

U.K. snap election - Uncertainty lingers

FBM KLCI: 1,776.95

Impact on Malaysian listed companies

2017 Year-end Target: 1,830 points

KEY HIGHLIGHTS

- **Initial polls indicate strong chance for Conservative win....but the lead is narrowing**
- **Even if Conservative wins, May’s capabilities may be undermined**
- **Malaysia’s trade with UK constitutes only about 1.0% of Malaysia total trade exports**
- **Mixed impact for Property, REITS, Gloves, Utility and Oil&Gas**

What does the news on UK Election tell us?

- **Snap election called to strengthen mandate.** On April 18, Prime Minister Theresa May called for a snap election on June 8 despite planning not to do so back in September 2016. The rationale behind this is for May to seek a stronger mandate in the Brexit process as she resumed office following David Cameron’s resignation when Britain voted to leave the European Union (EU). In March, May has triggered the Article 50 of the Lisbon Treaty which initiates the process for the U.K. to leave the EU.
- **Initial polls indicate strong chance for Conservative win.** Fresh polls conducted by YouGov from 18-19 April show that Conservative was leading the polls at 48%, more than twice of Labour. May’s plan to hold an early election was strongly backed by member of the parliaments, giving a four point boost for the Conservatives.

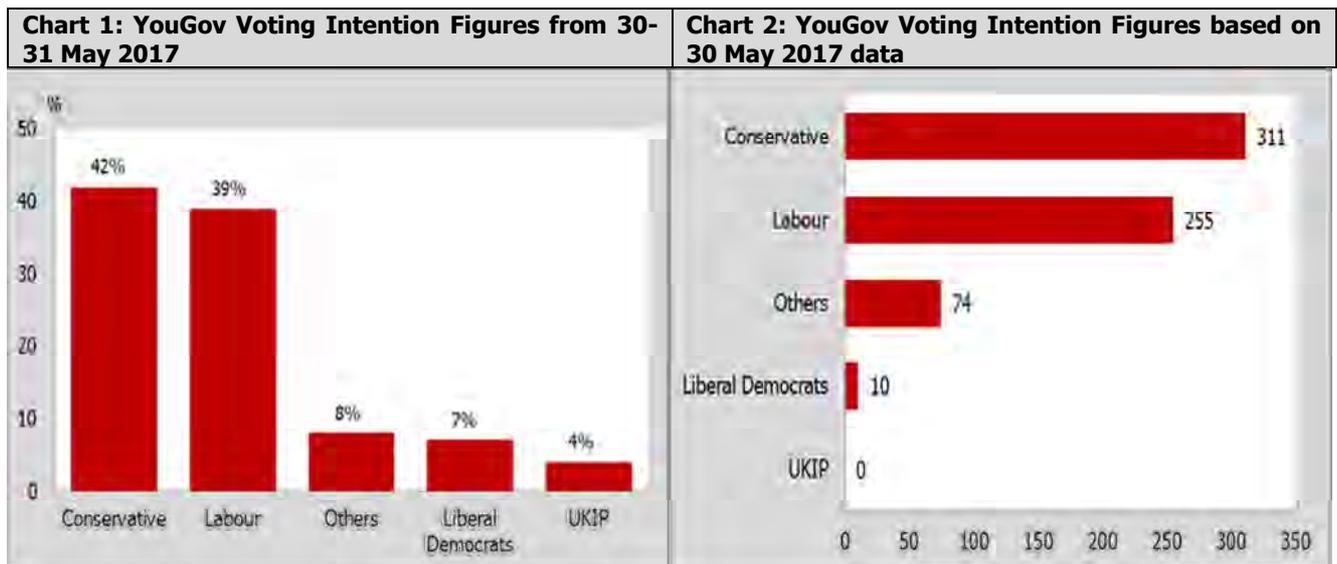
Table 1: Key manifestos of UK Political Parties

Manifesto			
Conservative	Labour	Liberal Democrats	UKIP
Reduce net migration	Scrap income thresholds for spouses of migrants who want to come to the UK	Protect Britain's place in Europe and oppose Brexit	Introduce a "one in, one out" immigration system
Increase levy on migrant workers	Retain benefits of single market and customs union.	Retaining the free movement of EU citizens	Scrap tuition fees for science, technology, engineering, mathematics, and medicine students.
Scrap universal free school lunches	Build a close new relationship with Europe as partners instead of members	Extra GBP6b funding for the NHS	Invest an extra GBP11b every year into the NHS and social care by the end of the next parliament.
Requiring foreign workers and overseas students to pay more to cover the cost of NHS care	Abolish tuition fees and reintroduce maintenance grant for university students	GBP7b boost in education spending	Increase the 40% income tax threshold to GBP55,000

