Building Material

2QCY24 Report Card: Metal Prices Find Firm Ground

OVERWEIGHT

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We maintain our OVERWEIGHT rating on the sector despite the recently concluded 2QCY24 reporting season delivering mixed earnings results, with stocks under our coverage either meeting or missing expectations. This is because we expect most players to benefit from stable ASPs and more manageable costs, leading to margin normalization. Amid weak demand visibility, we expect metal prices to remain firm, balanced by ongoing supply consolidation which should in turn stabilise steel prices and reduce earnings volatility for steel product manufacturers. Locally, water pipe makers are set for promising growth with the revival of key water infrastructure projects. Our sector top picks are PMETAL (OP; TP: RM5.80) and ENGTEX (OP; TP: RM0.81).

A mixed bag of results. In the 2QCY24 reporting season, non-ferrous metal players met our expectations, while ferrous metal players disappointed due to higher input costs and weaker demand. Within our coverage universe, 50% met our forecasts, and 50% fell short, compared to 33% exceeding and 67% meeting expectations in the preceding quarter. For pipe manufacturer **ENGTEX**, its 1HFY24 core net profit missed forecasts due to margin pressures from rising input costs, though this has subsequently normalised. **ULICORP (OP; TP: RM2.30)** also underperformed, as it hit full capacity, and delays in commissioning its powder coating line limited its ability to capture additional demand. Meanwhile, **PMETAL** and **OMH (OP; TP: RM1.80)** had results that came in within our expectations.

Watching for China's demand rebound to lift aluminium prices. Aluminium prices have been on an uptrend since the beginning of the year on surprisingly strong consumption in China during the early part of the year, while outside of China, demand was spurred by RE projects and EV production. We are mindful that sustainable demand in China depends on a revival of infrastructure and property projects of which outlook is still uncertain currently. Meanwhile, the closure of fossil fuel-powered smelters (especially coal) on rising environmental awareness coupled with Western sanctions against Russian aluminium producers will continue to cap supply.

YTD, LME aluminium prices have averaged at USD2,360/MT, 5% higher than an average of USD2,255/MT during the whole of 2023. Similarly, YTD, prices of SiMn averaged at USD994/MT, 3% higher than the average of USD962/MT for the whole of 2023, due to higher cost of ore. We expect SiMn prices to remain firm for the rest of the year on elevated ore prices. Conversely, at a YTD average of USD1,253/MT, prices of FeSi have come off 13% as compared to the average of USD1,437/MT for the whole of 2023 (buoyed by broad-based speculation on commodities during 1HCY23). We expect FeSi prices to remain soft for the rest of the year on a high stock level amid weak demand.

Anticipation of output cuts by Chinese steel mills. The current situation in the China's steel industry is more severe than the downturns of 2008 and 2015 primarily due to worsening economic conditions dragged by the ongoing property debt crisis and weaker manufacturing activities. Even a recent cut in China's benchmark lending rate has failed to lift market sentiment. While 1HCY24 loss margins for Chinese steel mills have widened, the losses have not yet triggered any significant output reductions. The more stable steel market may only be seen when Chinese steelmakers start cutting production. However, we expect China's steel industry to consolidate, as high inventory levels and rising supply pressures will likely force mills to reduce production, supporting price stability.

On the local front, the demand for steel should improve along with the roll-out of mega public infrastructure projects such as the Mutiara Line of Penang LRT, Kuching ART and MRT3. The good news is that stable steel prices translate to stable steel product prices, reducing earnings volatility of steep product producers including **ENGTEX** and **ULICORP.**

Exciting time ahead for pipe makers. We believe a pick-up in pipe replacement orders will be kicking in by 2HFY24 and accelerate into FY25. Potential pipe replacement programs remained largely untapped including those from: (i) non-revenue water (NRW) reduction initiatives or pipe replacement, and (ii) the construction or upgrading of water treatment plants (including the consolidation of old and small plants to optimize cost). We understand that water operators are currently identifying old pipes to be replaced and working out the cost to be submitted to the Ministry of Finance (MOF) for approval. According to Malaysian Water Association, water operators have thus far submitted proposals to the MOF for water projects worth ~RM4b. In addition, there are plans to raise water tariffs again within the next two years.

We maintain **OVERWEIGHT**. Our sector top picks are:

1. **PMETAL** given: (i) its structural cost advantage over international peers given its access to low-cost hydro-power secured under four long-term PPA contracts ending between 2034 and 2040, (ii) its strong secured alumina supply with stakes in two alumina miners, i.e., Japan Alumina Associate (40%) and PT Bintan (25%) which supply 80% of its requirements, and (iii) its green investment appeal as a clean energy source producer.

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.

Quarterly Results Performance

	2QCY24						1QCY24					
	KENANGA			CONSENSUS			KENANGA			CONSENSUS		
	Above	Within	Below	Above	Within	Below	Above	Within	Below	Above	Within	Below
ENGTEX			1			1		1			1	
OMH		1			1							
PMETAL		1			1		1			1		
ULICORP			1					1				
Total	**0**	**2**	**2**	**0**	**2**	**1**	**1**	**2**	**0**	**1**	**1**	**0**
Total (%)	**0**	**50**	**50**	**0**	**67**	**33**	**33**	**67**	**0**	**50**	**50**	**0**

Source: Kenanga Research, Bloomberg

Peer Table Comparison

Name	Rating	Last Price (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	0.565	0.810	43.4%	446.0	Y	12/2024	6.4	12.5	175.0%	96.4%	8.9	4.5	0.3	3.2%	0.8	1.3%
OM HOLDINGS LTD	OP	1.18	1.80	52.5%	904.2	Y	12/2024	17.7	29.8	63.6%	68.6%	6.7	4.0	0.5	7.0%	6.6	5.6%
PRESS METAL ALUMINUM HOLDINGS BHD	OP	4.51	5.80	28.6%	37,160.7	Y	12/2024	19.1	21.3	25.4%	11.8%	23.6	21.2	4.7	20.6%	7.6	1.6%
UNITED U-LI CORPORATION BHD	OP	1.71	2.30	34.5%	372.4	Y	12/2024	18.9	28.8	2.5%	52.6%	9.1	5.9	0.9	10.4%	6.0	3.5%
Sector Aggregate					**38,883.3**					**28.0%**	**18.2%**	**22.0**	**18.6**	**3.5**	**16.0%**		**3.0%**

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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