

Building Materials

Sentiment Remain Challenging

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UNDERWEIGHT



Overall, we maintain our UNDERWEIGHT call on the building material sector as we are negatively weighted on the steel and aluminium sub-sectors. We expect the higher raw material cost and lower average selling price to pile on more pressure on manufacturing margins. For aluminium, we estimate the average 2019 aluminium price to be at USD2,000/MT, a 5% drop from 2018 average of USD2,108/MT but still a recovery from current price of c.USD1,830 (as of 21 June 2019), supported by the current supply deficit globally. We believe the recent weakness in aluminium prices is temporary and hence, it could see some recovery in the near term. However, PMETAL has managed to hedge c.40% of its FY19 aluminium sales volume at USD2,000-2,100/MT. All in, no changes to our calls and TP except for ULICORP which we downgraded to UP with a higher TP of RM0.480 (previously, MP; TP: RM0.450).



Below expectation. Companies' performance for the first quarter are much weaker than the previous quarter. 1QCY19's result came in below our expectations - 2 stocks within our coverage, ANNJOO and PMETAL delivered lower-than-expected sets of results. Notable was ANNJOO's losses deviations-first time since 2015. The negative deviation were mainly due to: (i) ANNJOO-higher-than-expected raw material cost, lower-than-expected average selling price and sales tonnage, (ii) PMETAL- higher-than-expected alumina costs and lower-than-expected aluminium prices.

Share price cut-off date performance. Over 2QCY19, as of our report cut off date of 21/06/2019, the Industrial Product Index registered negative return of 4.0%, which underperformed the KLCI index as compared to a positive return of 2.4%. Counters under our coverage recorded a negative average capital of 1.3% QoQ, from a positive return of 9.5%, over 1QCY19, however both stocks were still outperformed the Industrial Product Index with a slightly smaller negative return. We believe the drop in share prices were largely due to i) disappointing 1QCY19's several earnings ii) lack of projects catalyst and newsflow despite the resumption of mega-infrastructure project announced by government, iii) intense competition in the domestic market and iv) uncertainty from the trade fiction.

Market remains challenging. Overall, the market remains challenging for steel and aluminium counters, largely due to i) higher raw material cost as a result of production and supply disruptions, ii) lower average selling prices led by oversupply situation and intense competition in the domestic market further depressing the company's margin. Despite the revival of a few mega-infrastructure projects announced by the government, we believe that the revenue will kick into to the industry in the later quarter considering the slower work progress as some of the projects are still undergoing redesigning and tendering phases. Besides, resumption of the projects at reduced cost and intense competition in the tendering phase will further restrict the potential earning. Hence, we opine that 2019 continue to be a tough year for building materials sectors led by unfavourable market sentiment.

Long Steel

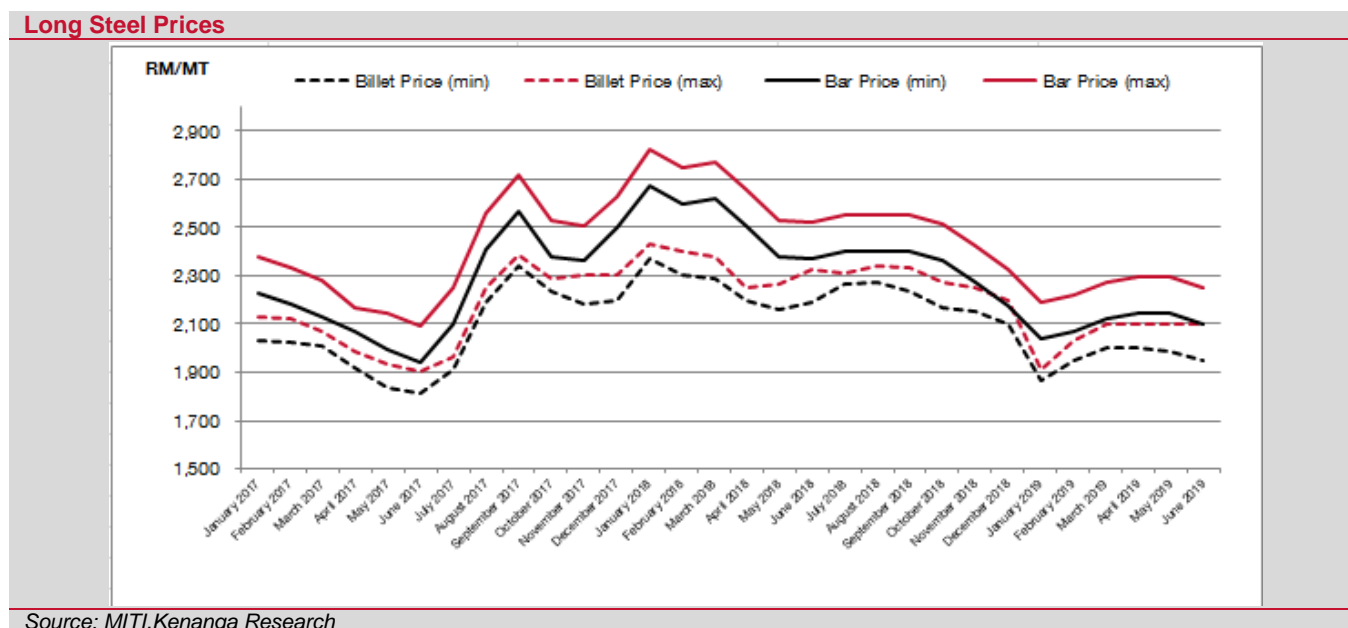
Chinese steel update. Based on the official data released by National Bureau of Statistic China, the Chinese steel output hit record high c.89.09m tonnes in May, having registered 10% growth, MoM. The strong steel production was mainly driven by i) attractive average selling price in China due to stronger demand and government's effort in cutting down capacity under the steel reform policy and ii) China's property remains robust and infrastructure construction pick up steady this year. Besides, china's steel prices have been fluctuating significantly in past years, achieving record high of RMB4,780/MT in September 2018 and record low of RMB1,750/MT back in February 2016. As cut-off date, the steel prices have been traded at c.RMB3,800/MT, having retraced from its previous peak of c.RMB4,200/MT in April 2019.

