midf RESEARCH

24 January 2018 | Sector Update

Automotive

***Maintain* POSITIVE**

Flattish 2017, growth seen for 2018

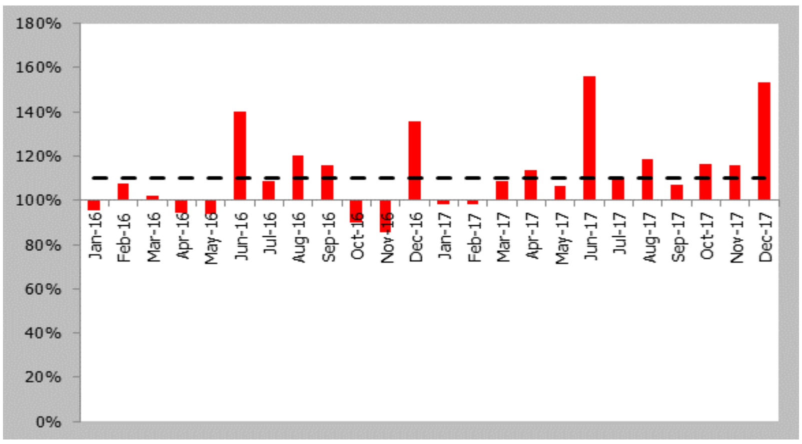
INVESTMENT HIGHLIGHTS

- **2017 TIV flattish**
- **MAA forecasts 2.3% 2018 TIV growth**
- **Bermaz Auto (BUY, TP: RM2.50/share) is our top pick for a solid 41% earnings CAGR, attractive 6% yield and value crystallisation of Philippines unit**
- **Our contrarian BUY (TP: RM6.00/share) on UMW is now Under Review, but thesis on earnings turnaround, balance sheet deleveraging and early cycle play into EEV-driven structural cost reduction intact**
- **MBM (BUY, TP: RM2.45/share) is a cheap proxy into Perodua's volume expansion and spillover on its parts manufacturing and Perodua dealership units. Attractive 39% earnings growth (FY18F) for less than half FY18F BV and a lean balance sheet (9% net gearing)**

MAA forecasts a 2.3% growth in 2018. December TIV registered at 54,729 units, bringing 2017 TIV to 576,635. This is broadly within expectations accounting for 98% of our 2017 estimates. We keep our FY18F TIV growth forecast of 1.7%yoy, though the actual number is tweaked down slightly to 586K given a slightly lower base in 2017. MAA projects a higher 2.3% growth to 590K for 2018.

Is discounting being rolled back? December TIV represented a 16%yoy decline – year-end sales this time around seem to be a lot weaker than usual. Industry production dropped by a much larger 26%yoy. While on the surface it may look as if consumer demand is weaker now, on the flip side, the numbers might suggest that the deep discounting in the market in the past 2 years is being rolled back as inventories in the system normalises. Sales-to-production ratio in 2017 in particular, has constantly been >100% and above a historical average of 110%. This indicates the industry is selling a lot more than it is producing and suggests inventories have been driven down quite substantially throughout 2017.

EXHIBIT 1: SALES TO PRODUCTION RATIO VS. HISTORICAL AVERAGE



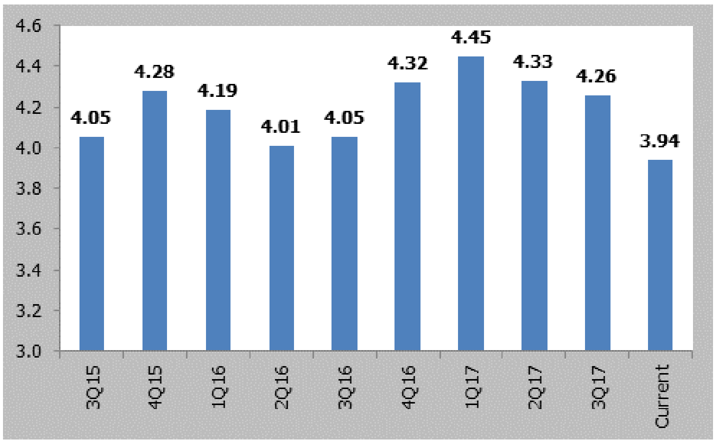
Source: Bloomberg, MIDFR

Perodua registered strongest month-on-month growth given full month benefit from the new MyVi. Bookings for the new MyVi (since launch) now stand at 36K units with >80% of bookings going towards the higher variants – this compares favourably versus management's conservative target of 6K/month MyVi volume. Some 11K units have been delivered so far. Mazda sales were weak in Dec17 despite its new CX5 but this is temporary as Mazda does not participate in year-end sales campaigns given its niche position in the market. This has been the trend historically and on a year-on-year basis, Mazda TIV is actually up by 18% (against the industry's 16% contraction).

