Regional Strategy – Malaysia

Malaysia boleh*? Overweight if BN strong mandate

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Phillip Securities Research Pte Ltd

31 August 2012

KLCI: 1646.11 (7.5% ytd)
MSCI Malaysia: 586.65 (4.9% ytd)

2011 Real GDP / Inflation: 5.1% /3.2%
2012(f) Real GDP / Inflation: 4.7% / 2.0%

Resilient domestic demand -on the back of an acceleration in investment- continued to drive the Malaysia economy in 2Q12. Investment received a boost from projects under the Economic Transformation Program as well as massive infrastructure investment. Along with healthy domestic consumption, the Malaysia economy should be relatively sheltered from external macro headwinds. However, the reliance on policy to drive investment is worrying. In view of the increasingly limited fiscal space, government expenditure is likely to be constrained. Thus, continued expansion in household consumption and private sector investment (esp by non government-linked companies) is essential to sustain the growth momentum amid weakness in external demand.

We maintain our view that Bank Negara Malaysia will continue to stand pat and re-assess its policy rate position post-elections (barring any significant deterioration in the global macro environment).

On the political front, uncertainties abound. Should global economic conditions worsen, the Najib administration might inevitably bear the brunt of the electorate's wrath, depending on how the Malaysia economy weathers this global economic malaise. Furthermore, the size of the recent Bersih 3.0 rally spells discontent. Thus, we opine that Najib might be apprehensive that his BN coalition might not be able to secure the two-thirds majority in Parliament -which it lost in the recent 2008 watershed elections- despite earlier populist moves. At the upcoming Budget 2013 which will be tabled on Sept 28, we do not rule out the possibility of further cash handouts to the low-income households as a political move to shore up further support for the BN Coalition. While these cash handouts and pre-election pump priming might help bolster domestic demand and mitigate weakness in external demand, we caution that these populist moves might push the government towards fiscal peril.

Amid an ongoing global slowdown, Malaysia's bourse has been relatively insulated -and even saw the listing of two mega IPOs priced towards the upper end of their range- demonstrating the healthy domestic demand as well as more critically Malaysia's Employees Provident Fund (EPF)'s significant investment in Malaysian equities (particularly the blue chips).

Our outlook for the KLCI is Marketweight, as although we like the domestic demand story, valuations are non-compelling in view of the considerable political risk ahead of the 13th General Elections which threatens to undermine Malaysia's robust macro fundamentals. Specifically, in the event that the incumbent Barisan Nasional fail to obtain a strong mandate, the Economic Transformation Program and Government Transformation Program -major pillars of the domestic demand story- may be confronted with headwinds. Conversely, a strong mandate for BN may lead us to re-visit with an Overweight.

- ***UT investors please contact your FA for Portfolio matters.***
- ***PhillipETF recommends "DBXT- MSCI Malaysia TRN Index ETF" (LG6: SGX) which proxies the MSCI Daily TR Net Malaysia USD Index.***
- ***PhillipCFD has the FBM KLCI MYR10 CFD long/short.***
- ***Featured companies are: Malayan Banking Bhd, AirAsia Bhd as well as updates on YTL Corp and Axiata***

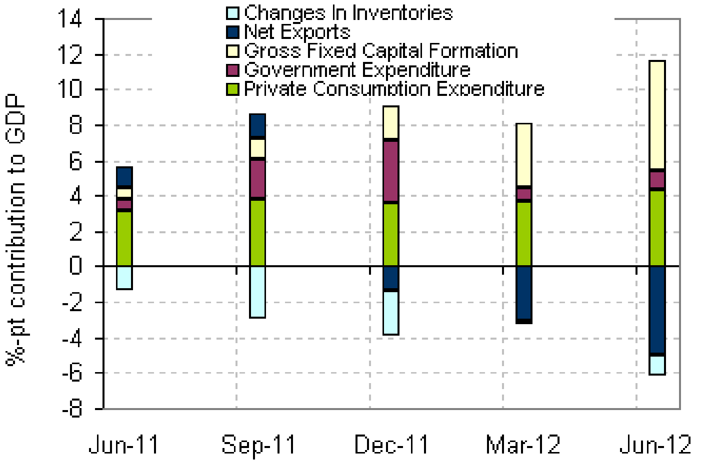
*****_The report title "Malaysia boleh?" is loosely translated as "Can Malaysia do it?" and in the context of our report "Can Malaysia sustain its robust economic and financial performance thus far?"_

GROWTH OUTLOOK:

