

## Whither the FBM KLCI

**Earnings and price trending hand-in-hand**

**KLCI: 1,654.37 points**

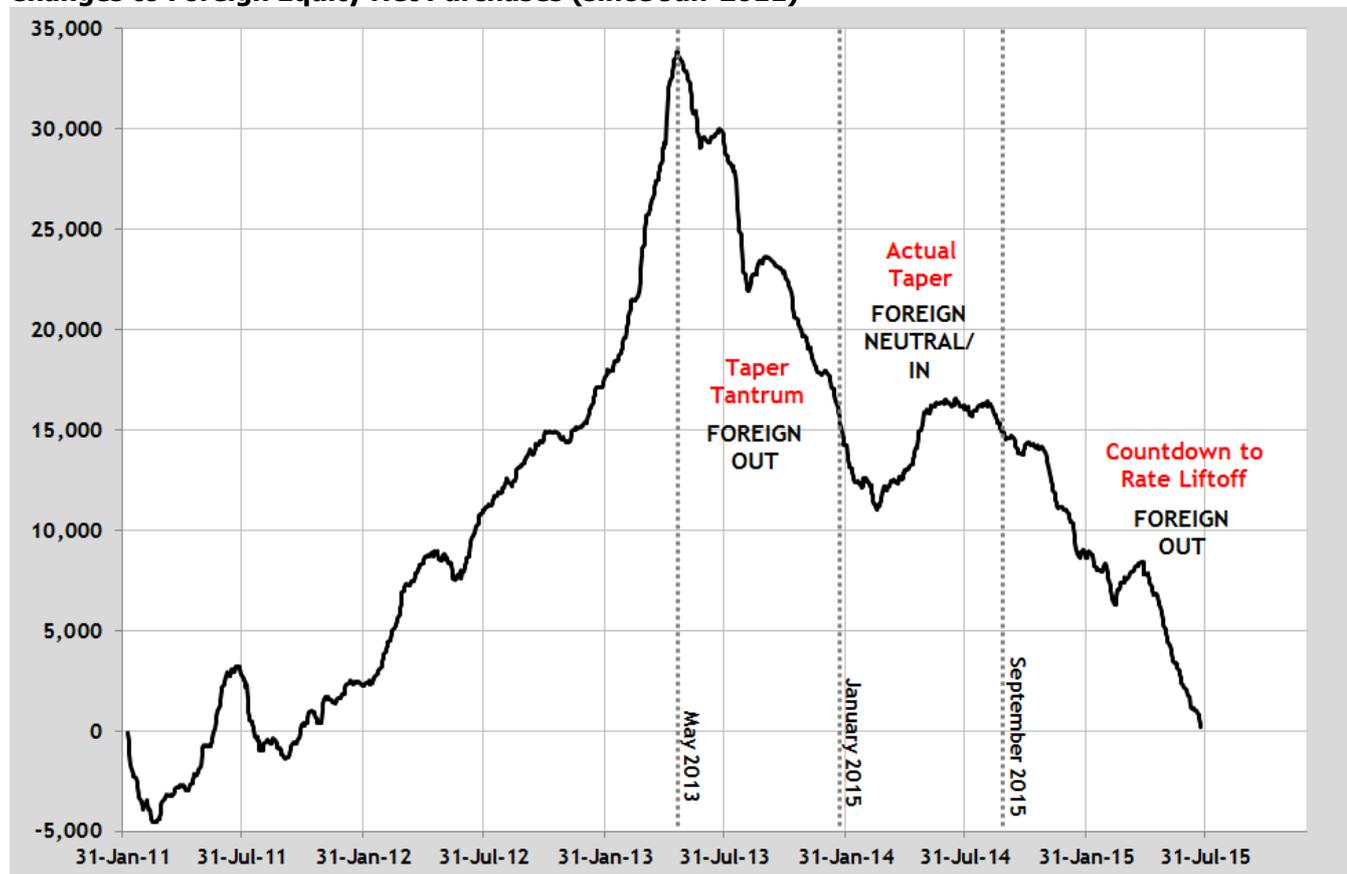
**2015 Year-end Target: 1,800 points**

### Near-term View

**The FBM KLCI is approaching the low end of our 2015 support levels at 1,650 points.** As stated in our Strategy report dated 8 January this year, "Insofar as the FBM KLCI downside is concern, apart from the expected earnings performance, the benchmark is also supported by its assets backing. Based on historical precedent, the FBMKLCI would not sustain at Price Book Value (PBV) of below 2.0x unless the economy is entering into a period of distress such during the world's financial crisis of 2008/09. At PBV of 2.0x, the FBM KLCI equates to 1,690 points. Hence we expect potential downside to the benchmark would be limited to circa 1,700-1,650 points range."

