

26 October 2006

Malaysia Strategy

Three positive trends to focus on

Index target at 1,075

The market has been an ASEAN laggard. Our bottom up KLCI target of 1,075 suggests upside of 10% or total return of 14% with net dividends included. Stock picking is key for outperformance.

An easy market to ignore. This is not the time.

Most of the negative 'noise' is well known and 'priced in'...

Malaysia is an easy market to be frustrated with. The market has been marginalised post the Asian crisis (now just 2.7% of MSCI AP ex-Japan). Consumer sentiment is weak, particularly at the low end of the market. Ex-Prime Minister Mahathir and Abdullah Badawi are at loggerheads. And liberalisation in selected sectors like property and financials has been slow vis-à-vis the region. But this is all very well known and has been priced into the market, we feel.

...But three key trends have emerged prompting us to stay Overweight

Beneath the negative 'noise', there are three positive trends to focus on. First, the General Election theme. The Election is likely to take place in the 1Q08, in our opinion. This means that Abdullah Badawi will have to convince fellow Malaysians that the economy is robust. It is critical that the implementation of the Ninth Malaysia Plan (9MP) is quick and effective. We estimate that nearly RM7bn worth of Government-related construction jobs have been awarded so far, with more on the way. Historical trends tell us that in three of the last four General Elections, the KLCI rallied 39-55% twelve months before the big day. Secondly, the long-neglected and undervalued office market. Tight supply and the introduction of the REIT guidelines last year have spurred rental upwards, and transactions have been priced at a 5-7% implied asset yield. Thirdly, M&A activity has accelerated. IJM has proposed to acquire Road Builder. The Chinese newspapers are likely to consolidate. We believe the banking sector could be next. Competition and regulatory requirement should force more mergers, we believe.

DB's KLCI index target at 1,075; Malaysia remains a stock-pickers market

Malaysia has always traded at a premium to the region. However, the premium has compressed over the last 2-3 years and is now close to regional parity at 14.9x PER 2006 (7% premium to the region) and 2.1x P/B (at par to the region). Our KLCI index target is 1,075, suggesting 10% upside from here or total return of 14% with 3.6% projected net dividend yield included. Stock picking remains critical for outperformance. Our high conviction stocks moving into 2007 are: Tenaga, Bumi-Commerce, IOI Corp, Transmile and KLCC Property. These companies are either leaders in their industry or are showing clear signs of being restructured for the better. The key risks to our Overweight call for the market lies in the weaker-than-expected economic growth and continued weakness in consumer confidence.

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Top picks

Tenaga Nasional BHD (TENA.KL),MYR9.95	Buy
Bumiputra-Commerce Holdings (BUCM.KL),MYR6.70	Buy
IOI Corp (IOIB.KL),MYR16.70	Buy
KLCC Property Holdings Bhd (KCCP.KL),MYR2.27	Buy
Transmile Group BHD (TMGB.KL),MYR12.10	Buy

Companies featured

Tenaga Nasional BHD (TENA.KL),MYR9.95			
	2006A	2007E	2008E
P/E (x)	16.5	14.2	15.9
EV/EBITDA (x)	8.5	7.6	7.2
Price/book (x)	1.9	1.9	1.7
Bumiputra-Commerce Holdings (BUCM.KL),MYR6.70			
	2005A	2006E	2007E
P/E (x)	16.9	16.0	12.4
Div yield (%)	2.1	1.6	2.1
IOI Corp (IOIB.KL),MYR16.70			
	2006A	2007E	2008E
P/E (x)	17.3	17.4	16.7
EV/EBITDA (x)	12.5	11.9	11.2
Price/book (x)	2.9	3.2	2.9
KLCC Property Holdings Bhd (KCCP.KL),MYR2.27			
	2006A	2007E	2008E
P/E(x)	11.1	10.7	9.7
EV/EBITDA(x)	9.1	9.4	9.0
Price/book(x)	0.8	0.6	0.6
Transmile Group BHD (TMGB.KL),MYR12.10			
	2005A	2006E	2007E
P/E (x)	26.3	19.3	17.5
EV/EBITDA (x)	17.6	10.4	8.7
Price/book (x)	2.6	2.6	2.0

