THEMATIC REPORT | Malaysia's Domestic Exports

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KEY HIGHLIGHTS

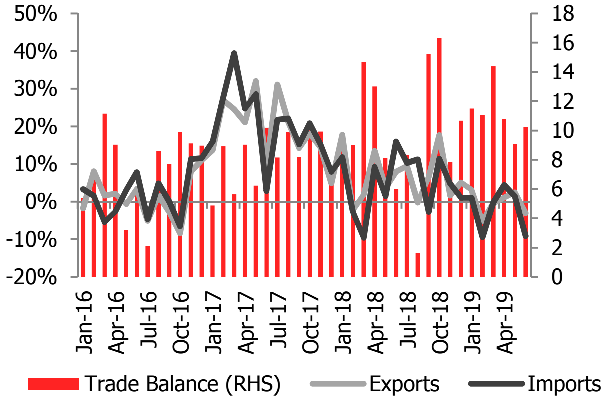
- **Domestic exports still solid. Brighter outlook for GDP growth in 2Q19 and 2H19 as domestic exports provide higher value-added to the economic growth**
- **Agriculture goods are high margin goods. For the 1H19, net export margin of agriculture goods is approximately 34%, the largest among the three main sectors.**
- **E&E products has low net exports margin despite high trade surplus**
- **Maintain NEUTRAL. The presence of the start-ups in the logistics industry will continue to bite into margins of existing players in the wake of higher demand from e-commerce activities.**

Trade surplus returns to above RM 10b mark despite falling exports. Trade surplus increased to RM 10.3b in June-19 from the first time in this year at below RM 10b in May-19 as imports fell harder than exports. Both exports and imports growth plunged to negative territory of -3.1%yoy and -9.2%yoy respectively after maintaining positive growth in the previous two months. Such weak external trade performances could be the result of multiple headwinds took place during the month. June-19 was the first full month of US tariff on Chinese imports after the truce and US ban on Huawei, both deteriorate global sentiment. Sector wise, manufacturing and agriculture exports contracted by -5%yoy and -0.8%yoy respectively. In contrast, mining exports rebounded sharply to a double digit positive growth of 15.4%yoy (May-19: -10.9%yoy).

Domestic exports still solid. Domestic exports expanded by 1.7%yoy, the lowest in three months but still above last year average of 0.8%. The seventh consecutive months of positive growth indicates a good momentum for this year and provides brighter outlook for GDP growth in 2Q19 and 2H19 as domestic exports provide higher value-added to the economic growth. In contrast, re-exports which have low domestic value-added contracted for the fifth consecutive month at -22.3%yoy. Meanwhile, the ratio of re-exports to total exports was recorded higher at 16.1% (for every RM1 value of exports, approximately 16sen of it is re-exports). Re-exports activities are expected to remain weak throughout the year mainly due to higher base effects besides external headwinds.

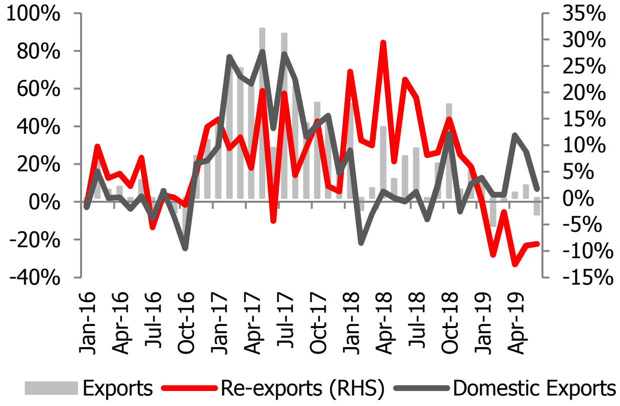
KINDLY REFER TO THE LAST PAGE OF THIS PUBLICATION FOR IMPORTANT DISCLOSURES

Chart 1: Trade Balance (RMb) vs Exports & Imports (YoY%)



Source: CEIC, MIDFR

Chart 2: Total Exports: Domestic vs Re-exports (YoY%)

