**20 April 2016 | Sector Update**

# Automotive

***Maintain* NEUTRAL**

## *March should mark bottom in growth trend*

### INVESTMENT HIGHLIGHTS

- **Total industry volume contraction deepened in March against an inflated base last year**
- **March contraction should mark bottom, but waiting lists are still scarce and sales are still heavily incentivised**
- **Maintain NEUTRAL on autos given a muted demand outlook but sustained strength of the Ringgit could trigger upgrades further out**
- **Berjaya Auto (BUY, TP: RM2.60/share) is our top sector pick and we remain NEUTRAL on UMW (TP: RM6.00/share)**

**Contraction widened in February.** Total industry volume (TIV) saw a deeper 28%yoy drop (vs. Feb's 25%yoy contraction) to 48,800 units in March 2016. However, this has to be taken in context with the inflated March 2015 numbers which saw a purchasing rush by consumers on expectations of a price hike post-GST as well as massive run-out of inventories by dealers ahead of the GST implementation in April 2015. As a recap, dealers were rushing to clear off old inventories (which were purchased under the previous sales tax regime) as only manufacturers were allowed full refunds of the sales tax once the GST system came into place. Dealers were only allowed partial refunds, which would have seen their margins significantly crimped if the old inventories were not cleared before the GST implementation.

Additionally, the weak March 2016 TIV could have been partly due to Proton's price hike (of between RM312 and RM2021) which was implemented from late February 2016. Proton saw the deepest contraction in March (-47%yoy) and was also the only player to register a contraction (-7%mom) on sequential basis vs the industry's +29%mom, which came off an exceptionally short working month in February. While we think March's -28%yoy should mark a bottom in TIV contraction, this does not necessarily mean a meaningful recovery will come soon as waiting lists are still scarce while sales are still heavily incentivised.

**Crossing fingers for a 2H recovery, but downside bias to forecasts.** Annualised 3M16 TIV would have only accounted for 79% of our 2016F TIV of 666K units, but it is too early to conclude the extent of a downgrade that is required at this point until there is more stability in the market. Our recent meetings suggest that players are expecting demand to recover in 2H16 and the weak TIV to persist up till March-April period. Most of the new launches by the major players are targeted from 2Q16 onwards, i.e. Toyota's IMV models. Mazda too, is only likely to launch CKD (completely knocked down) models from mid-2016 onwards.

**Toyota and Nissan now neck-to-neck.** Toyota is now neck-to-neck with Nissan in terms of market share (i.e. 8.9% market share and 2nd largest in the non-national segment). Toyota TIV recovered slightly in March at 4,319 units, but this is still a far cry from the typical 7,000 – 8,000 monthly TIV it used to register. The new Hilux is scheduled to be launched in April 2016 and we expect to see some sort of volume recovery thereafter. Nonetheless, we see potential downside to our FY16F Toyota TIV of 92,572 units. Toyota needs to register average monthly sales of 9,150 units for the remainder of the year to meet our forecast vs. the average 3,405 units/month so far this year.

**CX5 facelift drove a strong recovery for Mazda.** Mazda sales recovered to 8,133 units against a weak February, which saw a temporary gap in CX5 sales following the run out of the old model in the Dec-Jan period. March TIV is likely to have reflected the facelift CX5 deliveries (launched in late February 2016), which is targeted to garner volumes of 4,500 – 5,000 units/month, or 55% - 60% of Mazda's March TIV.

**We maintain NEUTRAL on the auto sector** given a muted demand outlook. Our top sector pick is Berjaya Auto (BUY, TP: RM2.50/share): (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, and (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. Ex-cash, BAuto trades at just 9.7x CY16F earnings.

