AmResearch

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BUDGET 2016

Market Strategy : A trading market

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Investment Highlights

- **From the market's standpoint, Budget 2016 is a non-event due to the absence of a significant uplift to corporate earnings or sentiment. In the near term, we expect the market to oscillate around our unchanged end-2015's fair value of 1,650 for the FBM KLCI. It would remain a trading market with funds nibbling on dips and locking in gains on liquidity-driven rebound. Although there is a general pessimism over the economy due to a confluence of factors, our sense is that the market would continue to be supported by ample domestic liquidity. Furthermore, an uneven global growth trajectory with acceleration in the US but slowdown in the EU and China as well as the ascendancy of the US dollar, have somewhat pushed back expectations of a hike in the US Fed Funds rate and the associated reversal in external liquidity. Therefore, a selldown off the current levels appears unlikely, we believe.**

- **The key challenge though is the lack of conviction over the earnings momentum to establish a bottoming of the market. With the exception of a select few exporters, the earnings revision cycle continues to contract due to margin compression from rising cost pressure and weaker-than-expected sales. Our bottom-up estimates now put the market's earnings growth to just 2.2% for 2015 but it may still decelerate further approaching the year-end. We expect the market recovery to be delayed to 2016 where we are retaining our fair value for the FBM KLCI at 1,750, based on 16x PE, and earnings to reaccelerate to 7.6% from 2.2% in 2015.**

- **The gloves sector would be a beneficiary of Budget 2016 because of its proposal for a special reinvestment allowance (RA) for companies that have exhausted their eligibility to qualify for RA. This applies to qualifying capex incurred for years of assessment 2016 until 2018. Such an incentive sits nicely with the glove companies' capex upcycle, which should see a lower effective tax rate going forward. The rubber gloves sector would continue to enjoy PE expansion. It is one of the few sectors that are experiencing earnings upgrades from volume growth and margin expansion. Our BUYs are Top Glove and Kossan. The proposed hike in the minimum wage under Budget 2016 would not significantly increase the operating cost of select industries as labour typically accounts for less than one-third of total production costs. We estimate that the hike in minimum wage would increase CPO production cost by less than RM20/tonne. We are Overweight on the plantation sector with IJM Plantation as our top pick because of its younger oil palm trees. We also like Inari within the technology space given its superior growth prospects from optimising its capacity expansion towards its high margin products. Laboir accounts for about 20% of its total production costs.**

- **We are Overweight on property equities with BUY on Mah Sing, MRCB, E&O and Titijaya. The sector is already trading on trough discount to NAV of more than 50%. Valuation-wise, the market has not only priced-in cuts in presales target but also, default risks eventhough developers' balance sheets are healthy. The risk here is that property equities may be caught in a value trap because of the lull in residential transactions. But we believe that the upside potential far outweighs the downside risk particularly when developers embark on inventory liquidation to kick start transaction volume. Such a move would lead to a rapid narrowing in discount to NAVs.**

- **Budget 2016 reaffirms the execution of MRT 2 and LRT 3. Following its appointment as the PDP for the MRT 2, Gamuda is a frontrunner for the tunnelling package of this RM28bil project. We believe Econpile and Kimlun Corp to be strong contenders for specialist works under the LRT/MRT projects, given their niche in piling and tunnel lining/segmental box girder (SBG) works, respectively. Other frontline projects that will kick off in 2016 include the Pan Borneo Highway, DASH and SUKE highways as well as more BRT projects. The Sunway Group is set to benefit from the latter given its experience in delivering Malaysia's first BRT project at Bandar Sunway.**

- **MRCB is expected to reap the benefits of its restructuring initiatives in 2016. Construction earnings are set to improve with the award of the PDP contract to the MRCB-George Kent JV. More assets injections into MRCB Quill REIT are on the cards. MRCB is trading at a steep discount of 55% to our NAV of RM2.76/share.**

- **Teo Seng, a leading egg producer, is one of the cheapest consumer stocks. It is trading on a PE of just 7x on 2016's earnings, and with a net cash balance sheet. The rebound in egg prices from 28 sen/egg in 2QFY15 to 34 sen/egg in 3QFY15 combined with the timely addition of two new farms (+25% capacity) would underpin a strong earnings rebound in 2HFY15. Our fair value of RM2.70/share is based on an FD FY15F PE of 13x. Tenaga Nasional (TNB) is expected to continue to report cost over-recovery under the Imbalance Cost Pass Through (ICPT) mechanism, due to cheaper fuel costs on the back of sustained power demand growth. Hence, we maintain BUY with a DCF-derived fair value of RM16.70/share. TNB's 4Q15 results will be released next week.**

