

12 April 2017 | Sector Update

Automotive

Maintain NEUTRAL

Players reacting to duty hike

INVESTMENT HIGHLIGHTS

- **Players raised pricing in reaction to excise duty hike for MPVs/SUVs <1.5 litre**
- **Honda BRV is largest player in the segment, least cost impact on Perodua Alza**
- **Bermaz Auto (BUY, TP: RM2.50/share) remains our top pick for company-specific catalysts and special dividends**
- **UMW remains a contrarian BUY (TP: RM6.50/share) as the stock is undervalued amid a turnaround in earnings, balance sheet deleveraging and management's renewed focus on EEVs for its auto division**


Excise duties raised. The Royal Customs recently increase excise duties for MPV/SUVs with 1.5 litre and below engine capacity from 60% to 65%. Excise duties are charged regardless whether the cars are CBU or CKD. However, CKD units enjoy excise duty rebates depending on depth of localisation. There will be a small snowball effect as input GST cost (which is charged on aggregate imported component cost plus import and excise duties) will also ultimately increase. This is a surprise move and we understand that Malaysian Automotive Association (MAA) is seeking clarification from the Customs Department on the matter.

Implications on players. Several key models in the market are impacted by the move i.e. Honda BRV, Perodua Alza, Toyota Avanza, Toyota Sienta and Toyota Rush. All the Toyota models are CBUs from Indonesia while the BRV and Alza are locally assembled. As a reaction, players have already started to raise pricing for these models. Our ground checks yesterday suggest that Toyota has already raised pricing for the Avanza by RM3700 – RM4000, the Sienta by RM4000 and the Rush by RM4990 – RM6000. Our chat with Honda dealers in town suggests that pricing of the BRV might be increased by RM4000 effective 1st May. Pricing of the Alza has yet to be revised nor is there any indication that it will be revised based on our checks with DMMS dealers. The Alza however, is very highly localised (typically 90% localisation rate for Perodua models) and the impact on cost should be much smaller relative to the non-national models impacted (See Exhibit 2).

BRV now has the largest share. The B-segment MPV market, which is the key segment impacted by the increase in duties, is mainly dominated by the Honda BRV and Perodua Alza. Our estimates suggests that the BRV now controls the largest share (51%) of the B-segment MPV market followed by the Perodua Alza at 41%. The Avanza and Sienta account for just 6% of the segment's market share. The move to increase duties for this segment came hot on the heels of the launch of the BRV which has now overtaken sales of the Alza, though this has to be taken in context with the Alza's status at the tail end of its lifecycle and cannibalisation by the new Perodua Bezza, to a certain extent.

Is there a silver lining? The impact of potentially lower volumes as a result of passing on the incremental duty cost has to be compensated by higher margins. As such, we would not rule out players raising pricing (or reducing existing promotional rebates) for the models affected beyond the actual incremental duty and input GST cost. Our estimates suggests incremental costs of between RM223 to RM2,253 for the MPV models affected versus the average RM4000 price increase announced in the market. As such, while we are cautious on the impact on volumes, the incremental margins should provide a buffer for players affected by the increase in duties. Toyota is a small player in the segment with models affected accounting for just 5%-6% of its TIV.

Bermaz Auto (BUY, TP: RM2.50/share) is still our top sector pick: Key share price catalysts over the next 12 months: **(1) Attractive dividend yield of 9%** underpinned by net cash which accounts for 12% of market cap and solid 8% FCFE yield (FY17F). The listing of BAuto Philippines will bump yields up further given potential one-off special dividends. **(2) Value unlocking from the listing of BAuto Philippines (BAP).** Current market cap attributes practically no value to BAuto's stake in BAP relative to the 16x indicative IPO valuation and historical sector valuation of 12x (for Malaysian autos). Ex-cash, BAuto trades at just 9x CY17F earnings. **(3) A more than doubling in associate earnings contribution** to group (via 30%-owned Mazda Malaysia SB and 29%-owned Inokom) given a massive export market expansion which will triple MMSB's prospective market. **(4) Launch of the new CX5 and new CX9** which will drive a recovery in volumes and margins.

UMW remains a contrarian BUY at unchanged TP of RM6.50/share. (1) Demerger of O&G units will deleverage balance sheet, drive earnings turnaround and allow better focus on core divisions (2) Reversal of prior years' market share loss given UMW Toyota's renewed focus on EEV models which will drive structural cost reduction and price advantage (3) A more than quadrupling of M&E division earnings once its aerospace division reaches full scale production (4) UMW is now underowned and at 12x FY18F earnings, trades below its historical average PER of 13.5x. 

VALUATION AND RECOMMENDATION

Company	Rating	Shr Price (RM)	EPS (sen)		PE (x)		P/BV (x)	ROE (%)	Div Yield (%)	Target Price (RM)	Total Upside (%)
			CY16 F	CY17 F	CY16 F	CY17 F					
B. Auto	BUY	2.05	17.1	20.5	12.0	10.0	4.5	40.2	8.6	2.50	30.6
Tan Chong	NEUTRAL	1.80	-19.8	-16.2	-9.1	-11.1	0.5	-1.5	0.0	1.90	5.6
UMW	BUY	6.10	31.7	48.6	19.2	12.5	0.9	-0.2	0.0	6.50	6.6
Sector average					15.6	11.3	2.0	12.8	2.9		

Source: Bloomberg, Companies, MIDFR

EXHIBIT 1: B-SEGMENT MPV ESTIMATED MARKET SHARE

B-segment MPV key models	Share
Alza	40.8%
BRV	51.2%
Sienta	3.4%
Avanza	2.7%

Source: Various, MIDFR

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EXHIBIT 2: ESTIMATED COST IMPACT ON KEY B-SEGMENT MPV MODELS

Perodua Alza CKD		RM		
Selling price		52,332		
Assumed gross margin	14%	7,409		
Total cost plus duties		44,923	Incremental cost at 65% excise duty (RM)	Percent cost increase
Plus: Input GST	6%	7,123	223	0.4%
Plus: Excise duty	60%	6,720		
Estimated localisation rate	90%	4,200		
Import duty	0%	-		
Estimated car cost (local + imported content)		42,000		
Toyota Avanza CBU				
Selling price		65,833		
Assumed gross margin	15%	9,865		
Total cost plus duties		55,968	Incremental cost at 65% excise duty (RM)	Percent cost increase
Plus: Input GST	6%	55,968	1,749	2.7%
Plus: Excise duty	60%	52,800		
Estimated localisation rate	0%	33,000		
Import duty	0%	-		
Estimated car cost (local + imported content)		33,000		
Toyota Sienta CBU				
Selling price		84,687		
Assumed gross margin	15%	12,607		
Total cost plus duties		72,080	Incremental cost at 65% excise duty (RM)	Percent cost increase
Plus: Input GST	6%	72,080	2,253	2.7%
Plus: Excise duty	60%	68,000		
Estimated localisation rate	0%	42,500		
Import duty	0%	-		
Estimated car cost (local + imported content)		42,500		
Honda BRV CKD				
Selling price		78,172		
Assumed gross margin	15%	11,695		
Total cost plus duties		66,477	Incremental cost at 65% excise duty (RM)	Percent cost increase
Plus: Input GST	6%	35,277	1,102	1.4%
Plus: Excise duty	60%	33,280		
Estimated localisation rate	60%	20,800		
Import duty	0%	-		
Estimated car cost (local + imported content)		52,000		

Source: Various, MIDFR

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STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> 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 <i>fall</i> 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.