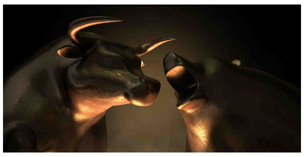
4Q19 Investment Strategy

Turning a Gentle Corner

FBMKLCI	1,597.41
Target	1,642.00 ↓

By Koh Huat Soon / huatsoon@kenanga.com.my

In our last strategy piece – Rain or Shine, the Market Goes On (Jul 2019) – we highlighted that we expected the market to register a turning point sometime during the period between Dec 2018 and Sep 2019. Indeed, we may be finally closing in on a bottom after several quarters of earnings downgrades. And, an expected sequential earnings recovery (albeit mild) in the 2H19 should serve to lift the KLCI in a seasonally strong quarter. We see 7% earnings growth next year on the back of modest commodity price recovery, a pick-up in loan demand post NIM compression at the banks and potentially, a resolution on the US-China trade war. However, anxieties over earnings disappointments, the continuous reduction in Malaysia's weight in major global bond and equity indices and falling interest rates globally, will likely see defensive yield seeking to be the dominant investment style in the near term. We see a mild upside in the year-end target to 1,642 points in the FBMKLCI. Our 4Q19 top picks are ABMB (OP; TP: RM3.45), BAUTO (OP; TP: RM2.75), CARLSBG (OP; TP: RM27.15), CIMB (OP; TP: RM6.45), HARTA (OP, TP: RM5.85), KOSSAN (OP, TP: RM5.25), MISC (OP, TP: RM8.80), MPI (OP; TP: RM12.10), PWROOT (OP; TP: RM2.30), and TAKAFUL (OP, TP: RM6.85).



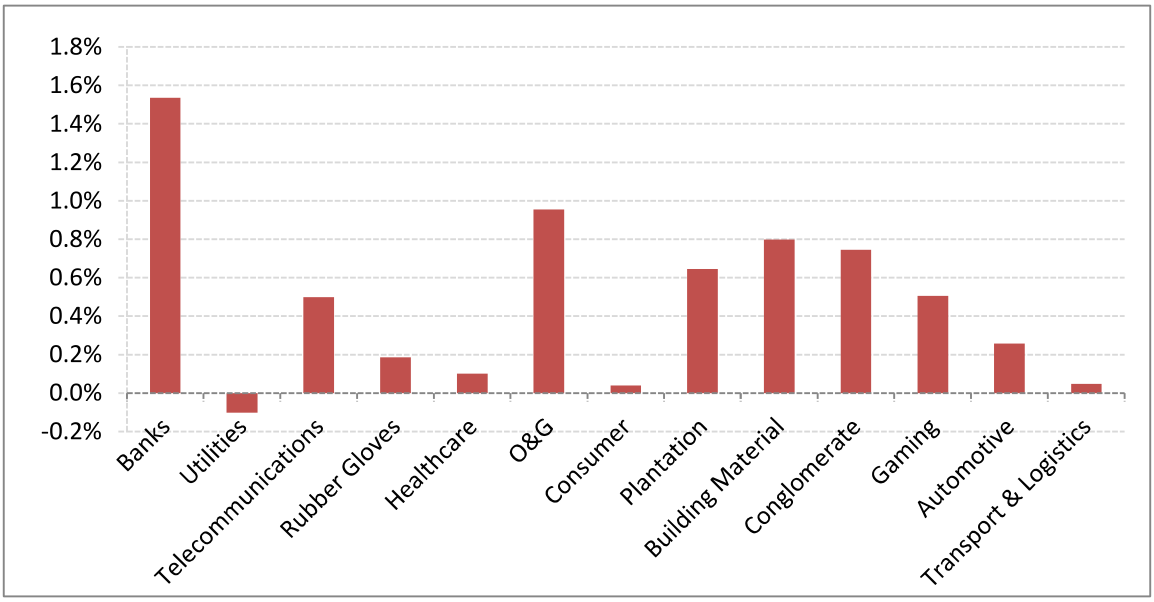
Forward earnings gaining momentum: The 2Q19 earnings report which concluded at the end of August led us to adjust our FY19E/FY20E earnings growth rates to -3.1%/+6.5% from -2.6%/+4.6% in the previous quarter (and compared to current consensus +3.6%/+6.6%). Our earnings expectations are slightly below consensus' 2019 and 2020 estimates by 1.2% each. We expect 2H19 to be better than 1H19 with a sequential earnings growth of 5% driven by among others, higher CPO price of fRM2,100 versus RM1,950 achieved in 1H and higher sequential earnings at some of the larger banks, Given that our earnings expectations are just moderately below that of consensus, we do not expect adverse market impact if earnings track our expectations in the next 3Q reporting season in November.

4Q Market Outlook – Remember, 4Q is a seasonally strong quarter: History shows quite convincingly that 4Q returns tend to be positive. In the past 20 fourth quarters, 14 turned out to be positive quarters versus just 6 negative ones. And, in a generally downbeat year dogged so much by bad news - from concerns over foreign funds outflows due to Malaysia's continually diminishing weighting in major global indices, moribund commodity prices on which Malaysia is dependent, heightened risk of global recession with a resolution to the US-China trade tension seemingly so distant, government debt levels, down to fears of persistently weak corporate earnings, it may not take much to get the market going again. Indeed, the insidious nature of such fears has led the market back down to its 5-year historic mean valuation PE of 15.8x (on 12-month forward earnings) alongside recent earnings downgrades. Based on our individual stocks target prices, our bottom-up constructed target level for the FBMKLCI of 1,687 points sits at 2SD above mean which admittedly, looks rich. Taking the average between current mean value levels of 1,597 and 1,687, we arrive at 1,642 – our year-end target. This level represents 16.3x, or 0.8SD above mean. On consensus earnings, this would be 16.1x. See table below:

	FBMKLCI (points)	2020PE (KNK)	Multiple from mean	2020PE (consensus)	Multiple from mean
Level at 20/9/19	1597.41	15.8x	At mean	15.6x	-0.5x
Bottom-up level	1687.00	16.7x	+2.0x	16.5x	+1.5x
Target level	**1642.00**	**16.3x**	**+0.8x**	**16.1x**	**+0.4x**

A year-end target that is at a premium above mean is justified given that (i) we are in a seasonally strong quarter; (ii) much that ails the market is reflected to some extent in prices which probably makes earnings estimates robust; and (iii) crowding into blue chips – many of which are in the FBMKLCI – should continue in times of heightened uncertainty.

Expect 6.5% FBMKLCI earnings growth in 2020: Coming off a low base, we see a return to growth for the FBMKLCI next year. Except for the utilities sector (on account of lower earnings by Petronas Gas), we see the rest of the component sectors contributing positive growth to the index (see below: sector calls and growth contributions).



Overweight	Banks & Non-Bank Financials↔, Gloves↔ & Technology/Semicon↔.
Neutral	Automotive, Aviation↓, Consumer, Gaming↓, Media, MREITs, Oil & Gas, Plastic Packaging, Ports & Logistics, Property, Telco as well as Utilities.
Underweight	Building Materials ↔, Construction↔, Healthcare↔ & Plantations↔.

3 Key Themes:

1. Seek Shelter In Defensive, Dividend Yielders

In addition to staying defensive and adopting a yield-seeking strategy to wait out this uncertain environment, we advocate a tactical overlay by raising the portfolio beta through an exposure to high beta stocks (i.e. betas greater than one) with downside limited by reasonable low P/NTA ratios.

Stocks with the above characteristics are likely to be resilient against market downturns, exhibit superior relative returns (given above average dividend yields) in the event of prolonged market weakness and outperform on the upside (given high betas) should there be a positive market surprise such as an amicable resolution to the trade dispute. We list below a few stocks which exhibit the aforementioned characteristics on which we have at least a MP (market perform) call.