TABLE 1 : TOP BUYs

Stocks	Rating	Last Price on 23 Oct (RM)	Fair Value (RM)	Core EPS (FD) (sen) FY15F	FY16F	FY17F	PE Ratio FY15F	FY16F	FY17F	Market Cap (RM mil)	Div. Yield (%) FY15F	Net Gearing (%) FY15F
Top Glove*	BUY	9.25	10.60	51.5	54.0	56.5	18.0	17.1	16.4	5,743.0	2.5	21.2
Kossan Rubber	BUY	8.46	8.40 (u.r)	31.6	35.3	40.7	26.8	24.0	20.8	5,409.9	1.3	11.2
Teo Seng Capital	BUY	1.57	2.70	20.8	23.2	26.7	7.5	6.8	5.9	470.6	3.5	37.7
Malaysian Resources Corp	BUY	1.23	1.65	3.2	6.2	6.7	38.4	19.8	18.4	2,197.5	1.6	152.6
Mah Sing	BUY	1.32	2.12	13.3	14.0	15.1	9.9	9.4	8.7	3,180.4	3.8	37.3
Eastern & Oriental*	BUY	1.62	2.78	7.3	11.1	11.0	22.2	14.6	14.7	2,028.2	0.1	60.2
Tenaga Nasional	BUY	12.80	16.70	123.7	126.5	132.8	10.3	10.1	9.6	72,238.2	2.9	40.1
Gamuda *	BUY	4.72	5.75	24.1	24.4	27.3	19.6	19.3	17.3	11,355.9	3.4	43.7
Econpile Holdings *	BUY	1.00	1.50	10.7	12.0	13.1	9.3	8.3	7.6	535.0	2.5	nm
Inari Amertron*	BUY	3.70	3.83 (u.r)	25.5	29.4	32.5	14.5	12.6	11.4	2,702.8	2.6	nm
IJM Plantation*	BUY	3.56	3.65	13.0	14.5	15.5	27.4	24.6	23.0	3,134.9	1.7	21.1
Sunway Bhd	BUY	3.05	3.54	33.1	32.1	33.2	9.2	9.5	9.2	5,455.8	10.7	43.9

Forecasted numbers for FY16F-FY18F
Source: Company Data, AmResearch Estimates, Bloomberg

Key 2016 Budget Proposals: Construction

Construction

KEY PROPOSALS:

- Allocation for development expenditure is up nearly 3% YoY (RM52bil) compared with the previous year.
- Key infrastructure projects to be implemented in 2016 include:
- MRT Line 2 (RM28bil);
- Klang Valley LRT 3 (RM10bil);
- Over RM1.5bil for new Bus Rapid Transit (BRT) projects and another ~RM1bil for the Kota Kinabalu BRT;
- Damansara-Shah Alam Elevated Expressway (DASH);
- Sg.Besi-Ulu Kelang Elevated Expressway (SUKE); and
- Pan Borneo Highway (toll free):

(1) Sarawak stretch (1,090km) worth RM16bil; and

(2) Sabah stretch: Construction works on the 706km highway from Sindumin to Tawau (RM13bil) will commence in 2016.

- Four development projects to boost domestic investments. They are:
- Malaysia Vision Valley (MVV): The project spans 108k hectares, covering Nilai until Port Dickson. An initial investment forecast of RM5bil is being penciled in for 2016;
- Cyber City Centre in Cyberjaya (development cost: RM11bil over five years);
- KLIA Aeropolis township (1,300 acres): Targeted investment of RM7bil; and
- RM7bil investment by Khazanah Nasional in nine high-impact domestic projects in sectors such as healthcare, education, tourism as well as communication software and infrastructure.
- Other road/logistics projects:
- RM900mil traffic dispersal project within Jln Tun Razak
- Pulau Indah & Central Spine road
- Rural infrastructure:

(1) RM1.4bil for the construction and upgrading of rural roads, including another RM200mil within the FELDA schemes;

(2) Allocation of RM878mil rural electrification projects (10k homes); and

(3) RM568mil for rural water supply projects (3k homes).