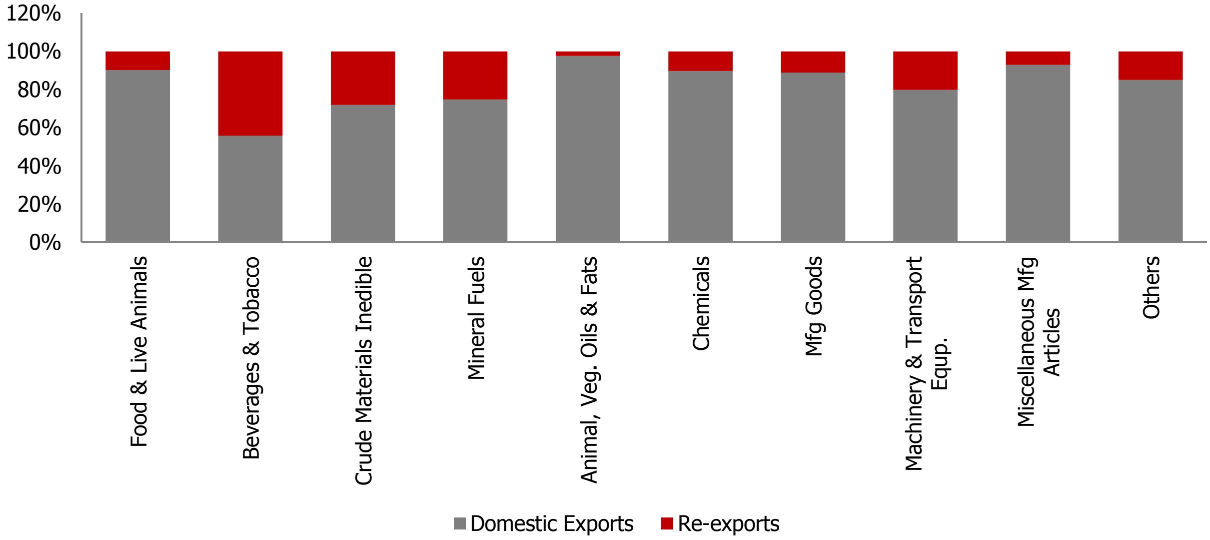


Source: CEIC, MIDFR

Animal, vegetable oils & fats has the highest domestic exports activities. Based on the SITC goods classification, year-to-date, approximately 98% of total exports of animal, vegetable oils & fats involved domestic exports activities in which goods are locally produced including those of foreign source but have been significantly changed through local processing. Only the balances 2% are re-export activities. It followed by domestic exports of miscellaneous manufactured articles which accounted for circa 93% of the total outbound shipments of that product. Based on the latest data in June-19, domestic exports of animal, vegetable oils & fats grew by 9.5%yoy while those of miscellaneous manufactured articles declined -6.3%yoy. In contrast, re-exports of animal, vegetable oils & fats contracted by -67%yoy while grew by a tepid pace of 0.1%yoy for the miscellaneous manufactured articles.

The highest re-export activities found in beverages & tobacco. Year-to-date, 44% of total exports of beverages and tobacco are re-exports. It followed by re-exports of crude materials inedible and machinery & transport equipment which hold 28% and 20% share respectively. Based on the latest data in June-19, re-exports of beverages & tobacco, crude materials inedible and machinery & transport equipment posted negative growth of -5.4%yoy, -32.8%yoy and -25.1%yoy, respectively. High re-export activities are less favorable as it has low value added activities hence less significant contribution to the economic growth. Nevertheless, it reflects the importance of Malaysia in the global value chain of various sectors.

Chart 3: Domestic Exports & Re-exports by SITC (Share %)

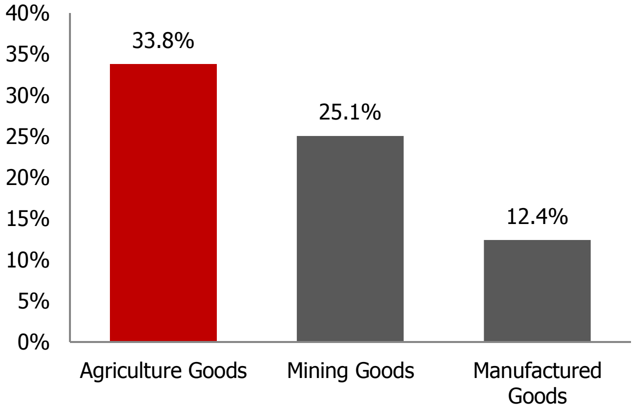


Source: CEIC; MIDFR

Agriculture goods are high margin goods. For the 1H19, net export margin of agriculture goods is approximately 34%, the largest among the three main sectors. It means Malaysia keeps 34% of the total revenue made from selling agriculture goods. The remaining 66% of the revenue was spent on buying the goods. Further breakdown showed that palm oil and its products has net export margin of circa 92% which simply means that Malaysia keep 92sen for every RM1 it made from palm oil sales. Meanwhile, mining goods has the second largest net exports margin and then followed by manufacturing. Among the mining goods, net export margin for LNG is 89%.

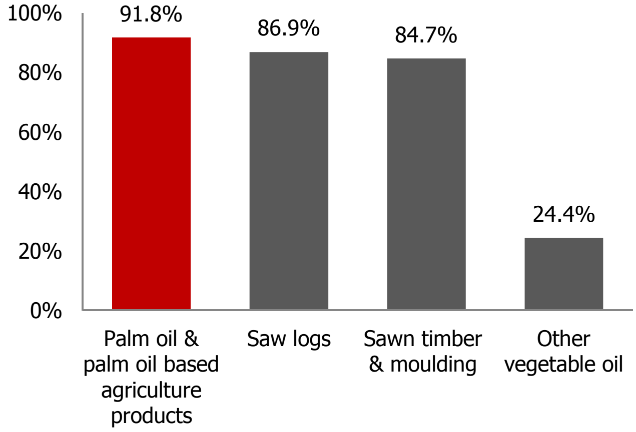
E&E products has low net exports margin despite high trade surplus. Trade surplus of E&E products was recorded at RM 62.4b which accounted for about 93% of total trade surplus in 1H19. Despite such a huge contribution, net exports margin of the products is just around 34%. It implies that Malaysia don't get a high level of profit from E&E products compared to the cost incurred on producing them. Similarly, other manufactured goods such as optical & scientific equipment have around the same level of net exports margin as E&E. Nevertheless, commodity-based manufactured goods such as palm-oil based manufactured products, rubber products and wood products have high net exports margin of 77%, 63% and 78% respectively.