- **Resilient domestic demand continued to drive growth.** In 2Q12, Malaysia's economy expanded by 5.4% y-y, following growth of 4.9% in the preceding quarter (Fig 1). Growth was driven entirely by domestic demand. Specifically,
  - Private consumption continued to maintain a strong pace of growth, rising 8.8% y-y in 2Q12, faster than the 7.4% growth registered in the preceding quarter. The healthy state of private consumption was largely due to (i) the implementation of the minimum wage, (ii) salary hikes for civil servants, (iii) cash handouts to low-income households, and (iv) stable labour conditions (low unemployment rate of around 3.0%) as well as continued wage growth.
  - Gross fixed capital formation also continued to expand at a double-digit pace (26.1%), accelerating from 16.2% in the preceding quarter. The acceleration in investment was largely due to increased public spending as well as private investments related to the Economic Transformation Program (ETP). Key investment projects include those in the infrastructure (construction of RM 700 million Legoland theme park) as well as the oil and gas sector (RM 3 bn regasification plant contract awarded by Petronas Gas Bhd).

In view of the government's increasingly limited fiscal space, continued expansion in household consumption and private sector investment is necessary to sustain the growth momentum. (Fig 1)

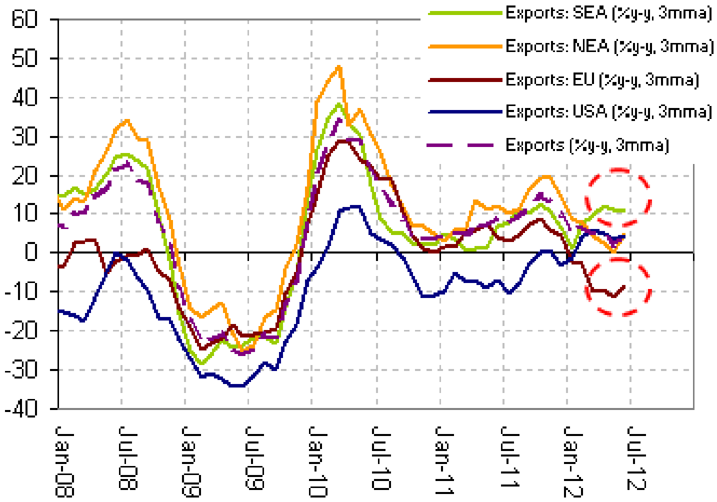
Fig 1. Robust domestic demand boosted growth in 2Q12, largely on the back of acceleration in investment.



Source: CEIC, PSR est.

- On the external front, exports continued to slump on the back of sluggish external demand as well as global macro uncertainties. Exports continued to moderate from 4.9% in 1Q12 to 4.0% in 2Q12, owing to weaker demand from the EU (Fig 2).

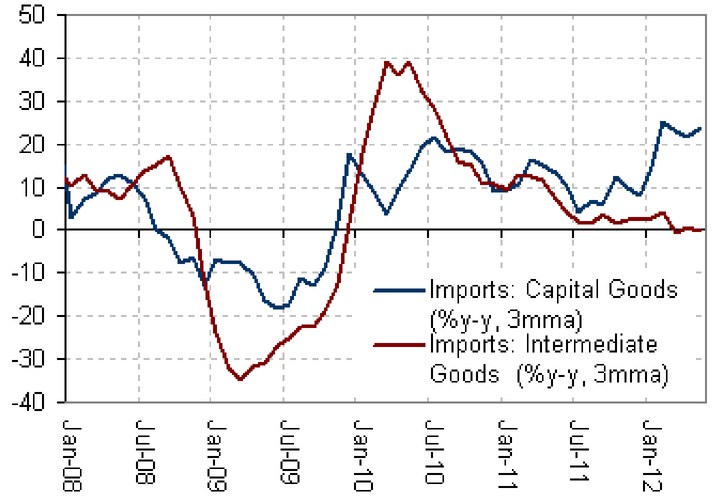
Fig 2. While demand from the EU remain sluggish, healthy demand from within the region (i.e. SEA) continue to lend support to export growth.



Source: CEIC, PSR est.

- Going forth, net exports are likely to continue to be a drag on growth. We have earlier established that sluggish external demand does not bode well for Malaysia's exports. Leading indicators for export performance such as imports of intermediate goods - which are used to manufacture other products mainly for export- continued to decline. By contrast, imports of capital goods continued to surge on the back of increased private and public sector investment (Fig 3).

Fig 3. Imports of capital goods continued to surge on the back of robust investment.



Source: CEIC, PSR est.

