

THEMATIC REPORT | Trade War Effects on SMEs

KEY HIGHLIGHTS

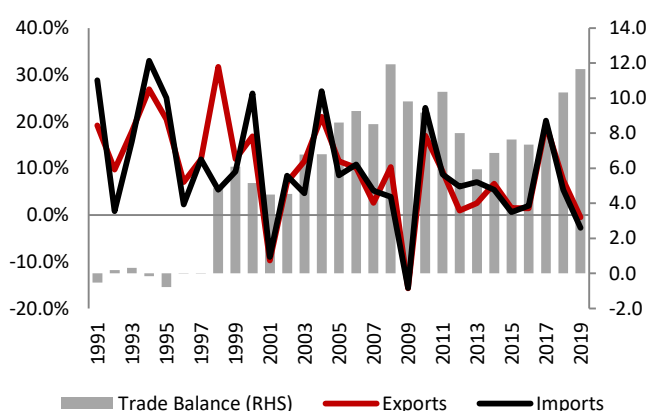
- **Large SMEs to suffer the most.** Based on our modelling results, trade war which will drag Malaysia's exports growth to cause Large SMEs by -6.4%, followed by Medium and Small SMEs by -5.6% and -4.9% respectively.
- **E&E products are the main victims of trade war.** Most of E&E products across all SMES will experience contractions if exports reduced at -10%.
- **Weak linkages between Large and other SMEs.**
- **Tasco Berhad (NEUTRAL, TP:RM1.22)** would be impacted as 24.0% of its revenue is contributed by its air freight forwarding division.
- **In contrast, we opine that the trade war would pose an advantage for Malaysian port operators.**

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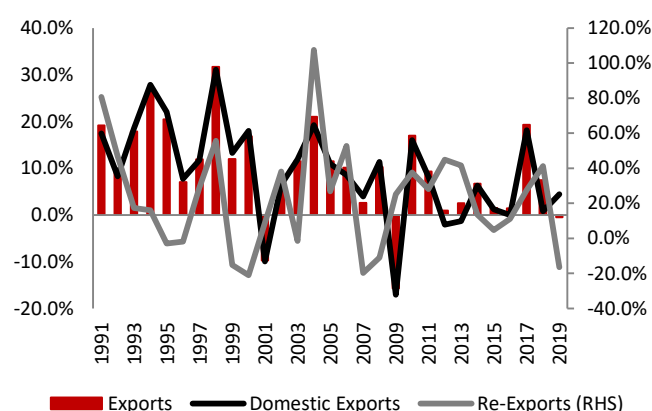
Global Financial Crisis 2009 was the worst for Malaysia. The crisis caused external trade performance of Malaysia to contract hugely in which exports and imports growths recorded at their lowest level, -15.7%yoy and -15.6%yoy respectively. However, trade balance remains on steady side, continuing expanding even though facing lower global commodity prices since 2014. Moving forward, developed and emerging economies including Malaysia are expected to face a cloudy global outlook as trade war deepens; USA's Presidential Election and fragmented EU. Malaysia as an export-oriented economy may experience further slowdown particularly on its external front.

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



Source: CEIC, MIDFR

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

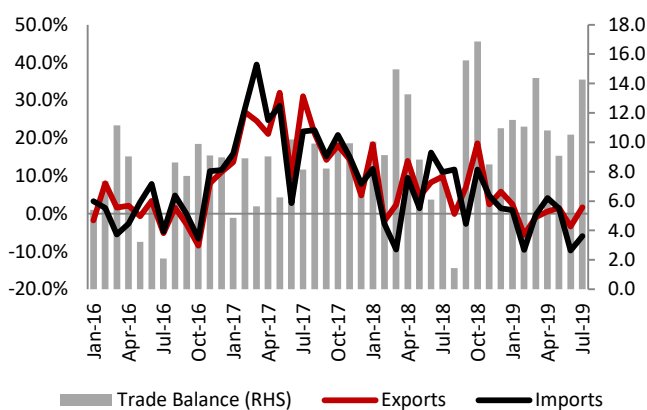


Source: CEIC, MIDFR

Exports return to positive territory. Exports rebounded in July-19 by 1.7%yoy from -3.1%yoy growth registered in the previous month. Meanwhile, imports continued to decline however at an improving rate of -5.9%yoy (June-19: -9.2%yoy). As a result of positive exports and negative imports, trade surplus hit four-month high at RM 14.3b. Sector wise, manufacturing exports which accounted for more than 80% of total exports rebounded by 3.8%yoy (June-19: -5%yoy). In contrast, mining and agriculture exports contract by -11.6%yoy and -9.3%yoy respectively.

