midf RESEARCH

28 March 2018 | Strategy

Research Team | research@midf.com.my

US Tariff Measures (Part 2)

Market & sectoral impacts

FBM KLCI: 1,862.45 points

2018 Year-end Target: 1,900 points

MARKET IMPACT

Earlier this month, US President Donald Trump signed a proclamation to impose tariffs of 25% and 10% respectively on all imported steel and aluminum into the US. However, the President later announced tariffs suspension to Argentina, Australia, Brazil, Canada, Mexico, South Korea, and the European Union states.

And last week, we witnessed a negative knee-jerk reaction in global equity markets after President Trump signed an executive memorandum that would slap punitive tariffs on up to USD60 billion of Chinese products imported into the US. As promised, China promptly hit back but with a rather modest USD3 billion tariff on US imports. The reaction from China was arguably more of a face saving measure and tacitly signals its unwillingness to flare up the situation.

To put both the proclamation and memorandum into perspective, as they are now, the amount of tariffs involved is minute in comparison to the quantum of trades between the affected countries.

Accordingly, our sectoral assessment foresees either mostly neutral or only slight negative/positive impact of the announced tariff measures to the Malaysian companies under our coverage. Hence we maintain our forward earnings growth as well as valuation estimates and reaffirm our FBM KLCI year-end 2018 target of 1,900 points.

Having said the above, it is worrying to note that as President Trump signed the memorandum on trade actions, he stated, "This is the first of many". On that score, we reckon a series of tariff measures would almost certainly result in a full-blown trade war. History taught us that trade wars invariably led to net negative outcomes to all parties. Hence for the sake of world's economy, we can only hope that the statement was made in jest.

SECTORAL IMPACT

Automotive

IMPACT: Neutral to Positive. Imposition of tariffs on steel from China may lead to possibilities of China flooding supply in the global markets. This in turn, may reduce cost for carmakers. For Malaysian distributors / assemblers, car components are purchased as part of CKD packs at a pre-negotiated price with principal OEMs who are the ones directly exposed to fluctuation in commodities prices.

Direct beneficiaries in this scenario would be the actual OEMs. In Malaysia, this would be Proton and Perodua as well as parts makers who are directly exposed to fluctuations in raw material price. However, vendors for the national cars have a leeway to pass on cost fluctuations from forex and raw material price to the carmakers on a retrospective basis.

On the demand side, there should be no direct impact as domestic car makers export very little volumes. Most of the exports are mainly to countries within ASEAN. However, a slowdown in China which is a major trading partner of ours may have spillover impact on consumption and eventually impact demand for vehicles.

Banking

IMPACT: Neutral. We expect that there will be no direct impact to revenue or earnings to banking stocks under our coverage from the possible "trade war" between the US and China. This is due to the fact that earnings of the banking sector are predominately domestic based.

For example, in terms of banking system loans book, household sector contributed 57.4% to total system loans of RM1.59t as at end January 2018. Comparatively, if we take the entire loans to manufacturing sector as a proxy to loans affected by the export sector (which is highly unlikely), the contribution is 6.5%.

However, we believe that there will be an indirect impact should the trade disagreement escalate further as per the worst case scenario highlighted by our economics team. It is possible that with slower global trade growth affecting the economy and reducing consumption, loans demand and deposits growth will also be negatively affected.

In addition, an unstable jobs market will have an upward pressure in loans delinquencies and this will in turn lead to higher provisions by banks. Nevertheless, at this juncture we are ruling out this possibility and remain upbeat on the prospect of banking sector earnings for CY18.

Consumer

IMPACT: Neutral. For fast moving consumer goods (FMCG), we believe that there will be a minimal impact as substantial revenue generated by local FMCG manufacturers are from the domestic sales. The same can be said in regards to local retailing companies. Hence, we do not expect that the US tariff move will negatively impact the local players.

While large local FMCG players are currently targeting to diversify their revenue stream by increasing their export sales contribution, nevertheless, the US is still not their main export destination. Instead, the local FMCG players are focusing on exporting to the Middle Eastern markets to leverage on government incentives to develop Malaysia as a global hub for halal products.

Glove

IMPACT: Neutral to Negative. We do not think that the tariff measures will include rubber gloves as it is a necessity medical product in the US. That said, rubber gloves producers will be negatively impacted if it is included in the tariff measures as the US is the main destination for rubber gloves export for all four major rubber gloves producers. Furthermore, the rubber gloves exports worldwide are also USD denominated hence, we believe that should the measures take into effect, the rubber gloves producers will be among the companies that are affected.

