Building Material

A Bright Spot in Water Pipes

NEUTRAL

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We reiterate our NEUTRAL rating on the sector. We believe prices for both ferrous and non-ferrous metals will remain stable despite the economic challenges in China given supply constraints arising from stricter environmental regulations coupled with Western sanctions against Russian producers. Water pipe makers stand to gain from the revival of water projects locally following water tariff hikes that strengthen cash flows of water operators. Our sector top picks are low-carbon ferrosilicon (FeSi) and silicomanganese (SiMn) producer OMH (OP; TP: RM1.80) and water pipe maker ENGTEX (OP; TP: RM1.41).

Commodity prices have bottomed out. We project a slightly higher average aluminium price of USD2,350/MT in CY24 vs. USD2,255/MT in CY23, while slightly lower average FeSi and SiMn prices of USD1,300/MT and USD920/MT in CY24 vs. USD1,437/MT and USD962/MT in CY23, respectively. We see slightly better aluminium prices after a 2-year lull, but remain cautious on FeSi and SiMn prices given the protracted downturn in China's steel sector. Generally, the demand outlook for these commodities is unfavourable due to economic challenges in China, though partially cushioned by supply constraints due to the decommissioning of fossil fuel-powered smelters (especially by coal) on stricter environmental regulations coupled with Western sanctions against Russian producers. Overall, we expect FY24 earnings growth for aluminium smelter **PMETAL (MP; TP: RM4.90)** to be driven by better aluminium prices, while FeSi and SiMn alloy producer **OMH** by higher production volumes.

We expect a slow recovery in China's steel sector amidst a deepening property debt crisis, partially cushioned by a robust automotive sector driven by the adoption of EV backed by extended tax breaks and investment in RE infrastructure. Nonetheless, we believe steel prices have bottomed out and hence there will be no significant inventory write-downs in CY24.

Pipe makers in a bright spot. We like **ENGTEX** on expectations of high demand for water pipes following water tariff hikes translating to strengthened cash flows of water operators, allowing them to kick start their capex programmes including non-revenue water (NRW) reduction initiatives. This will be in addition to a significant allocation for pipe replacement programmes under the Twelfth Malaysia Plan (12MP). The demand for water pipes will also be driven by the development of Sungai Rasau Water Supply Scheme Phase 2 in Selangor. We also see better margins as pipe makers will not be weighed down by high-cost steel inventory (which happens when steel prices are in a persistent downtrend) given that steel prices have bottomed out. For instance, in Mar 2024, local long steel price eased slightly to c.RM2,766/tonne (-2% MoM) while local flat steel price inched up to RM3,164/tonne (+1% MoM).

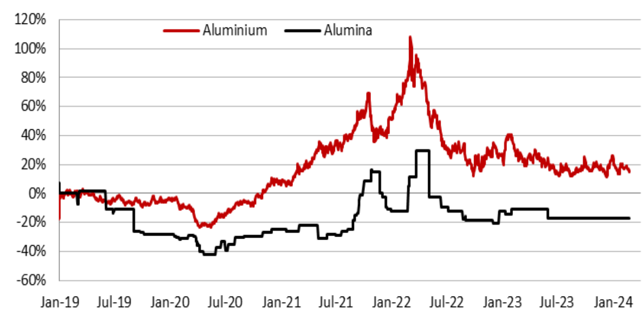
Our sector top picks are:

1. **OMH** given: (i) its structural cost advantage over international peers due to access to low-cost hydropower under a 20-year contract ending 2033, (ii) its strong growth prospects underpinned by plans to expand its capacity by 30%-36% to 610,000-640,000 metric tonnes per annum over the medium term, and (iii) its appeal to investor given its clean energy source.
2. **ENGTEX** given: (i) the huge potential in the water pipe replacement market locally, (ii) its dominant market position in both large-diameter mild steel (MS) pipes and ductile iron (DI) pipes, and (iii) its strong earnings visibility underpinned by significant order backlogs and a strong pipeline of new projects.

