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# Big Budget Beneficiaries

Now that the 2011 Budget has been unveiled, what are the winning stocks?

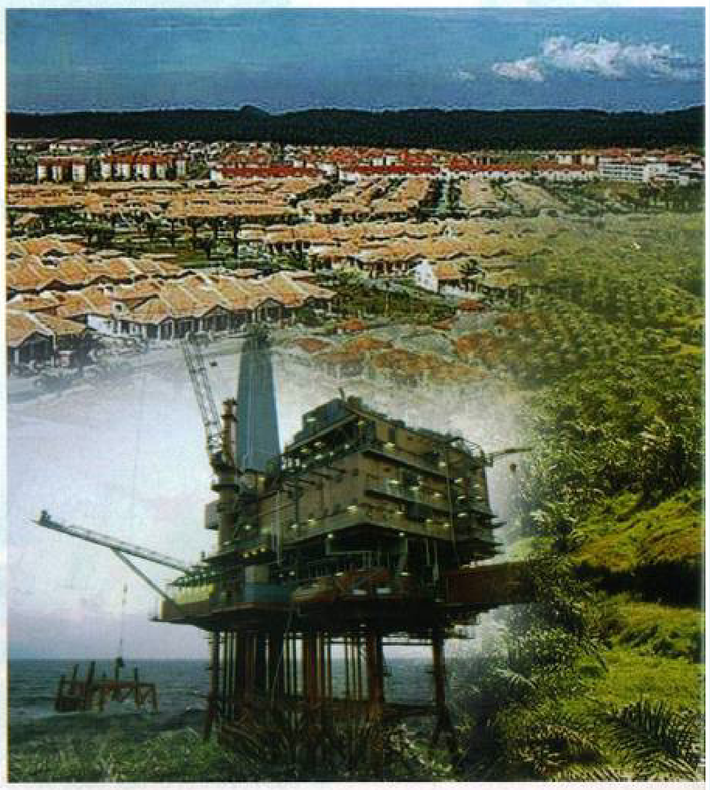
**ON OCT 15, 2011, PRIME** Minister Datuk Seri Mohd Najib Abdul Razak presented his second Budget speech and also the first Budget under the Tenth Malaysia Plan (10MP). As usual, there were a lot of media newsflows on this traditional event. However, according to analysts, from the market's standpoint, the 2011 Budget was a non-event, as most of the budget incentives were already announced during the Economic Transformation Programme (ETP) Open Day and it was also in line with the aim of the New Economic Model (NEM) – moving towards a high-income economy – that emphasises on:

(i) reinvigorating private investment, and

(ii) intensifying human capital development.

Both the ETP and NEM were already previously announced by the Government earlier as the thrust of its financial and economic strategy for the nation going forward.

To recap, Malaysia achieved 9.5% real gross domestic product (GDP) growth in 1H2010. The Government has revised up the full 2010 growth target to 7% and expects the domestic economy to continue to remain strong at a growth of between 5%-6% although it will strive to achieve the upper end of the targeted growth at 6%. Income per capita is expected to increase 6.1% to RM28,000 (or US$ 16,000) based on a moderate inflation level of 2%-3% and low unemployment of 3.5%. The Government said it is also committed to accelerating the nation's transformation process by ensuring that projects and programmes under the NEM and 10MP would be implemented successfully. To implement these strategies and measures, there is an allocation of RM212 billion for the 2011 Budget, which is 2.8% higher than the allocation for 2010.



Whilst the Budget aims to strike a balance between fiscal consolidation and the need to sustain spending to cushion the economy against the risk of any sharper-than-expected slowdown in the global economy, the lack of broader measures to increase revenue and reduce subsidies and other operating expenditure suggests that there is limited room for manoeuvre, says one economist. As a result, despite a less expansionary Budget, the fiscal deficit is only projected to ease marginally to 5.4% of GDP in 2011, from 5.6% estimated for 2010.

It was reported that the Federal Government revenue collection is estimated to increase 2.3% to RM165.8 billion in 2011, compared with RM162.1 billion in 2010. Under operating expenditure, RM45.6 billion was allocated for Emoluments, RM28.2 billion for Supplies and Services, RM86.4 billion was allocated to Fixed Charges and Grants, and RM1.4 billion for the Purchase of Assets and RM1.2 billion for Other Expenditures, all totalling RM162.8 billion and representing 98.2% of the Federal Government revenue. As for development expenditure, a sum of RM28.3 billion, representing 17.1% of government revenue, has been allocated to the economic sector for infrastructure, industrial, agricultural and rural development.