Chart 4: Net Exports Margin by Sector (%)



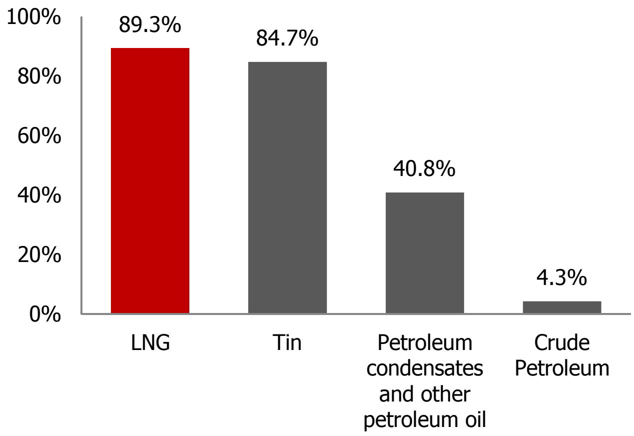
Source: CEIC, MIDFR

Chart 5: Agricultural Net Exports Margin (%)



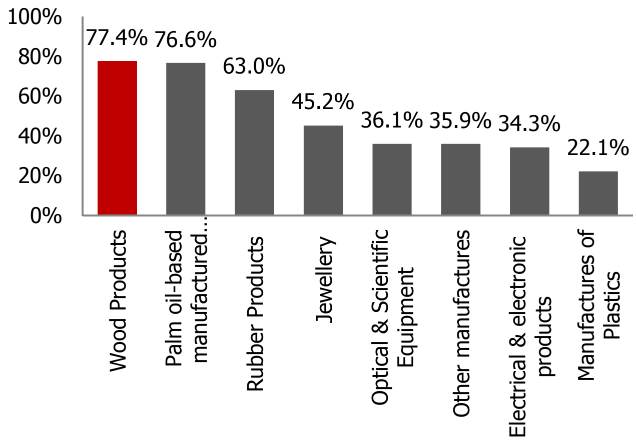
Source: CEIC, MIDFR

Chart 6: Mining Net Exports Margin (%)



Source: CEIC, MIDFR

Chart 7: Manufacturing Net Exports Margin (%)



Source: CEIC, MIDFR

Sectoral Impacts – Transportation

MNCs view Malaysia as a strategic hub for distribution. MNCs have seen Malaysia as a strategic location to place their distribution hubs especially in Selangor, Penang and Johor Bahru due to infrastructure which are conducive combined with connectivity to ports and airports. For instance in Penang, global technology firm, Broadcom aims to leverage on Penang's solid contribution of global back-end semiconductor output at 8% by opening its 150,000 sqft global distribution warehouse on a 2ha land at Batu Kawan Industrial Park, Penang.

Figure 1: Proximity of Batu Kawan Industrial Park with Penang Airport and Penang Port

Source: Invest Penang

Close proximity to airport. Due to its strategic location not too far away from the Penang International Airport (Bayan Lepas) and Penang Port (Butterworth), the facility serves as a central storage place for Broadcom's global inventory for products manufactured in the U.S, Taiwan, South Korea, Thailand and Malaysia before being distributed worldwide. It is also comforting to note that in the long run, Broadcom is planning to expand with an investment of RM4.1b over the next 10 years for global production planning, quality management and logistics management. Broadcom's presence would further strengthen Malaysia's electrical and electronics (E&E) ecosystem and create vast business opportunities for companies in supporting industries.

Higher exports contribution from air freight in Penang. Global major logistics player, FedEx Express (FedEx) also jumped on the expansion bandwagon by setting up a RM17.6m shipping facility spanning 4,830 sqm called the 'FedEx Gateway' at Penang International Airport which enables goods to be shipped to the U.S in one business day and overnight delivery to 20 major Asian cities. The services offered by FedEx are made possible with two Boeing 767s and three 40t trucks connecting Penang by road to Bangkok and Singapore. Internally, the facility features an X-ray scan for all packages regardless of size and has the capacity to sort 2,700 parcels per hour. Notably, the value of import and exports in Penang contributed by airports has always surpassed the value from sea port with at RM21.8b and RM11.2b respectively in January 2019. This serves as a strong predicament for FedEx to continue focusing in Penang.

Table 1: External trade by channel, Penang from January to June 2019

January to June 2019	Export (RM'b)	Import (RM'b)
Seaport	24.1 (+9.8%yoy)	18.7 (-3.4%yoy)
Airport	109.7 (-0.1%yoy)	62.9 (-3.4%yoy)

Source: Department of Statistics Malaysia

Pulau Indah to be the gem for Port Klang. As for Selangor, distribution hubs tend to focus more on sea freight given the significance of Port Klang. IKEA will be investing around RM900m in setting up its regional distribution centre in Pulau Indah Industrial Park which is expected to be completed by September 2020. This is Ikea's third largest distribution hub after Chicago and Dusseldorf, with a size of 95,000m^2 and estimated storage capacity of 192,800$m^3$is expected to cater not just IKEA stores in ASEAN, but also in India. Moreover, Ikea's plan accelerates momentum towards making Malaysia a regional distribution hub and preferred logistics gateway to Asia as outlined in the National Logistics and Trade Facilitation Masterplan and National E-Commerce Strategic Roadmap.

