31 July 2018 | Sector Update

Automotive

***Maintain* POSITIVE**

Looking at an overhaul?

INVESTMENT HIGHLIGHTS

- **Government looking to set "certain standards" and restrict foreign car access**
- **EEV program was at the core of 2014 NAP**
- **ASEAN major car producers competing for R&D, EV technology and battery manufacturing investments**
- **Details still scarce to make a conclusive call. Maintain POSITIVE; key picks: Bermaz Auto (BUY, TP: RM2.70/share), UMW (BUY, TP: RM7.11), Tan Chong (BUY, TP: RM2.05) and MBM (BUY, TP: RM3.20)**

What's new? Prime Minister Tun Mahathir is reported to be looking at setting limits on foreign car imports. Tun indicated that Malaysia is currently too open in allowing all kinds of foreign cars into the country particularly after the 2014 NAP. Tun also indicated that the Government will ensure any measures will comply with free trade agreements and is considering restrictions in terms of standards and look into weaknesses of the local industry that require protecting.

A re-look at the 2014 NAP. Details are still vague at this stage to take a stand. However, at the core of the 2014 NAP was the Energy Efficient Vehicle Program (EEV). Prior to 2014, there was a freeze on issuance of new manufacturing license except for cars >1.8 litre engine capacity and priced above RM150K. This freeze was abolished under NAP 2014 provided the models to be manufactured qualify as an EEV.

EXHIBIT 1: QUALIFICATION REQUIREMENT FOR MALAYSIA EEV PROGRAM

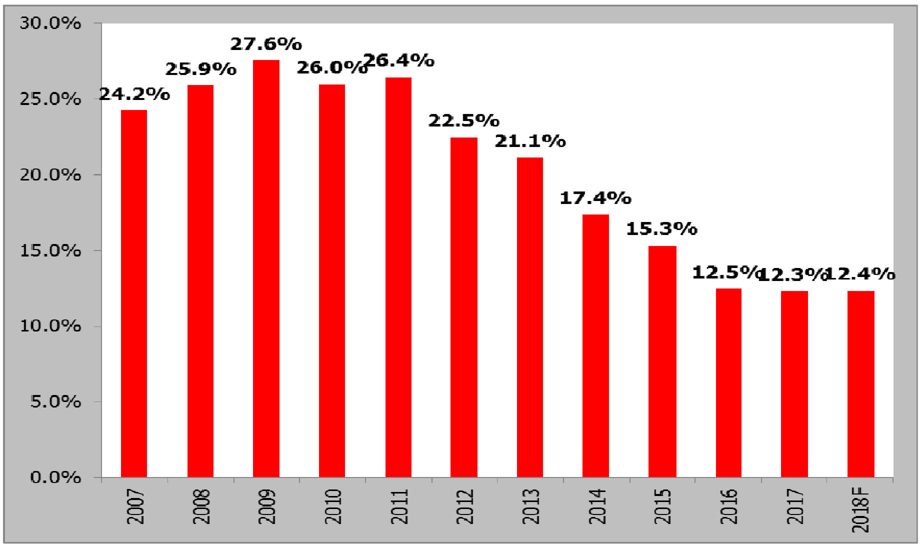
Segments	Kerb weight (kg)	Fuel efficiency requirement (litre/100km)	Details
A	<800	4.5	Micro car
	801 - 1000	5.0	City car
B	1001 - 1250	6.0	Super minicar
C	1251 - 1400	6.5	Small family car
D	1401 - 1550	7.0	Large family car / Compact executive car
E	1551 - 1800	9.5	Executive car
F	1801 - 2050	11.0	Luxury car
J	2051 - 2350	11.5	Large 4x4
Others	2351 - 2500	12.0	Others

Source: MAI, MIDF

EEV did facilitate new investments, to be fair. To recap, the EEV program is Malaysia's version of a green car program, which is a more comprehensive version which cuts across all vehicle segments compared to Thailand's Eco Car program and Indonesia's Low Cost Green Car program which are more rigid and focused on the small car segment. Models that qualify as an EEV and are locally assembled are allowed customised incentives (of which the bulk revolves around duty rebates for non-nationals). The incentives increase along with localisation depth. This allowed more opportunity for foreign cars to gain a more competitive cost base than previously and had induced new investments into local manufacturing lines and localisation of components over the past 4 years.

