# Stock Picks For 2001

Januray 18, 2001

**Preface**

What a roller-coaster year 2000 turned out to be! In line with global markets, the local bourse surged forward, buoyed by the technology sector as well as hopes for a continued sustainable recovery for the Malaysian economy as a whole. But that was where the good news ended. After hitting a year high of 1013 on February 18, it was downhill all the way as the bears continued to bare their claws with bad news pummeling the market all the way down. Volatility became the name of the game, moving in step with the 'blowing hot' and 'blowing cold' sentiment in US markets.

As we begin the year 2001, the signs are appearing ominous, with US markets headed for freefall and JP Morgan even pronouncing a hard landing for the US. Locally, the governments forecasted economic growth has also been cut, from the initial forecast of 7.5% GDP growth to a more tepid 5%. Investors have turned ever more cautious, as trading volumes continue to drop, and the adoption of the T+3 settlement period seems to have curtailed Malaysian investors' famous appetite for risk.

In this environment, it's not surprising that stock selection is going to be ever more important as a sectoral approach may be unwise under the present market conditions. zoomFinance has therefore invited a distinguished panel of fund managers and investment analysts to provide us with their top five stock picks for the year, that will hopefully provide a haven of safety in these times of spiraling volatility.

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**THE PANELISTS**

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**Tan Kok Kheng [TKK]**
(CEO of UOB-OSK Asset Management Sdn Bhd)
Prior to this position, he was with UOB Asset Management Ltd in Singapore, managing the award winning UOB Global Capital Fund. UOB Asset Management is the largest private fund manager in Singapore managing a fund size of SGD 3 Billion. Before joining UOB Asset Management, Tan was the Head of Investment at the Union Bank of Switzerland in Singapore. He has a total of more than 14 years in the investment field, working in the U.S., Hong Kong and Singapore.

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**Chow Quee Iee [CQI]**
(Head of Research, Kuala Lumpur Securities Sdn Bhd)
He graduated with a Bachelor of Science (1st class Honors) degree majoring in mathematics, from University of Malaya. He also holds an MBA majoring in Finance, from the same university. He has more than 13 years experience in the securities industry and has served in various senior capacities

with Mayban Securities, Phileo Peregrine, CIMB Securities, Kezan Securities and Hwang DBS Securities as well as Head of Research for Yamaichi Securities.

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**Nazaiful Affendi Zainal Abidin [NAZ]**
(Investment Analyst, Metrowangsa Asset Management)
Nazaiful is a graduate of IIUM (International Islamic University Malaysia), and initially joined Metrowangsa Asset Management as a Research analyst in July 1997, about the same time when the company first started. Due to the company's emphasis on global research and markets, he was assigned to cover and track the European market. Currently, Nazaiful is one of the senior advisors in the advisory arm of Kumpulan Metrowangsa.

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**Pankaj Kumar Bipinchandra [PKB]**
(Senior Investment Analyst, OSK Research)
A graduate from the School of Accountancy of University of Malaya in 1990, Pankaj started his career in a trading company. He joined OSK Research in 1996 as an Investment Analyst covering the plantation sector. Later, his expanded his stock coverage to include the power and insurance sector and presently covers about 14 stocks in the utilities and gaming sector.

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**MODERATORS:**
**Por Yong Liang [PYL]**
(Chief Content Officer, zoomFinance.com)

**Steven Poh [SP]**
(CEO, i2Media Sdn Bhd)

Below are excerpts of the discussion

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# zoomFinance - Round Table Forum

January 18, 2001 11:00 AM - 12:30 PM
**Stock Picks For 2001**

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**PYL: The consensus outlook seems to be that 2001 will be a really tough year for world financial markets. If you agree with this, what level do you think the local bourse will bottom out at? Will there be a late recovery in the second half of this year?**

