SECTOR UPDATE

Building Materials – Malaysia

Eco-Friendly Smelters In Sarawak Set To Be Global Champions

We came away from our site visit to SIP feeling positive on the outlook of smelters there. OM Holdings and Press Metal are among the prime beneficiaries that have a significant advantage over global peers, given their access to eco-friendly low-cost hydropower. Commodity prices may stage a reversal once the lockdowns in China are eased, which will improve demand and support prices, backed by favourable supply-demand balance. Maintain OVERWEIGHT.

WHAT'S NEW

- **Positioning to be global eco-friendly industrial park.** Samalaju Indglobustrial Park (SIP) is a part of the Sarawak Corridor of Renewable Energy (SCORE) initiative, which leverages on the state's abundance of low-cost long-term renewable energy. It is strategically located close to Samalaju Port (deep-sea port), giving vessels easy access to global shipping routes. Among the pioneers that have invested >RM25.3b to set up manufacturing plants there are OM Holdings (OMH), Press Metal (PMetal), Sakura Ferroalloys, Malaysian Phosphate Additives (MPA), Pertama Ferroalloys and OCIM. As they are from energy-intensive industries such as ferroalloy and aluminium, operating at SIP puts them ahead of their global peers in terms of power cost. The Bakun dam, coupled with more dams planned in the coming years, will ensure a constant supply of cheap electricity in the long run.
- **Expansion plan to boost earnings moving forward**. OMH is currently running 12 out of 16 furnaces (six FeSi and six Mn alloy) as evidenced by our recent ground checks. The conversion of two of the idle furnaces to produce manganese (Mn) alloys is expected to be completed in 3Q22, targeting to produce an additional 100,000mt/year. OMH pivots towards producing more Mn alloy because it offers: a) higher average returns per kWh consumed, b) improved hedging ratio with ore, c) better supply-demand, and d) higher efficiency. A new major steel plant, Wenan Steel, which is under construction in SIP, is set to be a major steel manufacturer in the region once it is completed in 2024-25, producing around 10m mt per year. This will boost further demand for OMH's alloys in the future.
- **Embracing volatility in 2022.** After reaching new record-high prices in 1Q22, prices of exported commodities have retraced to a lower range in 2Q22, mainly due to the weak market sentiment caused by the fear of recession. This presents an attractive buying opportunity entering 2H22, in anticipation of a recovery in commodity prices as inflation expectations ease, US Fed hikes moderate and China fully emerges from lockdown. Hard commodity prices will remain at the higher end of the historical range, supported by favourable long-term structural supply-demand dynamics and the global decarbonisation agenda. As Russia and Ukraine are the world's second largest ferroalloy producers, the prolonged conflict will support the ferroalloy prices further. Despite the lockdowns in China, policymakers have highlighted efforts to stabilise the economy. This will improve demand and help to support prices once the current restrictions are lifted in 2H22.

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 22 Jun 22 (RM)	Target Price (RM)
Press Metal	BUY	4.69	7.50

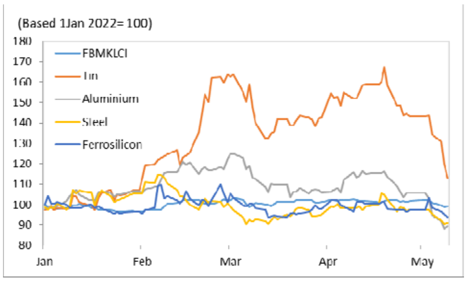
Source: UOB Kay Hian

KEY ASSUMPTIONS

	Current (Jun 22)	2022F	2023F
Cement (RM/mt)			
ASP – Bulk	340	280	260
Steel (RM/mt)			
ASP - Bars	3,205	2,800	2,600
Ferroalloy (US$/mt)			
ASP – FeSi Alloy	2,000	1,900	1,700
ASP – Mn Alloy	1,600	1,400	1,300
Tin (US$/mt)			
ASP	32,000	34,000	32,000
Aluminum (US$/mt)			
ASP - Aluminum	2,500	2,500	2,600
ASP – Alumina	378	388	403

