SECTOR UPDATE

Building Materials – Malaysia

Fear Of Recession Dampened Prices; Cement Emerges As A Dark Horse

Despite the continuing volatility, prices of selected industrial commodities have bottomed out and are poised for a rebound in 2023: a) amid easing inflation and peakish US interest rate cycle, and b) as ongoing supply tightness will stimulate demand and support prices. Meanwhile, cement stock Hume provides clear near-term upside reflecting, high cement prices and easing input costs. Maintain OVERWEIGHT. Top picks: Hume and Press Metal.

WHAT'S NEW

- **Volatility persists.** After rebounding following China's reopening in Dec 22, commodity prices have retraced amid the weak economic environment. Market sentiment is still expected to remain volatile. Meanwhile, commodities-related players' 1Q23 earnings were mixed, with the tin segment's results coming in within expectations while aluminium players' results came in below expectation mainly due to lower-than-expected LME aluminium prices alongside lower contribution from associate earnings. We expect the upcoming 1Q23 results to be weaker qoq as commodity prices have continued easing after rebounding in Dec 22 due to the rate hike and fear of recession.

- **Ferroalloy: Still not out of the woods.** In 1Q23, prices of ferrosilicon (FeSi) and manganese (Mn) alloy stayed range-bound at around US$1,663/mt (+2% qoq) and US$1,101/mt (+1% qoq). The prices were pressured mainly due to: a) the fear of recession, b) soft demand from steel mills, and c) elevated global power costs and weak sentiment in the current rising rates environment. According to World Steel Association, world crude steel production in Apr 23 declined by around 2% yoy. This is largely due to the ongoing slowdown in global steel production, especially in China and Europe. However, we expect prices to improve on the back of the steel recovery in China as it is the largest player, consuming and producing 60-70% of global ferroalloy.

- **Softer LME aluminium prices a reflection of cautious sentiment.** While LME aluminium prices were hovering at the US$2,650/tonne level in Jan 23, the price has retraced to the current level of US$2,237/tonne mainly due to a slowdown in industrial and manufacturing activities while real estate and consumer goods reflected greater-than-expected contraction. However, long-term LME aluminium prices are supported by: a) favourable structural demand globally, b) electric vehicles (EV), c) renewable energy (RE), d) infrastructure, e) supply tightness from partial plant shutdowns, f) power curtailment in China, and g) sky-rocketed energy prices in Europe.

- **Cement has emerged as a dark horse in 1H23,** with prices rising to RM410/mt in early-23 from around RM320/mt in 4Q23 before retracing to the current level of RM370/mt. The increase in cement prices can be attributed to the long period of losses for industry players, necessitating a rise to ensure industry survival. Additionally, the drop in coal prices to US$115/mt (-49% ytd), which accounts for 50-60% of their total COGS currently, has further boosted their earnings. We believe current cement prices are sustainable, especially considering the current subdued property market and the delay in key mega projects like MRT 3, Pan Borneo Highway, ECRL, RTS and PSR. Hume Cement Industries (Hume) remains our top pick in the industry due to its strong clinker capacity with a healthy utilisation rate of 80-90% (vs industry average of 60-70%) and better cost management.

OVERWEIGHT

(Maintained)

SECTOR PICKS

Company	Rec	Share Price (RM)	Target Price (RM)
Hume Cement	BUY	1.39	1.80
Press Metal	BUY	4.73	5.50

Source: UOB Kay Hian

KEY ASSUMPTIONS

	2022	2023F	2024F
Ferroalloy (US$/mt)			
ASP – FeSi Alloy	1,900	1,700	1,500
ASP – SiMn Alloy	1,400	1,300	1,200
Tin (US$/mt)			
ASP	30,000	25,000	30,000
Aluminum (US$/mt)			
ASP - Aluminum	2,828	2,580	2,700

Source: 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

KEY METALS SUPPLY CONDITION

Ferroalloy	Global steel production dropped 2% yoy in April.
Tin	Current LME inventory stands at 1.9k mt, which used to be between 5k and 6k mt during pre-covid time.
Aluminium	Current LME inventory stands at 600k mt, which used to be between 1-2mil mt during pre-covid time.