**TKK**: You have to look at the global scenario, especially at the interest rate environment. Last year, technology stocks took center stage, while we seem to be focusing on interest rates this year. Looking at the 50 basis points cut in the US, we will probably see more rate cuts which will come earlier than expected. Another 100 basis points cut is expected. If there is going to be a hard landing, [Alan] Greenspan still has some room to cut interest rates, maybe up to another 200 basis points. That is on the monetary level. Under the Bush administration, a tax cut could also cushion a recession. All these scenarios will definitely have an impact on Malaysia, but more so on the more interest rate sensitive countries like Hong Kong and Singapore. As you are probably aware, Malaysia is a bit different. We actually did pretty well in the early part of last year, and were probably one of the best performing markets in the world. Then suddenly we got bashed down, and by the end of the year, saw quite a massive outflow of foreign funds, and that triggered the selling and souring of sentiment. However, foreign outflow seems to have tapered off now. The consensus seems to be that foreign funds probably have up to 3% invested in Malaysia, which is very meager. So there won't be a lot of selling from here on, because it is so under weighted now. I haven't seen any foreign house that is presently bullish on Malaysia, but valuations have come down significantly, from 60-80% of their highs, and this includes even blue chips. We are very close to the bottom, although the index is not a good indicator of the market. If you take away the top three stocks, you will see a different index. Probably, the Emas index would be a better gauge then the KLCI. I think that is limited downside risk.

**NAZ**: Our view is more or less the same, that this year will be a tough year. We don't expect the US to actually crash land though. We see some respite in that the government is well aware of the conditions and rate cuts are inevitable. These two factors will mitigate the effects of a slowdown. So it is comforting to us to have the view that the US will not crash. But Malaysia is not just about external factors. We are still being bogged down by all those sentiment and event driven local factors, which continue to affect the general perception and activities of investors. To that extent, we have some reservations about what can be done. Our view is that we are quite close to the bottom of the market and we don't think that the downside is very much more. So there are some opportunities for those investors who are taking a long term view of the market. There will be some form of recovery, but bear in mind that our interest rate cycle is different from the one in the US. So US interest rate cuts may not directly affect us, but could improve other factors like sentiment.

**PKB**: I agree with the previous two views, that the global scenario has a lot to do with where Malaysia is headed. As you know, our economy is more or less dependent on our exports and the bulk of exports go the US, especially electronics. Obviously with a US slowdown, our exports will be affected and will impact our growth forecast for the year. The government has already lowered its GDP forecast for the year to about 5.8% and there are even some investment houses saying that that is too generous. If you look at the market locally, the market always looks ahead, for example the scenario early last year when the index was about 1000, a lot of bullish reports were published. Then when results started coming in the second and third quarters, earnings downgrades filtered into the market, resulting in valuations being expensive and selling pressure. Looking at 2001, we will hit another results season soon, and that is another watch point. Already, a lot of analysts have lowered their forecasts on certain key stocks. We have to wait to see how the results are when they are reported and watch out for surprises, especially on the downside. It will be a little tricky going ahead, and you may get another round of downgrades. But if you were to move ahead, maybe closer to 3Q 2001, you'll see people start looking at 2002 again. Then there may be some opportunities for upgrades. In terms of the index, I agree with Mr Tan that the index is not a true reflection of the market because of the weighting of Tenaga, Telekom and Maybank. This has caused the index to be artificially high. Going ahead, it is a bit difficult to place a target on the index, although I would say that the downside risk isn't very much, maybe 10-15% at the most. The upside is certainly a lot more, especially if the stocks are being re-rated.

**PYL: What is interesting now is that it is common knowledge that TMT in Malaysia stands for Tenaga, Maybank and Telekom. We know that these stocks constitute a large proportion of the Composite Index. If we take them out, where do you think the CI would be?**

**PKB**: I think that it is about 530 points.

**CQI**: If you take out those three stocks, you are removing about 150 points from the KLCI.

**PKB**: If you look back, some of the non-index stocks are already trading well below the crises levels in September 1998.