High Dividend Yielders with High Betas and Reasonably Low P/NTA Ratios:

Stocks	Last Price @ 20/9/19 (RM)	Dividend Yield (%) *	Equity Beta (x) **	P/NTA (x)*	Rating
MALAKOF	0.860	5.6%	1.2	0.72	OP
CIMB	5.02	5.2%	1.3	0.87	OP
AMBANK	4.21	4.9%	1.2	0.67	OP
RHBBANK	5.64	4.4%	1.1	0.90	OP
GENM	3.05	4.1%	1.3	1.1	MP
TENAGA	13.70	4.0%	1.3	0.84	MP
IOIPG	1.18	3.9%	1.3	0.33	OP
MISC	7.75	3.9%	0.9	0.97	OP

*Source: *Bloomberg current year estimates**Bloomberg estimates referenced to FBM100*

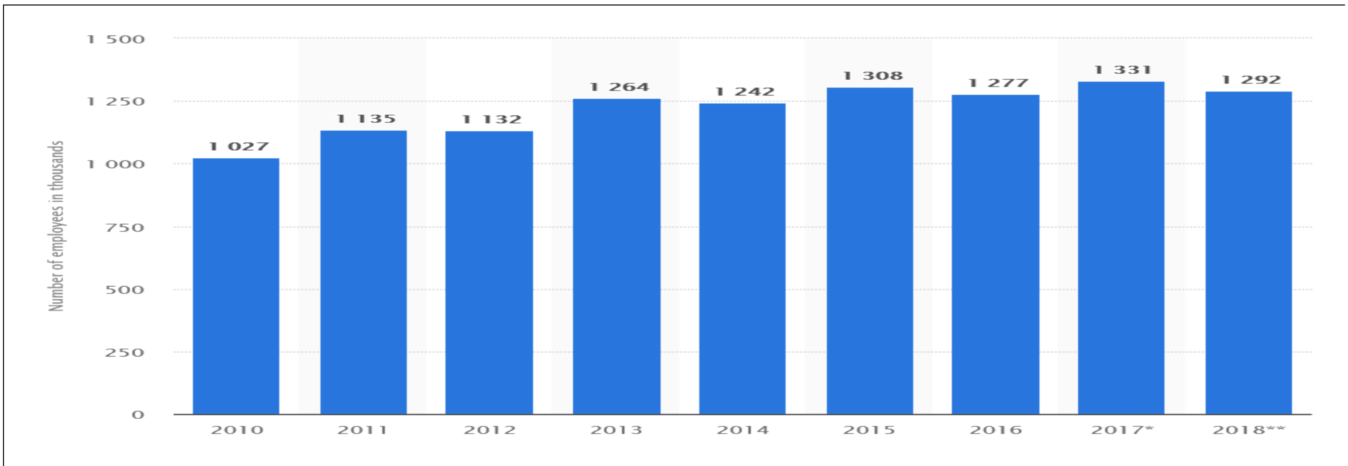
An alternative would be to adopt a barbell strategy by anchoring portfolios with pure high dividend yielders, with an overlay populated by pure high beta plays:

Stocks	Last Price @ 20/9/19 (RM)	Dividend Yield (%) *	Equity Beta (x) **	P/NTA (x)*	Rating
BAUTO	2.27	7.1	0.6	4.33	OP
MAYBANK	8.73	6.5	0.9	1.22	OP
BJTOTO	2.66	6.1	0.8	4.30	MP
MAGNUM	2.86	5.9	0.7	1.67	MP
ABMB	3.07	5.1	0.8	0.77	OP
VELESTO	0.310	0.0	1.7	0.99	OP
AXIATA	4.28	2.4	1.6	2.21	MP
SIME	2.30	4.0	1.6	1.03	MP
GAMUDA	3.55	3.3	1.6	1.13	MP

*Source: *Bloomberg current year estimates**Bloomberg estimates referenced to FBM100*

2. Policy Accommodation to Support Growth – Easy Monetary Conditions and Fiscal Support

For as long as threats of further slowing in growth by prolonged trade tensions remains, the way ahead for policymakers is accommodation by way of fiscal support and keeping monetary conditions loose. We are projecting over 6% increase in total expenditure from RM275.8bn in 2019 (after adjusting for the RM37.0bn tax refund) to RM292.8bn in 2020 during the final year of the 11th Malaysia Plan. We see a pick-up in construction activities after mega-project suspensions since 2H18. Besides the resumption of ECRL, LRT3, Pan Borneo Highway and KVDT2, three projects being closely watched for revival next year are the KL-SG High Speed Rail and the MRT3 while further progress is expected on the Penang Transport Masterplan. On the ECRL alone, 331 local contractors have been shortlisted to tender for RM10bn worth of jobs in 4Q19. This and the resumption of the RM17bn LRT3 bode well for many small and mid-sized contractors which forms a huge source of high margin lending opportunities for the banks. The Johor Bahru – Singapore Rail Transit Link (RTS) project will likely be revived next year as well. SME loans account for about RM320bn or close to 20% of the banking system loans as at 30 June 2019. The construction sector being a major employer in the country contributes a high multiplier impact on the economy.



Source: Statista

There is a lot of value created in the way the construction projects costs were reduced. Never mind that margin is less, it remains nevertheless, a profitable endeavour where the large construction companies are concerned. That development expenditure remains flat in 2020 is not an issue, as the greater amount of economic activity for the same Ringgit invested enlarges the number of stakeholders along the supply chain that will benefit from these investments. Just on the four projects that were resumed on lowered cost namely the ECRL, LRT 3, MRT2 and KVDT2, the amount of cost reduction saved the public RM46bn - nearly one-third of the original costs or the value of one MRT3. Development allocations to future infrastructure projects such as the MRT3 and Penang Transport Masterplan will likely be considered, in our view, under the 12th Malaysia Plan for which the term starts in 2021.

Major Infrastructure Projects Pipeline

Project	Initial Cost (RM'bn)	Revised Cost (RM'bn)	Updates
East Coast Rail Link	65.5	44.0	Calls for civil works tender starts 4Q19 for 331 shortlisted local contractors
LRT 3	31.5	16.6	Resumed in 2H19
MRT 2	39.4	30.5	On-going at reduced cost, completion July 2021
Pan Borneo Highway	33.5	27.0	Phase 1 construction to complete in 2021, Phase 2 to commence in 2020
KVDT2	5.3	4.5	Launched by Transport Minister in Sep 2019
Penang Transport Masterplan	32.0	N.A.	Approvals still pending
KL-SG HSR	110.0	N.A.	Decision by May 2020?
MRT3	45.0	N.A.	On hold. To be reconsidered when fiscal conditions permit

Fiscal Support: There is headroom for back-loaded spending for the rest of 2019

(RM'Million)	2019(B)	1H18(A)	1H19(A)	%YoY	2H18(A)	2H19(I)	%YoY
Revenue	261.8	106.8	125.8	18%	126.1	136.0	8%
Operating Expenditure	259.9	117.8	124.8	6%	113.2	135.1	19%
Current Balance	1.9	-11.0	1.0		12.9	0.9	
Net Development Expenditure	54.0	19.8	23.4	18%	35.5	30.6	-14%
Overall Balance	-52.1	-30.8	-22.4		-22.6	-29.7	

After two MPC meetings in which Bank Negara held rates steady, we see it leaning towards a rate cut in November given the risk of prolonged commodity price weakness and trade tensions. While this will likely lead to another quarter of NIM contraction for the banks, the impact is mitigated by potential gains from treasury holdings and stable credit quality in a low rate environment. We expect the Budget 2020 to contain measures to uplift the B40 households by helping to improve income and skill levels. In its latest Financial Stability Report, Bank Negara reported that exposure to this vulnerable segment stands at 18.5% of total household debt and that the outstanding debt to annual income has crept up to 8.9x currently from 8.8x at the end of 2018. Hence, targeted measures in the Budget to improve the income levels via job creation and up-skilling incentives would be welcomed relief for lenders.

