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ASSESSING THE LIRA CRISIS

SPECIAL REPORT | Impacts of Turkey's Lira Plunge

15 August 2018

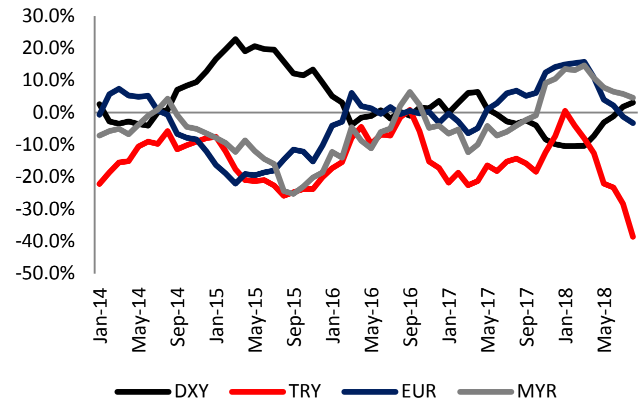
- *Lira is in a bad shape. Turkey is currently experiencing its worst currency crisis since 2001. The lira fell to a grim new record of around TRY7.2 against the dollar on Monday.*
- *With the less significant position, we expect the ongoing crisis in Turkey to have a minimal impact on Malaysia. However, Turkey's rank as one of the top five Malaysia's palm oil exports destinations remains a concern.*
- *Malaysia's total output to drop by -0.135% by Turkey. Following the simulation results, we noticed the fall in demand from Turkey will cause -0.135% contraction in Malaysia's total output.*
- *Global economy to drag down by -0.1% if Turkey contracts. Based on our estimate, ceteris paribus, global output is expected to shrink marginally for every 1% drop in Turkey's final demand. Zooming into various countries, EU27 is among economic area that will be significantly impacted, -0.27%.*
- *Of the 30 FBM KLCI constituents, three companies, namely Tenaga Nasional, Malaysia Airports, and IHH Healthcare, have operations in the Republic of Turkey.*
- *Nonetheless, their exposures in that country are not expected to materially impact their respective earnings performance in the immediate future due to, among others, insignificant contribution to total earnings as well as significant non-Turkish Lira revenue stream.*
- *We reiterate our FBM KLCI 2018 year-end target at 1,800 points*

Macroeconomic Analysis

Lira is in a bad shape. Turkey is currently experiencing its worst currency crisis since 2001. The lira fell to a grim new record of around TRY7.2 against the dollar on Monday. On weekly basis, the lira has dropped more than 20% last week compared to about -5% in earlier week. The fall was driven by concerns over deteriorating ties with the US and President Erdogan's increasing control of the economy. Last Friday, US announced higher tariffs on metal imports from Turkey, demanding for the release of American Christian pastor Andrew Brunson, who is currently under house arrest in the country due to terrorism-related allegation. However, the pastor is not the only stumbling block between the countries. Relationship between Turkey and the world's largest economy has long been flagging since the fallout over Halkbank & Iran sanctions case despite being strategic ally in Syria and Afghanistan.

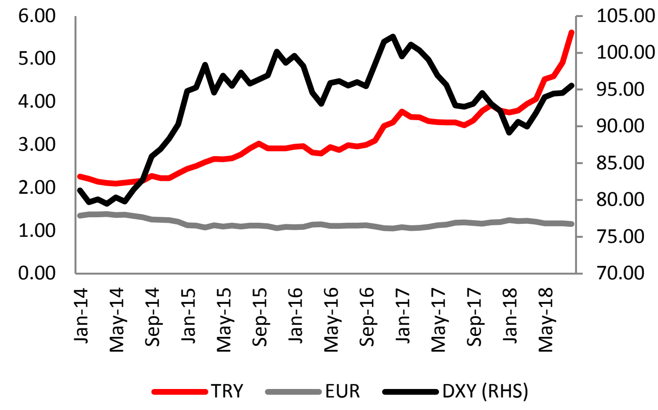
Turkey's economy at risk. Turkey has in recent years been one of the fastest-growing economies in the world, but its impressive growth numbers were fuelled by foreign-currency debt. Based on the latest data, the economy grew more than expected at 7.4% in 1Q18 following 7.3% in the previous quarter. High inflation on top of soaring debt which estimated at USD350b is some major factors weighing on Lira. Despite the escalating worries on the economy, Erdogan refused to increase interest rate as he strongly believes cheap credit is the way to fuel the economy. Besides, the appointment of his own son-in-law as the finance minister and his power to appoint central bank governor has sparked concerns over the president's influence.

