Malaysia Market Focus

Malaysia Strategy

Refer to important disclosures at the end of this report

DBS Group Research . Equity

14 Oct 2020

Bumpy road to recovery

KLCI : 1,525.20

- External uncertainties to weigh on equity market performance
- Better 2H20 earnings as economy gradually picks up pace
- Victory in Sabah state election positive for ruling coalition
- End-2020 KLCI target of 1,600 based on 18x CY21 earnings
- Top picks: TOPG, HART, TM, GAM, TDC, SWB, IJM, VS, MAG, BAUTO

External uncertainties. Volatility in the equity market is expected to continue despite ample liquidity. External uncertainties such as the resurgence of COVID-19 infections and the upcoming US presidential election continue to affect investors' sentiment. The expiry of Malaysia's loan moratorium in September has started to be reflected by normalised trading volume and value. However, it remains to be seen if the high retail participation exceeding 30% will be the norm, which is critical to offset the persistent selling by foreigners. Nevertheless, we believe ample liquidity will remain positive for the equity market, though the threat of slower economic recovery due to rising COVID-19 infections remains the key risk.

Decent support for ruling coalition. The ruling Perikatan Nasional (PN) coalition won the recent Sabah state election, wresting back the state from the opposition. This will provide more stability for the PN-led federal government which only holds a razor thin majority in the Parliament. Given its strong voters' support, overall sentiment on the ground seems to be supportive of PN which may bode well for Malaysia's economic recovery momentum.

Better 2H20 but not smooth sailing. While we expect a stronger 2H20 earnings performance given the easing of lockdown, the pace of a broader economic recovery may be affected by external uncertainties. Trade activities could slow down if the second wave of COVID-19 results in more restrictive lockdowns globally. Nevertheless, we maintain our end-2020 KLCI target of 1,600 pegged to 18x CY21 earnings (5-year mean of 12-month rolling forward price-to-earnings (PE)).

Selective picks. Strong glove demand and rising selling prices could be the near-term catalyst for Top Glove Corp (TOPG) and Hartalega Holdings (HART). Gamuda (GAM) and IJM Corp (IJM) are the best proxies for the revival of infrastructure projects. Post-lockdown demand recovery should benefit companies such as Sunway (SWB), VS Industry (VS), Magnum (MAG) and Bermaz Auto (BAUTO) that have been badly hit by COVID-19, with improvement expected in 2021. We also remain keen on beneficiaries of rising data usage like Telekom Malaysia (TM) and Time dotCom (TDC)

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Market Key Data

(%)	EPS Gth	Div Yield
2019A	(8.6)	4.1
2020F	(16.9)	3.0
2021F	23.6	3.8

(x)	PER	PB
2019A	17.3	1.5
2020F	21.8	1.5
2021F	17.0	1.4

STOCKS

	Price RM	Mkt Cap US$m	12-mth Target RM	Performance (%) 3 mth	Performance (%) 12 mth	Rating
Top Glove	9.09	17,865	10.20	17.8	535.7	BUY
Hartalega	17.58	14,551	24.70	3.4	238.1	BUY
Telekom Malaysia	4.19	3,818	5.10	1.7	17.4	BUY
Gamuda	3.59	2,179	4.60	6.9	(4.3)	BUY
TIME dotCom	12.40	1,809	14.10	12.7	37.5	BUY
Sunway Bhd	1.37	1,622	1.85	(0.7)	(18.5)	BUY
IJM Corp	1.45	1,268	2.20	(13.7)	(36.1)	BUY
VS Industry	2.38	1,075	2.60	118.4	84.5	BUY
Magnum Bhd	2.07	718	2.53	(5.0)	(24.0)	BUY
Bermaz Auto	1.28	359	1.65	(6.6)	(41.6)	BUY

