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OPR hike

FBM KLCI: 1,845.86 points

Market & sectoral impacts

2018 Year-end Target: 1,900 points

Bank Negara Malaysia (BNM) announced a 25 basis points hike in Overnight Policy Rate (OPR) from 3.00% to 3.25%, in line with our expectation. In its Monetary Policy Committee (MPC) statement, the BNM stated that "With the economy firmly on a steady growth path, the MPC decided to normalise the degree of monetary accommodation. At the same time, the MPC recognises the need to pre-emptively ensure that the stance of monetary policy is appropriate to prevent the build-up of risks that could arise from interest rates being too low for a prolonged period of time."

The decision is expected as industrial and trade activities across major as well as emerging economies remain on upward trajectory. Looking ahead, we forecast GDP growth to remain strong at 5.5% this year, supported with gradual rise in global commodity prices, further market integration, stable labour market and contained inflationary pressure. External trade and industrial activities are expected to remain on upbeat momentum underpinned by sanguine business environment and gradual rise in commodity prices. Plus, Malaysia's labour market is expected to stay on healthy condition, as unemployment rate to average at 3.2% this year.

SECTORAL IMPLICATIONS

Banking

We believe that the OPR hike to be short term POSITIVE for the banking sector. The OPR hike will provide a short term boost to net interest margins (NIM) as there will be an near-immediate adjustment to loans and financing which has a floating rate. The floating rate loans, on average, contribute circa 78.1% of total loans book of banks under our coverage. However, we expect NIM to normalise within 2 to 3 quarters due to an upward adjustment to the deposits rates, particularly fixed deposit rates which have been contracted before the OPR hike.

We opine that with a short term boost to NIM, earnings for banks will also be positively affected. We estimate an average improvement of +1.5% to banks' net profit when compared against our previous forecast. We expect banks with higher floating rate loans to benefit the most. As such, we believe that Alliance Bank Malaysia Bhd will be the most beneficiary as its floating rate loans comprised of 90.3% of its loans book, the highest amongst its peers. We estimate a rise of circa +3.9% to its FY19 earnings from our previous forecast.

With the expected boost to earnings of banks, we maintain our POSITIVE stance for the banking sector. Judging from the share price performance of banking stocks this past week, we believe that investors are factoring in the OPR hike already. Nevertheless, we believe that there is still upside premised not just on the OPR hike but also on continuing loans growth.

		Share price (RM)	
	Recommendation	Pre hike	Post hike
Maybank	BUY	10.30	10.30
Public Bank	BUY	23.30	23.50
CIMB	BUY	7.17	7.17
Hong Leong Bank	NEUTRAL	15.70	15.72
RHB Bank	NEUTRAL	5.20	5.22
AMMB	NEUTRAL	4.35	4.40
BIMB	BUY	5.00	5.03
Alliance Bank	BUY	4.65	4.69
Affin Bank	BUY	2.90	2.91

Plantation

Impact of 25bp interest rate hike on FBMKLCI Plantation stocks are minimal at between 0.1% to 0.2% of core net income:

SIME Plantation (NEUTRAL; TP: RM5.60) - estimated RM0.65m impact or 0.1% to total core net profit

IOICORP (Buy; TP: RM5.50) - estimated RM0.70m impact or 0.1% to total core net profit

KLK (Buy; TP: RM29) - estimated RM2.05m impact or 0.2% to total core net profit

PPB (Neutral; TP: RM17.69) - estimated RM1.30m impact or 0.1% to total core net profit

All in, maintain positive view on Plantation sector with IOICORP as our top pick.

Telecommunication

Generally, minimal impact to earnings will be seen for telco stocks pursuant to the 0.25% hike in OPR. Based on the latest quarterly data on borrowings, impact to Axiata is the greatest as compared to the other telcos at 3.1%. Meanwhile, the increase in OPR is expected to have the least impact on Digi at merely 0.3% to earnings.

Company	Latest data	Remarks	Amount (RM'm)	Additional cost (RM'm) based on 0.25% hike	FY17 reported profit (RM'm)	Annualised FY17 profit / loss (RM'm)*	Impact to earnings (%)
Digi.Com Bhd	4Q17	Loans and borrowings - Unsecured	1,784.3	4.5	1,476.7		-0.3
		Loans and borrowings - Secured	0.9				
Maxis Bhd	3Q17	Loans and borrowings - Unsecured	7,633.0	19.1		2,177.3	-0.9
		Loans and borrowings - Secured	207.0				
Axiata Group Bhd	3Q17	Loans and borrowings - Unsecured	14,291.0	35.7		1,179.7	-3.1
		Loans and borrowings - Secured	715.8				
Telekom Berhad	3Q17	Loans and borrowings - Unsecured	8,397.6	21.0		870.3	-2.5
		Loans and borrowings - Secured	105.7				

