26 February 2018 | Sector Update

Automotive

***Maintain* POSITIVE**

Mazda is back with vengeance

INVESTMENT HIGHLIGHTS

- **Flattish start but Mazda well outperforms industry with 83%mom growth**
- **Peugeot looking to acquire controlling stake in Naza's Gurun plant**
- **Bermaz Auto (BUY, TP: RM2.70/share) is our top pick for a solid 35% earnings CAGR and attractive 7% yield**
- **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)**
- **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**

Flattish start. January TIV was flattish registering a marginal 0.2%yoy contraction to 44,575 units. On a sequential basis, TIV fell 19%mom but this is normal against an inflated campaign driven December sales. Among the major players, the sequential weakness was across the board with the exception of Mazda. On a yoy basis, Mazda, Nissan and Perodua led the growth, while Proton and Toyota were the key drag.

Mazda outperforms industry. Mazda bucked industry trends, growing by some 62%yoy and 83%mom to 1300 units. This is close to its historical high of 1300-1400 units/month (excluding the pre-GST buying rush in 2015). The volume strength was driven by a resumption in purchases of the new CX5 moving into the New Year on top of still strong underlying demand for the model. The new CX5 entails >900 outstanding bookings, despite an additional RM1000 hike in price across all variants since Jan2018. Perodua also registered strong growth (+25%yoy) driven by 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.

Peugeot eyeing larger regional presence? Our channel checks suggest that Peugeot is acquiring a controlling 56% stake in Naza Automotive Manufacturing's (NAM) Gurun plant. This is also echoed by news reports over the weekend that a global carmaker intends to take up a controlling stake in the plant. Naza is likely to remain in control of distribution while manufacturing will be controlled by the French adopting a somewhat similar structure as BAuto (BUY, TP: RM2.70) and Perodua. Established in 2004, Naza has invested some RM700m into the plant which entails a 50K/annum capacity (on 2 shift) built on 148acres of land. However, we estimate the plant is currently grossly underutilised at well below 40% utilisation rate.

The PSA Group was last year reported to have put in a bid to acquire a stake in Proton but eventually lost out to Geely. In fact, that was not the first time the PSA group has expressed interest to acquire Proton. Back in 2011-2012, the PSA Group was also rumoured to have submitted a proposal to acquire and turnaround Proton by among others, making use of Proton's underutilised manufacturing facilities. While Peugeot already has an existing assembly arrangement with NAM and NAM is underutilised, deep localisation and advanced manufacturing/assembly requires the transfer of key technologies and processes. As such foreign OEMs are usually reluctant to share critical technology unless it attains a controlling stake. Once more advanced manufacturing processes is adopted and deep localisation is achieved, it makes sense for a foreign OEM to make the plant a regional hub. It is a similar case for BAuto which only owns a 30% stake in its manufacturing unit with the rest controlled by principal, Mazda Corporation. BAuto's manufacturing unit is now the largest exporter of CBUs out of Malaysia.

EXHIBIT 1: NAZA GURUN PLANT LAYOUT

Source: Various, MIDFR

Beneficiary of the stronger Ringgit. 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: 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: RM2.70) remains our top sector pick. Key catalysts over the next 12 months:

1. **An 11%yoy Mazda TIV growth** (FY19F) coupled with margin expansion driven by full year impact of new CX5 from 3QFY18 onwards
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. **Launch of CBU CX8** in 2QCY18 and CKD variants in CY19F.
5. **Attractive dividend yield of 7%** - net cash accounts for 10% of market cap coupled with solid 9% FCFE yield (FY19F). Our payout assumption is capped at 80% vs. historical 80%-113% payout.

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: JANUARY 2018 TIV SUMMARY

									Market share	
Marques	**Jan-17**	**Dec-17**	**Jan-18**	**YoY**	**MoM**	**YTD17**	**YTD18**	**YTD %**	**Jan-17**	**Jan-18**
Proton	7,207	4,802	4,783	-33.6%	-0.4%	7,207	4,783	-33.6%	16.1%	10.7%
Perodua	14,203	20,180	17,693	24.6%	-12.3%	14,203	17,693	24.6%	31.8%	39.7%
Toyota	5,811	7,238	3,564	-38.7%	-50.8%	5,811	3,564	-38.7%	13.0%	8.0%
Honda	8,594	11,221	8,133	-5.4%	-27.5%	8,594	8,133	-5.4%	19.2%	18.2%
Nissan	1,555	2,264	2,008	29.1%	-11.3%	1,555	2,008	29.1%	3.5%	4.5%
Mazda	804	711	1,300	61.7%	82.8%	804	1,300	61.7%	1.8%	2.9%
Others	6,493	8,313	7,094	9.3%	-14.7%	6,493	7,094	9.3%	14.5%	15.9%
Total	**44,667**	**54,729**	**44,575**	**-0.2%**	**-18.6%**	**44,667**	**44,575**	**-0.2%**	**100.0%**	**100.0%**

Source: MAA, MIDF

EXHIBIT 5: JANUARY 2018 TIV SUMMARY BY VEHICLE TYPE

Segment	Jan-17	Dec-17	Jan-18	YoY	MoM	YTD17	YTD18	YTD %
Passenger cars	40,294	48,077	39,982	-0.8%	-16.8%	40,294	39,982	-0.8%
Commercial vehicles	4,373	6,652	4,593	5.0%	-31.0%	4,373	4,593	5.0%
Total	**44,667**	**54,729**	**44,575**	**-0.2%**	**-18.6%**	**44,667**	**44,575**	**-0.2%**

Source: MAA, MIDF

EXHIBIT 6: JANUARY 2018 TIV SUMMARY BY VEHICLE TYPE

									Market share	
Segment	**Jan-17**	**Dec-17**	**Jan-18**	**YoY**	**MoM**	**YTD17**	**YTD18**	**YTD %**	**Jan-17**	**Jan-18**
National cars	21,410	24,982	22,476	5.0%	-10.0%	21,410	22,476	5.0%	47.9%	50.4%
Non-nationals	23,257	29,747	22,099	-5.0%	-25.7%	23,257	22,099	-5.0%	52.1%	49.6%
Total	**44,667**	**54,729**	**44,575**	**-0.2%**	**-18.6%**	**44,667**	**44,575**	**-0.2%**		

Source: MAA, MIDF

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	2.25	16.7	20.1	13.3	11.0	4.7	35.2	7.1	2.70	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.