- Construction of five new hospitals in Pasir Gudang, Kemaman, Pendang, Maran and Cyberjaya. The existing Kajang Hospital will also be redeveloped.
- Construction of more affordable housing, including RM1.6bil for 175k new PR1MA homes.
- Others: Development of Rubber City in Kedah (RM320mil), Samalaju Industrial Park (RM142mil), water treatment plants (RM877mil), IBS Promotion Fund of RM500mil for developers and contractors in category G5 and below.

Comments:

Budget 2016 sets the tone for the commencement of the 11th Malaysia Plan (11MP) period from 2016 and 2020.

Under Budget 2016, development expenditure has been set at RM52bil, representing an increase of nearly 3% YoY compared to the previous year's allocation.

This accounts for roughly one-fifth of total development expenditure under the 11MP (RM260bil).

Notably, we take comfort that several big ticket projects earmarked under the 11MP are re-affirmed under Budget 2016. These projects are set to commence in 2016, and will help reignite prospects for Malaysian contractors after a lull in 2015.

(1) **MRT Line 2 (Sg.Buloh-Serdang-Putrajaya):** MRT Corp has obtained approval for the MRT Line 2's final alignment. With this, construction works on this new line is expected to kick-off by 2Q16.

The entire line is to be delivered by 2022. Phase 1 (Sg.Buloh-Kg. Batu) is expected to be operational by 2021, followed by Phase 2 (Kg. Batu- Putrajaya Sentral) a year later.

Tenders for major civil work packages will be issued from this month ahead of the award of major contracts (including tunnelling works) by mid-2016.

Following its appointment as the Project Delivery Partner (PDP), we envisage the **MMC-Gamuda JV** to be the frontrunner for the tunnelling packages under MRT Line 2, which is initially estimated at RM28bil.

We envisage specialist contractors such as **Econpile** and **Kimlun Corp** to be the other strong contenders by virtue of their niche expertise in piling and segmental box girdle (SGB)/tunnel lining works.

(2) **Klang Valley LRT 3:** Much like the MRT Line 2, we expect construction works for the LRT Line 3 to kick-off next year ahead of its scheduled completion by 2020.

The PDP contract was awarded to the **MRCB-George Kent JV** last September. The LRT3 project (36km) runs from Bandar Utama to Klang before terminating at Johan Setia in Klang.

We expect tenders to be dished out soon after the terms of the PDP's definitive agreement are signed by year-end.

We expect more traction for MRCB's share price once the JV finalises the terms of the PDP contract by year-end.

Likewise, while competition for major civil works packages will likely be intense, we believe that **Sunway Bhd** (via Sunway Construction Group) could be a strong contender by virtue of its prior track record in handling major LRT/MRT/BRT contracts within the Klang Valley.

(3) **DASH & SUKE:** News flow on this two proposed urban highways appear to be on the cards again after the pre-qualification exercise closed on 17 September.

In particular, DASH's alignment has been included into the Petaling Jaya City Plan 2 in June although it is unclear if the same can be said for SUKE.

The RM4.2bil DASH and RM5.3bil SUKE projects are elevated highways that are under Projek Lintasan Kota Holdings Sdn Bhd (PROLINTAS).

According to the local press, **IJM Corp, Sunway, MRCB, Mudajaya Group** and **UEM Group** are among five suitors in the running for these jobs.

(4) Pan Borneo Expressway: The initial cost for the Pan Borneo Highway is estimated at RM27bil as per the 11MP. The Sarawak stretch – spanning 1,090km – will cost RM16bil and is expected to be completed by 2021.

As for the Sabah stretch, construction works for the Sindumin-Tawau highway (706km) will kick-off next year at an estimated cost of close to RM13bil.

With the Sarawak state elections due to be held next year, we envisage several job flow opportunities for local home-grown contractors such as HSL (FV: RM2.30/share, BUY) and KKB Engineering.

As for the Sindumin-Tawau highway, we are unsure who are the key beneficiaries at this juncture, given the lack of details and absence of any large Sabah-based contractors with the relevant knowhow and expertise.

We also expect more allocations to develop Sarawak, particularly via the construction of hydro dams under SCORE and rural infrastructure. This would benefit **Sarawak Cable**, which is the leading domestic transmission line player.

(5) BRT projects: Under Budget 2016, over RM1.5bil in BRT projects and a nearly RM1bil Kota Kinabalu BRT initiative were announced.

As a pioneer in BRT projects via the RM453mil Sunway BRT line (5.4km), **Sunway** once again could be in a position to secure more such projects.