*Based on latest available quarterly earnings report
Source: Company, MIDFR

Oil & Gas

For the FBMKLCI oil and gas constituent stocks, we believe that there will be very minimal impact from the 25bps interest rate hike. For Petronas Chemicals (BUY; TP: RM8.18), the company current has zero debts. For Petronas Dagangan (BUY; TP: RM28.00), its debts with variable rates total RM70m, against a total cash hoard of RM3.5b and expected FY18 profit or RM994m. As for Petronas Gas, RM1.4b of its RM3b debts are unsecured variable term rates which are hedge against variable interest rates via interest rates swap contracts. As such, the interest rate hike will have minimal adverse impact to the company.

However, given that these companies have significant amount of cash hoard, the interest rate hike will be beneficial for them.

Property

Impact of 25bp interest rate hike on FY18 earnings of property companies are minimal at between 0.2% - 2.6%. Among nine property companies under our coverage, impact on earnings of IOI Properties and Magna Prima earnings are estimated to impact by most at 2.6% while earnings impact on E&O, UOA Development, UEM Sunrise, S P Setia, Mah Sing, Sunway and Eco World Development is less than 2%. Hence, we are not making changes to earnings estimate and recommendations.

We reckon the hike in interest rate may negatively affect buying interest as increase in average lending rates will result in an increase in monthly mortgage payments. Nevertheless, we think that the negative impact should be short-lived. In the previous rate hike by Bank Negara in July 2014, total applied loan for purchase of property decreased by 6.4%m-o-m to RM27.6b in July while the figures hovered between RM28b – RM29b in August to October, indicating stronger and stable buying interest from property buyers after the dip in July.

We maintain our positive stance on the sector as we see that the sector has bottomed out and marginal recovery is anticipated. Our top picks for the sector are S P Setia, UOA Development and Mah Sing.

Construction

For construction sector imminent impact are as follows:

Reduction of loans to the construction sector; 11-year monthly average loans disbursed to the sector amounts to c. RM4.3bn hence disbursement amount would be revert close to the average instead of RM5.0bn-RM6.0bn range monthly.

Private Finance Initiatives Project such as MRT3 (Circle Line) will see a setback for local consortium; Sapura-TIEC Consortium, Gamuda-MMC and the Pacific-Mudajaya-JEC Consortium will face higher funding expenses in order to undertake the MRT3 project. China Communication Construction Co Ltd will gain upperhand in the tender.

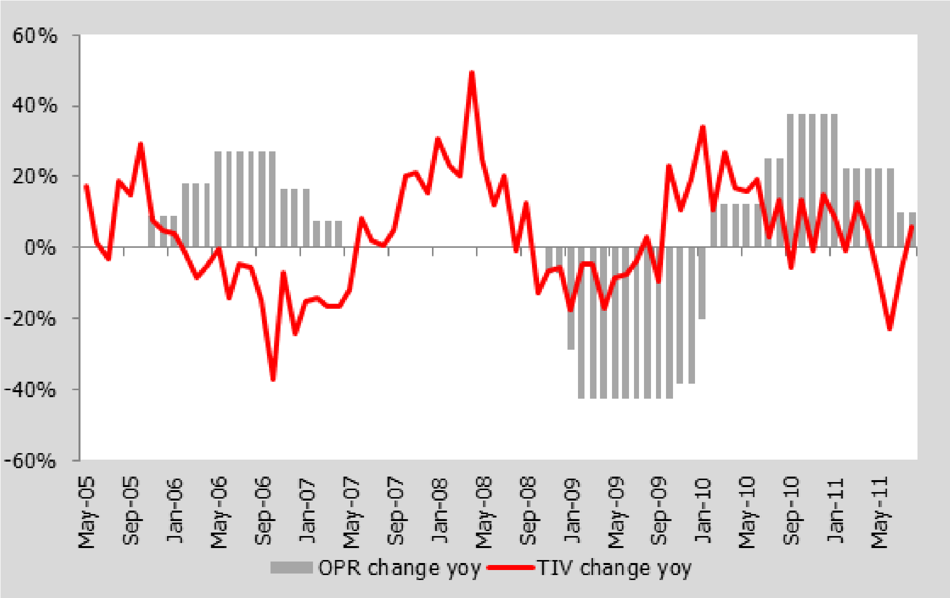
More challenge for big caps construction companies to obtain financing; As funding cost increases construction companies must be selective for projects especially pricing.

Slight increase in construction companies debt affecting Gamuda (Total Net Debt : RM4.2bn) and IJM (Total Net Debt: RM3.45bn) hence its must readjust is pricing mechanism when bidding for projects.