Funding the Government

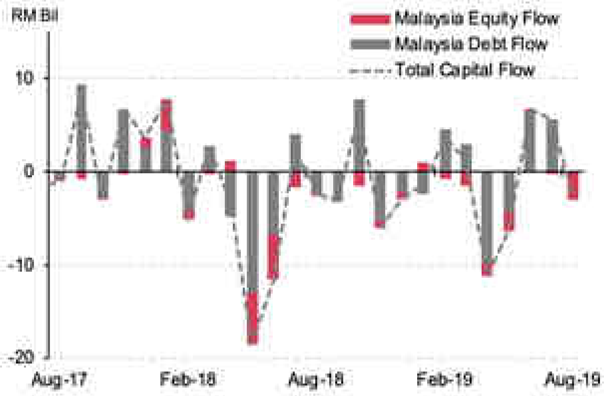
A major challenge as always is funding the projects while keeping the budget deficit within targets. For the government it may well be a case of jump starting the creation of a virtuous circle which involves enlarging the GDP via increased private sector enterprises activities rather than consumption and property led growth of the past. Besides tax revenues, the government will likely consider asset sales and encourage high dividend pay-outs by GLCs. We list below some of the GLCs with under-geared balance sheets and estimated expected dividend yields:

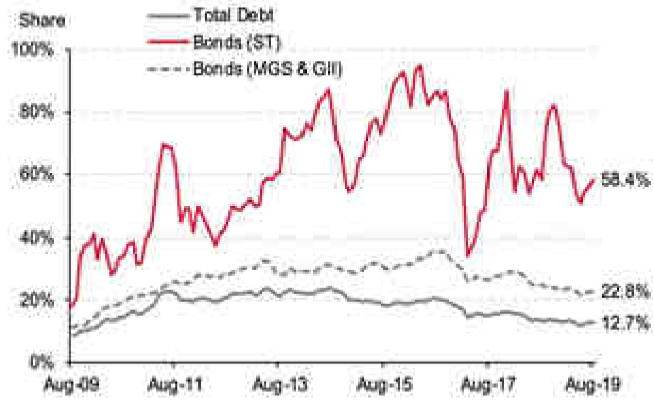
GLC	*Net Gearing (x)	*Dividend Payout (%)	Dividend Yield (%)
Petronas Dagangan	(0.4)	82%	3.1%
Petronas Chemcial	(0.4)	51%	3.2%
Gas Malaysia	(0.2)	96%	4.9%
Sime Darby	(0.1)	88%	4.1%
Petronas Gas	(0.0)	79%	4.3%
IHH	0.1	39%	0.5%
MISC	0.2	102%	3.8%
Sime Property	0.2	53%	3.1%
Tenaga	0.5	80%	3.9%
CIMB	N.A	42%	5.2%
Maybank	N.A	78%	6.6%

3. Near term MYR Weakness to Persist

The decision by FTSE Russell to retain Malaysia in the WBGI on 26 Sept is a welcome respite as it provided at least a temporary relief for the MYR currency market. We say ‘temporary’ because Malaysia remains in the watch-list and hence vulnerable to exclusion in the March 2020 review. Even if it remains in the WBGI, we fear that Malaysia’s weight – currently at 0.4% - might be reduced if China were to be included next. Based on an estimated US$2trn in value of funds that track the WGBI, each 0.1% drop in weight translates to US$2bn potential outflow. This represents about 2% of total MGS issuance. This and Malaysia’s phased reduction of 0.1% in the JPM GBI-EM index effective Feb 2020 serve as overhang weighing on the MYR. And, for as long as the US-China trade relations remain tense, regional currencies are likely to be capped by the Yuan weakness.

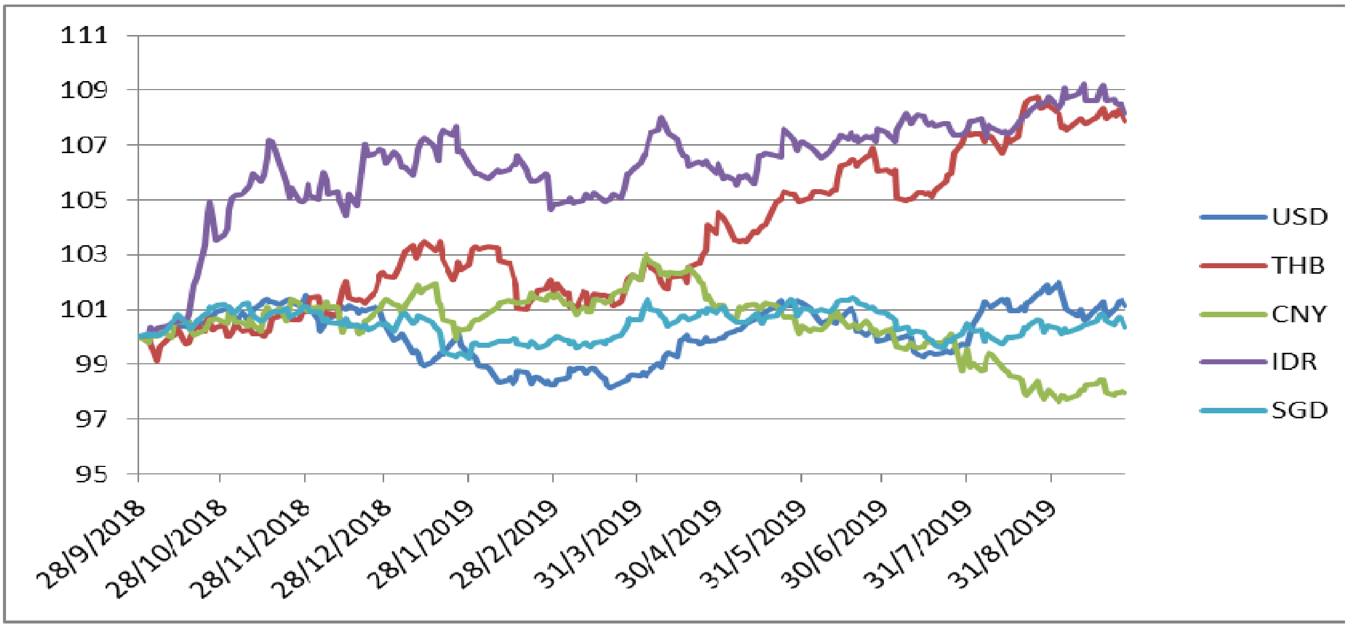
Year-to-date, there has been an outflow of foreign equity funds and likely to remain so in the near term. The largest outflow in 14 months was charted in August (RM2.8bn versus just RM0.1bn) at the height of worsening US-China trade tension. Including bond flows, the capital market collectively experienced its first outflow of foreign funds in three months amid a weaker MYR and growing tensions in US-China trade relations.





Our economics team is projecting the MYR to end the year close to 4.20 to the USD and average 4.15 for 2020 – an improvement from current levels but still weak nonetheless. The beneficiaries of the weak MYR are the Rubber Gloves and Tech – two sectors that we have Overweight recommendations on.

The other play on the MYR weakness would be tourism. Tourist arrivals in the 1H19 have been encouraging with 13.4m arrivals that represent nearly 5% YoY growth. The Tourism, Arts and Culture Ministry is working towards achieving a target of 30m tourist arrivals that is expected to generate around RM100bn in income under the Visit Malaysia 2020 campaign. A successful campaign would have appreciable flow on benefits to employment, F&B, hospitality, retailers, airports and airline operators when one considers that tourism contributed around 15% of the country’s GDP in 2018. The weak MYR is also expected to encourage more domestic tourism as locals will likely be deterred by more expensive holidays abroad. Except against the CNY, MYR has weakened against currencies of major visitors in the past year.



Source: Bloomberg

Lightening up the mood in 2020 are the Euro 2020 and the Tokyo Olympics. While the Euro 2020 will be a one-month event from 12th June to 12th July, the Olympics follows soon after, from 24th July till 9th August. As has been the case, expect booze consumption to spike up in 3Q20 to the benefit of the likes of Carlsberg and Heineken. Between the two, our preference is clearly for Carlsberg as it continues gaining market share not just over the other but against the illicit market too (thanks to effective measures by the authorities). And topping this is a consistent dividend yielder that gives 4% on the current price.