Upcoming events

	Date
Tenaga Nasional NDR London, Edinburgh	9-10 Nov 2006
Media Prima NDR New York, Chicago	31 Oct- 2 Nov 2006
Malaysia Corporate Day Singapore	9-10 Jan 2007

Related recent research

	Date
Budget07 - pump priming for growth Joe Liew, Aun Ling Chia and Pauline Chong	1 Sept 2006
Malaysia's moment - stay overweight Su Yin Teoh	8 June 2006
KLCC - iconic assets at 10% asset yield Aun Ling Chia	16 Oct 2006

Deutsche Bank AG/Hong Kong

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Positive trends have emerged

Ignore the negative trends – they are well known.

Malaysia is an easy market to be negative on. The market has been marginalised since the Asian crisis. Liberalisation in selected sectors, e.g. property and financials, has been slow by regional standards. Consumer sentiment, particularly at the low end, is weak. Economic growth has eased. Malaysian companies are investing more abroad and the list continues. And ex-Prime Minister Tun Mahathir is telling the press what a poor job the current Prime Minister is doing. However, this is not a report to moan about Malaysia. Instead, we highlight three positive trends emerging in Malaysia. We remain Overweight on Malaysia.

Figure 1: Positive and negative trends in Malaysia

Positive	Negative
Construction pump priming has kicked off	Consumer sentiment weak, particularly in the low end
Commercial property activity accelerates	Loans growth appears to be slowing, especially in HP
GLC restructuring bearing fruit	Limited IPOs this year to draw investors' interest
M&A activity has taken off e.g. IJM-RBH	Malaysia is only 2.7% of MSCI Asia Pacific Ex-Japan
Visit Malaysia Year 2007, tourist arrivals climbing	Uncertainty with existing PPA agreements
Commodity boom filtering into the economy	Malaysian companies investing more abroad
Growing number of quality mid caps	Education system ill-equipped to cope with growing population
Inflation may have peaked	Retail participation in the market has waned
Political environment stable	Country not 'reinventing' itself. Using the same growth model

Source: Deutsche Bank

(1) General Election theme to dominate 2007

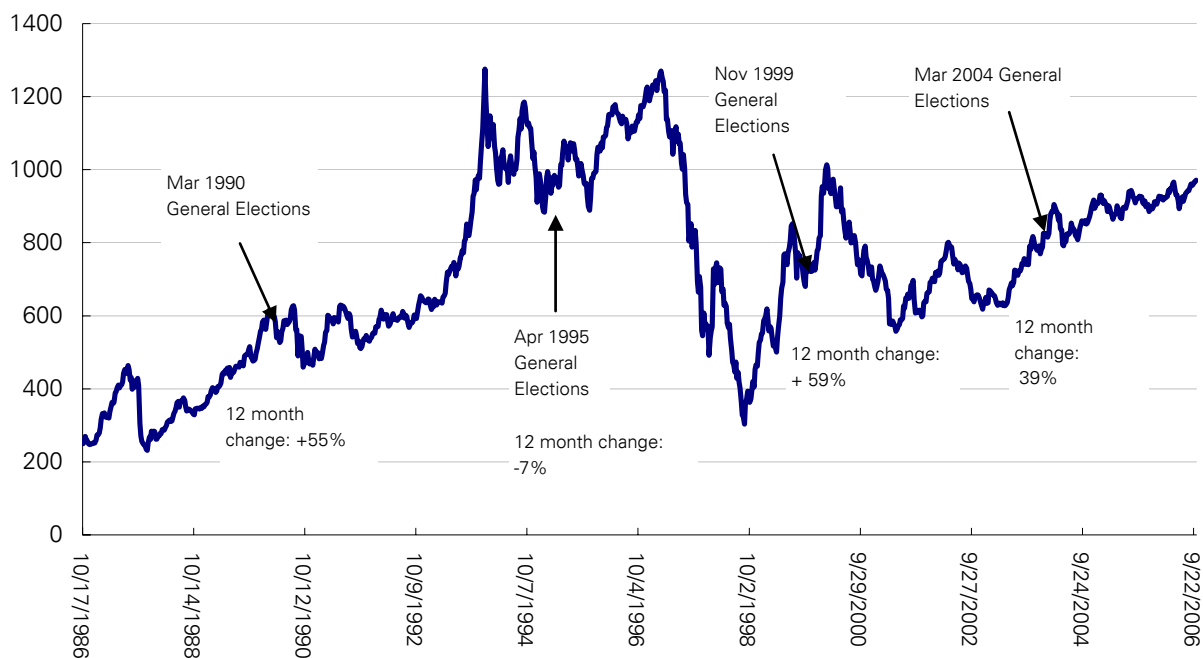
UMNO, the majority party within the Barisan National coalition, has deferred its party polls until after the next General Election, which must take place by March 2009. PM Abdullah Badawi said "(the deferment)...allows us to give full attention and focus on the country's development and progress".