Source: Official website of respective UK political parties

- **Conservative landslide victory is no longer a certainty.** Campaigning went back on track after the last week’s Manchester attacks last week. The polls published since then showed Conservative leads ranging from 3-14 points based on YouGov’s voting intention figures. From 30-31 May 2017, YouGov’s intention figures

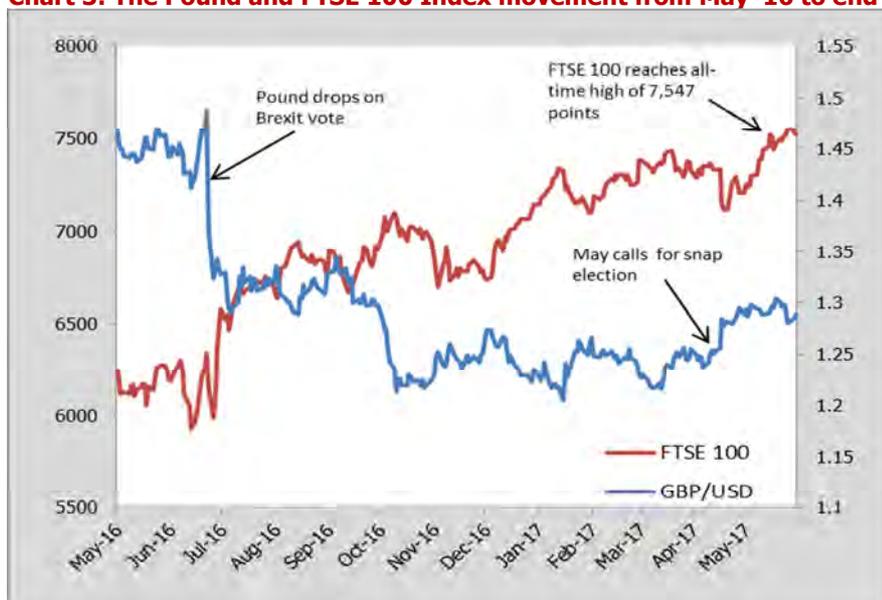
suggested Conservative's 3% lead over Labour, narrowing further from 7% during 25-26 May 2017. The polls portrayed a complicated public opinion, with voting intentions influenced by both the deadly Manchester attack and May's unpopular social care proposals. Henceforth, the gap between Conservatives and Labour has been shrinking sharply, implying that the June 8 election could be much tighter than initially thought.



Source: YouGov

- New election model suggest May would lose majority of seats.** YouGov's new election model translates voting intention figures to the number of seats. Estimates of the new election model reckon that May could only win 311 seats, well below 326 seats needed to form a majority government. As a consequence, the pound faltered on May 31, dipping by 0.14% to GBP/USD1.2769, the lowest since April 21. Nonetheless, the pound regained momentum to close at a three-day high at GBP/USD 1.2885 on the same day. Interestingly, a research company called Panelbase released estimated polls showing Conservatives with a 15 point lead over Labour. It was this set of results that partly contributed to the rally of the pound, although the survey was carried out on May 23. In contrast, FTSE 100 index dipped 6.56 points to 7,519 points following the release of the polls. However, caution shall be taken as anything can happen between now and June 8.