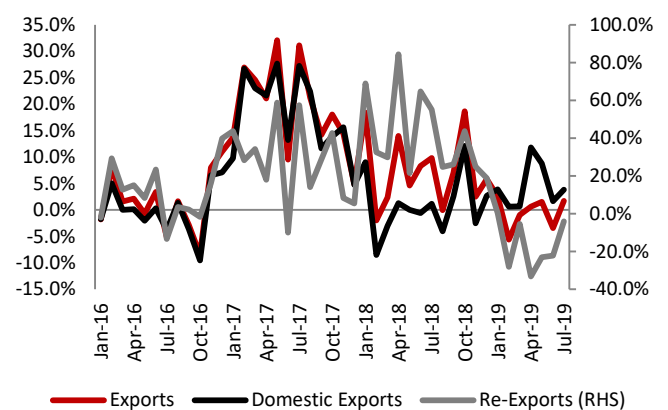
Robust domestic exports. Domestic exports expanded by 3.3%yoy, higher than 1.7%yoy gains in the previous month. The eighth consecutive months of positive growth indicates a good momentum for this year and provides brighter outlook for GDP growth in 3Q19 as domestic exports involve high value-added activities. In contrast, re-exports which have low domestic value-added contracted for the sixth consecutive month but at a far improving rate of -3.9%yoy (June-19: -22.3%yoy). Hence, the ratio of re-exports to total exports recorded higher at six-month high of 20.3% (for every RM1 value of exports, approximately 20sen 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.

Chart 3: Trade Balance (RMb) vs Exports & Imports (YoY%)



Source: CEIC, MIDFR

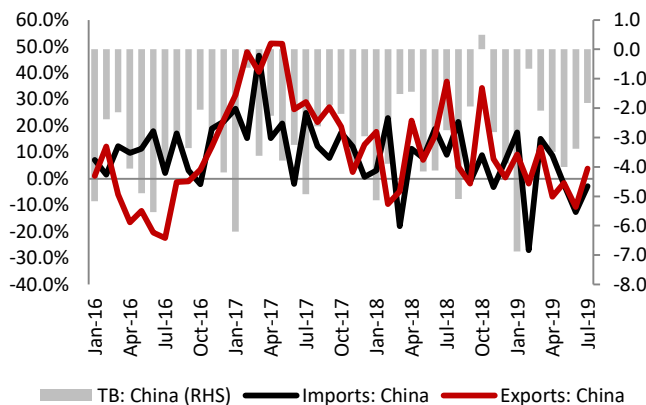
Chart 4: Total Exports: Domestic vs Re-exports (YoY%)



Source: CEIC, MIDFR

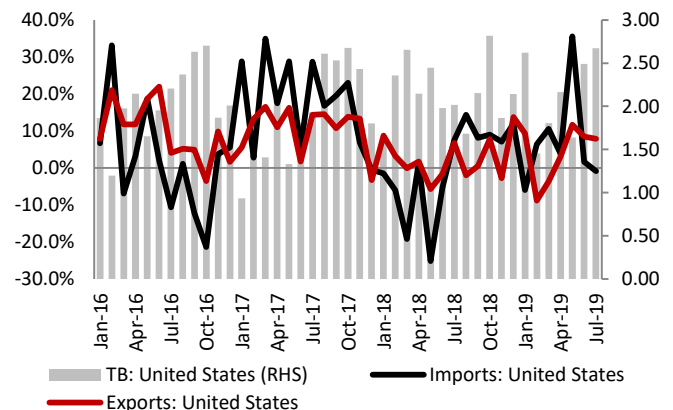
Deficit with China, surplus with the US. Based on external trade data, Malaysia registers trade deficit with China while deficit with the US. External trade expansion rate with both economies have been moderating since 2018 due to the trade war. Among others, high imports of manufactured goods, machinery & transport equipment, miscellaneous manufacturing articles and food & live animals from China have caused the widening trade deficit. Malaysia has comparative advantage on certain products such as crude materials and mineral fuels with China. Across the globe, Malaysia has trade surplus with the US, RM25.9 billion in 2019. Oversea sales of machinery & transport equipment, miscellaneous manufacturing articles and manufactured goods among others contributed the net exports with the US. Despite trade war, we do not observe significant change in the patterns of trade balance with both economies.

