SECTOR UPDATE

Building Materials – Malaysia

2Q23 Results Within Expectations; Cement As Near-term Winner

2Q23 results are broadly in line. We believe prices of selected industrial commodities have bottomed out and are poised for a rebound in 2024 due to: a) easing inflation and peakish US interest rate cycle, and b) ongoing supply tightness which will stimulate demand and support prices. Meanwhile, cement stock Hume is poised to record stronger qoq earnings, reflecting high cement prices and production volume. Maintain OVERWEIGHT. Top picks: HUME, Press Metal and OMH.

WHAT'S NEW

- **2Q23: Within expectations.** 2Q23 results came in within our expectations with the exception of: a) Press Metal (PMAH), which came in below expectations mainly due to lower-than-expected LME aluminium prices; and b) Hume Cement Industries (HUME), which came in above expectations mainly due to higher-than-expected cement prices alongside lower-than-expected coal prices. Among all these names, Hume gave us the biggest positive surprise as the group fully leveraged the upswing in cement prices and lower coal costs, leading to better margins.

- **Stronger 2H23 and beyond for cement players.** Cement prices rose to RM410/mt in early-23 from around RM320/mt in 4Q22 before retracing to the current level of RM360-370/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$119/mt (-48% ytd), which account for 50-60% of total COGS currently at floating basis, has further boosted their earnings despite the recent oil price run up. We believe that current cement prices are sustainable, especially given the current subdued property market and the delay in key mega projects such as MRT 3, Pan Borneo Highway, ECRL, RTS and PSR. HUME remains our top pick in the industry due to its strong clinker capacity with a healthy utilisation rate of 75% (vs industry average of 60%) and better cost management.

- **Ferroalloy: Still not out of the woods.** In 2Q23, prices of FeSi and Mn alloys were range-bound at US$1,400-1,550/mt and US$900-1,050/mt respectively, given the slow recovery of the steel market. Prices were mainly pressured by: a) recession fears, b) soft demand from steel mills, and c) elevated global power costs and weak sentiment in the current rising rate environment. According to the International Manganese Institute, world crude steel production in Apr 23 and May 23 fell 2.4% and 5.1% yoy respectively to 161.6m tonnes, largely due to the power crisis and weak demand for steel. We expect prices to improve gradually in 2024 as demand recovers following the reversal of the US interest rate cycle.

- **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$2,260/tonne mainly due to the weak global demand. Segment-wise, softening demand was observed from the machinery and packaging sectors while building and construction remains as the weakest segment. 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.

OVERWEIGHT

(Maintained)

TOP SECTOR PICKS

Company	Rec	Share Price 13 Sep 23 (RM)	Target Price (RM)
Hume Cement	BUY	1.83	2.54
Press Metal	BUY	4.92	5.50
OMH	BUY	1.57	2.95

Source: UOB Kay Hian

KEY ASSUMPTIONS

	2022	2023F	2024F
Ferroalloy (US$/mt)			
ASP – FeSi Alloy	1,900	1,400	1,500
ASP – SiMn Alloy	1,400	1,000	1,100
Tin (US$/mt)			
ASP	30,000	25,000	30,000
Aluminum (US$/mt)			
ASP - Aluminum	2,828	2,530	2,700

Source: UOB Kay Hian

KEY REGIONAL PRODUCTION CUTS

Ferroalloy	China: Cut output by >60% India: Slash production by 40%
Tin	Myanmar: Suspension of all mining activities in Myanmar's Wa region (contributes approximately 10% of global tin 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 5% yoy in May.
Tin	Current LME inventory stands at 6.5k mt, higher than pre-covid time of 5k-6k.
Aluminium	Current LME inventory stands at 500k 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 13 Sep 23 (RM)	Target Price (RM)	Market Cap (RM)	EPS FY23F (x)	EPS FY24F (x)	P/E FY23F (x)	P/E FY24F (x)
Press Metal Aluminium Holdings	PMAH MK	BUY	4.92	5.5	40,538.9	33.4	25.3	14.7	21.7
OM Holdings Limited	OMH MK	BUY	1.57	2.95	1,159.6	13.5	9.5	11.6	30.9
Malaysia Smelting Corporation	SMELT MK	BUY	2.2	2.69	924.0	6.5	4.1	33.7	65.5
Hume Cement Industries	HUME MK	BUY	1.83	2.54	934.7	16.9	18.9	10.8	9.7

Source: Bloomberg, UOB Kay Hian

- **Recovery of tin prices.** Due to China's reopening, tin prices have surged to US$32,000/mt before retracing to around US$26,000/mt currently (still up about 40% from its bottom last year). Inventory at LME warehouses increased significantly to 5,866mt in Aug 23 (+280% compared with 2Q23 average) likely due to the short squeeze in LME tin. However, we think the inventory at LME warehouses will ease in the coming months due to the suspension of all mining activities in Myanmar's Wa region. The duration of this suspension remains unknown. According to the International Tin Association, the Wa region contributes about 10% of global tin production and 26% of China's demand. As a result, Chinese producers including Yunnan Tin (global largest Tin refiner) are shutting plants for maintenance and upgrades, possibly to preserve raw material stocks during the Myanmar mining suspension.