The deferment in party polls is a clever move, in our opinion. It offers the PM the opportunity to win the next General Election convincingly (again); therefore, putting him in a much stronger position moving into internal party elections. What is more critical is this - he has to convince Malaysians that economic activity is robust. This means he has to implement the Ninth Malaysia Plan (9MP) quickly and effectively. In fact, we believe the 'pre-election machinery' has already begun.

General Election likely to take place in 1H2008, in our opinion

Abdullah Badawi must call for a General Election by March 2009. However, we believe there is a good chance that the election will be held as early as 1Q2008. The key reasons are these: First, Anwar Ibrahim is eligible to enter politics again in April 2008. Whilst we do not believe Anwar will be a threat to Abdullah Badawi, we believe the PM will want to avoid potential political distractions. Secondly, it will take at least 12 months for the Government's current pump priming initiatives to trickle through to the 'rakyat' (Malaysians).

Figure 2 tells us that in three of the last four General Elections, the KLCI rallied 39-55% twelve months before the big day. Whilst this provides little assurance that a rally may happen again, we are confident that news flow from the Government should start to accelerate.

Figure 2: KLCI performance during General Election years

Source: Deutsche Bank, Bloomberg, press

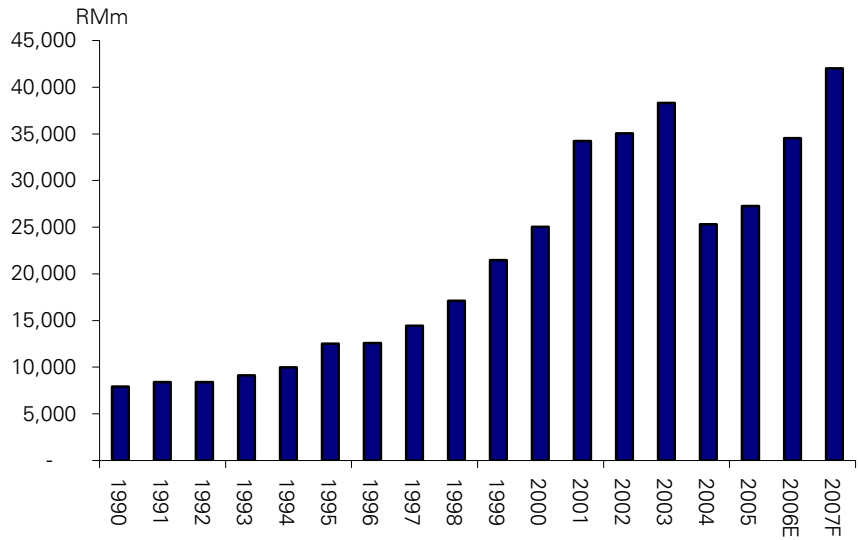
Infrastructure pump priming has started

It has finally happened. The Government has started to award construction contracts. Figure 3 highlights that net development expenditure is set to accelerate after a drop-off in 2004. Based on our calculations, nearly RM7bn worth of jobs has been issued since the start of the year, with the bulk from the Government. Most are infrastructure jobs carried forward from the Eighth Malaysia Plan (8MP). In fact, contracts from the 9MP have yet to really make an impact. We believe contracts from the 9MP, amounting to approx. RM30bn (infrastructure, communication, water and energy) should start to trickle into the economy soon. General Election pressures aside, the Government will need infrastructure pump priming to help cushion weaker private consumption growth of late. The risk of course is implementation. Aside from the usual bureaucratic hurdles, the lack of skilled engineers and labour could delay construction progress, and hence, billings.

