STRATEGY – MALAYSIA

US-China Trade Beneficiaries Swinging Into Action

As the US-China trade tension escalates to a new level this week, we re-explore Malaysian exporters which can benefit either via better export prospects, forming new ventures (capacity expansion) with mainland Chinese peers, or/and having China investors buy stakes in them. Our channel checks indicate that potential winners could include many E&E companies, some furniture manufacturers, port operators, and (indirectly) plastics injection companies.

WHAT'S NEW

- **Escalating US-China trade war reforming Asia's supply chain...** Some Malaysian exporters are set to benefit from the ongoing US-China trade tiff, with this week's imposition of 10% tariffs by the US on US$200b worth of imports from China, with the former threatening to further raise tariffs to 25% by Jan 19. Rather than forcing the affected manufacturing supply chain in Asia to relocate facilities to the US, the US sanction will force many manufacturers in China to diversify to/or expand their manufacturing bases in Indochina or Southeast Asia (SEA).
- **...and will benefit some Malaysian exporters.** Producers in China, MNCs and locally-owned alike, may have to soon swing into action their plans to diversify or emphasise their manufacturing bases in Indochina and SEA. Observations and our ongoing channel checks indicate that: a) mainland Chinese have been exploring having JVs in Malaysia over the past few months, b) MNCs have been transferring some production facilities from China to Malaysia, and c) some companies like Lii Hen are already experiencing higher export orders.
- **On the M&A front,** Unisem announced on 12 September that it had received a conditional voluntary joint takeover offer from China-based OSAT Tianshui Huatian Technology (THT, which is the world's 5th largest OSAT and about 3x larger than Unisem) and Unisem's directors John Chia and Alexander Chia. The offer price of RM3.30 per share, valuing Unisem at RM2.4b and 24.5x 2018F PE/19.2x 2019F PE, is at a +1SD premium to Unisem's 5-year mean of 13.7x and 17.1x respectively, based on consensus forecast.
- **2H18 is already more promising with forex kicker.** Besides the longer benefits of the realignment of regional production facilities, Malaysian exporters are expected to deliver appreciable stronger earnings in 2H18. Earnings drivers include: a) new products for selected E&E manufacturers (Inari, Globetronics, VS Industry), b) rising export orders (Lii Hen), and c) impact of the ringgit's weakness vs USD (now 4.4% below 2H18's average).
- **Key winners identified for this investment theme include** E&E companies, some furniture manufacturers, port operators, and (indirectly) plastics injection companies. Plantation companies could possibly benefit from China's hefty 25% import tariff imposed on US agricultural produce, although we have not yet seen any appreciable surge in demand for palm oil as a substitute for China's soybean import. Our sectorial assessments are provided overleaf.

ACTION

- **BUY-rated potential beneficiaries** include E&E companies Inari, Vitrox and VS Industry, flexible plastics manufacturer Scientex, while notable NON-RATED winners include Lii Hen and Petronas Chemicals.

STOCK PICKS

Company	Ticker	Rec	Mkt Cap (US$m)	Price 24 Sep 18 (RM)	Target Price (RM)	PE (x) 2018F	PE (x) 2019F	P/B (x) 2018F	P/B (x) 2019F	Div Yield (%) 2018F
Inari Amertron	INRI MK	BUY	1,661.5	2.17	2.68	24.6	17.4	5.8	5.2	2.7
Scientex	SCI MK	BUY	1,043.8	8.82	10.41	11.3	10.2	2.1	1.8	2.7
Vitrox	VITRO MK	BUY	888.1	7.80	8.25	35.5	26.5	9.0	7.2	0.7
VS Industry *	VSI MK	BUY	623.9	1.52	1.75	13.5	10.6	2.1	1.9	3.3

**FY already expired; data reflects actual reported number.*
Source: Bloomberg, UOB Kay Hian

TOP POTENTIAL BENEFICIARIES

Company	Ticker	Share Price (RM)	Target Price (RM)
Inari Amertron	INRI MK	2.17	2.68
Scientex	SCI MK	8.82	10.41
Vitrox	VITRO MK	7.80	8.25
VS Industry *	VSI MK	1.52	1.75

**FY already expired; data reflects actual reported number.*
Source: UOB Kay Hian

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POTENTIAL BENEFICIARY SECTORS

Sector	Companies	Remarks
E&E: Semiconductor-related	Inari	The enquiries from MNCs (both existing and non-existing clients) to explore the possibility to divert their assembly processes to Malaysia are increasing. If any of these potential business opportunities materialise, it will be supported by Inari's under construction new plant at Batu Kawan.
	Vitrox	Expecting to gain more businesses from the China market, which might expedite investments in its semiconductor industry (as part of the "Made In China 2025" roadmap).
	Globetronics	LED IDM clients have been exploring the possibility of transferring their China assembly facilities to Malaysia.
	Metal stamping companies	Approached by sizeable metal stamping producers from China for a potential JV to establish production in Malaysia.
EMS	VS Industry	Although products produced by VSI were not in the list of tariff-imposed items by both the US and China, Malaysian EMS producers have been approached by prospective China-based EMS producers for potential JVs or component supply.
Furniture	Lii Hen	Experiencing rising export orders and surge in enquiries from the US. Currently Liihen sells 70% of its furniture to the US market. Interestingly in a recent furniture Expo in China, potential US buyers were not present.
Manufacturing – Flexible Plastics	Scientex	Flexible packaging producers like Scientex should benefit when more of China's production facilities relocate to SEA. Scientex is a competitive supplier in SEA while it is not competitive (no presence) in China's market given high logistics costs.
Oil and Gas	Petronas Chemicals	In an Aug 18 article, PChem's CEO was quoted as saying that the trade rift is perceived as both opportunities and threats. China may seek ethylene and polyethylene supplies from SEA as a short-term alternative. PChem has a 16% (out of 12.7mtpa) of its total production exported to China. While PChem has received increased queries from the nation, we understand that nothing concrete has materialised.
Ports	Westports	Westports earlier guided that the trade war is unlikely to have a material negative impact given its insignificant exposure to the transpacific route, although there is speculation that SEA ports could thrive as transshipment hubs with the continuing US-China trade tiff. The Asia-America trade lane comprised only 8-9% of WPRTS total volumes. Nevertheless, we note that monthly transshipment volumes in Singapore port (PSA) still recorded 7-9% yoy growth rates from Apr to Aug 18.
Rubber Gloves	Top Glove, Hartalega, Kossan	US buyers may potentially switch to SEA-made nitrile or latex gloves instead of buying China-made gloves. Hence, this may benefit Malaysian producers since they are the largest in the world. However, the sector's steep valuations still point to underperformance.
Plantation		A potential beneficiary if China reduces import of soybean. The 25% import duty on US soybean has yet to see any positive spillover impact to palm oil. This is likely due to the high soybean and soybean oil inventory in China. However, in the case that China reduces soybean import, it would translate to less soybean crushing. The lesser soybean crush will lead to less soyoil available in the market. This could be positive to palm oil. Assuming that China cuts 5m tonnes of soybean imports, supply of soyoil will decline by 0.9m tonnes and palm oil could make up for the supply gap. China currently imports about 5m tonnes of palm oil from Malaysia and Indonesia.

Source: UOB Kay Hian