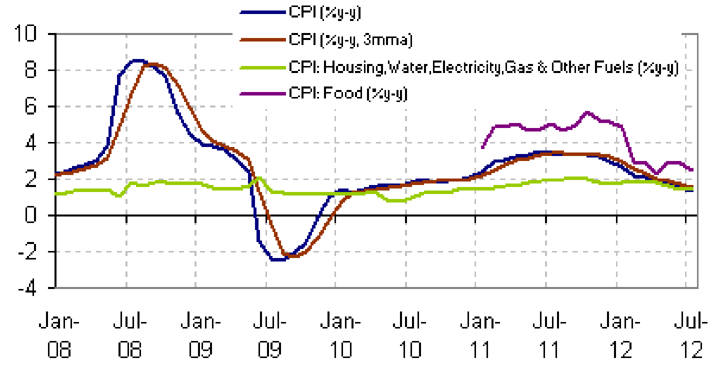
- Nonetheless, healthy domestic demand should partly offset sluggish external demand (particularly from the EU) and continue to lend support to growth. Thus, the policy initiatives to support domestic demand cannot be underestimated for an economy that has exports estimated at 100% of GDP. Specifically, (i) the implementation of minimum wage (likely to benefit the rural workers rather than the urban workers), (ii) increase in wages of civil service workers as well as pre-election handouts will lend support to private consumption, and (iii) Gross fixed capital formation should receive a boost from increased private and government investments under the Economic and Government Transformation Programmes (ETP, GTP). In the 1H12, the economy has already registered growth of 5.1%. **For the whole of 2012, we are forecasting growth of around 4.7%, as we expect resilient domestic demand to partly mitigate sluggish external demand.**

- Downside risks to growth are: (i) domestic political uncertainties i.e. Barisan Nasional (BN) failing to retain a simple majority, which we shall elaborate later; (ii) weaker-than-expected global economic conditions, and (iii) possible escalation of the EU sovereign debt crisis as well as fiscal uncertainties in the US (see Global Macro, Asset Strategy: 26 July)

INFLATION & POLICY:

- **Inflation remained benign in Malaysia.** Headline inflation continued to moderate to 1.6% y-y, 3mma in July (26-moonth low), owing to softer food and fuel prices (Fig 4). Year to date, inflation has averaged around 1.9% for the first 7 months of 2012 We are expecting full-year inflation to come in at around 2.0% this year, lower than the 3.2% increase in the previous year.

Fig 4. Inflation has been decelerating as prices of food and fuel -which account for around half of the CPI basket- continued to ease.



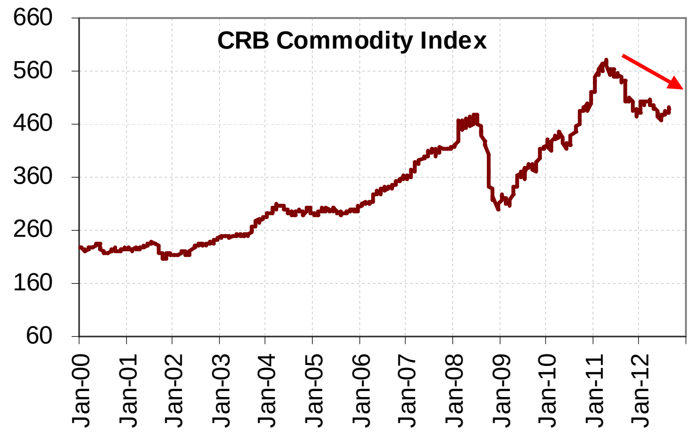
Source: CEIC, PSR est.

- **Nonetheless, there are both upside and downside risks to the inflation outlook. The upside risks are domestically driven, while the downside risk is chiefly the global economy.**

- On upside risks, firstly it is likely that subsidies for food (eg. flour, sugar, cooking oil) and fuel (diesel, petrol) - major drivers of headline inflation – will get scaled back after the 13th General Elections. If the subsidies withdrawal comes in this year (though not our base case), our inflation forecast might be exceeded. Secondly, minimum wage hikes. In May, PM Najib introduced the minimum wage of RM900 for Peninsular Malaysia and RM800 for those in Sarawak, Sabah and Labuan. Most firms will have to start paying the minimum wage in six months, while small companies with have a year to comply. As the wage hike is not premised on higher productivity, the **upside risk to inflation is that the increase in money could outpace the growth in output, firms which are able will likely decide to pass on the costs to consumers.**

- The downside risk to inflation is that the global economy is weakening. Both the US and China are slowing while the Eurozone remains mired in recession for all intents and purposes. As such it is likely that commodities are entering a bear market amid a sluggish demand, *barring supply shocks* (Fig.5).

Fig 5. Global commodity prices have eased.



Source: Bloomberg, PSR est..

