Building Materials

In a supercycle

OVERWEIGHT ↑

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Upgrade the BMAT Sector to OVERWEIGHT from NEUTRAL given our optimism over PMETAL's prospects which make up >95% of our sector weighting. With our view that aluminium prices up-cycle would persist coupled with its new +42% new capacity, potential logistic cost savings and favourable raw material costs should propel its earnings to new heights. Reiterate OP with TP of RM13.00 for PMETAL. As for flat steel player ULICORP, we believe earnings will remain consistent as most of their smaller competitors diminish during this pandemic - allowing them to regain market share and pricing power. Still an OP with TP of RM1.45. That said, we think the rally for long steel manufacturer under our coverage, i.e., ANNJOO might have overpriced in the prospects of the commodity rally. Being a commodity manufacturer, we find current fwd valuations of 15x is a stretch. Hence, keep ANNJOO at UP with TP of RM1.57.

LONG STEEL

Our long steel coverage ANNJOO performed well in the last quarter (+36%) as long steel prices in China saw a steep rise driven by a surge in demand while supply only came on stream gradually.

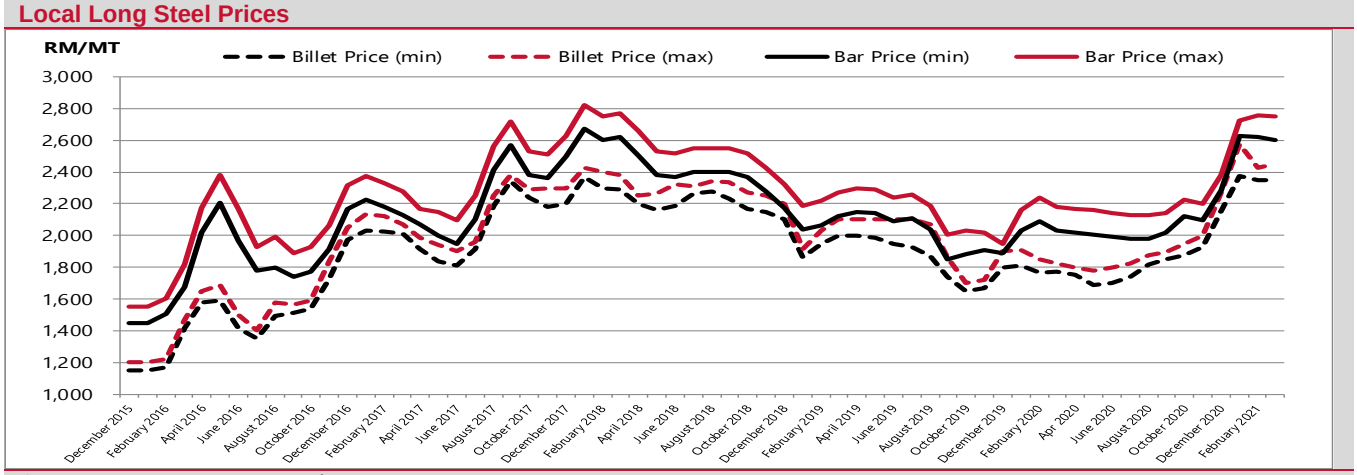
1QFY21's profits will be strong. We are anticipating 1QFY21 to come in strongly at c.RM40m CNP mainly due to 2 key factors: (i) the sharp rise in long steel prices seen in 1QFY21 (from RM2100/t to RM2700/t) and (ii) an inventory lag effect*. However, we think the subsequent quarters' profits (after 1QFY21) should come off as raw material prices play catch up and supply tightness for long products would ease once plants (which were idle) ramp up production. Also, we opined that long steel demand from China's construction activities may gradually ease for the remainder of the year.