Current projects are not affected as the pricing mechanism for construction projects mostly imputes fluctuations i.e. interest rate hike but obtaining financing for construction sector remains a hurdle. Hence, it is a negative impact which signals the start of construction sector's gloom. The prospect for orderbook replenishment rate will be challenged hence forward earnings FY19/FY20 faces compression threat.

Automotive

Historically, there has been inverted correlation between OPR changes and TIV movement. TIV growth tends to weaken or in circumstances where OPR is hiked sharply, e.g. in Oct05-May06 period when OPR was hiked from 2.75% to 3.50% within a period of just 7 months, TIV shifted into contraction mode instead of just slow growth. Provided such sharp rate hike trend does not occur this time around, TIV should still register positive growth in 2018, especially after two consecutive years of contraction in 2016-17.



Healthcare

Minimal impact on earnings of the healthcare sector players as majority of the borrowings (up to 75%) are based on fixed rate. No changes made to our call or earnings.

IHH Healthcare: Little to no impact on borrowing costs as only 7.5% out of RM7.2b of IHH's debt are in Ringgit Malaysia. Therefore, impact on earnings is less than 1%.

KPJ Healthcare: Despite having high amount of borrowings, KPJ's borrowings are mostly fixed rate i.e sukuk and equipment leasings. Floating rate is only for OD/RC. Fixed rate borrowings is around 75% of total debt. Therefore, expect minimal impact on earnings of about 2-3%.

Glove

In general, the OPR hike will result in 4-5% increase in glove companies' finance costs of up to RM1m increase in finance costs in absolute term. However, in terms on earnings impact, it will be less than 1% at about 0.2-0.5% of net profit. No changes made to our call or earnings.

Transport

For MISC Berhad (BUY; RM7.68), the OPR hike translates into an estimated impact of RM20m which is 0.9% to total FY18 net profit . Henceforth an OPR rate hike will be minimal to the company.

For MMC Corp (BUY; RM2.67) its total unsecured debts totaled RM3.6b versus a total cash balance of RM844m and an expected FY18 profit of RM394m. Nonetheless after assuming the increase of the 0.25% increase the OPR, the estimated increase in total interest paid of RM8.9m is 2% from the expected FY18 profit, making the impact to be minimal.

As for Westports (NEUTRAL, RM3.83), the impact of the rate hike would be minimal as the increase in interest payable of RM3.5m only constitutes 0.4% of the operating cash flows which stands at RM792m as of 30 Sept 2017.

Meanwhile GD Express Carriers(Neutral, RM0.59) has a cash hoard of RM18m but has no unsecured debt as at September 2017, hence no impact from the OPR hike.

Overall, the impact of the OPR hike would still be manageable for these companies given their decent cash levels.

Consumer

The impact of 25bp interest rate hike today on the consumer stocks under our coverage are minimal and is explained as below:

F&N, Oldtown, Spritzer and Padini - These companies are in net cash position and hence, more than able to absorb the price hike. Hence, no material impact to earnings.

Panasonic - The company has no borrowings. Hence, no impact.

Nestle - The impact to earnings is negligible as 90% of its borrowings are intra-group borrowings. The remaining are OD faclitities at floating interest rate. The impact of the hike to earnings is less than 1% .

QL Resources - Of its RM1b borrowings, approximately 50% is at floating interest rate. Nevertheless, the impact of the hike to earnings is less than 1%.

Insurance

We expect no impact post 25 basis point rate hike. Earnings will stay intact as all of the companies are not laden by debt borrowings.

Non-bank Financials

For Bursa Malaysia, we expect no impact on earnings due to the absence of debt borrowings. Meanwhile for AEON Credit and MBSB, we believe OPR rate hike to be positive. We expect additional 2 sen to AEON Credit TP of RM14.75. We also maintain our BUY recommendation for MBSB.

Aviation

We believe that there will be slight impact of less than one percent for both AirAsia and AirAsia X. We see the minimal changes as non-material to the earnings fundamental. Meanwhile for MAHB, we foresee 0% changes in core earnings, due to the company's debt structure which are entirely composed of Ringgit-denominated fixed rate debt.

REITs

We believe that the fundamentals of individual REITs will outweigh the impact from the rate hike as impact to earnings are limited by -0.2% to -2.1% for REITs under our coverage.

Among the REITs that we cover, Amanahraya REIT's loans are all based on floating rates. Conversely, IGB REIT's floating rate loans was only kept at 1%. REIT managers are working on converting part of their floating rate loans to fixed rate loans to mitigate the risk of potentially higher interest costs in the event of more rate hikes. That said, our house economist expects only one rate hike this year.