- Looking ahead, we expect Bank Negara Malaysia (BNM) to continue to stand pat, maintaining the Overnight Policy Rate at 3%. Amid a global slowdown as well as persistent external downside risks (US fiscal crisis, EZ sovereign debt crisis), we might have been tempted to forecast a rate cut to mitigate the growth downside given the benign inflation context. However, in view of the impending elections as well as resilient domestic demand, **we maintain our view that BNM will continue to stand pat till after, and re-assess it's policy rate position post-elections (barring any extreme deterioration in the global macro environment).**

- We opine that if the Najib administration (Barisan Nasional, or BN) does not gain a simple majority or does not win with a strong mandate in the upcoming elections (i.e. securing more than two-third majority in Parliament which they lost in the recent 2008 elections), the acceleration in investment as well as domestic growth drivers - largely premised on the execution of ETP initiatives - will lose steam. In such an event, BNM might consider cutting rates to boost growth and they would have room to do so, especially if inflation continues to remain benign. This would normally translate to possible upside for the KLCI, but a weakened domestic demand story, unable to offset a weakening global economy, may not result in much upside to the KLCI.

- On the other hand, positive for the KLCI would therefore actually be a mandate for BN to continue its ETP while inflation remains benign. Any cuts in this scenario would be merely an extra plus.

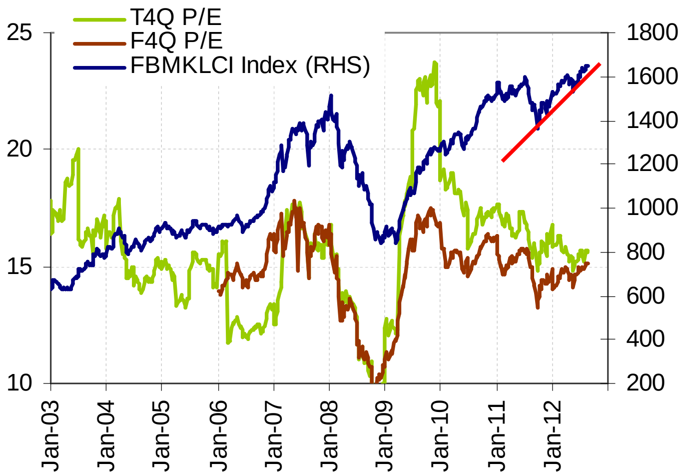
EQUITIES:

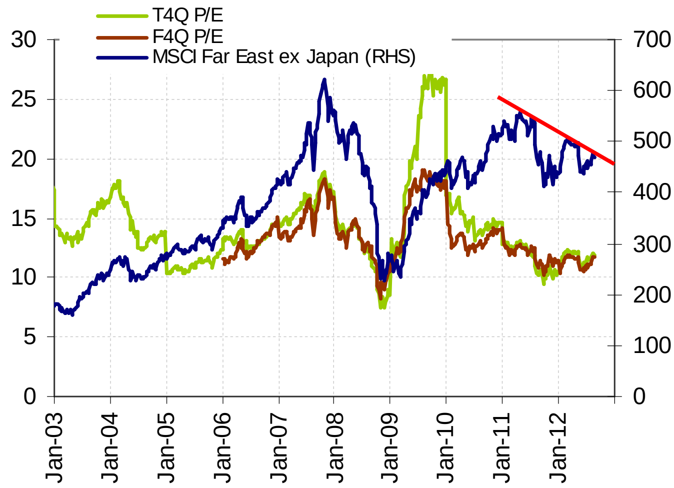
- **Market Strategy. Amid an ongoing global slowdown, Malaysia's equity markets have been relatively insulated on the back of healthy domestic demand investors and more importantly Malaysia's Employees Provident Fund (EPF)'s significant investment in Malaysian equities (esp. the blue chips).**

- In a year where appetite for IPOs are anaemic at best across major bourses, Malaysia's buoyant market saw two of the largest global listings ytd- plantation operator Felda Global Ventures Holdings Bhd (RM 9.6 bn) and hospital operator IHH Healthcare Bhd (RM 6.2 bn). Notably, Malaysia's EPF and other state-owned funds undertook cornerstone roles and made significant investment in both listings. Furthermore, there are plans of other IPO listings in the pipeline: cable-TV operator Astro All Asia Networks Plc, power company Malakoff Corp Bhd and shipping terminal operator Westports Malaysia Sdn Bhd.

- Compared to MSCI Far East ex Japan, market valuations for Malaysia is not cheap, as investors have paid more for a domestically driven economy as compared to other more export dependent countries in Asia. Specifically, the FBM-KLCI is trading at around 31% premium valuation against the MSCI Far East ex Japan (Fig 6). While KLCI T4Q P/E (15.6x) and F4Q P/E (15.1x) is in line with the ten-year average of around 15.7x**, we caution that market valuations might not have priced in possible downside risks from the upcoming elections.**

Fig 6. The KLCI continued to maintain an uptrend (higher lows). By contrast, the MSCI Far East ex Japan is trending down (lower highs). However, we caution Malaysia is not cheap compared with the region ex Japan and we are wary that downside risks -arising from uncertainties over the upcoming 13th General Elections- might not have been fully priced in.





