MALAYSIA EQUITY
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Strategy

Alternative Defensives

For The Longer Term

The global sell-off in equities has definitely raised the risk of an early recession, which we had hoped could be averted until 2012 as a crisis of confidence could easily turn into a self-fulfilling prophecy. While it's still early days yet to say that a bear market is taking hold, we feel that it is prudent to highlight a list of alternative defensive stocks for the longer run that would benefit in the event a recession does set in early. These stocks will benefit from a drop in incomes and commodity prices and are generally more inward looking as we believe domestic incomes should be more resilient. Our alternative bunch includes AirAsia, KPJ Healthcare, QL Resources, Media Chinese, SEG International and Supermax.

A global Sell-off. Given the global sell-off in equities, the global investment community seems to have belatedly realised that the economic outlook does not look so promising. While we have long held the view that economic prospects for 2012 are poor, we had thought that the continued rally in late 2010 and early 2011 meant that investors were still keen to chase after the final round of profits. We had also felt that domestic factors in the form of the ETP and the impending General Election meant that the global market could outperform as long as there was no global meltdown. However, in the event there is a global recession, the Malaysian market cannot expect to continue to climb this year.

A taste of crow. While it may be too early in August for us to eat crow on our "Forget Defensives, Go for the Rebound" August outlook, a taste of crow is definitely justified. As such, we unveil 6 alternative defensive stocks that will benefit in the event of a global recession from falling incomes, falling commodity prices as well as a potentially stronger US Dollar due to the flight to safety. We call these 'alternative defensives' as they do not come from the traditional sectors of Brewery, Tobacco and Gaming.

Our alternative bunch. These are:
- **AirAsia (BUY, FV: RM4.34) –** Asia's largest Low Cost Carrier
- **KPJ Healthcare (BUY, FV: RM5.37)** – Malaysia's largest private hospital chain.
- **Media Chinese (BUY, FV: RM1.70)** – Malaysia's largest Chinese newspaper publisher.
- **QL Resources (BUY, FV: RM3.81) –** Malaysia's second largest producer of chicken eggs and South East Asia's largest producer of fish paste (surimi).
- **SEG International (BUY, FV: RM2.23) –** Malaysia's largest private education provider.
- **Supermax (BUY, FV: RM5.90)** – The world's second largest rubber glove producer.

Stock	Price	Target	Mkt Cap	Volume	PER (x)		FY0	FY1	Rel. Performance %			P/NTA	Rating
	RM	RM	RMm	'000	FY1	FY2	ROE %	DY %	1-mth	3-mth	12mth	(x)	
AirAsia	4.10	4.34	11,383.7	7,646.9	11.3	10.5	29.4	-	20.1	34.4	118.8	3.0	BUY
KPJ	4.69	5.37	2,671.6	986.7	19.4	16.5	20.7	3.3	4.9	13.0	16.0	4.0	BUY
Media Chinese	1.21	1.70	2,040.6	1,327.2	10.7	9.7	14.4	5.6	-1.8	1.7	19.7	2.0	BUY
QL Resources	3.18	3.81	2,645.8	434.8	21.3	18.3	21.2	1.1	0.1	-4.1	27.9	5.3	BUY
SEGi	1.90	2.23	1,039.6	850.8	13.3	11.2	21.3	2.7	-0.4	-7.5	56.4	7.0	BUY
Supermax	3.69	5.90	1,254.9	591.5	10.7	8.1	26.6	3.1	1.4	-10.6	-47.8	1.7	BUY

Share prices as at 4 Aug 2011

A Global Sell-off. Despite the temporary resolution of the US debt ceiling crisis with the passing of an acceptable plan by both the US House of Representatives and US senate, the world seems to have finally woken up to the fact that the global economic outlook does indeed look less than positive. While we have long stated that global economic fundamentals looked poor for 2012, we had also felt that there was still enough liquidity sloshing in the market, and a lack of a crisis of confidence meant that markets could paper over any cracks up till year-end. On the domestic front, we had also felt that the strong news flow with regards to the general election and the Economic Transformation Programme (ETP) meant that barring a global sell-off, the Malaysian market could continue to climb for the remainder of 2011.

