Building Materials

Tools Still Down

UNDERWEIGHT
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Overall, we maintain our UNDERWEIGHT call on the building material sector as we are negatively weighted on the long and flat steel as well as ceramic tiles sub-sectors. We expect higher raw material, lower average selling price, weaker demand and intense competition to pile on more pressure to manufacturing margins. However, for aluminium, we estimate the average 2019 aluminium price to be USD1,920/MT, a 9.0% drop from 2018 average of USD2,108/MT but still a recovery from current price of c.USD1,809 (as of 20 September 2019), supported by the current supply deficit globally. We believe the recent weakness in aluminium prices is temporary and it could see some recovery in the near term. We have UW calls on all counters in the sector except for PMETAL (OP, TP:RM5.50).

All below expectation. Overall, companies' performance for the second quarter was much weaker than the previous quarter. 2QCY19's result came in below our expectations - 4 stocks within our coverage delivered lower-than-expected sets of results. The negative deviations were mainly due to: (i) ANNJOO - higher-than-expected raw material and production cost as well as lower-than-expected average selling price, (ii) PMETAL - lower-than-expected aluminium prices, (iii) ULICORP - lower-than-expected revenue and thinner-than-expected margins, and (iv) WTHORSE- weaker-than-expected revenue and margin.

Share price cut-off date performance. Over 3QCY19, as of our report cut-off date of 20/09/2019, the Industrial Product Index registered negative return of 3.8%, which slightly outperformed the KLCI index of negative 4.5%. Share price performance for counters under our coverage deteriorated to negative return of 7.0% from +11% over 2QCY19, largely due to: (i) disappointing earnings results for 2Q 2019, (ii) lack of project catalyst, (iii) intense competition in the domestic market, and iv) uncertainty from US-China trade friction.

Market remains challenging. Overall, the market remains challenging for building materials counters, largely due to: (i) higher raw material cost as a result of production and supply disruptions, and (ii) lower average selling prices led by oversupply situation and intense competition in the domestic market further depressing steel players' margin. Despite the revival of a few mega-infrastructure projects as announced by the government, we believe that revenue will kick in into the industry only in subsequent quarters 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 limit earnings potential. Hence,we opine that 2019 will 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 recorded c.87.3m tonnes in August, having registered 2.4% growth, MoM or 9.3% increase from a year earlier. Under the steel reform policy, the China government has shut down substandard steel mills which has helped to resolve overcapacity issue. On the other hand, the strong steel supply was also taken up by stable demand from property and infrastructure construction industry, hence balancing both supply and demand in the China market. As of cut-off date, the steel prices were traded at c.RMB3,690/MT, having retraced from its previous peak of c.RMB4,200/MT in April 2019.