In addition, private sector infrastructure jobs in the office and retail segments should accelerate. The improvement in rental yields and capital values, as well as greater interest from REIT investors has kick-started more construction in this segment.

The recent announcement by IJM Corp (IJM, MK, RM6.15, TP RM7.65) to privatise Road Builder (RBH MK, RM2.94, Buy, TP RM3.80) tells us of greater construction activity domestically and, more importantly, the need to have sufficient human resource capacity to execute a fast-growing order book.

Figure 3: Net development expenditure by the Government accelerates again



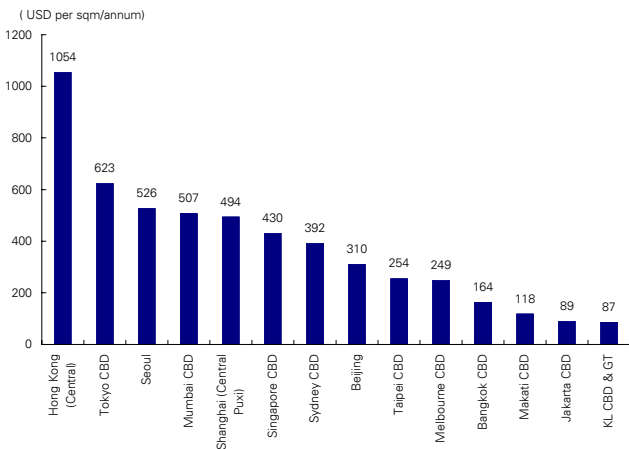
Source: Ministry of Finance

(2) Office sector has started to recover and could well surprise

The Malaysian office sector has long been neglected and is undervalued versus the region. Also, it has been a major laggard in the region. This is set to change, we believe. Spurred on by: (a) tight supply for office space, particularly for quality grade A (it has been very difficult to get regulatory approval for new office construction within the Kuala Lumpur CBD area since the Asian Crisis); and (b) by the introduction of REIT guidelines in 2005, the number of office transactions has accelerated (Figure 6). Figures 7 and 8 also highlight the improvement in rental rates and capital values of late.

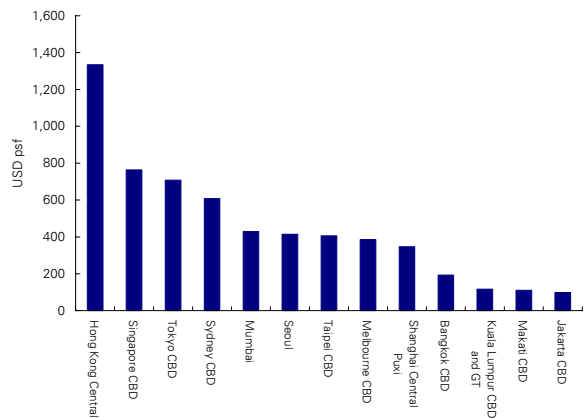
We estimate that recent office transactions have been priced at an implied yield of 5-7%. This compares with 10% for listed KLCC Property and 11% for IGB Corp, and around 3-4% for regional comparables. This yield gap should narrow, in our opinion.

