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# 'FBM KLCI not yet overvalued'

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**T**he FBM KLCI has recovered somewhat since it fell to a low of 1,674 points in mid-December last year. The index reached a high of 1,856.51 points last Tuesday, before retreating to close at 1,844.31 points on Friday.

Hurt by the weak ringgit and low oil prices, the FBM KLCI's decline towards the end of 2014 had wiped out considerable gains from the year's high, which had briefly exceeded 1,890 points in July when the market had begun to look overvalued.

This year, the local bellwether has gained more than 5% to date. Meanwhile, its regional peers, the Hang Seng Index and Nikkei 225, have each gained over 14%.

At current levels, which is almost back to last year's high, fund managers and analysts are mixed about the local stock market's valuations — some say it is still overvalued, while others say there is still upside potential.

Pacific Mutual Fund Bhd chief investment officer Koh Huat Soon believes that at the current price-earnings ratio (PER) of 16 times, the FBM KLCI is overvalued as it is trading above the historical average. According to him, the expensive valuation is mainly supported by government-linked domestic funds.

"The government faces tremendous challenges in meeting budget targets as we are not out of the woods yet in terms of the impact of cheap oil prices on the budget and current account. This makes Malaysia vulnerable to a credit rating downgrade," he tells *The Edge*.

As it is, Fitch Ratings last month said Malaysia's credit rating is "more than 50% likely" to be downgraded on a worsening trade balance and the inability of state investment fund 1Malaysia Development Bhd (1MDB) to meet its debt obligations.

Pacific Mutual expects the FBM KLCI to reach 1,817 points by year-end, 1.6% lower than its current level.

"We don't see much upside. With headwinds before us — namely the challenges of meeting budget targets, shrinking current account surplus, heightened political risks and threat of a rating downgrade — it is difficult to justify paying above-mean valuation for this market at the moment," Koh explains.

On the contrary, Danny Wong, chief executive of Areca Capital Sdn Bhd, believes that factors such as weak oil prices, the impact of the Goods and Services Tax (GST) and the possibility of a rating downgrade have largely been priced in.

"I think many have priced in the negative factors. Some foreign funds may return due to our economic growth and continued Economic Transformation Programme initiatives, especially our subsidy reforms. What we need is to overcome the bearish ringgit issues," Wong tells *The Edge*.

The ringgit has plunged more than 18% against the greenback since August last year, hitting a low of 3.73 on March 20, 2015. It is currently hovering around 3.66.

Wong says the FBM KLCI and Malaysian stocks in general deserve a premium over their peers due to their defensive nature and high dividend yields.

Over at Etiqa Insurance and Takaful, head of research Chris Eng says the FBM KLCI is "not yet overvalued".

However, the market is expected to continue seeing some volatility, and Etiqa is forecasting a broad range of 1,828 to 1,870 points for the year.

The following are some FBM KLCI component stocks on the radar screen of the investment community that may be worth a look.

## Tenaga Nasional Bhd

"On Tenaga, we continue to see relatively low coal prices and increasing market share as the company completes its Manjung 4 [coal-fired] power plant and hydro dams," says Eng.

Manjung 4 recently missed its end-March commercial operation date and is expected to be delayed for another two to four weeks.

But TA Securities' James Ratnam says the delay is not expected to have any operational impact on Tenaga (fundamental: 1.3; valuation: 1.8) given the short delay and 30% reserve margin.

"Tenaga's unit fuel cost is expected to fall as it increases the use of coal — a cheaper alternative to gas — in the coming quarters as Manjung 4 comes on stream," says Pacific Mutual's Koh.

"Lower generation cost would present an opportunity for the subsidy on liquefied natural gas to be reduced without an adverse impact on tariff during the next review."

Tenaga has also just received 90.21% acceptance for its offer to take over Integrax Bhd, a strategic move that will ensure the latter focuses on its coal handling services to Tenaga's Janamanjung power plant complex.

Including the 1,000MW Manjung 5, the complex will have a total capacity of 4,000MW — 16% of Peninsular Malaysia's capacity.

TA raised its target price on Tenaga to RM16.29 from RM16.25, and has a "buy" call on the stock. Tenaga closed at RM14.50 last Friday with a PER of over 11 times — still cheap, according to Etiqa's Eng.

"As it is, Tenaga trades on a calendar 2016 PER of just 12 times against the market's FBM100 PER of 15 times. Tenaga deserves to be re-rated to at least parity with the market," says Koh.

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### RHB Capital Bhd

A catalyst to watch for in RHB Cap is a possible internal reorganisation of the group, whereby RHB Bank will take over RHB Cap's listing status and house all its entities.

The exercise, which could include a rights issue, is expected to improve the group's tax efficiency, although details are not yet clear.

