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MALAYSIA BUDGET 2019 – Restoring the Malaysian Economy as an Asian Tiger

Budget 2019 themed "***A Resurgent Malaysia, A Dynamic Economy, A Prosperous Society***" was tabled by the Finance Minister on 2 November 2018 and generally it is within expectations. In fact, we were expecting a broadly punitive budget as both the Prime Minister and Finance Minister alluded a budget with more taxes and "…*expect some pain and even offer some sacrifice*" during the Malaysia: A New Dawn Investors' Conference, a month ago.

Taking over the worrying state of country's financial affairs, the new government's budget focusses on optimal allocation efficiency. Various measures are taken to raise revenues ranging from new tax measures, revision of existing tax measures and non-tax measures. A range of new tax initiatives were introduced such as service tax on imported online services, soda tax, departure levy on outbound travellers, new tiered levy system on foreign labour and digital tax (which will only be implemented from 1 January 2020). As for the existing tax measures, the new administration has raised the rates for gaming tax, fees and levy as well as real property gains tax including property stamp duty. Meanwhile, the disposal of non-core assets, plan scheduled & staggered land sales through auction and open tender mechanism for Private Partnership Projects public projects will also be constantly carried by the new administration. While, there was no mention on capital gain tax and inheritance tax in this budget.

On the opex front, the government will focus on providing more for social development and well-being enhancement especially in terms of healthcare and consumption. The main beneficiaries would be the B40 and M40 income groups with more initiatives implemented to improve their well-beings while the main losers will be gaming, aviation and to a certain extent property (selective) sectors; where the new tax revisions could have a setback on their earnings growth. Nonetheless, recent market correction seems to have factored in part of the near term higher taxes.

Overall, we find the goodies of this budget is rather centric on the lower-to-medium income Rakyat especially the B40 but unpleasant to certain corporates. We are disappointed that there are no incentives to encourage bigger participation from the private sector to drive the economy.

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Numbers at a Glance:

Federal Government Finance

(RM bn)	2017A	2018P	2019F
Revenue	220.4	236.5	261.8
Operating Exp	217.7	235.5	259.8
Development Exp	43.0	54.3	54.0
Overall (Deficit)/ Surplus	(40.3)	(53.3)	(52.1)
Deficit/GDP (%)	(3.0)	(3.7)	(3.4)
GDP Growth (%)	5.9	4.8	4.9
- Agriculture	7.2	(0.2)	3.1
- Construction	6.7	4.5	4.7
- Manufacturing	6.0	4.9	4.7
- Mining	1.0	(0.6)	0.7
- Services	6.2	6.3	5.9

Sources: Economic Report 2017/ 2018, Ministry of Finance
P = Preliminary
F = Forecast

As expected, it is unlikely that the new government is able to attain fiscal deficit consolidation to 2.8% or RM39.8bn of GDP for the year 2018, as budgeted by the previous government. As such, the fiscal deficit for 2018 has been revised to 3.7% of GDP due to the re-implementation of SST to replace GST, which has led to lower tax revenue collections and also after taking into account of the unbudgeted items arising from such as interest servicing cost for 1MDB debts, compensation for the acquisition of Eastern Dispersal Link in Johor including rail projects as well as some GST refunds made.

For 2019, the new Pakatan Harapan government expects 2019 fiscal deficit to contract to 3.4% through prudent spending and one-off special dividend contribution of RM30bn from Petronas.

The new administration also expects Malaysia's real GDP growth to sustain at a slightly stronger pace of 4.9% in 2019, which is