Figure 4: KL has the lowest office rental rate. 2Q06



Source: Jones Lang LaSalle

Figure 5: Office sector under-valued, 2Q06



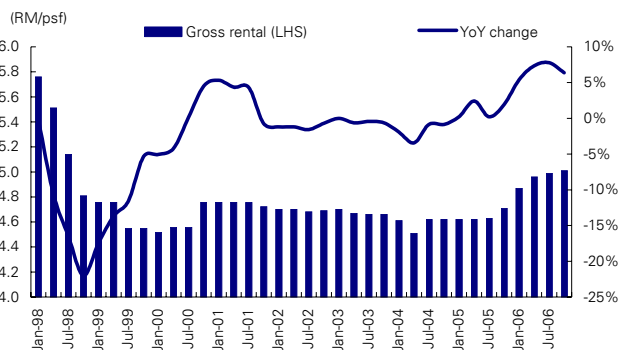
Source Jones Lang LaSalle

Figure 6: The number of office transactions has accelerated

Date	Property	Buyer	Vendor	Location	Price (RMm)	NLA (sq ft) or no of room	Price per sq ft or per room	Occupancy (%)	Independent valuer's price (RM/sq ft or RM/room)
Jan-06	Feringgi Beach Hotel	Mister Phoenix (M) Sdn Bhd	AP Land	Batu Ferringhi, Penang	43.0	350	122,857	NA	157,143
Feb-06	Unnamed (under construction) Office Tower	Lembaga Tabung Amanah Tentera	Unit of Boustead Hlgs	Mutiara Damansara, KL	168.3	336,655	500	U/C	530
Feb-06	Menara HLA	Tower REIT	GuocoLand	Jalan Kia Peng, KL	221.0	396,820	557	n/a	n/a
Mar-06	Unnamed (under construction) Office Tower	Hong Leong Bank	Unit of Hong Leong Co	PJ	86.3	194,489	444	U/C	444
Apr-06	Lot 24, Bandar Sultan Sulaiman Industrial Area	AXIS REIT	EC Distribution Sdn Bhd.	Port Klang	10.3	130,000	79	100%	104
May-06	Menara Ambank	AMFirst REIT	AmBank Bhd	Jalan Yap Kwan Seng, KL	230.0	458,882	501	92%	501
May-06	Bangunan Ambank Group & Leadership Centre	AMFirst REIT	AMFirst Property Trust	Jalan Raja Chulan, KL	199.0	417,967	476	n/a	476
Jun-06	Menara Genesis	Not disclosed	Not disclosed	Jalan Sultan Ismail, KL	53.6	134,000	400	n/a	n/a
Jun-06	Bangunan MAS	PNB	MAS	Jln Sultan Ismail, KL	130.0	270,000	481	n/a	n/a
Aug-06	Sucasa Service Apartments	KL City Corp Bhd	IGB/Topway/Hi com Prop	Jalan Ampang, KL	53.0	179	296,089	78%	n/a
Aug-06	Empire Tower	MacQuarie Global Property Advisors	AP Land	Jalan Ampang, KL	269.8	580,188	465	80%	505
Aug-06	City Square	MacQuarie Global Property Advisors	AP Land	Jalan Ampang, KL	170.0	303,000	561	75%	561
Aug-06	Crown Princess Hotel	MacQuarie Global Property Advisors	AP Land	Jalan Ampang, KL	239.8	571	420,000	59%	420,315
Aug-06	Plaza Ampang	MacQuarie Global Property Advisors	Sub of Low Yat & Sons Realty	Jalan Ampang, KL	80.0	n/a	n/a	n/a	n/a
Aug-06	Wisma Denmark	Great Eastern	Not disclosed	Jalan Ampang, KL	150.0	273,000	549	n/a	n/a
Aug-06	Westin Hotel	Newood Assets Ltd	Ireka Corp	Jalan Bukit Bintang, KL	455	452	1,006,637	69%	1,006,637
Sep-06	Casuarina Beach Resort	HPL Properties (SEA) Pte Ltd	IOI Corp Bhd	Batu Ferringhi, Penang	43	177	242,938	n/a	
Sep-06	Sheraton Subang	Far East Consortium Int'l	SPV of Faber Group	SS12/1, Subang Jaya	140	502	278,884	n/a	288,845
Oct-06	Menara ING	Tower REIT	ING Insurance	Jalan Raja Chulan, KL	75	151,372	495	100%	495

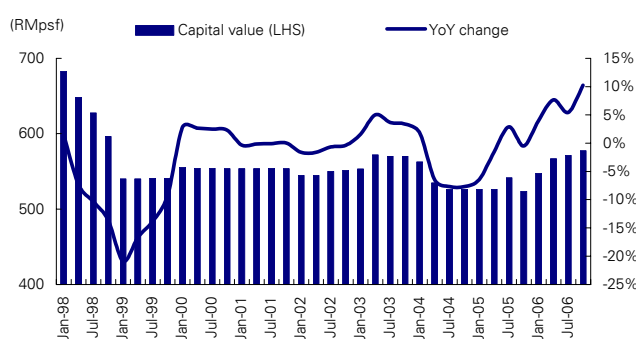
Source: Deutsche Bank, company announcements