Source: UOB Kay Hian

EXPORTED BUILDING MATERIALS INDEX



Source: Bloomberg, UOB Kay Hian

ANALYST(S)
Hazmy Hazin
+603 2147 1934
noorhazmy@uobkayhian.com

PEER COMPARISON

Company	Tickers	Rec	Share Price 22 Jun 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	4.69	7.50	38,640	26.1	24.0	8.5	6.8	40.5	31.5
Malaysia Smelting Corp	SMELT MK	BUY	2.40	4.45	1,010	5.4	5.8	1.4	1.1	25.7	20.5
OM Holdings	OMH MK	NR	2.29	n.a.	1,796	5.2	4.1	1.1	1.0	11.8	16.1

Source: UOB Kay Hian

ESSENTIALS

- **Remain selective in current economic landscape.** Under our coverage, tin and aluminium prices were impacted the most, declining to about US$32,000/mt (-6% mom, +3% yoy) and US$2,500/mt (-14% mom, +9% yoy) respectively. FeSi and Mn alloy prices remain stable in 1H22 at US$2,000-2,300/mt and US$1,500-1,700/mt respectively. We believe prices will remain elevated (at well above pre-pandemic levels) as structural supply shortage may persist. In the midst of the global power crisis and increase in electricity costs, we believe companies such as OMH and PMetal have a significant advantage over global peers given their access to the eco-friendly low-cost hydropower in SIP.

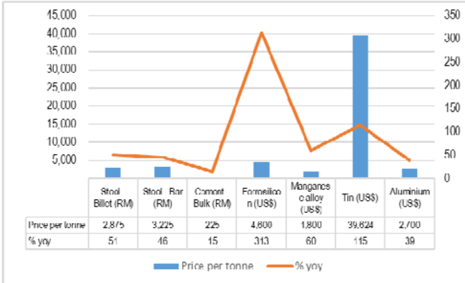
- **Clear cost price leader.** Smelters like OMH and PMetal offer significantly lower costs than their peers mainly due to the >20-year take-or-pay power purchase agreement with Sarawak Energy. It provides them with 300MW of inexpensive hydropower. Generally, electricity accounts for 40% of smelting cost. For OMH, we estimate electricity costs at US$0.04-0.06/kwhr, with a 1.5-2.5% p.a. escalation, placing OMH in the lowest quartile for production costs (fifth-largest FeSi producer, ex-China). A long-term low price for a key input places OMH at the bottom of the cost curve, giving it a significant advantage over its peers, enhancing its strategic position. Note that 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 help to reduce their carbon footprint too.

- **Diversification to ensure long-term earnings growth.** OMH is also in the midst of converting the remaining two idle furnaces to produce silicon metal (MetSi), which is expected to be completed in 4Q22 (30,000mt/year). This marks OMH's first step in diversifying into the aluminium, chemicals and solar downstream industries in order to deliver higher value-added products, which offer better margins. MetSi is typically used for manufacturing microchips, steel and solar cells. The MetSi furnaces are expected to also be able to produce FeSi for more flexibility in terms of product mix. Depending on the grade/purity level, MetSi prices are currently hovering at US$3,000-4,000/mt vs. historical average of around US$2,000/mt. The price trajectory and cost structure are similar to FeSi. The only major difference is it commands 50% higher for power intensity.

- **Ahead of global competitors.** For Mn alloy, OMH is in the first quartile of the global cash cost curve. We believe that over time, higher-cost producers like India and South Korea will feel more pressure from the rising cost of domestic electricity. For China, its environmental policy will force non-compliant smelters to shut down, further reducing supply. Moving forward, low electricity cost will be the key differentiator and OMH together with PMetal stand to be the beneficiaries of this factor. They also enjoy a tax holiday until 2022 and another additional five-year exemption on 70% of their statutory income. These benefits will ensure the sustainability of their margins vs peers'. OMH also plans to expand its smelting capacity significantly, yielding an additional 150,000mt/year of Mn alloy by end-23 via bigger 2-4 33MVA furnaces. This can potentially put OMH among the top three largest Mn alloy producers globally (ex-China).