Source: Bloomberg, PSR est.

- As we said, a BN victory would provide a boost to ETP/GTP initiatives. If the Najib administration wins a strong mandate, it will signal a more stable political climate and help in the acceleration of investments. It would allow the Najib administration to push through its various initiatives with greater ease. **In an economic climate of slowing global growth, it is crucial that the domestic demand story continue for the KLCI to exhibit relative resilience. In the absence of such a growth story, it is unlikely even a rate cut cycle would help**.

- By contrast, if BN fails to retain a simple majority in parliament, uncertainties over the political situation as well as the ETP initiatives will ensue, weighing on market sentiment. Though the odds of such a scenario are low at this juncture, and BN is likely retain a simple parliamentary majority**.**

- We expect elections to be held in 2H12 or early 2013, as although the election is only due in Apr 2013, we are of the view that early elections will be held to build on the feel good sentiment arising from various 'populist' moves such as the introduction of miniumum wage, civil service salary increases as well as the abolition of the Internal Security Act. However, the turnout size of the Bersih 3.0 rally - estimated to be around 250,000 participants (5 times that of the turnout of Bersih 2.0 rally) - **spells discontent and might weigh on BN's odds of registering better performance in the upcoming 13th GE as compared to the 12th GE.** Furthermore, should global economic conditions worsen, the Najib administration might inevitably bear the brunt of the electorate's wrath, depending on how the Malaysia economy weather this global economic malaise.

- **Thus, Najib might be apprehensive** that his BN coalition might not be able to secure the two-thirds majority in Parliament (necessary to pass through any legislation it deem fit) -which it lost in the recent 2008 watershed elections. Based on a June survey conducted by independent Merdeka center, approval rating for Najib remained relatively high at 64% while his BN coalition saw approval ratings slump to 42%. Thus, at the upcoming Budget 2013 which will be tabled on Sept 28, we do not rule out the possibility of further cash handouts to the low-income households as a political move to shore up further support for the BN Coalition. **While these cash handouts and pre-election pump priming might help bolster domestic demand and mitigate weakness in external demand, we caution that these populist moves might push the government towards fiscal peril.**

- **In view of the uncertainties shrouding the election outcome, plus non-compelling valuations, we are of the view that the KLCI should be Marketweight for now**, though we like the domestically driven economy story. A strong mandate for BN would make us re-visit our call to a possible Overweight as that would spur the domestic demand story, which would be a counter to what would likely be a weak global demand context.

- **Unit Trust investors contact your FA on portfolio matters.**

- **PhillipETF department recommends "DBXT- MSCI Malaysia TRN Index ETF which proxies the MSCI Daily TR Net Malaysia USD Index. Stock Ticker: [LG6 SP]. (See risks for ETFs: www.phillipetf.com > ETF education > Risks for ETFs).**

- **PhillipCFD has the FBM KLCI MYR10 CFD for long/short the KLCI. For levered short term trades, technical analysis is advised for entries and exits.**

- **Featured Malaysian companies are regional bank *Malayan Banking Berhad* and regional low-cost carrier *AirAsia***

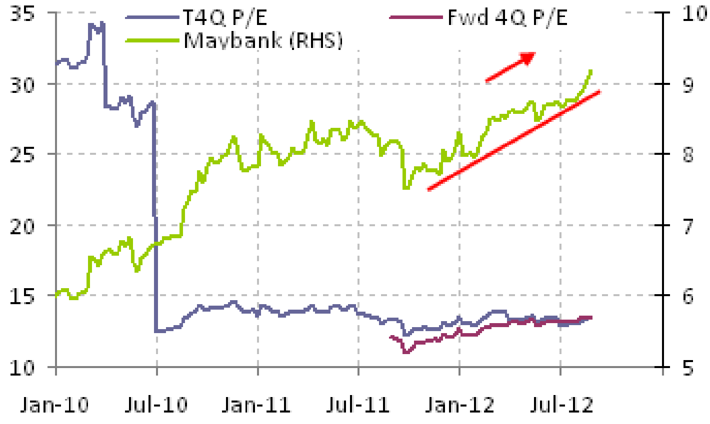
Malayan Banking Berhad (Maybank)
Maybank is the largest financial services group in Malaysia with a strong regional presence in South-east Asia.

- RM 9.15, Market Cap RM 72,019mn

- Valuation: T4Q p/e 13.6x, Fwd 4Q p/e 13.5x, EPS growth +11.4% in FY12Est, +7.4% in FY13Est

- Dividend Yield: 5.56% FY12Est, 5.64% FY13Est

Fig 7. Maybank



Source: Bloomberg, PSR est.