Figure 7: Office rental yields have started to recover



Source: Jones Lang Lasalle

Figure 8: Similarly, capital values are finally rising



Source: Jones Lang Lasalle

(3) M&A activity has taken off – keep an eye on the banks

The consolidation theme has taken off in the construction sector with IJM's recent proposal to acquire Road Builder. In the Chinese Newspaper segment both Nanyang (NAN MK, RM4.10, NR) and Sin Chew (SCM MK, RM2.65, NR) now share a common shareholder.

The banking sector could be next. The most recent transaction, i.e the acquisition of Southern Bank by Bumi-Commerce, was priced at 1.9x P/B and 2.5x P/NTA (before clean-up) or 2.4x P/B and 2.9x P/NTA post provisioning. It is quite unlikely that the remaining small banks, if sold, would command the same premium multiples. However, growing (foreign) competition and the need for capital (to meet BASEL II requirements by 2008) should spur on the next stage of consolidation within the banking sector. Smaller banks are likely to be in focus again.

Figure 9: Valuation for the banks under coverage by DB

	BB Code	Ratings/Target Price	Share Price (RM)	Market Cap (US\$ m)	P/BV - FY06	P/BV - FY07	P/E - FY06	P/E - FY07	Yield - FY06	Yield - FY07	ROE - FY06	ROE - FY07
AMMB	AMM MK	Hold/RM2.35	2.65	1,541	1.06	0.99	13.95	11.04	1.9%	2.3%	7.9%	9.3%
BCHB	CAHB MK	Buy / RM7.90	6.75	5,819	1.99	1.78	16.67	12.83	1.6%	2.1%	13.0%	15.1%
H LBank	HLBK MK	Buy / RM6.10	5.45	2,350	1.85	1.75	16.03	13.63	3.3%	4.0%	11.7%	13.1%
Maybank	MAY MK	Buy / RM12.80	11.40	11,910	2.45	2.29	14.07	12.81	4.9%	5.1%	17.7%	18.4%
Public Bank	PBKF MK	Hold / RM6.60	6.85	6,451	2.85	2.66	14.57	13.20	4.5%	4.9%	20.2%	20.8%

Source: Deutsche Bank, Bloomberg

Market valuations matter but stock picking is even more critical

Malaysia has never ranked highly in a regional context when it comes to valuations. The market has always been expensive vis-à-vis its regional peers, particularly post crisis. This is mainly because a large chunk of the market is still owned by the Government-related agencies, accounting for c.36% of the market. These companies are either undergoing restructuring or have low free float, hence, valuations tend to be 'unusually' steep.

However, two key trends do stand out. First, earnings momentum has picked up again (Figure 12). This is due to a combination of an 11% tariff increase for Tenaga in June 06 and a fast-expanding order book for the contractors. Secondly, the premium in which the market trades against the region has narrowed significantly. Malaysia is now trading at 14.9x PER 2006 or a 7% premium to the region (versus average historical premium of 15-20%) and 2.1x P/B or at par with the region (versus average historical premium of 15-20).