Source: AllianceDBS, Bloomberg Finance L.P.
Closing price as of 13 Oct 2020

Gradual recovery but not all rosy

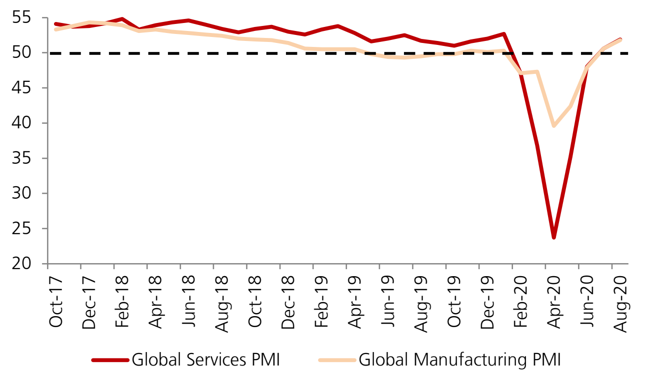
The global equity market has been weighed down by the resurgence of COVID-19 infections in recent weeks which have seen several countries exceed their previous record-high number of cases. As we enter the winter season in the northern hemisphere, there are concerns that the resurgence will inevitably result in a delay of the much anticipated economic recovery in 2021.

In addition, the upcoming US presidential election in November may pose more uncertainties to the nascent economic recovery. The incumbent president may cause more trade frictions among major economies.

Nevertheless, the healthy and sustained rebound of China's economy will continue to underpin the relatively decent pick-up in Asia's trade activities. Pent-up demand, stimulus-driven infrastructure spending and resilient exports in China will lend support to the global recovery, though the recent spike in COVID-19 infections could derail the recovery momentum.

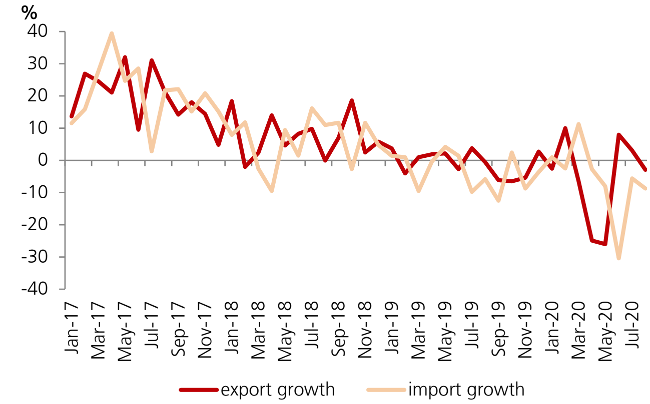
We believe that Malaysia, as a relatively open trading nation, will likely see a pick-up in broader economic growth although it is expected to be moderated by the external uncertainties. For instance, Malaysia's export growth in August fell 2.9% y-o-y after registering two consecutive months of positive growth due to weak demand from Association of Southeast Asian Nations (ASEAN).

Global PMI



Source: AllianceDBS, Bloomberg Finance L.P.

Malaysia's external trade growth

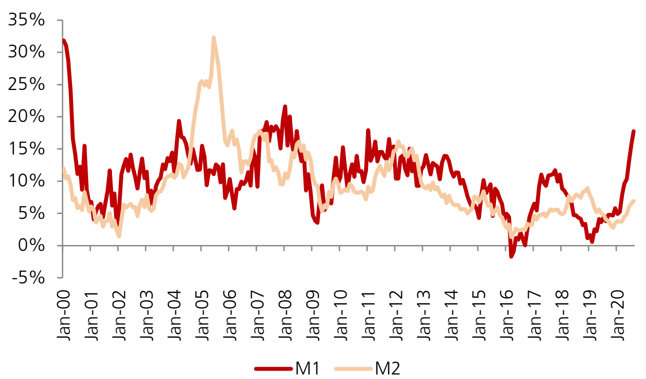


Source: AllianceDBS, Bloomberg Finance L.P.