The proposed KLIA Aeropolis airport township project is spearheaded by **Malaysia Airports Holdings Bhd (MAHB).** Its overarching objective is in promoting Malaysia as a hub for aviation, aerospace and logistics besides being an engine for growth in tourism activities.

One of its earliest projects, the Mitsui Outlet Park KLIA, was recently launched in May.

Given the current economic climate, we nevertheless believe that KLIA Aeropolis, much like the MVV, Cyber City Centre and other development projects under Khazanah, could take some time to take-off before any tangible benefits can be seen.

Last but not least, **IJM** stands to benefit from the balance of works under the West Coast Expressway (WCE) worth RM2.2bil after it was awarded the first package (RM2.8bil) in May 2014

Key 2016 Budget Proposals: Conglomerates

Conglomerates

KEY PROPOSALS:

For conglomerates, the following measures may benefit **Sunway and DRB-Hicom**, respectively:-

- MRT II project from Sungai Buloh- Serdang-Putrajaya spanning 52km, with an estimated cost of RM28bil.
- LRT3 project from Bandar Utama Damansara to Johan Setia, Klang spanning 36km, with an estimated cost of RM10bil.
- For public bus services, the Rapid Transit Bus (BRT) project at a cost of more than RM1.5 billion and BRT Kota Kinabalu at a cost of almost RM1 billion, will be implemented.
- RM17.3bil is allocated to the Ministry of Defence. This includes the procurement of six Littoral Combatant Ships, Very Short Range Air Defence weapons system, armoured vehicles and the A-400M Airbus.
- The armed forces will be equipped with the latest technology including the use of Unmanned Airborne System to improve Intelligence, Surveillance and Reconnaissance capacity.

Comments:

Sunway Bhd (FV: RM3.54/share. BUY) is a pioneer of BRT development, having completed the maiden 5.4km line at Bandar Sunway well ahead of schedule this year at a cost of RM453mil.

Sunway's (FV: RM3.54/share, BUY) listed subsidiary Sunway Construction Group Bhd is expected to be a prime beneficiary of additional proposed BRT lines.

Sunway had previously said up to 12 other corridors had been identified by the Land Public Transport Commission as suitable for BRT. We also expect Sunway to participate in the upcoming LRT and MRT projects.

Our fair value for Sunway represents an implied PE of 11x FY15F – +2STD above its historical 5-year forward PE mean of 8x. The stock is a laggard to both property and construction counters.

Meanwhile, **DRB-Hicom (FV: RM1.96/share, BUY)** will be among the beneficiaries of the allocation to the Defence Ministry.

Specifically, DRB-Hicom will continue to roll out the armoured-vehicle (AV8) defence project under a RM7.55bil contract. DRB-Hicom also has aerial and amphibious defence capabilities.

Our fair value for DRB-Hicom is based on a 45% discount to our SOP value – which implies a P/BV ratio of 0.5x – at its 10-year historical mean and below the five-year mean of 0.6x. We expect contributions from the AV8 project to peak in FY17-FY18.

Key 2016 Budget Proposals: Banking

Banking

KEY PROPOSALS:

- Federal Government Emolument: Total allocated for emolument has been raised to RM70.5bil, or 2.0% increase from 2015's revised RM69.1bil (2015: +3.1% YoY).

- Civil servants: To appreciate the contributions of civil servants, the government agrees to the following major benefits: (a) to provide benefit of salary adjustment equivalent to one annual increment according to grade, which will benefit all the 1.6mil civil servants with an allocation of RM1.1bil; (b) set a minimum starting salary in the civil service at RM1,200 a month, which will benefit 60,000 civil servants; (c) set the minimum pension rate at RM950 a month for pensioners with at least 25 years of service, which will benefit almost 50,000 pensioners; (d) offer permanent post to contract of service officers who have at least 15 years of service. This will benefit 43,000 contract officers. All these measures will be implemented effective from 1 July 2016 with a total allocation of RM1.4bil.

  To reduce the burden of rising cost of living, the government agrees to provide a special assistance of RM500 to all civil servants. For the 700,000 government pensioners, a special payment of RM250 will be provided. Both payments totalling almost RM1bil will be made in January 2016.

- Capital market: To further invigorate the capital market, the government agreed to implement several initiatives, including tax deduction on issuance costs of Sustainable and Responsible Investments (SRI) sukuk and 20% stamp duty exemption on Shariah-compliant loan instruments to finance the purchase of houses.

- Foreign currency: To diversify the use of foreign currency in trade transactions, Bank Negara Malaysia will provide the Ringgit-Renmimbi credit swap facility for local banks.

