

Budget 2005: Sectors to Watch

Datuk Seri Abdullah Ahmad Badawi's first budget as Prime Minister takes a more macro and long-term approach to the market and the economy as a whole.

By James S

MOST analysts and market strategists appear to view the Budget positively, although a number were disappointed that it lacked any major catalysts to spur a market rally. Any immediate impact would be more on the macro economic front where there could be rating upgrades from rating agencies, according to an analyst. The reason is that the government has been prudent in keeping the Budget to a lower 3.8% deficit, which is even lower than the consensus estimate of 4.0%. This is viewed positively by most international rating agencies.

Any upgrades are likely to be accompanied by more foreign inflow of funds and this could boost the market in the long run. Some market strategists are hopeful that this, together with the continuous efforts taken by the government in restructuring government-linked companies (GLCs) such as Telekom Malaysia Bhd, Malayan Banking Bhd, Tenaga Nasional Bhd, Sime Darby Bhd, etc and enhancing transparency and corporate governance, could help attract the major foreign funds that the country lost to regional markets like Thailand and Indonesia in the last few years to finally come back again. In fact, this is one of the major themes that could be shaping up an expected strong market rally towards late this year or early next year.

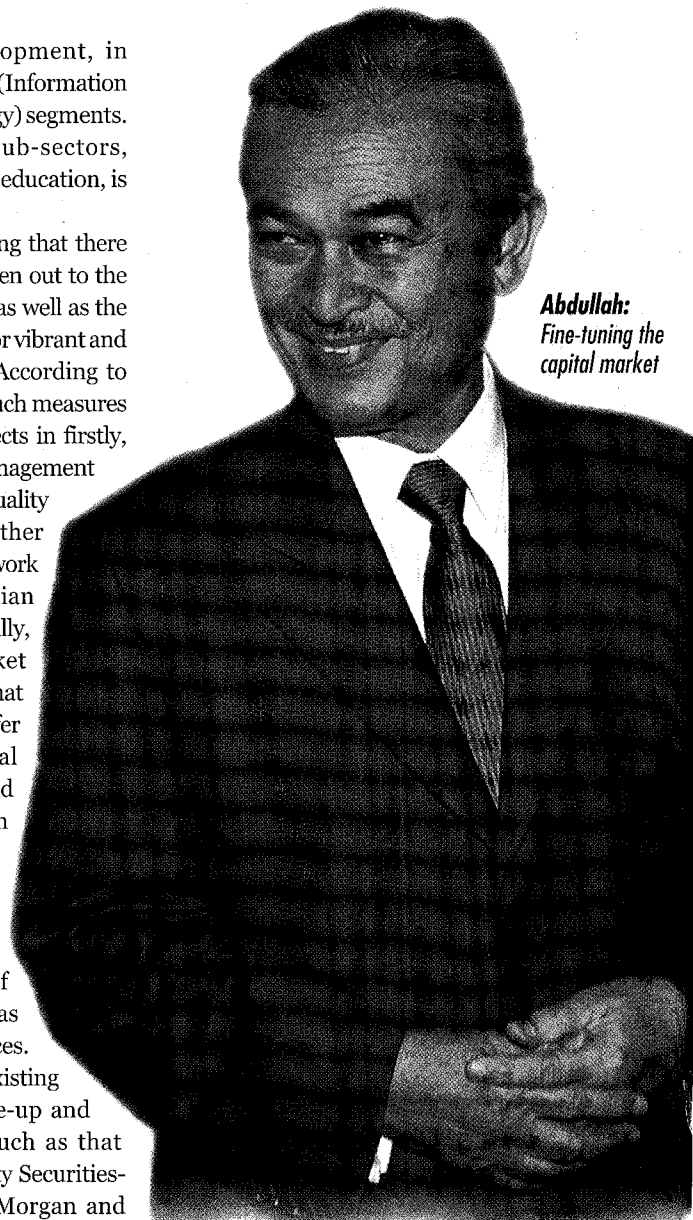
Structural changes to the capital market in the long run

In the Budget, the government has put emphasis on the services sector as a key

source of economic development, in particular the finance and ICT (Information & Communications Technology) segments. Development in other sub-sectors, including tourism, health and education, is also the focus.

As such, it was not surprising that there were quite a lot of goodies given out to the banking and financial system as well as the capital market to keep the sector vibrant and promote long-term growth. According to Avenue Securities Research, such measures are likely to have positive effects in firstly, enhancing Malaysian fund management expertise and improving the quality of services; secondly, to further strengthen the distribution network and hence promote Malaysian investment instruments globally, and lastly, increasing market liquidity. However, it notes that such measures will invite stiffer competition between local (including universal brokers and investment bankers) and foreign brokers.

The foreign brokerages may come into Malaysia via a 'package deal, meaning they could offer the whole facet of broking, fund management as well as futures trading services. This may affect the current existing local and foreign brokers' tie-up and operations in the market such as that involving Hwang-DBS, KL City Securities-Merrill Lynch, JF Apex-JP Morgan and



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Fine-tuning the
capital market

Kenanga-Deutsche.