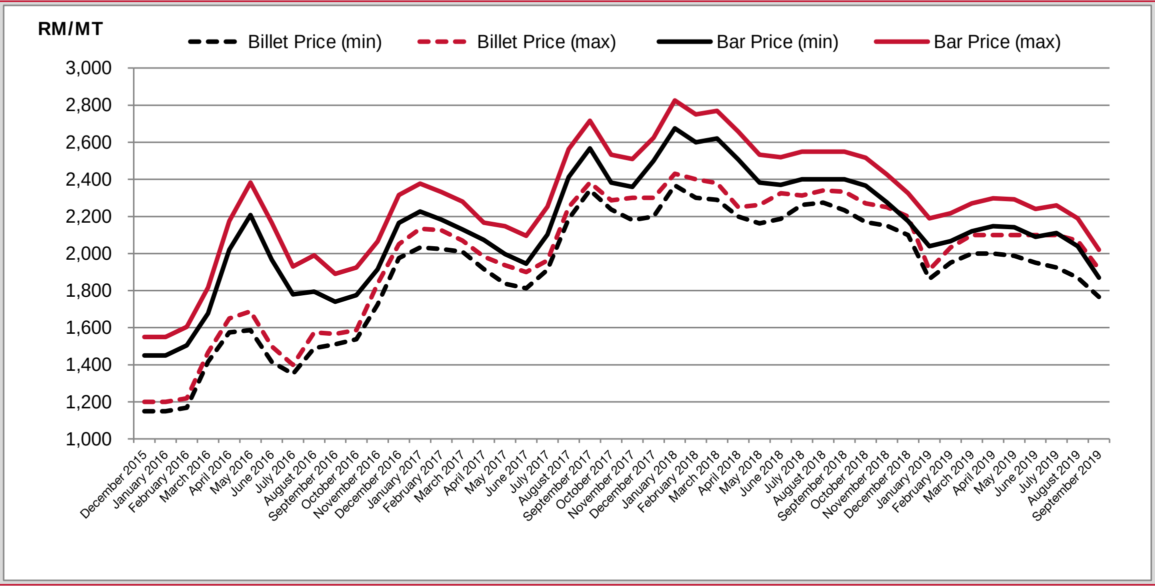
Domestic steel. Back home, we see contraction in Malaysia's 7M19 steel production by 24% compared to the same period a year earlier, largely caused by weaker domestic demand due to restricted development budget, lower property and construction activities, as well as uncertainty in international market due to the US-China trade friction. Besides, the domestic steel price have been relatively flattish over the past few months, and we noted that prices have started to drop following the plunge in iron ore price recently to USD93/DMTU, as Vale SA has partially resumed their operation. To recap, the iron ore price has increased significantly to USD120/DMTU (58%) from USD76/DMTU over the past few months due to a dam collapse in Brazil forcing the world's biggest iron ore operation to temporary shut down operations.

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 the Malaysian government's effort in implementing safeguard measures as well as import duty, which make China's steel import 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. RM2,600/MT, 40% higher than the domestic average steel price of RM1,855/MT (based on MITI weekly Bulletin).

Challenging FY19 for ANNJOO. We expect weaker earning performance from ANNJOO in the subsequent quarter driven by higher iron ore prices and depressed average selling price. However, we like the company with its hybrid production approach, which give the flexibility to alter their cost structure based on cheapest available raw material, an advantage to outperform its peers in the market. Besides, we are also positive with the company strategy of expanding their export market considering the weak domestic demand and benefits from export tax incentive. Overall, we opine that sentiment remains challenging for ANNJOO while awaiting more projects to be announced and iron ore prices to moderate.

Maintain UNDERPERFORM on ANNJOO with unchanged Target Price of RM1.10 based on unchanged Fwd. PBV of 0.5x pegged to FY20E BV/share of RM2.20, which is at its 5-year -0.5SD levels, reflective of the current challenging operating environment for the steel industry.

