

## Her subjects have spoken

The UK voted unexpectedly in favour of exiting the European Union (EU) in the Brexit referendum by a margin of 51.9% to 48.1%. In our view, there are no positives from the outcome. The consequences on the UK and the EU, if the contagion effect spreads, would drag down the already precarious global growth. Thankfully, we estimate that the direct impact on Malaysia is manageable in terms of the macro picture and earnings. However, our biggest fear is if this prompts further EU disintegration and impairs the credibility of the Euro, triggering a global recession that would put pressure on the Brent price due to demand destruction. This would directly impair Malaysia's fundamentals. Bottom line: global financial markets are entering a period of volatility while the risk profile for Malaysia has also increased.

### A messy divorce

The kneejerk financial market reaction is one thing but the tasks ahead to extricate Britain from the EU is messy. Any existing preferential treatment for a member of the EU would be rolled back and new barriers would be enacted for trade, employment, immigration, investments and capital flows, all of which have far-reaching consequences on the economy. The implications are extensive for the GDP with valuable resources dedicated to dealing with the consequences when they could be deployed for productive growth. Worse still, renegotiating trade deals and treaties would be a long drawn-out affair, not to mention the tough stand by the EU given the likely upper hand in bargaining power and resentment towards UK's exit. It is therefore unfortunate that the world's fifth largest economy is heading towards a period of more economic uncertainties that would trigger headwinds for global growth.

### Muted direct impact on Malaysia but contagion could be damaging

The direct impact on Malaysia is relatively muted. In 2015, the UK was the destination for just 1.2% of total Malaysian exports; this works out to RM9.3bn. Nonetheless, we are worried about the contagion effect from Brexit. If the repercussions spill over into the EU resulting in a hit to EU's growth, we could see as much as 10.1% of Malaysia's total exports being affected (including the UK portion); this works out to a substantial RM78.8bn. Worse, a precedent has been set now for relinquishing EU membership. If the core EU members are unable to hold the block together it could spawn referendums in other countries that could unravel the EU and the single currency, and extrication would be far more difficult than for the UK given their deeper integration.

### Market earnings for Malaysia resilient to Brexit

We believe the market earnings exposure to UK and EU is manageable given the geographical distance of Malaysia to Europe. We estimate the worst-case scenario is a 0.8% decline in 2016E fully diluted EPS if all market earnings from the UK disappear. The impact increases to 0.9% if this is extended to the EU. This takes into account both YTL Power and YTL Corp, which have huge earnings from the UK but the risk of zero contribution is minimal given the utility nature of the business. Stripping these out, the potential decline in earnings is reduced from 0.9% to 0.7%.

### Companies most at risk

Overall, the companies most impacted, measured by percentage of earnings contribution from the UK (excluding YTL companies), are Amcorp Properties, SP Setia, and Genting Malaysia, the latter being a top pick and has the most significant impact on the market given its large market cap.

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## Strategy

# Malaysia Strategy

**KLCI 1,634**

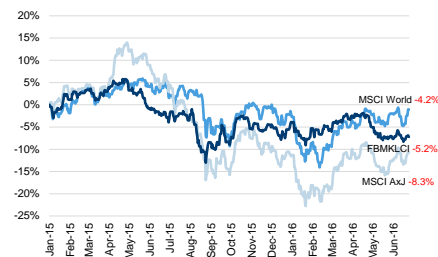
**@ 24 June 2016**

**POSITIVE (maintain)**

**KLCI Target: 1,746**

Previous target: 1,746

**KLCI vs MSCI World vs MSCI AxJ (since 2015)**



Source: Bloomberg

### Key market statistics

	2015	2016E
GDP growth (%)	+5.0	+4.5
KLCI EPS growth (%)	-4.4	+3.0

Source: BNM, Affin Hwang estimates and forecasts

### Top calls for 2016

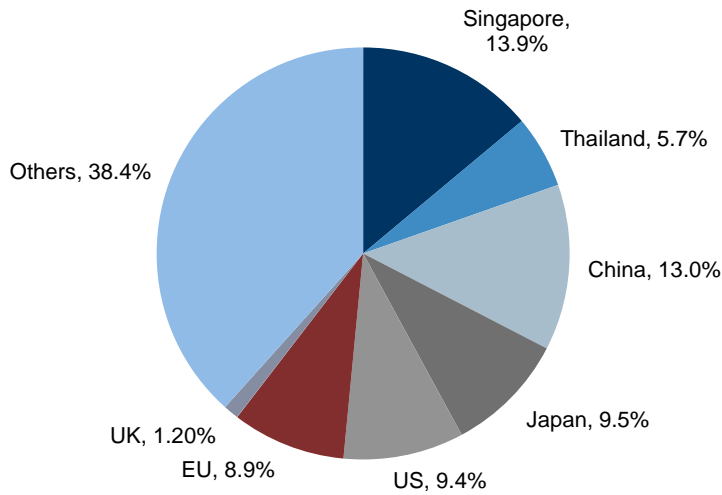
Stock	Rating	Price (RM)	TP (RM)	Upside (%)	Mkt Cap (RMm)
<b>Top Buys</b>					
AEON CREDIT	BUY	12.90	14.80	14.7	1,857.6
AFG	BUY	4.09	4.50	10.0	6,330.4
CARLSBERG	BUY	13.00	14.40	10.8	4,029.4
CIMB	BUY	4.31	5.00	16.0	37,621.4
GAMUDA	BUY	4.82	5.70	18.3	11,648.1
GENTING MALAYSIA	BUY	4.35	5.00	14.9	25,828.3
INARI	BUY	2.87	3.54	23.3	2,745.2
JAKS RESOURCES	BUY	0.92	1.60	73.9	403.3
KPJ	BUY	4.25	4.87	14.6	4,502.3
PUBLIC BANK	BUY	19.20	21.80	13.5	74,537.1
PETRA ENERGY	BUY	1.26	1.48	17.5	405.4
PAVILION REIT	BUY	1.68	1.90	13.1	5,073.3
SUNWAY CONSTRUCTION	BUY	1.55	1.98	27.7	2,004.0
SOICOM	BUY	2.25	2.62	16.4	799.8
SUNWAY	BUY	3.01	3.90	29.6	6,103.0
TA ANN	BUY	3.15	4.42	40.3	1,401.4
TENAGA	BUY	14.00	16.50	17.9	79,010.6
TOP GLOVE	BUY	4.63	6.30	36.1	5,830.1
UOA DEVELOPMENT	BUY	2.10	2.64	25.7	3,193.6
WCT	BUY	1.54	2.02	31.2	1,934.9
<b>Top Sells</b>					
MAHB	SELL	6.37	5.50	(13.7)	10,569.1
MCL	SELL	0.71	0.55	(22.5)	1,197.9
MEDIA PRIMA	SELL	1.41	1.21	(14.2)	1,564.0
STAR	SELL	2.60	1.85	(28.8)	1,920.3
UMW-OG	SELL	0.92	0.73	(20.2)	1,978.2
UNISEM	SELL	2.36	1.76	(25.4)	1,731.8