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	0.1% higher than its 4.8% forecast for 2018. The economy growth will be supported by 1) robust domestic consumption in particularly with the development and well-being enhancement of the B40 segment, 2) increasing expansion in electrical & electronics, 3) higher oil prices to be steered by external demand and 4) moderate public spending. *Additionally, we think that the budget will provide short-term impacts as evident in the increase in operating expenditure to RM259.8bn instead of development expenditure which remains at RM54bn. The main highlight in the opex is the one-off settlement of the outstanding tax refunds forecasted at RM37bn, of which RM18bn dues from income taxes and RM19bn from GST.*
Automotive • Provision of fuel subsidy to individual car owners with engine capacity of 1,500cc or less and motorcycle owners of 125cc or less.	*This initiative may increase the demand for budget passenger cars with 1,500cc or less and motorcycles with 125cc or less. This will generally benefit the entire auto industry as most of the major marques in Malaysia have model in 1,500cc or less. The key beneficiaries will be Perodua (**UMW Holdings** & **MBM Resources**) and Honda (**DRB-Hicom**) as they have the most <1,500cc models in their line up* *However, we remain **neutral** on the sector as we expect sales volumes to stay soft in 2019 due to the 3 months tax holidays in 2018 (June 18 – Aug18) where consumers brought forward their vehicles before the implementation of SST. Malaysia Automotive Association (MAA) also expects a 2% annual growth in the TIV for 2019.*
Aviation • Proposing the first Airport REIT where investors will receive income arising from user fees collected from airport operator (MAHB). • To raise RM 4b from selling 30% stake of the REIT in private investing institutions while gaining an invaluable opportunity to invest in top quality infrastructure asset.	*This measure will make **MAHB** an asset light operator which is not bogged down by heavy capital investment and debt. However at this juncture, there are still many uncertainties with the Airport REIT such as the values attached to the airports and who will bear for the future construction development capex. Listed REIT can only fund up to 15% of construction development capex. Hence we maintain **neutral** in **MAHB**.*
• Imposition of levy for all passengers travelling overseas via air routes starting 1 June 2019, RM 20 for passengers travelling to ASEAN countries and RM 40 to other countries.	*We see this as a negative news for **AirAsia** and **AirAsia X** as the passengers for budget airlines are more sensitive toward an increase in fare prices.*
• Declaring Pulau Pangkor as a duty free Island	*By turning Pangkor Island into a duty free zone, more tourists will travel to Pangkor*

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	*Island and promote Malaysia Island to International tourists. This will benefit airlines such as **AirAsi**a and **AirAsia X** to explore new opportunities.*
Banking • RM1bn fund established by Bank Negara Malaysia (BNM) to help lower income group earning not more than RM2,300 per month to purchase affordable houses priced up to RM150,000 with participating financial institutions, namely **AmBank**, **CIMB**, **Maybank**, **RHB** and BSN at a concessionary financing rate of 3.5% p.a. • "Property Crowdfunding" platforms are established to serve as alternative source of financing for first time home buyers through peer-to-peer lending. • Extend loan repayment period from 30 to 35 years for the first loan and from 25 to 30 years for the second loan for civil servants. • Reduce corporate income tax rate from 18% to 17% for taxable income of up to RM500,000 for SMEs with less than RM2.5m in paid up capital. • RM1bn SME Syariah Compliant Financing Scheme made available via Islamic financial institutions where the Government will provide a subsidy of 2% profit rate.	*We see the new government is taking initiative to make financing easier and more accessible for first home buyer and low income group who want to buy a house. Participating banks in the RM1bn fund established by BNM are anticipated to benefit but it is insignificant to the sector as the total residential property loan size is about RM548bn as at September 2018.* *"Property Crowdfunding" will be in competition with banks but we think that the impact is minimal to the banks. The platform will most likely be an alternative to borrowers who fail to obtain financing from the banks. Hence, required return for investors should be higher given the risks involved.* *Extend loan repayment period for civil servant should affect **MBSB** but we think the impact is minimal.* *Overall, we like **Maybank** for its balanced and diversified loans portfolio and **Public Bank** for its strong asset quality.*
Brewery • No hike in excise duty for alcoholic beverages.	*The absence of an excise duty hike is good news for **Heineken Malaysia** and **Carlsberg Brewery Malaysia.** This is because a further hike in excise duties will lead to a dramatic increase in contraband beers, which accounts for 25% of beer consumption in Malaysia. Nevertheless, volume growth in the brewery has been lacklustre and this is likely to continue.*
Construction **On-hold projects:** • East Coast Rail Link (ECRL) is suspended, pending renegotiation of the cost of the project. • Cancel RM60bn MRT3 project for now, pending the completion of MRT2. • RM110bn Kuala Lumpur – Singapore High-Speed Rail (HSR) project will be delayed to 2020. **Ongoing projects:** i) RM16.6bn – LRT3. ii) RM30.5bn – MRT2. iii) Pan Borneo Highway encompassing Sabah and Sarawak will proceed, subject to cost rationalisation exercise. iv) Re-tender RM5.2bn Klang Valley Double-Tracking (KVDT)	*We remain **neutral** on the construction sector given that no new significant contracts mentioned and mega projects namely ECRL, MRT3 and HSR are subject to review. However, we believe there are a few notable mentions as there is greater clarity on future direction.* *Local players such as **CMS** and **HSL** are set to benefit from the total of RM9.3bn development expenditure in Sabah and Sarawak. Players from West Malaysia that working on Pan Borneo Sabah and Sarawak projects such as **AQRS** and **Vizione** are*