Chart 1: Lira vs Other Currencies (YoY%)



Source: Bloomberg, MIDFR

Chart 2: Lira vs USD vs EUR (Currency Value)



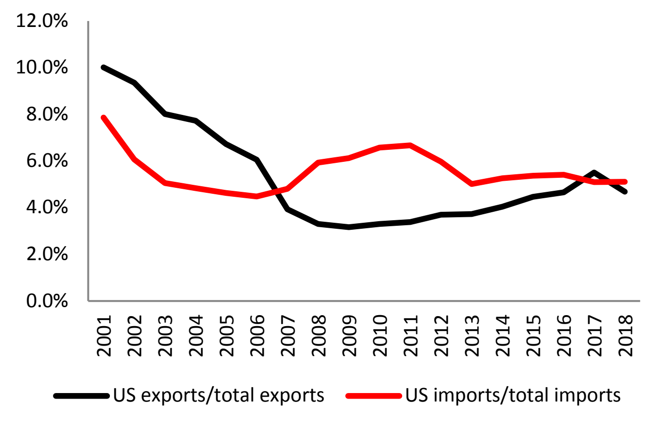
Source: Bloomberg, MIDFR

What occurs in Turkey won't stay in Turkey. The ongoing lira crisis has ignited concerns beyond Turkey's border as it could spill over into both emerging and developing markets besides European Banks. European Banks and some emerging economies that lent money in Turkey are beginning to worry about the country's ability to pay back their loans. Meanwhile from trade perspective, Turkey's current tensions will be harmful to other countries in two ways. First, Lira depreciation will make imports to the country more expensive. Second, lower exports to US as a result of higher tariffs will disrupt Turkey's imports of goods from other counties that are in the supply value chain.

Snapshot - Turkey-US bilateral trade ties. Historically, share of US exports to Turkey's total exports have been trending downward since 2000 before a modest recovery in 2009 until 2017. However, starting mid-2017, the downward spiral repeats. In Jun-18, share of US exports to Turkey's total exports was recorded at 4.8%, far lower than 6.9% in Jun-17. Besides that, Turkey was having trade deficit with the US since Apr-06. In Jun-18, Turkey's trade deficit with the US was recorded at USD521.4m as exports declined sharply by 30.4%yoy while imports expanded by 7.9%yoy. Hence, the latest tariff threat by the US is considered as an act of rubbing salt into the wound.

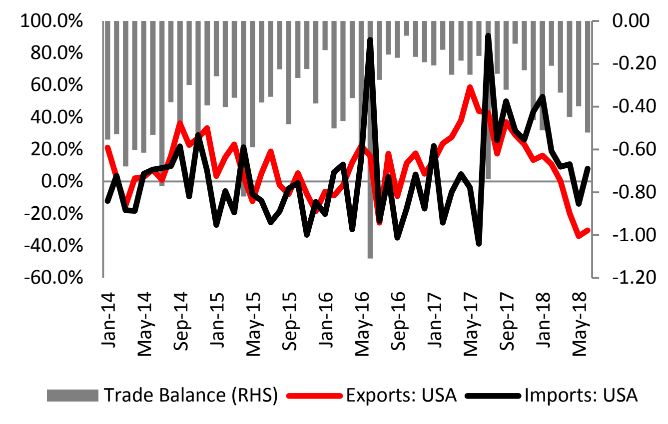
Minimal yet cautious impact to Malaysia. Tracking back the data, share of Turkey exports to Malaysia's total exports were steady for a period of time before skyrocketing in Aug-15 due to the implementation of Malaysia-Turkey Free Trade Agreement (MTFTA). Since then, share of Turkey exports to Malaysia's total exports were increasing and hit highest ever share of 1.3% in Jun-17. In Jun-18, the share was registered at 1% of Malaysia total exports. Despite the positive trend, Turkey is not positioned as Malaysia major export destinations when compared to other countries such as China, US and Japan. With the less significant position, we expect the ongoing crisis in Turkey to have a minimal impact on Malaysia. However, Turkey's rank as one of the top five Malaysia's palm oil exports destinations remains a concern.