We are neutral on the impact the rate hike has for REITs under our coverage. Although borrowing costs are expected to increase for REITs with high levels of floating rate loans, most of the REITs under our coverage see limited impact from the rate hike as 80% or more of their debts are based on fixed rates. Even for Amanahraya REIT which has 100% of its loans based on floating rates is expected to see earnings impact limited to -2.1%.

Adjustments of EPU, DPU and TP following the rate hike

	Pre rate hike			Post rate hike		
FY18	**Core EPU**	**Net DPU**	**TP**	**Core EPU**	**Net DPU**	**TP**
Amanahraya	6.54	5.71	1.11	6.40	5.59	1.09
Axis	9.33	8.22	1.66	9.22	8.13	1.64
Pavilion	8.57	7.94	1.70	8.48	7.86	1.68
Sunway	9.70	8.73	1.91	9.66	8.69	1.90
KLCCP	40.69	35.63	7.60	40.64	35.59	7.59
CMMT	7.88	7.55	1.49	7.85	7.53	1.49
IGB REIT	8.83	8.47	1.73	8.81	8.46	1.73

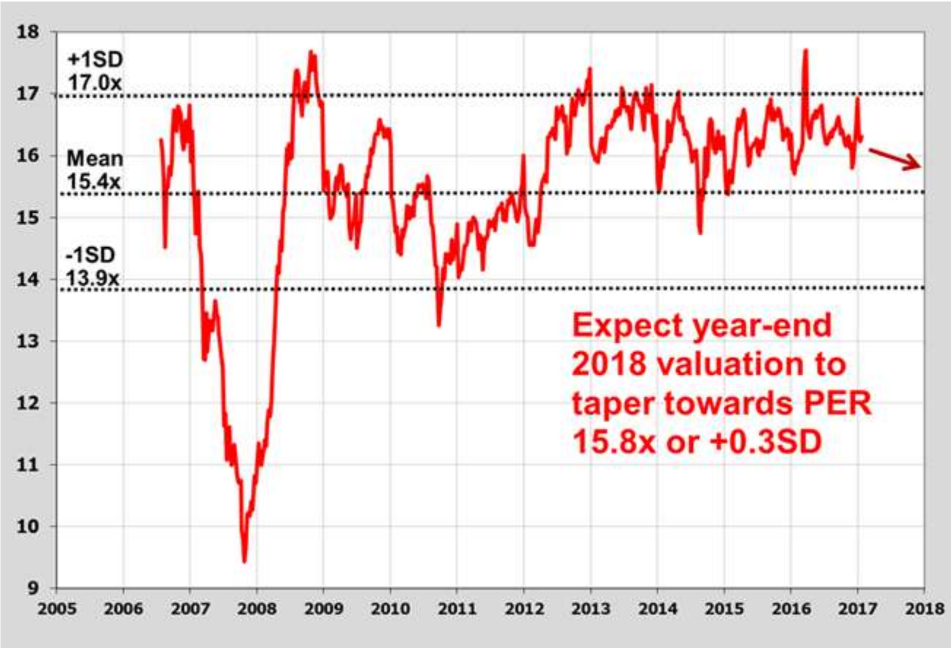
Source: Companies, MIDF Research

MARKET OUTLOOK

A tighter domestic monetary stance as well as among major economies… In the MPC statement, BNM also stated that "The global economy has strengthened further, with growth becoming more entrenched and synchronised across regions." On this score, we reckon BNM is not alone in its stance to "continue to assess the balance of risks surrounding the outlook for domestic growth and inflation." The US Fed is widely expected to raise its key overnight rate at least 3 more times this year. Meanwhile, the ECB may pare down or altogether stop asset purchases later this year as the economic recovery in Euro region gaining traction.

…likely to exert moderating effect on risk assets valuation. When we introduced our FBM KLCI 2018 year-end target of 1,900 points on 29 September last year (refer to 4Q17 Outlook, page 25), we postulated that, "The tightening bias especially among major economies (i.e. United States, Eurozone, Japan) is expected to be more prevalent in 2018 against the backdrop of general improvement in macro environment." We further added that, "This situation is likely to exert a degree of downward pressure on risk assets valuation next year."

PE Ratio of FBM KLCI (with Mean and +/- 1-SD lines)



Source: Bloomberg, MIDFR

Against the backdrop of continued earnings growth this year, we foresee a slightly descending valuation trajectory insofar as the PER valuation of FBM KLCI going forward. Having said that, the ever present 'noises' from short-term price volatility (due to market sentiment and other situational issues) may intermittently alter the short-term course of the valuation trajectory.

Reaffirm year-end target at 1,900 points. We thereby reaffirm our FBM KLCI 2018 year-end target at 1,900 points which is equivalent PER18 of 15.8x and +0.3SD.

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >+10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >+10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >-10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.