26 January 2018 | Sector Update

Automotive

***Maintain* POSITIVE**

Growth in check , benefits from stronger RM

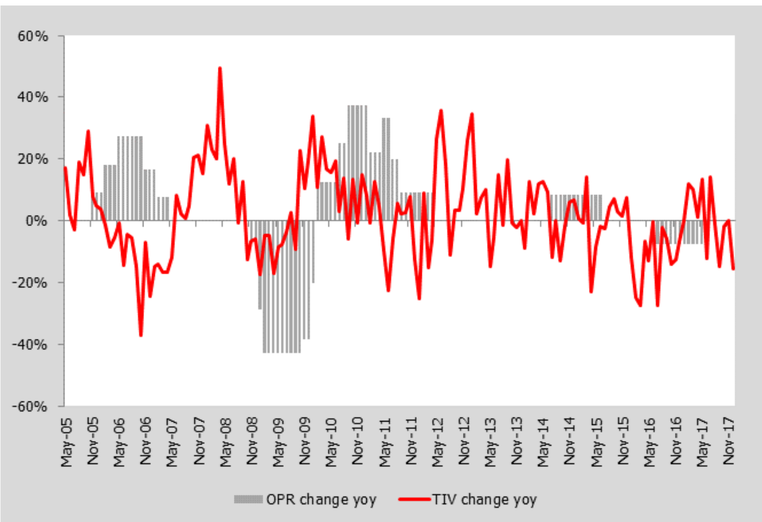
INVESTMENT HIGHLIGHTS

- **OPR hike not the start of a tightening cycle**
- **TIV growth in check provided minimal OPR fluctuation. Impact if any, hits national cars first.**
- **On flip side, sector benefits from stronger Ringgit post-hike**
- **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**
- **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. Tan Chong now trades at just 0.4x FY18F PBV amid a potential turnaround in earnings over the next few years**

Not the start of a tightening cycle. The OPR was hiked by 25bps to 3.25% yesterday. This is in line with MIDF Economics' view as industrial and trade activities across major and emerging economies remain on an upward trajectory. MIDF Economics' baseline view is for one rate hike in 2018. Importantly, the hike is seen as a step to normalise the degree of monetary accommodation rather than the beginning of a tightening cycle.

TIV growth kept in check provided minimal OPR fluctuation. Historically there has been inverted correlation between OPR changes and TIV movement as shown in Exhibit 1 - TIV growth tends to weaken or in circumstances where OPR is hiked sharply e.g. in Oct05-May06 period when OPR was hiked from 2.75% to 3.50% within a period of just 7 months, TIV shifted into contraction mode instead of just slow growth. Provided such sharp rate hike trend does not occur this time around (underpinned by MIDF Economics' view of just one rate hike in 2018), TIV should still register positive growth in 2018, especially after two consecutive year of contraction in 2016-17. On the contrary, small or gradual changes in OPR as seen in later years (2013-2016) had little impact on TIV growth. More importantly, our 1.7%yoy TIV growth forecast for 2018 already reflects a conservative TIV-GDP growth multiplier of 0.3x vs. a 15-year historical average of 0.5x and is slightly more conservative than MAI's and MAA's forecasts of 2% and 2.3% growth respectively.

EXHIBIT 1: INVERTED CORRELATION BETWEEN OPR CHANGE & TIV GROWTH



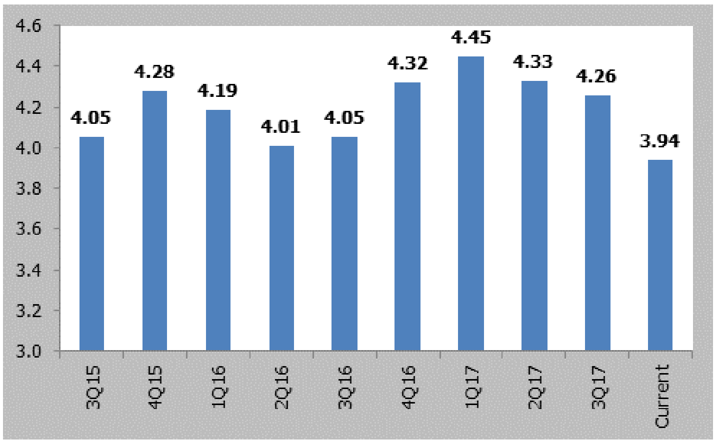
Source: Bloomberg, MIDFR

Impact if any, hits national cars first. National car segment customers are most price sensitive and as such are likely to be at the forefront of any impact to industry volumes – which at this point we expect to be manageable. The majority of non-national models are priced >RM75K and for Mazda specifically, more than half of sales are derived from the >RM120K price segment, which typically consist of customers with reasonably good credit profiles.

Beneficiary of the stronger Ringgit. On the flip side, the Ringgit strengthened further following the OPR hike to RM3.89: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, its bottomline is very sensitive to forex changes.

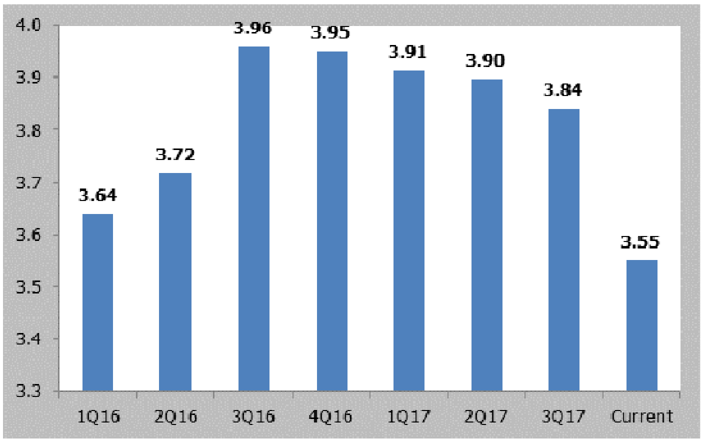
Bermaz Auto is a key beneficiary of the Ringgit strength against the JPY as its imports are 100% exposed to the latter; BAuto is exposed to the JPY via CBU imports, whereas CKDs i.e. the CX5 and Mazda 3 models are purchased at a fixed Ringgit price from 30%-owned Mazda Malaysia Sdn Bhd (MMSB), which 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.

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.