The US consumption of gloves per capita is the highest in the world due to its strict medical regulations which prohibit doctors from using the same examination gloves for different patients; a policy which is yet to be implemented in most countries. We believe that the trade ban on rubber gloves products will be futile as Malaysian rubber gloves producers remain the biggest supplier of rubber gloves in the world due to: (i) scalability of production; and (ii) lower cost of production. Additionally, to transport natural rubber (latex) which mainly originates from Thailand, Indonesia and Malaysia; it will require high transportation cost & high risk due to the fact that natural rubber could get spoilt during the transport duration which could inflate the cost of production even further.

Insurance

IMPACT: Neutral. We see no direct impact of US-protectionism policy on tariffs particularly to the insurance and takaful sector. While the immediate impact on global economy is still uncertain, we believe the insurance/takaful business will remain fundamentally intact. We opine the impact to the underlying business will be largely muted, as the insurance/takaful services are largely catered for the domestic market. Given our current view, we maintain our POSITIVE stance on the Insurance/Takaful sector.

Oil & Gas

IMPACT: Neutral. There are currently no significant revenue contributions from North America to the local O&G service providers.

Plantation

IMPACT: Neutral to Positive. The impact is positive if China were to buy less soybean from United States. This should lead to higher demand for palm oil as it is a substitute for soybean oil. Soybean is a key commodity purchased from United States in China. Impact is neutral if soybean purchase from United States is not affected.

Property

IMPACT: Neutral. Property sector in Malaysia is exposed mainly to local economy. Hence we expect no material impact from the US tariff measures to property sector in Malaysia.

REIT

IMPACT: Neutral. We do not expect significant direct impact on the REITs sector at this juncture as the sector is largely exposed to the local economy. That said, depending on the severity and duration of the trade war, if the Malaysian economy is affected, then we expect a negative impact on the sector.

Technology (Semiconductor)

IMPACT: Neutral to Negative. There will be no direct impact for the local semiconductor industry players. Nonetheless, the local industry players sell their products/services (back-end) to China clienteles. As such, should there be any reduction in demand from the US which impacted the China clienteles, it would in turn translate to lower volume order for the local players. A quick check with some of the local semiconductor companies indicate that business is as usual. There has yet been any downward revision in volume order.

On another note, according to US trade representative Robert Lightizer, the new measures against China will primarily target certain products in the technology sector where Beijing holds an advantage over Washington, and it will include restrictions on Chinese acquisitions and investments. Given that the tariff will be targeted, the impact might not be widespread.

However, should the US extends the list of countries that may be subject to the tariff (to include Malaysia), it may have a more damaging effect. Note that Malaysia is among the countries that President Trump has called out as being responsible for the US trade deficit.

Transport (Aviation)

IMPACT: Neutral. We are of the view that travel demand to stay elevated based on the strong underlying demand of passenger traffic despite the possibility of US-additional tariffs on China. Despite aerospace being one of the area targeted for additional tariff, we expect any possible impact will be exclusively directed to the trading countries namely China and US.

At this juncture, we view the aviation industry to remain resilient particularly for companies under our coverage namely AirAsia, AirAsiaX and MAHB. This is considering that domestic and international traffic continued to show positive momentum at the beginning of the year, despite coming from a high-base. Moving forward, we expect the positive trend to persist, benefiting Low Cost Carriers such as AirAsia and AirAsiaX as well as MAHB, as the largest airport operator in Malaysia. We maintain our POSITIVE stance on Aviation.

Transport (Ports, Shipping)

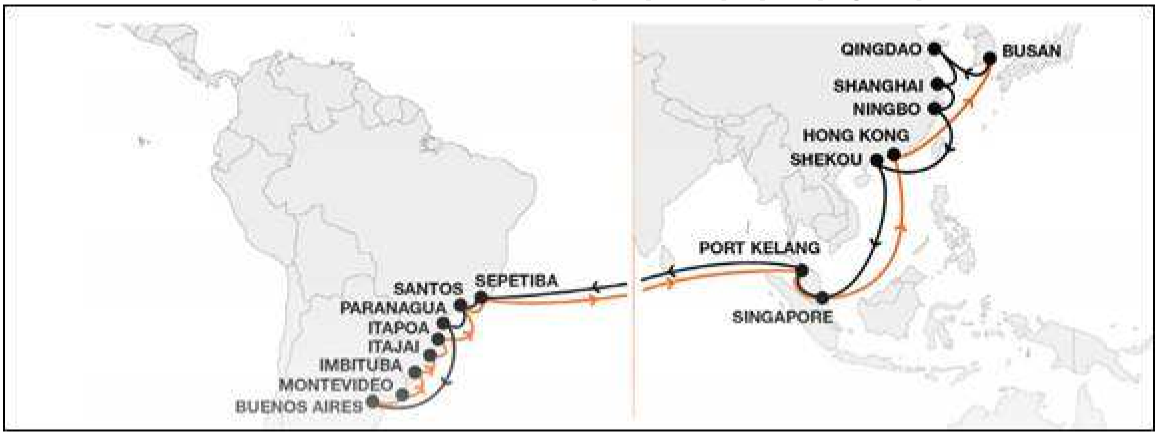
IMPACT: Neutral. As impact from the latest 25% tariff on steel is expected to be minimal with US trade restrictions already covering more than 90% of US steel imports from China, we believe repercussions towards the shipping industry and port operators to be limited. The reason being is that China was only the 10th largest supplier of steel to the US in 2017 with 94% of the exports already subjected to special tariffs.