Chart 3: The Pound and FTSE 100 Index movement from May '16 to end of May '17



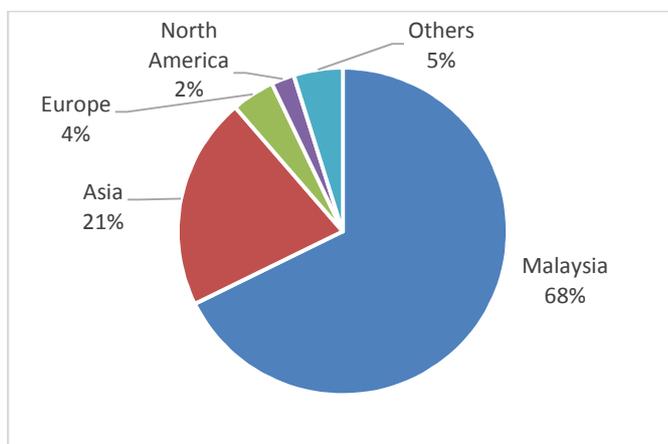
Source: Bloomberg

- **Support for May even shrunk earlier.....** A few weeks back, support for Conservatives started to weaken when May's manifesto was launched on May 18. The Conservatives' manifesto proposed a "dementia tax" whereby home of social care beneficiaries/recipients will be claimable by the state to defray the costs incurred, after their death.
- **U-turn on "dementia tax" amid backlash.** The manifesto has then received a backlash from supporters, forcing May to backtrack the policy on May 22. May then defended by stating that her party would pledge to introduce a cap on lifetime care costs, following widespread protests that more families on the "dementia tax". No details were disclosed regarding on the level at which the cap would be set.
- **What could a victory for the Labour lead to?** Labour emphasized that it will seek a softer departure from the EU by ending the freedom of movement while retaining benefits of the Single Market and Customs Union. Through that, EU nationals living Britain will have the right to remain in the UK after Brexit takes place. Despite planning a softer Brexit, political uncertainty may heighten as how it will be worked out in reality would be unknown, posing a downside risk for the pound. If Labour really manages to negotiate the plan to exit the EU while retaining benefits of the Single Market and Customs Union, the pound may gain traction as uncertainty fades.
- **Possibility of a slight decline in trade with EU nations.** Once Brexit formally happens, EU's customs duties could apply to imports from the UK as it is no longer a part of the EU's Customs Union. But with the Labour's approach to seek a single market deal with the EU post Brexit, this may give room for further trade negotiations that could buoy trading activities between the UK and EU.
- **Overcoming immigration not a priority for Labour.** Labour party leaders agreed that the freedom of movement has to end but with no cap set on the number of immigrants. Nevertheless, Labour has agreed on a reasonable management of migration, fair rules and more equality within systems applicable to EU and non-EU citizens. Even one of the Labour manifestos pointed out that a Migrant Impact fund will be established to support public services where immigration is high. Therefore, immigration levels are not expected to ease of the Labour party takes over.
- **Abolishment of education fees.** Labour plans to abolish tuition fees for new university students in England as early as this coming autumn under its GBP25b package for education. Current university students are not left out as they would no longer need to pay from 2018. Moreover, Labour intends to provide free tuition for EU students in the UK while negotiating a mutual arrangement with EU universities as part of the Brexit deal. Assuming that the said agreement with EU universities will break through, the number of international students excluding EU students will probably decline. There is a possibility that rates for international students will be increased in order to support the free tuition for the local and EU students.
- **Even if Conservative wins, May's capabilities may be undermined.** Although Labour is unlikely to claim victory during the snap election, the party may stage a tougher fight that may undermine the power of Conservatives. This leaves the distinct possibility that the Conservatives can emerge weaker after next month's vote, throwing another hurdle in the forthcoming Brexit negotiations.

Impact on Malaysia

- **What's in it for Malaysia if Labour wins?** Malaysia's exposure to the U.K. as a trade partner is small, with Malaysia's total trade with UK constitutes only about 1.0% (of Malaysia total exports) or RM3.87bn in the first 3 months of 2017. Furthermore, an analysis of FY2016 revenues for listed companies under our coverage showed that only 4% or revenue are received from Europe, let alone the UK.
- Therefore, the trading activities between Malaysia and the UK will be indifferent regardless of which party claims victory on the June 8 election. Nonetheless, a Labour party win could still have an indirect impact on Malaysia on the business level, particularly for some of the companies within our coverage in sectors such as Property, REITS, Gloves, Utilities and Oil & Gas.

**Chart 4: MIDFR Universe Revenue Breakdown
(by Geography for CY2016)**



Sources: Bloomberg, MIDFR

- **Overall, Brexit remains even if Labour wins.** If Labour wins the election, Brexit is still taking place albeit with a softer approach by emphasising to retain as many of the benefit of the Single Market and Customs Union. This differs with Conservative's approach which appears to be more reckless by discharging U.K.'s obligation to allow unlimited migration from the EU, known as "freedom of movement." Assuming Conservative does win, the party may emerge weaker after the election due to the tough fight by Labour which could another hurdle in the forthcoming Brexit deals.