Long Steel Prices



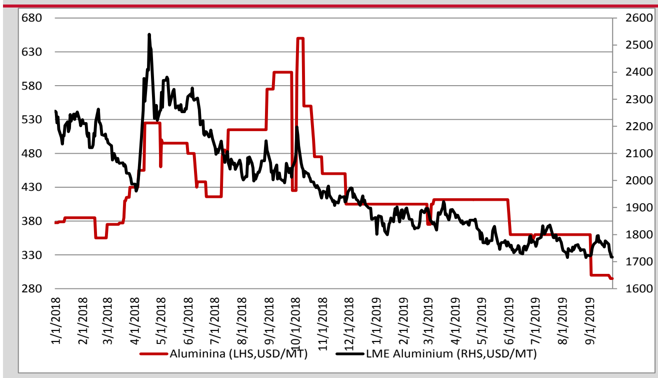
Source: MITI,Kenanga Research

ALUMINIUM

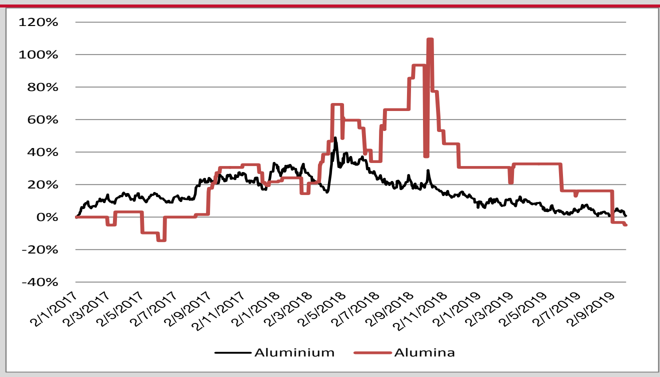
Alumina cost moderated. To recap, the price of alumina spiked significantly to a high of USD650/MT as the partial closure (50% of capacity) of Brazil's Alunorte plant and US' sanction on Rusal created scarcity of alumina supply in the global market. Alunorte is the world's largest alumina refinery with 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. Recently, the prices of the said raw materials continued to moderate to USD300/MT, bringing down YTD average by 17% to USD383/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 stablilise at the current range as restriction on Alunorte's production were recently lifted, while the Al Taweelah alumina refinery with 2m MT/year capacity has also recently commenced in April which will increase the alumina supply in the global ex-China market.

Aluminum vs. Alumina Prices



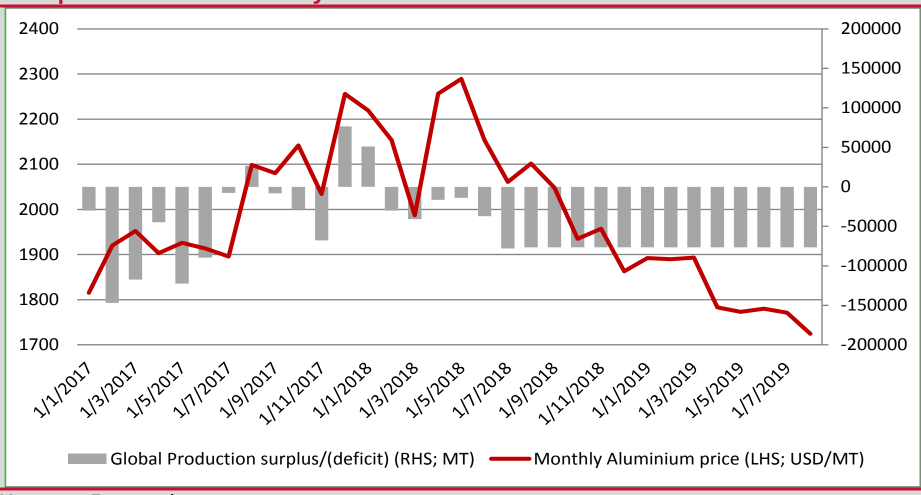
Aluminum vs. Alumina Prices – % Movement



Source: Bloomberg, Kenanga Research

Aluminium prices have likely bottomed. We estimate 2019 aluminium price to average at USD1,920/MT, a 9.0% drop from USD2,108/MT in 2018 but higher than the average current price of c.USD1,809 (as of 20 September 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 sanction lifting 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.

Global Production Surplus/Deficit vs. Monthly Aluminium Price



Source: Bloomberg, Kenanga Research

Maintain OUTPERFORM on PMETAL with unchanged Target Price of RM5.50 based on FY20E PER of 25.4x, implying +0.5SD valuation basis, justified by sturdy earnings growth prospects in FY21 (+24% CNP growth) on the back of capacity expansion. Independent of the expansion, PMETAL's operating outlook is already looking positive with increasing contribution from value-added products and a series of upstream acquisition in the pipeline.

Flat steel

Challenging outlook for ULICORP, underpinned by the weak prospects in the construction industry and stiff competition from other new players. The company's performance is highly premised on their ability to fight off competition in this weak market given that they currently command a market share of c.40%, and the silver lining is the lower flat steel input cost, which has been on a downtrend.