Chart 5: Msia Trade with China (YoY% & Rmb)



Source: CEIC, MIDFR

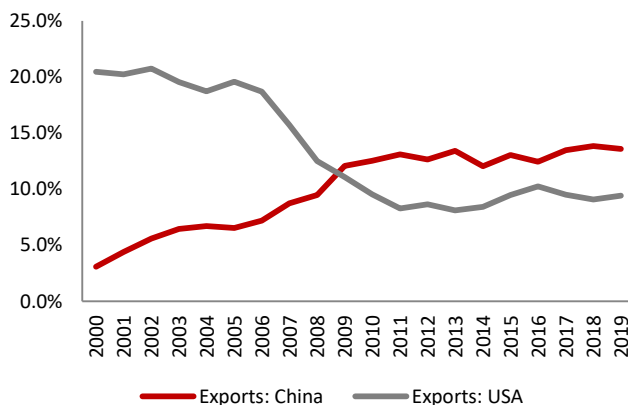
Chart 6: Msia Trade with USA (YoY% & Rmb)



Source: CEIC, MIDFR

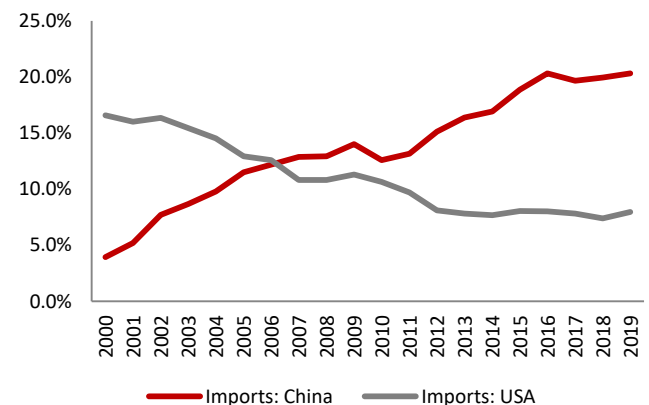
Rising trade share with China. Malaysia is more dependent with China as compared to the US prior to GFC'09. The exports and imports shares of the US in Malaysian external trade market have been falling. Exports share from 20.5% in 2000 declined to 9.1% in 2018. On the other hand, China holds larger share in the exports market at 13.8% in 2018. Nevertheless, both economies still play significant influence on Malaysian economy by direct and indirect angles.

Chart 7: Msia's Exports Share by Destination (%)



Source: CEIC, MIDFR

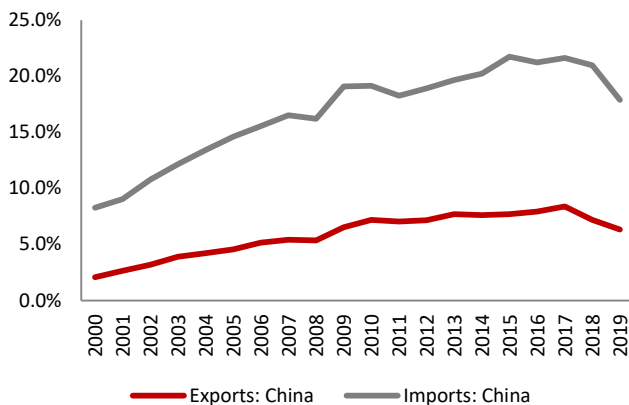
Chart 8: Msia's Imports Share by Destination (%)



Source: CEIC, MIDFR

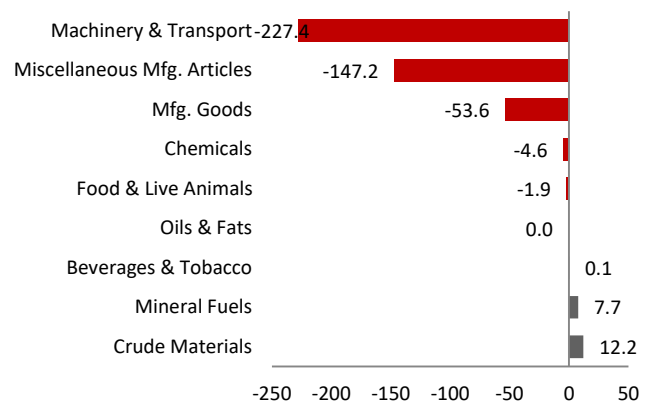
Trade war effects observed. Protectionist policies undertaken by Trump-led administration are resulting slowly particularly on external trade relationship between the US and China. Looking at the share of exports and imports, both the US and China are losing market access to each other's economy. In 2017, exports to China contributed about 8.4% of total American outbound shipments. The share declined gradually in 2018 and so far 2019, 7.2% and 6.3% respectively. This is indirectly due to the retaliation moves by Chinese government. Similarly, imports from China reduced from 21.6% in 2017 to 17.9% in 2019. Looking ahead, we opine external trade relationship between the US and China to remain in uncertainty as long as Trump stays in office.

