13 May 2016 | Sector Update

Automotive

***Maintain* NEUTRAL**

First thoughts on Nissan-MMC tie-up

INVESTMENT HIGHLIGHTS

- **Nissan-MMC capital tie-up could create another partnership akin to Renault-Nissan in near future**
- **Synergies in the form of platform/technology sharing, logistics, manufacturing and joint purchasing can reduce cost and accelerate new model introductions**
- **In the local context, Tan Chong and DRB are possible indirect beneficiaries**
- **Maintain NEUTRAL on Autos given a muted demand outlook. Berjaya Auto (BUY, TP: RM2.50/share) is still our top pick and we remain NEUTRAL on UMW (TP: RM6.00/share)**

Capital tie-up in the making? Nissan Motors (Nissan) is in advanced talks with Mitsubishi Motors Corporation (MMC) to buy a controlling >30% stake in the latter via the issuance of new MMC shares, reportedly valued at USD1.8b. We gather that an extraordinary meeting by Nissan and MMC is expected to be convened within a week to get the deal through, while the boards of the respective companies met yesterday to discuss operational details. This development comes hot on the heels of MMC's fuel economy scandal, which will come with potential liabilities, reported at USD1b. Four models are involved - Nissan sells two of these models supplied by MMC (Dayz and Dayz Roox) under the Nissan badge while the other two (eK Wagon and eK Space) are sold by Mitsubishi.

Achieving the 10m goal. If the deal goes through, Nissan's stake in MMC will be a lot more than the 15% stake it currently has in Renault (Renault in turn, has a 43% stake in Nissan). The deal could create a similar relationship vis-à-vis Renault-Nissan in the near future, we believe. As a recap, the Renault-Nissan alliance was formed in 1999, the longest running transnational partnership between two major automakers. Four key areas of synergy were identified, i.e. engineering, manufacturing and logistics, purchasing and human resource. In 2013, the alliance sold 8.3m vehicles in almost 200 countries, i.e. ~10% share of global TIV. Renault-Nissan has set a target of achieving 10m global TIV by 2016 and the tie-up with MMC (which sells just over 1m cars per annum) could pretty much pave the way for this.

Potential synergies: On first thoughts, the potential benefits from the Nissan-MMC capital tie-up may include:

(i) A fresh capital injection of USD1.8b into MMC which will help it weather the fuel economy scandal and accelerate R&D,

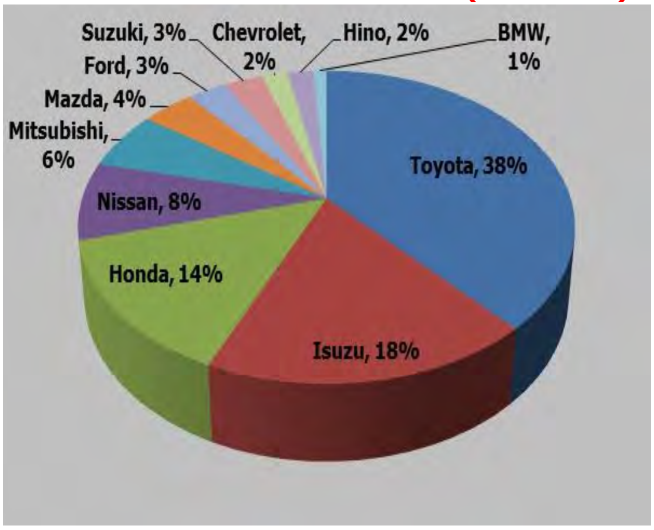
(ii) Possible platform sharing which will reduce cost and accelerate development of new models,

(iii) Access to MMC's strong distribution and production network in ASEAN, as well as its PHEV (Plug-in Hybrid Electric Vehicle) technology, and

(iv) Other synergistic areas i.e. joint-purchasing, human resource, logistics, manufacturing.