Comments:

The increase in total emoluments is higher than last year's, and is expected to aid in easing affordability of personal loans. The benefits for civil servants also included an increment this year, unlike last year's where there was no increment but a half-month bonus was announced. However, we expect earnings growth for MBSB to remain flattish, mainly due to ongoing effects from more stringent household measures implemented last year by Bank Negara.

The 20% stamp duty exemption on Shariah-complaint loan instruments to finance the purchase of houses is positive but we do not expect a major impact on the industry's residential mortgage loans demand.

In addition, the diversification of foreign currency in trade transactions is positive in terms of trade financing activities, as this may enable better planning by importer borrowers.

No major surprises for the banking sector. We maintain a NEUTRAL stance on the sector.

Key 2016 Budget Proposals: Tobacco

Tobacco

KEY PROPOSAL:

- Tobacco excise duty maintained at 28 sen/stick

Comments :

Budget 2016 made no mention of a hike in excise duty or indirect taxes for tobacco products. This is positive as the absence of an increase would help alleviate the decline in legal total industry volumes (TIV) and reduce illicit trades.

We believe this latest positive development could have been triggered by the industry's depressed volume growth, which ultimately poses a risk to the government's revenue collection. (The tobacco industry is projected to contribute 41% to the government's total excise duties in 2015. The latter, in turn, is estimated to constitute 7% of tax revenues and 6% of total government revenues.)

As it is, legitimate TIV was already down by 9.6% YoY for the Jan-Jun 2015 period in tandem with the reduction in disposable incomes and persistently high level of illicits (32.8% as at Dec 2014).

Additionally, the government had also implemented the GST on 1 April 2015. While the 6% GST effectively replaces the 5% sales tax which was previously imposed on the cigarette manufacturers, it is not a direct substitute as the calculation bases are different. The introduction of the GST had resulted in cigarette prices being raised by 30 sen/pack on 29 June 2015 as the manufacturers seek to pass on the higher costs. The quantum of the price increase was however notably lower than the 50 sen/pack initially put forward by BAT.

Notwithstanding the above, we caution that there still remains the possibility of an off-budget excise hike announcement as seen last year. Recall, the excise duty for tobacco was raised by 3 sen/stick from 25 sen/stick to 28 sen/stick (+12%) on 1 November 2014 with the Budget 2015 reading having been held on 10 October 2014.

In response, British American Tobacco (M) and the other tobacco manufacturers, namely JT International (JTI) and Philip Morris International (PMI), had raised the retail selling prices of their 20-stick packs by RM1.50/pack (+12.5% to +14.3%) effective 5 November 2014.

We are keeping our **NEUTRAL** stance on the sector as **BAT** remains a **HOLD** with an unchanged fair value of **RM68.60/share**. Despite the lack of positive catalysts for industry growth, we believe the stock is still attractive for its defensive attributes. The group's stellar dividend track record as premised on a 100% dividend payout translates to attractive average yields of 5.2%.

Key 2016 Budget Proposals: Malt Liquor

Malt Liquor

KEY PROPOSAL:

- Status quo for alcohol excise duty at RM7.40/litre

Comments:

As anticipated, the government has extended its reprieve for the malt liquor industry for the 10th consecutive year.

This decision would be very much welcomed by the brewers as they had indirectly been levied a higher tax payment following a change in the basis for excise duty valuation since November 2013 for Guinness Anchor Bhd (GAB) and January 2014 for Carlsberg Brewery (M) Bhd (CAB). To recap, the tax valuation base has been expanded to include A&P expenses and royalty payments.

Additionally, both the brewers had in the past year been served with bills of demand of RM56.4mil each by the Royal Malaysian Customs (RMC). We understand from both managements that the bills stem from the retrospective application of the Customs' new method of valuation for excise duty. The outcome of their legal challenges is pending.

We are keeping our **OVERWEIGHT** stance on the MLM sector. Compared to the other consumer companies under our coverage, the brewers have weathered the GST implementation relatively well and their position as a relatively safe consumer play offering stable returns will appeal to investors seeking respite from the present market volatility.

Although some downtrading activities had been recorded, we understand that the premium/imported segment which command greater margins continue to perform well. In a bid to protect their margins post-GST, the brewers had also raised their prices by 3%-5% in December 2014.

