

Malaysia Strategy

Riding the bull market

OVERWEIGHT

Maintained

1,372

@18/6/07

Target Index: 1,700

KLCI INDEX

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- **Can the bull market sustain?** When we first turned bullish nearly a year ago, our view was considered contrarian and overly aggressive by many. 12 months on, the KLCI has exceeded everyone's wildest dreams. Many analysts have turned bullish though there are still some sceptics who feel that the market resurgence is artificial. Without a doubt, Malaysia is in a bull market as the KLCI has risen 51% in the past 12 months. The question on everyone's mind now is whether the rally can be sustained and should investors take profits.
- **Rally good for 12 more months.** Although we are tempted to take a more cautious approach, we believe the stock market has significant room for further upside for the following reasons: 1) general elections could be held later rather than sooner, 2) positive newsflow on pump-priming and new development corridors remains strong, and 3) corporate earnings and growth continue to beat expectations. We believe these positive developments will sustain the KLCI on an upswing for another 9-12 months to mid-08.
- **Fundamentals keeping pace.** Besides the event-driven newsflow reasons for our positive take on the market, fundamentals and valuations also remain sound. We are very encouraged by the significant earnings upgrades over the past 3-6 months. The KLCI is trading at a CY08 core P/E of only 14.6x, still the bottom of its 20-year range. Upward revisions to projected ROEs have also been robust and we expect ROAE to reach 15.2% by 2007 and 15.6% by 2008. As for yields, dividends have kept pace with the market upturn and yields remain attractive at above 4%.
- **KLCI target of 1,700 points.** We introduce our 12-month KLCI target of 1,700 points based on an unchanged 18x P/E while keeping our end-07 KLCI target of 1,440 points. The 1,700-point target comes on the back of accelerating market EPS growth from 19% in 2006 to 22% in 2007. While we remain bullish about stock market prospects, the greatest risk continues to be the performance of regional markets and Wall Street. However, it is reassuring that regional P/E valuations are undemanding, being mostly in the mid-to-high teens.
- **Sector and stock themes.** Our earlier themes, i.e. 9MP, GLC revamp and VMY 2007, should remain very relevant over the next 12 months. However, three other sectors investors should focus on are banking, property and oil & gas. The banking sector is a natural beneficiary of PFI financing and the upcoming property boom. Oil & gas should remain a favourite, shored up by sustained high oil prices and global opportunities. Our top 10 picks are drawn from these sector themes and our top five picks are MRCB (election play), Gamuda (9MP proxy), Maybank (mega project funding), SP Setia (property boom) and Kencana (oil & gas exposure). Please refer to the printed strategy note for full details.

CIMB's top picks

	Bloomberg ticker	Recom.	Price (RM)	Target Price (RM)	Mkt cap (RM m)	Core P/E (x)	3-yr EPS CAGR (%)	P/NTA (x)	ROE (%)	Div yield (%)		
						CY07	CY08	CY07	CY07	CY08	CY07	
AirAsia	AIRA MK	O	1.93	2.45	4,553.0	17.2	14.2	28.3	3.1	21.9	19.7	-
AMMB	AMM MK	O	4.52	5.35	9,630.2	nm	20.2	nm	2.0	(4.1)	9.4	1.4
Gamuda	GAM MK	O	8.75	10.60	8,385.9	25.9	15.5	23.4	2.7	10.5	15.9	5.3
Hunza Prop	HPB MK	O	3.24	4.50	438.4	12.2	8.7	44.8	1.7	17.0	20.5	4.0
Kencana	KEPB MK	O	1.91	2.20	1,702.8	25.6	18.7	39.7	7.6	37.8	39.4	0.2
KL Kepong	KLK MK	O	13.30	14.50	14,215.0	19.2	16.3	27.9	2.9	14.7	15.7	3.0
Maybank	MAY MK	O	12.40	15.30	48,182.0	16.0	14.7	3.2	2.7	17.8	17.5	7.1
MRCB	MRCB MK	TB	2.50	3.15	2,216.9	43.6	28.5	77.8	3.3	7.6	10.4	-
SP Setia	SPSB MK	O	9.15	10.00	6,154.3	22.8	19.8	14.2	3.3	15.2	16.2	3.6
Tenaga	TNB MK	O	11.50	15.00	49,754.7	14.2	13.4	53.0	2.2	19.1	15.7	3.6

O = Outperform, N = Neutral, U = Underperform, TB = Trading Buy and TS = Trading Sell
Source: Company, CIMB/CIMB-GK Research, Bloomberg, Reuters Estimates, Xxxx

12-month KLCI target of 1,700 points

The spate of recent privatisation exercises (see Figure 1) is indication that many stocks remain undervalued even after the market upturn. In fact, the pace of privatisations appears to be accelerating. We also believe that a property boom will take place over the next 3-5 years. PNB appears to share our optimism as it is in the process of taking private two of its property companies including Malaysia's largest property land bank owner, Island & Peninsular. Many other property companies still trade at massive discounts to their RNAVs and are also candidates for privatisations.