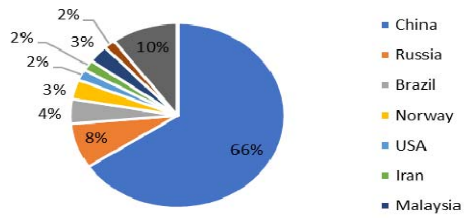
- **Consolidating control to boost profitability.** OMH announced that it has entered into a conditional share purchase agreement with Cahya Mata Sarawak (CMS) for CMS to sell its 25% stake in OM Sarawak to OMH for US$120m (RM525m). The deal is expected to be completed by 4Q22. We believe it is a win-win deal for both CMS and OMH. The proceeds can be reinvested by CMS to capture the growth opportunities within its core businesses. For OMH, this will allow it to have full control (100% stake) of its smelting business in Sarawak and will enhance its earnings further going forward. The deal will be earnings-accretive in the long term and will solidify OMH's position as a major ferroalloy player in the region. Due to its hedging practice, OMH has locked in most of its sales volume in 1H22 at above US$2,000/mt. OMH is also training local workers so as to reduce reliance on foreign workers going forward. It has created about 1,700 jobs so far for its operation in Sarawak.

COMMODITIES PRICES



Source: MITI, Bloomberg, UOB Kay Hian

TOP FERROSILICON ALLOY PRODUCING COUNTRIES

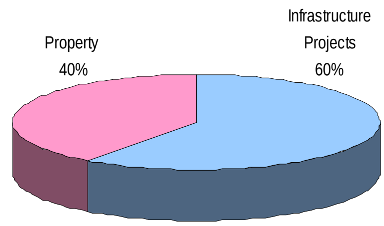


Source: AlloyConsult

TIN INVENTORIES IN LME WAREHOUSES

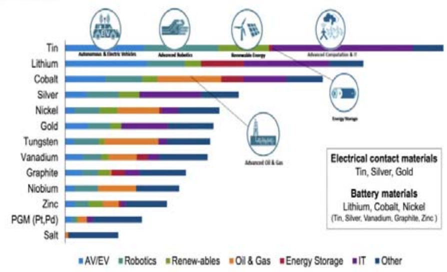
Source: LME

CEMENT CONSUMPTION



Source: UOB Kay Hian

METALS MOST IMPACTED BY NEW TECHNOLOGIES



Source: MIT, Rio Tinto

Disclosures/Disclaimers

This report is prepared by UOB Kay Hian Private Limited ("UOBKH"), which is a holder of a capital markets services licence and an exempt financial adviser in Singapore.

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities.

This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. Advice should be sought from a financial adviser regarding the suitability of the investment product, taking into account the specific investment objectives, financial situation or particular needs of any person in receipt of the recommendation, before the person makes a commitment to purchase the investment product.

This report is confidential. This report may not be published, circulated, reproduced or distributed in whole or in part by any recipient of this report to any other person without the prior written consent of UOBKH. This report is not directed to or intended for distribution to or use by any person or any entity who is a citizen or resident of or located in any locality, state, country or any other jurisdiction as UOBKH may determine in its absolute discretion, where the distribution, publication, availability or use of this report would be contrary to applicable law or would subject UOBKH and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by UOBKH to be reliable. However, UOBKH makes no representation as to the accuracy or completeness of such sources or the Information and UOBKH accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. UOBKH and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of UOBKH and its connected persons are subject to change without notice. UOBKH reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) UOBKH, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) UOBKH, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; (3) the officers, employees and representatives of UOBKH may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business"); and (4) UOBKH may otherwise have an interest (including a proprietary interest) in the subject corporation(s) referred to in this report.

As of the date of this report, no analyst responsible for any of the content in this report has any proprietary position or material interest in the securities of the corporation(s) which are referred to in the content they respectively author or are otherwise responsible for.

IMPORTANT DISCLOSURES FOR U.S. PERSONS

This research report was prepared by UOBKH, a company authorized, as noted above, to engage in securities activities in Singapore. UOBKH is not a registered broker-dealer in the United States and, therefore, is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. This research report is provided for distribution by UOBKH (whether directly or through its US registered broker dealer affiliate named below) to "major U.S. institutional investors" in reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"). All US persons that receive this document by way of distribution from or which they regard as being from UOBKH by their acceptance thereof represent and agree that they are a major institutional investor and understand the risks involved in executing transactions in securities.