- *Shareholders of the group have been consistently rewarded with dividends exceeding the policy Dividend Payout Ratio of 40-60% due to the Group's successful Dividend Reinvestment Plan. Interim dividend payout ratio stands at 68%.*

- In the 1HFY12, Profit after Tax and Minority Interest (PATMI) expanded 21% y-y to RM 2.8 bn. Revenue also increased 18% y-y to RM 8.2 bn, largely due to growth in Global Wholesale Banking (+49%) as well as International Banking segments (+26%).

- The strong performance registered in the 2QFY 12 - PATMI (+6.7% q-q)- was largely due to strong loans growth (+5.9% q-q) as well as 4bps q-q net interest margin (NIM) increase.

- Group is in good financial health with an improvement in asset quality (Net Impaired Loans ratio declined to 1.28%) as well as ample liquidity (Loan-to-Deposit Ratio relatively stable at 87%).

- Loan growth expected to remain healthy and on track to meet FY12 targets (Fig 8), especially in markets such as Malaysia and Indonesia -which are relatively insulated from the global slowdown owing to robust domestic demand. Furthermore, there is significant potential to capitalise on in Indonesia's under-penetrated banking sector. By contrast, loan growth was slow in the Singapore market (4.9% y-y). If management decides to accelerate loan growth in the Singapore market in 2H to meet the FY12 target (11.4%), this might potentially result in compression of NIM.

Fig 8. Key Performance Indicator for 1HFY12

	FY12 Target	1H FY12
Group Loans Growth	16.2%	15.0%
Malaysia	13.6%	15.8%
Indonesia**	20.9%	18.8%
Singapore**	11.4%	4.9%

Source: Maybank

- While annualised ROE stood at 16.1% in 1H FY12, the management is maintaining its target of 15.6% for FY12, implicitly guiding for an earnings deceleration in 2H FY12 against a challenging macro backdrop.

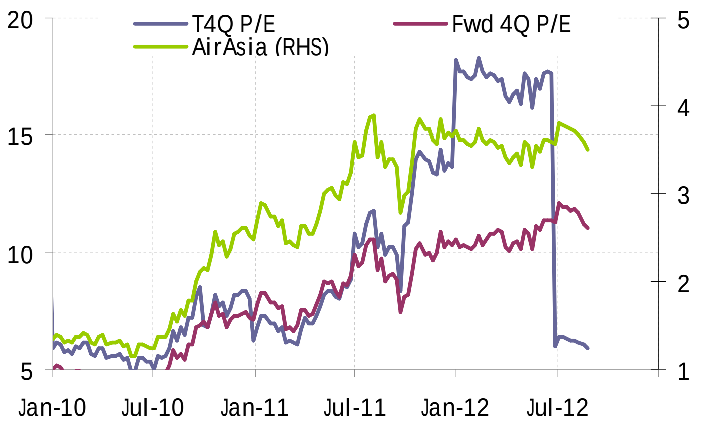
AirAsia Berhad
AirAsia is a regional low-cost carrier (LCC) operator with a route network that spans through to over 20 countries. Apart from its base in Malaysia, it has joint ventures (JVs) with associate companies in Thailand, Indonesia, Philippines and Japan.

- RM 3.45, Market Cap RM 9,756mn

- Valuation: T4Q p/e 5.9x, Fwd 4Q p/e 9.2x, EPS growth +67.7% in FY12Est, +9.8% in FY13Est

- Dividend Yield: 1.12% FY12Est, 1.17% FY13Est

Fig 9. AirAsia



- We are positive on AirAsia on account of the following:

  First, AirAsia's recent acquisition of Indonesia's Batavia Air (RM253 mn in cash) will allow AirAsia to (i) tap on the huge potential of Indonesia's aviation market (with around 13% market share once the acquisition is complete), (ii) increase its routes and fleets as well as (iii) capitalise on South-east Asia open-skies policy which will be implemented in 2015. Furthermore, listing of its Indonesia operations (which should receive a boost from the acquisition) is in the pipeline. Air Asia is moving its regional base to Indonesia to focus on its expansion plans in South-east Asia.

  Second, AirAsia is likely to be one of the first few LCC airlines moving to North Asia, thus it is likely to enjoy first mover advantages. Specifically, the Japan JV commenced commercial flight operations on 1 August 2012.