The expiry of the six-month loan moratorium in September will present an additional risk to Malaysia's economy which is still well below pre-pandemic levels. Borders have remained closed and this has negatively affected several industries, especially the tourism and aviation sector. The unpredictability, duration and severity of COVID-19 will continue to take its toll on Malaysia's economy, though it has been recognised for its success in tackling the outbreak.

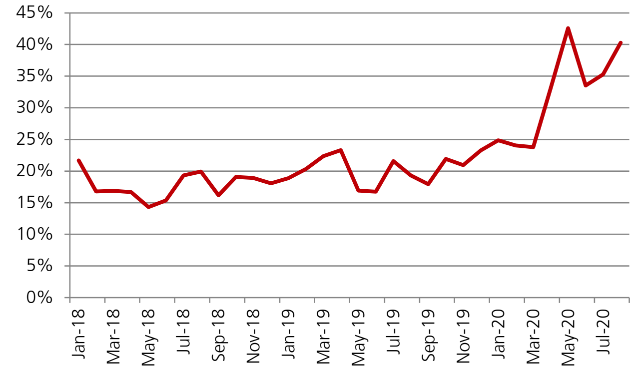
We will be keeping a close watch on Malaysia's equity market trading volume and value in the aftermath of the expiry of the loan moratorium. This is due to the high participation of retail investors which has more than offset the relentless selling by foreigners over the past few months. This could be a critical driver for the near-term performance of our equity market, although the financial system remains flush with ample liquidity.

M1 and M2 money supply growth



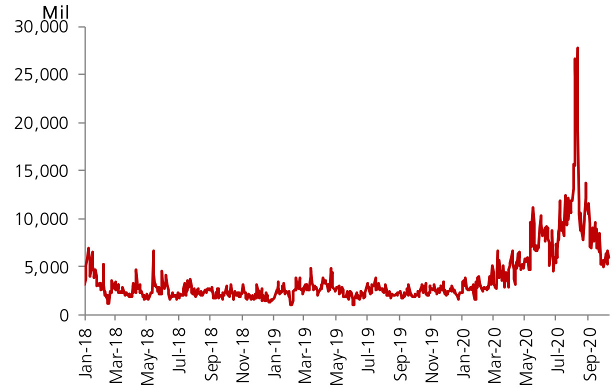
Source: AllianceDBS, Bloomberg Finance L.P.

Strong retail participation



Source: AllianceDBS, Bursa Malaysia

Total trading volume



Source: AllianceDBS, Bursa Malaysia

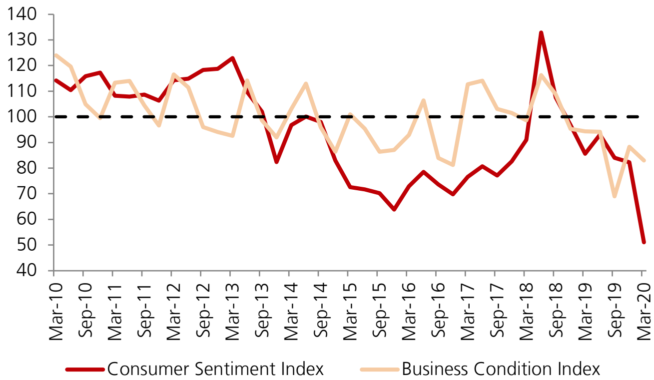
Malaysia has been perceived as lacking political clarity since the change of federal government in March. The razor thin majority held by the ruling PN coalition government continues to cause political instability, which could partly explain the incessant foreign selling in Malaysia's equity market which has exceeded RM20bn this year.

Nevertheless, the ruling PN won the recent Sabah state election, wresting back the state from the opposition. This may provide more stability for the PN-led federal government though a potential power struggle within the coalition could still lead to a snap election.

Judging by the results of the Sabah state election and Slim by-election in Perak, the PN coalition continues to garner strong ground support which may strengthen the stability of the federal government. A committed and focused administration may lead to a better economic recovery.