Chart 3: US contribution to Turkey external trade (%)



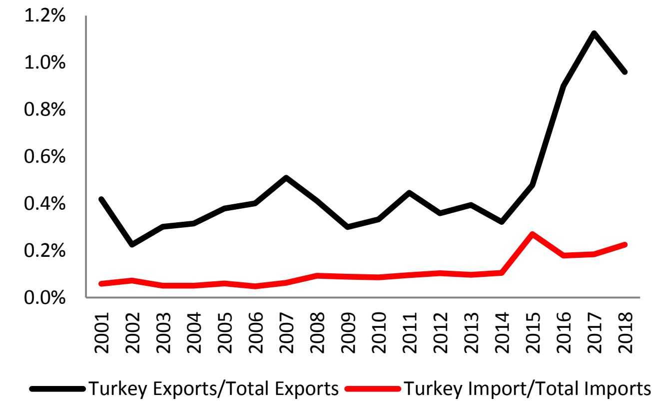
Source: CEIC, MIDFR

Chart 4: Turkey external trade with US (YoY %)



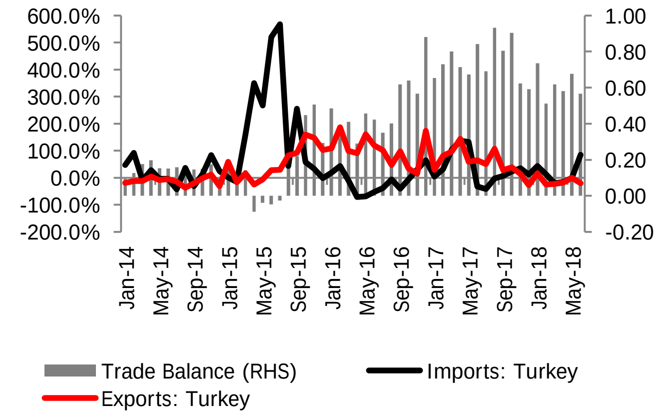
Source: CEIC, MIDFR

Chart 5: Turkey contribution to Malaysia external trade (%)



Source: CEIC, MIDFR

Chart 6: Malaysia external trade with Turkey (YoY%)



Source: CEIC, MIDFR

Global economy to drag down by -0.1% if Turkey contracts. Based on our estimate, ceteris paribus, global output is expected to shrink marginally for every 1% drop in Turkey's final demand. Zooming into various countries, EU27 is among economic area that will be significantly impacted, -0.27%. Other major economies such as the US and China are predicted to experience slight slowdown of -0.07% and -0.09% respectively. Overall, we opine the impacts of contraction in Turkey's economy are minimal towards global economy, possibly due to its relative economic contribution. Nevertheless, further escalating trade war may induce larger economic slowdown in several economies including major and emerging economies. Greater market uncertainties, weakening currencies and falling business confidence are key downside risks in the medium term.

Malaysia's total output to drop by -0.135% by Turkey. Following the simulation results, we noticed the fall in demand from Turkey will cause -0.135% contraction in Malaysia's total output. By sector, among others textiles & textile products, F&B products, rubber & plastic products, wholesale & retail trade and agriculture products are the top six sectors most impacted in the event final demand by Turkey reduced by -1%.