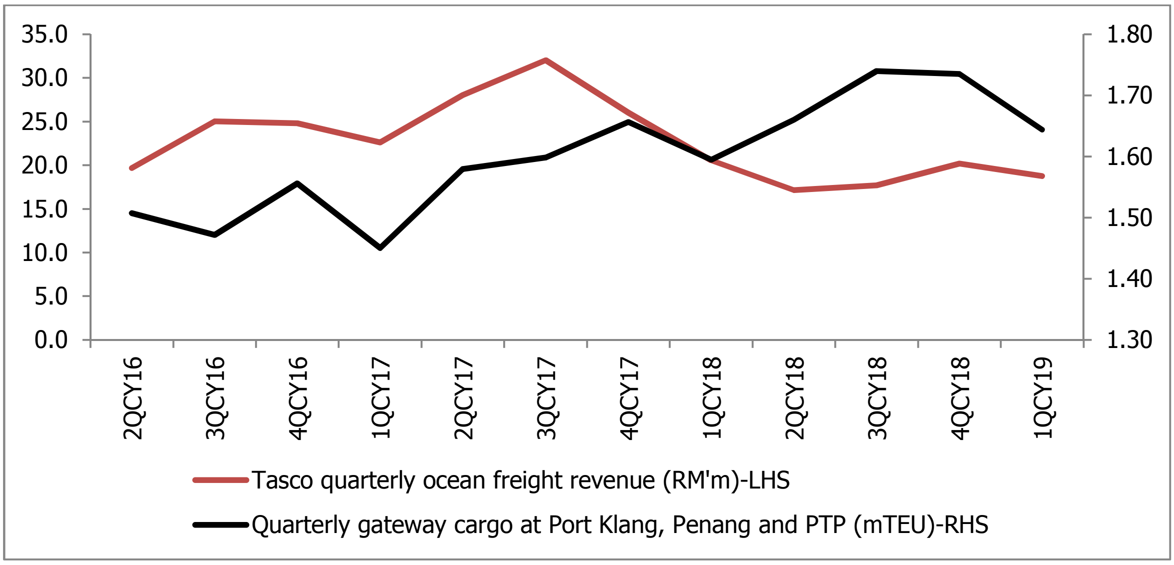
The emergence distribution hubs to benefit local logistics companies which have plans to develop facilities within Pulau Indah. In mid-2018, Tasco completed its acquisition of MILS Cold Chain Logistics Sdn Bhd (MILS) together with six parcels of land near Westports for a total of RM144m. Following the acquisition, Tasco has a footprint in Pulau Indah via MILS's temperature-controlled storage facility with a capacity of approximately 10,500 pallet space. More importantly, it allows Tasco to gain a sizeable landbank with close proximity to the busiest container port in Malaysia, which is Port Klang. In addition, these properties are strategically located within Westport's free zone gazetted by MOF under the Free Zone Act, 1990, allowing Tasco to provide warehousing services tailored to the needs of multi-national corporations for transshipment and the import/ export trade. Furthermore, approximately 17.78 acres of the Properties remain unoccupied, which could be utilised in future to build additional warehouse facilities and provide ancillary services especially when re-export and distribution activities ramp up.

Ocean freight forwarding division to be mainly contributed by Port Klang. Based on our analysis, Tasco's revenue for the ocean freight forwarding division moves in tandem with the container volumes of the main ports in Malaysia, i.e. Port of Tanjung Pelepas, Port Klang and Penang Port. Amongst the total container volume of these three ports, more than half is contributed by Port Klang. Therefore, Tasco's move to have a landbank in Pulau Indah would enable it to setup warehousing facilities when demand arises from the increase is re-export activities.

Table 2: Acquisition of MILS and Pulau Indah Land

Subject	Details
Announcement date	23rd Jan 2017
Completion	Mid-2018
6 parcels of land at Pulau Indah with size of 39.52 acres @ Free trade zone	RM113,827,400
100% of MILS Cold Chain Logistics (MILS)	RM29,925,100
Cold room pallets	10,500
Warehouse & land location	Pulau Indah (Westports)
Other info	Land located in free trade area
	QSR Group is a key customer
Valuation	1) Land based on an 8.1% discount to current market value
	2) MILS based on revised NTA

Chart 8: Relation between Gateway Cargo from ports and TASCO Ocean freight Revenue

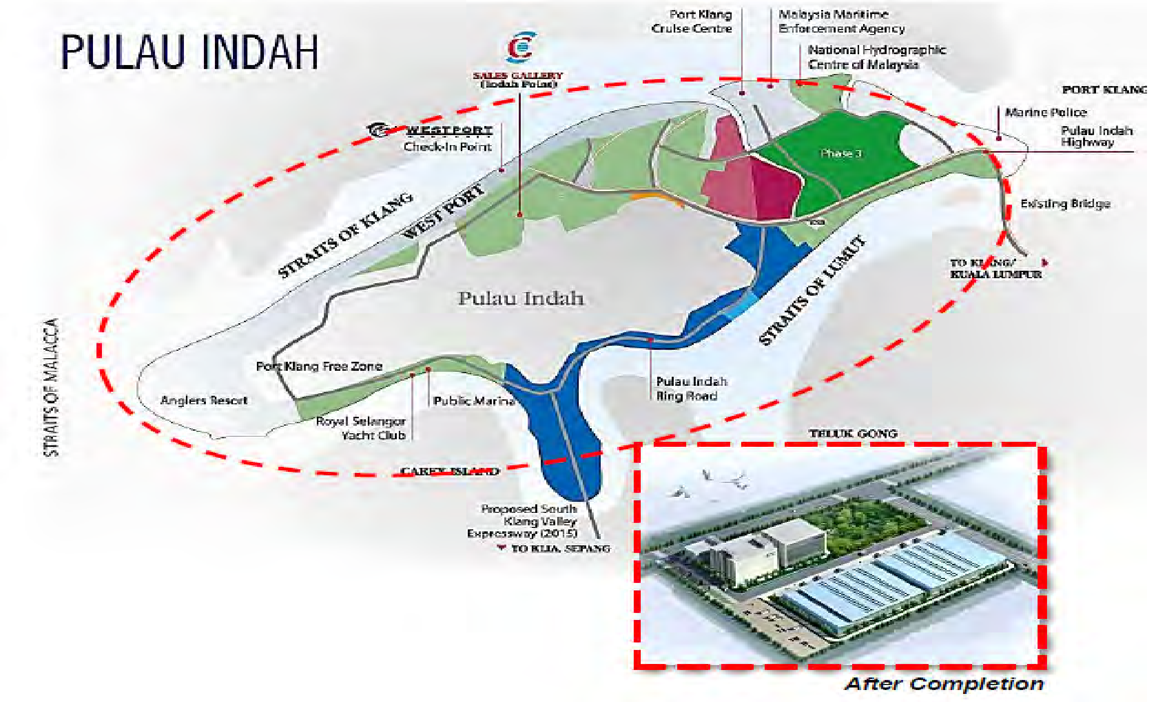


Source: CEIC Data, MIDFR, Tasco

Other companies also want to grab a piece of the pie. Tri-Mode System (M) Berhad (Tri-Mode) (Non-rated) has also targeted Pulau Indah to be the strategic location for its new headquarters and distribution hub with the size of around 517,928 sqft or roughly 12 acres, which is expected to contribute in FY20. The distribution hub will centralise Tri-Mode's operations under one roof with a warehouse equipped with racking system and bar-coding inventory monitoring system.