Nevertheless, weak sentiment among consumers and corporates is a key risk to Malaysia's economic growth given that private consumption and investment constitute ~70% of our gross domestic product (GDP). Particularly, the Consumer Sentiment Index has dropped to a record-low of 51, worse than during previous crises. Poor confidence levels could be a deterrent for steady economic recovery. The economy was on a soft patch even prior to the pandemic, owing to the lack of financial discipline over the years.

Malaysian Institute of Economic Research (MIER) surveys



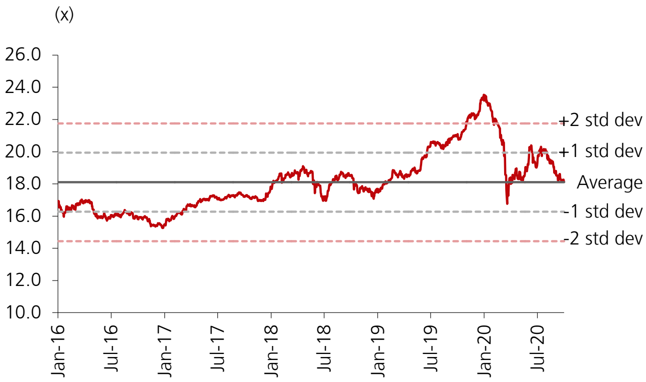
Source: AllianceDBS, Bloomberg Finance L.P.

Market strategy

Supported by ample liquidity. We maintain our end-2020 KLCI target of 1,600, which is based on 18x earnings or the 5-year mean PE multiple on a 12-month rolling-forward basis. The flush liquidity in the market (July M1 money supply rose 17.8% – the highest since 2011) has largely negated the impact of earnings deterioration and remained supportive of the equity market.

The potential entry of two glove-makers into the KLCI by December could significantly increase the weightage of the healthcare sector which tends to command much high valuations and may lift overall valuation of the KLCI. We are projecting FBM KLCI earnings to contract by 17% in 2020 before rebounding by 24% in 2021.

FBM KLCI 12-month rolling forward PE



Source: AllianceDBS, Bloomberg Finance L.P.

Selective picks. We remain positive on; a) stocks with strong earnings growth and visibility despite the pandemic-induced slowdown, b) beneficiaries of post-pandemic demand recovery as health authorities continue to make progress on vaccine development, c) beneficiaries of rising data usage in the digital era.

Strong glove demand and rising selling prices could be the near-term catalyst for **TOPG** and **HART**. **GAM** and **IJM** are the best proxies for the revival of infrastructure projects. **Post-lockdown demand recovery** should benefit companies such as **SWB, VS, MAG** and **BAUTO** that were badly hit by COVID-19 with improvement expected in 2021. We also remain keen on beneficiaries of rising data usage such as **TM** and **TDC.**

We continue to have Overweight ratings on the healthcare, gaming, gloves, construction, plantation and telecommunication sectors.

Sector calls

Sector	Rating	Top picks
Automotive	Neutral	BAUTO
Aviation	Underweight	MAHB
Banking	Neutral	HLBK
Building Materials	Neutral	LMC
Construction	Overweight	GAM, IJM, SCGB
Consumer	Neutral	-
Gaming	Overweight	BST, MAG
Glove	Overweight	TOPG, KRI, HART
Healthcare	Overweight	IHH, KPJ
Media	Neutral	STAR, ASTRO, MCIL
Oil & Gas	Neutral	SDB, BAB
Plantation	Overweight	KLK, TSH
Property	Neutral	SWB
REIT	Neutral	SREIT
Technology	Neutral	-
Telecommunication	Overweight	TM, TDC
Utilities	Neutral	GMB, YTLP

Source: AllianceDBS

Construction: More positive news flow ahead
(Analyst: CHONG Tjen-San)

We retain our non-consensus Overweight stance on the construction sector. Expect news flow and project revival to be imminent with the medium-term recovery plan expected in October and the Budget 2021 tabling in November. We expect the revival of the Mass Rapid Transit Line 3 (MRT 3), High Speed Rail (HSR) and other potential new Private Finance Initiative (PFI) projects in the water or solar energy space. More recently, at the end of August there were news reports that the cabinet has approved the HSR project and will start negotiations with Singapore soon. The project delivery vehicle MyHSR Corp launched two tenders to appoint consultants for the project recently

The recently concluded 2QCY20 marked an earnings trough for companies that were heavily impacted by the Movement Control Order (MCO). Stronger earnings expected in 2H20 will aid the sector's recovery.

