

18 June 2024

Building Material

1QCY24 Report Card: Metal and Water Turn Auspicious

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OVERWEIGHT



We upgrade our sector call to **OVERWEIGHT** (from **NEUTRAL**), anchored by our recent upgrade of sector heavyweight **PMETAL** (OP; TP: RM6.35) to **OUTPERFORM** from **MARKET PERFORM**. There was a significant improvement in earnings delivery (against our expectations) by the sector in the recently concluded 1QCY24 reporting season with stocks under our coverage either beating or meeting our forecasts. We expect aluminium prices to stay firm on supply constraints while stable steel prices translate to stable steel product prices, reducing earnings volatility of steep product producers. Water pipe makers are poised for an exciting time ahead on the revival of water projects. Our sector top picks are **PMETAL** and **ENGTEX** (OP; TP: RM1.41).

There was a significant improvement in earnings delivery (against our expectations) by the sector in the recently concluded 1QCY24 reporting season with 33% and 67% of companies under our coverage exceeding and meeting our forecasts, vs. 25% and 75% meeting and missing our forecasts three months ago, respectively. **PMETAL** beat our forecast driven by higher-than-expected ASP and stronger-than-expected performance from associate PT Bintan, while **ENGTEX** and **ULICORP** (OP; TP: **RM2.38**) met our expectations as they shook off margin suppression from high-cost inventories.

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, the demand has been spurred by RE projects and the 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 the supply. YTD, LME aluminium prices have averaged at USD2,337/MT, 4% higher than an average of USD2,255/MT during the whole of 2023.

Meanwhile, at a YTD average of USD1,253/MT, prices of FeSi have come off 13% as compared the average of USD1,437/MT for the whole of 2023 (buoyed by broad-based speculation on commodities during 1HCY23). We expect FeSi to remain soft for the rest of the year on a high stock level amid weak demand. Conversely, 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.

On the other hand, steel prices have remained stable despite the recent hike in tariffs imposed by US authorities on Chinese steel imports to 25% (from 7.5%) as China's steel exports to the US are insignificant and they are largely less price sensitive high-grade steel products. The global demand for both long and flat steel, driven largely by China, will remain muted weighed down by the property debt crisis in China. Locally, 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**.

Water pipe makers are poised for exciting times ahead as water operators kick start their long-overdue water projects backed by stronger finances following the recent water tariff hikes including: (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 upgrade our sector recommendation to **OVERWEIGHT** (from **NEUTRAL**) following our recent upgrade of **PMETAL**, which holds significant weighting of the sector, to **OUTPERFORM** from **MARKET PERFORM**. Our sector top picks are: (i) **PMETAL** given its structural cost advantage over its global peers thanks to its access to low-cost hydropower locked in until 2040, and (ii) **ENGTEX** as a proxy to the revival of water projects locally.

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Quarterly Results Performance												
	1QCY24						4QCY23					
	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	1	2	0	1	1	0	0	1	3	0	1	2
Total (%)	33	67	0	50	50	0	0	25	75	0	33	67

Source: Kenanga Research, Bloomberg

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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) 1-Yr. Fwd.	Net Div Yld 1-Yr. Fwd.
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.				
Stocks Under Coverage																	
ENGTEX GROUP BHD	OP	1.08	1.41	30.6%	478.8	Y	12/2024	9.2	12.5	300.0%	35.0%	11.7	8.7	0.5	4.7%	0.8	0.7%
OM HOLDINGS LTD	OP	1.47	1.80	22.4%	1,126.4	Y	12/2024	17.7	29.8	63.6%	68.6%	8.3	4.9	0.6	7.0%	6.6	4.5%
PRESS METAL ALUMINUM HOLDINGS BHD	OP	5.80	6.35	9.5%	47,789.8	Y	12/2024	23.2	27.0	52.5%	16.3%	25.0	21.5	5.9	24.8%	9.3	1.2%
UNITED U-LI CORPORATION BHD	OP	1.97	2.38	20.8%	429.1	Y	12/2024	23.9	29.8	29.7%	24.6%	8.3	6.6	1.0	13.2%	6.0	3.0%
Sector Aggregate					49,824.0					54.3%	20.0%	23.3	19.4	4.4	19.0%		2.4%

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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