

The Return of 1MDB Saga

Market View

April 27, 2016

Concerns about sovereign downgrade to resurface

News

- 1MDB confirmed that it has defaulted on a US\$1.75bn bond issue after neither it, nor Abu Dhabi's IPIC, made a US\$50m interest payment. Cross defaults have also been triggered on two other ringgit-denominated Islamic noted totalling RM7.4bn (RM5.0bn 1MDB sukuk due 2039 & RM2.4bn Bandar Malaysia sukuk due 2021-2024).

Comment

- 1MDB said that the default was very specific to its dispute with IPIC and will make clarifications to all its bond and sukuk holders on its financial position.

- The default by 1MDB made a new twist to the already subsided fiscal risk after Budget recalibration on 28 Jan. We now expect speculation of sovereign downgrade to resurface, despite a mini rally in crude oil prices that has removed the oil revenue uncertainty (MOF assumption of US\$30-35/bbl vs. current price of US\$40-45/bbl).

- It is still unclear whether IPIC (sole guarantor of the bond) will honour the payment. In the scenario where IPIC decides to default and ultimately call on the guarantee of the Malaysian government on the US\$1.75bn bond, the additional liability (circa RM6.9bn) could potentially balloon the fiscal deficit level by 0.6ppt to 3.7% of GDP.

- While we keep our ringgit year-end forecast at RM3.80-4.00/US\$, we expect ringgit to experience weakening bias to above RM4.00/US\$ in the near term on macro concerns.

- 1MDB saga aside, the drag on announcement of BNM governor successor would also further dampen market sentiment.

- As we enter the month of May, investors may stay cautious over the old saying "Sell in May and Go Away" adage.

- On technical front, FBM KLCI had already deviated from the uptrend channel since early April. Coupled with the long black Marubozu candlestick penetrating below the psychological level of 1,700, bears are now in control with support at 1,670 (200d SMA).

Target

- Pending further developments on the 1MDB saga, we maintain our end-2016 FBM KLCI target at 1,760 based on 15.0x one-year forward earnings.

Strategy

- We advocate defensive stance in larger cap stocks with earnings certainty and re-rating catalysts to weather market volatility.
- Construction a still a clear winner. After the recent surge in contract awards, we continue to expect a strong flow of announcements in 2Q, reinforced by potential admission of both Gamuda and IJM as KLCI index component stocks.
- Changes in Top Picks:** We remove Maybank and AirAsia as both are sensitive to macro risk-off mode and fading of foreign interest. We include **Evergreen (TP: RM1.60)** and **Unisem (TP: RM2.49)** as our top picks given the resilience in earnings certainty while riding on the weakening bias of ringgit in the near term.

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Economics at a glance

	13	14	15	16f
World growth	3.3	3.4	3.1	3.4
Malaysia				
Real GDP	4.7	6.0	5.0	4.2
CPI	2.1	3.2	2.1	2.5
Current Account Bal (RM bn)	39.9	55.0	34.0	10.0
OPR (%) (end-period)	3.00	3.25	3.25	3.25
MYR/US\$ (end-period)	3.28	3.25	4.29	3.80-4.00

Sector Weight

Sector	Rating
Auto	Underweight
Banking	Neutral
Brewery	Overweight
Building Mat	Neutral
Construction	Overweight
Consumer	Neutral
Gaming	Neutral
Healthcare	Neutral
Media	Neutral
Oil & Gas	Neutral
Plantation	Neutral
Power	Overweight
Property	Neutral
Rubber Products	Neutral
Tech	Neutral
Telcos	Neutral
Tobacco	Underweight
Transport	Overweight

Figure #3 Top Picks

Stock	Price (RM)	TP (RM)	% Upside
Big Caps			
Digi	4.53	5.78	27.6%
Gamuda	4.70	5.65	20.2%
IJM	3.50	3.82	9.1%
TNB	14.40	16.50	14.6%
Westports	4.15	4.80	15.7%
S/M Caps			
Edgenta	3.65	4.32	18.4%
Evergreen	1.07	1.60	49.5%
Mitrajaya	1.21	1.98	63.6%
SunCon	1.57	1.94	23.6%
Unisem	2.18	2.49	14.2%

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BUY	Positive recommendation of stock under coverage. Expected absolute return of more than +10% over 12-months, with low risk of sustained downside.
TRADING BUY	Positive recommendation of stock not under coverage. Expected absolute return of more than +10% over 6-months. Situational or arbitrage trading opportunity.
HOLD	Neutral recommendation of stock under coverage. Expected absolute return between -10% and +10% over 12-months, with low risk of sustained downside.
TRADING SELL	Negative recommendation of stock not under coverage. Expected absolute return of less than -10% over 6-months. Situational or arbitrage trading opportunity.
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NEUTRAL	The sector, based on weighted market capitalization, is expected to have absolute return between -5% and +5% over 12-months.
UNDERWEIGHT	The sector, based on weighted market capitalization, is expected to have absolute return of less than -5% over 12-months.