We expect 2020/2021to be affected similar to previous crises with the government tolerating a higher budget deficit, raising the government debt-to-GDP ceiling and pump-priming the economy. This may be more crucial now with increased job losses, extremely challenging economic outlook and potential general elections which has to be called by 2023. Between MRT 3 and HSR, the more immediate project would likely be MRT 3, as MRT 2 is already c.75% completed and the MRT 3/Circle Line is deemed vital to complete the loop and ensure that ridership continues to grow.

We also expect a flurry of awards in Sarawak leading up to the state election which has to be called by September 2021. Based on our channel checks, the state is contemplating awards of some major projects such as Smart City, Oil and Gas City and Methanol Plant. This is on top of the trunk road, coastal road and water supply grid projects.

Our top picks for the sector are GAM, IJM and Sunway Construction Group (SCGB). GAM (BUY: target price (TP): RM4.60) is the bellwether for the sector. The company has the best leverage for the Penang Transport Master Plan (PTMP), MRT 3 and HSR, while a maiden win in Australia would be a bonus - it has been shortlisted for two sizeable jobs. IJM (BUY: TP: RM2.20)'s valuation at 05x book value (BV) is too cheap to ignore. We expect it to be a key beneficiary of economic revival by the government and private sectors. SCGB (BUY; TP: RM2.30) is our other pick. It has a ready pipeline of projects from; i) its parent company SWB, ii) a niche in MRT, light rapid transit (LRT and bus rapid transit (BRT) projects and, iii) Petronas-related building works. For exposure to Sarawak, we have a non-rated call on Sarawak Consolidated Industries Berhad (SCIB).

Plantation: Higher CPO prices in 2H20

Crude palm oil (CPO) prices have increased to RM3,074 per MT after recovering from its May slump. We believe that CPO prices are supported by; 1) low inventory levels driven by softer output from Indonesia combined with the normalisation of demand post-lockdown and, 2) strong spike in soybean oil prices due to market concerns on limited soybean supply caused by dry weather in soybean producing countries.

However, we feel that the high CPO prices are not sustainable as fresh fruit bunches (FFB) production is expected to peak in 4Q20 on seasonally peak production cycle. Moreover, palm oil demand could be weaker during winter season as palm oil tends to crystalise in low temperatures.

Year-to-date (YTD) September, the average Malaysian Palm Oil Board (MPOB) CPO price was RM2,564 per MT. We are assuming average CPO price of RM2,450 per MT for 2020.

On 30 September 2020, the US Customs and Border Protection (CBP) placed a Withhold Release Order (WRO) on palm oil and palm oil products produced by FGV Holdings (FGV) and its subsidiaries and joint ventures (JVs). According to US CBP's media release, the WRO was issued based on information that reasonably indicates the use of forced labour. In our view, the WRO's immediate impact on FGV's earnings is unlikely to be significant. The US and Canada contributed 5% of FGV's total revenue in FY19.

In FY19, US only contributed 3.8% of Malaysia's total palm oil exports. If US CBP extends the WRO to other plantation companies in Malaysia, we believe that it would have minimal impact on earnings as contribution from the US is relatively small. The KL Plantation Index dipped 3.3% to 6,841 on 2 October after the WRO was announced. However, the KL Plantation Index recovered to 7,075 on 9 October. FGV's share price fell to RM1.01 on 6 October from RM1.15 on 30 September (-12%). It recovered to RM1.07 on 9 October (+6%).