Figure 10: DB's regional valuation comparison

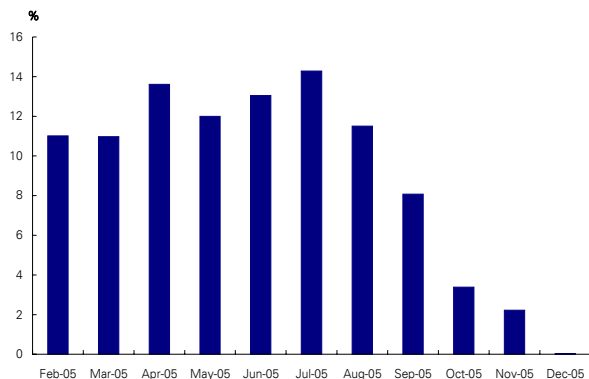
Sector	2006F						2007F					
	PE (x)	PB(x)	ROE %	EPS grth %	Div yield %	Net D/E %	PE (x)	PB(x)	ROE %	EPS grth %	Div yield %	Net D/E %
China	13.3	2.3	18.8	22.4	2.9	20.2	12.4	2.1	17.7	7.3	3.1	16.4
Hong Kong	16.1	1.8	11.7	14.2	3.5	20.7	14.6	1.7	12.1	10.4	3.8	17.0
Korea	11.5	1.5	13.4	-5.9	2.0	19.7	9.5	1.3	14.5	21.4	2.0	14.8
India	16.7	3.2	21.6	15.2	1.7	1.1	14.9	2.8	20.5	11.8	1.9	-5.0
Taiwan	13.5	2.1	16.0	18.3	4.1	11.0	11.7	1.9	16.9	15.8	4.1	9.0
Singapore	16.3	1.9	12.1	12.4	3.4	24.4	15.0	1.8	12.3	8.5	3.2	19.3
Malaysia	14.9	2.1	14.1	12.2	3.7	32.3	13.3	2.0	15.4	11.9	3.7	25.9
Thailand	9.7	2.0	21.8	10.2	3.9	45.4	9.0	1.7	20.4	7.1	4.2	36.3
Indonesia	14.8	3.1	22.7	23.8	2.1	32.2	13.0	2.7	22.4	14.6	2.6	17.4
Philippines	15.3	2.3	15.4	4.6	3.1	44.0	12.5	2.1	17.4	22.0	4.2	35.8
Regional average	13.9	2.1	15.8	12.8	2.9	19.7	12.4	1.9	15.8	12.1	3.1	15.1

Source: Deutsche Bank

KLCI index target at 1,075

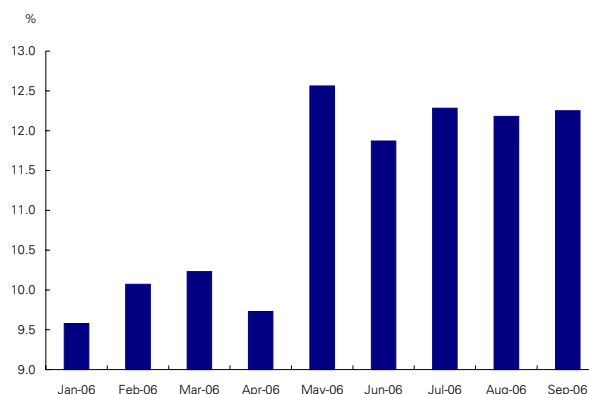
Based on our universe (which accounts for 76% of KLCI) of stocks, our bottom up index target of 1,075 suggests upside of 10%, or total return of 14% with a net dividend yield of 3.7% included. We believe there is a risk that the street has under-estimated potential higher capital repayments from companies like Maybank, Public Bank, KL Kepong, IOI Corp and YTL Power. Our index target at 1,075 suggests implied market 16.4x and 14.6x PER 2006 and 2007, respectively, and 2.3x P/B for the same period.