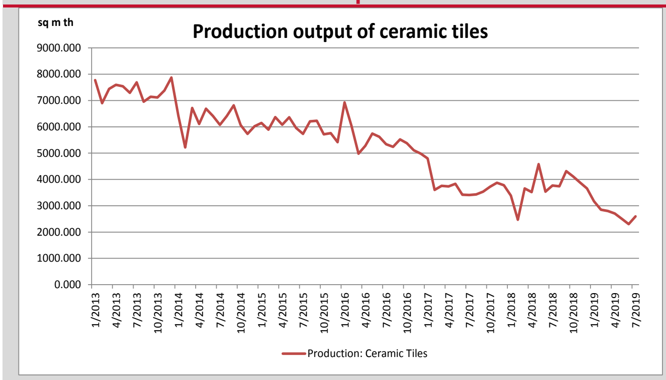
Maintaining UNDERPERFORM call with a unchanged Target Price of RM0.400 based on Fwd. PBV of 0.3x applied to FY20E BV/share of RM1.31, which is at its 5-year trough levels, and -1.5SD-level is also inline with sector negative sentiments and challenging operating environment.

Tiles

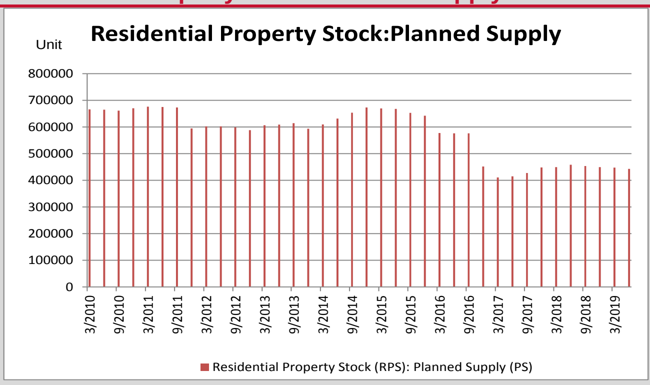
Unexcited outlook ahead. YoY, 7M19 ceramic tiles production volume dropped significantly by 24% to 18,930sqm as compared to the same period in a year ago. As the ceramic tiles industry relies heavily on construction and property industry, hence slowdown in these markets have reduced tiles demand in domestic market. Moving forward, we opine that developers will continue to slow down property supply in view of oversupply condition in domestic market, lower loan approval rate and market uncertainty. While for the construction sector, we have seen a significant drop in constracts secured since 2018, especially after the PH government halted a few mega infrastructure projects. Overall, we expect the tiles industry to remain unexciting pending more contracts announcement by both public and private sector as well as a recovery in property market.

As such, we reiterate UNDERPERFORM call for WTHORSE with a unchanged Target Price of RM1.00 based on 0.40x Fwd. PBV pegged to FY20E BV/share of RM2.49. Our valuation is below the current trough level of 0.5x, which we believe is justified due to: (i) the company recording losses for five consecutive quarters since 2Q18, (ii) slower pace in construction and property development, and (iii) widening losses from rising production costs.

Ceramic Tiles Production Output



Residential Property Stock: Planned Supply



Source: CEIC, Kenanga Research

SUMMARY

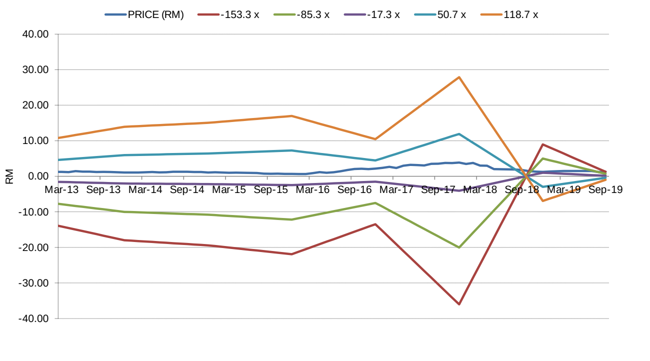
Maintain UNDERWEIGHT. All in, we reiterate UNDERWEIGHT call on the building material sector as we are negative on the steel and tiles subsectors, while the aluminium segment, should see price recovery in the near term. This, and prospects of capacity expansion puts PMETAL as the only sector OW.