**inventory lag effect works as a double edged sword. In a commodity uptrend, the quantum of increase in revenue would be greater than the quantum of increase in COGS (cost of goods sold) as raw mat purchased at lower prices from previous quarters would be accounted for in the existing quarter's COGS – leading to higher margins. Vice versa, in a downtrend, as revenue comes off due to lower repricing of products to remain competitive, the COGS would take a longer time to come off as raw mats purchased from previous quarters were higher. This would consequently lead to a margin squeeze.*

Compared to the 2016-2018 steel rally experienced, the current context is less favourable to margins. Firstly, raw materials (iron ore, coke, scrap) this time around are higher. Secondly, there is a higher proportion of sales being derived from China exports (instead of domestic sales) given the strong demand there. Sales to China are in the form of semi-finished products i.e billets which commands thinner margins as compared to rebars (finished product) considering that Annjoo does not have the required license to export rebars to China. Taking these two aspects into considerations, margins this time around would be lower compared to the 2016-2018 period.

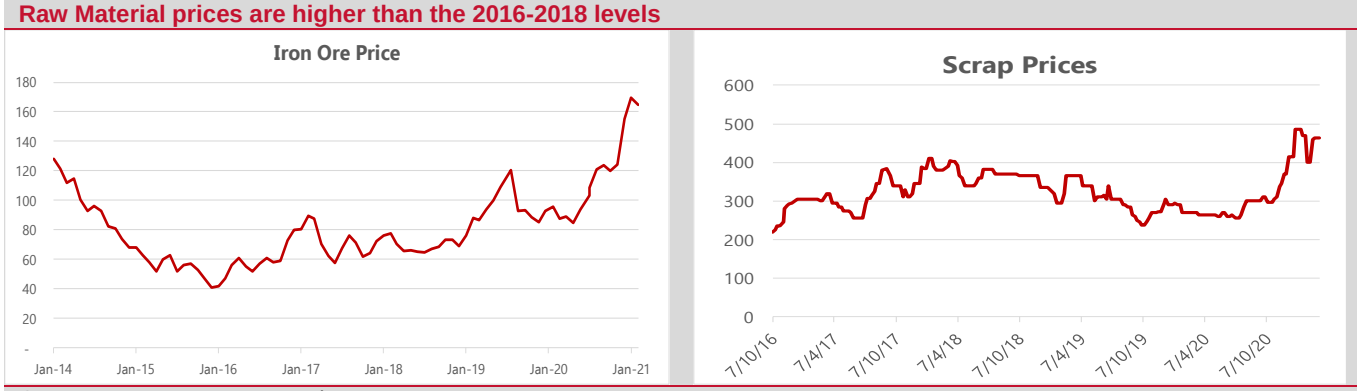
We think that current valuations may have over-priced its prospects. Using the 2016-2018 upcycle valuations as a yardstick, peak valuations were only c.11x then compared to current levels of c.15x now despite the less favourable context. Also, being a commodity player whose profits strongly hinges upon the global prices (with no form of differentiation when it comes to product specs), we think that Annjoo's current valuations maybe a stretch. All in all, **we maintain UP for ANNJOO with unchanged TP of RM1.57** based on FY21E PER of 11x.

Local Long Steel Prices



Source: MITI,Kenanga Research

Raw Material prices are higher than the 2016-2018 levels



Source: MITI,Kenanga Research

FLAT STEEL

ULICORP's earnings to be resilient. With a reduction in competition coupled with HRC prices (raw material for Ulicorp; refer graph below) continuously rising due to the pent up demand from reopening of economies, Ulicorp will be able to enjoy the cost pass through and also register higher margins due to the inventory lag effect*. The main difference in our view between long steel player ANNJOO and ULICORP is that ULICORP's products are less commoditised and more localised which have lesser competition (allowing for better pricing power) and our view that flat steel prices will hold up relatively better compared to long steel.

Maintain it at Outperform with unchanged TP of RM1.45 on 10x FY21 PER. We believe ULICORP should see profitability revert back to pre-competition years given the favourable environment. Coupled with its current net cash position of RM52m (as of 4Q20), we foresee potential dividends of 11.5 sen in FY21E – translating to lucrative yield of 12% (based on closing price of RM0.95 as at our strategy cut off date).