**We expect the lower support level to hold** unless the foreign outflow from the domestic equity market intensifies and the USD/MYR continues to escalate. Even so, any breaches below the support level would only be sustainable if the move is associated with a major deceleration in the macro growth outlook. On this score, it must be noted that our economist remains sanguine on (i) the GDP growth prospects for both 2015 and 2016 at 4.7% and 5.0% respectively, while (ii) price situation is expected to remain benign at between 2.0-2.5%. Moreover, anticipate subdued imported inflation effect as, despite the strengthening US Dollar, the value of Ringgit is well supported against other major currencies such as the Euro and Japanese Yen.

### Changes to Foreign Equity Net Purchases (since Jan-2011)



Source: Bursa, MIDFR

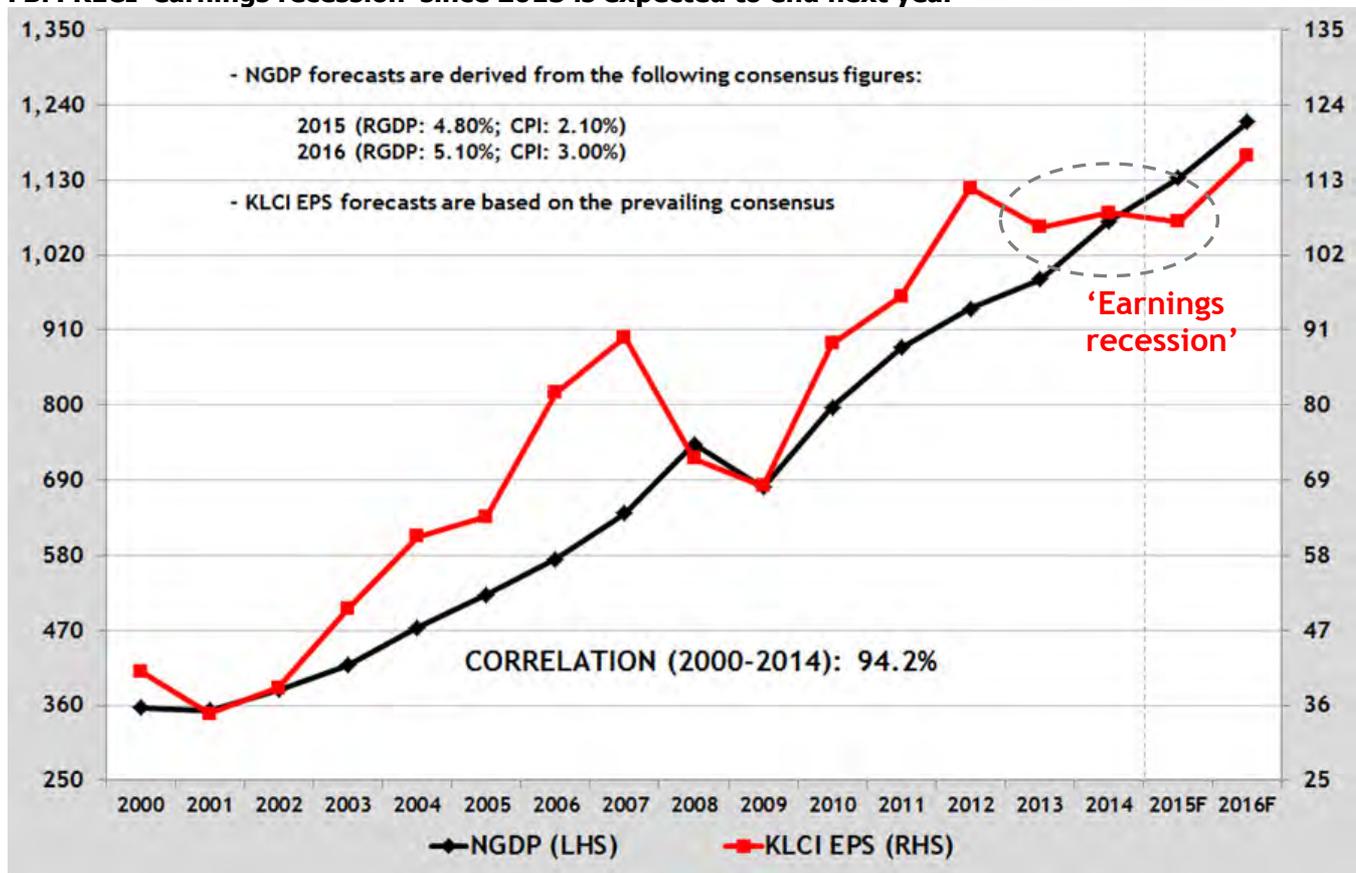
**Nevertheless, the weakening Ringgit is a boon to some companies** or industries with incomes and/or assets in US Dollar and other relative strengthening currencies such as the UK Pound. Therefore, we can expect near-term price outperformance among the glove makers such as Hartalega, shipping companies like MISC, and the electronics exporters, among others, Globetronics. Moreover, property investment and development companies such as SP Setia with assets and projects denominated in the stronger currencies may also benefit from favourable forex translations.