Aluminium Prices

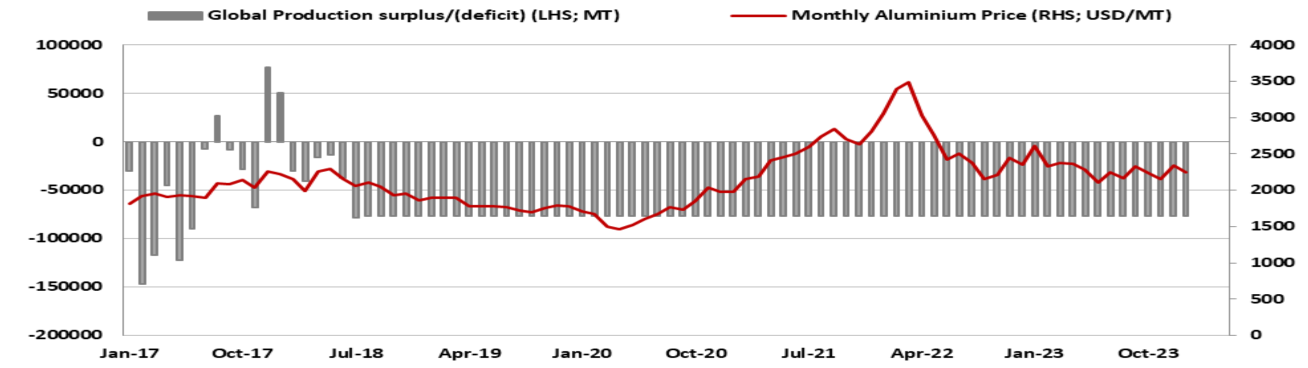
Source: Bloomberg, Kenanga Research

Aluminium vs. Alumina Prices – % Movement



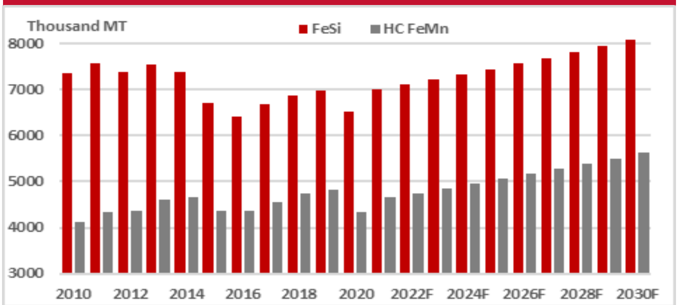
Source: Bloomberg, Kenanga Research

Global Production Surplus/Deficit vs. Monthly Aluminium Price



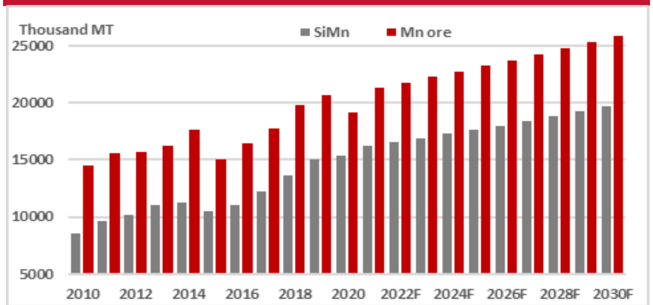
Source: Bloomberg, Kenanga Research

Global Consumption of FeSi and HC FeMn (2010-2030)



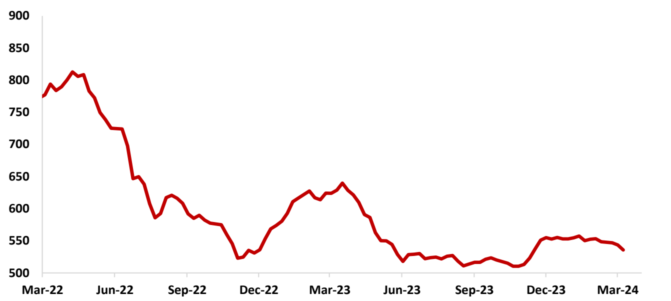
Source: AlloyConsult / World Steel Association