Sector Analysis

i. Property

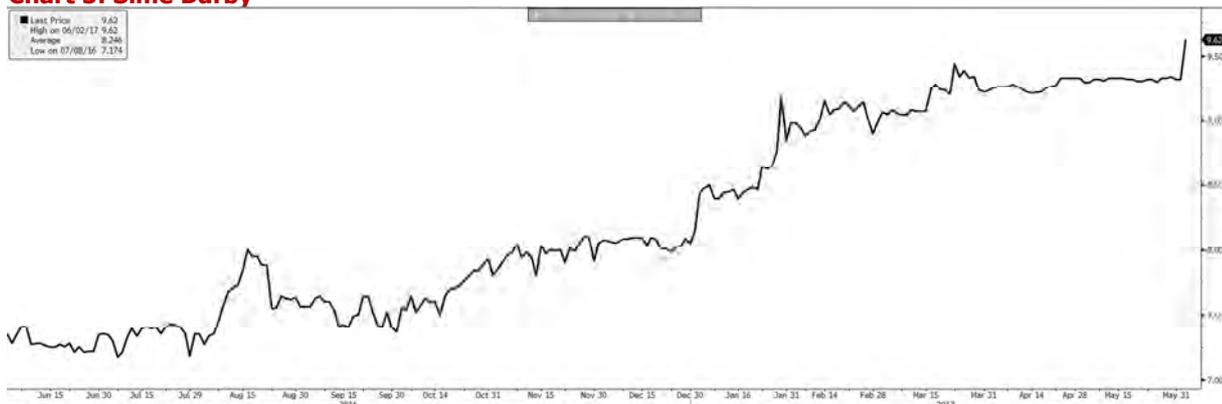
- Affordable housing and new townships is a target.** According to Numbeo, the mortgage-to-monthly ratio in London on average is at 167.12%. As a consequence, Labour will focus more on building more affordable homes reserved for first time buyers while building new generations of townships. Having said that, Malaysian companies having exposure in U.K.'s property market such as **Sime Darby (NEUTRAL, TP: RM9.00)** and **SP Setia (BUY, TP: RM4.03)** would not be directly impacted as the Battersea Project aims high-end property buyers. Moreover, the Battersea Project resides in London which is a financial hub of the nation that does not have the propensity to cater for a lot of affordable housing projects. Nevertheless, if political uncertainty were to prolong during the Labour rule could reduce demand for U.K. properties from locals and foreigners which could adversely affect the sale performance of the Battersea project.

Chart 2: SP Setia



Source: Bloomberg

Chart 5: Sime Darby



Source: Bloomberg

ii. REITS

- Education sector is bound to be impacted.** With the possibility of international student fees being increased amid the scrap of tuition fees for UK and probably EU citizens, students from other nations may flock to other countries including Malaysia. Malaysia itself has emerged as a regional education hub with the establishment of foreign universities, including UK based universities. International students may opt to study in Malaysian branches of UK based universities as rates are cheaper compared to studying in the UK campus.

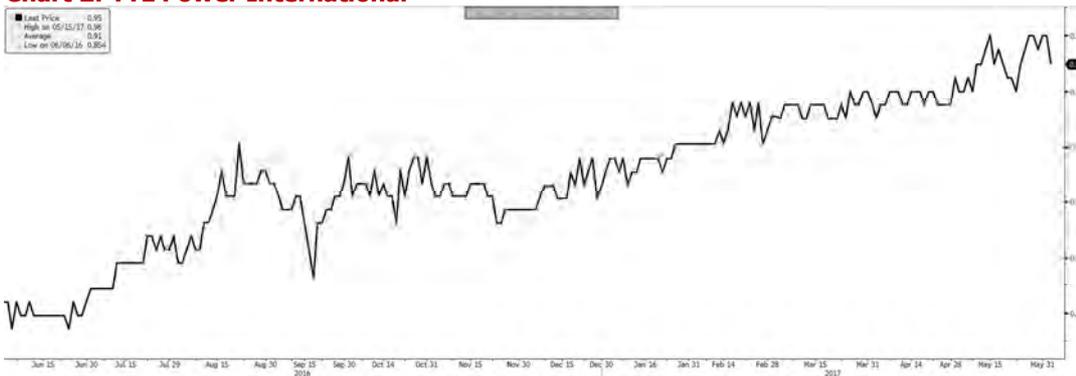
Table 2: U.K. Universities with a Malaysian Campus

No.	Universities
1	University of Nottingham
2	Heriot-Watt University
3	University of Southampton
4	University of Reading
5	Newcastle University

Source: Malaysian Qualifications Agency

- Availability of Malaysian based universities with twinning programmes.** Besides foreign universities with campuses in Malaysia, there are a number of local higher institutions offering 3+0 twinning programs with foreign universities with one of them being SEGi University. The increase in international students could ensure the continuity of SEGi University's Kota Damansara lease renewal for **AmanahRaya REIT (BUY,TP:RM1.15)**. Resilient rental reversion would in turn bode well of Amanah Raya REIT's rental income.