Beneficiary of the stronger Ringgit. Since our last report, the Ringgit has strengthened further to RM3.94:USD and RM3.55:JPY(x100). The strong Ringgit is a big positive for auto players under our coverage and underpins our bullish sector call. UMW Toyota has large exposure to USD given that all its imported CKD kits and CBUs are transacted in USD. Given low localisation rates (of between 20%-60%) relative to the national makes (of 80%-95%), we estimate around half of total component costs are imported. Tan Chong is estimated to have circa 80% (of total imported cost) exposure to USD imports with the rest in JPY. Every 1% change in the USD impacts our FY18F by 4.7% for UMW (Group) and 64% for Tan Chong. As Tan Chong's earnings is close to break-even point it is bottomline is very sensitive to forex changes.

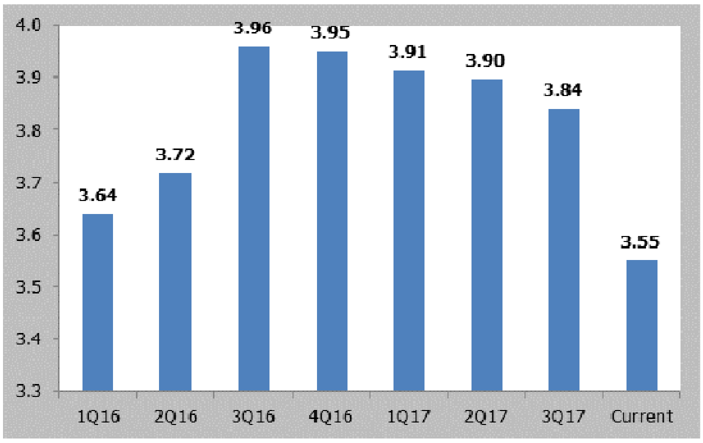
Bermaz Auto is a key beneficiary of the Ringgit strength against the JPY as its imports are 100% exposed to the latter; BAuto is exposed to the JPY via CBU imports, whereas CKDs i.e. the CX5 and Mazda 3 models are purchased at a fixed Ringgit price from 30%-owned Mazda Malaysia Sdn Bhd (MMSB), which is the importer and assembler of Mazda CKDs. To make this possible, MMSB absorbs JPY volatilities from CKD imports; which means that MMSB also benefits from the current Ringgit strength. We estimate that every 1% strengthening of the Ringgit against the JPY impacts BAuto's FY18F (FYE April) earnings by 3%. Perodua is another beneficiary given its exposure to the JPY (and partly USD). Every 1% change in the JPY impacts our FY18F by 1%. UMW is the largest local shareholder of Perodua with a 38% stake followed by MBM with an effective 22.6% stake.

EXHIBIT 2: QUARTERLY USD:RM TRENDS



Source: Bloomberg, MIDFR

EXHIBIT 3: QUARTERLY JPY:RM TRENDS



Source: Bloomberg, MIDFR

EXHIBIT 4: EARNINGS SENSITIVITY TO FOREX

	FY18F earnings impact for every 1% change in USD/JPY
UMW Holdings	4.7%
Tan Chong	64.0%
Bermaz Auto	3.0%
Perodua	1.0%

Source: MIDFR

- **BAuto (TP: RM2.50)** remains our top sector pick. Key catalysts over the next 12 months:
    1. **A 20%yoy growth in FY18F Mazda TIV** coupled with margin expansion driven by the new CX5 from 3Q18
    2. **Ringgit strength** against the JPY
    3. **A more than doubling in associate earnings contribution** to group (via 30%-owned Mazda Malaysia SB and 29%-owned Inokom) given export market expansion to South East Asia (ex-Vietnam) and re-acceleration in production for the domestic market.
    4. **Attractive dividend yield of 5%** underpinned by net cash which accounts for 12% of market cap and solid 6% FCFE yield (FY18F). Potential listing of Philippines unit will bump yields up further given possible special dividends.
    5. **Value unlocking from the listing of BAuto Philippines (BAP).** Current market cap attributes just 7x CY18F PE to BAuto's stake in BAP relative to the 15x indicative IPO valuation and historical sector valuation of 12x (for Malaysian autos). Ex-cash, BAuto trades at just 9x CY18F earnings.

- **Our contrarian BUY on UMW (TP: RM6.00/share) in now Under Review.** Key catalysts: (1) Demerger of O&G units deleverages balance sheet, drives UMW back into the black and allows better focus on core divisions (2) Reversal of prior years' market share loss, structural cost reduction and pricing advantage from UMW Toyota's EEV-focused strategy (3) Monetisation of UMW's 861 acres Serendah landbank which will unlock value of the asset – easily worth 40sen/share, or 6% of our SOP valuation (4) A more than quadrupling of M&E division earnings once its aerospace division reaches full scale production (5) An underleveraged balance sheet post UMWOG de-merger suggests room for acquisitive growth.