Chart 9: USA's Exports & Imports Share by Destination (%)



Source: CEIC, MIDFR

Chart 10: USA's Trade Balance with China in 2018 (\$Billion)



Source: CEIC, MIDFR

Definition SMEs by specific standards. According to SME Corp's SME Input Output table, there are four types of SMEs. Large, Medium, Small and Micro are the four types which differentiated by each annual sales turnover and number of employees. The Input Output table provides clearer picture of Malaysia's SME economic landscape. The table indicates how each SME interacts and interlinks between each other. In addition, it shows multipliers and linkages of each SME in accordance to sectors.

Table 1: Definition of SMEs

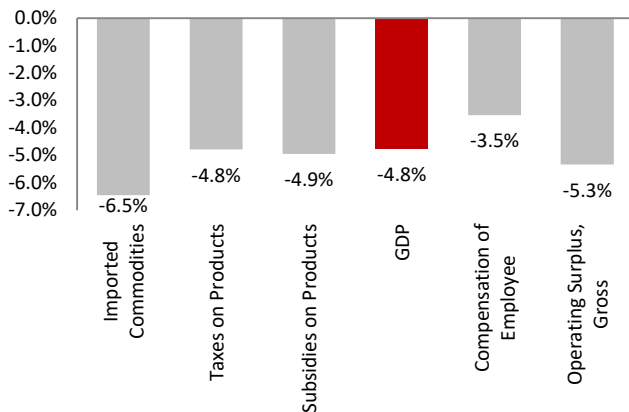
	Manufacturing		Services & Other Sectors	
	Annual Sales Turnover	No. Employees	Annual Sales Turnover	No. Employees
Large	>RM50m	>200	>RM20m	>75
Medium	RM15m<RM50m	75<200	RM3m<RM20m	30<75
Small	RM300k<RM15m	5<75	RM300k<RM3m	5<30
Micro	<RM300k	<5	<RM300k	<5

Source: SME Corp., MIDFR

-10% drop a proxy of worsening trade war. For the purpose of "What If" scenario analysis, we assume Malaysia's exports to fall by -10% if trade war between USA and China go full blown. Since trade war between the two has taken place since 2017, we do not see Malaysia's outbound shipments to contract more than the GFC 09's, -15.7%yoy. In addition, diversification of exports products and destinations indirectly reduce economic shock impacts on Malaysia's external front.

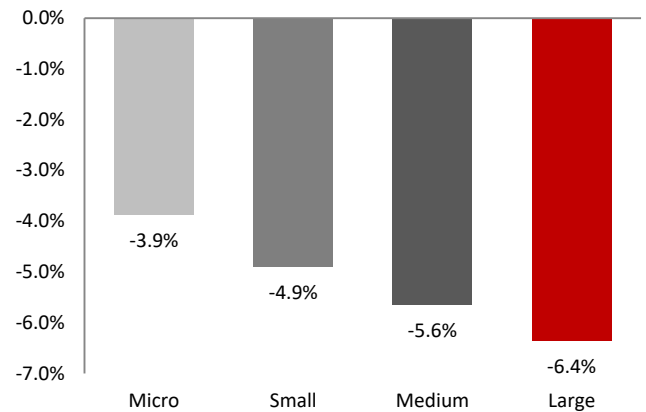
Large SMEs to suffer the most. Based on our modelling results, trade war which will drag Malaysia's exports growth to cause Large SMEs by -6.4%, followed by Medium and Small SMEs by -5.6% and -4.9% respectively. The smallest SMEs will contract at the very least size of -3.9%. The results are in tandem with the exposure of each SMEs to external trade activities. Almost 70% of Large SMEs activities are driven by exports market whereas Micro SMEs is only exposed to outbound shipments at 34.7% only. Other than SMEs, trade war will reduce overall economic growth by -4.8%, compensation of employees by -3.5% and operating surplus by -5.3%.

Chart 11: Trade War Impacts on GDP Components (%)



Source: CEIC, MIDFR

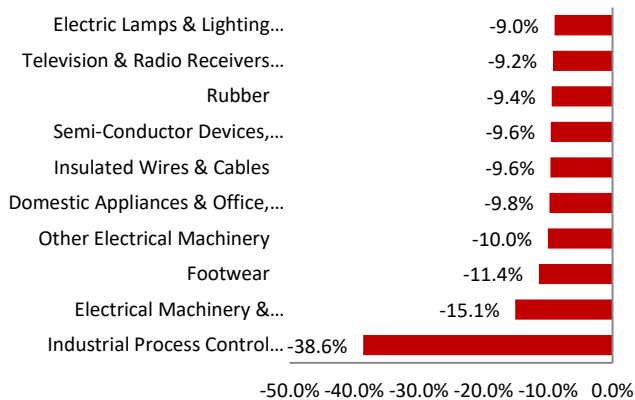
Chart 12: Trade War Impacts on SMEs (%)