"On RHB Cap, plans to restructure the bank and the return of foreign interest (to the FBM KLCI) should help boost the company, which also has a new CEO," says Eng.

On March 5, RHB Cap (fundamental: 1.5; valuation: 2.1) announced that group CEO Kellee Kam had resigned from his position. This will take effect in May. The group has identified a successor and is awaiting Bank Negara Malaysia's approval.

Some quarters do not expect the banking sector to see exciting prospects in the near term. That said, RHB Cap's valuations may still be a selling point at this time.

"Bank stocks are not currently overvalued. They are good as defensive and dividend-yielding stocks," says Edmund Tham, head of research at Mercury Securities Sdn Bhd.

"Consumer loan growth may be slower due to the GST, which may affect sentiment, and Bank Negara guidelines [which may result in] low approval rates. But corporate banking, trade finance and investment banking will still be growing," he adds.

Where RHB Cap is concerned, its 12 months trailing PER is just under 11 times — compared with Public Bank Bhd's 16 times and Malayan Banking Bhd's 13 times — and it has a dividend yield of 1.96%.

### Public Bank

In a banking sector that is experiencing a slow-down in growth and an increase in non-performing loans, Public Bank (fundamental: 2.8; valuation: 1.5) has largely bucked the trend.

The banking group outperformed its peers by a large margin in numerous valuation metrics, and its position as a favoured stock among fund managers could point to further upside.

"Public Bank's share price is expensive but investors are willing to pay a premium because it is perceived as a defensive pick. The stock carries a large weight in the composite index, so it has to be reflected in a fund manager's portfolio," says Koh.

Compared with its banking peers, Public Bank was a top performer for the financial year ended Dec 31, 2014. Return on equity stood at 19.9% compared with the industry average of 13%.

Its loan growth saw a 10.8% increase on a year-on-year basis, also outperforming the industry average of 8.7%.

In a March 25 note, Affin Hwang Capital Research says it expects the banking group to continue the outperformance this year, pegging a target price of RM21.80 to the stock.

"The group has the lowest gross impaired loan ratio (of 0.65%), the number one position in franchise retail banking and a well-capitalised balance sheet," it says.

### MISC Bhd

Ever since the failed takeover bid by national oil firm Petroliaam Nasional Bhd (Petronas) in 2013, MISC's (fundamental: 2; valuation: 1) share price has appreciated by leaps and bounds.

The stock gained 24% this year as at April 10, making it one of the best-performing stocks among the 30 constituents in the FBM KLCI.

Being one of the few niche industry stocks on the component index, MISC is influenced by external factors in the shipping sector.

With the prevailing low oil price environment prompting companies to store their oil inventory, crude tanker rates have seen a resurgence, thanks to the uptick in demand.

A lifting of sanctions on Iranian oil production is also set to offset the delivery of newbuild ships, ensuring that tanker demand outpaces supply.

"Both factors are significant re-rating catalysts for MISC. In a prolonged situation of cheap oil, the demand for storage will continue to grow if the oil oversupply continues. Current crude tanker rates are already at multi-year highs, which is indicative of a longer-term trend," says an analyst of a bank-backed research house, who has a "buy" rating on MISC.



Koh expects the FBM KLCI to reach 1,817 points by year-end, 1.6% lower than its current level



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SOURCE: THE EDGE MARKETS

## Possible FBM KLCI stocks with further upside ahead

	SHARE PRICE AS AT APRIL 10 (RM)	YEAR-TO-DATE GAIN (%)	HISTORICAL PE RATIO	DIVIDEND YIELD (%)	NET ASSETS PER SHARE (RM)	RETURN ON EQUITY (%)
RHB Capital	8.21	7.74	10.45	1.96	7.31	11.47
Tenaga Nasional	14.50	5.07	13.13	1.99	7.66	15.98
MISC	8.96	24.1	18.02	1.69	5.54	9.10
Public Bank	19.06	4.15	16.33	2.82	7.26	18.65

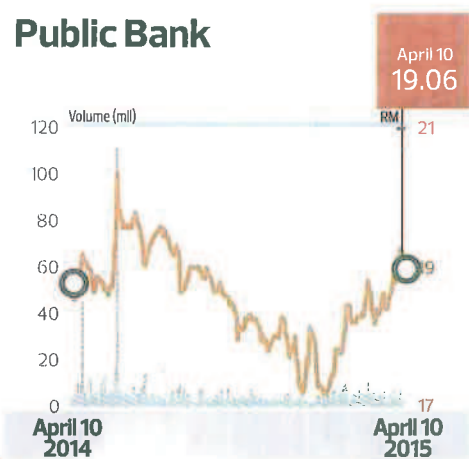
### Tenaga Nasional



### RHB Capital



### Public Bank



### MISC