**CQI**: On interest rates, if you look at the Fed funds futures market, there is a possibility that the Fed can cut interest rates by another 100 basis points by the first half. In total, they would have cut a total of 150 basis points for the first half. On the US economy, if there is any downturn, the question is whether it will affect our economy. The answer is yes, on two fronts. The first is the electronics sector and the second is on commodity prices, specifically oil and CPO. If there is any downturn in America, commodity prices will be affected and this will dampen any recovery in CPO prices and consequently plantation stocks as well. Now, in the Malaysian market, I would take comfort at the current low levels. A lot of people have actually downgraded their earnings and foreign houses have downgraded the country as a whole. This is actually a comfort to me because valuations have become cheaper. So it is an opportunity to look at values. There isn't further downside to this market, which is currently holding at the 680 mark. Is there further downside here? Yes there is, probably at the 650 mark and if it goes, it will be 600 points. So we shouldn't be too alarmed that the market will fall further, because much of the bad news has already been factored into the market. With regards to the upcoming reporting season due next month, if there are any shocks, it would have been factored in.

**PYL: One more piece of adverse news is that because of the new MSCI reweighting which favours stocks that have more free float, our rating will be cut again by half. Will we be further hit again?**

**CQI**: I think that when MSCI first announced its free-float plans sometime in September, the market has been adjusting itself, hence the downtrend in the market. So when MSCI finally made a decision on that issue in December, the market had already factored it in.

**PYL: US inflation figures just came in last night, in the region of 3.5 percent. Is this benign or does that mean that it will restrict Alan Greenspan's ability to further cut interest rates?**

**TKK**: I think the market is expecting another cut soon, and my fear is that since the whole market in the US is expecting this rate cut, and if it doesn't happen, the market will not take it very well. The anticipation is really being built into it. For example on CNN and CNBC, all the fund managers are saying to expect a rate cut. That is why the Dow Jones has been supported so well over the past few buying sessions. Coming back to the MSCI free float, you mentioned about half, from 10 to 11 percent to 5 to 6 percent. I think that the news is that we are being marginalized. But then the whole Asia is also being marginalized because the free float in Asia is a lot lower than in US and Europe. In Asia, it is at about 40 percent, compared to 80 to 90 percent in US and Europe. The Malaysian free float stands at 20 to 30 percent. These figures tell us that the market will be marginalized. Nevertheless, since foreign fund managers weighting in Malaysia is only in the range of 2 to 3 percent, there won't be any further selling due to this free-float reweighting. Those foreign funds that wanted out of Malaysia have already exited and this free-float issue is not a significant one. Nonetheless, the impact of a slowdown in the US is great, because 30 percent of our exports are to the US, and 60 percent of our manufacturing is in electronics. A slowdown in PC sales and semiconductors will have a very direct bearing on us. We have to watch these numbers very closely.

**SP: The consensus here is that there isn't much more downside, but you did mention earlier that if the US slows down significantly, both the commodities and electronics sectors will be hard hit.**

**TKK**: You have to look at it sector by sector. As you know, the electronic sector has come down so much that it seems to have crashed already! So I am beginning to see good value. Look at stock prices of Korean and Taiwan semiconductor companies. They have already rebounded from previous lows. Similarly, you could see a small rebound in stocks like Unisem and MPI because of their share prices have come down so much. Talking about CPO prices, the outlook is just as bad. I believe that the break-even price is around RM600 per cubic ton. It's currently slightly above that, so they must be making a little bit of money. But my worry is that because of the protectionism around the world, for example, Pakistan has recently introduced import tax on commodities and other countries may do the same. Indonesia is also exporting palm oil in great quantities, and has given tax breaks to their exporters. We are also trying to do the same thing. So competition is really intensifying. Therefore, we are not in favour of the commodities sector at the present. And most of these counters also have a property element in them. We are under weighting this sector. Since commodities are not going to save us this time, and manufacturing is very cyclical, we'll have to look inwards now. Hopefully, consumption now will save us. The key sectors that I am looking at are infrastructure and construction, where we are assigning an overweight position. What has happened is that over the last two years, the money allocated for construction has not been fully used. So there is a delayed impact on us. Over the next few years, we may be seeing a lot of construction. For example the revived Bakun Dam project may be taking off.