Still, while competition will get more intense, Avenue believes that it will be good in promoting the local capital market. Besides, it believes that local funds will have ample opportunities to benefit from the additional RM6 billion in funds that are being allowed to the Employees' Provident Fund to be placed out under a relaxation rule set out in the Budget.

Avenue adds that a well-developed capital market could be another source of income for some banking groups as there is currently a need for banks to diversify from their mainstream net interest income revenue amid rising price competition. This could come from their merchant banking or investment banking arm, Bancassurance and wealth management activities, as well as treasury activities.

However, this structural change is only expected to bring some major excitement to the market in the long run as it would probably take a year or two for foreign outfits to make any major comeback to the country.

Goodies for bankers

In the 2005 Budget, bankers continue to see the government's determination in making Malaysia the hub for Islamic financial services. While Islamic banking income is basically a sub-set of interest income for conventional banks, the segment is seen as one to have ample opportunities to grow further.

It is believed that the measures in the Budget are to keep to the Financial Sector Master Plan's target of promoting Islamic banking and financial services to achieve a 20% share of total industry assets by 2010.

According to Bank Negara Malaysia's 2003 Annual Report, as at end 2003, the Islamic banking market share accounted for only 9.7% of the total industry assets (2000: 6.9%), 10.4% of total deposits (2000: 7.4%) and 10.3% of total financing of the banking system (2000: 5.3%). While analysts believe that the measures here will not excite the market or even banking stocks in the short-term, banks that have a strong will to excel in this segment such as Commerce Asset-Holding Bhd and RHB Capital should nonetheless benefit later from their first mover advantage.

The government has also proposed in the

Budget for the tax authority to deem interest-in-suspense as a special provision for bad debts and be allowed as a deduction in the computation of the income tax. However, the income tax will be charged when such interest-in-suspense is received. However, this measure is seen as having little impact on banking stocks' valuations as the move is seen as creating 'timing differences, and not permanent differences to the banks' effective tax rates while pre-tax profits remain unchanged', according to Avenue Securities.

Good news too for other service sub-segments

For the ICT sector, the measures in the Budget are largely within market expectations. In fact, at the recent Asean Communications and Multimedia (ACM) Expo and Forum, Prime Minister Datuk Seri Abdullah Ahmad Badawi had already hinted that the government would continue to aggressively pursue its ICT mandate in transforming the nation to a full ICT hub.

All in all, the measures are positive for the ICT sector but not substantial to warrant a re-rating of the players such as Computer Systems Advisers (M) and VADS, says a local analyst.

Meanwhile, the market is likely to view the major private education providers such as Inti Universal, SEG International and Stamford College positively as the Budget allows colleges to be exempted from stamp duty and real property gain tax for their merger and acquisition exercise (before Dec 31, 2006), which could prompt expansionary plans by these players.

No cheers for the construction sector

According to K & N Kenanga Research, the reduction in overall development expenditure from RM31.1 billion in 2004 to RM28.3 billion in 2005 and the reduction in development expenditure for Sabah and Sarawak from RM11 billion in 2004 to RM3.8 billion for 2005 is not unexpected, given that the government has repeatedly cautioned on the need to reduce budget deficit. The cut in development expenditure signals that only high-priority projects will be carried out.

It is of the view that the cut in development expenditure would negatively affect construction companies that rely heavily on government projects such as Gamuda Bhd, Road Builder Bhd, MTD Capital Bhd and the

Sarawak-based Hock Seng Lee as their current high order books are not sustainable, resulting in lower construction earnings over the next two-to-three years. However, it believes that the impact on IJM Corporation Bhd and WCT Engineering Bhd could be muted, given their strength in private projects.

While the research house sees a squeeze in the construction margin for the industry players, it notes that most of the construction companies have successfully diversified their earnings base to include contributions from the property development, toll, water and power concessions.

Non-event for the property sector

Following the Budget, property trust funds are now exempted from income tax on chargeable income distributed to unit holders, whereas the undistributed income would continue to be taxed at 28%. Avenue Securities Research believes that such incentives nonetheless could have a muted effect as property trust funds are still not popular among investors.

Cure for bird flu?

The incentive given to the poultry sector should help the sector to cushion their losses arising from the recent bird flu breakout. While it is positive to the sector as a whole, market participants somewhat believe that this will not give a significant yet sustainable boost to players yet.

Bad news for 'sin' stocks

The Budget once again singled out the brewery and tobacco sectors by imposing a much higher tax on liquor and cigarettes. While the increase in sin taxes was largely expected, the quantum was somewhat larger than expected. However, analysts generally believe that the companies should be able to pass down the cost to consumers, hence maintaining their profitability.

No fireworks, but enough sparks

All in all, Budget 2005 did not meet some high expectations but was in line with the consensus expectations, which is not unusual. Apart from the potential upgrade by foreign rating agencies and also potential higher inflow of foreign funds, most analysts and market strategists believe that the impact on most stocks and sectors in the market would be largely neutral. **mb**