The status quo excise duty will also lend further weight to the present recovery in malt liquor market (MLM) volumes although volumes are still generally soft. After recording healthy MLM volume growth of 6% in 2007-2013, volumes had moderated in 2014 against the backdrop of declining consumer confidence, proliferation of illicits/contrabands/parallel imports (2013: 3-yr CAGR of 33%) and other negative external factors (i.e. lower-than-expected tourist arrivals and bad weather).

We maintain **BUY** on both **GAB (FV: RM15.80/share)** and **CAB (FV: RM13.70/share)**. While yields for both are comparable at 6%, we prefer GAB to CAB for its dominant position (~60% market share), strong franchise value, and increasingly attractive stable of brands.

Key 2016 Budget Proposals: Healthcare

Healthcare

KEY PROPOSAL:

- Zero-rating of all types of controlled medicines under the Poisons List Group A, B, C and D as well as addition of 95 brands of over-the-counter medicines including treatment for 30 types of illnesses such as cancer, diabetes, hypertension and heart disease. This is a double increase from 4,215 to 8,630 brands of medicines.

Comments:

Under Budget 2016, the list of zero-rated medicines will double to 8,630 brands from the current 4,215 listed in the National Essential Medicines List (NEML) issued by the Ministry of Health. This will be effective from 1 Jan 2016.

Recall that under the Goods and Services Tax (GST), businesses are eligible to claim input tax credit in acquiring these supplies. The customers are then charged GST at zero rate.

We do not see any direct impact on healthcare providers under our coverage (KPJ Healthcare and IHH Healthcare) as the providers would be able to claim input tax credit on these supplies. Medicines that are not under the NEML are subject to 6% GST standard rate.

Nevertheless, we opine that the expansion of the zero-rated medicines is indirectly positive as cheaper medicines will make healthcare cheaper and more accessible for patients. This, in turn, will drive volume growth for healthcare players. We forecast revenue CAGR of 7%-13% over the next three years for KPJ and IHH.

Thus far, inpatient volumes growth has continued to sustain post GST implementation, while price reversions will help to mitigate any cost inflation. We have HOLD calls for both KPJ (fair value: RM4.10/share) and IHH (fair value: RM5.55/share).

Key 2016 Budget Proposals: Rubber Gloves

Rubber Gloves

KEY PROPOSALS:

- Special Reinvestment Allowance Incentive for companies in the manufacturing and agriculture sectors which have exhausted their eligibility to qualify for RA.
  - The rate of claim is at 60% of the qualifying capital expenditure and is allowed to be set off against 70% of statutory income from year of assessment 2016 to 2018.

- Minimum wage increase:
  - from RM900 to RM1,000 per month for Peninsular Malaysia
  - from RM800 to RM920 for Sabah, Sarawak and the Federal Territory of Labuan
  - Implemented in all sectors except domestic services or domestic maids
  - Effective 1 July 2016

- Improve the rubber production incentive (IPG)
  - IPG activation price of SMR20 FOB is raised from RM4.60 to RM5.50 per kg as well as from RM1.75 to RM2.20 per kg at farm price for scrap rubber or cuplumps

Comments :

The rubber gloves sector would be a prime beneficiary of Budget 2016 because of the proposal for a special reinvestment allowance (RA) incentive. Many of the glove makers have exhausted their eligibility to qualify for RA (valid for 15 years from the year of assessment RA is claimed) given their long operating history. The scope of RA includes reinvestments for expansion, modernisation, automation and diversification.

We believe that such an incentive sits nicely with the glove companies' current capex upcycle. Against the backdrop of robust global glove demand (+9% YoY), we understand that the manufacturers are investing between RM150mil and RM400mil p.a. for the next three years.

Following this, we see earnings upside for the rubber glove players as the effective tax rate would decline moving forward.

We deem the impact from the 11% minimum wage to be insignificant given that labour costs make up only ~10% of the glove manufacturers' total operating costs. In addition, the industry has a cost pass-through pricing mechanism and there is an eight-month grace period to the implementation date. We see no impact from the government's move to raise the activation price of SMR20 as the glove manufacturers use bulk latex and procure most of their natural rubber from neighbouring countries. The product mix for most players also currently lean towards nitrile gloves.

All in, we maintain our **OVERWEIGHT** stance on the rubber gloves sector given the manufacturers' prime position as exporters operating in a defensive sector, and strong earnings growth momentum on the back of expanding EBITDA margins. The present RM weakness will also be supportive of margins and as such, we expect valuations of the rubber glove players to remain inflated. We also foresee the sector enjoying another round of PE expansion from the introduction of the Special RA Incentive. Our top BUYs for the sector are Top Glove (FV: RM10.60/share) and Kossan (FV: RM8.40/share (u.r.)).