Source: Bloomberg, UOB Kay Hian

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PEER COMPARISON

Company	Tickers	Rec	Share Price 14 Jun 23 (RM)	Target Price (RM)	Market Cap (RM)	PE FY22F (x)	PE FY23F (x)	P/B FY22F (x)	P/B FY23F (x)
Press Metal Aluminium Holdings	PMAH MK	BUY	4.73	5.50	38,973.4	16.2	19.4	29.2	24.4
OM Holdings Limited	OMH MK	BUY	1.82	3.53	1,344.3	60.3	65.3	3.0	2.8
Malaysia Smelting Corporation	SMELT MK	BUY	1.96	2.69	823.2	33.7	53.6	5.8	3.7
Hume Cement Industries	HUME MK	BUY	1.39	1.80	707.2	6.9	13.8	20.1	10.1

Source: Bloomberg, UOB Kay Hian

ACTION

- **Maintain OVERWEIGHT** as we expect the favourable structural supply-demand to support the lofty commodity prices, especially after inflation eases in 2023. 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. Meanwhile, cement stock Hume provides clear near-term upside reflecting high cement prices and easing input costs. Top pick: Hume and Press Metal.

- **Our preferred picks:**

  a) **Press Metal (PMAH MK/BUY/Target: RM5.50).** PMetal is a prime beneficiary of strong aluminium prices backed by structural supply shortage and robust demand. Preference for low carbon and greener aluminium lends further strength to current prices. Our target price is based on 28.0x 2024F PE (which is at its -0.5SD to its five-year forward PE mean). Should prices remain elevated, based on our analysis, every US$100/mt increase to our current spot aluminium price assumption of US$2,450/mt in 2023 would increase PMetal's earnings by 16% annually.

  b) **Malaysia Smelting Corp (SMELT MK/BUY/Target: RM2.69).** The ramp-up in production at MSC's new eco-friendly smelter will support earnings, supported by the improved tin prices. Our target price is based on 9x 2023F PE (close to -1SD to its five-year mean PE). Based on our analysis, every US$2,000/mt change in our tin price assumptions would affect earnings by about 10% a year.

  c) **OM Holdings (OMH MK/BUY/Target: RM3.53).** As the world's lowest cost quartile manganese smelter, OMH is in a sweet spot to benefit from elevated ferroalloy prices backed by structurally favourable supply-demand dynamics. Its use of low-cost ecofriendly hydropower, tax benefits and long-term earnings visibility via its capacity expansion and diversification plan, puts it ahead of its global peers. Our target price implies 8x 2023F PE (five-year mean: 15x)

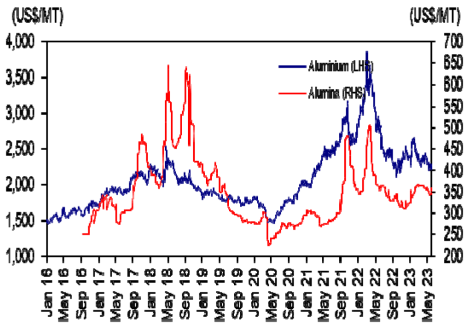
ESSENTIALS

- **Recovery of tin prices.** Due to China's reopening, tin prices have surged to US$32,000/mt before retracing to around US$25,000/mt currently (still up 50% from its bottom last year). Note that China consumes >50% of global tin. In 2022, global refined tin production reached 380,400mt (+0.3% yoy). Yunnan Tin remained as the world's largest producer, followed by Minsur, PT Timah and MSC. Minsur, which suspended its operations in Jan 23, has resumed mining activities in Mar 23. However, EM Vinto, the 8th largest tin producer globally, has entered force majeure, as it struggles with sourcing coal from Peru and debt issues. This could impact production of up to 200mt of tin/week. Inventory at LME warehouses remains low at 1,629mt in May 23 (-22% qoq). The last time the stocks were at this level was when tin prices were >US$30,000/mt. Most mine exploration will take over 2-3 years, which means the near-term deficit will remain.