Spill-over effect from IKEA is highly likely. It is comforting to note that IKEA's regional distribution and supply chain hub in Pulau Indah is within the vicinity of Tri-Mode's new headquarters. If IKEA were to engage Tri-mode for its warehousing and freight forwarding services, with the warehousing capacity expected to be increased by an additional 50-55k sq ft (currently at 11.8k sq ft, with utilisation near 100%), Tri-Mode is more than ready to handle shipments for IKEA.

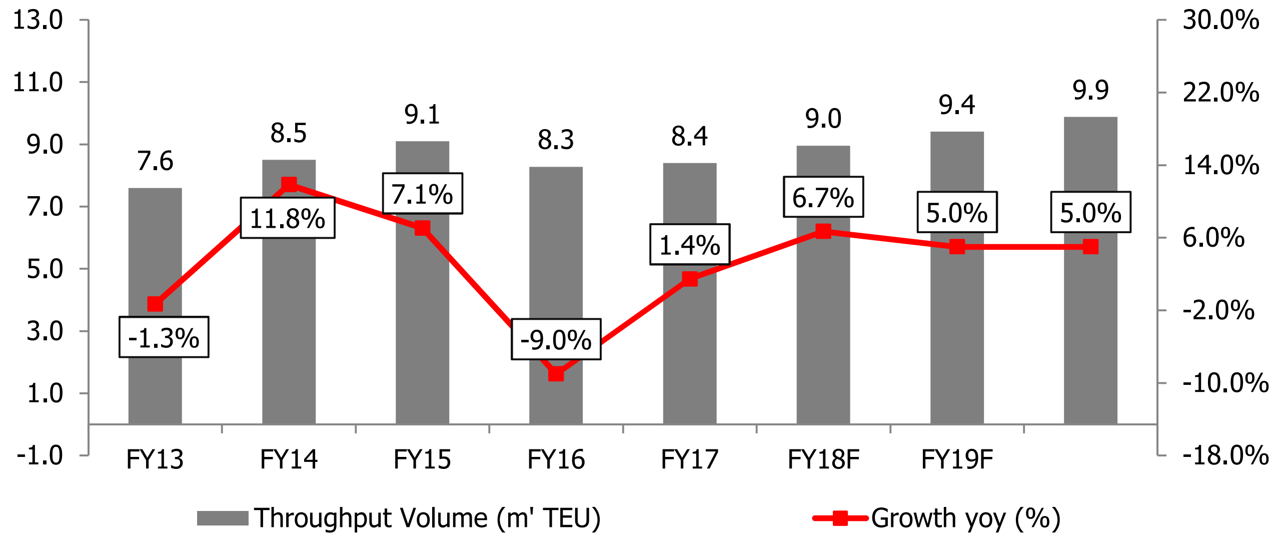
Figure 2: Tri- Mode New Headquarters and Distribution Hub in Pulau Indah



Source: Tri-Mode Systems

Southern free trade zones gaining traction from international car companies. Over the past few years, there have been a slew of international car companies relocating their aftersales hub to the free trade zones in Johor. MMC Corp's **(BUY; RM:1.31)** PTP has invested around RM2.4b in its Free Zone covering 1,586 acres of land with more than 80% of the developed land in phase 1 and 2 subleased to various local and global companies while has chalked up an annual shipping turnover of 100,000 TEUs. Meanwhile, MMC Corp has obtained approvals to develop phase 3 of the Free Zone which will cover 168 acres and is expected to start physical works in around 2 years' time. One of the latest occupants in the PTP Free Zone is Volkswagen's regional parts centre of MMC Corp's PTP which commenced operations in October 2018, serving 20 markets across ASEAN, Australia and New Zealand for Volkswagen, Skoda, Audi and Porsche. As the centre has a direct connection to the port, the requirement for intermediate handling is eliminated and container volumes at PTP could be sustained from the distribution activities from the centre.

Chart 9: Port of Tanjung Pelepas container throughput



Source: MMC Corp, MIDFR

Other big names present in PTP. Global automaker BMW has also commenced operations for its regional parts distribution centre at the Free Industrial Zone of Senai International Airport. This is BMW's largest facility in Asia Pacific located on a 775,000 sqft land and will not only target ASEAN countries but to as far as North Asia and Oceania (i.e. Australia, New Zealand, Tahiti, New Caledonia, Fiji and Guam). The facility could leverage on the strategic location from the sea port and airport access found in the Free Industrial Zone of Senai International Airport enabling customers across the region to experience better availability and faster lead time of spare parts and components of BMW.

Figure 3: BMW Regional Parts Distribution Centre in Senai

Source: Paultan.org

Resilient TIV may promote more parts to be imported. Although bulk of the monthly total industry volume for the automotive segment is made up by Perodua and Asian made cars, the portion of 'others' that include continental European cars is rather decent, making up 14.0% of market share in June 2019. Passenger vehicles too are still showing a positive trend so far this year, increasing by 3.8% on a year-to-date basis. On a regional scale, the ASEAN after sales market was valued at USD17.8b by the end of 2015 and is expected to expand at a CAGR of 9.6% by 2026 which we opine would flow positively for the demand of continental automotive parts.