Table 1: Output Change (%) For Every 1% Drop of Turkey's Final Demand

	USA	**China**	**EU27**	**Malaysia**
Agriculture, hunting, forestry and fishing	(0.005)	(0.001)	(0.004)	(0.007)
Mining and quarrying	(0.004)	(0.003)	(0.016)	(0.004)
Food products, beverages and tobacco	(0.001)	(0.001)	(0.003)	(0.009)
Textiles, textile products, leather and footwear	(0.002)	(0.005)	(0.009)	(0.017)
Wood and products of wood and cork	(0.002)	(0.002)	(0.008)	(0.003)
Pulp, paper, paper products, printing and publishing	(0.003)	(0.003)	(0.008)	(0.003)
Coke, refined petroleum products and nuclear fuel	(0.002)	(0.003)	(0.014)	(0.004)
Chemicals and chemical products	(0.004)	(0.005)	(0.015)	(0.010)
Rubber and plastics products	(0.002)	(0.004)	(0.014)	(0.008)
Other non-metallic mineral products	(0.001)	(0.002)	(0.007)	(0.003)
Basic metals	(0.008)	(0.004)	(0.029)	(0.007)
Fabricated metal products	(0.003)	(0.005)	(0.012)	(0.006)
Machinery and equipment, nec	(0.004)	(0.004)	(0.019)	(0.007)
Computer, Electronic and optical equipment	(0.003)	(0.006)	(0.012)	(0.005)
Electrical machinery and apparatus, nec	(0.002)	(0.004)	(0.015)	(0.004)
Motor vehicles, trailers and semi-trailers	(0.001)	(0.002)	(0.020)	(0.002)
Other transport equipment	(0.007)	(0.004)	(0.009)	(0.001)
Manufacturing nec; recycling	(0.003)	(0.009)	(0.008)	(0.005)
Electricity, gas and water supply	(0.001)	(0.003)	(0.005)	(0.003)
Construction	(0.000)	(0.000)	(0.001)	(0.000)
Wholesale and retail trade; repairs	(0.002)	(0.005)	(0.007)	(0.007)
Hotels and restaurants	(0.001)	(0.002)	(0.002)	(0.001)
Transport and storage	(0.002)	(0.004)	(0.008)	(0.004)
Post and telecommunications	(0.001)	(0.001)	(0.004)	(0.002)
Financial intermediation	(0.002)	(0.002)	(0.004)	(0.003)
Real estate activities	(0.000)	(0.001)	(0.002)	(0.001)
Renting of machinery and equipment	(0.002)	(0.002)	(0.006)	(0.002)
Computer and related activities	(0.001)	(0.002)	(0.004)	(0.001)
R&D and other business activities	(0.001)	(0.001)	(0.006)	(0.004)
Public admin. and defence; compulsory social security	(0.000)	(0.000)	(0.001)	0.000
Education	(0.000)	(0.000)	(0.001)	0.000
Health and social work	(0.000)	(0.000)	(0.000)	(0.000)
Other community, social and personal services	(0.000)	(0.001)	(0.003)	(0.002)
Private households with employed persons	0.000	0.000	0.000	0.000
Total Output	**(0.072)**	**(0.092)**	**(0.271)**	**(0.135)**

Source: OECD, MIDFR

Sectoral Analysis

Aviation Sector

Our take on the news is Neutral. MAHB generates about 40.5% of its total revenue from Turkey ISG, with Malaysia operations contributed the rest. However, the revenues from Turkey are primarily generated in Euros (85.0%) while the opex are in the local currency of Lira. In regards to this, we opine that any depreciation of Lira may improve margins. As of 1QFY18, the margin of ISG stood at 21.9%.

Operationally still strong. Over the past years, ISG airports have managed to attract a strong flow of passengers, leading to strong annual growths in both domestic and international sectors. For example, growing by double digit for both international (+13.4%yoy) and domestic (+12.4%yoy) in 1HFY18. This had led to revenue from Turkey's operations rising by +13.2%yoy to RM1.1b in FY17 on the back of +5.6%yoy improvements in passenger traffic at ISG. Nevertheless, it has remained loss-making due to high amortization expenses. Despite this, we expect ISG to turn the corner by the end of FY18, underpinned by robust passengers' growth, revenue optimisation and operational efficiency improvement. We believe this is likely, considering the narrowing trend of losses at ISG.

Moving forward, we opine that growth is likely to continue driven by increased airport capacity and future opening of ISG's second runway. This should provide a solid structural base for ISG to maintain its momentum, catering to the growing passengers' traffic. We noted that ISG was recognized as Europe's fastest growing airports in terms of number of passengers for seven consecutive years. While the depreciation of Lira could bring upon uncertainties to domestic traffic flow in the immediate term, we believe it could also spur more demand in the international sector. This stemmed from the possibilities of higher purchasing power among international tourists, leading to stronger growth in the sector.

MAHB still a BUY, TP: RM9.88. While we are **NEUTRAL** on the news, we maintain our **POSITIVE** view on the group's overall operation**.** We believe the strong momentum of traffic flow primarily international to continue, underpinned by the robust air travel demand. This will be supported by supportive visa policies in Malaysia and favourable demographic factors. Accordingly, we maintain our **BUY** call on the stock with an unchanged TP of **RM9.88**.