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Back home, Malaysia domestic steel prices were relatively flattish over the past five months, ranging in between RM2,000/MT-RM2,300/MT. Besides, we also see contraction in Malaysia’s 4M19 steel production by 31%, YoY, largely caused by weaker market demand as the new government halted few mega-infrastructure projects after GE14. Currently, domestic steel prices remain lower than China’s effective cost of importing steel to Malaysia, thanks to strong market demand back in China and our government’s effort in implementing safeguard measures as well as import duty, which make the China’s steel price uncompetitive. Based on our estimates, after incorporating shipping fees, import duties and safeguard measure, the total effective cost for importing Chinese steel bars will be c. RM2,850/MT, 27%-36% higher than the domestic steel price of RM2,100-RM2,250/MT (as of 18 June 2019 based on MITI weekly Bulletin).

Remain cautious for FY19 as we expect weaker earning performance in the subsequent quarter driven by higher iron ore prices resulted from i) accident which lead to lower iron ore output from Brazil and ii) increasing iron ore demand from China in line with it’s higher steel production. According to the data released by MITI, iron ore was trading at USD100/MT as at May 2019, 16% and 41% higher than trading prices as at March and Jan 2019 respectively. In addition, mismatch of steel production output and consumption volume will further erode the company’s margin. However, with the hybrid production approach, ANNJOO has the flexibility to alter their cost structure based on cheapest available raw material, an advantage to outperform its peers in the market. Overall, we opine that FY2019 will be the tough year for ANNJOO while awaiting for more projects to be announced and iron ore prices to moderate.

Maintain UNDERPERFORM on ANNJOO with unchanged Target Price of RM1.15 based on unchanged Fwd. PBV of 0.5x pegged to FY20E BV/share of RM2.30, which is at its 5-year -0.5SD levels, reflective of the current challenging operating environment for the steel industry.