Figure 11: EPS growth crunch in 2005



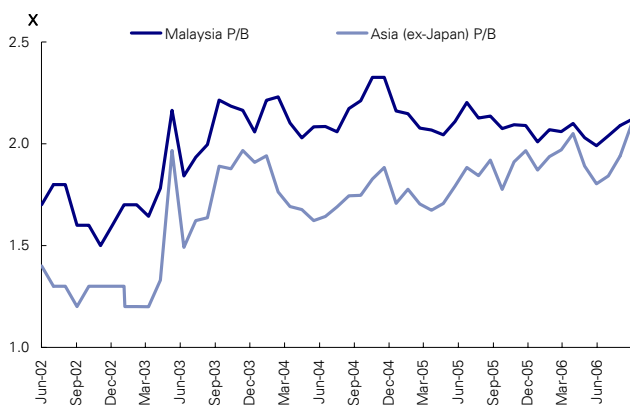
Source: Deutsche Bank

Figure 12: 2006 EPS growth has started to recover



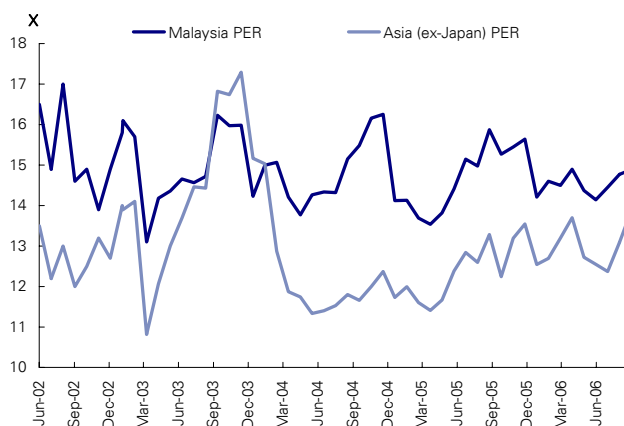
Source: Deutsche Bank

Figure 13: P/B now at parity with the region



Source: Deutsche Bank

Figure 14: PER premium has narrowed



Source: Deutsche Bank

Keeping it simple - five 'must own' stocks moving into 2007

Malaysia has always been a stock-pickers market. This is where investors would gain greater outperformance. Here (Figure 15) we feature five high conviction calls as we move into 2007. These companies are either leaders in their field - e.g. IOI Corp in plantations, Transmile in regional express freight forwarding - or are currently experiencing a significant structural change for the better under 'new management', e.g. Bumi-Commerce or Tenaga. For these companies we see imminent re-rating catalysts and/or growing demand for their operations. In the smaller cap segment, we like IJM Corp, LITRAK and IGB Corp.

Figure 15: DB's high conviction buys moving into 2007

Company	BB Code	Share price (RM)	Mkt Cap (USDm)	Target Price (RM)	Rec	Upside	PER (x)		P/B (x)		Divi yield (%)		ROE (%)	
							FY06E	FY07E	FY06E	FY07E	FY06E	FY07E	FY06E	FY07E
Tenaga Nasional *	TNB MK	9.85	11,347	12.20	Buy	23.9%	14.1	13.7	1.8	1.7	1.5	1.9	14.0	11.3
Bumi-Commerce	CAHB MK	6.65	5,685	7.90	Buy	18.8%	16.6	12.8	2.0	1.8	1.7	2.1	13.0	15.1
IOI Corp *	IOI MK	16.10	5,371	18.70	Buy	16.1%	16.9	16.6	3.1	2.8	3.7	3.7	19.1	18.2
Transmile	TGB MK	12.00	767	14.70	Buy	22.5%	19.7	17.9	2.6	2.0	0.3	0.3	14.5	13.5
KLCC Properties *	KLCC MK	2.20	556	2.90	Buy	31.8%	14.7	12.9	0.6	0.6	3.6	4.1	7.0	6.5

Source: Deutsche Bank * *ratios are for FY07E & FY08E respectively. Share prices as of 10 Oct.

Appendix 1

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Equity rating key Equity rating dispersion and banking relationships

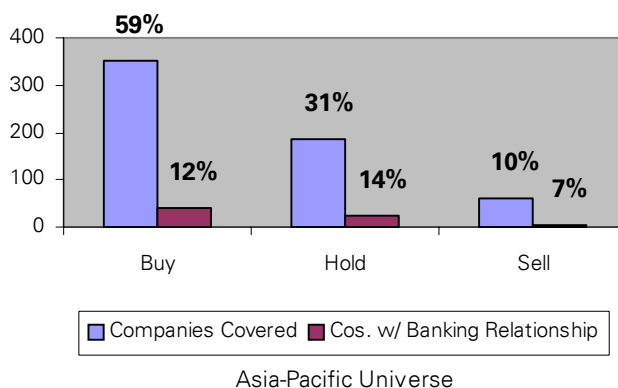
Buy: Expected total return (including dividends) of 10% or more over a 12-month period.

Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period.

Sell: Expected total return (including dividends) of -10% or worse over a 12-month period.

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