<u>In Which Sectors are the Returns?</u>

In keeping to the three major themes and after assessing our individual stocks' target prices against current prices, we find that the outperformers are likely to be found in the following sectors:

Banks: High dividend yielders are well represented in this sector. Banks are well capitalised, and as regulatory capital are sufficiently robust, it is reasonable to expect dividends to be maintained if not increased in the coming year. While NIMs may come under pressure again with the likelihood of another cut in OPR, potential gains in treasury holdings and stable asset quality in a low rate environment are mitigating factors. Compelling valuations where Price-to-Book ratios are below historical means have more than discounted concerns over declining ROEs in our view. Our top picks are **CIMB (OP; TP: RM6.45)** and **ABMB (OP; TP: RM3.45).**

Rubber Gloves: A beneficiary of the weak MYR, earnings growth will be led firstly, by higher ASPs as the pace of new industry capacities coming on-stream had been less than initially feared and secondly, on expected trade diversion sales as the US switches purchases away from China after a 15% tariff imposed on medical and vinyl gloves in September. The last quarter's margin squeeze as a result of rise in latex cost should recover as there is typically a time lag in cost pass through. Our top picks are **HARTA (OP; TP: RM5.85) and KOSSAN (OP, TP: RM5.25).**

Food & Beverages: Stable employment, prospects of lower interest rates and supportive government policy via a consumer friendly Budget 2020 are reasons to be bullish on the sector. Expectations of higher tourist arrivals and increased domestic tourism as a result of a weak MYR should also help boost consumption. Our top picks are **CARLSBG (OP; TP: RM27.15)** and **PWROOT (OP; TP: RM2.30).**

Technology: The environment looks encouraging for a recovery as the outlook for smartphones and automotive segments are improving, while valuations have remained undemanding. As our semiconductor players' prospects are more closely tied to North American and Korean smartphone manufacturers, they are relatively shielded from the misfortunes of the Chinese manufacturers. Here our top pick is **MPI (OP; TP: RM12.10).** And, there are early signs of a long awaited auto sales recovery (a huge market for electronics chips) in Europe and China. Our top picks are **D&O (OP; TP: RM0.625)** and **KESM (OP; TP: RM8.70).**

Appendix

4Q19 Top 10 Stock Picks (Closing as at 20 Sep 2019)

Stocks	Last Price (RM)	FY19/20 Core NP Growth	FY20/21 Core NP Growth	FY19 /20 Core PER	FY20/21 Core PER	FY19/20 Net Div Yield	FY19/20 ROE	Target (RM)	Upside	Rating
ABMB	3.07	-1.5%	10.9%	9.0	8.1	5.3%	9.0%	3.45	12.4%	OP
BAUTO	2.27	-16.4%	16.7%	11.9	10.2	7.0%	34.0%	2.75	21.2%	OP
CARLSBG	25.50	5.4%	4.8%	27.0	25.7	3.9%	173.9%	27.15	6.5%	OP
CIMB	5.02	-18.9%	-0.7%	10.4	10.5	4.5%	8.5%	6.45	28.5%	OP
HARTA	5.26	11.6%	6.7%	34.1	31.9	1.3%	21.2%	5.85	11.2%	OP
KOSSAN	4.21	23.7%	6.0%	21.7	20.4	1.4%	17.7%	5.25	24.7%	OP
MISC	7.75	31.2%	5.3%	20.1	19.1	3.9%	4.9%	8.80	13.6%	OP
MPI	9.11	25.4%	4.6%	10.8	10.3	3.6%	18.1%	12.10	32.8%	OP
PWROOT	2.05	44.3%	12.6%	20.0	17.8	4.4%	12.2%	2.30	12.2%	OP
TAKAFUL	5.92	23.9%	4.4%	13.3	12.8	3.2%	33.3%	6.85	15.7%	OP

Source: Kenanga Research
Note: Please refer to Figure 4 for brief comments on Top picks.

Figure 1: Overweight Sectors

Sector	Sector Call Changes	Brief Comments	Stock Calls/Ratings
Banks and Non-Bank Financial Institutions	**Maintain**	• While viewing the sector as challenging due to external uncertainties, we are inclined to maintain **OVERWEIGHT** due to undemanding valuations plus potential total returns >15%, expecting clarity post Budget 2020 and accommodative interest rates supporting loans growth. • With employment expected to remain stable, external headwinds are raising concerns on credit demand and asset quality. Hence, our view on selective asset growth still holds; we do not expect any changes in such strategy in light of concerns regarding external risks ahead. Furthermore, we do not anticipate deterioration in asset quality as the banks' loan loss provisions and impairment allowances are stable given the stable economy. The stable domestic economy and employment are expected to support a normalised credit costs for 2019 coupled with accommodative interest rates paving the way for the banks to more likely adopting a riskier appetite given their stable asset quality. At present, positive/stable economic outlook (on the home front) coupled with low unemployment is backing resilient household spending and supporting loans growth with a recent interest rate cut looking to bolster credit demand and lower credit charge. • Most of the stocks' valuations in our banking universe are undemanding; hence, being rated at **OUTPERFORM** with only HLBANK at **MARKET PERFORM.** Valuations are undemanding as most of stocks in our banking universe are trading at their 5-year mean PBV. We raised **BIMB and PBBANK to OUTPERFORM** given their operational efficiency (PBBANK) and receding risk of share dilution (BIMB). **Our Top Pick for the sector is ABMB and CIMB.** We like CIMB due to: (i) its potential corporate loan traction both in Malaysia and Indonesia given the	**OP:** AFFIN (TP: RM2.45) ABMB (TP: RM3.45) ***– Top Pick*** AMBANK (TP: RM4.75) BIMB (TP: RM4.80) CIMB (TP: RM6.45) ***– Top Pick*** MBSB (TP: RM1.10) MAYBANK (RM9.70) PBBANK (TP: RM25.20) RHBBANK (TP: RM6.05) TAKAFUL (TP: RM6.85) ***– Top Pick*** **MP:** BURSA (TP: RM6.85) HLBANK (TP: RM17.30) LPI (TP: RM16.50) **UP:** AEONCR (TP: RM13.00)

		impetus of fiscal spending ahead, and (ii) stable asset quality motivating higher appetite or riskier loans. For ABMB, its cheap valuation means M&A potential with a main prize is its SME loan book. • **TAKAFUL** is our top pick within the NBFI space, as the stock offers the strongest book (ROE: 30% vs industry average 20%). While topline growth may taper with its bancassurance partnership with Bank Rakyat reaching maturity, continual efficiency works should keep profitability buoyant.	
Rubber Gloves	**Maintain**	• Our investment case is based on: (i) our analysis that the new capacity expansion industry-wide is slower-than-expected, which should help maintain the supply-demand equilibrium, (ii) expected earnings growth driven by new capacity expansion and higher ASPs, and (iii) US-led uptick in demand due to trade war where the US accounts for between 25%-50% of glove players group sales. • Due to the impact of trade war whereby effective Sept 1, a 15% tariff will be imposed on Chinese-made medical and vinyl gloves, local rubber glove players expect to see an uptick in demand for gloves of which the positive impact is expected to be felt from the Dec-ending quarter period. • Looking ahead, the keen competition in the latex segment could negatively impact latex gloves margin. The robust demand for nitrile gloves has led to longer delivery lead times to between 45 to 50 days as compared to 30 to 40 days previously. • Investors should focus on nitrile-centric players. Due to the intense competition in the latex segment, we recommend players which are largely nitrile-centric including HARTA and KOSSAN which product mixes hinge largely towards nitrile • Our Top Pick in the sector is HARTA (OP; TP: RM5.85). We like HARTA for: (i) its "highly automated production processes" model, which is moving from 'good' to 'great' as they are head and shoulders above peers in terms of better margins and costs reduction, (ii) constantly evolving via innovative products development, and (iii) its nitrile gloves segment, which is booming.	**OP:** HARTA (TP: RM5.85) – ***Top Pick*** KOSSAN (TP: RM5.25) – ***Top Pick*** SUPERMX (TP: RM1.75) **UP:** TOPGLOV (TP: RM4.00)
Technology / Semiconductor	**Maintain**	• **Smartphone segment regaining limelight.** We see trading interests potentially returning to the smartphone space within the semiconductor industry in 4Q19 as outlook turns positive. The launch of iPhone 11 series coincides with smartphone replacement cycle of 2-3 years (Note: 2016 and 2017 iPhone generations did remarkably well). According to Reuters, JD.com said that pre-orders for the iPhone 11 series skyrocketed 480% compared to last year. • **Huawei Android ban to lend support.** Less tech-savvy and conservative customers may gravitate toward, inter alia, Apple or Samsung to avoid the inconvenience of not being able to use Google services. This has positive implications for our local semiconductor players as their prospects are more closely tied to the Korean and North American smartphone players. • **Light at the end of the tunnel for the automotive market**. In Europe, passenger car registrations have already seen positive growth in July 2019 (+1.4% YoY). Going forward, we believe passenger car registrations would start picking up, especially considering the low bases in September-December 2018. Meanwhile, in China, passenger vehicle sales are likely to return to the	**OP:** D&O (TP: RM0.625) KESM (TP: RM8.70) MPI (TP: RM12.10) – ***Top Pick*** SKPRES (TP: RM1.15) **MP:** PIE (TP: RM1.20) UNISEM (TP: RM2.15)

		growth trajectory post-conclusion of the VI emission standards in July 2019, further boosted by a series of friendly policies such as tax cut for rural consumers, fees reduction and lifting of licence plate quota in Guangzhou and Shenzhen. • **5G to be valuation kicker.** We look forward to more commercial launches of 5G worldwide as it will not only drive the offtake of existing products (especially those relating to data infrastructure, radio frequency and sensors) but also lead to the creation of new/next-generation products and services. With the ban on Huawei "somewhat" lifted, the 5G rollout could potentially progress as planned, thus resuscitating the sentiment in the technology sector. • **Reiterate OVERWEIGHT stance on the technology sector.** Overall, with a potential turn of the tide in the technology sector, while current valuations remain undemanding, we reckon it is opportune to revisit the technology sector. We select MPI (OP, TP: RM12.10) as our top pick. Catalysts are: (i) positive earnings momentum (1Q20 potentially QoQ growth on new product introductions; 2Q20 likely further boosted by contributions from multiple newly acquired customers for Suzhou plant), (ii) potential re-inclusion into the Shariah-compliant list in November and (iii) unjustifiably low ex-cash PER of 6x.	