China HRC Prices

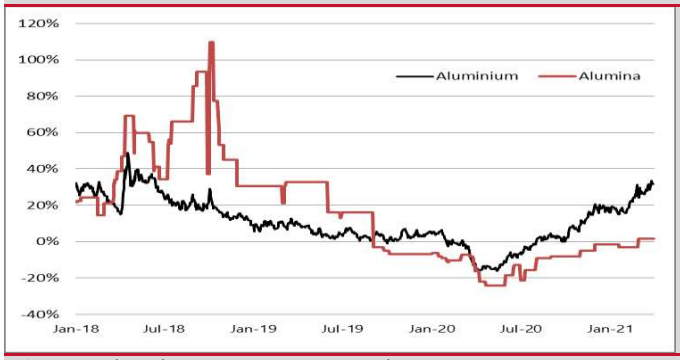
Source: LME

ALUMINIUM

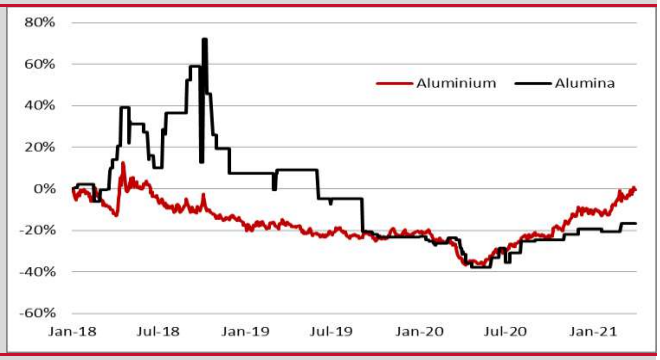
Aluminium prices are on the rise. After a good recovery in the LME aluminium prices last year from the new low of USD1,425/MT in early April last year during the market meltdown, the LME prices continued to trend upward which rose another 7% in the past three months or +12% YTD to well above USD2,200/MT at USD2,212/MT currently. The solid price movement was also in line with other commodities rally of late on the back of upbeat sentiment driven by economies reopening-led demand. Meanwhile, supply of aluminium ins not expected to match robust demand especially in China where the authority there had directed old environment-unfriendly plants to shut down which has stage a price up-cycle. Meanwhile, the average aluminium prices in 1QCY21 grew further by 9% QoQ to USD2,095/MT from USD1,920/MT. This was 24% YoY higher against the average prices of USD1,692/MT in 1QCY20. We remain upbeat on the price prospects as the current price is still 13% below recent high of USD2,540/MT in April 2018. With the current supply-demand dynamic, prices are expected to go higher. Its 10-year mean of aluminium prices is RM1,900/MT.

Raw material cost structure remains favourable. Despite rising aluminium prices, the pace of rising raw material was not as much as alumina prices only grew 4% QoQ to USD306/MT on average in 1QCY21 as opposed to 9% jump in aluminium prices. As such, the cost of alumina only made up 14.6% of aluminium prices in 1QCY21 from 15.4% in the preceding quarter, both were well below the normalised range of 16%-17%, as opposed to 16.0% in 3QCY20. In fact, the price of alumina as a percentage to aluminium price has been on the downtrend from 16.8% in 1QCY20 to 16.4% in 2QCY20. This was much lower as compared to the past three yaers, 22.0% in 2018, 19.9% in 2019 and 16.2% in 2020. As such, we are likely to see further margin improvement given the favourable raw material cost. Meanwhile, the upstream acquisition of two supply chain refineries will ensure raw material supply certainty while the acquisition of PT Bintan has enabled transportation cost savings for PMETAL.