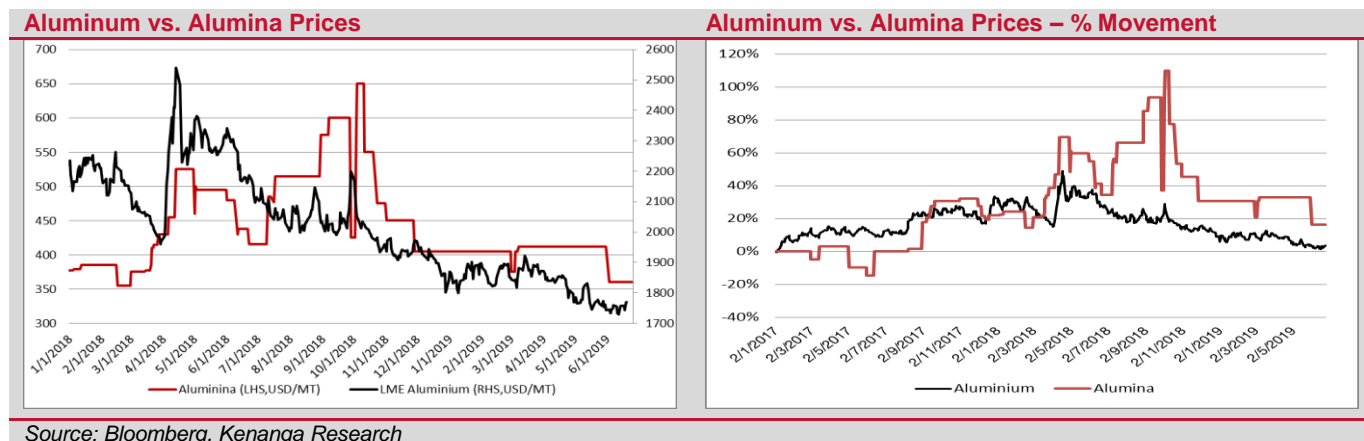


Source: MITI, Kenanga Research

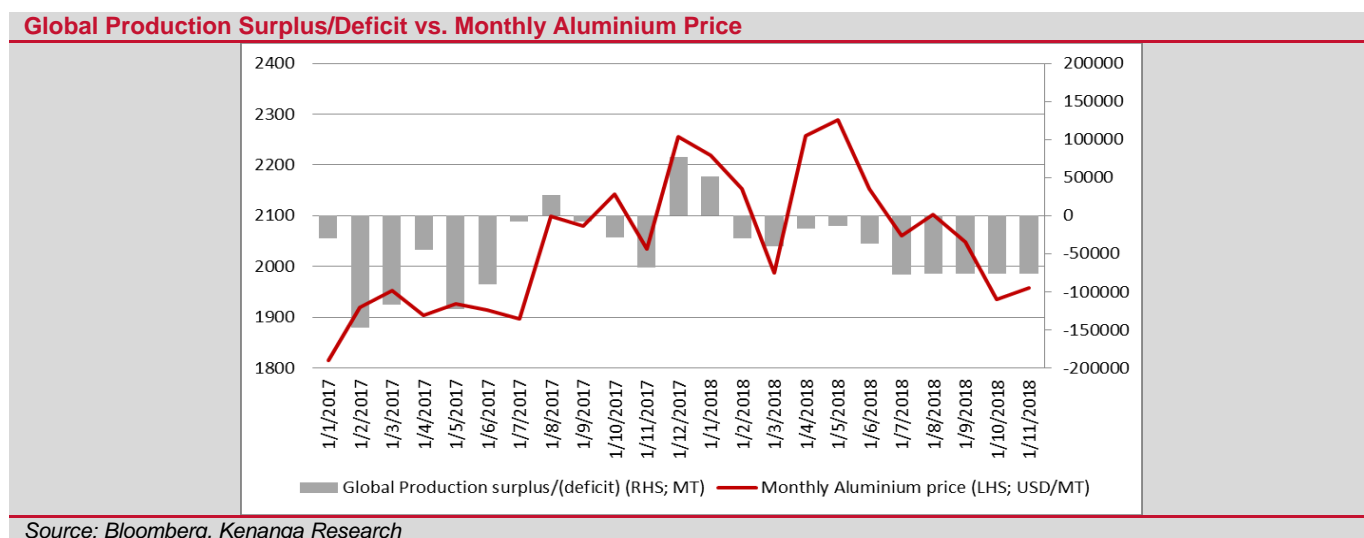
ALUMINIUM

Alumina cost normalised. The price of alumina spiked by almost 40% to as high as USD650/MT as the partial closure (50% of capacity) of Brazil’s Alunorte plant and US’ sanction on Rusal created scarcity of alumina supply in the global market. Alunorte is the world’s largest alumina refinery with c.5.8m MT annual production, while Rusal is the world’s second largest aluminium company producing c.7.8m MT yearly. Collectively, they control about a quarter of global ex-China alumina supply. Fortunately, prices of the said raw materials have recently moderated to USD360/MT, bringing down YTD average by 13% to USD405/MT compared with 2018 average of USD463/MT. This has positive implications on aluminium smelters’ profit margins, including that of PMETAL as alumina costs make up c.50% of the smelting cost.

Going forward, we believe alumina prices would stabilise at the current range as restriction on Alunorte’s production were recently lifted, while Al Taweelah alumina refinery with 2m MT/year capacity has also commenced in April which will increase the alumina supply in the global ex-China market. In view of these, we maintain our alumina price assumption of USD370/MT for now.