Source: Kenanga Research

Figure 2: Underweight Sectors

Sector	Sector Call Changes	Brief Comments	Stock Calls/Ratings
Building Materials	**Maintain**	• **UNDERWEIGHT** outlook on Building Materials maintained. • **Below expectation**. Overall, 2Q19 results for all the four counters under our coverage came in below expectation, the negative deviation largely due to: (i) higher-than-expected raw materials and production cost, (ii) lower-than-expected selling price or margin, and (iii) weaker demand from construction and property markets. • We opine that outlook for 3 counters under coverage, ANNJOO, ULICORP and WTHORSE remain challenging in view of: (i) softer domestic demand, (ii) higher raw materials and production cost, and (iii) depressed margin resulting from lower average selling price or intensive competition in the market. • While for PMETAL, we noted alumina prices have normalised to USD300/MT, bringing down YTD average by 17% to USD383/MT, we gather that shipments of high-cost alumina should spill over to the greater part of 3Q19. Hence, the benefit of the drop in alumina prices should only be fully felt from 4Q19 onwards. Looking ahead, we expect the group to register sturdy earnings growth in FY20-21 on the back of 42% smelting capacity expansion, cheaper alumina prices and rising sales composition of high-value products (i.e. billet and wire rod). • All-in, we reiterate our calls on PMETAL (OP; TP: RM5.50), ANNJOO (UP; TP: RM1.10), ULICORP (UP; TP:RM0.400) and WTHORSE (UP; TP: TM1.00)	**OP:** PMETAL (TP: RM5.50) **UP:** ANNJOO (TP: RM1.10) ULICORP (TP:RM0.400) WTHORSE (RM1.00)

Construction	**Maintain**	• Reiterate **UNDERWEIGHT** on construction sector due to its unexciting outlook. • Year-to-date, listed companies clinched total RM10.1b, (-9%, YoY) worth of projects. • Maintain our view that contract flows in 2HCY19 could be slower than 1HCY19 if contract awards from KVDT and ECRL commences in 2020, bringing total awards to <RM16.0b for 2019. • Budget 2020 is highly anticipated in which we hope that the government will revive mega infrastructure projects like MRT3 and High-Speed-Rail.	**<u>OP:</u>** GKENT (TP: RM1.15) KIMLUN (TP:RM1.35) MUHIBAH (TP:RM3.20) **<u>MP:</u>** GAMUDA (TP:RM3.75) HSL (TP:RM1.40) **<u>UP:</u>** IJM (TP:RM1.80) KERJAYA (TP:RM1.20) MITRA (TP:RM0.200) SUNCON (TP:RM1.45) WCT (TP:RM0.815)
Plantation	**Maintain**	• **Stockpiles to rise, exerting pressure on CPO price**. We believe CPO prices will remain under pressure in 4Q19, potentially trading in the range of RM1,900-2,200/MT and averaging only RM2,000/MT in 2019, as stockpiles in both Indonesia and Malaysia are picking up. • **ENSO neutral conditions not helping.** In July, sea surface temperatures (SST) in the tropical Pacific Ocean returned to ENSO-neutral levels (0.1-0.5°C above average SST) and current signs are indicating that the neutral conditions will sustain through to November 2019 with a 60% probability. Moving forward, with neutral conditions to reign and minimal impact from the previous weak El Niño, production is unlikely to be affected and should continue its growth trajectory. • **EU's proposed ban dampens excitement.** Additionally, while biodiesel mandates seem to be panning out well (expected to absorb c.11% of CPO production in Indonesia and c.4% in Malaysia), the EU's regulation to limit palm oil consumption for biofuel use at 2019 levels up to 2023, with further gradual reduction through 2030 until an eventual phase-out dampens prospects. • **Valuations remain unattractive.** Planters under our coverage are currently trading at, on average, -1.0SD (range: -2.0 to +1.0SD) from their respective mean PER/PBV. Notwithstanding, we believe the current valuations are still unwarranted as the companies were mostly trading at -2.0SD in 4QCY18, during which CPO price was hovering around RM1,700-2,100/MT (similar to the current situation). • **Reiterate UNDERWEIGHT** on the plantation sector with an unchanged 2019 CPO price target of RM2,000/MT.	**<u>MP:</u>** CBIP (TP: RM0.850) FGV (TP:RM0.945) HSPLANT (TP: RM1.50) IJMPLNT (TP: RM1.50) IOICORP (TP: RM4.10) TAANN (TP: RM2.20) TSH (TP:RM0.900) UMCCA (TP: RM5.00) **<u>UP:</u>** GENP (TP: RM8.80) KLK (TP: RM21.50) PPB (TP: RM15.60) SIMEPLT (TP: RM4.00) SAB (TP: RM2.90)
Healthcare	**Maintain**	• We maintain our UNDERWEIGHT rating on the sector which is expected to be dull in terms of earnings growth and further capped by expensive valuations. • Overall, we still believe that the healthcare industry will continue to enjoy stable growth supported by the growing healthcare expenditure, rising medical insurance and an aging population demographic. The latest 2QCY19 results season saw a mixed bag of results. KPJ and Pharmaniaga's earnings came in line with expectations. However, IHH's 1HQ19 earnings were impacted by lacklustre performance from Acibadem and widened losses in its India operation. • **KPJ's valuation appears to be attractive again, Reiterate OP.** We like KPJ because: (i) start-up costs	**<u>OP:</u>** KPJ (TP: RM1.15) **<u>MP:</u>** PHARMA (TP: RM2.35) **<u>UP:</u>** IHH (TP: RM4.85)

		from new openings will be absorbed by incremental ramp-ups from earlier openings and steady contributions from matured hospitals, and (ii) the stock is currently trading at 20% and 40% discount compared to historical average of 27.5x and regional peers of 35x, respectively.	