- **New expanded capacity in Sarawak for OMH.** As at end-Mar 23, 11 out of its 16 furnaces were in operation (five FeSi and six Mn alloy). Of the remaining five furnaces, three are undergoing scheduled major maintenance while the other two are still undergoing reviews to rectify issues regarding the production of silicon metal (MetSi). Four furnaces have completed maintenance so far while the other eight furnaces (two Mn alloy and six FeSi) will undergo maintenance in phases throughout 2023, to minimise disruptions to production. Recall that in Jan 23, OMH announced that it had successfully converted one of its FeSi furnaces to produce MetSi. The furnace has entered the hot commissioning and performance testing phase. OMH aims to commission the furnaces within the next 12 months. Once completed, it will be ramped up to its capacity of 10,500-12,250 mt/year. For comparison, PMBTECH which will have capacity of 108,000 mt by 3QFY23 (vs current 76,000 mt) is currently valued at around RM5b.

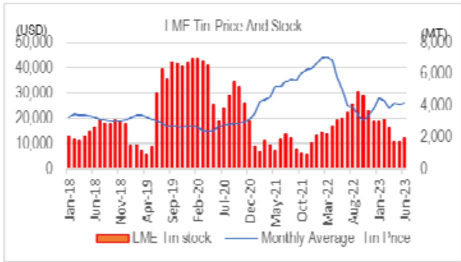
- **Favourable raw material costs to support PMETAL's margins.** Despite a slight rise in alumina prices (1Q23: US$360/tonne, 4Q22: US$318/tonne), alumina-to-aluminium cost ratio was still favourable at 15% in 1Q23. Note that we have already assumed a higher alumina cost ratio at 15-16% of our aluminium spot price assumption. Meanwhile, carbon anode prices have retraced 14% at an average of Rmb6,866/tonne in 1Q23 due to lower PET coke prices. As of May 23, the group has hedged 35% of US$2,400-2,500/tonne for 2023, 30% of US$2,400/tonne for 2024 and 15% of US$2,600/tonne for 2025.

ALUMINIUM TO ALUMINA RATIO



Source: MITI, Bloomberg, UOB Kay Hian

LME TIN PRICES AND STOCK



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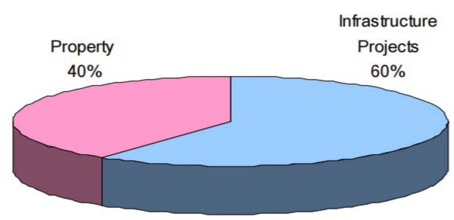
CEMENT CONSUMPTION



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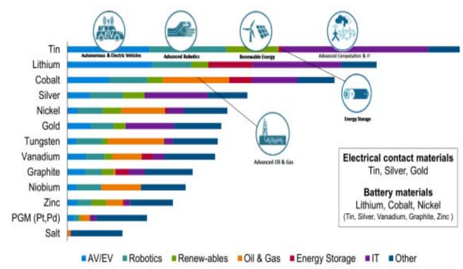
METAL MOST IMPACTED BY NEW TECHNOLOGIES



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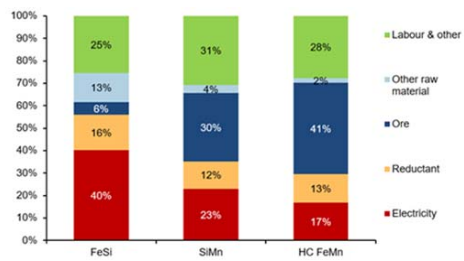
BREAKDOWN OF FERROALLOY PRODUCTION COSTS



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