Building Materials

Commodity Prices Remain Robust

OVERWEIGHT
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We remain OVERWEIGHT on the Building Material Sector given our optimistic outlook for PMETAL. The index-linked stock is expected to benefit from the strong aluminium prices which is at its decade high of above USD2,900/MT currently. As such, together with its new 42% capacity, potential logistic cost savings and favourable raw material costs, this should propel its earnings to new heights. Reiterate OP with TP of RM6.50 for PMETAL. For flat steel player ULICORP, we believe earnings will remain consistent as most of their smaller competitors have diminished during this pandemic - allowing ULICORP to regain market share and pricing power. Still an OP with TP of RM1.85 pegged to 10x FY22E PER. As for ANNJOO, we foresee earnings softening in 2HFY21 amidst the stabilising steel ASPs while lagging raw material prices in previous quarters play catch-up. Thus, maintain MP with unchanged TP of RM2.20 anchored to 9x FY22E PER.

LONG STEEL

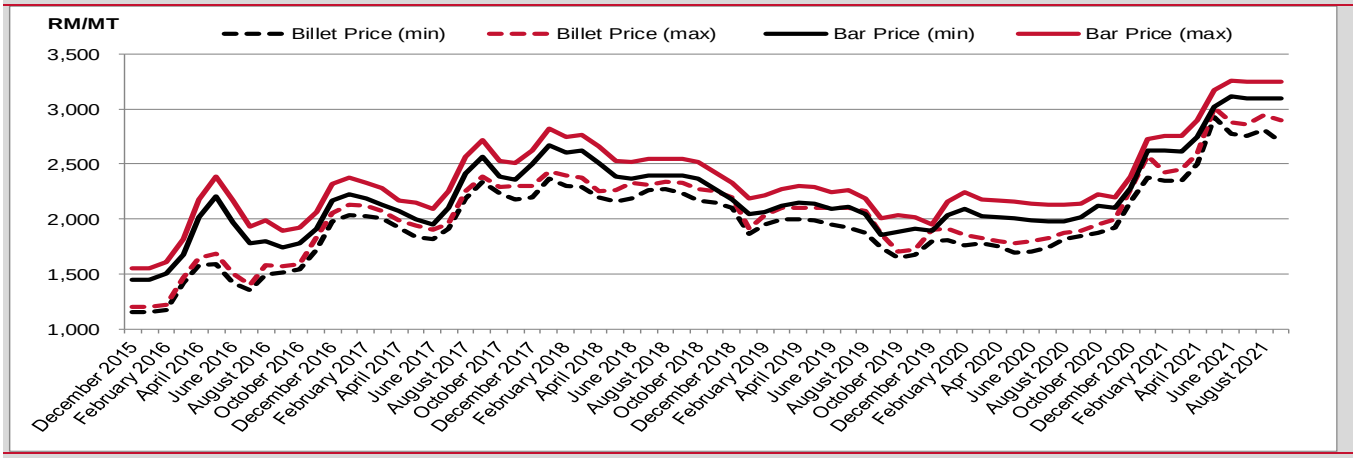
2HFY21 earnings for Annjoo will be weaker, in our opinion. We foresee 2HFY21 to register weaker earnings **HoH** as (i) steel selling prices stabilise while weighted average inventory/raw material costs play catch-up – leading to weaker margins at its manufacturing and trading division, and (ii) higher freight costs in tandem with increased freight rates globally.

Structurally, outlook points to a stable steel price environment. China's long-term policy to achieve carbon neutrality by 2060 has been felt by Chinese steel manufacturers through production limitations. Being the largest steel producer in the world, a steel production cap would mean a tighter supply while demand remains elevated in line with the global Covid-19 recovery (albeit at an uneven rate among countries). Consequently, we believe this dynamic would keep steel prices at elevated levels relative to previous years.

But stronger steel prices above current levels unlikely. However, at the end of the day, China's target to limit 2021 steel production to 1.065b tonnes to achieve carbon neutrality is a **long-term target**. Hence, being overly rigid with this policy amid a recovery from the pandemic would bring about another problem – inflation – something **more dire and serious in the short term**. Thus, we believe if steel prices do soar further on tight supply, the Chinese government will allow for some leeway for its production cap target to ease. Coupled with the Evergrande debt crisis which would potentially shrink the demand of steel in China as construction activities decline – the prospects of higher steel prices in the immediate future is unlikely.