Source: Affin Hwang, pricing as of 24 June 2016

Chue Kwok-Yan  
(603) 2146 7618  
kwokyan.chue@affinhwang.com

**Fig 1: Malaysia exports by country 2015**

**Malaysia exports by country 2015**



Source: CEIC

**Fig 2: Companies with exposure to Great Britain**

Company	Exposure
Amcorp Properties	Property development in Central London
E&O	Property development in London
Sime Darby	Property development at Battersea, NBPOL has oleochemical plant in Liverpool
SP Setia	Property development at Battersea
YTL Corp	Indirect exposure via its subsidiary YTL Power
YTL Power	Water and sewerage business in South West England
Genting Malaysia	Direct exposure due to casino operations in the UK
Genting Berhad	Indirect exposure via its subsidiary Genting Malaysia

Source: Company, Affin Hwang

**Fig 3: Companies that are affected due to UK and EU exposure**

Company	Impact
Amcorp Properties	90% of group profit from London
E&O	UK property projects do not contribute to FY Mar 2017E earnings, but contribute 5% of total gross development value and 0% of RNAV (conservatively did not factor in any value for UK projects due to long gestation period)
IJM Corp	UK property projects do not contribute to FY Mar 2017E earnings, but contribute 3% of total gross development value and 1% of RNAV
IOI Corp	European downstream operations likely to contribute around 5.8% of FY17E group EBIT.
KLK	Have oleochemicals plants in Germany, Switzerland and the Netherlands. Expected to contribute around 6.5% of group PBT in FY16 and FY17.
Sime Darby	5.5% of FY17E PBT is expected to be from Battersea. Contribution from NBPOL's Liverpool plant is not available but not expected to be significant.
SP Setia	40% stake in Battersea project, which accounts for 24% of our turnover forecast for FY16 and make up 10.5% of our RNAV forecast
Uchi Tech	More than 90% of sales/profit from the EU
YTL Corp	40% of net profit from indirect exposure via its subsidiary YTL Power
YTL Power	73% of net profit via Wessex Water
Genting Malaysia	11% of net profit due to direct exposure from casino operations in the UK
Genting Berhad	4% of net profit due to indirect exposure via its subsidiary Genting Malaysia

Source: Company, Affin Hwang

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- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

In addition to the above, Registered Credit Rating Agencies are subject to the supervision of the Financial Services Agency ("FSA"), and as such may be ordered to produce reports, be subject to on-site inspection, and be ordered to improve business operations, whereas unregistered Credit Rating Agencies are free from such regulations and supervision.

#### **The Name of the Credit Rating Agency group, etc**

The name of the Credit Rating Agency group: Fitch Ratings ("Fitch")

The name and registration number of the Registered Credit Rating Agency in the group:

Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

#### **How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings**

The information is posted under "Outline of Rating Policies" in the section of "Regulatory Affairs" on the website of Fitch Ratings Japan Limited (<http://www.fitchratings.co.jp>)

#### **Assumptions, Significance and Limitations of Credit Ratings**

Ratings assigned by Fitch are opinions based on established criteria and methodologies. Ratings are not facts, and therefore cannot be described as being "accurate" or "inaccurate". Credit ratings do not directly address any risk other than credit risk. Credit ratings do not comment on the adequacy of market price or market liquidity for rated instruments. Ratings are relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk. Credit ratings, as opinions on relative ranking of vulnerability to default, do not imply or convey a specific statistical probability of default.

In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The assignment of a rating to any issuer or any security should not be viewed as a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating or the results obtained from the use of such information. If any such information should turn out to contain misrepresentations or to be otherwise misleading, the rating associated with that information may not be appropriate. Despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

**Additional information may be available upon request.**

**Japan - additional notification items pursuant to Article 37 of the Financial Instruments and Exchange Law**  
(This Notification is only applicable where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with us based on the information described in materials presented along with this document, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, we will collect a trading commission\* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction.
- In some cases, we may also charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident of Japan.
- For derivative and margin transactions etc., we may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by us.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

\*The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with us.

Corporate Name: Daiwa Securities Co. Ltd.  
Financial instruments firm: chief of Kanto Local Finance Bureau (Kin-sho) No.108  
Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan  
Japan Investment Advisers Association  
Type II Financial Instruments Firms Association