**PYL: To summarise our conclusions so far, we are almost at the bottom, with maybe another 10 percent downside. The second half of the year sounds like it will firm up which makes this an excellent time to accumulate some stocks. Please list your top stock picks for the year and your reasons.**

**TKK**: I am more defensive over the next 6 months while not being overly cautious since valuations aren't demanding and am awaiting signals like rate cuts. On the consumption side, we will continue to be holders of **BAT** and **KFC**. I like the construction sector very much, and **Gamuda** and **IJM** would be my choices there. Mainly, we like the infrastructure, construction and consumer sectors. With more construction projects coming on board, we will probably put more of these counters on our list.

**SP: On the issue of corporate governance, is it the main cause of foreign fund outflow? Has it contributed significantly to the condition of the market?**

**PKB**: To most foreign fund managers, Malaysia just isn't on the radar screens anymore. They don't have a reason to be in this market.

**TKK**: I think the next few months will be mainly a domestic play. I don't expect foreign funds to come in, simply because they have just pulled out recently. They don't do asset allocations that quickly! At the moment, they are pretty positive on China and Hong Kong. I expect them to come back to Malaysia, since we are still one of the most important emerging markets around. They will keep an eye on events here. And I am sure they will come back, since there are still emerging markets funds out there that will invest here when the time comes.

**PKB**: **Gamuda** is also out top pick, because of the infrastructure play. In the telecommunications sector, we like **Digi** for its clean balance sheet, strong shareholder backing and innovation in the marketplace. Among the power stocks, we prefer **Malakoff** because it has new contracts to expand its generating capacity and can be considered the main beneficiary of Tenaga's asset disposal program due to its acquisition of the Kapar power plant.

**SP: What about YTL Power?**

**PKB**: Valuation-wise, it seems stretched. We have pegged a fair value of RM2.50 to it. The reason why its share price has held up so well is because 70 percent of trades done are actually share buybacks. So we don't see any reason why the share price should hold at that level. In fact, if we look at that company, it has raised a lot of cash through a bond issuance, in preparation for acquisition of more assets. Sadly, this did not happen and it may not happen anytime soon. Of course they have plans to venture into overseas power ventures but to-date nothing has really materialised. So they have a big pile of cash and it's not surprising then that they are undertaking an aggressive share buyback scheme.

**PYL: It is interesting that everyone here is recommending Gamuda when there was a scandal last year over its acquisition of DynaPlastics, a battery manufacturer and fund managers dumped the stock heavily. What is the situation on that now?**

**PKB**: We have a fair value for it at RM5.70 so there is a chance for significant upside there. It's share price has come off quite a bit, and is currently sitting at about RM3.50, which again goes back to our view that some stocks have reached a level that is attractive enough to consider buying. When Gamuda first announced the DynaPlastics deal, the share price was hovering at RM5.00, so at that time, it was not very much away from its fair value.

**CQI**: We also like **Gamuda**. I actually met them a few weeks ago. The share has a RNAV/share value of about RM6.40 and it has an order book of RM1.8 billion which can carry them through the next few years. With regards to DynaPlastics, I think that the fears over it have subsided. The latest I have heard is that the plant is up and running and should be breaking even over the next few months. In the construction sector, we like **MTD Capital**, a contractor for the East Coast Highway. This stock is very cheap, although illiquid. On telecommunications, we like **Digi** because of its management. They do know what they are doing. They were the first in the prepaid market and were able to seize a large chunk of that market. It is also spending a large sum of money to upgrade existing facilities. On power, we like **Malakoff** because it is the biggest IPP around. It gives you exposure to the power sector and earnings will be bumped up by the Kapar plant, which will come on-stream in 2001. Malakoff is trading at a steep discount to its RNAV of RM13.80 per share. On banks, we like **Hong Leong Bank**, because valuations are cheap and it has a strong balance sheet. We like the quality of the assets in its banks, which is second to Public Bank only. It has a niche in the consumer loans market, from which they will be able to capture a portion of loans growth.