**Curious observations of foreign liquidity behavior.** Another important point to note is that empirical evidences [see Chart above] from the immediate past suggest foreigners tended to sell on rumour (Taper Tantrum) but turned buyer/neutral on fact (Actual Taper). As the foreigners are now selling on yet another rumour (Countdown to Rate Liftoff) hence, they may similarly turn buyer/neutral upon the fact (Actual Rate Liftoff). On this score, assuming the actual rate liftoff will take place in September, a repeat of past behavior may result in fairly supported equity market during the final quarter of 2015. Thus we reiterate our 2015 year-end baseline target at 1,800 points with upper and lower bounds of 1,850 points and 1,750 points respectively.

## Secular View

**Earnings growth recovery next year.** Firstly, it must be highlighted that the consensus 2016 FBM KLCI earnings growth is expected to return to a healthy, and more normal, level of 9.01% [see Chart below]. The anticipated forward year performance is in stark contrast to the current year earnings growth estimate of -1.26% as well 2014 and 2013 growth figures of merely 1.99% and -5.05% respectively. As a rule of thumb, basing of past performance, the equity benchmark would normally register earnings growth that outperform or at least matches the percentage rise in nominal GDP.

## FBM KLCI 'earnings recession' since 2013 is expected to end next year



Source: Bloomberg, MIDFR

**The source of FBM KLCI forward year earnings growth** can be gauged from the earnings forecasts of its 30 constituents. Please refer to the **APPENDIX** for our current and forward year earnings estimates as well as brief remarks on the basis of the forward year earnings growth.

## FBM KLCI 'price recession' since 2013 may likewise end next year



Source: Bloomberg, MIDFR

**Earnings and price trending broadly hand-in-hand.** Secondly, empirical observations between earnings and price are conclusive with regard to the nature of their secular direct relationship [see Chart above]. This is despite the ever present 'noises' from short-term price volatility which is influenced by market sentiment and other situational issues. Hence the expected recovery in earnings growth next year is central to our assessment on the likely path of the FBM KLCI going forward. On this basis, we expect the secular trend trajectory of FBM KLCI to remain upward sloping. 

## APPENDIX

	Earnings (RM mn)			Earnings (%YoY)		Remarks on CY2016 Earnings %YoY
	CY2014	CY2015	CY2016	CY2015	CY2016	
Sime Darby	3,007	1,878	2,503	-37.6%	33.3%	1) To benefit from FFB volume recovery expected at +10.5%yoy which should outweigh CPO price decline of 3.4%yoy; and 2) Low-base effect
SapuraKencana	1,641	1,080	1,316	-34.2%	21.9%	1) Growth is likely to stem from its 'Energy' division comprising production and sale of crude oil from its oilfields in Malaysia; and 2) Low-base effect
IHH Healthcare	754	1,012	1,216	34.2%	20.2%	Expect higher inpatient admissions and increase in revenue intensity for all 3 markets, i.e. Malaysia, Singapore, Turkey
Petronas Dagangan	502	619	724	23.4%	16.9%	Increase is anticipated from higher volume sold, increase in vehicles on the road and also anticipated slight hike (natural rise in crude oil prices) in pump prices
RHB Capital	2,038	2,104	2,437	3.2%	15.8%	Expect lower NIM contraction with a stable credit cost in FY16. Improvement in cost to income from cost management focus with a fully leveraged Islamic Banking model coupled with an improved NOII ahead under IGNITE 2017
CIMB	3,159	3,692	4,223	16.9%	14.4%	Expect improvement in credit cost in FY16 following the Group's heavy provisioning for Niaga's coal and coal-related loans which impacted the Group's earnings in FY15. Lower cost base in FY16 post IB restructuring and MSS exercise and lower NIM contraction in FY16