In relation to farming products such as pork bellies in the US which were slapped with tariffs by China, it is expected to affect the shipments from the US to China, specifically via the Transpacific shipping route. In spite of US exports of pork to China which may be reduced, China could shift to other major pork producing countries from the Eurozone such as Germany, Spain, Denmark and Netherlands. The Transpacific shipping volumes would be adversely affected but this may provide new opportunities for shipping liners servicing routes from Europe to Asia (China).

Assuming retaliatory tariffs are also imposed on US agricultural products such as soybeans, China could seek other alternative sources from Latin America such Brazil and Argentina which are the second and third largest soybean producers in the world for 2016, respectively. This would then again spur cargo volume for the Latin America-Asia shipping routes.

The above would bode well for local port operators namely Westports and MMC Corp due to its strategic location where shipping liners would pass through them in servicing routes covering Europe to Asia and Latin America to Asia, contributing to drybulk cargo. For instance, major shipping liners such as Maersk, a member of the 2M Alliance is a major client of MMC Corp's Port of Tanjung Pelepas in Johor. PTP is one of the ports of call for Maersk's AE10 Eastbound services starting from from Gdansk, Poland followed by Bremerhaven, Germany and Rotterdam, Netherlands with China's main ports such as Shanghai and Ningbo as its final destination. Moreover, PTP has a partnership model with Maersk via the AP Moller-Maersk group that owns 30% of PTP.

Asia-South America East Coast Service/ Loop 2 (ASE2) by Hapag Lloyd



Source: Hapag-Lloyd

Although Westports is the other Southeast Asia hub for Hapag-Lloyd besides PSA, we believe Westports can leverage on Hapag Lloyd's Asia-South America Service/ Loop 2 (ASE2) if China mainly sources its soybean from Brazil instead of the U.S. It is noteworthy that Westports' transshipment tariffs are cheaper than PSA at USD39 per TEU. Even after the rate hike later in 2018, the transshipment tariffs are still lower than the ones in PSA, making Westports more attractive. In addition, Westports' plan for implementing automation in its system in the long run could increase efficiency and thus bode well to attract liners to start new services at Westports.

Transport (Logistics)

IMPACT: Neutral. On a broad level, we opine that there should be no direct impact from the possible trade war on last mile delivery players such as GDEX as growth in the Malaysia's e-commerce industry is a strong buffer for parcel volume growth. Companies such as Tiong Nam too could benefit from South East Asian and Chinese e-commerce through its cross border trucking business which more time effective compared to sea freight and more cost effective than air freight.

Companies such as Tasco operate a regional distribution hub for Renesas, a Japanese semiconductor company where 'pick and pack' activities are done for their products and distributed overseas. If demand from the U.S for electronic products decreases and impacts Chinese manufacturers, it may translate to lower orders for Renesas' products.

Nonetheless, other Asian countries and Europe both contribute 14% to Renesas' revenue. Hence Asia Pacific and Europe will help outweigh if volume orders from China were to decline as sales from these regions remained resilient in January 2018 with commendable demand in semiconductor products amid new smartphone line-up and stable demand from automotive industry.

Utility (Power)

IMPACT: Neutral. There is no direct impact as revenues are pretty much domestic focused. Tenaga has exposure to power generation in Turkey, India and the UK mainly. YTL Power is mainly in Malaysia, Singapore, Indonesia and Jordan in terms of power sector exposure. However, electricity demand is mainly driven by the manufacturing and commercial sectors. Slower trade as an implication of a slowdown in China may impact domestic manufacturing negatively and indirectly hit power demand.

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein This document may not be reproduced, distributed or published in any form or for any purpose.

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.