Source: CEIC, MIDFR

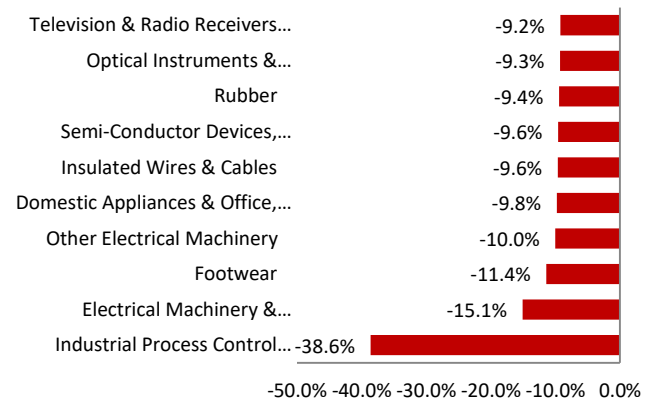
E&E products are the main victims of trade war. Most of E&E products across all SMES will experience contractions if exports reduced at -10%. Industrial process control equipment, electrical machinery, domestic appliances and semi-conductor wires are among the main products to be affected if trade war worsening. Other than E&E products, productions of footwear and rubber are expected to be impacted. The charts below only display the top ten products. There are other 60-70 products impacted among others basic metals, crude oil & gas and palm oil.

Chart 13: Sectoral Impacts on Micro SMEs (%)



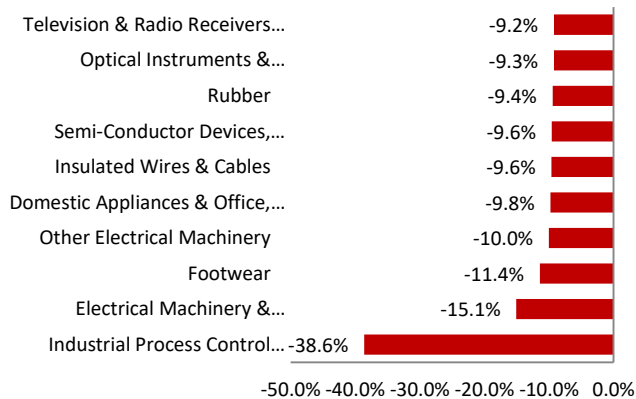
Source: CEIC, MIDFR

Chart 14: Sectoral Impacts on Small SMEs (%)



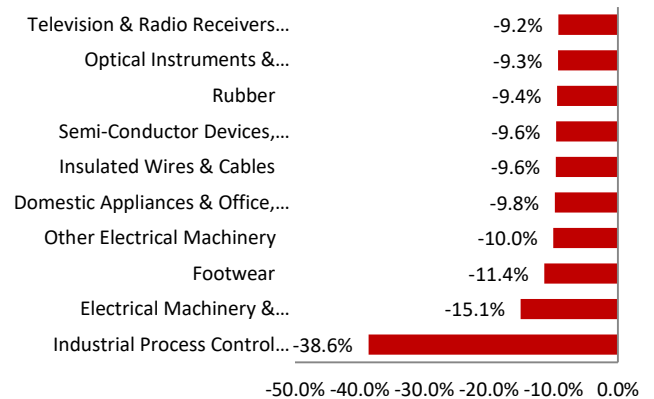
Source: CEIC, MIDFR

Chart 15: Sectoral Impacts on Medium SMEs (%)