Global Consumption of SiMn and Mn Ore (2010-2030)



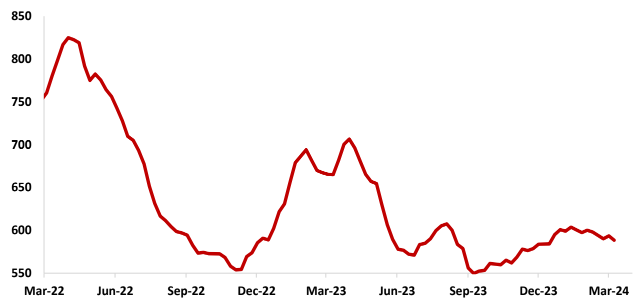
Source: AlloyConsult / World Steel Association

China Rebar Steel Prices



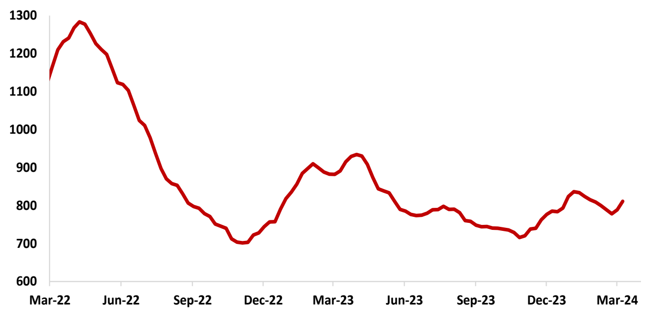
Source: Bloomberg, Kenanga Research

Malaysia Rebar Steel Prices



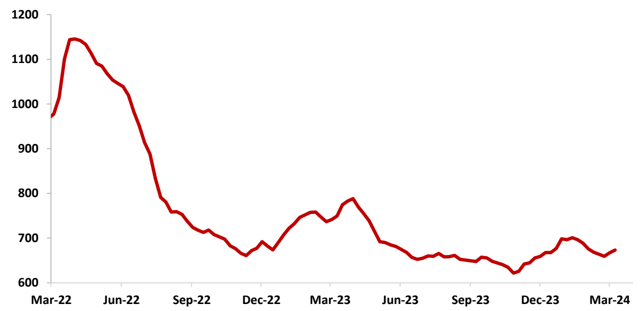
Source: Bloomberg, Kenanga Research

Malaysia Cold Rolled Coil Prices



Source: Bloomberg, Kenanga Research

Malaysia Hot Rolled Coil Prices



Source: Bloomberg, Kenanga Research

Peer Table Comparison

Name	Rating	Last Price @8/3/24 (RM)	Target Price (RM)	Upside	Market Cap (RM m)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE	Net. Div. (sen)	Net Div Yld
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Stocks Under Coverage																	
ENGTEX GROUP BHD	OP	0.930	1.41	51.6%	410.5	Y	12/2024	9.2	12.5	300.0%	35.0%	10.1	7.5	0.5	4.7%	0.8	0.8%
OM HOLDINGS LTD	OP	1.53	1.80	17.6%	1,172.4	Y	12/2024	17.7	29.8	63.6%	68.6%	8.7	5.1	0.6	7.0%	6.6	4.3%
PRESS METAL ALUMINUM HOLDINGS BHD	MP	5.35	4.90	-8.4%	44,082.0	Y	12/2024	17.3	19.9	13.8%	14.9%	30.9	26.9	5.7	18.8%	6.9	1.3%
UNITED U-LI CORPORATION BHD	OP	1.48	1.91	29.1%	322.3	Y	12/2024	23.9	29.8	29.7%	24.6%	6.2	5.0	0.8	13.2%	6.0	4.1%
Sector Aggregate					**45,987.1**					**19.2%**	**19.9%**	**27.9**	**23.3**	**4.2**	**15.0%**		**2.6%**

Source: Kenanga Research

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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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