Source: Kenanga Research

Figure 3: Neutral Sectors

Sector	Sector Call Changes	Brief Comments	Stock Calls/Ratings
Automotive	**Maintain**	• **The MIER consumer sentiment index scored 93.0 pts (+7.4pts QoQ, -39.9pts YoY) in 2Q19** which is below the optimistic threshold (>100 pts) due to muted growth post the zero-rated tax holiday. • Reflecting this, we are seeing car sales trending in favour of value-for-money national marques. • Non-national marques on the other hand, are focusing on higher-margin lower-volume models (catering to higher purchasing power consumers). • **Looking forward to 2H 2019,** vehicles sales volume for 3Q 2019 is expected to be weaker than 2Q 2019 in the absence of festivities, and due to the higher base for Hari Raya Aidilfitri promotional activities. • Nonetheless, we expect 4Q 2019 sales to make up for the rest of the year, boosted by the usual year-end promotion as well as the anticipation of another cut in Base Lending Rate (BLR) by 20-25bps (in November 2019), to meet our year-end target of 600,000 units, in-line with MAA's target. • Our sector top-pick is BAUTO (OP; TP: RM2.75) which offers a steady dividend yield of 7.2%.	**OP:** BAUTO (TP: RM2.75) – ***Top Pick*** **MP:** DRBHCOM (TP: RM2.60) MBMR (TP: RM4.40) SIME (TP:RM2.20) TCHONG (TP: RM1.40) UMW (TP: RM5.45)
Aviation	**Downgrade**	• We downgrade Aviation from OVERWEIGHT to NEUTRAL. While we like Malaysia Airports Holdings Berhad (MAHB) as an attractive play on the propensity for air travel in the region due to rising per capita income, the stock has risen 32% over a 52-week period and is currently trading at rich valuations of 27x on FY19E earnings and 21x on FY20E earnings. However, there is potential earning or rating upgrade catalysts upon the release of the final consultation paper on the implementation of RAB in early October. Separately, AirAsia is expected to face near-term tough operating environment of intense competition, higher operating costs due to the sale-and-lease-back of aircrafts and sustained high jet fuel price over the medium term. • **Tough operating environment for AirAsia.** The group expect load factors to remain solid and fares to hold steady in 2H19. There are nascent signs indicating that higher supply of seats is potentially outstripping passenger demand growth which are leading to competitive fare war. Recall, 2Q19 load factor was commendable (2Q19 load factor at 85%, versus 86% in 2Q18). However, the higher supply of seats, coupled with competitive pressure have capped AirAsia's RASK (revenue per ASK) growth at 4% YoY, which far trailed the 15% growth in CASK (cost per ASK). Separately, we expect a tough operating environment over the short to medium term due to the sustained high jet fuel price (accounts for 40% of total cost) and its planes are now leased vs. owned previously. We note that the maintenance costs spiked up in 2Q19 (+105% YoY) due to accounting treatment for the aircrafts under sales and leaseback arrangements which also	**MP:** AIRASIA (TP: RM1.70) AIRPORT (TP: RM8.70)

		contributed to the hike in CASK. As such, we expect tough operating environment to persist over the medium term. We expect maintenance cost to be higher in 2H19 upon gradual disposal of the group's remaining 39 aircrafts as at June 2019 to 5 by end 2019. • **Malaysia Airports Holdings Berhad (MAHB) is well-entrenched** because (i) of its monopolistic position as an airport operator in Malaysia, while (ii) earnings downside in the aeronautical segment under the operating agreements is protected. The government of Malaysia and MAHB signed operating agreements on 12 February 2009 which provide a framework for the airport operations. A key component under the operating agreements lies in the Marginal Cost Support Sums (MARCS) system which would compensate MAHB for reduction in aeronautical (Passenger Service Charge or 'PSC') resulting in PSC rate being lower than the benchmark rate as per the OA due to governmental instructions. MAHB continues to register steady passenger traffic (including ISG) growth of 7.5% for YTD 8M19 (+9.2% for Malaysian operation and +3.1% for Turkey operation YoY-Ytd), which we believe is on track to meet our target of 4.3%.	
Consumer	**Maintain**	• **We reiterate our NEUTRAL rating on the consumer sector.** • We are cautiously optimistic that consumer sentiment, and by extension, our F&B and Retail players, will be resilient against economic challenges • This is premised on; (i) sticky demand for our consumer staples, evidenced by minimal negative impact to sales amid passive government policies (i.e. SST and sugar tax), (ii) stable job conditions, (iii) potential lower interest rate environment with our inhouse forecast putting a 75% probability of another rate cut by 25 bps to 2.75% in November, and (iv) expectations for a consumer friendly Budget 2020. • Nonetheless, the lacklustre Ringgit outlook, which could spell further pressure on discretionary spending, remains a concern. • For 4Q19, we continue to like **PWROOT (OP; TP: RM2.30)** as it continues to deliver strong growth numbers, reaping the benefits of its on-going rationalisation efforts. **CARLSBG (OP; TP: RM27.15)** for its rosy growth trajectory of its premium beer portfolio which fetches 7% FY20E CAGR, ahead of HEIM's 5%. Both our top picks carry stable dividend yield of c.4%, which offer some measure of defence amidst the current market volatility.	**OP:** AEON (TP: RM1.70) BAT (TP: RM23.10) CARLSBG (TP: RM27.15) – ***Top Pick*** PWROOT (TP: RM2.30) – ***Top Pick*** PADINI (TP: RM4.35) PARKSON (TP: RM0.270) MYNEWS (TP: RM1.55) **MP:** AMWAY (TP: RM5.90) F&N (TP: RM36.60) HEIM (TP: RM23.25) SEM (TP: RM1.35) SPRITZER (TP: RM2.40) **UP:** DLADY (TP: RM54.60) HAIO (TP: RM1.95) NESTLE (TP: RM128.00) QL (TP: RM6.30)
Gaming	**Downgrade**	• **No longer attractive,** cut to Neutral. Not as exciting as before as the acquisition of Empire has impacted GENM badly and GENTING as well. NFO players are fairly priced for now following a commendable rally of 47% and 26% YTD for MAGNUM and BJTOTO, respectively, as enforcement clamping down on illegal operators boosted ticket sales. Positively, NFOs still offer above average yield of 4-5%. • **Casino: RPT a key sentiment dampener,** as the loss-making Empire needs capital injection for debt restructuring which will suppress sentiment for GENM further. It may pay RM1.6b to own 49% stake in Empire eventually. While the Empire transaction is affecting GENTING as well, valuation	**OP:** GENTING (TP: RM6.75) **MP:** BJTOTO (TP: RM2.80) GENM (TP: RM3.20) MAGNUM (TP: RM2.80)

		for GENTING remains attractive which trades at 50% discount to its SoP while positive sentiment may also arise from the legalising of casino in Japan. • **NFO: ticket sales remain upbeat.** Meaningful improvement in ticket sales was seen in the past few quarterly results as enforcement have been clamping down on illegal operators. In fact, the latest quarterly results showed solid average ticket sales per draws albeit seasonality decline post-CNY effect. Overall ticket sales are expected to come off in the near term given the reduction in special draws. • **A year-end peak quarter ahead,** especially for the casino operators expected to enjoy better business volume, while NFO may not have year-end peak season but the continuous clamping down on illegal operator will help to boost ticket sales which will benefit NFO players.	
Media	**Maintain**	• **Reiterate our NEUTRAL call for the sector**, given the on-going industry structural issue. Coupled with the (i) continual digital disruption, (ii) weak on-going consumer sentiment, and (iii) lack of key sporting events, we do not expect an uptick in total national gross adex. • **Minimal impact from analogue switch-off (ASO),** to MEDIA and ASTRO in the FTA-TV and Paid-TV offerings respectively. This is due to the bite size contribution from MEDIA's transmission cost of 6-8% of the group's total direct cost. Meanwhile, we believe ASTRO's free set-top boxes NJOI would still appeal to customers with its wider range of 30 freemium TV channels, 20 radio channels and flexibility to opt for premium content. • **ASTRO (OP, TP: RM2.00) remains our preferred pick** driven by its resilient earning and cheap valuation, given that it is trading at FY20E PER of 10x vs. our media coverage average of 15x. In addition, we continue to like its attractive dividend yield (>7%). • Amid the on-going industry structural issue, we see media players ramping up their effort in search of new revenue streams. However, further gestations are required before meaningful contribution can be seen. With that, we have MARKET PERFORM call on MEDIAC (TP: RM0.165) and STAR (TP: RM0.570) as we believe that the negatives have been largely priced in. Meanwhile, we keep our UNDERPERFORM call on MEDIA (TP: RM0.260) as we expect losses to continue as OPEX are high at current level.	**OP:** ASTRO (TP: RM2.00) **MP:** MEDIAC (TP: RM0.165) STAR (TP: RM0.570) **UP:** MEDIA (TP: RM0.260)
MREITs	**Maintain**	• **Stable but unexciting fundamentals.** All MREITs results have met expectations but fundamental outlook remains unexciting given the oversupply of office, retail and even hotel spaces in the Klang Valley. We expect low single-digit or flattish due to oversupply concerns in the retail, office and hospitality segments. All in, FY19 will see c.21-53% leases up for expiry for MREITs under our coverage, but we do not expect strong earnings growth, targeting menial FY19-20E DPU growth of 1-2%. • **Industrial segment the only bright spot.** We favour industrial assets due to the long-term leases c.6-10 years (vs. 2-3 years for retail and office) while reversions are on par with other asset classes (i.e. low to single-digit), providing earnings stability over a longer term. • **We lower our 10-year MGS target to 3.40%** (from 3.70%) on increased demand for bonds in light of constant market uncertainty, and are relieved for now on FTSE Russell's decision to maintain Malaysia in the World Government Bond Index (WGBI). Additionally, we lowered our spread for	**OP:** AXREIT (TP: RM2.00) CMMT (TP: RM1.15) **MP:** MQREIT (TP: RM1.05) IGBREIT (TP: RM2.05) KLCC (TP: RM8.25) PAVREIT (TP: RM1.90) SUNREIT (TP: RM1.90)