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Phase 2 project via open tender. **Others:** • Allocation of development expenditure of RM5bn for Sabah and RM4.3b for Sarawak increased 21.1% and 0.2% respectively, as compared to Budget 2018. • Allocation of RM1.3bn compensation for acquisition of the Eastern Dispersal Link (EDL). • Freeze toll hikes on all intra-city tolls in 2019 that will cost the Government approximately RM700m. • Allocation of RM926m for upgrade and maintenance of road and bridges. • RM1.5bn allocated for construction of affordable housing through Program Perumahan Rakyat, Perumahan Penjawat Awam Malaysia, PR1MA and Syarikat Perumahan Nasional Bhd.	*expected to benefit as well.* *The compensation to EDL is positive for **MRCB**, which owns a 100% stake in EDL as it will remove the RM1bn EDL debt from MRCB's balance sheet.* *The freeze on toll rate hikes is neutral to intra-city toll road concessionaires such as **Gamuda, Litrak, Ekovest and IJM** as they will be compensated by the government. However, growth in traffic volume will be mildly affected as RM100 unlimited public transport passes for rail and bus network is slated to be introduced.* *Players in road maintenance works such as **UEM Edgenta** and **Protasco** are expected to benefit from the allocation of RM926m for upgrade and maintenance of road and bridges.* *Contractors that bagged affordable housing contract previously such as **Mitrajaya, Vizione** and **Pesona** may benefit from the RM1.5bn allocated for construction of affordable housing.*
Consumer **RM5bn Bantuan Sara Hidup (BSH) cash handout to B40 group**: • Household income of RM2,000 and below will receive RM1,000 • Household income of RM2,001-RM3,000 will receive RM750 • Household income of RM3,001-RM4,000 will receive RM500 • Additional aid (BSH) of RM120 for each child aged 18 years and below, to be limited to 4 persons, except those disabled person (OKU) with no age limit • One-off assistance of RM500 to pensioners who are receiving pensions of less than RM1,000	*We are positive on the measures that will increase the disposable income of the B40. This coupled with savings from lower housing and transportation costs (the two largest expenditure components other than food) are expected to benefit the consumer sector.* *The support given to B40 consumer group will benefit consumer stocks in general. The excise duty on sugary drinks is expected to have marginal impact on the earnings of drink producers such as **F&N** and **Nestle** as we believe the additional tax would be passed on to consumer via price increases.*
Gaming • Casino licences will be increased from RM120m to RM150m annually. • Casino duty will be raised to 35% from 25%. • Gaming machine dealer licence to be raised from RM10,000 to RM50,000 per year. • Tax on operators of gaming machines to increase from 20% to 30% of gross collection.	*The higher tax imposed on casino operators have a negative impact to both **Genting Berhad** and **Genting Malaysia**. The increase in gaming tax from 25% to 35%, which is way more than what we expected. We estimated 1% increase in gaming tax will reduce Genting Malaysia and Genting Berhad bottom line by 3% and 1% respectively.* *Share of **Genting Malaysia** will be under selling pressure as the hike in gaming tax directly impacted its bottom line. As for **Genting Berhad**, we suggest to **Hold** as **Genting Berhad** only has 30% earnings exposure to Malaysian casino operations.*