Table 3: June 2019 TIV Summary By Vehicle Type

Segment	Jun-18	May-19	Jun-19	YoY	MoM	YTD18	YTD19	YTD %
Passenger cars	57,744	55,914	38,513	-33.3%	-31.1%	261,043	270,875	3.8%
Commercial vehicles	6,758	4,866	4,013	-40.6%	-17.5%	28,671	25,459	-11.2%
Total	**64,502**	**60,780**	**42,526**	**-34.1%**	**-30.0%**	**289,714**	**296,334**	**2.3%**

Source: MAA, MIDFR

Table 4: June 2019 TIV Summary

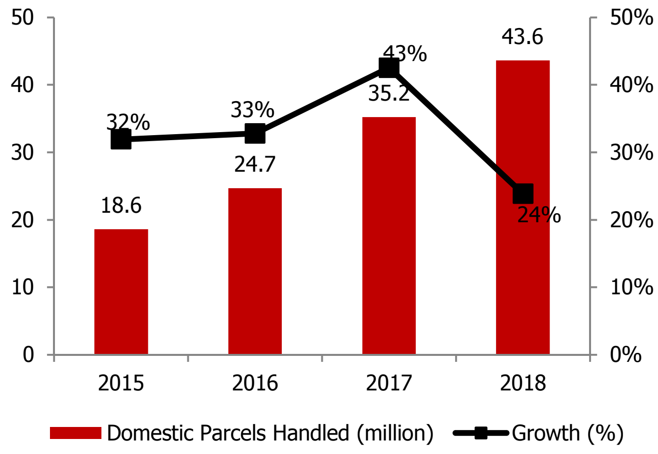
									Market share	
Marques	**Jun-18**	**May-19**	**Jun-19**	**YoY**	**MoM**	**YTD18**	**YTD19**	**YTD %**	**Jun-18**	**Jun-19**
Proton	6,173	10,611	7,615	23.4%	-28.2%	27,106	43,518	60.5%	9.6%	17.9%
Perodua	19,611	22,945	16,037	-18.2%	-30.1%	117,098	121,782	4.0%	30.4%	37.7%
Toyota	11,482	6,842	5,222	-54.5%	-23.7%	31,709	31,251	-1.4%	17.8%	12.3%
Honda	11,418	10,509	5,386	-52.8%	-48.7%	51,354	44,260	-13.8%	17.7%	12.7%
Nissan	3,008	2,103	1,506	-49.9%	-28.4%	11,926	10,383	-12.9%	4.7%	3.5%
Mazda	1,514	1,060	818	-46.0%	-22.8%	6,696	6,491	-3.1%	2.3%	1.9%
Others	11,296	6,710	5,942	-47.4%	-11.4%	43,825	38,649	-11.8%	17.5%	14.0%
Total	**64,502**	**60,780**	**42,526**	**-34.1%**	**-30.0%**	**289,714**	**296,334**	**2.3%**	**100.0%**	**100.0%**

Source: MAA, MIDFR

Warehouses in urban areas to grow with the advent of e-commerce growth…. Last mile delivery companies' strategy of tying up with well-known e-commerce marketplaces has translated into higher demand of their delivery services. This is apparent during events such as the 2018 Singles Day sale where the gross merchandise value (GMV) of Alibaba rose by +26.9% to reach a record of RMB213.5m or USD30.8b. Meanwhile, 11street recorded a six fold rise in its GMV compared to average sales on a regular business day while Lazada Malaysia surpassed its 2017 Singles' Day performance within the first nine hours. According to Statista, the amount spent on consumer e-commerce categories continues to grow with food and personal care experiencing the largest annual change in 2018 in Malaysia. As such, the number of parcels handled domestically is still on the rise (refer to chart 2).

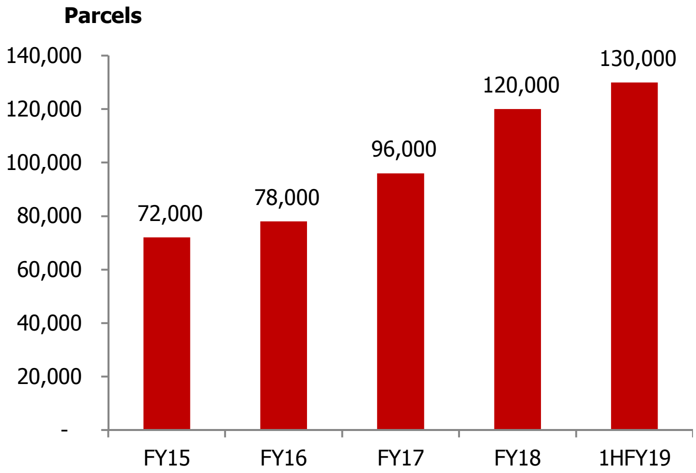
…leading to expansion in operations. In pursuit of meeting such demands, last mile delivery companies are actively expanding operations and networks. In this regard, **GD Express Carrier Berhad (GDEX) (NEUTRAL;TP:RM0.30)** has been aggressively enhancing the average sorting capacity at its Hub 1 in PJ from 110,000 parcels per day to around 130,000 parcels per day. Meanwhile, **Tiong Nam Logistics Holdings Berhad's (Tiong Nam) (SELL;TP:RM0.41)** has setup overseas distribution centres in other ASEAN countries and express delivery business called 'Instant'.