Source: CEIC, MIDFR

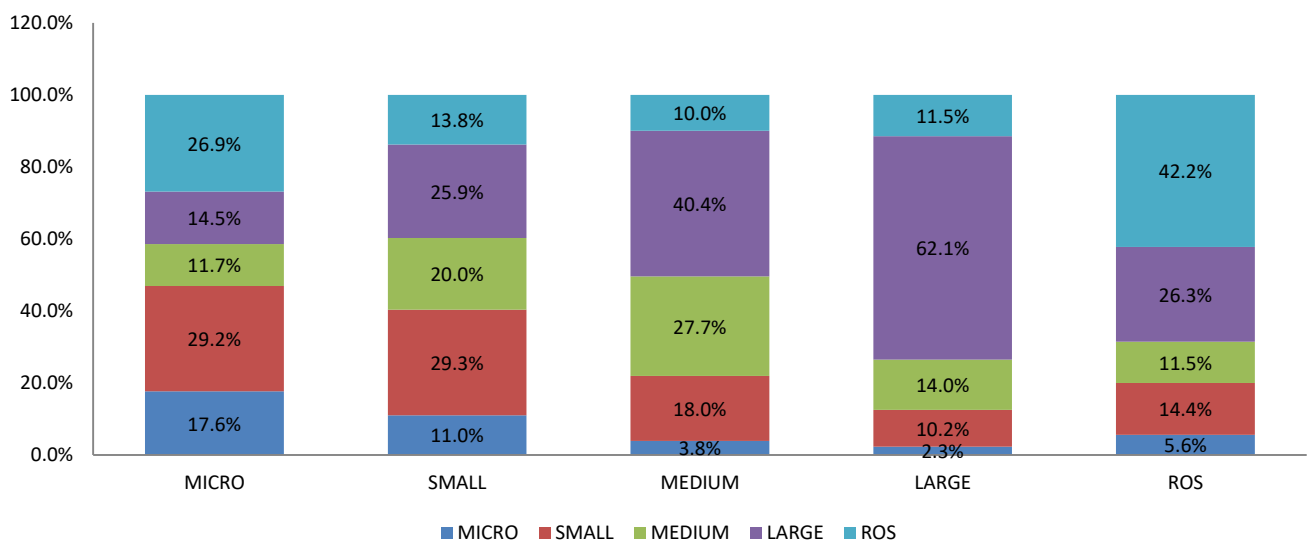
Chart 16: Sectoral Impacts on Large SMEs (%)



Source: CEIC, MIDFR

Weak linkages between Large and other SMEs. Almost half of Malaysia's economic activities supported by Large SMEs, 48%. Small and Medium SMEs contribute about 13.4% and 13.9% respectively while Micro SMEs by 4.7%. Looking at each SMEs, Large SMEs only require small portions of input from other SMEs at less than 30%. On a flip side, Large SMEs provide significant support to Micro, Small and Medium SMEs at 14.5%, 25.9% and 40.4% respectively in term of inputs. In a simple word, the other SMEs are rather inefficient in producing its output without the assistance of Large counterparts. On the other hand, Large SMEs can stand alone as more than half of its inputs supported by the SMEs itself. Based on this structural analysis, there is a weak interlink between Large and other SMEs in the Malaysia's economy.

Chart 17: Structural Analysis of SMEs across All Levels



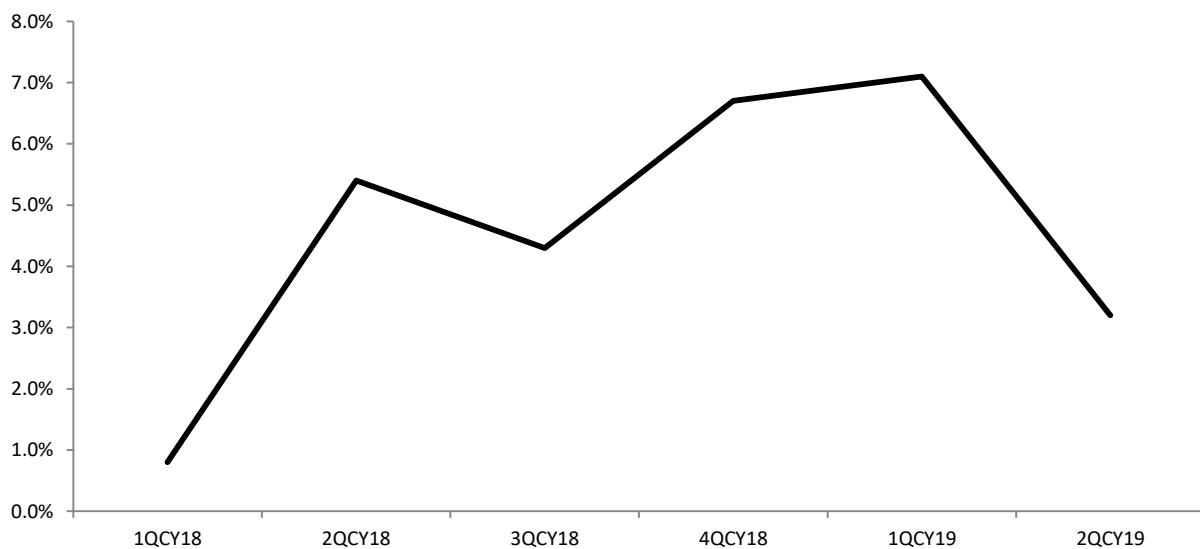
Source: SME Corp., MIDFR

*ROS: Rest of Sector which refers to sectors that are not captured by specific SMEs

Impact to the Transportation (Logistics) Sector

Most of the sectoral impacts from the trade war on Large and Small SMEs cover electrical machinery, domestic appliances, semiconductor devices, and optical instruments which are usually transported via air freight. Hence, **Tasco Berhad (NEUTRAL, TP:RM1.22)** would be impacted as 24.0% of its revenue is contributed by its air freight forwarding division. In addition, we observed that the PBT of Tasco's air freight forwarding (AFF) division declined by -50.4%yoy due to the drop in shipments of capacitor and chemical customers coupled with intense competition within the industry. As such, PBT margins of the division have declined to 3.0% in the latest quarter of 2QCY20 from 7.1% in 1QCY20. We opine that the trend of margin compression could prolong under a full-blown trade war scenario.