**SP: Any comments about IJM?**

**CQI**: We have a hold on **IJM** since the bulk of its contracts are in the construction of highways in India, where the margins are actually thin compared to what they can get here. Recently, they have secured a project to construct a dedicated highway to Putrajaya. This will help them over the next two years. Increasingly, this company is looking outside Malaysia as they feel that they can't secure many more contracts here due to it being too competitive. They are presently looking to secure more projects in India.

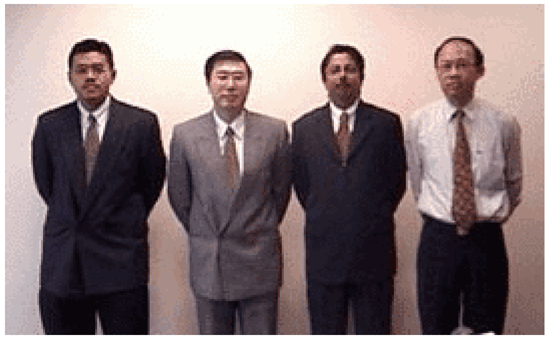
**NAZ**: We also have **Gamuda** and **Malakoff** on our buy list. We also have a buy view on **Palmco**, which is a reverse play on palm oil. We are betting that CPO prices will continue to remain low. **Tenaga** is our index play, and we see some upside in further Yen weakness, going forward. **Pharmaniaga** is also a good buy since it is a direct play on the pharmaceutical sector here.

**PYL: Going on to the Time DotCom IPO, would you advise any of your clients to subscribe?**

**PKB**: I cover the telecommunications sector, and I receive a lot of calls on this topic. The pertinent question here is this: is RM3.30 a good price and can I make money out of it? If you remember, when Time DotCom first announced that it was going public, the NASDAQ was in the region of 3800 points. A lot of telecommunication stocks were trading at very high levels. Between then and now, Malaysian telecommunication stocks have dropped between 30 and 50 percent. The NASDAQ has fallen 33% as well. So just based on relative valuation, and if Time DotCom had been listed last year, it would be worth only RM2.30 now. Another argument here concerns the revenue figures for Time DotCom that the media has been publishing. If you look at some of the recent figures, it looks as though Time DotCom is projecting compounded earnings growth of 49% over the next 4 years, which seems a bit fantastic to me. Obviously, this is going to be difficult to achieve. Nevertheless, I will reserve any further comments because I have not seen the prospectus yet and don't know the assumptions underlying these projections. Lastly, you have to see your market share as well as the quality of your subscribers. If you look at Time Wireless's financial results, when comparing its third quarter with its second quarter ones, revenue growth was only 11% while operating profit margin was only 8%. That to me is a bit too low for a telco (compared to Telekom, DiGi or even TRI). My advice to investors is that it is better to adopt a wait and see attitude on Time DotCom as there is a possibility that they could buy the shares at a cheaper price than the offer price.

**CQI**: I think that on the basis of valuations, it looks expensive. It would trade at 52 times PE if listed at that price, so it looks expensive and better value can be found elsewhere. Nevertheless, it could find some support amongst Time Engineering shareholders because they would switch to Time DotCom for direct exposure to a Telco.

**TKK**: I agree that there could be some switching, and its merchant banks are underwriting 80% of the deal. Also Khazanah is buying at RM3. I agree that it looks expensive, but will still be oversubscribed. As a long-term investor though, I have some reservations about buying it.



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