SECTOR UPDATE

Building Materials – Malaysia

China To Boost The Outlook Ahead

Prices of hard commodities such as aluminium, ferroalloy and tin have gradually rebounded on the back of China's economic reopening, which has helped to stimulate demand. Favourable fiscal policies from China's government will also boost its economic growth and support commodity prices accordingly. Continued global supply disruption and the energy crisis also put further pressure on the ongoing shortage. Maintain OVERWEIGHT. Top pick: Press Metal.

WHAT'S NEW

- **Potential recovery in 2023...** After reaching a new record high in 1H22, prices of exported commodities retraced to a lower range in 2H22, mainly due to weak market sentiment amid the rising rates environment. As highlighted in our previous report, this presents an attractive buying opportunity, in anticipation of commodity price recoveries as inflation expectations ease, US Fed hikes moderate and China gradually emerges from its lockdown. Going into 2023, China is ending its COVID-19 quarantine requirement for travellers, marking the last major shift from its zero-COVID policy. After almost three years, China finally reopened its borders and this news sent commodity prices through the roof.

- **…backed by reopening of China.** We believe the commodity prices are being supported by: a) higher demand from the construction and industrial sectors amid the recovery of the second biggest economy in the world, b) additional restocking ahead of the Chinese New Year holidays, and c) stimulus from the Chinese government to boost its economy. China has been dishing out favourable policies to help the ailing property market recover from its historical slump. The government plans to help improve the balance sheet of the developers by extending debt and providing equity financing for them. Recently, China announced that it will inject around Rmb85b via reverse repos and provide Rmb162b in new credit lines to private developers. This will help to improve homebuyer confidence with household savings remaining elevated after years of limited consumption, implying strong pent-up demand potential for properties.

- **Bumpy recovery expected.** Market sentiment is still expected to remain volatile in the near term given that a commodity rally will add to the ongoing inflationary pressures, which central bankers are trying to get under control. There are still rampant COVID-19 infections in China currently, which may dampen the recovery. A robust and consistent fiscal policy is required to see a substantial and sustained increased in commodity prices. Nevertheless, we believe hard commodity prices will remain at the higher end of the historical range, backed by favourable long-term structural supply-demand dynamics and the global decarbonisation agenda. We expect local smelters to post healthy earnings growth this year as the industry is entering a prolonged period of high selling prices and margins backed by greater traction for commodities due to growing global demand.

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 2023. We favour the exported commodities such as ferroalloy, tin and aluminium as they are poised to benefit from: a) elevated ASPs, b) improved production, and c) healthy demand. Amid the global power crisis, we prefer the hydroelectric-powered smelter companies as they stand ahead of their global peers given their access to the eco-friendly low-cost hydropower in Sarawak. Top picks: a) Press Metal, and b) OM Holdings.

PEER COMPARISON

Company	Tickers	Rec	Share Price 13 Jan 23 (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	5.01	6.30	36,090	18.3	16.6	6.0	5.5	40.3	31.7
Malaysia Smelting Corp	SMELT MK	BUY	1.92	2.42	588	4.9	5.2	1.2	1.0	27.9	22.0
OM Holdings	OMH MK	BUY	2.15	3.53	1,425	5.2	4.1	0.7	0.6	12.3	17.1

Source: Bloomberg, UOB Kay Hian

OVERWEIGHT

(Maintained)

TOP SECTOR PICKS

Company	Rec	Share Price 13 Jan 23 (RM)	Target Price (RM)
Press Metal	BUY	5.01	6.30

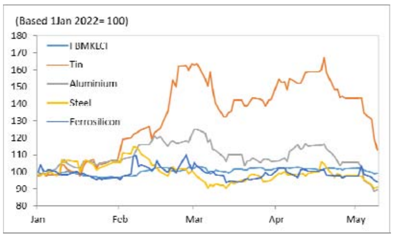
Source: UOB Kay Hian

KEY ASSUMPTIONS

	Current	2022	2023F
Ferroalloy (US$/mt)			
ASP – FeSi Alloy	1,630	1,900	1,700
ASP – Mn Alloy	1,090	1,400	1,300
Tin (US$/mt)			
ASP	28,527	30,000	25,000
Aluminum (US$/mt)			
ASP - Aluminum	2,595	2,500	2,600

Source: UOB Kay Hian

EXPORTED BUILDING MATERIALS INDEX



Source: Bloomberg, UOB Kay Hian

IMPACT OF CHINA'S REOPENING (DEC 22-JAN 23)

	Price	Remarks
FeSi Alloy	+5%	China consumes and produces about 60-70% of global ferroalloy.
Mn Alloy	+3%	
Tin	+43%	China consumes >50% of global tin. It is a net importer and the biggest market for tin-based solders.
Aluminum	+15%	China is the world's largest refined aluminium consumer (consumes two-thirds of volume).

Source: UOB Kay Hian

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- **Our preferred picks**:

  a) **Press Metal (PMAH MK/BUY/Target: RM6.30).** Press Metal (PMetal) continues to be a prime beneficiary of strong aluminium prices backed by structural supply shortage and robust demand. Riding on such favourable trends, PMetal has hedged 35% of US$2,400-2,500/tonne for 2023. Our target price is based on 28x 2023F PE (-0.5SD below its five-year mean PE). Based on our analysis, every US$100/mt change in our aluminium price assumptions would affect earnings by about 9% a year.

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

  c) **Malaysia Smelting Corp (SMELT MK/BUY/Target: RM2.42).** The ramp-up in production at MSC's new eco-friendly smelter will help to support earnings going forward, supported by the improved tin prices. Our target price is based on 9x 2023F PE (-0.5SD below 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.