To sum up, the changes in our recommendations:

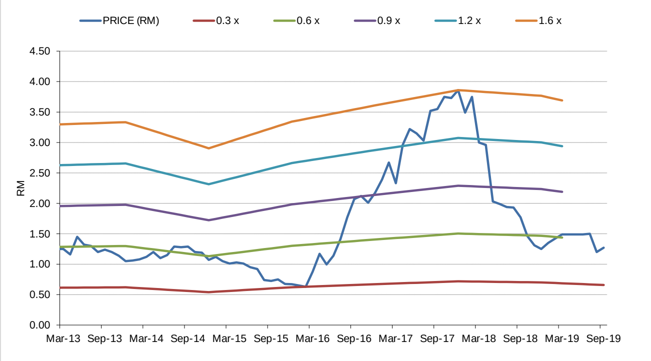
1. **Maintain UP on ANNJOO with the unchanged TP of RM1.10** at Fwd. PBV of 0.5x pegged to FY20E BV/share of RM2.20, which is at its 5-year -0.5SD levels.
2. **Maintain OP on PMETAL with unchanged TP of RM5.50** based on FY20E PER of 25.4x, implying +0.5SD valuation basis.
3. **Maintain ULICORP on UP with unchanged TP of RM0.400** based on Fwd. PBV of 0.3x applied to its FY20E BVPS of RM1.31 implying -1.5SD valuation basis.
4. **Maintain UNDER PERFORM on WTHORSE with an unchanged TP of RM1.00** based on Fwd. PBV of 0.4x pegged to its FY20E BVPS of RM2.49.