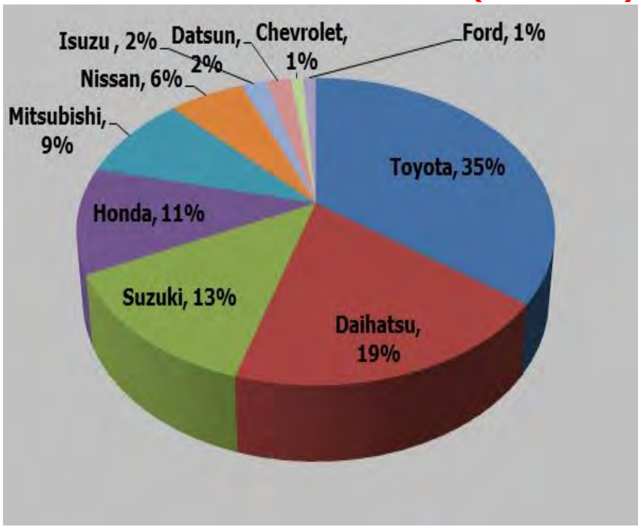
Strengthens foothold in ASEAN: Nissan derives a third of its domestic (Japan) sales from the small/compact car segment (11% share of Japan's minicar market), which is a segment MMC is also relatively strong at (9% share), making MMC an ideal partner for Nissan. About a fifth of MMC's 1.05m global sales volume is derived from ASEAN (which is a fast growing market for compact cars given the emphasis of Thailand's and Indonesia's green car programs on this segment) vs. just 7% for Nissan. Thailand, Indonesia and the Philippines account for 68% share of the 3m/annum ASEAN TIV. MMC is notably a very strong player in the fast growing Philippines market with a 25% share (vs. Nissan's 1% share).

EXHIBIT 1: THAILAND TIV SHARE (BY BRAND)



Source: AAF, MIDFR

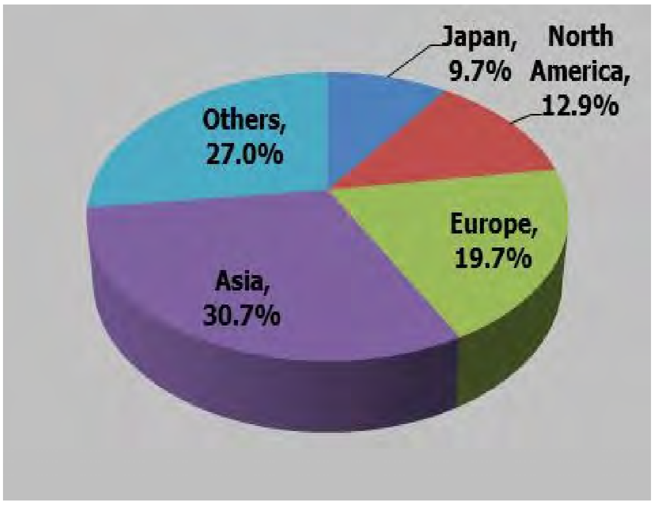
EXHIBIT 2: INDONESIA TIV SHARE (BY BRAND)



Source: AAF, MIDFR

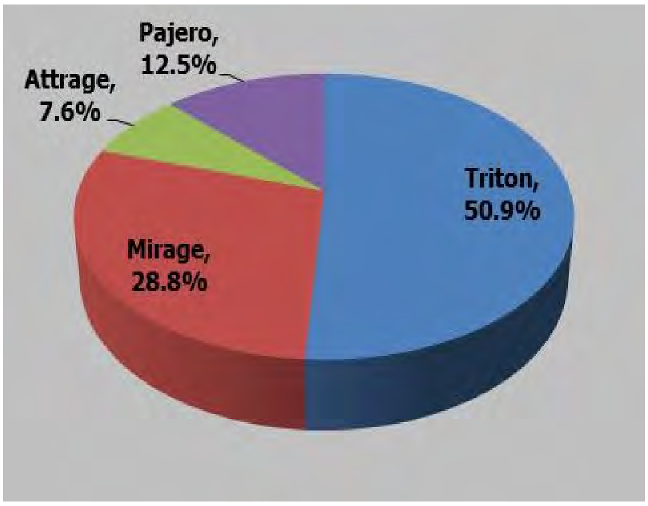
MMC was the first automaker to export out of Thailand and uses it as an exclusive base for the production of its main pick up models, the Triton and Pajero. MMC has also qualified both of its compact models, i.e. the Mirage and Attrage, for Thailand's eco car program which is a fast growing segment accounting for circa 12% of Thailand's TIV. The group controls the second largest share of Thailand's Eco-car segment (22%) via the Mirage and Attrage models while Nissan has an 18% share via the Almera and March (3rd largest share). Combined, Nissan-MMC can easily take top spot from Toyota which controls a 38% share in this segment via the Toyota Yaris. In Indonesia, MMC has yet to participate in the Low Cost Green Car (LCGC) program, while Nissan is re-introducing the Datsun brand for the program.

EXHIBIT 3: MMC SALES BY REGION



Source: AAF, MIDFR

EXHIBIT 4: MMC THAI TIV BY MODELS



Source: AAF, MIDFR

Market position could improve significantly. In Malaysia, MMC is represented by Mitsubishi Malaysia, a 52:48 JV between MMC and DRB-Hicom's unit, EON (NON-RATED). Performance has been pretty weak with just a 2.4% share of TIV but Nissan is the 4th largest player with an 8% share after the two national cars and Honda and Toyota.