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Healthcare • Government to partner with the private insurance industry to pilot a national B40 Health Protection Fund to provide free protection against top 4 critical illness (heart attack, stroke, cancer and kidney failure) for up to RM8,000 and up to 14 days of hospitalization income cover at RM50 per day starting 1 January 2019. • Contribution from Great Eastern Life Insurance of initial seed funding of RM2bn with the expectation of more partnership and contributions with other foreign insurance companies in due of paring down their stakes to local investors. • Allocation of RM20m for the Malaysia Healthcare Tourism Council to generate 25% growth in a year to collaborate with reputable private hospitals to enable branding of Malaysia as a destination of choice for medical tourism	*The healthcare sector is set to welcome refreshment with the introduction of the B40 Health Protection Fund which aims to provide financial assistance for the primary care treatment for critical illness for the B40 households, to ensure better health coverage. As such, this will enable the B40, which is represented by approx. 12m people, to gain medical treatment at private hospitals.* *We believe **KPJ** stands to be the main beneficiary of the spill-over patients from the public sector given its relatively lower pricing compared with its private healthcare peers in conjunction with its extensive and more notably, comprehensive domestic hospital network.*
Insurance • Pilot national B40 Health Protection Fund to provide free protection against top 4 critical illness for up to RM8,000 and up to 14 days of hospitalisation income cover at RM50 per day**.** Great Eastern Life Insurance contribute initial seed funding of RM2b to the fund. • Waive stamp duty for all Tenang Insurance products for 2 years beginning 1 January 2019.	*The tax relief for EPF contribution and life insurance or takaful deduction could be positive for life insurance businesses. It could help to speed up the insurance penetration rate but life insurance is highly driven by the income level of policyholders.* *We are neutral on insurance sector. We like **Allianz** for its resilient general insurance segment and its fast growing life insurance segment.*
Logistics • To convert 380 acres of land in Pulau Indah into Free Trade Zone (FTZ) to support and catalyse increased shipping and logistics activities in Port Klang. The New FTZ will serve as a natural extension of Port Klang Free Zone	*We are positive on the new FTZ at Pulau Indah as there will be more activities arising in the area. This will benefit **Westports** for being the dominant logistic players in that region. We believe the impact will be positive for **Westports** over the long term.*
Oil and Gas • A one-off special dividend of RM 30bn from Petronas to help government to repay the GST and income tax refunds of RM37bn.	*We are **neutral** on this development as the special dividend of RM30bn will not affect Petronas operations due to the strong fundamental of Petronas and the recovery of oil price.*
Plantation • Effective 2019, Malaysia will implement Biodiesel B10 (comprising a mix of 10% palm oil) program for transportation sector and B7 for industrial sector. • Extension levy for foreign workers who have served for 10 years or more will be reduced from RM10,000 to RM3,500 per worker per annum. • RM30mn allocation to assist smallholders to obtain the Malaysian Sustainable Palm Oil (MSPO) certification. • Minimum wage to increase from RM1,050 per month to RM1,100 per month nationwide starting Jan 1, 2019	*The B10 biodiesel mandate is positive news for the sector as it is expected to increase demand for CPO by 0.25m tonnes to 1m tonnes per year. Meanwhile, the minimum wage hike will have minimal impact as most workers are earnings above minimum wage but it will help plantation companies to overcome labour shortage problem.*
Property Development	