These numbers were not a major surprise, and consequently, the consensus' market outlook, earnings and sector calls of most research houses remained relatively unchanged after the Budget.

## Construction stocks clear-cut winners

The major beneficiaries of the 2011 Budget are seen as being those players involved in the construction and building material sectors, given the government's push to accelerate infrastructure spending and urban renewal, says local research house AmResearch in its note on the Budget's impact on equity stocks.

Under the Budget, the RM40-billion Mass Rapid Transit (MRT) project in the Klang Valley will be implemented beginning 2011. At the same time, the government also reaffirmed that it will develop several new major projects such as the Ampang-Cheras-Pandan Elevated Highway, KL International Financial District (KLFD) and the redevelopment of the Malaysian Rubber Board's (MRB) land of 2,680 acres in Sungai Buloh. Perhaps the main major surprise in the Budget was the announcement of the development of a landmark 100-storey tower at PNB's Warisan Merdeka land bank in central Kuala Lumpur at a cost of RM5.0 billion, it notes.

According to the research house, Gamuda Bhd and MMC Corporation Bhd may be awarded a significant portion of the MRT project given its ownership of the concept plan. Nonetheless, it advocates a switch from Gamuda to IJM Corporation Bhd for investors looking to play the sector because it says that the market may have already factored in the project for the former.

The research house says that IJM's value propositions are more compelling and it is well positioned to bid for the MRT jobs as well since it has an excellent track record in constructing Grade A office buildings and luxurious condominiums that may characterise the KLFD, Warisan Merdeka and 1Malaysia Development Bhd (1MDB)'s projects.

Meanwhile, another research house, MIMB Research, believes that Kimlun Corporation Bhd could also be one of the beneficiaries of the MRT project since it can supply pre-cast concrete products for the project. It was reported that Kimlun is one of the very few local Industrialised Bulding System (IBS) players and is also the only supplier of pre-cast concrete products for Singapore MRT projects. The research house also believes that Favelle Favco Bhd, a listed subsidiary of Muhibbah Engineering Bhd, could also be another beneficiary in the Warisan Merdeka project. The company is the only major cranes player that was involved in the construction of the Petronas Twin Towers in 1998 and Taipei 101, Taiwan in 2004, both major high-rise building projects.

After the theme play of construction counters following the further boost from Budget 2011, the next leg of theme play may gravitate towards steel and cement companies, says AmResearch. It prefers steel stocks in the equation as it says that cement stocks such as Lafarge Malayan Cement Bhd has had a strong rally already and is being traded at a forward price earnings multiple (PE) of 16x.

As for the steel sector, the rebound in steel prices and strong demand of steel for the mega projects above mean that the prospect of steel stocks ahead would be promising. According to AmResearch, the proposed MRT project may require at least 10 times more steel bars than the SMART tunnel project. Given that the steel requirements are front-loaded, it could point towards a strong inflexion point in domestic steel demand. As such, the research house believes that long steel players such as Lion Industries Bhd, Perwaja Steel Bhd, Kinsteel Bhd and Ann Joo Bhd could be the prime beneficiaries here. It chose Ann Joo as its top pick, saying that the recent capacity expansion of Ann Joo appears timely to coincide with the potential mega boom.

**SUMMARY OF BUDGET WINNERS**

| SECTOR | STOCKS |
|---|---|
| Cement | Lafarge Malayan Cement |
| Construction | Gamuda, MMC Corporation, IJM Corporation, Kimlun Corporation, Favelle Favco, Muhibbah Engineering and Naim Holdings |
| Steel | Lion Industries, Perwaja Steel, Kinsteel and Ann Joo Resources |
| Property | IJM Land, SP Setia, Ivory Properties and Hua Yang |
| Plantation | Sime Darby, Kulim Malaysia, IOI Corporation, Kuala Lumpur Kepong and Genting Plantation |
| Oil & Gas | Kencana Petroleum and Dialog Group |

## Property developers benefit too

In the 2011 Budget, the Government has also proposed several incentives to increase home-ownership among the lower-income households. The Government said that it is aware of the difficulties faced by the *rakyat*, particularly young adults who have just joined the workforce with an income of less than RM3,000 to own a house. To assist this group, the Government said in the Budget that it will introduce *Skim Rumah Pertamaku* through Cagamas Bhd, who will provide a guarantee on the down-payment of 10% for houses below RM220,000.

This scheme is for first-time house buyers with household incomes of less than RM3,000 per month. In other words, the house buyers will obtain a 100% loan without having to pay the 10% down-payment. In addition to this, first-time house buyers will also be given a stamp duty exemption of 50% on instruments of transfer on house prices not exceeding RM350,000. The Government also proposed that a stamp duty exemption of 50% be given on loan agreement instruments to finance such first-time purchase of houses.