Aluminium prices have likely bottomed. We estimate 2019 aluminium price to average at USD2,000/MT, a 5% drop from USD2,108/MT in 2018 but at a recovery from average current price of c.USD1,830 (as of 21 June 2019), supported by the current supply deficit globally (see Exhibit below). Recall that aluminium prices fell from >USD2,100 after the US Treasury lifted the sanction on Rusal, allaying concerns of a supply disruption in the aluminium market. However, we understand that Rusal was allowed to continue supplying to its existing customers even during the sanction, which means that the supply relief should have no major impact on the aluminium supply landscape. As such, we believe the recent weakness in aluminium prices is temporary and should see a recovery in the near term. Furthermore, PMETAL has managed to hedge c.40% of its FY19 aluminium sales volume at USD2,000-2,100/MT, mitigating concerns of aluminium price weakness.



Maintain MARKET PERFORM on PMETAL with unchanged TP of RM4.50 based on FY20E PER of 21.8x, implying -0.5SD valuation basis. Despite its long-term positive operating outlook and earnings growth potential, volatility in the aluminium and alumina markets could continue to disrupt earnings' visibility in the near term.

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SUMMARY

Maintain UNDERWEIGHT. All in, we maintain UNDERWEIGHT call on the building material sector as we are negative on the steel, while the aluminium segment remains unexciting at this juncture.

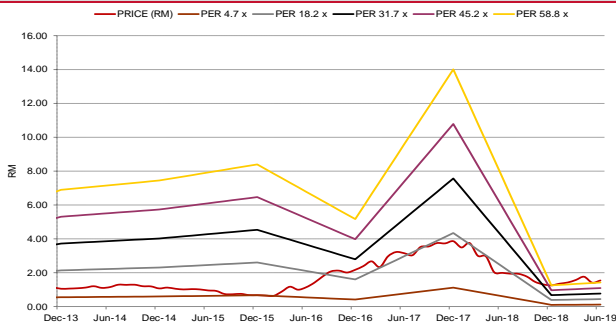
To sum up, the changes in our recommendations:

1. **Maintain UP on ANNJOO with the unchanged TP of RM1.15** at Fwd. PBV of 0.5x pegged to FY19E BV/share of RM2.30, which is at its 5-year -0.5SD levels.
2. **Maintain MP on PMETAL with unchanged TP of RM4.50** based on FY20E PER of 21.8x, implying -0.5SD valuation basis.
3. **Downgrades ULICORP from MP to UP with a higher TP of RM0.480 (previously, RM0.450)** based on Fwd. PBV of 0.34x applied to its FY20E BVPS of RM1.42 as we roll forward from FY19E.
4. **Maintain MARKET PERFORM on WTHORSE with an unchanged TP of RM1.15** based on Fwd. PBV of 0.4x pegged to its FY20E BVPS of RM2.88.

