Shock-proof Dividends

Selecting Dividends Stocks Amid Middle East Conflict Uncertainty

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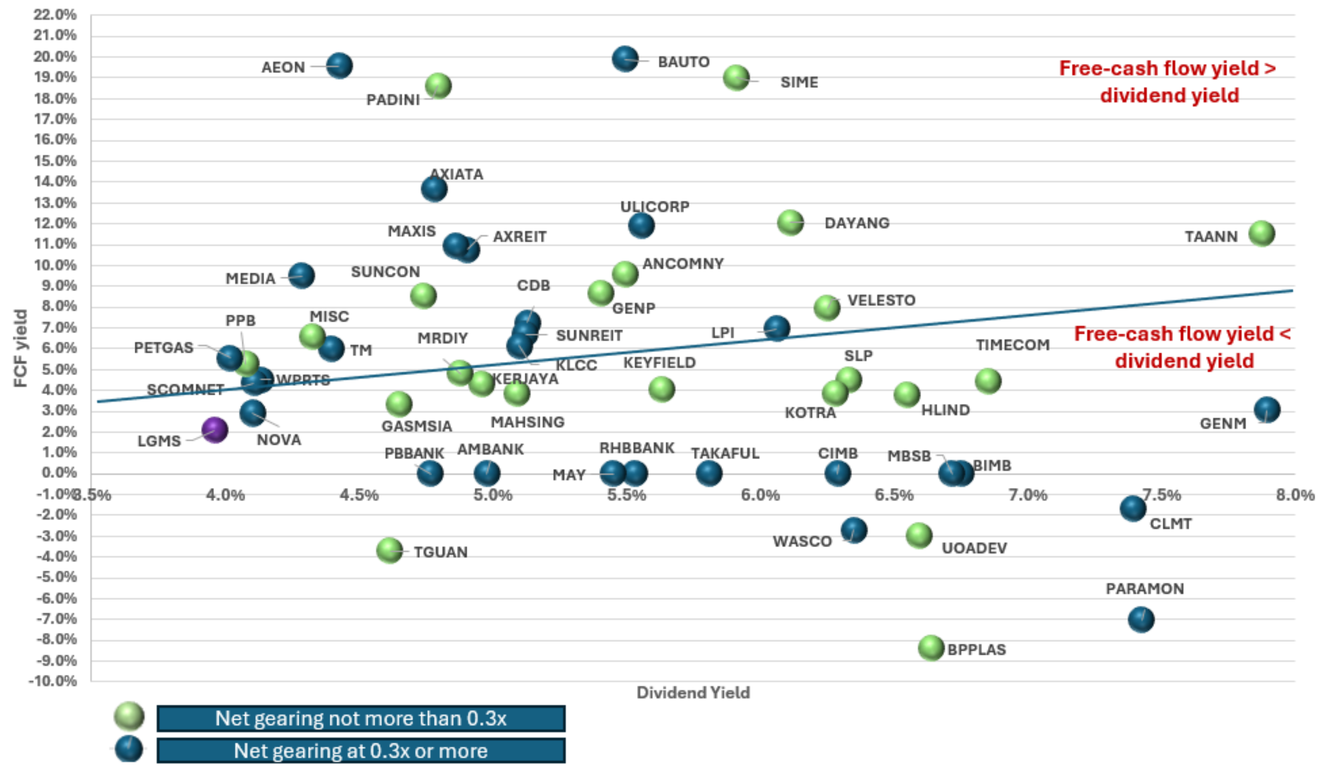
The Middle East conflict remains fluid, with potential further attacks on energy infrastructure not ruled out at time of writing. Even so, the conflict has shifted US Federal Reserve policy pivot timing, while locally it has led to Kenanga nudging up 2026 inflation forecast, creeping into returns. Thus, in this note, we examine dividend names that should prove resilient amid the conflict. This is viewed from the angles of i) cashflow generation ability versus expected dividends, ii) avoidance of potential supply disruption, and iii) generally lower stock volatility being preferred.

We anchor our dividends pool with more domestic plays which include TIMECOM, PBBANK, MRDIY, CIMB, SUNCON and PARAMON (but have left out REIT names for now due to sentiment from recent tax ruling). For the more external facing and potentially volatile sectors, we highlight DAYANG and MISC for oil and gas, SIME, and planters such as PPB, and TAAAN.

Examining dividend resillience. Amid the still-fluid events unfolding in the Middle East conflict, the timing of pivot of the Federal Reserve rate cut has shifted towards the last quarter. Locally, Kenanga Economists foresee that inflation will inch up for 2026, to 2.1% from 1.9% previously, slightly crimping on returns including from dividends. Thus, we take the opportunity to consider dividend counters that are more resilient in this environment.