All in all, while we do not expect a sharp drop in steel prices ahead given the pent-up demand post pandemic, Annjoo will no longer benefit from the inventory lag effect from rising steel prices which provided a boost to earnings in 1HFY21. In tandem with the weaker anticipated earnings in subsequent quarters, we believe valuations would revert back to normalised levels instead of the strong momentum-driven levels seen previously. **Hence, maintain MP with unchanged TP of RM2.20 pegged to 9x FY22E PER.**

Local Long Steel Prices



Source: MITI,Kenanga Research

FLAT STEEL

We continue to believe Ulicorp has bright reopening prospects in the coming quarters backed by:

i. **Dwindling number of competitors facing cash flow issues under the pandemic.** Currently there are <10 local manufacturers vs. a peak of 20+ three years ago. Current shortage in raw materials (HRC and CRC) coupled with high prices will further suppress smaller competitors (in terms of cash flow) without a strong balance sheet.

ii. **Pent-up demand from export markets (SG, Bangladesh, Myanmar).** Current order-book stands at c.RM120m (1/3 for export; and the other 2/3 local) to be delivered in the next six months. Given that current demand far outstrips supply, Ulicorp gets to select good paymasters and avoid the bad ones.

Ulicorp's products are less commoditised and more niche in nature. While we acknowledge that Ulicorp has benefitted from the inventory lag effect from rising steel prices in the previous quarters, we think they will still be able to sustain its strong profits once steel price stabilises. This is mainly due to Ulicorp's ability to dictate product pricing given their less commoditised products coupled with the weakening competition which has diminished by the pandemic. This explains our targeted PER of 10x – at the higher-end spectrum for a manufacturer in the cyclical steel space. **All in all, we maintain Outperform with unchanged TP of RM1.85 on 10x FY22E PER.**

ALUMINIUM

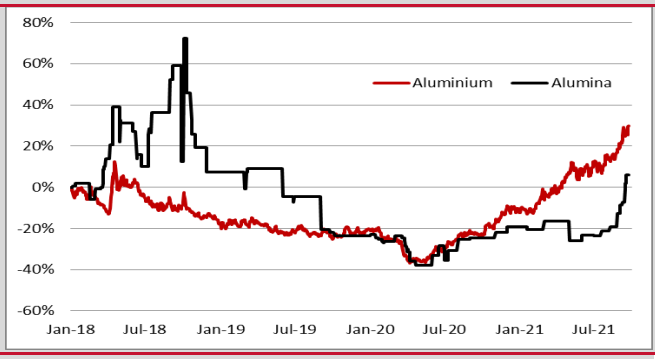
Aluminium prices still on the uptrend. In early Sep, a military coup in the African mining nation of The Republic of Guinea (Guinea) shook the aluminium market at a time when the aluminium prices were already elevated since early of the year in line with the commodity rally that was driven by economies reopening-led demand. The coup has raised concern of a likely supply chain distruption as Guinea accounts for 55% of China's bauxite supply. Aluminium price have jumped to decade high of above USD2,900/MT as of last Friday from the start of the month that below USD2,700/MT. YTD, aluminium prices have risen solidly by 49% from USD1,974/MT at the beginning of the year. Meanwhile, after a 14% sequential jump in average aluminium prices in 2QCY21 to USD2,396/MT from USD2,094/MT, the quarter-to-date (QTD) average in 3QCY21 rose another 10% to USD2,631/MT. And, together with YTD average of USD2,368/MT, the average aluminium prices are still well above our FY21-FY22 price assumptions of USD2,050/MT-USD2,100/MT.

Raw material cost remains favourable. Average alumina prices grew 9% to USD320.4/MT QTD in 3QCY21 from USD295.2/MT in 2QCY21 as opposed to a 10% rise in average aluminium price. Thus, the percentage of alumina cost to aluminium price fell to 12.2% from 12.3% in the preceding quarter, which is well below the usual range of 16%-17%. YTD, the alumina price as a percentage to aluminium price is averaging at 13.0% as opposed to 16.1% in 2020. This implies that aluminium smelters are expected to see their profit margin expanding further 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 for which its first delivery is expected soon, has enabled transportation cost savings.