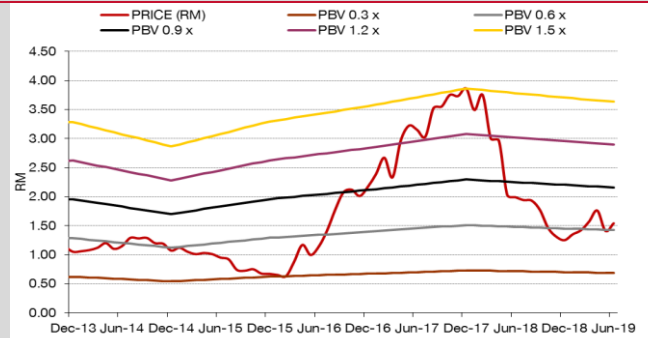


APPENDIX

ANNJOO – Fwd PER Band



ANNJOO - Fwd PBV Band

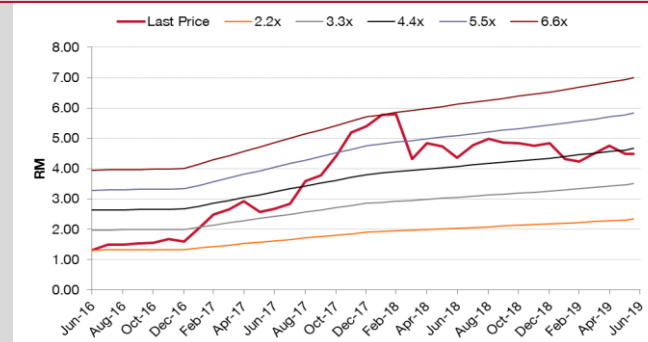


Source: Company, Kenanga Research

PMETAL – Fwd Core PER Band

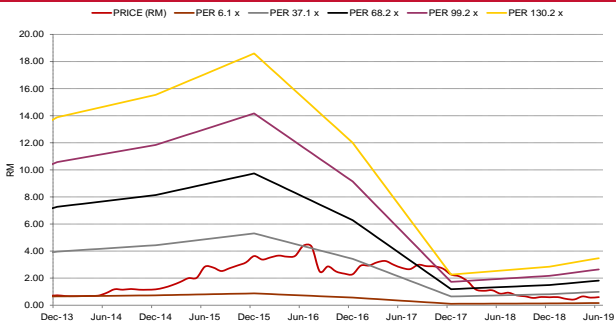


PMETAL - Fwd PBV Band

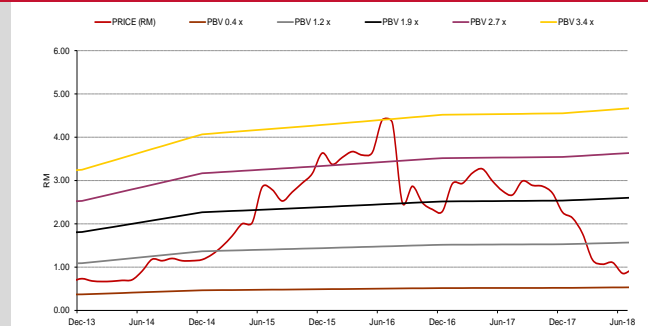


Source: Company, Kenanga Research

ULICORP – Fwd Core PER Band

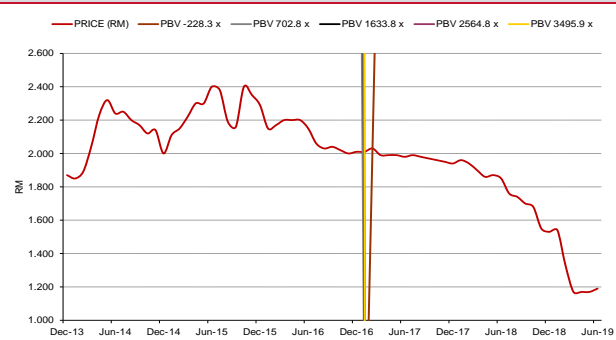


ULICORP - Fwd PBV Band

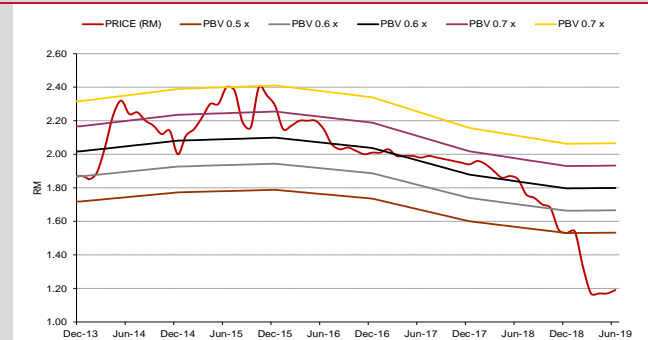


Source: Company, Kenanga Research

WTHORSE – Fwd Core PER Band



WTHORSE - Fwd PBV Band



Source: Company, Kenanga Research

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Peer Comparison

Name	Last Price @ 21 June-19 (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div.Yld. (%)	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.		
BUILDING MATERIALS UNDER COVERAGE																	
ANN JOO RESOURCES BHD	1.54	829.6	Y	12/2019	-19.4%	12.5%	-91.1%	27.0%	6.5	73.5	57.9	0.6	0.7	0.9%	0.0%	1.15	UP
PRESS METAL ALUMINIUM HOLDIN	4.48	18,064.8	Y	12/2019	1.7%	1.7%	9.6%	18.2%	28.1	25.6	21.7	5.2	4.5	19.7%	1.3%	4.50	MP
UNITED U-LI CORP BHD	0.600	130.7	Y	12/2019	-21.6%	-9.6%	-41.4%	147.1%	45.1	76.9	31.1	0.5	0.4	0.6%	0.5%	0.480	UP
WHITE HORSE BHD	1.19	271.6	Y	12/2019	-1.0%	6.0%	-257.6%	657.1%	N.A.	N.A.	194.7	0.4	0.4	-1.4%	0.0%	1.15	MP
Simple Average					-10.1%	2.6%	-95.1%	212.4%	26.6	58.7	76.3	1.7	1.5	5.0%	0.5%		

Source: Bloomberg, 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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