Exhibit 1: Dividend Yield and Free-Cash-Flow Yield of Stocks (With 4% Dividend Yield for FY26 or Greater)



*Source: Kenanga Research. *Note for banks, there is no cashflow yield and we have shown as zero above.*

Company dividends could depend more on cashflow strength amid potential supply chain/logistics disruption. Given that the effective blockade on the Straits of Hormuz is likely to have knock on impact to supply chains, and logistics bottlenecks, firms will likely prioritize working capital needs. Thus, the willingness to pay dividends would be tied in with cashflow strength, in addition to maintaning comfortable gearing levels, rather than purely profits. To begin our screening, we base our universe with stocks that are capable to meet a 4% dividend yield, which filters out most of the higher growth sectors such as technology, and renewable energy. We followed that up with mapping out stocks' free cash flow (FCF) yield and dividend yield – in exhibit 1 above, stocks that fall above the line generally exhibit stronger FCF than dividend commitments. The reverse is true for those that fall below the line (meaning company may have to borrow or dip into reserves). We next filter for the stocks' gearing position, whereby we have generally counted simplistically firms below 0.3x as possessing relatively more flexibility in paying dividends (as indicated by the green circles in exhibit 1 above); the logic here is that firms operating with higher gearing may have to more carefully weigh the strain of debt servicing ability in case of slowing demand ahead.

Anchored by steady domestic names. We count **MRDIY** (MP; TP: RM1.95) and **PADINI** (MP; TP: RM1.90) as fitting the criteria with respect cashflow strength, and also relatively lowly geared balanced sheets (though low stock trading liquidity in the latter could be a consideration for some). Within the industrials/construction space, we like **SUNCON** (OP; TP: RM7.76). While **BAUTO** (OP; TP: RM1.10) possesses a more elevated gearing, and we are mindful of temporary potential shipment delays, these are in our view overshadowed by the encouraging sales from CBU MAZDA models, which in turn preserves good dividend visibility. Within the Telco space, **TIMECOM** (OP; TP: RM6.60) formalling adopting an improved dividend payout policy (mentioned during the previous results brief) will keep interest high.

Patience would be rewarded for banks. While our base case is for banks to nudge up dividends, this view may take longer than 1H26 to materialize. Initially, provision overlays and macro-economic variables may be needed out of prudence, where we expect a 5-10 bps credit cost top up should lift the banks' loan-loss coverage (LLC) to above the "psychological" 100%. More specifically, assusming a 10 bps top up to credit cost, the LLC average of the 10 banks under Kenanga's coverage (excluding outlier MBSB) would rise from 96% to 104%. Moving into 2H, we therefore believe there would then be scope for overlay write-backs, as tensions subside. Our picks for dividends resilience include **CIMB** (OP; TP: RM8.45) and **PBBANK** (OP; TP: RM5.75) - the former given its stated intention to reward shareholders and the latter for higher potential payout from improved CET1 ratio come July, where we estimate the potential benefit could be up to c4% in yield terms. For Shariah compliant names, we prefer **TAKAFUL** (OP; TP: RM4.40), which offers a competitive 5.8% yield, given capital appreciation potential versus **BIMB** (MP; TP: RM2.55) and **MBSB** (MP; TP: RM12.30) despite the latter two's better dividend yields.

REIT sector affected by non-extension of preferential tax rate. We have a **NEUTRAL call** for the REIT sector at this juncture, with no OUTPERFORM picks. Despite the sector average gross yield of 5.4%, we believe the sentiment for REITs is slightly dulled after a very recent change in the way REIT holders are being taxed which went against our expectation, following the non-extension of a withholding tax preferential rate of 10% that had been in place since 2007. Compared to previously a 10% withholding tax, investors will have to bear own taxes and could end up with a higher rate of tax; the most affected segment is likely to be foreign investors which will now be taxed at the most punitive 30%. A silver lining is available for individuals whose tax brackets are lower than 10%, as they may stand to benefit from the new framework compared to the previous version. On the other hand, Companies are generally insulated. For more details, please see Analyst Chris Tong's REIT Sector Update titled Withholding Tax Removed.

Within utilities, we observe that **GASMSIA** (MP; TP: RM5.23) provides a decent yield of around 4.7%. However, given our Target Price indicates some downside risks, we have left GASMSIA out of our dividend recommendations for now. An alternative would be **TENAGA** (OP; TP: RM17.00), which we note had just narrowly missed our chosen cut-off of 4% yield.