A Taste of Crow. Despite the massive sell-off in US markets yesterday with the S&P 500 index diving 4.8% to an eight-month low of 1200.07 pts and the Dow Jones Industrial Average sliding 4.3% to 11,383.68 pts – and in the process erasing its 2011 gains - we feel that it is still too early in August and not the time yet for us to eat crow. However, a taste of the crow is definitely justified. As such, we highlight some alternative defensive stocks for investors with a longer term horizon as regardless of the outlook for the remainder of the year, we are still bearish on 2012's prospects. 4 out of these 6 alternative defensive stocks are already part of our Top 10 Buys for 2H2011, which did indeed build in some defensiveness despite appearing outwardly bullish. We call these counters 'alternative defensives' since they do not belong to the traditional defensive counters in Gaming, Brewery and Tobacco but which we believe would will benefit from an environment of falling income and commodity prices, with a possible strengthening of the US Dollar due to a flight to safety in the longer term.

Our alternative bunch. The 6 stocks listed below are all buy calls and our FVs are based on a 12-month outlook. They are:

- **AirAsia (BUY, FV: RM4.34) –** Asia's largest Low Cost Carrier will benefit from falling jet fuel prices in line with oil prices. Although overall air travel should suffer in a recession, the drop in corporate and personal incomes will likely see more business and leisure travelers downtrade from full service to low cost carriers. We believe AirAsia's lowest operating cost advantage will see it increasing its market share.
- **KPJ Healthcare (BUY, FV: RM5.37)** – Malaysia's largest private hospital chain will continue to see good business in the healthcare industry despite a possible global downturn. While some may argue for a downtrade from private to public healthcare, the disparity between the two in Malaysia is quite large and there will more likely be downtrading among patients seeking private healthcare in Singapore to patients seeking healthcare locally.
- **Media Chinese (BUY, FV: RM1.70)** – Malaysia's largest Chinese newspaper publisher should continue to see sustained demand for its Chinese newspapers, which in any case are cheaper reading materials than magazines. The fall in commodity prices should also bring down the price of newsprint, which is the major cost item.
- **QL Resources (BUY, FV: RM3.81) –** Malaysia's second largest producer of chicken eggs and South East Asia's largest producer of fish paste (surimi) would likely see demand for its products rise as consumers downtrade to cheaper food products during an economic downturn. While its expansion plans in Indonesia and Vietnam may slow down, domestic profits would be enough to sustain the company.
- **SEG International (BUY, FV: RM2.23) –** Malaysia's largest private education provider with 23,000 students will likely benefit from a possible recession and stronger US Dollar as overseas education becomes less affordable, thus making its domestic courses more attractive.
- **Supermax (BUY, FV: RM5.90)** – The world's second largest rubber glove producer has been suffering from high latex prices, which in turn has been somewhat driven by oil prices. With latex as its biggest cost item, the fall in oil price in the event of a recession will allow margins to rebound as demand for healthcare related rubber gloves remains resilient.

A full discussion on all 6 alternative defensive stocks follows:

AIRASIA (BUY, FV: RM4.34)

Background

1. Asia's largest Low Cost Carrier operating short haul routes. It also owns a 16% stake in sister company AirAsia X, which operates medium and long haul routes
2. Headquartered in Malaysia with associate operating hubs in Thailand, Indonesia and plans for Philippines and Japan
3. Lowest operating costs in the airline industry with an average fleet age of 2.5 years old
4. Currently has a fleet of 93 aircraft with orders for 286 more until 2026. Most of these will be for fleet replacement as old aircraft are retired to maintain a young fleet age profile

Defensiveness

1. In the event of a recession, oil prices will likely retrace and oil is 77% of operating cost (for FY11f). For every 1USD retracement in jet fuel price, earnings will increase by 2% (RM20m)
2. While demand for overall air travel may drop, passengers are more likely to downtrade to Low Cost Carriers given their lower fares
3. Given its lowest cost advantage, AirAsia may use this opportunity to increase market share in all its operating markets