Key 2016 Budget Proposals: Agriculture

Agriculture

KEY PROPOSALS:

- Development of the RM320mil Rubber City in Kedah and RM20mil palm oil jetty in Sandakan;
- Special Reinvestment Allowance will be given to companies in the manufacturing and agriculture sectors. The rate of claim is 60% of qualifying capital expenditure and can be set off against 70% of statutory income from 2016 to 2018;
- Companies that invest in food production will be given tax deduction equivalent to the amount invested. Companies undertaking new food production projects will be given 100% income tax exemption for 10 years. Existing companies expanding their plants will be given the incentive for five years;
- RM852mil will be allocated to RISDA and FELDA to implement income and productivity enhancement programmes;
- The price of SMR20 rubber sold under the rubber production incentive scheme will be raised from RM4.60/kg to RM5.50/kg. For scrap rubber, the price will be raised from RM1.75/kg to RM2.20/kg;
- Implementation of a paddy grading initiative and improvement of the paddy price subsidy scheme from 1 January 2016 onwards. The rate of subsidy for paddy will be raised from RM248.10/tonne to RM300/tonne;
- RM5.3bil will be allocated to the Ministry of Agriculture and agro-based industries. These include RM450mil for high-impact programmes such as fruit and vegetable cultivation, RM180mil to upgrade drainage and irrigation, RM190mil to FAMA and RM90mil for the Youth Agropreneur Development Programme; and
- RM25mil for the development of rubber, oil palm and other cash crops under the Orang Asli Economic Development Project.

Comments:

In contrast to the agricultural proposals under the previous Budget, which mainly benefited smallholders, Budget 2016 is expected to be favourable to the large companies as well due to the Special Reinvestment Allowance.

The tax incentive would allow companies with oleochemical and specialty fats operations to enjoy a lower effective tax rate. We think that IOI Corporation (BUY), Kuala Lumpur Kepong (BUY), Genting Plantations (BUY) and Felda Global Ventures (SELL) would benefit.

The development of the palm oil jetty in Sandakan would modernise facilities and allow palm oil products to be shipped faster and more efficiently. Palm refiners in Sandakan are IOI Corporation and Wilmar International. A company with upstream operations in Sandakan is IJM Plantations.

Finally, the development of the RM320mil Rubber City in Kedah is expected to benefit Tradewinds Group, which was privatised several years ago.

Key 2016 Budget Proposals: Property

Property

KEY PROPOSALS:

- Core focus is on the construction of more affordable housing:-

  (1) RM1.6bil for the construction of 175k units of new PR1MA homes at prices that are 20% below its market value. 10k units are expected to be delivered by next year.

  (2) 100k homes to be supplied under the 'Perumahan Penjawat Awam 1 Malaysia' (PPA1M) scheme priced between RM90k-RM300k/unit by 2018. This will be aided by a facilitation fund of up to 25% of development cost.

  (3) 5k units of PR1MA and PPA1M homes in ten locations to be built within the vicinity of LRT and monorail stations (e.g. in Pandan Jaya, Sentul and Titiwangsa).

  (4) 10k new units by SPNB, which is aided by a subsidy of RM20k/unit under a RM200mil allocation.

  (5) 22,300 units of apartments and 9,800 units of terrace homes will be built under the People's Housing Program (PPR) for RM863mil.

  (6) Government-linked companies (GLCs) will build affordable homes within the vicinity of MRT stations in Bandar Kwasa Damansara (Kwasa Land – 800 units; Sime Darby Property – 4,600 units).

  (7) FELDA - 20k units of homes for second generation settlers; FELCRA (2k units) and RISDA (2k units). The maximum price for homes to be built by FELDA will be reduced from RM90k to RM70k.

- Four development projects aimed at boosting domestic investments:

  (1) Malaysia Vision Valley (MVV): The project spans 108k hectares, covering Nilai until Port Dickson. An initial investment forecast of RM5bil is being penciled in for 2016.

  (2) Cyber City Centre in Cyberjaya (development cost: RM11bil over five years)

  (3) KLIA Aeropolis township (1,300 acres): Targeted investment of RM7bil

  (4) RM7bil investment by Khazanah Nasional in nine high-impact domestic projects in sectors such as healthcare, education, tourism as well as communication software and infrastructure.