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• Exemption of stamp duty on property transfer letter for first house purchase for houses priced between RM300,001 and RM1m for the period of six months starting from Jan 1, 2019. • Secured the commitment from the Real Estate Housing Developers Association (REHDA) for a 10% reduction in the price of houses that are not subjected to price control in new projects. • For first-time home-buyers purchasing residential properties priced up to RM500,000, the Government will exempt stamp duty up to RM300,000 on sale and purchase agreements as well as loan agreements for a period of two years until December 2020. • For first-time home-buyers with household income of RM5,000 or less, the Government will allocate RM25m to Cagamas Berhad to provide mortgage guarantees to enable borrowers to obtain higher financing from financial institutions, inclusive of down payment support. • The Public Sector Housing Financing Board will extend the loan repayment period of civil servants from 30 to 35 years for the first loan, and from 25 to 30 years for the second loan. **Others:** • For companies and foreigners, real property gains tax (RPGT) to be doubled to 10%. • For locals and PRs, the RPGT shall be increased from 0% to 5%. However, low cost, low-medium cost and affordable housing with prices below RM200,000 will be exempted. • The rate of stamp duty on property transfer worth more than RM1mn will increase 3% to 4%. • Introduction of "Property Crowdfunding" platforms as an alternative source of financing for first time home buyers. These exchange platforms, to be driven by the private sector, will be regulated by the Securities Commission under the peer-to-peer financing framework. The first exchange is expected to be rolled out in 1Q2019.	*The list of measures to assist first-time home buyers to own a house is within our expectations.* *The government continues its efforts to increase supply of affordable homes with total allocation of RM1.5bn for Program Perumahan Rakyat, Perumahan Penjawat Awam Malaysia, PR1MA and Syarikat Perumahan Nasional Bhd. Furthermore, Bank Negara Malaysia will establish a RM1bn fund to assist the lower income group earning not more than RM2,300 per month to purchase affordable homes priced up to RM150,000.* *We believe affordable housing developers such as* ***Mah Sing and Mitrajaya*** *will benefit from these measures. We remain upbeat on the outlook of the company.* *Meanwhile, the stamp duty exemption is short term positive for the property sector as it helps to address the RM22bn worth of overhang residential properties. However, developers are required to offer a minimum price discount of 10% for these residential properties, which is expected to squeeze their profit margins.* *The increase in RPGT is mildly negative to the property market as it may impact new property sales especially foreigners buying for investment purpose.* *The increase in stamp duty rate on properties above RM1mn is slightly negative to property developers with high exposure to properties above RM1mn such as* ***Eastern & Oriental*** *and* ***Eco World Development****.* *Overall, the measures introduced in Budget 2019 are mixed to the property sector. We maintain our* ***neutral*** *call.*
Power and Utilities • Increase subsidies per month on electricity bills from RM20 to RM40 to the poor and hardcore poor households registered under e-Kasih program, with an allocation of RM80m. • Allocation of RM694m to supply electricity to rural and remote regions.	*The monthly subsidy program will not have impact on* ***Tenaga****'s earnings as it will be borne by the government under Incentive Based Regulation (IBR) framework but they are anticipated to benefit from the allocation to supply electricity to rural and remote regions.*
Pharmaceutical • Allocation of approx. RM29bn for Ministry of Health and this includes an allocation of RM10.8bn to provide medicine, to upgrade and improve the quality of health services at clinics and hospitals.	*The increase in 2019 healthcare allocation which is 7.8% higher than the previous year will benefit* ***CCMD*** *as 49% of its FY17's revenue was derived from the public sector.* ***YSP*** *is another stock to watch out. We remain* ***positive*** *on the sector as we expect the generic pharmaceutical producers are*