Our top pick for the plantation sector is Kuala Lumpur Kepong (KLK, BUY, target price (TP): RM27.00). We believe that KLK is one of the more efficient palm oil players in the industry and is expected to enjoy higher profits by way of higher CPO prices due to its operating leverage. We also like FGV Holdings (FGV, BUY, TP: RM1.45). Although the group is one of the biggest plantation land owners in the country, it trades at an enterprise value/hectare (EV/ha) of USD9,000, a 57% discount to the average EV/ha of USD21,000 for plantations under our Malaysian coverage, indicating significant improvement potential. We expect the company to focus on cost management measures to maximise profitability. We are optimistic on improvements materialising in 2HFY20 on the back of improved FFB production.

Gloves: Supported by record earnings

Global COVID-19 daily infection rates have increased to new highs and breached above 300k daily cases. Countries such as India, United States and Brazil remain the top three contributors to daily new cases accounting for 21%, 14% and 10% of new cases as of 10 October. Countries such as Malaysia are experiencing a second wave of COVID-19. Compared to the previous H1N1 outbreak, the current COVID-19 pandemic seems more contagious. H1N1 had 491,382 confirmed cases. COVID-19 currently has 37.5m confirmed cases, about 76 times H1N1 levels.

The rising infection rates will likely keep demand for gloves strong and support average selling price (ASP). ASP is set to increase in the near term. Nitrile glove ASP is expected to increase at a stronger quantum compared to natural rubber latex (NR) glove ASP due to the larger shortage of nitrile gloves in the market caused by tight supply of raw materials for nitrile rubber. For instance, Top Glove Corp's (TOPG) nitrile glove ASP is expected to increase 30% m-o-m, 30% m-o-m and 15% m-o-m for September, October and November respectively. Its NR glove ASP is expected to increase 20% m-o-m for September, and 5% m-o-m for October and November respectively.

In the near term, we believe that share prices of rubber glove manufacturers are likely to be supported by robust earnings. Demand for gloves is not likely to taper off immediately if a COVID-19 vaccine is developed. The timeline for sufficient access to vaccines to contain the global pandemic is still uncertain. Even if a vaccine is developed by the end of this year or in early 2021, manufacturing billions of doses will take time. In the long term, even as infection rates ease, we expect COVID-19 to drive increased usage of gloves globally, sustaining a "new normal" of demand.

Telecommunication: Fixed-line players to benefit more from government initiatives
(Analyst: TOH Woo Kim)

Lockdown restrictions due to the Movement Control Order (MCO) have led to a 25-30% q-o-q surge in mobile data usage in 2Q20. But this hardly translates to uplift in mobile operators' earnings given the weak data monetisation and lack of subscriber acquisition activities. Instead, the key beneficiaries were the fixed-line operators that experienced higher demand for wholesale bandwidth and retail fixed broadband in 2Q20. We believe this situation should persist in 2H20, with some improvements expected for mobile operators after the free data initiative of 1GB/day is fine-tuned for selective usages only

The government has announced a new plan called Jalinan Digital Negara (JENDELA) that aims to upgrade the country's digital communications infrastructure under the 12th Malaysian Plan (2021-2025). Phase 1 (2020-2022) will primarily involve: 1) Expansion of 4G mobile broadband from 92% to 97% of population coverage; 2) Faster mobile broadband speed from 25Mbps to 35MBps; and 3) 7.5m premises passed with gigabit fixed broadband access. 3G networks will also be gradually shut down in stages by end-2021. All these should pave the way for 5G introduction and network deployment starting 2022, representing a delay from the original timeline of 2H20 rollout.

The total cost and method of funding for JENDELA are still unclear, but we believe it shouldn't run too far from the RM21.6bn budget for NFCP, with RM10-11bn coming from MCMC's Universal Service Provision fund. Same as before, we believe fixed-line operators will benefit more from JENDELA given its key focus on improving fixed network infrastructure to bring faster broadband speed to consumers (be it mobile or fixed-line).