Figure 1: Privatisation exercises in 2007

Offeror	Company	Date of offer	Offer price (RM)	Price before offer (RM)	Premium offered
Hotel Resort (Tan Sri Vincent Tan)	MOL Access	14-Jun	0.58	0.46	27%
Computer Science Corporation	CSA (M)	17-May	3.50	3.24	8%
Berjaya Corp	Berjaya Capital	17-May	3.00	2.44	23%
Boustead	UAC	7-May	4.85	4.22	15%
Net Edge Online, Tan Sri Vincent Tan	Nexnews	7-May	1.27	0.94	35%
Binariang GSM/Usaha Tegas	Maxis	3-May	15.60	13.00	20%
PNB	Petaling Garder	27-Apr	2.50	2.15	16%
PNB	I&P	24-Apr	2.35	1.80	31%
Temasek Team Sdn Bhd	Rohas-Euco	23-Apr	1.80	1.77	2%
EPF	RHB	12-Mar	1.80	1.74	3%
Linde	MOX	21-Feb	15.00	12.90	16%

Source: Bloomberg, CIMB estimates

The KLCI has gained more than 400 points since we turned bullish on Malaysia a year ago and is on track to meet our end-07 target of 1,440 points. The 1,440-point target implies a forward P/E of around 15.3x, lower than our original target of 18x due to the upward revisions in earnings. We introduce our 12-month target of 1,700 points based on an unchanged 18x P/E for 2008 market net profit. We believe 18x P/E is reasonable as it is based on the KLCI's post Asian financial crisis average. If we applied the 20-year P/E average of the average P/Es achieved during the 1980s and 1990s bull markets (see Figure 2), the upside to the KLCI would be substantially higher.

Figure 2: KLCI at various P/E ratings

Basis	P/E on 2008 EPS	KLCI
3-year average	15x	1,410 points
Post-Asian crisis average	18x	1,700 points
25-year average	20x	1,880 points
1988-1990 bull market average	21x	1,970 points
1993-1996 bull market	24x	2,260 points
1993 superbull market	34x	3,200 points

Source: CIMB estimates

As indicated earlier in the note, the Malaysian market's valuations remain reasonable. Despite the KLCI's upsurge over the past 12 months, stronger-than-expected earnings growth has kept P/E valuations at near the historical lows. Dividends have also kept pace with earnings growth, allowing dividend yields to stay above the 4% level. Core ROAE has started its upward climb and would be back to the pre-Asian financial crisis levels once it hit the mid-teens levels.

Figure 3: KLCI statistics

KLCI Statistics (@ 1,372)	2004	2005	2006	2007F	2008F
Core EPS growth (%)	14.6	2.9	18.9	22.0	11.9
Core EPS growth ex-TMT (%)	17.0	(2.1)	19.4	22.6	12.5
P/E (x)	21.9	23.1	19.0	15.6	14.3
Core P/E (x)	24.5	23.8	20.0	16.4	14.6
Core P/E (ex-TMT)	24.2	24.7	20.7	16.9	15.0
EV/EBITDA (x)	15.7	16.0	14.5	11.5	10.9
Dividend Yield (%)	3.2	3.3	3.9	4.6	4.4
P/BV (x)	3.0	2.8	2.6	2.4	2.2
Core ROAE (%)	12.8	12.1	13.5	15.2	15.6
CIMB/Consensus (x)				0.96	0.96

Source: CIMB estimates

However, Malaysia's valuations relative to its regional peers are nothing to shout about as they are at slight premiums to the regional average. On P/E basis, Malaysia is trading at a wider premium of 18% to the region vs. 12-13% six months back. Malaysia has finally caught up after lagging behind for the past few years and is one of the best performers YTD. The premiums are justified by the improving earnings outlook and relatively high dividend yields.