		more stable MREITs (IGBREIT and AXREIT) and increased our spreads for REITs facing YoY declines (CMMT and MQREIT). • **Maintain NEUTRAL.** All in, we increase MREITs TP's by 0-14%. Maintain NEUTRAL as we have accounted for most foreseeable upsides while MREITs under our coverage are offering average gross yields of 5.5% which we as deem decent**.**	
Oil & Gas	**Maintain**	• **Brent crude stabilising at current price range.** Brent prices have been trading within the USD55-70/barrel range throughout most of the 2019, barring some occasional up and down spikes. In recent weeks, drone strikes in Saudi Aramco's refineries affected about half the country's oil output, igniting a sharp albeit temporary surge in Brent crude prices to as high as USD69/barrel mid-last month. However, the quicker-than-expected restoration of production, on top of maintaining export volumes using spare inventories and production capacity quickly put a firm halt on the surge. That said, OPEC and Russia's continued compliance towards self-imposed production cuts have helped eased supply-side worries, with the U.S.-China trade war tensions causing greater demand-side concerns. Overall, we maintain our projected 2019-2020 average Brent price assumptions at USD65/barrel. We believe this price range to be relatively comfortable for oil majors to commit to higher investments. • **Investments in upstream expected to recover.** On the back of gradually steadying oil prices, we expect to see greater investments in the upstream space for the coming years. Locally, despite already committed to higher dividend pay outs in 2019, Petronas has maintained its higher capex spending guidance, with increased focus on upstream. Globally, we have also witnessed increased flow of engineering/construction jobs from the Middle-east and floater demand have jumped rapidly from South America. • **Improvement in local contract flow.** Meanwhile, local players have also starting to see uptick of contracts flow in the past 4-5 quarters. As expected, the newer jobs mainly came from the upstream space, such as floaters, fabrication and drilling. While this can be seen as a clear sign of a bottoming-out, we note that the recovery process could be long and gradual, with many of the local players still plagued with earnings uncertainties and balance sheet constraints, all while cost optimisation still remains a key theme for new job tendering. • **Maintain NEUTRAL.** Despite a slightly more optimistic undertone, we continue to remain NEUTRAL towards the sector, given limited upside to Petronas-linked counters. Nonetheless, while traders could find some value in heavily discounted stocks within the upstream space (e.g. SAPNRG, MHB), we would still be selective with our stock picks for a long-term investment approach, favouring more defensive names with stable dividends, clear earnings delivery coupled with a palatable balance sheet. **Top picks for the quarter include MISC and SERBADK.**	**OP:** DIALOG (TP: RM4.15) MHB (TP: RM1.05) MISC (TP:RM8.80) ***– Top Pick*** PANTECH (TP: RM0.69) SAPNRG (TP: RM0.33) SERBADK (TP: RM5.25) VELESTO (TP: RM0.35) YINSON (TP: RM7.75) **MP:** DAYANG (TP: RM1.45) PCHEM (TP: RM7.70) PETDAG (TP: RM22.45) UZMA (TP: RM0.61) WASEONG (TP: RM0.62) **UP:** ARMADA (TP: RM0.20)
Plastics and Packaging	**Maintain**	• **Mixed results.** Plastic packagers' results were mixed with three below (SCGM, TOMYPAK and SCIENTX), and two within (SLP and TGUAN), worst off than 1Q19. • **Focused on ramping up utilisation.** Plastic packagers have been focusing on capacity expansion over the past three years, and are now focused on ramping up utilization to drive top-line growth to c.75% (from 60-70% currently for most). We expect SLP to gradually increase annual capacity by 38% by FY21-22, while other	**OP:** TGUAN (TP: RM3.00) **MP:** SCGM (TP: RM1.20) SCIENTX (TP: RM9.45) SLP (TP: RM1.45)

		packagers such as SCIENTX will focus on ramping utilisation, targeting 75% over the next few years, TOMYPAK plans to improving utilisation to c.67% by FY21 and SCGM will focus on improving utilisation rates targeting 70% by end FY20 (from c.60% currently) post moving into a new factory in April 2019 (4Q19). Meanwhile TGUAN will continue to invest in R&D to improve sales and margins for existing products (i.e. stretch films). • **Strong margin improvements crucial**. Plastic packagers have seen declining earnings with some recording operating losses (i.e. SCGM and TOMYPAK) due to raw material prices as well as the quality of product mix. Going forward, even if raw material prices were to stabilise at current low levels of USD850-1,000/MT, packagers still need to fix the issue of weaker product margins to see stable earnings. • **Earnings unchanged but TGUAN our preferred pick on higher valuations** to 11x PER (from 9x PER) on improving margins to normalised levels of 6-8%, from lows of 4-5% in FY18. SLP's ascribed valuation is the highest among its peers at historical average levels owing to its consistent earnings performance and superior margins of c.15% EBIT margins vs. peers of 4-7%) which have remained stable vs. peers when most plastic packagers are facing margin pressures. • **Maintain NEUTRAL.** Valuations are at average to -2.0SD to the 4-year PER and PBV averages which we believe is justifiable in light of weak earnings and margins over the past two years. We maintain our sector call at NEUTRAL as we remain cautious on margin pressure for this sector, and believe that we have accounted for most positive upsides for now.	TOMYPAK (TP: RM0.270)
Ports & Logistics	**Maintain**	• **Lacklustre outlook for the logistics players.** Within the last-mile delivery space, earnings volatility persists to cast a long shadow over the sub-sector, as the margin compressive environment is unlikely to recover in the near-term. That said, we believe that the crowded parcel delivery space is likely to remain saturated until the intensified competition eventually squeezes out the smaller players, leading to an industry consolidation in the longer-term. • **Signs of pick-up in port throughput volumes.** The commendable improvement in Port Klang's container throughput volume (+21% YoY, in 1H19) is likely to persist, albeit at a moderate pace, on the back of: (i) an increase in Ocean Alliance calls, (ii) trade diversions arising from the US-China trade war continuing to spur the gateway segment, and (iii) rapidly growing Southeast Asia economies which may expedite greater trade activities in the Intra-Asia trade lines. Nonetheless, we view WPRTS' Westports 2 expansion plan as a longer-term prospect with full completion by 2040. That said, we opt to tweak our assumption to 10% container throughput growth for FY19-20 from previously 5% as we maintain our MP call on WPRTS with a higher TP of RM4.15. **Maintain NEUTRAL** on the sector, given the lack of any major rerating catalyst. Within our coverage, MMCCORP and WPRTS are MARKET PERFORM as we believe that they are fairly valued at this juncture. Meanwhile, logistics players such as POS and CJCEN are given UNDERPERFORM calls due to their bleak outlook.	**MP:** MMCCORP (TP: RM1.10) WPRTS (TP: RM4.15) **UP:** CJCEN (TP: RM0.300) POS (TP: RM1.25)
Telecom-munications	**Maintain**	• **Maintain NEUTRAL call for the sector.** • Market share mix (particularly postpaids) is becoming more evenly distributed amongst incumbent telcos with smaller	**OP:** AXIATA (TP : RM4.80)