Healthcare Sector

Natural hedge for Acibadem with potential increase in medical tourism. We understand from the Management that, despite the steep decline in Turkish Lira over the week (Lira went down as low as -14% against USD which is the worse since the Turkish financial crisis back in 2001) it has actually resulted in an increase in medical tourism (~ 10% of Acibadem's revenue), bringing hard medical receipts in USD and EUR. Also, in terms of operating costs, Acibadem is also less impacted as the team has already converted majority of its operating leases into Lira, thereby greatly reducing the increase in operating costs. As a result, we expect the impact to revenue and EBITDA to be rather insignificant as it would just be translational loss on the Lira due to stronger RM (non-cash nature).

Foreign currency debt could impact bottom line. However, we note that the impact to the bottom line is the foreign currency debt which Acibadem has (Due to the liquidity/funding limitation in the Turkish financial market, IHH has taken up USD & Euro debt to finance Acibadem's expansion which in blended costs lower than the financing costs in Lira). We understand that the management team has already shelved all capex plans for Acibadem as revealed in its 1QFY18 conference call and at the same time, the team is looking to resize Acibadem's balance sheet so as to reduce the foreign currency debt exposure which we believe would significantly guard Acibadem's interest against the volatility of the Turkish Lira.

Stronger SGD to cushion translation loss from devaluation of Lira. Furthermore, the receipt coming for Acibadem in Lira is 89% and Euro/USD is 11% which we opine provides some cushion from the devaluation of the Turkish Lira to IHH on its financing costs. In addition, we believe that the stronger SGD will also assist in mitigating the impact of the devaluation of Turkish Lira on IHH's overall revenue. Recall that Acibadem makes up roughly 36% to IHH's total revenue and the balance of 64% is from its other home markets with Singapore being the largest contributor among the others at 53%.

Reiterate BUY on IHH, TP: RM7.00. Due to this, we are reiterating our BUY recommendation on IHH Healthcare with an unchanged TP of RM7.00per share. Given that the share price has come down to a new low last seen on 25th May 2017 (RM5.56per share), we opine that this presents an opportunity to accumulate the shares given that IHH's share price as at 5.00pm was recorded at RM5.41per share, -5.9% down from RM5.75 which is its Friday's closing price pre-Lira devaluation. We also believe that the sell down has been overdone considering the fundamentals and growth opportunity going forward of the company remains intact. We continue to like IHH for its: (i) Geographically diversified revenue exposure; (ii) Robust balance sheet and; (iii) Strategic expansion plans.

Energy Sector

Share price impacted by weak Lira. Tenaga's share price was hit yesterday following a continued fall in the Turkish Lira. The Lira has fallen 24% since late last week. Tenaga has a 30% stake (purchased for USD250m back in 2016) in Turkish based GAMA Enerji, which operates a portfolio of wind, hydro and gas turbine power plants. GAMA Holdings owns a 50.5% stake and the remaining 19.5% are held by International Finance Corp and Global Infrastructure Fund.

Small earnings contribution. GAMA Enerji generated PAT of RM52m in FY17 (Tenaga's share: RM16m) accounting for just 0.2% of Tenaga's earnings. Tenaga still carries a RM264m goodwill from the acquisition of the stake in GAMA Enerji. If the goodwill is written off, the impact is just a one-off 4% of Tenaga's annual earnings, to give a yardstick.

Debt could be a concern. It has been reported that GAMA Holdings (GAMA Enerji's major shareholder) has been looking to restructure USD1b worth of debt while at GAMA Enerji level, is looking to refinance a USD500m loan it took to construct a gas power plant in 2013. Both GAMA Holdings and GAMA Enerji are private companies, but GAMA Enerji has been reported to be GAMA Holdings' largest asset. There have also been reports of GAMA Holdings' intention to sell off its 50.5% stake in GAMA Enerji.

Mark-to-market could hit earnings. If the bulk of GAMA Enerji's debt is foreign debt, there is possibility of a mark-to-market adjustment which could hit earnings by an exceptional amount. While we would presume most of GAMA Enerji's debt are long term in nature (concession backed), if there is any rollover or refinancing of existing debt, there is likelihood that GAMA will realize some forex loss.