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	poised to benefit from the spill over effects from the deliberated policies overseeing the healthcare sector.
Rubber Gloves • Increasing the minimum wage to RM1,100 per month for the whole of Malaysia starting 1 January 2019. • Implementation of a new tiered levy system where the levies charged will be higher for employers with a higher percentage of foreign workers. • Creation of RM3bn Industry Digitalisation Transformation Fund with a subsidised interest rate of 2% under Bank Pembangunan Malaysia Bhd, with the purpose of accelerating the adoption of smart technology consisting of automation, robotics and artificial intelligence. • Provision of matching grants from MIDA through High Impact Fund with a specific emphasis of Industry 4.0 initiatives. This includes activities such as Research & Development, initiatives to obtain international certification and standards, modernizing and upgrading of facilities and tools and licensing or purchase of new or high technology.	*The implementation of minimum wage and new tiered levy system are expected to increase the cost of production for rubber gloves manufacturers. Nonetheless, we believe the impact to be minimal as the glove producers have always been able to fully pass any cost increase through revision of ASPs. More importantly in recent years, rubber glove manufacturers have been automating their factories to be less labour intensive.* *Meanwhile, the financial/ grant incentives for Industry 4.0 are expected to benefit rubber gloves players such as **Hartalega**, **Top Gloves** and **Kossan** that have been expanding their capacities through automation. Most of the stocks have performed well since 2017, which is in line with the strong demand and a more stable supply-demand dynamics which underpinned earnings recovery. Due to the run-up in share prices, their price-to-earnings valuations appear stretched compared with earnings growth and as such remain **neutral** on the sector.*
Technology • Allocation of RM2bn under Business Loan Guarantee Scheme where the government will provide guarantees up to 70% so as to incentivise SMEs to invest in automation and modernisation forms part of the Industry 4.0. • Creation of RM3bn Industry Digitalisation Transformation Fund with a subsidised interest rate of 2% under Bank Pembangunan Malaysia Bhd, with the purpose of accelerating the adoption of smart technology consisting of automation, robotics and artificial intelligence. • Provision of matching grants from MIDA through High Impact Fund with a specific emphasis of Industry 4.0 initiatives. This includes activities such as Research & Development, initiatives to obtain international certification and standards, modernizing and upgrading of facilities and tools and licensing or purchase of new or high technology.	*The popularisation of industrial automation and Industry 4.0 in the manufacturing sector due to rising labour costs will bound to benefit automated test and inspection equipment makers such as **Vitrox, Pentamaster** and **Mi-Equipment**. Despite the market noises of late, we remain **positive** with equipment makers as they are in expansion mode and on track to attain good growth moving forward as they are benefitting from technology mega trends such as 5G networks, autonomous driving, Internet of Things, Artificial Intelligence and Industrial Revolution 4.0.*
Telecommunication • To launch National Fibre Connectivity Plan (NFCP) in 2019 with an allocation of RM1bn.	*During the Malaysia – A New Dawn conference on 9 October 2018, the Minister of Communication and Multimedia, Gobind Singh set a target of 98% broadband population coverage by 2023.* This initiative will improve broadband penetrate in Malaysia. We expect telco infrastructure service providers to benefit from this initiative such as

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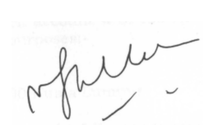
	OCK Group.
• Enforcing the Mandatory Standards of Access Pricing (MSAP) which result in fixed broadband prices to reduce by at least 25% by end of 2018.	*The implementation of MSAP is currently on-going and has already resulted* ***Telekom Malaysia****,* ***Maxis*** *and* ***Time dotcom*** *to reduce their fixed broadband prices. We remain* ***neutral*** *on Telco sector as Telco players will have to spend additional capex to upgrade their infrastructure for higher speed while having a margin compression.*
Tobacco • No hike in excise duty.	*The tax reprieve is good news for* ***British American Tobacco (BAT)****. Additionally, the government has pledged to step up enforcement against cigarette smuggling and recover at least RM1bn in tax losses. Nevertheless, we are negative on the growth prospects in the Malaysian tobacco industry as the sector landscape is getting increasingly difficult due to consumer switching to contraband cigarettes. Year-to-date,* ***BAT*** *volume declined 5.8% on the back of high incidence of illicit (63% market share). In order to achieve the Ministry of Health's goal to be a "Smoke-free Malaysia", the government will also expand the number of locations where smoking will be disallowed starting Jan 1, 2019.* *All said, we are* ***neutral*** *on* ***BAT****.*

For Phillip Capital Management Sdn Bhd



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Executive Chairperson