Any U.S. recipient of this research report wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided in this research report should do so only through UOB Kay Hian (U.S.) Inc ("UOBKHUS"), a registered broker-dealer in the United States. Under no circumstances should any recipient of this research report effect any transaction to buy or sell securities or related financial instruments through UOBKH.

UOBKHUS accepts responsibility for the contents of this research report, subject to the terms set out below, to the extent that it is delivered to and intended to be received by a U.S. person other than a major U.S. institutional investor.

The analyst whose name appears in this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA") and may not be an associated person of UOBKHUS and, therefore, may not be subject to applicable restrictions under FINRA Rules on communications with a subject company, public appearances and trading securities held by a research analyst account.

Analyst Certification/Regulation AC

Each research analyst of UOBKH who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of UOBKH or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including UOBKH's total revenues, a portion of which are generated from UOBKH's business of dealing in securities.

Reports are distributed in the respective countries by the respective entities and are subject to the additional restrictions listed in the following table.

General	This report is not intended for distribution, publication to or use by any person or entity who is a citizen or resident of or located in any country or jurisdiction where the distribution, publication or use of this report would be contrary to applicable law or regulation.
Hong Kong	This report is distributed in Hong Kong by UOB Kay Hian (Hong Kong) Limited ("UOBKHHK"), which is regulated by the Securities and Futures Commission of Hong Kong. Neither the analyst(s) preparing this report nor his associate, has trading and financial interest and relevant relationship specified under Para. 16.4 of Code of Conduct in the listed corporation covered in this report. UOBKHHK does not have financial interests and business relationship specified under Para. 16.5 of Code of Conduct with the listed corporation covered in this report. Where the report is distributed in Hong Kong and contains research analyses or reports from a foreign research house, please note: (i) recipients of the analyses or reports are to contact UOBKHHK (and not the relevant foreign research house) in Hong Kong in respect of any matters arising from, or in connection with, the analysis or report; and (ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Hong Kong who is not a professional investor, or institutional investor, UOBKHHK accepts legal responsibility for the contents of the analyses or reports only to the extent required by law.
Indonesia	This report is distributed in Indonesia by PT UOB Kay Hian Sekuritas, which is regulated by Financial Services Authority of Indonesia ("OJK"). Where the report is distributed in Indonesia and contains research analyses or reports from a foreign research house, please note recipients of the analyses or reports are to contact PT UOBKH (and not the relevant foreign research house) in Indonesia in respect of any matters arising from, or in connection with, the analysis or report.
Malaysia	Where the report is distributed in Malaysia and contains research analyses or reports from a foreign research house, the recipients of the analyses or reports are to contact UOBKHM (and not the relevant foreign research house) in Malaysia, at +603-21471988, in respect of any matters arising from, or in connection with, the analysis or report as UOBKHM is the registered person under CMSA to distribute any research analyses in Malaysia.
Singapore	This report is distributed in Singapore by UOB Kay Hian Private Limited ("UOBKH"), which is a holder of a capital markets services licence and an exempt financial adviser regulated by the Monetary Authority of Singapore.Where the report is distributed in Singapore and contains research analyses or reports from a foreign research house, please note: (i) recipients of the analyses or reports are to contact UOBKH (and not the relevant foreign research house) in Singapore in respect of any matters arising from, or in connection with, the analysis or report; and (ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Singapore who is not an accredited investor, expert investor or institutional investor, UOBKH accepts legal responsibility for the contents of the analyses or reports only to the extent required by law.
Thailand	This report is distributed in Thailand by UOB Kay Hian Securities (Thailand) Public Company Limited, which is regulated by the Securities and Exchange Commission of Thailand.
United Kingdom	This report is being distributed in the UK by UOB Kay Hian (U.K.) Limited, which is an authorised person in the meaning of the Financial Services and Markets Act and is regulated by The Financial Conduct Authority. Research distributed in the UK is intended only for institutional clients.
United States of America ('U.S.')	This report cannot be distributed into the U.S. or to any U.S. person or entity except in compliance with applicable U.S. laws and regulations. It is being distributed in the U.S. by UOB Kay Hian (US) Inc, which accepts responsibility for its contents. Any U.S. person or entity receiving this report and wishing to effect transactions in any securities referred to in the report should contact UOB Kay Hian (US) Inc. directly.

http://research.uobkayhian.com

RCB Regn. No. 197000447W