On the flipside, MMC controls a 6% share in Thailand and a 9% share in Indonesia (vs. Nissan's 9% and 6% respectively) *(See Exhibit 3 and 4)*. Combined, Nissan-MMC's market share in Indonesia could leapfrog to 2nd largest at 15% share after Toyota-Daihatsu's 54% share, while for Thailand, Nissan-MMC's market share could improve to 14%, shifting it up to 3rd largest after Toyota (38% share) and Isuzu (18% share).

Implications on Malaysian autos?: Tan Chong (Nissan franchise holder and distributor for Malaysia) and DRB-Hicom (which owns a 48% stake in Mitsubishi Malaysia) are likely to be indirect beneficiaries, particularly if platform sharing is realised as this will accelerate new model introductions in the future. Meanwhile, the scale created from potential resource sharing should translate into cost savings which may be passed down to distributors like Tan Chong and Mitsubishi Malaysia in the form of cheaper CBUs or CKD kits.

Mitsubishi models are currently contract manufactured by DRB-Hicom, while Nissan models are assembled by Tan Chong, where Nissan only has a 5% strategic stake. It is uncertain how synergies in manufacturing can be structured for operations here as neither principle have a meaningful stake or control over production facilities in Malaysia. Nonetheless, any increase in production from new model introductions or increased volumes will still benefit both players. Export potential is unlikely as has been the case so far, as both OEMs have better control over the larger manufacturing facilities in Thailand.

We maintain NEUTRAL on the Auto sector given a muted demand outlook. Our top sector pick is Berjaya Auto (BUY, TP: RM2.50/share) underpinned by the following: (1) While there is considerable pressure from the stronger JPY, exposure to JPY imports is limited to CBUs while almost half of CY16 JPY exposure is fixed at RM3.45, (2) Aggressive model mix expansion, i.e. the CBU CX3, Mazda 6 CKD and upcoming CKD CX3, which will expand margins and volume, (3) An underleveraged balance sheet (FY16F net cash of RM252m which accounts for 10% of market cap) coupled with strong FCF yield of 7%, suggests special dividends and potential acquisitive growth, and (4) Potential value unlocking form the listing of BAuto Philippines. Ex-cash, BAuto trades at just 9.7x CY16F earnings.

We are still cautious on UMW (NEUTRAL, TP RM6.00/share). Valuation at 23x FY16F earnings is excessive amid rising cash flow and forecast risks. O&G losses are expected to extend into early FY16 at least, while Toyota TIV has remained weak and is suffering market share loss. Key earnings risk in the near-term will come from: (1) Renewal of rig contracts at unfavourable rates, i.e. spot rates are now 30%-35% lower than current contracts, (2) Extended idling of rigs which is a drain on cash flows and is driving losses for the O&G division, (3) Weak underlying demand for autos especially after the recent price hikes and plant diseconomies of scale which will pressure margins, and (4) Possible cash call at UMWOG which may require UMW to gear up to avoid dilution of its stake in the former.

EXHIBIT 5: MALAYSIA YTD-MARCH 2016 TIV SUMMARY

				Market share	
Marques	**YTD15**	**YTD16**	**YTD %**	**Mar-15**	**Mar-16**
Proton	27,682	19,225	-30.6%	16.4%	14.6%
Perodua	57,153	47,181	-17.4%	34.0%	35.9%
Toyota	16,241	10,216	-37.1%	9.6%	7.8%
Honda	22,145	18,777	-15.2%	13.2%	14.3%
Nissan	13,226	10,773	-18.5%	7.9%	8.2%
Mazda	3,372	3,552	5.3%	2.0%	2.7%
Others	28,483	21,531	-24.4%	16.9%	16.4%
Total	**168,302**	**131,255**	**-22.0%**	**100.0%**	**100.0%**

Source: MAA, MIDFR

VALUATION AND RECOMMENDATION

		Shr Price	EPS (sen)		PE (x)		P/BV	ROE	Div Yield	Target	Total
Companies	**Rating**	**(RM)**	**CY16F**	**CY17F**	**CY16F**	**CY17F**	**(x)**	**(%)**	**(%)**	**Price (RM)**	**Upside (%)**
B.Auto	Buy	2.22	19.0	19.8	11.7	11.2	3.5	35.7	4.2	2.50	16.8
Tan Chong	Neutral	2.05	5.2	8.1	39.4	25.3	0.6	2.7	0.8	2.50 UR	N/A
UMW	Neutral	6.26	27.6	27.1	22.7	23.1	1.4	5.0	1.6	6.00	-2.5
Sector average					***24.6***	***19.9***	***1.8***	***14.5***	***2.2***		

Source: Bloomberg, Companies, MIDFR ****UR: Under Review***

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.