- **MBM Resources (BUY, TP: RM2.45/share) is a cheap proxy to Perodua**'s volume expansion and the spillover on its parts manufacturing and Perodua dealership units. Attractive 39%yoy earnings growth (FY18F) for less than half FY18F BV and on the back of a lean balance sheet (9% net gearing). Key catalysts: (1) Strong growth in Perodua TIV on the back of the new MyVi and potentially a new SUV to fill up a vacum in its model mix (2) A stronger Ringgit (3) A recovery in industry production driven by new national car launches.

- **We recently raised Tan Chong to a BUY (TP: RM2.05/share)** as a deep value play into the sector's earnings recovery driven by the strong Ringgit and a bottoming in market share. Having seen share price fall some 40% in the past 24 months, Tan Chong now trades at just 0.4x FY18F PBV (which is lower than even its historical trough PBV of 0.5x) amid a potential turnaround in earnings over the next few years. Key catalysts include: (1) Resumption of new model launch in FY18F (2) Sustained Ringgit strength (3) Further reduction in inventory levels.

EXHIBIT 4: DECEMBER 2017 TIV SUMMARY

									Market share	
Marques	**Dec-16**	**Nov-17**	**Dec-17**	**YoY**	**MoM**	**YTD16**	**YTD17**	**YTD %**	**Dec-16**	**Dec-17**
Proton	7,223	4,810	4,802	-33.5%	-0.2%	72,290	70,991	-1.8%	11.1%	8.8%
Perodua	24,625	16,636	20,180	-18.1%	21.3%	207,110	204,887	-1.1%	38.0%	36.9%
Toyota	7,347	6,763	7,238	-1.5%	7.0%	63,757	69,492	9.0%	11.3%	13.2%
Honda	11,461	10,482	11,221	-2.1%	7.1%	91,830	109,511	19.3%	17.7%	20.5%
Nissan	4,804	2,121	2,264	-52.9%	6.7%	40,706	27,154	-33.3%	7.4%	4.1%
Mazda	603	1,010	711	17.9%	-29.6%	12,493	9,730	-22.1%	0.9%	1.3%
Others	8,759	7,362	8,313	-5.1%	12.9%	91,939	84,870	-7.7%	13.5%	15.2%
Total	**64,822**	**49,184**	**54,729**	**-15.6%**	**11.3%**	**580,125**	**576,635**	**-0.6%**	**100.0%**	**100.0%**

Source: MAA, MIDF

EXHIBIT 5: DECEMBER 2017 TIV SUMMARY BY VEHICLE TYPE

Segment	**Dec-16**	**Nov-17**	**Dec-17**	**YoY**	**MoM**	**YTD16**	**YTD17**	**YTD %**
Passenger cars	57,593	43,152	48,077	-16.5%	11.4%	515,125	466,602	-9.4%
Commercial vehicles	7,229	6,032	6,652	-8.0%	10.3%	65,000	110,033	69.3%
Total	**64,822**	**49,184**	**54,729**	**-15.6%**	**11.3%**	**580,125**	**576,635**	**-0.6%**

Source: MAA, MIDF

EXHIBIT 6: DECEMBER 2017 TIV SUMMARY BY VEHICLE TYPE

									Market share	
Segment	**Dec-16**	**Nov-17**	**Dec-17**	**YoY**	**MoM**	**YTD16**	**YTD17**	**YTD %**	**Dec-16**	**Dec-17**
National cars	31,848	21,446	24,982	-21.6%	16.5%	279,400	275,878	-1.3%	49.1%	45.6%
Non-nationals	32,974	27,738	29,747	-9.8%	7.2%	300,725	300,757	0.0%	50.9%	54.4%
Total	**64,822**	**49,184**	**54,729**	**-15.6%**	**11.3%**	**580,125**	**576,635**	**-0.6%**		

Source: MAA, MIDF

VALUATION AND RECOMMENDATION

		Shr Price	**EPS (sen)**		**PE (x)**		**P/BV**	**ROE**	**Div Yield**	**Target**	**Total**
Companies	**Rating**	**(RM)**	**CY17F**	**CY18F**	**CY17F**	**CY18F**	**(x)**	**(%)**	**(%)**	**Price (RM)**	**Upside (%)**
Bermaz Auto	BUY	2.25	15.0	21.2	15.6	11.1	4.7	35.2	6.3	2.50	17.4
Tan Chong	BUY	1.80	3.1	9.0	58.9	20.0	0.3	(1.6)	0.0	2.05	13.9
UMW	BUY U.R.	6.95	12.7	32.2	50.9	20.1	0.9	5.4	0.0	6.00 U.R.	-13.7
MBM	BUY	2.40	25.9	31.5	9.3	7.6	0.5	5.5	2.8	2.45	4.9
Average					***25.3***	***12.9***	***1.6***	***11.1***	***2.3***		

Source: Bloomberg, Companies, MIDF ***U.R.: Under Review***

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% 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.