		competitors slowly creeping up as consumers become more data-driven, value-for-money oriented • With the AXIATA-Telenor merger now being shelved, we expect MCMC to carry out its original plan to commence the assignment process for the 700MHz, 2300MHz and 2600MHz by 4Q19 • Again on AXIATA, we believe that the sell-down post-merger cancellation could have been overdone. It could have also clouded the strong market share and profit gains posted by its regional subsidiaries in 2Q19. Anticipating similar rebounds as DIGI to pre-cancellation levels, **we favour AXIATA (OP, TP: RM4.80) as a Top Pick for the sector.** • We believe the same for TM (OP, TP: RM3.95) where the sell-down from the announcement of aggressive mobile ambitions could have been overplayed as being detrimental to the group's business. Firstly, the Unifi Mobile brand has been present for 3 years (started as Webe) hence should not require as much brand building as a fresh set up. Secondly, if any, we do not believe any capex roll ups could outpace the backbone fixed line business and undo cost savings earned in the last 2 quarters.	TM (TP: RM3.95) **MP:** DIGI (TP: RM4.70) OCK (TP: RM0.625) **UP:** MAXIS (TP: RM4.90)
Utility	**Maintain**	• **MESI 2.0 reform initiative revealed.** Key takeaways are: (i) generators, including TENAGA and IPPs, are allowed to profit from open fuel sourcing arbitrage; (ii) move from PPA regime to capacity and energy market; (iii) establishing TPA framework and network charges to allow 3rd party using the infrastructure; and (iv) facilitate green energy producers and consumers. • **TENAGA is facing seasonally weaker quarters ahead** given the seasonally strong 1H19 earnings on lower opex and capex recognition. However, earnings for FY19 and FY20 will be at similar level to FY18 of RM5.4b on the back of 7.3% asset return. Nonetheless, Government's commitment towards ICPT mechanism while the continuation of surcharge after the KWIE fund is fully utilised, likely in 2020, is a key critical factor. • **PETGAS and GASMSIA are waiting for new RPs to start in 2020.** PETGAS to face two step-downs in earnings in RP1 and RP2 as base-tariff is expected to reduce sharply by 60% to RM0.502/GJ in 2026 from RM1.248/GJ in 2018. GASMSIA is in final year of RP1. Potential reduction in asset return rate for RP2. If return rate drops to 7.3% from 7.5%; earnings could drop 5% as margin spread fall to RM1.50-1.70/mmbtu from RM1.80-RM2.00/mmbtu. • **IPPs are still looking for new earnings stream** to bridge earnings gap as PPA Extension Contracts for YTLPOWR's Paka and MALAKOF's PD Power are expiring soon beside the already weakened earnings. Two new offshore green-field projects for YTLPOWR will only be ready in 3-4 years while MALAKOF is still looking for new projects. Thus, near-term earnings' prospects are weak. • **Maintain NEUTRAL,** in view of lacklustre prospects for the Utilities players in the near to mid-term. This is on the back of expected weak 2H19 results for TENAGA while both PETGAS and GASMSIA face uncertainty ahead of new RPs but we reckon the sector offers decent yields of >3%. However, despite the dull prospect for the sector, PESTECH is still an alternative small cap play.	**OP:** MALAKOF (TP: RM1.00) PESTECH (TP: RM1.75) YTLPOWR (TP: RM0.820) **MP:** GASMSIA (TP: RM3.00) PETGAS (TP: RM15.75) TENAGA (TP: RM13.40)

Source: Kenanga Research

Figure 4: 4Q19 Top Picks List

Top Picks	Comments
ABMB **(OP; TP: RM3.45)**	Although our TP is reduced to RM3.45 from RM4.25 (based on a 0.8x FY21E PBV target) we feel its valuations are undemanding and ripe for M&A exercise. One of the advantages of ABMB is its SME loan book which represents 4% of the industry market share. Given that ABMB is trading at the bottom of its PBV 5-year mean, we feel it is decently priced and ripe for a M&A play especially with a bigger bank that has the appetite for riskier loans and ambition to increase its SME market share.
BAUTO **(OP; TP: RM2.75)**	BAUTO (OP; TP: RM2.75) is our sector top pick: We like the stock for its: (i) expected earnings recovery from the stream of all-new models, (ii) superior margins which is above industry peers (average profit margin of c.9% vs. peers of c.2%), and (iii) steady dividend yield of 7.2%. BAUTO has launched its popular face-lifted and turbo variants of CX-5 on 30th Sept, and all-new Mazda CX-8 on 1st Oct. BAUTO is also looking to bring in the all-new CX-30 (CBU from Thailand) and face-lifted CX-3 (CBU) in Dec 2019. Our TP is based on 13x CY20E EPS (at -0.5SD of its 3-year Fwd. historical PER).
CARLSBG **(OP; TP: RM27.15)**	We favour CARLSBG for (i) its defensive earnings nature which is further backed by its premiumisation growth story which yields a 5-year earnings CAGR of 7% in FY20E against HEIM's 5% of the same, (ii) a possible shift in market share towards CARLSBG based on our back of the envelope calculations, coupled with (iii) a potential improvement in operating environment going forward as we deem a further excise duty hike to be unlikely as this could worsen the illicit trade market situation of alcoholic beverages which the government is trying to curb. The share also fetches a decent yield of c.4%, which could provide some comfort in the midst of current market uncertainties.
CIMB **(OP; TP: RM6.45)**	CIMB's domestic loans have consistently outperformed the industry (in high single-digit) and we expect its domestic and Indonesian loans to gain traction in 2H19; post Budget 2020 (Malaysia) and with the conclusion of the Indonesian Presidential election which will influence infra/fiscal spending ahead. CASA ratio is the highest among the banking stocks with NIM compression likely mitigated by the influx of SME and Corporate loans coming on stream by end of 2019. With its share of investment securities, the banks will be significant beneficiary of MTM gains should there be another OPR cut by the end of the year. While GIL is still a concern, credit costs are looking stable and normalized. Coupled with accommodative interest rate, we believe CIMB will have a higher risk appetite ahead. TP is at RM6.45 ascribing a target PBV of 1.06x implying a 5-year mean. Valuations are undemanding coupled with a decent dividend yield of >4.0% giving a total upside >30%.
HARTA **(OP; TP: RM5.85)**	We like HARTA for: (i) its "highly automated production processes" model, which is moving from 'good' to 'great' as they are head and shoulders above its peers in terms of better margins and reduction in costs, (ii) constantly evolving via innovative products development, and (iii) its nitrile gloves segment, which is booming. Our TP is RM5.85 based on unchanged 36x CY20 EPS (at +1.0SD above 5-year historical forward mean).
KOSSAN **(OP; TP: RM5.25)**	We like Kossan because it is trading at an unwarranted 25% discount to peers' PER average considering that its net profit growth is the highest at 23.7% compared to peers average at 7%.
MISC **(OP; TP: RM8.80)**	We like MISC given its stable dividend yield of ~4%, being one of the better ones among FBMKLCI constituent stocks, which provides some defensive support to its share price and thereby limiting the counter's downside risk over the long-term. MISC is seeking to tap into the global mega-FPSO market with active tenders in Brazil. Fruition of this would be another key re-rating catalyst. Meanwhile its low-base in FY18A could help set-up earnings recovery potential for the next 1-2 years (FY19E earnings growth of +30%).
MPI **(OP; TP: RM12.10)**	Earnings momentum is looking positive with 1Q20 potentially posting QoQ growth on the back of a full pipeline of new product introductions (NPIs) earlier, while 2Q20 is likely to be further boosted by contributions from multiple newly acquired customers for Suzhou plant, which is already running at 93% capacity and is currently undergoing major expansion (Suzhou currently contributes c.30% of group revenue and is expected to climb to 50% later). Potential re-inclusion into the Shariah-compliant list in November is also a catalyst. These positive prospects are juxtaposed with an unjustifiably low ex-cash PE of 6x
PWROOT **(OP; TP: RM2.30)**	We continue to like PWROOT for its anticipated delivery of strong growth numbers, driven by: (i) continuous cost improvements, (ii) better hedged commodity positions and, (iii) new SKUS coupled with (iv) more efficiently appointed distributors providing exciting growth prospects. Decent dividend yield of c.4% also act as the cherry on top.
TAKAFUL **(OP; TP: RM6.85)**	TAKAFUL remains our preferred pick within the insurance space. Although we anticipate topline growth to ease after enjoying a run through its bancassurance tie-up with Bank Rakyat in 3Q18, the stock remains attractive as compared to its peers for its: (i) superior ROE at 30% (vs peers' average of 20%), (ii) leading market position to sustain against industry headwinds, and (iii) well-diversified general business mix (i.e. fire, motor classes) which are under Bank Negara's radar for detariffication. Per our recent report dated 1 Oct 2019, we streamline our valuations for TAKAFUL to 4.0x FY20E PBV (from a blended 16.0x PER/4.0X PBV, within the +1SD over 3-years) to apply greater emphasis on the stock's solid balance sheet as earnings growth could be less exciting going forward.

Source: 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.

Published and printed by:

KENANGA INVESTMENT BANK BERHAD (15678-H)
Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my