Still underappreciated; OP on PMETAL. We remain upbeat on PMETAL for the promising aluminium price prospects coupled with its new 42% additional capacity expansion which will lead to an explosive earnings growth this year. Meanwhile, the upcoming 3QFY21 earnings could be affected by higher logistic costs due to disruption in the shipping market and the delayed commissioning of P3 from 3QFY21 to 4QFY21. However, although the commissioning of P3 is delayed to 4QFY21, coupled with the first delivery of alumina from PT Bintan expected soon, this should help to enhance margins and boost earnings higher going forward. Thus, PMETAL remains an OP with unchanged TP of RM6.50 which is based on +0.5SD to its 5-year mean at FY22E PER of 32x.

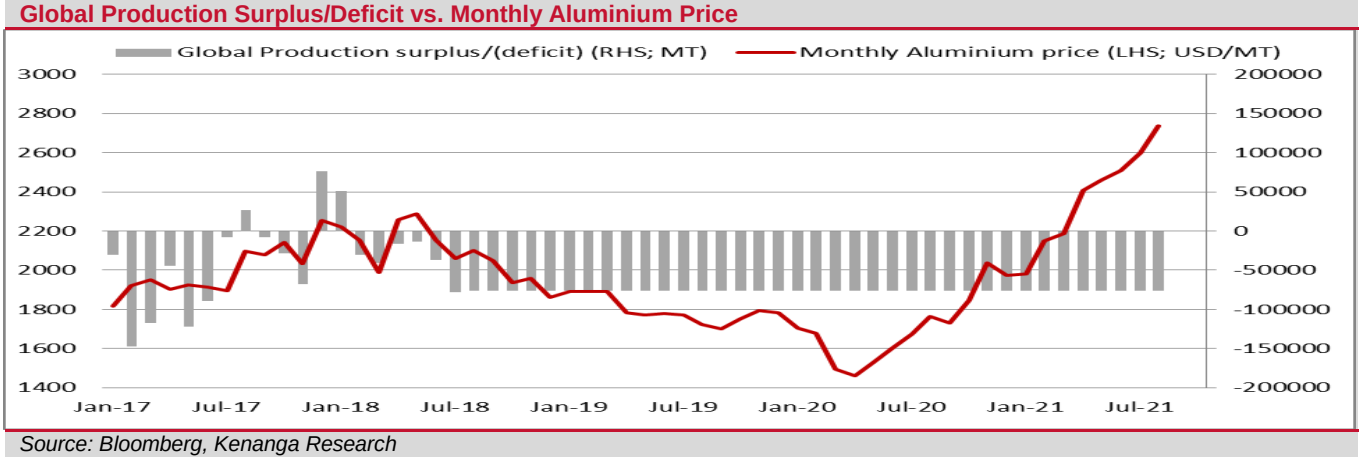
Aluminum Prices

Aluminum vs. Alumina Prices – % Movement



Source: Bloomberg, Kenanga Research

Global Production Surplus/Deficit vs. Monthly Aluminium Price



Source: Bloomberg, Kenanga Research

SECTOR CALL

Overall, we maintain our OVERWEIGHT sector call given our optimistic outlook for PMETAL which makes up >95% of our BMAT Sector weighting and flat steel player ULICORP. However, we are still bearish on long steel player ANNJOO.

Peer Comparison

Name	Last Price @ 24 Sep 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	2.44	1,324.0	Y	12/2021	N.A.	5.8	9.9	1.1	1.2	22.7%	4.3%	2.20	MP
PRESS METAL ALUMINIUM	5.63	45,469.1	Y	12/2021	33.4	40.0	24.8	11.1	9.8	28.4%	0.4%	6.50	OP
UNITED U-LI CORP BHD	1.44	313.6	Y	12/2021	55.4	7.6	7.7	1.1	1.1	14.3%	3.8%	1.85	OP
Simple Average					**44.4**	**17.8**	**14.1**	**4.4**	**4.0**	**21.8%**	**2.8%**		

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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