ACTION

- **Maintain OVERWEIGHT** as we expect the favourable structural supply-demand to support the lofty commodity prices for ferroalloys and aluminium, especially after inflation eases in 2024. Meanwhile, cement stock Hume provides clear near-term upside reflecting high cement prices and easing input costs. Top pick: Hume, OMH and Press Metal.

- **Our preferred picks:**

  a) **Hume Cement (HUME MK/BUY/Target: RM2.54).** We expect Hume will report stronger quarter-over-quarter earnings, as the group is poised to fully capitalise on the surging cement prices and easing coal prices (on a floating basis). Our forecast is considered conservative, taking into account that the annualised earnings for 4Q23 are already 34% higher than our 2024 projection. If we were to simply annualise the earnings from 4Q23, the stock would now be trading at a PE ratio of 8x. Our target price implies 15x FY24F PE, below the industry's 2011-13 average 19x PE, prior to the earnings disappointment in 2017 to reflect the positive outlook for the industry on the back of the economic recovery.

  b) **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.

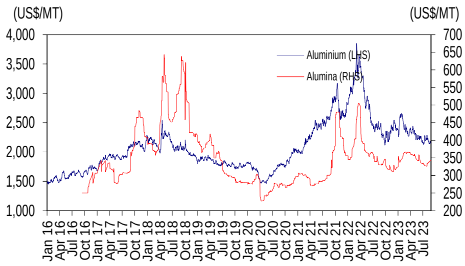
  c) **OM Holdings (OMH MK/BUY/Target: RM2.95).** As the world's lowest cost quartile manganese smelter, OMH is in a sweet spot to benefit from elevated ferroalloy prices backed by structurally favourable supply-demand dynamics. Its use of low-cost eco-friendly hydropower, tax benefits and long-term earnings visibility via its capacity expansion and diversification plan puts it ahead of its global peers. Our target price implies 10x 2024F PE (five-year mean: 15x)

ESSENTIALS

- **Diversification of product portfolio for OMH.** OMH is diversifying into MetSi which has a higher CAGR of 4.6%, double that of FeSi and Mn alloys over 2023-30 (Straits Research, Grand View Research). This is due to of its exposure to higher-growth renewable energy sectors (please refer to RHS) such as: a) acting as an alloying agent for aluminium to replace steel in vehicles (making them lighter and more energy efficient), and b) consumption for polysilicon use to make solar PV panels and serving as a raw material for the manufacture of single-crystal silicon wafers. OMH aims to produce the highest grade (98-99% purity level) it possibly can as silicon metal commands higher margins. Depending on the grade and region sold, MetSi prices are currently hovering at US$1,900-2,235/mt vs historical average of around US$2,245/mt. The price trajectory and cost structure are similar to FeSi. The only major difference is that it requires 40-50% more in terms of power intensity.

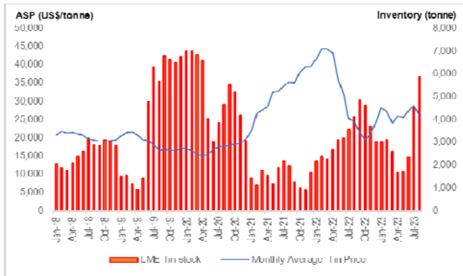
- **Favourable raw material costs to support Pmetal's margins.** Notably, there was a slight drop in alumina prices (at US$344/tonne in 2Q23 vs US$360/tonne in 1Q23) which led to a favourable alumina-to-aluminium cost ratio of 15% in 2Q23. Note that we have already assumed a marginally higher alumina cost ratio at 15-16% of our aluminium spot price assumption. Based on our sensitivity analysis, every US$20/tonne increase to our assumption of US$380/MT would reduce PMetal's earnings by RM137m, assuming no hedging is done on a fixed US$2,450/tonne aluminium price and vice versa. Meanwhile, carbon anode prices have retraced 21% at an average of Rmb5,436/tonne in 2Q23 due to the decline in PET coke prices and continued fall in tar pitch prices.

ALUMINIUM TO ALUMINA RATIO



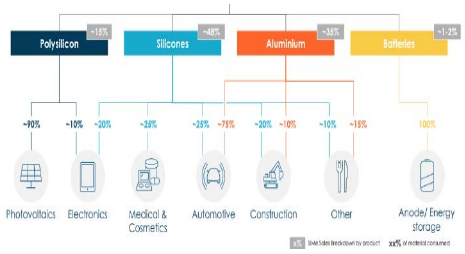
Source: MITI, Bloomberg, UOB Kay Hian

LME TIN PRICES AND STOCK



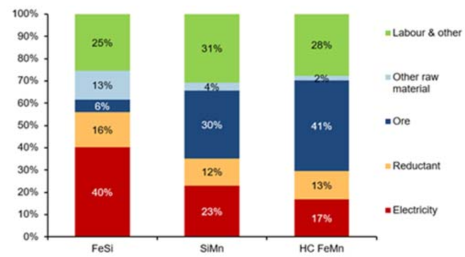
Source: UOB Kay Hian

SILICON METAL CONSUMPTION



Source: Ferroglobe

BREAKDOWN OF FERROALLOY PRODUCTION COSTS



Source: OMH

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