Figure 4: Regional comparisons as at 18 June 2007

	P/E (x)		EPS growth		
	2007	2008	2006	2007	2008
S&P 500	17.0	15.3	15.8%	7.9%	11.2%
NASDAQ 100	29.0	23.9	12.3%	17.4%	21.5%
Nikkei 225 (JP)	23.8	21.0	14.7%	17.7%	10.3%
Hang Seng Index (HK)	16.8	16.4	2.6%	7.9%	8.6%
LQ45 (ID)	17.3	14.9	20.0%	30.9%	15.7%
Sensex 30 (IN)	19.9	17.0	26.6%	16.9%	13.4%
Kospi 50 (KR)	13.0	11.4	-6.0%	10.1%	13.2%
KLCI (MY)	18.9	17.1	18.9%	18.1%	14.1%
PSE (PH)	15.7	14.4	28.2%	1.8%	10.0%
Straits Times (SG)	19.6	18.2	17.4%	8.8%	11.4%
SET 50 (TH)	10.2	10.6	-15.1%	0.8%	13.1%
TAIEX (TW)	15.8	13.8	16.4%	26.3%	15.9%
Simple AxJ, KL avg	16.0	14.6	17.8%	23.6%	13.8%
KLCI P/E premium over region	18.0%	17.6%			

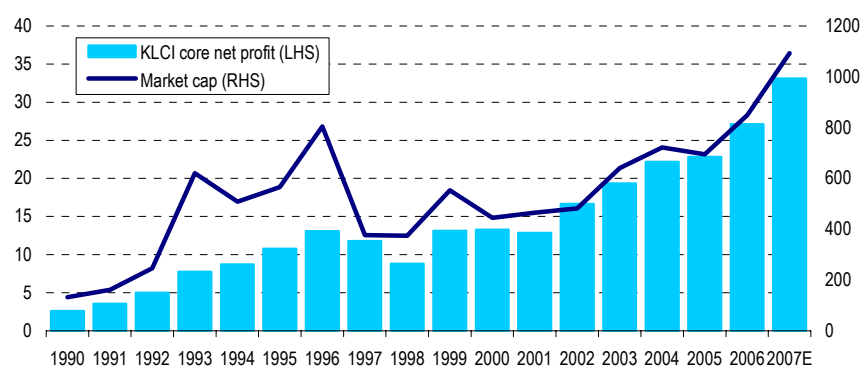
Source: JCF, Bloomberg

Figure 5: Regional comparisons

	P/E (x)			Div	PEG	Price/NAV
	06	07F	08F	yld (%)		(x)
Overall				2007		2007
Hong Kong	24.6	18.0	15.8	2.6	1.6	3.7
Indonesia	19.0	12.9	10.7	5.4	0.4	2.7
Malaysia	19.0	15.6	14.3	4.6	1.1	2.4
Singapore	20.4	17.8	15.1	3.1	1.2	2.6
Thailand	11.1	11.2	10.1	4.0	2.3	2.7

Source: Bloomberg & CIMB estimates

Figure 6: KLCI core net profit vs. Bursa Malaysia market cap



Source: CIMB estimates, Bloomberg, BMSB

Top sector picks

Our top sector recommendations are unchanged from a year ago, apart from the addition of property and rubber glove. Earlier in the year, we upgraded the property sector on the back of improving economic and stock market prospects. Government incentives and an economic upturn point to boom times for the sector. The rubber glove sector is one of the few sectors where Malaysian companies dominate the global market due to their aggressive management and competitive advantages. Growth remains robust and we have OUTPERFORM calls on rubber glove stocks across the board.

Figure 7: Sector weightings

Overweight	Neutral	Underweight
Airlines	Automotive	Brewery
Banking	Building materials	Tobacco
Conglomerates	Food & beverage	
Construction	Insurance	
Gaming	Media	
Infrastructure	Semiconductor	
Oil & gas	Shipping	
Plantation	Technology	
Property	Telecommunications	
Rubber Gloves		
Utilities		

Source: CIMB estimates

Top 10 stock picks

Our top picks have changed substantially from a year ago due to significant outperformance by many of our selections. Only two – Gamuda and Tenaga – remain on our new list. Gamuda is still our top construction pick even though its share price has more than doubled from a year ago. Tenaga remains our top GLC revamp pick. The eight new additions correspond to the investment themes highlighted above.

Figure 8: CIMB's top picks

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Source: Company, CIMB/CIMB-GK Research, Bloomberg

Top small cap picks

Although the 2nd Board and Mesdaq indices continue to lag behind the KLCI and indicate underperformance by smaller-cap stocks, the companies under our coverage have performed otherwise. In fact, many of the small-cap stocks that we initiated coverage on have done very well and significantly outperformed the KLCI. The small caps we like are a mixed bag of manufacturing, export, construction, plantation and technology companies. Our top three picks are Boon Koon, LCL Corp and Wellcall.