ESSENTIALS

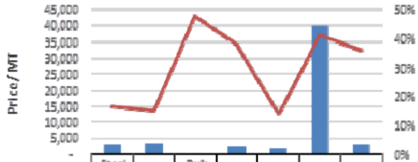
- **Ferroalloy: Riding on steel recovery...** In 2H22, ferroalloy prices were pressured by: a) soft demand from steel mills amid the lockdown in China, and b) elevated global power costs and weak sentiment in the rising rates environment. World crude steel production in Nov 22 declined 2.6% yoy, largely due to the slowdown in global steel production, especially in China and Europe. As such, FeSi and manganese (Mn) alloy prices eased to US$1,630/mt (-16% qoq) and US1,090/mt (-15% qoq) entering 2023. The prices are expected to gradually rebound on the back of the steel mills' recovery in China as the country is the largest player in the industry, consuming and producing about 60-70% of global ferroalloy. Mn alloy also is expected to rise in tandem with the increase in raw material cost, with Mn ore rising to $5.19 (+16% qoq) in Jan 23.

- **...amid rising demand from China and supply disruption in Russia.** In 4Q22, 28 Mn alloy producers halted production in China, resulting in about a 25% yoy decrease in production. Meanwhile, in Ukraine, the second-largest Mn alloy producer in the world, the export of ferroalloy dropped 48% yoy in 2022 as the country reduced production by 32% due to the war. Russia is also the second-biggest exporter of FeSi in the world. In Europe, more than 20% of the ferroalloy production capacity had been shut off in 4Q22 mainly due to the elevated power costs.

- **Tin prices on upward trajectory.** After the news of China's reopening, tin prices have surged to around US$28,527/mt (up 58% from its bottom last year). Note that China consumes >50% of global tin. It is a net importer and the biggest market for tin-based solders. Minsur, the second largest tin producer globally, has also suspended its tin mine operations following the recent deadly anti-government protests in Peru. On top of that, the world's top tin exporter, Indonesia, had indicated that it may potentially stop tin exports by 2024. These factors will put further constraints to the global tin supply and help to support tin prices. Inventory at warehouses remain low with London Metal Exchange (LME) stocks declining to around 3,030mt in Jan 23 (-37% qoq). The last time the stocks were at this level was when the tin price was over US$30,000/mt.

- **Receded aluminium prices still above 2021 level.** LME aluminium prices have eased by 43% from its peak to around US$2,260/mt in 4Q22 due to the global weak sentiment. That said, the 2022 average of US$2,771/mt is still higher yoy (vs 2021's US$2,475/tonne) and comfortably above our conservative assumption of US$2,500/tonne in 2022. Entering 2023, the aluminium prices have gradually increased to US$2,595/tonne. As the world's largest refined aluminium consumer (consumes two-thirds of volume), an uptick in China's economy activities would drive aluminium demand (and hence prices) which is in a tight supply condition currently.

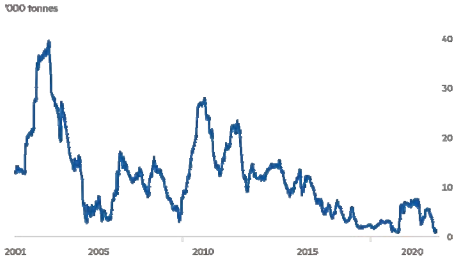
COMMODITIES PRICES



	Steel - Billet (RM)	Steel - Bar (RM)	Bulk Cement (RM)	FeSil (US$)	Mn alloy (US$)	Tin (US$)	Aluminium (US$)
Price/MT	3,026	3,293	310	2,150	1,600	40,054	3,075
% yoy	17%	15%	48%	38%	14%	41%	36%

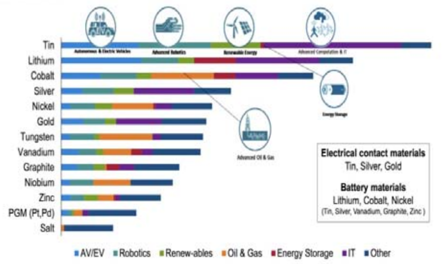
Source: MITI, Bloomberg, UOB Kay Hian

TIN INVENTORIES IN LME WAREHOUSES



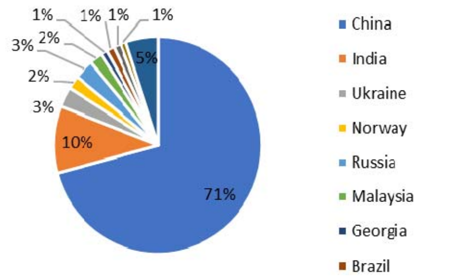
Source: LME

METALS MOST IMPACTED BY NEW TECHNOLOGIES



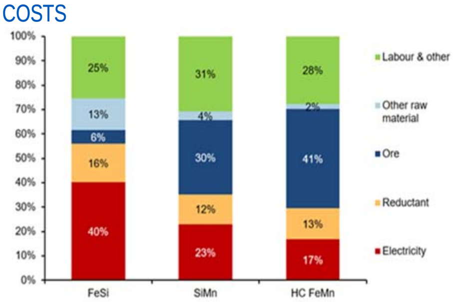
Source: MIT, Rio Tinto

TOP MANGANESE ALLOY PRODUCING COUNTRIES



Source: AlloyConsult

BREAKDOWN OF FERROALLOY PRODUCTION COSTS



Source: UOB Kay Hian

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