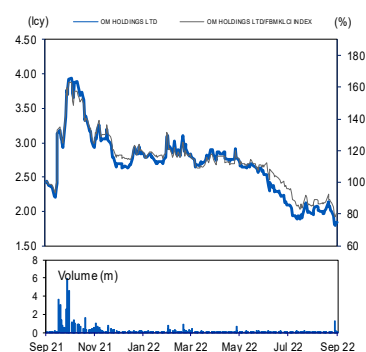
Price Performance (%)

52-week high/low	RM3.94/RM1.79			
1mth	3mth	6mth	1yr	YTD
(10.1)	(30.6)	(36.5)	(28.1)	(36.7)

Major Shareholders

	%
Huang Gang	14.0
Amplewood Resourced Ltd	13.6
Low Ngee Tong	9.2
FY22 NAV/Share (RM)	2.21
FY22 Net Debt/Share (RM)	0.67

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- Sales volume remains healthy.** FeSi volumes traded in 1H22 increased by 17% yoy, contributing about RM820m (+129% yoy) to OMH's revenue. Revenue contribution from Mn alloy also jumped 38% yoy to RM903m despite an 11% yoy decrease in volumes traded. On the other hand, revenue contribution from Mn ore fell by 30% yoy to RM361m as OMH's Bootu Mine temporarily ceased operations in 1Q22 to enter a care & maintenance phase, which impacted the production and volumes traded (-38% yoy).
- Always darkest before the dawn.** In 2Q22, prices of ferroalloy gradually eased, moving in tandem with the broader commodity market, mainly due to the weak market sentiment caused by the fear of recession. Ferroalloy prices are currently pressured by: a) soft demand from steel mills amid the ongoing lockdown in China that has impacted demand, and b) elevated global power costs and weak sentiment in the current rising rates environment. According to Worldsteel, world crude steel production in Mar and Apr 22 declined by 6% yoy to 334m mt. As such, FeSi and Mn alloy prices eased to US\$1,925/mt (-13% qoq, +0.3% yoy) and US\$1,225/mt (-31% qoq, -20% yoy) respectively towards end-2Q22. Mn ore price rose to US\$7.80/mt in 1Q22, before declining gradually to US\$7.27/mt (+46% yoy) in 2Q22.
- Global power crunch and supply cuts to uplift prices.** We believe that ferroalloy prices may have bottomed as current spot prices could be below some global producers' cash production costs. Skyrocketing electricity costs and declining prices amid the rising rates and fear of an economic slowdown have led to some global producers cutting production or even exiting the market. The Ferroalloy Association in China asked its members to cut output by >60%, and over 40 producers have 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 note that FeSi spot price is currently hovering around US\$1,700/mt, which is below cash cost for some of these producers (vs OMH's cash cost: US\$1,200-1,400/mt). Producers in India also cut output by 40% in July.
- OMH a prime beneficiary of the price rebound ahead.** 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. In anticipation of a recovery in commodity prices as inflation expectations ease and the quantum of US Fed hikes moderate, we believe OMH will benefit from the prolonged elevated ferroalloy prices in the long run given the favourable structural supply-demand dynamics amid the ongoing global decarbonisation agenda, the current power crisis and the Ukraine-Russia war.
- Strong balance sheet to support capacity expansion.** Benefitting from the commodity rally, OMH has strengthened its balance sheet with net gearing falling 19% yoy to 0.54x and net assets per share increasing by 28% yoy to RM2.98/share. OMH also registered strong operating cash flow of >RM320m with consolidated cash position standing at >RM370m. The robust balance sheet coupled with future operating cash flows, and/or potential bank borrowings/equity raising, will be more than sufficient to accommodate the estimated >RM300m capex for expansion ahead. OMH plans to expand its capacity significantly, yielding an additional 150,000mt/year of Mn alloy by end-23 via bigger 2-4 33MVA furnaces (currently: c.300,000 mt). This can potentially put OMH among the top three largest Mn alloy producers globally (ex-China).

EARNINGS REVISION/RISK

- None**, although there will be a big upward revision to our 2023-24 forecasts on the completion of its proposed acquisition of a 25% stake in OM Sarawak (OMS). Meanwhile, every US\$100/mt hike in ferroalloy price will boost earnings by 20%.

VALUATION/RECOMMENDATION

- Reinitiate coverage with a BUY call and a conservative target price of RM3.53**, implying 8x 2022F PE (5-year mean: 15x). OMH currently trades at 3-4x 2022F core earnings. Our target price has imputed the proposed 25% acquisition of OMS, capacity expansion at OMS, and improvement in trading liquidity over time, which will meaningfully boost valuations (c.15% of paid-up is listed in Bursa currently).

ENVIRONMENTAL, SOCIAL, GOVERNANCE (ESG) UPDATES

<ul style="list-style-type: none"> Environmental <ul style="list-style-type: none"> Eco-friendly smelters help to reduce carbon dioxide emissions by 2.2m mt p.a.. Social <ul style="list-style-type: none"> OMH offers career opportunities and provides training to the indigenous community. Governance <ul style="list-style-type: none"> Majority of the board are independent directors (5 out of 7 non-exec directors).