Chart 2: YTL Power International

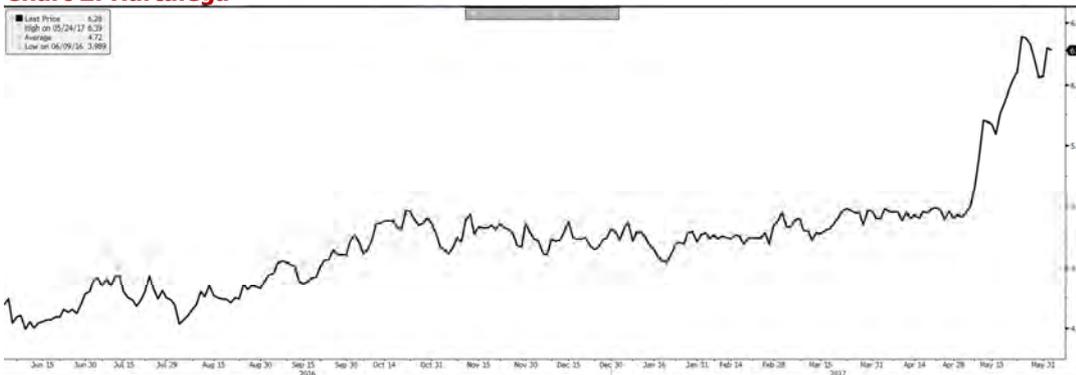


Source: Bloomberg

iii. Gloves

- Increased NHS spending will impact glove producers.** Labour plans to inject more than GBP6b annually into the NHS raised from the increased income tax for the nation's top earners. Under this plan, citizens will be guaranteed to access treatment within 18 weeks, increasing the amount of medical procedures carried out. Henceforth, the demand for medical equipment especially medical gloves is bound to increase, benefitting Malaysian glove producers such as **Hartalega (NEUTRAL, TP: RM5.07)**.

Chart 2: Hartalega

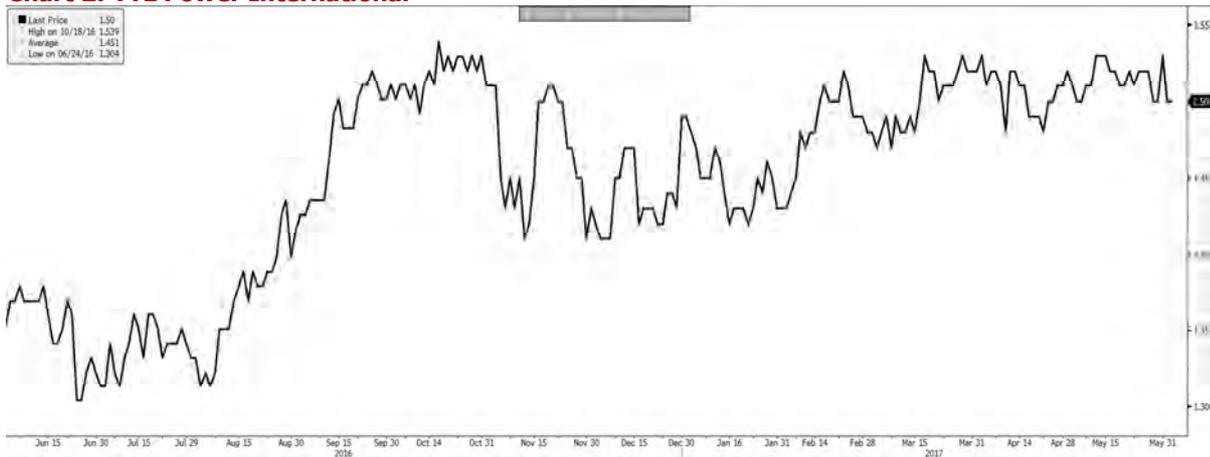


Source: Bloomberg

iv. Utilities

- Nationalisation of key utilities under Labour rule.** Labour intends to bring key utilities back into public ownership to promote democratic accountability for the services which in turn could to deliver lower prices. This may create an uneasy environment for privately owned utility companies such as Wessex Water Ltd, a subsidiary of **YTL Power International Berhad (NEUTRAL, TP RM1.56)**. YTL Power International may seek measures in order to change the ownership structure of Wessex Water.

Chart 2: YTL Power International



Source: Bloomberg

v. Oil and Gas

- Creation of public owned local accountable energy companies.** Under the purview of energy, Labour backs the establishment of public owned local energy companies with at least in every region. The rationale of doing so is to spur competition against the public owned local companies with existing private energy suppliers. Malaysian oil and gas players like **KNM Group (NEUTRAL, TP: RM0.27)** are likely to be affected as they have a UK-based subsidiary, Peterborough Green Energy Ltd. Establishment of public owned local energy companies will increase the barriers of entry for KNM Group's UK subsidiary as it operates a biomass waste to energy power plant.

Chart 5: KNM Group



Source: Bloomberg

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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.