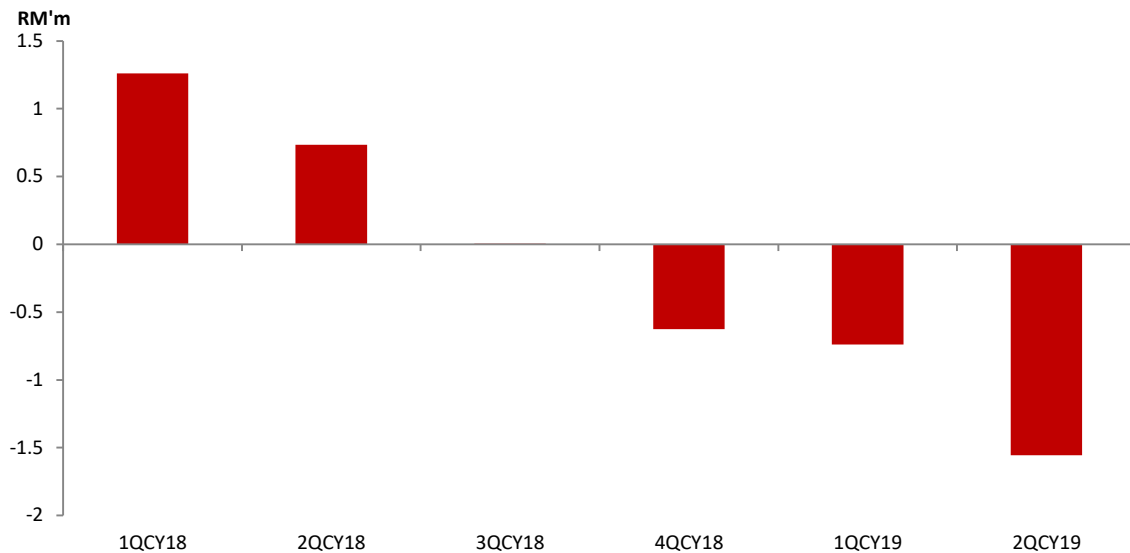
Chart 18: PBT Margins of Tasco Berhad's Air Freight Forwarding Division



Source: Tasco

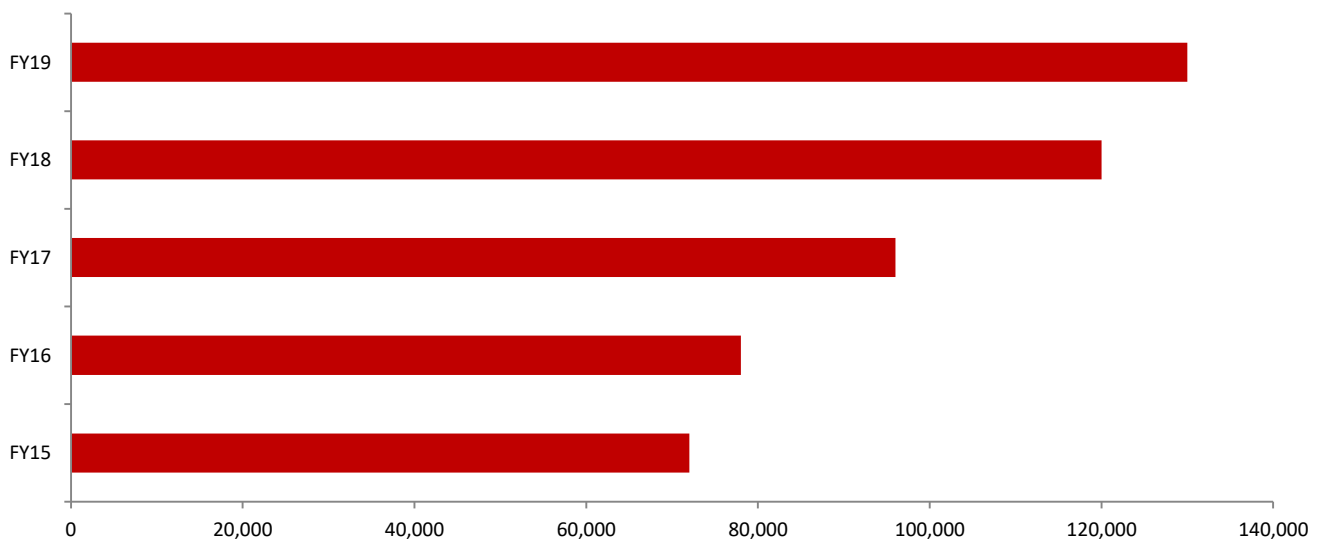
With large and small SMEs expected to be impacted by the trade war, it should be noted that haulage and land freight businesses would also be impacted directly as SMEs rely on these freight forwarders to either transport their products or materials. In fact, the profitability of trucking business for companies such as Tasco Berhad have been on the downtrend mainly due to intense competition in the field. As such, slower business activities by SMEs due to the trade war could exacerbate the weakness of the trucking and haulage business. Another perspective we can infer from a trade war is parcel volumes delivered from the SMEs to the customer's destination which is the case for last mile delivery providers. For instance, if an SME faces a slowdown in sales, last mile delivery providers such as **GD Express Carriers (NEUTRAL; TP:RM0.30)** will face in shortage of parcel volumes delivered. This will further bite in the margins in an environment which is already crowded with many players and leads to an underutilization of its present sorting hubs which have expanded to cater an average 130,000 parcels per day.