KLK	1,032	853	952	-17.3%	11.5%	1) To benefit from FFB volume recovery expected at +6.5%yoy which should outweigh CPO price decline of 3.4%yoy; and 2) Low-base effect
Genting M'sia	1,189	1,395	1,549	17.3%	11.1%	Not under coverage (consensus figures)
Genting	1,496	1,941	2,152	29.8%	10.8%	Not under coverage (consensus figures)
Malayan Banking	6,716	6,963	7,665	3.7%	10.1%	Expect lower NIM contraction in FY16. Improvement in operating efficiency with lower cost to income ratio arising from a focus on cost optimization
Telekom M'sia	832	874	960	5.0%	9.9%	Expansion in UniFi subscribers and upgrade of package to higher surfing speed package
Public Bank	4,519	4,692	5,105	3.8%	8.8%	Expect lower NIM contraction in FY16 from a more stable COF and lower impact from portfolio rebalancing affecting its asset yield
Hong Leong Fin.	1,681	1,730	1,880	2.9%	8.7%	Expect higher MGS yield in FY16 after US Fed rate hike. Higher interest to result in lower actuarial reserve provisions hence stronger earnings for insurance business. We expect this as well as better earnings contribution from Hong Leong Bank with stable asset quality and lower NIM contraction in FY16 to improve HLF's earnings moving forward
Westports	512	543	586	6.0%	8.0%	Container throughput growth of 6.7% in FY16 and an increase in container handling tariffs
Hong Leong Bank	2,137	2,205	2,381	3.2%	8.0%	Expect lower NIM contraction in FY16 than FY15 and an improvement in cost to income ratio with the Group's digital banking initiatives. Expect some improvement in NOI in FY16
Axiata	2,349	2,535	2,704	7.9%	6.7%	Performance from Celcom (Malaysia) and XL (Indonesia) operations to remain subdued
BAT	902	970	1,032	7.6%	6.4%	1) Improved illicit cigarette level as compared to the previous years which is supported by the stricter enforcement from the Royal Malaysia Custom; and 2) Higher revenue supported by the cigarette price hike which took place recently
Maxis	1,717	1,929	2,043	12.3%	5.9%	Anticipating lower ARPU due to competition from its peers
Astro	491	581	613	18.3%	5.6%	Subdued consumer sentiment to impact Pay-TV residential subscribers growth
Digi	2,031	2,079	2,182	2.3%	5.0%	More competitive pricing package as compared to Celcom and Maxis to further increase customer base
MISC	2,204	1,822	1,902	-17.3%	4.4%	1) Better earnings contribution mainly from the Petroleum (firm VLCC & Aframax tanker rates) and storage (better demand for storage) segments benefitting from low crude oil prices; 2) Better USD/MYR exchange rate; and 3) Low-base effect
KLCCP Stapled	582	593	617	1.8%	4.1%	To benefit from 9% rental reversion for Petronas Twin Tower which is part of the increase in rental every 3 years
YTL Corp	1,282	1,326	1,376	3.5%	3.7%	Mainstay utilities business expected to generate stable yet subdued growth
Tenaga	6,467	6,602	6,824	2.1%	3.4%	Electricity units sold growth is expected at 2.5%yoy
PPB	917	963	977	5.0%	1.5%	Impact from low CPO prices to be moderated by expected improvement in consumer division margin
Petronas Gas	1,843	1,784	1,798	-3.2%	0.8%	Demand expected to be moderate and company not expected to hit efficiency incentive from plant operations
Petronas Chem.	2,465	2,862	2,878	16.1%	0.6%	Flat growth anticipated from soft regional market
UMW Holdings	652	780	781	19.6%	0.1%	Heightened challenges in auto division while the outlook of other divisions remains difficult, e.g. O&G division affected by lack of demand for jack-up rigs in the region
IOI Corp	1,391	1,233	1,228	-11.4%	-0.4%	Upstream earnings will be lower due to expected CPO price decline of 3.4%yoy. However, downstream division should benefit from low CPO price.
AMMB	1,863	1,791	1,770	-3.9%	-1.2%	Group continues to de-risk its auto loan book. Impact from portfolio rebalancing is expected to gradually taper-off reaching the tail end in FY16. Lower NIM contraction expected in FY16 on account of lesser impact on the drop of its asset yield from portfolio rebalancing. Cost to income ratio to improve only post-completion of IT system integration works for Kurnia, MBF cards as well as the Group's core banking system Phase 1

Source: MIDFR

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#### STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

#### SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.