While these measures may not have a significant impact on major listed developers as they are mostly focused on high-end development projects, AmResearch still views the proposals above in the Budget positively as the feared higher cap on the loan-to-value ratio was conspicuously absent and the real property gains tax (RPGT) regime also remains status quo. As such, the research house says investors could still buy property companies such as IJM Land Bhd, SP Setia Bhd and Ivory Properties Bhd given the still underlying robust residential demand and pricing trends. The proposed creation of a *Shariah*-compliant Bumiputra Property Trust Scheme should also widen demand for investment properties, it adds.

MIMB Research, on the other hand, believes that while the Budget has yet to mention potential administrative measures to curb property speculation, it cautions that high-end property developers will still be more vulnerable should these administrative measures be implemented. As such, it believes that affordable housing developers such as Hua Yang Bhd should be more resilient given

(i) the strong underlying real demand, and

(ii) the above-mentioned incentives that are positive to affordable housing segment.

## CPO planters are also big winners

In the Budget, the Government also said it will implement the Programme on the Blending of Biofuels with Petroleum Diesel (B5 Programme or a mandatory blending of transport diesel with 5% of palm oil-based fuel) on a mandatory basis beginning in Putrajaya, Kuala Lumpur, Selangor, Negeri Sembilan and Melaka in June 2011. While the price subsidy is unclear, the implementation of this policy may increase crude palm oil (CPO) demand by about 500,000 tonnes (one-third of the country's inventory level), says AmResearch, and this could give CPO prices an added kick. This, it says, together with the current weakness in the US dollar, may further underpin the present CPO price rally, which touched a two-year high of RM3,000/tonne recently.

Generally speaking, this measure should benefit the plantation sector as a whole. Nonetheless, the research house says that for Sime Darby Bhd and Kulim Malaysia Bhd, which are planters with biodiesel plants, they should see a greater boost in their earnings from the above scheme vis-à-vis their peers such as IOI Corporation Bhd or Kuala Lumpur Kepong Bhd.

## Oil & gas sector – a re-rating on the cards?

The general consensus view is that the impending listings of Malaysia Marine Heavy and Engineering Bhd (MMHE) and Petronas Chemicals Group Bhd (PCG) will significantly increase the sector's representation in the market, says AmResearch. The debut of MMHE could trigger an acceleration of large deepwater contracts from its parent Petrolium Nasional (Petronas) and benefit the sector as a whole. Kencana Petroleum Bhd is the research house's high conviction buy in the sector on valuation grounds coupled with potential transformation from its strategic tie-ups and acquisitive growth. The stock is also seen as a decent alternative to MMHE.

To expand the downstream activities of the oil & gas sector, the Government will also be allocating RM146 million to support the sector under the 2011 Budget. Among the projects to be implemented include the establishment of the Oil Field Services and Equipment Centre in Johor with private investments of RM6 billion over a period of 10 years. To meet the increase in gas demand by industries, Petronas will also implement a re-gasification project with an investment of RM3 billion in Melaka, which will be operational in 2012.

MIMB Research believes Dialog Group Bhd will be the immediate beneficiary here as it has officially obtained approval from the state government of Johor to develop an independent deepwater petroleum terminal at Pengerang for a period of 30+30 years. It has passed the technical part of the feasibility study while the other parts of the feasibility study and the environmental impact assessment are ongoing in progress. The terminal will have an initial storage capacity of 1.4m $m^3$ and eventually, the entire development will support up to 5m $m^3$ of storage capacity, which will take about 10 years to be fully developed. This will be the first deepwater terminal in Southeast Asia.

## Sarawak theme play as well

Some analysts also speculate that the Sarawak theme could be embedded in the 2011 Budget where the focus on enhancing basic infrastructure was announced. A sizeable RM6.9 billion has been allocated in the Budget here to develop water, electricity supply and rural roads. The government also plans to construct a 300-MW gas power plant in Kimanis, Sabah. With the Sarawak election looking imminent, analysts say that Naim Holdings Bhd could offer the best leverage to the Sarawak election theme play.

## Conclusion

While there were really no major surprises in the Budget, analysts say that the local market rally could still take the cue from the positive 'election' budget this round to give it further strength to extend the rally to early next year. In this case, some of the above stocks are likely to see more interest by investors than others, given their position in the right sector and theme play.

However, some observers caution that investors will still have to be more alert given that global markets could still be vulnerable to a steep pullback if cheap money from foreign investors exits emerging markets on any weakness in US and Europe. mb