Recommendation. Our TP remains unchanged at RM16.30 at this juncture, and our BUY call is maintained. Dividend yields are attractive at 4.6% (+ve spread against 10yr MGS of 4.26%) while valuations are cheap at 12x FY18F earnings, a substantial discount to the market's 16x-17x.

Table 2: GAMA ENERJI'S Key Financials

Gama Enerji (RMm)	**FY17**
Revenue	1683.1
PAT	51.7
TNB's share of profit	**15.5**
Contribution to TNB net profit	**0.2%**
Non-current assets	7,264.7
Current assets	924.5
Non-current liabilities	(5,069.3)
Current liabilities	(758.7)
Non-controlling interest	(38.1)
Net asset	**2,323.1**
TNB's share of net asset	**696.9**
Goodwill carried by TNB	263.9
Goodwill as a percentage of TNB net profit	**3.9%**

Source: Company, MIDFR

Table 3: GAMA ENERJI'S Assets

	Fuel	Capacity (MW)	Stake	Commencement Year	Concession Period (Years)	Concession Start
Birecik	Hydro	672	18%	2001	15	-
Lamas	Hydro	36	100%	2009	49	2006
Cakirlar	Hydro	17	100%	2009	49	2007
Sares	Wind	25	96%	2010	49	2008
Karadag	Wind	10	96%	2012	50	2008
Gok II	Wind	35	96%	2014	49	2012
Tynagh	CCGT	385	40%	2006	30	2004
		1,179				
Previously Under Construction						
Kirikkale	CCGT	840	96%	2016	49	2016
		2,019				
Previously In Development						
Kirkagac	Wind	45	100%	2016		
Marmara	Wind	10	100%	2018		
Istanbul	Wind	200	100%	2019		

Source: Company, MIDFR

Plantation Sector

Turkey is one of the top ten export destinations of Malaysia palm oil export. In 2017, it is ranked 6th with value of exports worth RM2.02b based on the data from Department of Statistics. By volume, export to Turkey amounts to 0.68m tonnes in 2017. Based on International Monetary Fund (IMF) estimate, Turkey has a population of 80.81m as of end-2017 and it is expected to grow to 86.91m by end-2023. In 2017, Turkey has nominal GDP of USD851.10b based on World Bank estimate.

In view of the recent crisis that hit Turkey Lira, we believe that the **impact to Malaysia palm oil export is minimal**. Firstly, the export of Malaysia palm oil is diversified across many countries. Note that the contribution of export to Turkey of RM2.02b makes up only 4% of total palm oil exports value of RM46.12b. Secondly, palm oil volume may not be affected as severe as other items as it is food related hence the consumption volume tend to be more stable.

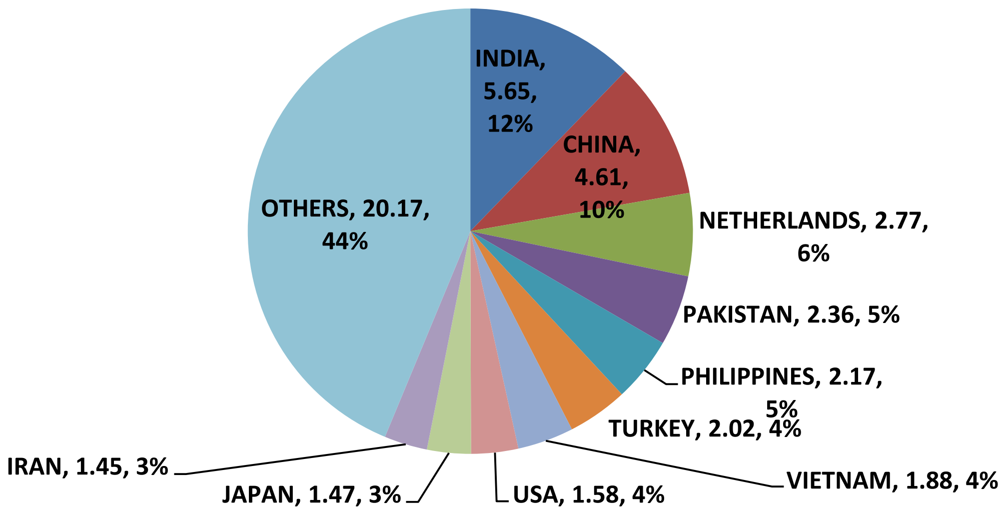
Maintain NEUTRAL on the sector; buy calls on KLK and GENP. We maintain our average CPO price forecast of RM2400 per tonne for 2018. We like KLK for its earnings resiliency and decent dividend yield of 2.6%. We like GENP as we expect its FFB growth at 13% yoy to be the strongest among planters under our coverage. This is due to new contribution from recently acquired estate of 12,893 ha and 5000 ha coming to maturity in Indonesia.