KPJ HEALTHCARE (BUY, FV: RM5.37)

Background

1. The largest private healthcare provider in Malaysia
2. Operating a network of 21 hospitals in Malaysia and 2 in Indonesia
3. Network will grow to 26 hospitals by end 2014

Defensiveness

1. Demand for private healthcare is relatively recession-proof whereby a slowdown in demand typically lags by 6 months after a recession starts
2. Community based hospitals and strong brand loyalty with insignificant exposure to medical tourism
3. The overcrowded and long queues in public hospitals will continue to sustain demand for private healthcare
4. With the lower cost advantage in Malaysia, it will attract back Malaysians who used to seek medical services overseas as well as attract cost-sensitive medical tourists

MEDIA CHINESE (BUY, FV: RM1.70)

Background

1. Malaysia's largest Chinese media group with a near monopoly on local Chinese dailies
2. Core operations in Malaysia, which makes up >80% of group profit, with presence in HK and China through Ming Bao (free daily publication) and few magazine titles
3. Turned around operations successfully since mega merger in 2008 (involving Ming Bao, Nanyang, and Sinchew) on costs synergies

Defensiveness

1. Should oil price retrace amid fears over global recession, we expect to see similar movements in newsprint prices (which made up >50% of the group's COGS) as energy costs constitute some 25% of newsprint production costs
2. Demand would likely remain sturdy given the relatively inelastic purchases of newspaper; might even go up given the more "exciting" news on the occurrence of natural disasters and with potential national snap polls ahead
3. Fears over global recession would have minimal impact on local advertising expenditure, as domestic consumption remains robust on decent economic numbers

QL RESOURCES (BUY, FV: RM3.81)

Background

1. Diversified agricultural-based group (marine-based manufacturing, integrated livestock, oil palm related and other distribution activities) of companies
2. Is a leading poultry player in Malaysia with 12% and 20% share in the production of eggs and feed raw material products respectively, leader in marine products in South-East Asia, with a 35% share of the surimi market.
3. Has 9 marine manufacturing plants and 6 poultry farms in Malaysia and newly ventured into Vietnam (breeder farm) and Indonesia (Surimi, breeder, layer and fishmeal)
4. Among the first in the world that can convert palm oil waste into readily exportable and eco-friendly palm pellets

Defensiveness

1. Due to the cheap selling prices of its products and the fact that poultry products and surimi are deemed necessities, demand is unlikely to be affected
2. Demand could in fact increase due to downtrading
3. A recession will likely lead to lower cost of its feed material thus sustaining its margins

SEG INTERNATIONAL (BUY, FV: RM2.23)

Background

1. One of Malaysia's largest tertiary education providers with 25k students onboard as of June 2011
2. Higher margins in comparison to its peers given the economies of scale, diversified offerings, and huge presence in the international students segment (which typically pay more on general admin charges)
3. 6 campuses in Malaysia, with its flagship Kota Damansara campus upgraded to University College status in 2008
4. Following the upgrade in status, SEGi is allowed to introduce homegrown programs

Defensiveness

1. Demand for tertiary education is unlikely to be affected with various govt loans, scholarships and even payment on installment offered
2. Even more so for SEGi given their students are typically from mid to high income families
3. The possible strengthening of the US Dollar and reduced personal incomes will mean that local courses in Malaysia become even more attractive.

SUPERMAX (BUY, FV: RM5.90)

Background

1. Is the 2nd largest examination rubber glove manufacturer in the world
2. Has a higher natural rubber compared to nitrile gloves mix (70:30)
3. The company is gradually increasing its nitrile mix to 40% to create a more balance product mix in the future.

Defensiveness

1. Demand is mainly driven by global healthcare awareness rather than global economic conditions
2. With the potential slowdown in global economy, we expect all commodity prices (including latex price) to retreat and this would be good for the company
3. The rubber glove sector has already undergone a sell-down when latex price was trading at an all-time high. Selling should be minimal now.

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