**We are still cautious on UMW** (NEUTRAL, TP RM6.00/share). Valuation at 25x 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 1: MARCH 2016 TIV SUMMARY**

| | | | | | | | | | Market share | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Marques** | **Mar-15** | **Feb-16** | **Mar-16** | **YoY** | **MoM** | **YTD15** | **YTD16** | **YTD %** | **Mar-15** | **Mar-16** |
| Proton | 10,528 | 5,947 | 5,535 | -47.4% | -6.9% | 27,682 | 19,225 | -30.6% | 16.4% | 14.6% |
| Perodua | 22,497 | 14,014 | 17,629 | -21.6% | 25.8% | 57,153 | 47,181 | -17.4% | 34.0% | 35.9% |
| Toyota | 7,187 | 2,917 | 4,319 | -39.9% | 48.1% | 16,241 | 10,216 | -37.1% | 9.6% | 7.8% |
| Honda | 9,581 | 5,616 | 7,418 | -22.6% | 32.1% | 22,145 | 18,777 | -15.2% | 13.2% | 14.3% |
| Nissan | 5,005 | 2,773 | 4,350 | -13.1% | 56.9% | 13,226 | 10,773 | -18.5% | 7.9% | 8.2% |
| Mazda | 1,503 | 782 | 1,416 | -5.8% | 81.1% | 3,372 | 3,552 | 5.3% | 2.0% | 2.7% |
| Others | 11,009 | 5,815 | 8,133 | -26.1% | 39.9% | 28,483 | 21,531 | -24.4% | 16.9% | 16.4% |
| **Total** | **67,310** | **37,864** | **48,800** | **-27.5%** | **28.9%** | **168,302** | **131,255** | **-22.0%** | **100.0%** | **100.0%** |

*Source: MAA, MIDFR*

**EXHIBIT 2: MARCH 2016 TIV SUMMARY BY SEGMENT**

| **Segment** | **Mar-15** | **Feb-16** | **Mar-16** | **YoY** | **MoM** | **YTD15** | **YTD16** | **YTD %** |
|---|---|---|---|---|---|---|---|---|
| Passenger cars | 59,318 | 34,126 | 43,247 | -27.1% | 26.7% | 148,932 | 117,373 | -21.2% |
| Commercial vehicles | 7,992 | 3,738 | 5,553 | -30.5% | 48.6% | 19,370 | 13,882 | -28.3% |
| **Total** | **67,310** | **37,864** | **48,800** | **-27.5%** | **28.9%** | **168,302** | **131,255** | **-22.0%** |

*Source: MAA, MIDFR*

## EXHIBIT 3: MARCH 2016 TIV SUMMARY BY SEGMENT

| | | | | | | | | | Market share | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Segment** | **Mar-15** | **Feb-16** | **Mar-16** | **YoY** | **MoM** | **YTD15** | **YTD16** | **YTD %** | **Mar-15** | **Mar-16** |
| National cars | 33,025 | 19,961 | 23,164 | -29.9% | 16.0% | 84,835 | 66,406 | -21.7% | 50.4% | 50.6% |
| Non-nationals | 34,285 | 17,903 | 25,636 | -25.2% | 43.2% | 83,467 | 64,849 | -22.3% | 49.6% | 49.4% |
| **Total** | **67,310** | **37,864** | **48,800** | **-27.5%** | **28.9%** | **168,302** | **131,255** | **-22.0%** | | |

*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 | 2.20 | 19.0 | 19.8 | 11.6 | 11.1 | 3.5 | 35.7 | 4.2 | 2.50 | 17.8 |
| Tan Chong | Neutral | 2.42 | 5.2 | 8.1 | 46.5 | 29.9 | 0.6 | 2.7 | 0.8 | 2.50 | 4.1 |
| UMW | Neutral | 6.89 | 27.6 | 27.1 | 25.0 | 25.4 | 1.4 | 5.0 | 1.5 | 6.00 | -11.4 |
| ***Sector average*** | | | | | ***27.7*** | ***22.1*** | ***1.8*** | ***14.5*** | ***2.2*** | | |

*Source: Bloomberg, Companies, MIDFR*

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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. |