Marked stepdown in Proton's market share. Whether coincidentally or not, since 2014, there has also been a marked stepdown in Proton's market share, whereas on the contrary, Perodua's market share saw little change. However, not all early cycle beneficiaries of the EEV program were moving into national car territory. Bermaz Auto for example is very focused on the C-segment SUV segment priced >RM130K with very little exposure in the <RM100K price segment. In fact Bermaz Auto is now the largest CBU exporter out of Malaysia being one of Mazda's regional hub. Honda was one of the largest beneficiaries of the EEV program, more than doubling its production in Malaysia to 100K from 40K prior to 2014 and introducing locally assembled and EEV-qualified models such as the Jazz and the City at more competitive pricing post-2014 NAP. UMW Toyota was late to join the EEV bandwagon having only qualified the Camry, and more recently the Vios with an updated powertrain and drivetrain.

EXHIBIT 2: PROTON MARKET SHARE SAW MARKED STEP DOWN SINCE 2014



Source: MAA, MIDF

Looking at an overhaul? While it is uncertain if the EEV program will be entirely phased out or if there is intention to overhaul the program, Tun Mahathir had indicated of the Government's intention to look at "certain standards" to restrict foreign car access into the country. **Other possible means** may include **(1) Re-looking at the minimum standards for localisation** which from our channel checks, is set at 40% (though there has been leeway provided to this standard), in line with AFTA requirement for import duty free movement of vehicle products within the region **(2) Requiring selective critical parts** to be locally manufactured **(3) Rewarding R&D** that is done domestically **(4)** Requiring the foreign OEMs to **consider Malaysia as a regional hub**. These could pave the way for deeper, more meaningful localisation and enhance technology transfer. On the other hand, Malaysia too **needs to develop more Level 4 and Level 5 vendors** to enhance the industry's competitiveness.

More importantly, all three of ASEAN's major car producers (Thailand, Indonesia, Malaysia) are competing to lock in: (1) R&D, (2) Battery manufacturing facilities, (3) EV development investments from the foreign OEMs. The way things are developing, it looks like Malaysia is going down the national car route to compete for this (via a foreign partner).

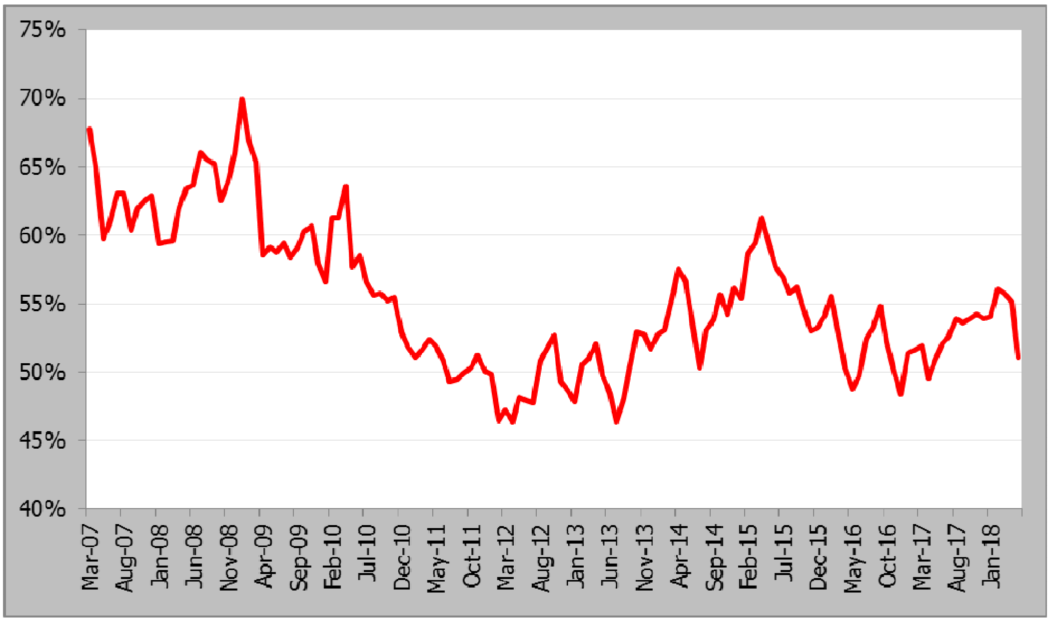
Our brief take of the brief comments. Briefly, if the move involves outright restriction even on well localised CKD models, this will definitely have an impact on the industry, create an unlevel playing field and stunt foreign investment growth into the sector. Such a move is akin to allowing national cars to solely drive sector growth in the future, which requires a much larger market than just domestic for volume competitiveness. While we are not in the position to determine which is right or wrong (and this would very much depend on the actual plans which is still very vague at this juncture), the latter looks to suggests a major overhaul of the current auto sector policy which is driven by the introduction of the EEV program in 2014. This is just our brief take pending actual details to be ironed out on the future direction of the industry which includes a detailed plan for an ASEAN car or a third national car. At this point, details are simply too scarce to make a conclusive call. Pending the ironing out of details, we maintain our OVERWEIGHT call on the sector.