Aluminum vs. Alumina Prices

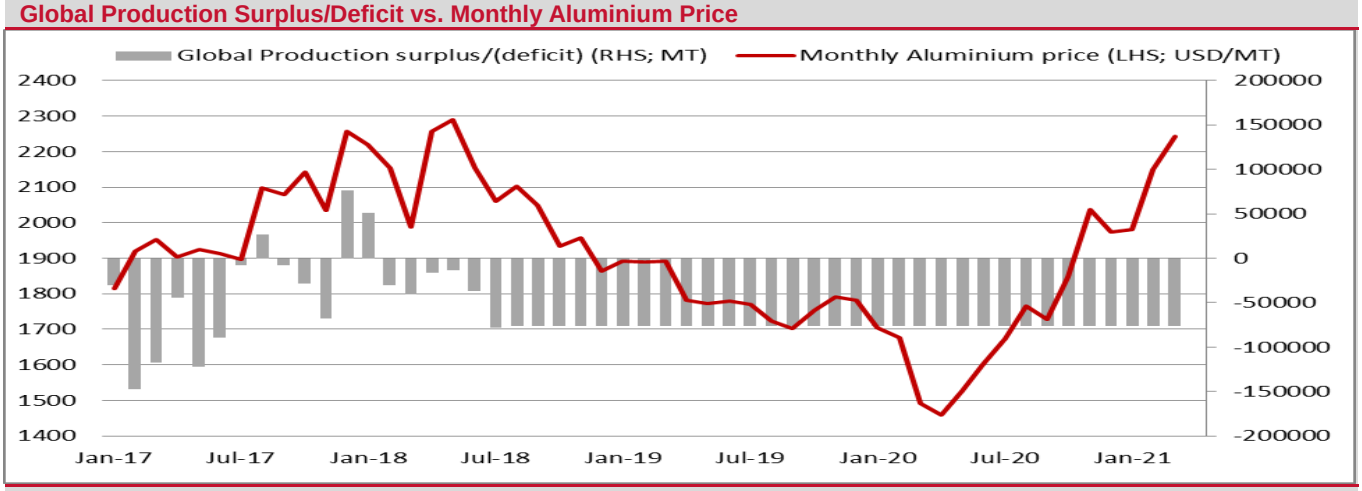


Aluminum vs. Alumina Prices – % Movement



Source: Bloomberg, Kenanga Research

Global Production Surplus/Deficit vs. Monthly Aluminium Price



Source: Bloomberg, Kenanga Research

OP maintained on PMETAL. Share price of PMETAL continued its uptrend which rallied another 20% YTD after a 80% jump in 2020, largely driven by aluminium price rally. However, we believe there is still upside on the back of aluminium price upcycle as supply trailing behind high demand on economies reopening. In addition, new capacity from Samalaju Phase 3 while raw material costs remain favourable and potential logistic cost savings, will propel its earnings to new heights over the next two years. Our new target price of RM13.00 which is based on +0.5SD to 5-year mean at FY22E PER of 32.0x.

SECTOR CALL

Upgreade to OVERWEIGHT from NEUTRAL given our optimism over PMETAL's prospects which make up >95% of our BMAT Sector weighting.

Peer Comparison

Name	Last Price @ 19 Mar 2021 (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	PER (x) - Core Earnings Hist.	PER (x) - Core Earnings 1-Yr. Fwd.	PER (x) - Core Earnings 2-Yr. Fwd.	PBV (x) Hist.	PBV (x) 1-Yr. Fwd.	ROE (%) 1-Yr. Fwd.	Net Div.Yld. (%) 1-Yr. Fwd.	Target Price (RM)	Rating
BUILDING MATERIALS UNDER COVERAGE													
ANN JOO RESOURCES BHD	2.14	1,154.7	Y	12/2021	N.A.	15.0	20.1	1.0	1.0	7.7%	0.0%	1.57	UP
PRESS METAL ALUMINIUM	9.82	39,654.2	Y	12/2021	58.3	69.8	43.2	9.7	8.6	28.4%	0.4%	13.00	OP
UNITED U-LI CORP BHD	0.950	206.9	Y	12/2021	36.5	6.6	5.6	0.1	0.7	10.8%	12.1%	1.45	OP
Simple Average					**47.4**	**30.5**	**23.0**	**3.6**	**3.4**	**15.7%**	**4.2%**		

Source: Bloomberg, Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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