Our top picks for the sector is TDC and TM. We like TDC for its strong growth momentum and meaningful exposure to the data centre segment (~12% of revenue) that should benefit from higher information technology (IT) spending by enterprises. For TM, we believe the turnaround in the broadband segment (stronger net adds, stable ARPU) will lead to the re-rating of its valuation, which is also the cheapest among Malaysian peers.

Beneficiaries of US-China trade diversion

(Analyst: TOH Woo Kim)

The US-China trade war started the trend of supply chain shifting away from China, mainly to avoid the tariffs imposed on Chinese imports. This has been accelerated further by the COVID-19 pandemic, which has highlighted the need to diversify production networks and supply sources to minimise disruption risks. ASEAN countries, especially Malaysia, are key beneficiaries of this trend. Malaysia is one of the major hubs for the global electrical and electronics (E&E) industry.

This trend is starting to gain traction with Malaysian companies, especially in the semiconductor and electronic manufacturing sectors. For instance, **VS Industry (VSI)** recently secured a new US-based customer, making it the first and only supplier outside of China. Initial production is expected to commence in 2021, followed by a sizeable jump in 2022-2023 volume forecasts - an indication that the US-based customer may be gradually shifting production away from China.

Similarly, the joint venture (JV) between **Inari Amertron (INRI)** and Taiwan-based PCL Technologies is also taking shape, with new production lines and equipment currently being installed at INRI's P34 plant. PCL will be shifting some production of its optical transceiver modules from its China plant to the JV. Another company **PIE Industrial (PIE)** started contract manufacturing for a new customer in 3Q20 as part of its parent company's (i.e. Foxconn) plan to divert some production volume away from China.

Top picks

					P/E		EPS Growth (YoY)		Dividend Yield		Price/ BVPS		ROAE	
	Call	Target Price	Share Price	Market Cap	CY2020	CY2021	CY2020	CY2021	CY2020	CY2021	CY2020	CY2021	CY2020	CY2021
Top Glove	BUY	10.20	8.97	73,000.4	23.2x	16.8x	258%	38%	2.2%	3.1%	9.0x	6.4x	39%	38%
Hartalega	BUY	24.70	17.50	59,983.1	48.4x	34.0x	162%	41%	1.0%	1.4%	18.0x	13.7x	37%	40%
TM	BUY	5.10	4.17	15,735.8	14.4x	13.5x	9%	7%	4.2%	4.5%	2.0x	2.0x	14%	14%
Gamuda	BUY	4.60	3.50	8,797.3	18.2x	12.9x	(16%)	41%	1.4%	2.0%	1.0x	0.9x	5%	7%
TIME dotCom	BUY	14.10	12.20	7,372.0	21.0x	18.8x	(3%)	12%	1.9%	2.1%	1.9x	2.4x	12%	11%
Sunway	BUY	1.85	1.39	6,812.9	14.5x	12.4x	(28%)	17%	4.1%	4.8%	0.7x	0.7x	5%	6%
IJM Corp	BUY	2.20	1.41	5,106.0	23.8x	18.8x	(26%)	27%	1.6%	1.6%	0.5x	0.5x	2%	3%
VS Industry	BUY	2.60	2.39	4,469.4	28.2x	18.4x	19%	53%	1.6%	2.5%	2.5x	2.4x	9%	13%
Magnum	BUY	2.53	2.10	3,018.1	20.3x	12.1x	(38%)	67%	1.7%	4.8%	0.0x	0.0x	6%	9%
Bermaz Auto	BUY	1.65	1.30	1,510.8	11.2x	9.5x	(13%)	18%	9.0%	5.3%	2.9x	2.5x	26%	27%

Based on closing price on 12 Oct 2020
Source: Bloomberg Finance L.P, AllianceDBS

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

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Sources for all charts and tables are AllianceDBS unless otherwise specified.

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