- Third, healthy earnings performance as well as positive outlook. For 2Q12, AirAsia's net profit rose more than ten-fold to RM1.2 bn, largely boosted by gains from the sale of its 4% equity stake in Thai AirAsia as well as gains on its remaining 45% stake in Thai AirAsia after the IPO of Asia Aviation (the major shareholder of Thai AirAsia). Net gearing remained low at 1.1x. Management guided that (i) forward bookings and demand still remain healthy, (ii) additional new routes will be launched and frequencies on a couple of existing routes within Asean will be increased during 2H12, (iii) focus on containment of costs still remain and new avenues of cost savings are being explored.

- However we caution that (i) rising fuel prices (which account for a significant share of operating costs), (ii) extended losses in some JVs (eg. with Japan, Indonesia) as well (iii) intense competition amongst the LCCs are some of the downside risks that AirAsia is confronted with.

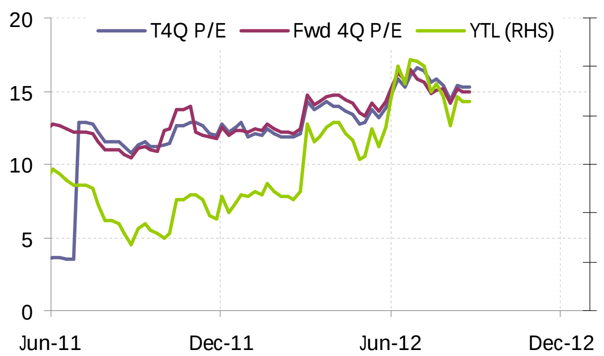
- **We once again showcase some of the M'sian companies that we featured in May: utility-contruction-real estate conglomerate *YTL Corp Berhad*, and regional telco *Axiata*. Since we last featured these companies, YTL Corp and Axiata have risen by around 6.2% and 13.7% respectively. *Latest financial results are not available at the time of writing 29 Aug12.***

YTL Corp:

- RM 1.81, Market Cap RM 19,418mn

- Valuation: T4Q p/e 14.9x, Fwd 4Q p/e 14.7x

Fig 10. YTL



Source: Bloomberg, PSR est.

- While the consensus projected EPS growth for YTL Corp is conservative, YTL is a Utility and Infrastructure conglomerate behemoth with defensive and diversified earnings, with 65.3% of Profit Before Tax (PBT) in defensive sectors Utility Assets (61.9%) and Utility & Rail Management

(3.4%), and the remaining 34.7% of PBT in cyclical sectors Cement Production (20.5%), Property Investment (9.1%), Construction (4.2%), Hotel Assets (0.6%) and e-Commerce (0.2%).

YTL Corp's Profit Before Tax (MYR m)

Source: Company	9MFY11	9MFY12	%9m Chg	% PBT
Utility Assets	1,112.6	1,136.0	2.1%	61.9%
Cement Production	334.7	376.5	12.5%	20.5%
Property Invmt & Devt	166.7	167.1	0.2%	9.1%
Construction	39.1	76.8	96.4%	4.2%
Utility & Rail Mgt Svc	65.7	63.1	-4.0%	3.4%
Hotel Assets	11.8	11.7	-0.8%	0.6%
e-Commerce	0.8	2.8	250.0%	0.2%
Total:	1,731	1,834	5.9%	

- Utility assets are geographically diversified with 100% stake in 1212MW of gas fired plants in Malaysia, 35% stake in 1220MW coal fired plants in East Java Indonesia, 100% stake in 3200MW in Power Seraya Singapore, 33.5% power transmission stake for the South Australia, 100% stake in Wessex Water in the UK.

- YTL Corp also owns 50% of the company that operates and manages the high-speed rail between KL International Airport and KL Sentral, the main mode of transport between the airport and city. Built at MYR 35mil/km it boasts to be the most cost-effective high speed rail ever built, a credential which touts it as a leading contender to win the much anticipate KL-Singapore high speed rail line. A win would be a major positive catalyst.

- Cement production (YTL Cement Berhad), construction, and property development are direct proxies to the ASEAN infrastructure theme. This sector is a key beneficiary of the Economic Transformation Program, especially the YTL Cement which has seen earnings compound at 21% a year for the past 4 years. YTL Corp at the end of 1q12 privatised the rest of YTL Cement it did not own (52.6%) thru a share swap of YTL Corp shares for YTL Cement shares, thus paving the way for cement production earnings to be fully consolidated into YTL Corp, EPS could be boosted by up to 6%, making the current consensus of 7% growth look a little pessimistic.