APPENDIX

ANNJOO – Fwd PER Band

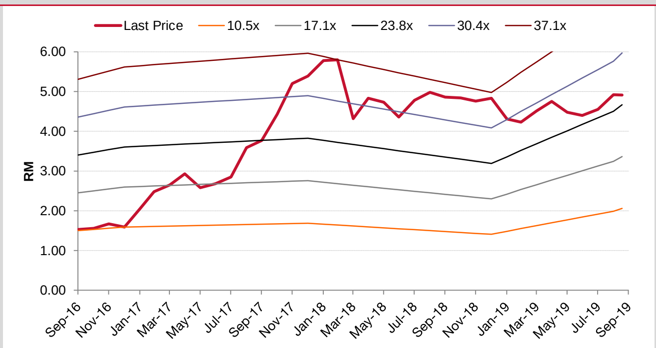


ANNJOO - Fwd PBV Band

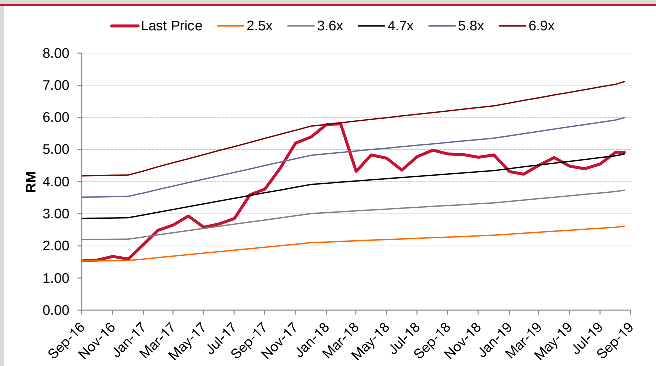


Source: Company, Kenanga Research

PMETAL – Fwd Core PER Band

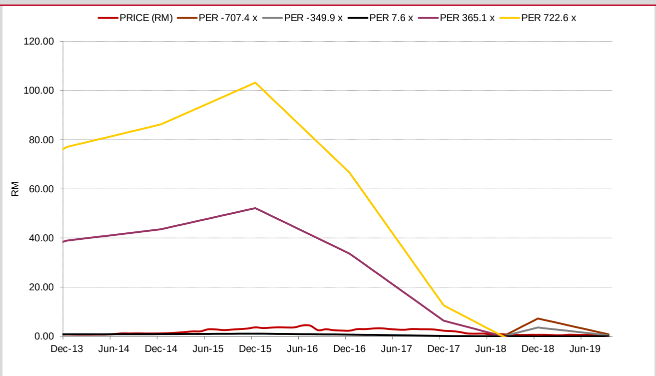


PMETAL - Fwd PBV Band

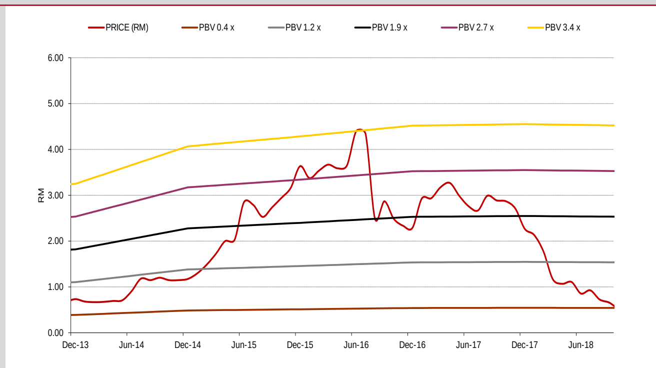


Source: Company, Kenanga Research

ULICORP – Fwd Core PER Band

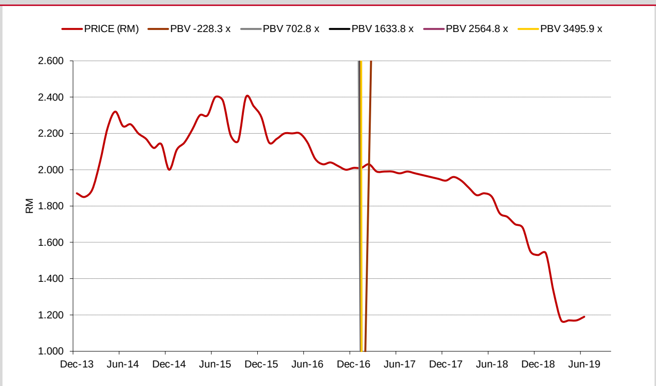


ULICORP - Fwd PBV Band

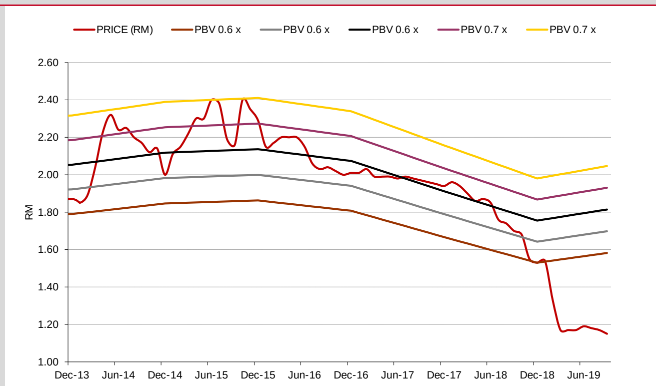


Source: Company, Kenanga Research

WTHORSE – Fwd Core PER Band



WTHORSE - Fwd PBV Band



Source: Company, Kenanga Research

Peer Comparison

Name	Last Price @ 20 Sept 19 (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth 1-Yr. Fwd.	Revenue Growth 2-Yr. Fwd.	Core Earnings Growth 1-Yr. Fwd.	Core Earnings Growth 2-Yr. Fwd.	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	1.27	658.4	Y	12/2019	-19.4%	12.5%	-124.9%	702.4%	5.4	N.A.	152.8	0.5	0.5	-2.4%	0.0%	1.10	UP
PRESS METAL ALUMINIUM HOLDIN	4.91	19,827.1	Y	12/2019	-1.5%	10.4%	-16.5%	61.5%	29.1	34.9	21.6	5.9	5.3	15.4%	0.9%	5.50	OP
UNITED U-LI CORP BHD	0.480	104.5	Y	12/2019	-21.6%	-9.6%	-158.8%	543.1%	28.2	N.A.	24.0	0.4	0.4	-0.8%	0.0%	0.400	UP
WHITE HORSE BHD	1.15	262.4	Y	12/2019	-12.9%	0.8%	-66.8%	-98.8%	N.A.	N.A.	N.A.	0.4	0.4	-5.4%	0.0%	1.00	UP
Simple Average					**-13.9%**	**3.5%**	**-91.8%**	**302.1%**	**20.9**	**34.9**	**66.1**	**1.8**	**1.7**	**1.7%**	**0.2%**		

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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