Figure 9: Small cap picks

	Bloomberg ticker	Recom.	Price (RM)	Target Price (RM)	Mkt cap (RM m)	Core P/E (x)	3-yr EPS CAGR (%)	P/NTA (x)	ROE (%)	Div yield (%)		
						CY07	CY08	CY07	CY07	CY08		
ACPI	ACP MK	O	2.13	2.62	471.8	21.5	8.6	nm	2.4	8.4	18.3	0.5
Boon Koon	BOKG MK	O	1.24	1.80	171.6	8.5	6.9	19.9	1.5	21.8	23.5	5.6
Dreamgate	DCB MK	O	1.85	2.09	523.2	13.8	12.4	14.2	3.2	25.3	23.5	1.1
Eksons	EKSON MK	O	1.56	2.62	259.5	5.2	4.9	22.9	1.0	18.0	17.8	7.2
Jobstreet	JOBS MK	O	2.03	2.50	412.2	15.7	12.3	28.9	5.8	36.8	35.2	1.9
LCL Corp	LCL MK	O	5.75	8.90	237.7	8.6	5.8	59.5	2.4	32.3	35.3	1.7
Mudajaya	MDJ MK	O	4.48	5.60	670.2	26.9	13.4	54.4	3.7	14.3	24.4	1.6
Supermax	SUCB MK	O	2.52	3.30	572.2	10.8	8.5	22.9	2.8	22.9	26.9	2.2
UM Land	UML MK	O	2.97	3.12	712.9	13.4	10.8	30.1	1.3	6.6	7.8	4.0
Wellcall	WELL MK	O	2.95	4.46	247.9	11.2	9.7	31.2	3.9	28.6	34.1	4.8
Simple average						13.6	9.3	31.6	2.8	21.5	24.7	3.1

O = Outperform, N = Neutral, U = Underperform, TB = Trading Buy and TS = Trading Sell
Source: Company, CIMB/CIMB-GK Research, Bloomberg

Conclusion – this bull still has legs

After weighing the positive and negative factors affecting the stock market, we come to the conclusion that there are far more positive catalysts driving the market higher and the risk to reward equation remains very favourable.

The positives:

1. General elections could be held later rather than sooner, thus prolonging the positive newsflow needed to generate the “feel good” sentiment.
2. The full impact of 9MP pump-priming including disbursement of contracts and mobilisation of equipment is likely to be felt in 2008.
3. Besides construction works, newsflow on property sector incentives and development corridors should be strong.
4. The momentum of market EPS upgrades remains robust and there is still significant upside potential for 2008 estimates.
5. 2007 EPS growth is forecast at 22%, an acceleration from 2006’s 19%. ROEs are set to improve from 15.2% in 2007 to 15.6% in 2008.
6. The KLCI is trading at a 2008 P/E of below 15x, the low end of the KLCI’s historical P/E range. P/Es were 21-24x during the 1980s and 1990s bull markets.
7. Regional and Wall Street prospective valuations are reasonable at mid to high teens levels, coupled with strong earnings performances.
8. Market psychology is still favourable as many local institutional and retail investors remain cautious. We do not see any “irrational exuberance” yet.

The negatives:

1. The KLCI has risen more than 400 points over the past nine months to an all-time high.
2. Many regional markets and Wall Street are also at all-time highs. The stock markets in China and Vietnam are trading at very high P/E multiples.
3. Certain sectors such as plantations have gone into uncharted territory and analysts have started recommending somewhat dubious stocks.
4. There has been aggressive buying by foreign funds, particularly hedge funds, which have little memory of the pitfalls of investing in popular themes in Malaysia.

Still not too late to ride the bull

Last year, our parting shot to investors when we turned bullish after being cautious for the previous two years was to be brave and go for higher-beta stocks with strong newsflow. We still hold that view and although we do not dare to ask investors to discard the burden of “past experience,” i.e. knowing too much, we believe that many investors remain overly sceptical and pessimistic. There is still much value to be found, especially in small to mid cap stocks and there are significant profits to be made. While it is still too early to tell whether Malaysia can enjoy a prolonged multi-year bull market supported by solid and improving fundamentals, we are confident about its prospects, at least for the next 9-12 months. Investors should not miss this market opportunity as this is the bull market that the investment community has waited a decade for.

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NEUTRAL: The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.

UNDERPERFORM: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.

TRADING BUY: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 months.

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OVERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

NEUTRAL: The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.

UNDERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months.