Chart 10: Number of domestic parcels handled is still on a positive trajectory



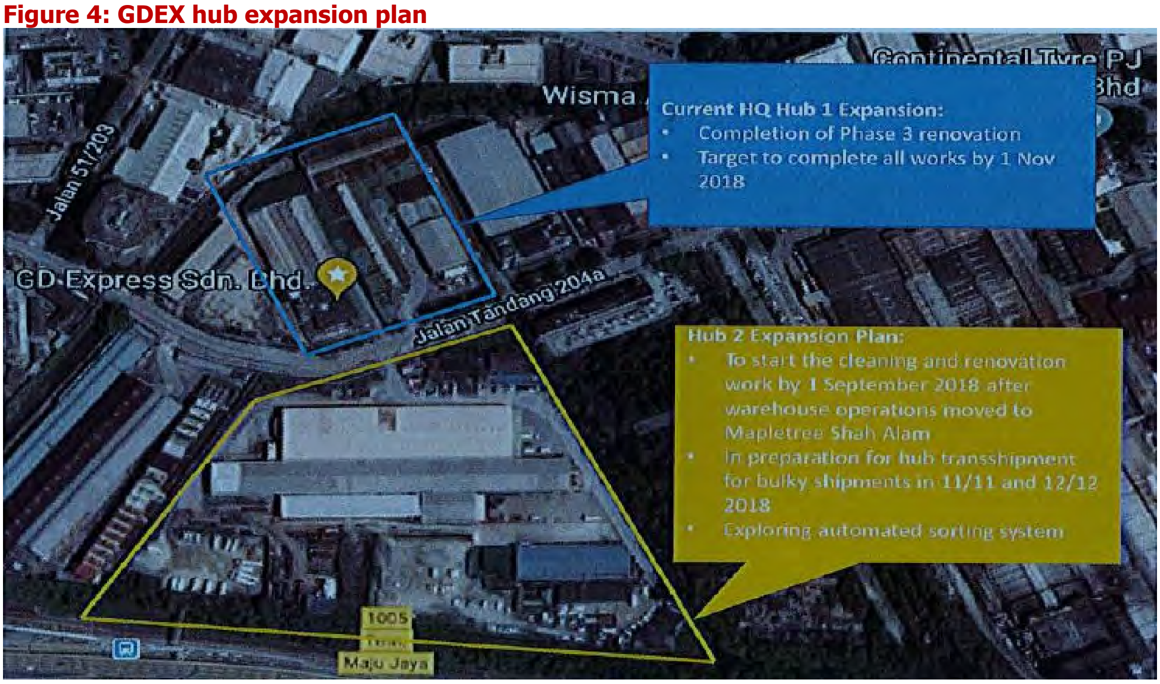
Source: MCMC, MIDFR

Chart 11: Average Sorting Capacity (Parcels Per Day) of GDEX



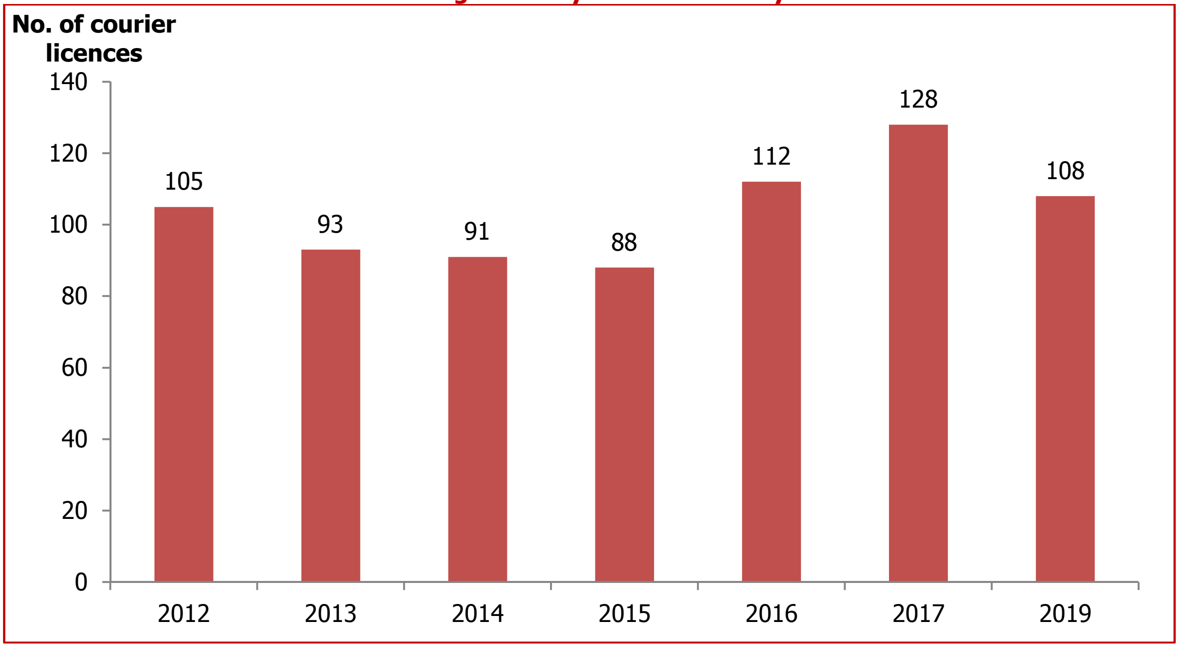
Source: GDEX

Figure 4: GDEX hub expansion plan



Source: GDEX

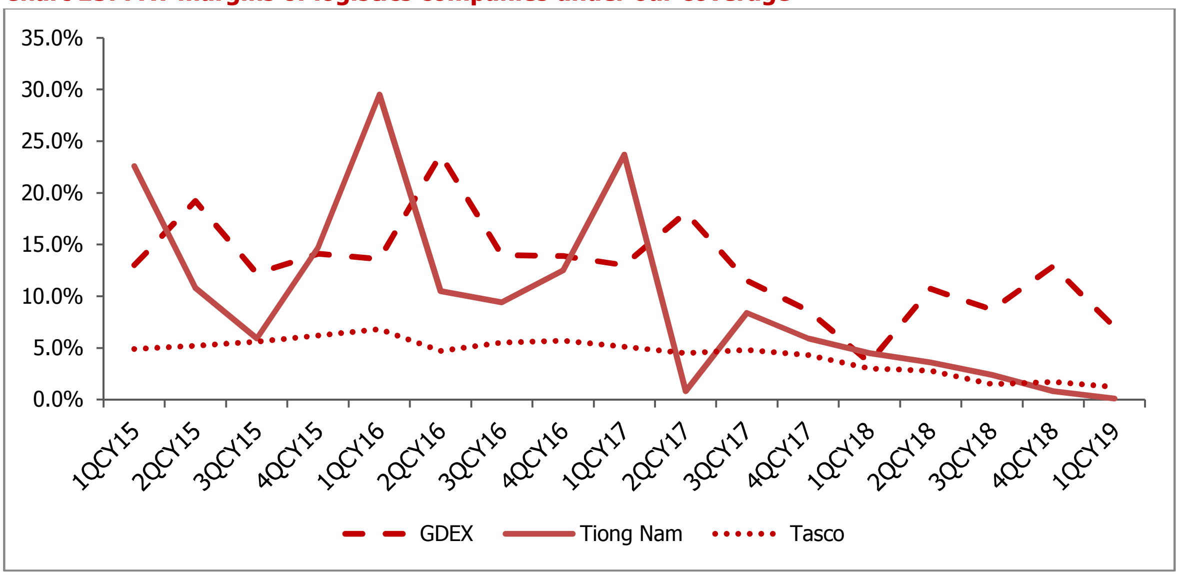
Chart 12: Number of courier licenses granted by MCMC as of July 2019



Source: MCMC, MIDFR

However, winning more business comes at a cost amidst increased competition. The local e-commerce industry is projected to register a +20.8% growth by 2020 indicated by the increasing number of domestic parcels handled. We view that this will entice more last mile deliveries companies to pursue strategic tie up with the various e-commerce companies including startups such as J&T Express and Lalamove which will lead to intense price competition. Existing last-mile delivery companies will need to continuously revise the delivery fees downward whilst increasing efficiency and productivity of its operations, in order to remain competitive in view of the high number of players in the industry *(refer to chart 3).* This will inevitably lead to compression in profit margin which, in turn, impacted the earnings of these companies

Chart 13: PAT margins of logistics companies under our coverage



Source: Companies, MIDFR

*Note: PAT margins of GDEX was partly caused by gain from redemption of convertible bonds in SAP Express

The need to offer niches services become essential. Competition is expected to remain stiff as new entrants seeks to tap into the growth in Southeast Asian e-commerce which is expected to grow from USD23.2b in 2018 to USD102b by 2025 (>+300%) according to a study by Google and Temasek. In order to circumvent this situation logistics companies need to develop their own niche. For example, GDEX has used its 'myGDEX' online portal to firm up its C2C segment in Malaysia while expanding its footprint by acquiring a 44.5% stake in Indonesia-based courier player, SAP Express. Competition is much tougher in Indonesia given its large demographics of 280m people spread across islands. However, we view that SAP Express's extensive coverage to more than 6000 delivery points will serve as a competitive advantage. Based on our understanding, SAP Express was still loss-making in FYE17 and we are cautiously optimistic on its path to break even in the coming quarters.