VALUATION AND RECOMMENDATION

		Shr Price	EPS (sen)		PE (x)		P/BV	ROE	Div Yield	Target	Total
Companies	**Rating**	**(RM)**	**CY18F**	**CY19F**	**CY18F**	**CY19F**	**(x)**	**(%)**	**(%)**	**Price (RM)**	**Upside (%)**
Bermaz Auto	BUY	2.26	16.7	20.1	13.5	11.2	4.9	35.2	7.1	2.70	26.6
Tan Chong	BUY	1.82	3.1	9.0	59.6	20.2	0.4	1.1	1.8	2.05	14.4
UMW	BUY	6.40	31.7	47.5	20.2	13.5	1.1	5.4	2.4	7.11	13.5
MBM	BUY	2.37	25.9	31.5	9.2	7.5	0.5	5.5	3.0	3.20	38.0
Average					***14.3***	***10.7***	***1.7***	***11.8***	***3.6***		

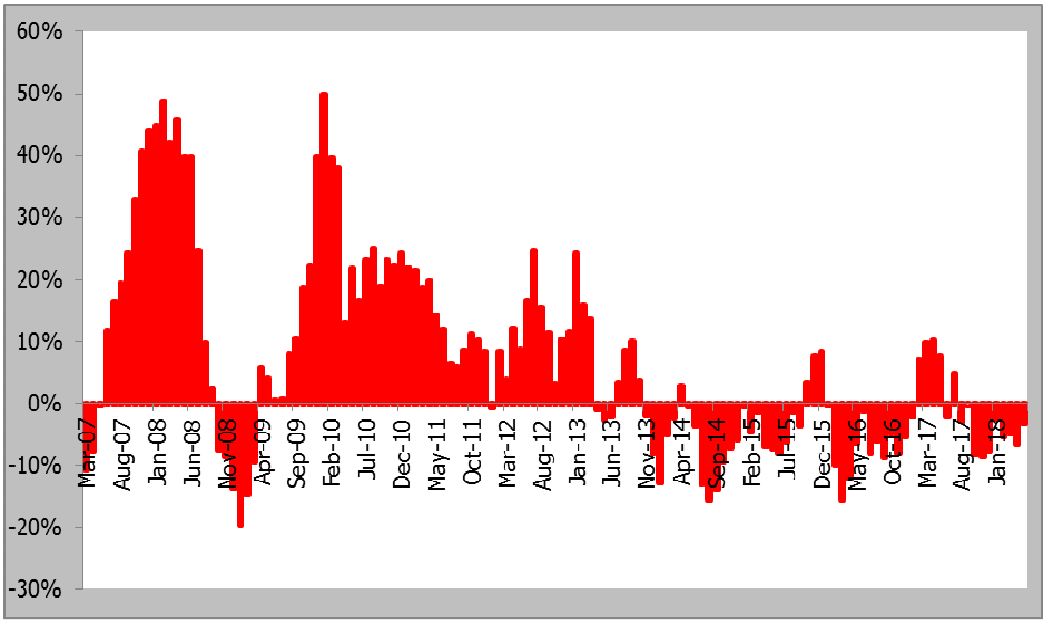
Source: Bloomberg, Companies, MIDF

EXHIBIT 3: HIRE PURCHASE LOAN APPROVAL RATE (3-MTH MOVING AVERAGE)



Source: BNM, MIDF

EXHIBIT 4: HIRE PURCHASE LOAN APPLICATION GROWTH (3-MTH MOVING AVERAGE)



Source: BNM, MIDF

Hafriz Hezry
hafriz.hezry@midf.com.my
03-2173 8392

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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.