AXIATA:

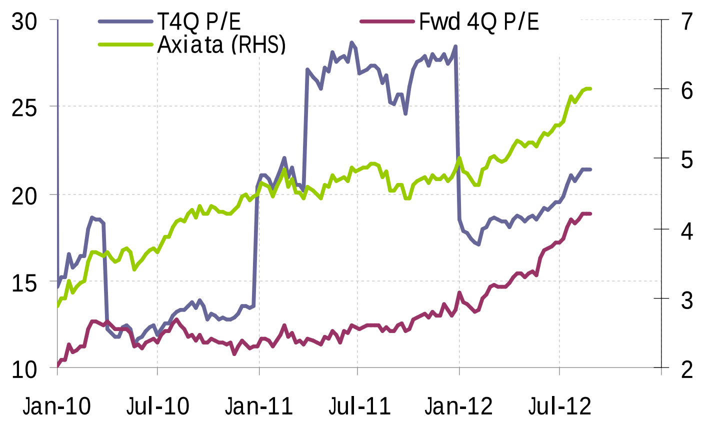
- RM 5.99, Market Cap RM 50,939mn

- Valuation: T4Q p/e 21.4x, Fwd 4Q p/e 18.8x, EPS growth +13.7% in FY12Est, +12.0% in FY13Est

- Dividend Yield: 3.39% FY12Est, 3.92% FY13Est

- Valuation: At this juncture, trailing 4Q P/E is higher than forward 4Q P/E, suggesting there might be some possible upside in earnings in the months ahead (Fig 11).

Fig 11. Some possible upside in earnings going forward

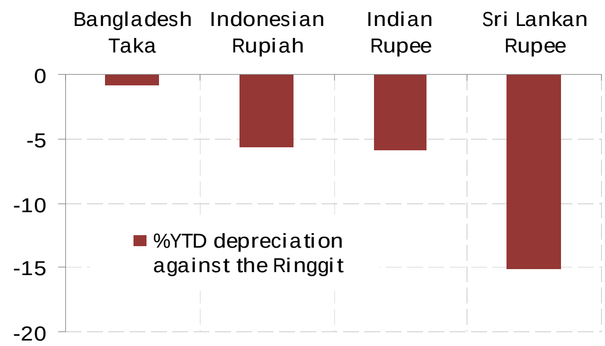


- Despite the challenging macroeconomic backdrop as well as stronger Ringgit, Axiata reported a healthy set of earnings in its 1QFY12 results. Specifically, revenue (in RM mn) grew by 8.0% y-y and net profit rose by 3.1% y-y. In fact, Axiata looks on track to surpass its KPI of 5.3% revenue growth.

- However, downside risks persist: (i) translation loss (in terms of profit contribution at the group level) due to the strengthening of the Ringgit against most regional currencies as well as (ii) increased regulatory risks in India and Bangladesh.

- First, a stronger Ringgit is likely to result in translation loss in terms of subsidiaries' profit contribution at the group level. Apart from Celcom Malaysia which contribute about 45% of the revenue in 2011, Axiata also derive a significant share of its revenue from markets such as XL-Indonesia (38%), as well as Dialog -Sri Lanka and Robi- Bangladesh (each around 8%). In recent quarters, the currencies of its major overseas subsidiaries have slid significantly against the Ringgit (Fig 12). Already, fluctuation in exchange rates has negatively impacted 1QFY12 revenue growth by 2.4pp.

Fig 12. Ytd, the currencies of its major overseas subsidiaries have depreciated significantly against the Ringgit.

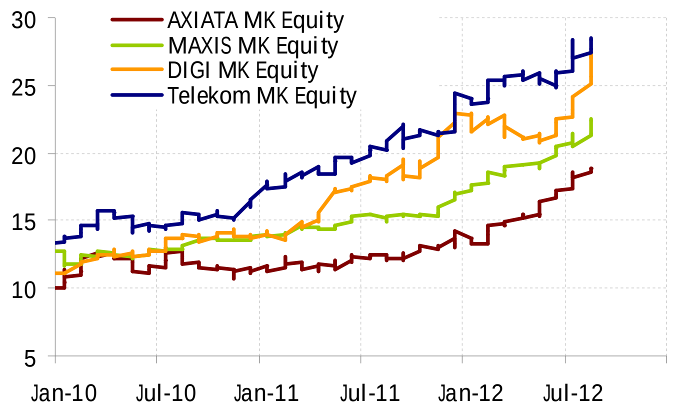


Source: Bloomberg, PSR est.

- Second, regulatory risks facing subsidiaries Idea (India) and Robi (Bangladesh). Specifically, regulatory uncertainties in these markets are not conducive for M&A activities.

- **Nonetheless, we like Axiata on account of two factors (i) telco as a defensive stock is worth having in view of possible bearish sentiment shrouding the upcoming general elections, sluggish global economy and (ii) based on F4Q P/E, it is more attractively priced compared to its peers (Fig 13).**

Fig 13. Based on F4Q P/E, Axiata is attractively priced compared to its peers.



Source: Bloomberg, PSR est.

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