Chart 19: PBT of Tasco's Trucking Division



Source: Tasco

Chart 20: GDEX's Average Sorting Capacity per day



Source: GDEX


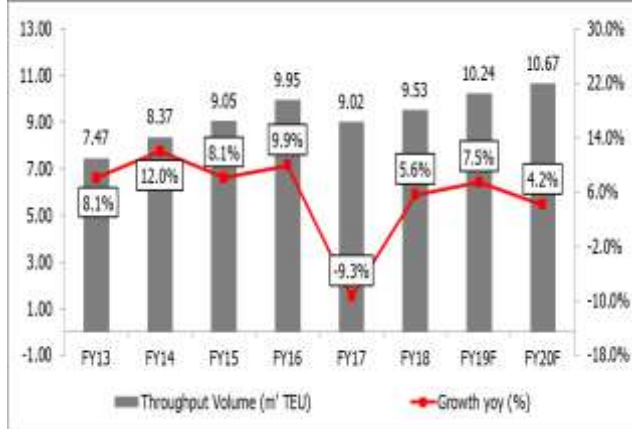
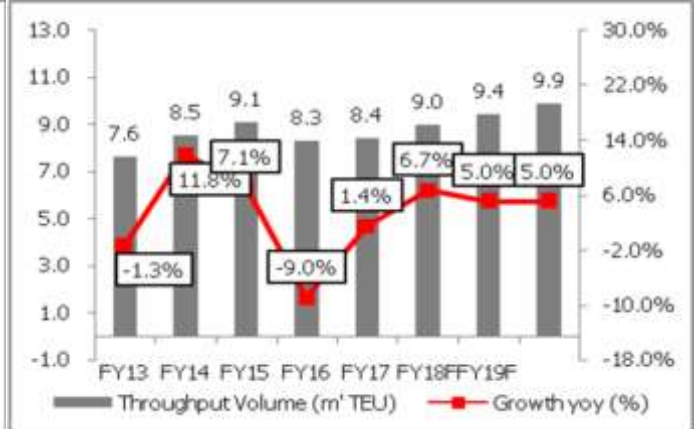
In contrast, we opine that the trade war would pose an advantage for Malaysian port operators. In 1HFY19, container volume of major ports in Malaysia such as **Westports (BUY; TP:RM4.27)** and Port of Tanjung Pelepas, which is owned by **MMC Corporation Bhd (MMC) (BUY; TP:RM1.30)**, increased by +17.1%yoy and +5.0%yoy respectively. In the long run, we opine that impact from the ongoing trade war between the U.S and China to be muted on ports under our coverage given its position as a transshipment hub and supported by intra-ASEAN trade and the development of regional distribution hubs near both Port of Tanjung Pelepas and Port Klang. This will more than offset the items transported for SMEs which are usually transported via air freight. It is also worthwhile to note that the percentage of contribution from U.S and China to Malaysia's total trade have been increasing slightly thus far this year despite the trade tension. 

Chart 21: Westports container throughput



Source: Westports, MIDFR

Chart 22: Port of Tanjung Pelepas container throughput



Source: MMC Corp, MIDFR

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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 <i>rise</i> 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 <i>fall</i> 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.