1H22 PRODUCTION

Production ('000 mt)	1H22	2Q22	qoq % chg	yoy % chg
Alloy				
Ferrosilicon	69	35	3	52
Manganese alloy	121	61	1	61

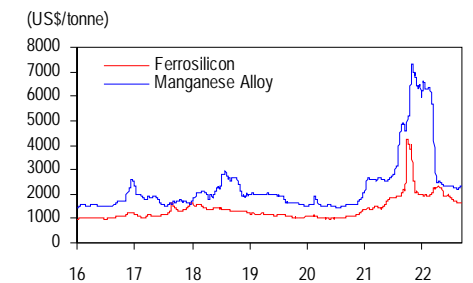
Source: OMH, UOB Kay Hian

KEY ASSUMPTIONS

	2021	2022F	2023F	2024F
Production ('000 mt)				
Alloy				
Malaysia - FeSi	131	130	135	140
Malaysia - Mn	217	220	320	400
ASP (US\$/mt)				
FeSi alloy	2,200	1,900	1,700	1,500
Mn alloy	1,600	1,400	1,300	1,200

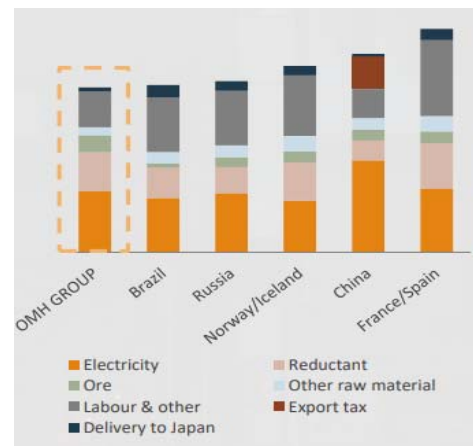
Source: OMH, UOB Kay Hian

FERROSILICON AND MANGANESE PRICES



Source: Bloomberg, UOB Kay Hian

FESI PRODUCTION COST COMPARISON



Source: OMH

OMH'S MANGANESE ORE SUPPLY IN THE PIPELINE

Hole No	Mn Intersection
Element 25	Offtake agreement: 365,000 mt/year with grade of 30-35%
Great Sandy	Mining exploration: Rights of 80% over the Mn ore and iron minerals in the area
Bryah	Mining exploration: Entitled to 100% of the Mn ore in the area

Source: OMH

PROFIT & LOSS

Year to 31 Dec (RMm)	2021	2022F	2023F	2024F
Net turnover	3,164	3,469	3,801	4,061
EBITDA	559	637	723	763
Deprec. & amort.	173	138	150	161
EBIT	386	499	574	603
Associate contributions	16	82	88	93
Net interest income/(expense)	-57	-72	-63	-54
Pre-tax profit	259	402	525	569
Tax	-10	-36	-41	-61
Minorities	-80	0	0	0
Net profit	249	341	446	482
Net profit (adj.)	307	341	446	482

BALANCE SHEET

Year to 31 Dec (RMm)	2021	2022F	2023F	2024F
Fixed assets	43	43	43	43
Other LT assets	2,196	2,193	2,356	2,344
Cash/ST investment	279	547	502	520
Other current assets	1,250	925	967	1,295
Total assets	3,768	3,709	3,868	4,202
ST debt	361	361	361	364
Other current liabilities	585	501	611	798
LT debt	825	680	535	390
Other LT liabilities	227	226	225	223
Shareholders' equity	1,465	1,636	1,831	2,119
Minority interest	305	305	305	308
Total liabilities & equity	3,768	3,709	3,868	4,202

CASH FLOW

Year to 31 Dec (RMm)	2021	2022F	2023F	2024F
Operating	273	632	284	346
Pre-tax profit	327	236	270	399
Tax	(10)	(36)	(41)	(61)
Deprec. & amort.	112	131	143	153
Working capital changes	(318)	301	(87)	(148)
Other operating cashflows	162	0	0	3
Investing	20	(117)	(88)	(88)
Capex (growth)	(2)	(1)	(1)	(1)
Capex (maintenance)	(24)	(116)	(87)	(87)
Investments	38	0	0	0
Proceeds from sale of assets	8	0	0	0
Others	1	0	0	0
Financing	(155)	(246)	(241)	(243)
Dividend payments	0	(29)	(34)	(50)
Issue of shares	0	0	0	3
Proceeds from borrowings	61	0	0	3
Loan repayment	(148)	(145)	(145)	(145)
Others/interest paid	(68)	(72)	(63)	(54)
Net cash inflow (outflow)	138	268	(45)	15
Beginning cash & cash equivalent	141	279	547	502
Changes due to forex impact	0	0	0	3
Ending cash & cash equivalent	279	547	502	520

KEY METRICS

Year to 31 Dec (%)	2021	2022F	2023F	2024F
Profitability				
EBITDA margin	17.7	15.0	13.2	13.2
Pre-tax margin	10.8	9.9	9.2	10.3
Net margin	7.9	8.4	7.8	8.8
ROA	6.7	5.3	6.0	8.4
ROE	18.1	12.9	13.2	17.3
Growth				
Turnover	32.6	(21.0)	23.2	32.0
EBITDA	224.9	(33.0)	8.7	32.1
Pre-tax profit	n.a.	(27.8)	14.6	47.7
Net profit	1,430.4	(15.9)	14.6	48.9
Net profit (adj.)	1,996.6	(31.7)	14.6	48.9
EPS	1,991.1	(31.7)	14.6	48.9
Leverage				
Debt to total capital	40.1	34.9	29.6	23.7
Debt to equity	81.0	63.6	48.9	35.6
Net debt/(cash) to equity	61.9	30.2	21.5	11.1
Interest cover (x)	9.3	4.9	6.2	9.6

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