- Others:

  (1) 20% stamp duty exemption on Shariah-compliant loan instruments for purchase of houses.

  (2) RM200mil allocation for first-time home buyers under the First House Deposit Financing Scheme.

  (3) Extension of the stamp duty exemption for revival of abandoned housing projects for another two years.

Comments:

The measures outlined under Budget 2016 are mainly geared towards providing more affordable homes to address the housing needs for the lower income population amid rising house prices and tighter access to financing.

In any case, these projects are mainly federal-driven initiatives which do not form the targeted addressable markets of listed property developers within our stock universe.

More importantly, save for the 20% exemption on Shariah non-compliant loan instruments for home purchases, we are not entirely surprised by the absence of any incentives/relaxation of policies to boost Malaysian properties. Hence, we expect this development to be neutral from a market-standpoint.

Likewise, we believe that the development projects aimed at boosting domestic investments (e.g. MVV, KLIA Aeropolis, Cyber City Centre) would need more time to realise their development potential given the current economic climate.

While transaction volumes are likely to remain muted in the near term, we maintain our **OVERWEIGHT** stance on the property sector. At current levels, the market has not only priced-in cuts in presales target but also, default risk even though developers' balance sheets are generally healthy. As things stand,the sector is already trading at trough NAVs of more than 50%.

Mah Sing Group, E&O, MRCB and **Titijaya Land** remain as our top picks for leverage to any recovery in property volumes

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Key 2016 Budget Proposals: Oil & Gas

Oil & Gas

KEY PROPOSALS:

- Reaffirmation of the construction of the Refinery and Petrochemical Integrated Development (RAPID) Complex in Pengerang, Johor, with an estimated investment of RM18bil for 2016.
- GST relief is provided on the re-importation of equipment such as equipment for oil and floating platforms that are temporarily exported for the purpose of rental and leasing.

Comments:

The government's reaffirmation for RAPID is in line with Petronas' target for commissioning in 2019. The estimated investment of RM18bil for 2016 is also in line with the total estimated capex of ~RM90bil for the entire development.

The immediate beneficiary should be Dialog Group, which has completed the 1.3mil m^3 Phase 1 of its tank terminal facility in Pengerang, located nearby the RAPID development, and which is fully leased out. The group has also commenced EPCC works on Phase 2, which is a dedicated industrial tank terminal catered for the RAPID complex. Phase 2 is due for completion by mid-2018, while the LNG regasification plant and storage tanks will be completed by end-2017.

Currently, goods which have been exported temporarily for the purpose of rental and lease are subject to imposition of GST at standard rate when re-imported into Malaysia. The GST exemption on the re-importation of equipments would provide some reprieve to some of the service providers in terms of their cost structures. This, in turn, would allow these companies to bid more competitively for contracts going forward. Overall, we do not expect significant impact from this.

Overall, we prefer established companies that are exposed to the production phase with long-term service contracts and recurring income, as these are less sensitive to the oil price fluctuations. We maintain our NEUTRAL view on the sector with BUY calls on Yinson Holdings (FV: RM3.60/share) and Dialog Group (FV: RM2.05/share).

Key 2016 Budget Proposals: Technology

Technology

KEY PROPOSALS:

- To increase the national minimum wage from RM900 to RM1,000 per month for Peninsular Malaysia employees
- Special Reinvestment Allowance (RA) incentive for companies which have exhausted their eligibility to qualify for RA (after 15 consecutive years)

Comments:

The proposed increase to the national minimum wage from RM900 to RM1,000 per month for Peninsular Malaysia is not expected to significantly impact the semiconductor industry. The average wage expense as a percentage of total costs is circa 20% for **Inari (BUY, FV:RM3.83 /share [u.r])** and circa 25% for MPI **(BUY, FV: RM9.08 /share)**. Hence, higher wages are expected to only increase costs by circa 1%. On the other hand, this will ensure a sustained workforce to appease the foreign workers affected by the significant depreciation of the ringgit since the end of 2014 against the USD and regional currencies.

While we are positive on the special RA incentive, it does not have any impact on the semiconductor companies under our coverage, **Inari** and **MPI**. This is due to tax benefits in place which are currently being enjoyed by their subsidiaries as a result of the pioneer status and other tax relief benefits.

We maintain our **OVERWEIGHT** stance on the sector with our top pick being **Inari** due to its accelerating growth prospects as a result of capacity expansion towards its higher margin products with its new P13 building in Penang.

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