Table 4: Top ten export destinations of Malaysia palm oil by value

Country	2017		2016		Change in Rank
	Value (RM'b)	Rank	Value (RM'b)	Rank	
INDIA	5.65	1	7.37	1	Unchanged
CHINA	4.61	2	5.90	2	Unchanged
NETHERLANDS	2.77	3	3.75	3	Unchanged
PAKISTAN	2.36	4	2.31	4	Unchanged
PHILIPPINES	2.17	5	1.92	7	Down by 2
TURKEY	2.02	6	2.13	6	Unchanged
VIETNAM	1.88	7	1.57	8	Up by 1
USA	1.58	8	2.17	5	Down by 3
JAPAN	1.47	9	1.49	9	Unchanged
IRAN	1.45	10	1.07	12	Up 2 rank

Source: Department of Statistics of Malaysia (DOSM); MIDFR

Chart 7: Turkey is one of the top ten export markets for Malaysia palm oil



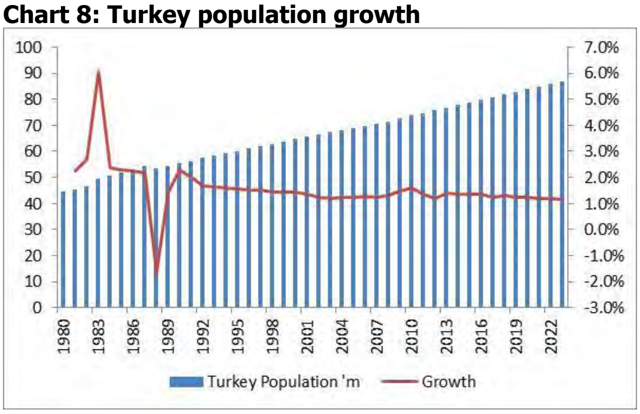
Source: DOSM, MIDFR

Table 5: Top ten export destinations of Malaysia palm oil by volume

Country	2017		2016		Change in Rank
	Volume ('m MT)	Rank	Volume ('m MT)	Rank	
INDIA	2.03	1	2.83	1	Unchanged
CHINA	1.92	2	1.88	2	Unchanged
PAKISTAN	1.02	3	0.88	4	Up by 1
NETHERLANDS	1.00	4	1.02	3	Down by 1
PHILIPPINES	0.75	5	0.63	6	Up by 1
TURKEY	0.68	6	0.66	5	Down by 1
VIETNAM	0.63	7	0.56	8	Up by 1
USA	0.55	8	0.59	7	Down by 1
IRAN	0.52	9	0.36	14	Up by 5
JAPAN	0.50	10	0.46	9	Down by 1

Source: DOSM, MIDFR

Chart 8: Turkey population growth



Source: International Monetary Fund (IMF), MIDFR

Chart 9: Turkey GDP since 1968

Source: World Bank, MIDFR

Strategy

Of the 30 FBM KLCI constituents, three companies, namely **Tenaga Nasional**, **Malaysia Airports**, and **IHH Healthcare**, have operations in the Republic of Turkey.

Nonetheless, as explained in above, their exposures in that country are not expected to materially impact their respective earnings performance in the immediate future due to, among others, insignificant contribution to total earnings as well as significant non-Turkish Lira revenue stream.

Furthermore, from valuation standpoint, at this juncture we reckon the situation in Turkey would not result in a market contagion thus we maintain our year-end PER target for the FBM KLCI at 16.6x which equates to -0.2SD (based on 5-year historical data).

On that score, we reiterate our **FBM KLCI 2018 year-end target at 1,800 points**.

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >+10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >+10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >-10% 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.