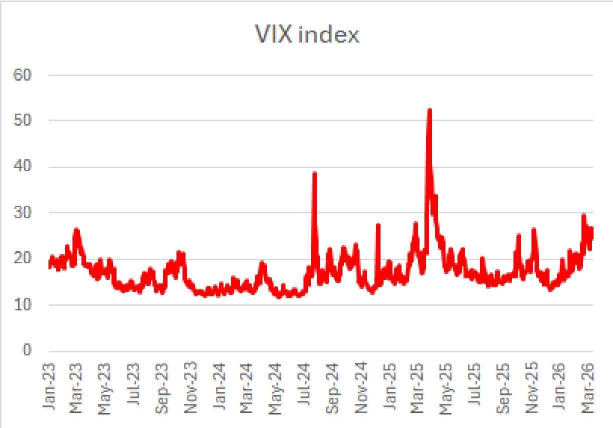
Plantation and oil and gas sectors tick the boxes though these are the more volatile sectors. Plantation and oil and gas firms have been previously highlighted by us as potential beneficiary from the middle east conflict (See Strategy Note "Not So Strait-Forward). For oil and gas firms, crude oil prices potentially staying sustainably elevated provides a fillip to capex. In the interim, some of these companies generate strong cashflow and thanks to solid balance sheets and names such as **DAYANG** (OP; TP: RM2.45)**, VELESTO** (MP; TP: RM0.32) and **MISC** (OP; TP: RM8.60) fit our dividend recommendations. The same could also be said for planters, where **PPB** (OP; TP: RM12.50)**, GENP** (OP; TP: RM5.40) and **TAAAN** (MP; TP: RM4.40) and we monitor for potential for dividend surprise from upstream business earnings. To a lesser extent, while **ANCOMNY** (OP; TP: RM1.20) also met our screens, we are mindful of sensitivity to logistics costs and also input cost rises at this juncture in the chemicals space.

Elsewhere, while **SIME**'s (OP; TP: RM2.75) business outlook is affected via several moving parts at this juncture, we consider that it gets our greenlight given stated intention for non-core asset disposal in 2HFY26 that could add to dividends. Staying with the asset disposal theme, that flexibility is also available to **PARAMON** (OP; TP: RM1.47). Despite not meeting all of our screens (weak cashflow generation in FY26 would be a temporary blip before improving in FY27), we fancy **PARAMON** for sector-leading dividend yield exposure among our property coverage.

Additional volatility considerations for dividend portfolio

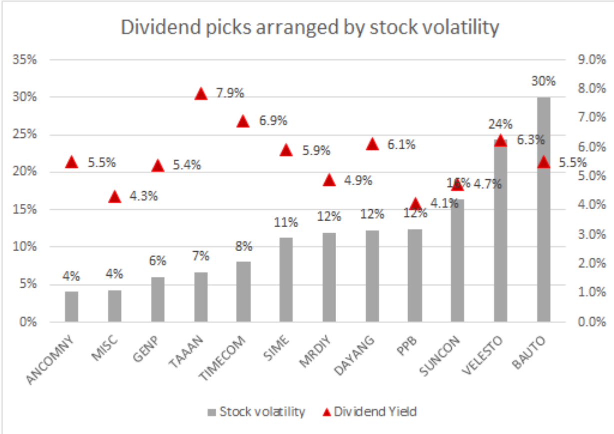
Heightened volatility. At time of writing, US President Donald Trump has said to postpone strikes on Iranian power plants, quoting the real possibility of deal with Tehran. This comes after Donald Trump earlier threatened strikes on said plants if Iran doesn't reopen the Straits of Hormuz, which led to Iran responding by vowing that it would also strike Gulf infrastructure if attacked. Based on the CBOE Volality Index (VIX), which indicates expected volatility for the S&P500 index, this indicator has moved up closer to the high 20s range, levels last seen during the 2025 Trump Liberation Day. As we expect capital preservation could also be a key objective amid the conflict, the lesser volatile names include **MISC**, **GENP**, **TAAAN, SIME, DAYANG, PPB, TIMECOM** and **MRDIY.** On the other hand, **SUNCON**, **BAUTO** and **VELESTO** demonstrated more volatility, measured by standard deviation over the past 2 years. To note, for a large majority of the names above, Kenanga is currently ahead of consensus with regards to FY26 expected dividend yields.

Exhibit 2: VIX Index



Source: Kenanga, Bloomberg

Exhibit 3: Dividend yield and volatility



Source: Kenanga, Bloomberg. Stock volatility calculated as standard deviation of daily share price (2-years) over average price.

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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