Tapping on the growth of online grocery shopping. As highlighted in *Table 6*, food and personal care make up the largest portion of goods purchased online. Although the food products are primarily non-refrigerated this presents a great opportunity for cold chain service providers in the long-run, as the emergence of online shopping for groceries should create additional demand for refrigerated (reefer) trucks and warehouses near major urban areas. Aside from that, opportunities to provide retailers from various industries such as pharmaceuticals, agri-business and halal food production are still ample. **Tasco Berhad's (Trading BUY; TP:RM1.68)** growth in the cold chain logistics business is a testament to this as PBT margins of the segment has remained healthy above 10% for the past five consecutive quarters. Nonetheless, competition in cold chain logistics is not high in view of high setup costs which also include higher financing costs. We expect profit margin to improve further as the elevated finance costs is expected to taper within three to four years.

Table 5: Growth of industries relying on cold chain logistics

Category	FY15-FY20 CAGR
Pharmaceuticals	10% p.a.
Agri-business	6% p.a.
Halal food production	5% p.a.

Source: Alibaba via Techcrunch

Table 6: Annual change in total amount spent on consumer e-commerce categories in Malaysia

Category	Annual Change (%)
Food and personal care	39
Toys, DIY and hobbies	33
Furniture and appliances	30
Electronics and physical media	29
Fashion and beauty	26
Travel (including accommodation)	18
Video Games	16
Digital Music	10

Source: Statista Digital Market Outlook for E-commerce, E-Travel and digital media industries

*Note-figures are based on estimates of full year consumer spend for 2018

Figure 5: Tasco's freezer room

Source: Company, MIDFR

Figure 6: Tasco's reefer trucks

Source: Company, MIDFR

Maintain NEUTRAL. The presence of the start-ups in the logistics industry will continue to bite into margins of existing players in the wake of higher demand from e-commerce activities. As such, we opine that logistics players will need to adapt to the consumer dynamics that prevail over time to remain relevant in the wake of stiff competition coming from these start-ups. In addition, logistics companies will have to venture into niches well before it turns mainstream. All things considered, we reiterate our **NEUTRAL** stance on logistics sector.

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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 +15% 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.