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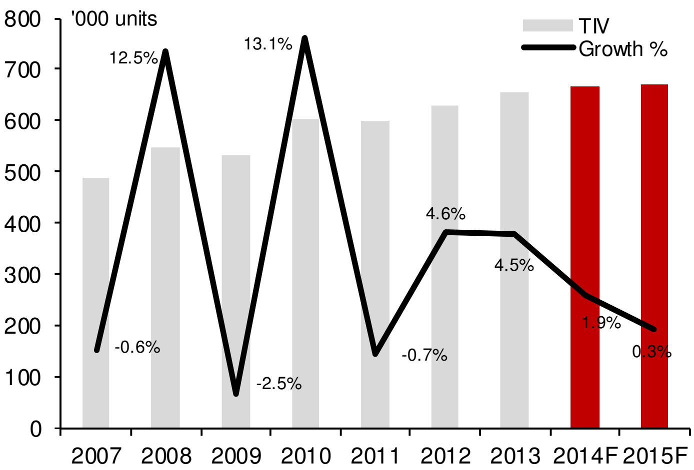
Outlook: Automotive Sector

Taking a breather – a deeper look at the sector

***Maintain* NEUTRAL**

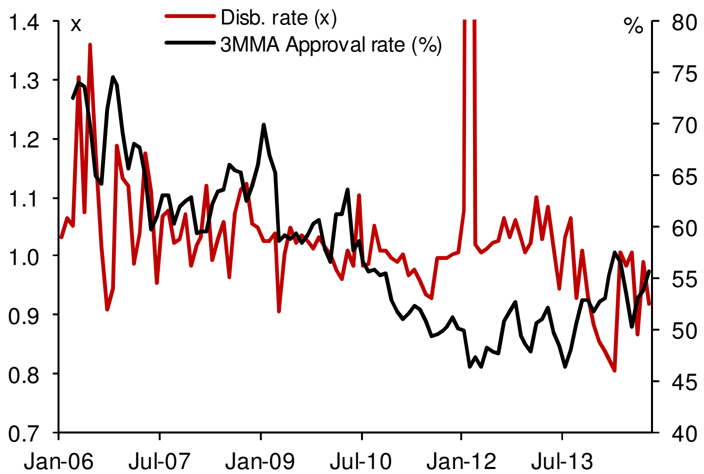
- While we believe that earnings risks are largely priced in, we remain NEUTRAL on the sector. Within our coverage, we retain our BUY rating on MBM Resources (MBM) and NEUTRAL on UMW Holdings (UMW) while we recently downgraded Tan Chong Motor Holdings (TCM) to NEUTRAL. We also introduce our FY15 TIV target of 670k units which implies a +0.3%yoy growth from 668k units for FY14F.
- The TIV figure for the first ten month of 2014 stood at 546,492 units, i.e. 82% of our 668k target for whole of 2014. This implies that the November and December TIV figures would need to average at >60k units/month or grow +7.8%yoy for our FY14 target to be met. While current sentiment dictates that our 2014 TIV target is likely to be missed, we believe the fairly lacklustre October TIV figure was subject to backlog in deliveries amidst the longer processing time for HP loan approval.
- In BNM's recently-released monthly statistics, there was an uptick in HP loan approval rates for October to 57%. This is 3ppts above the FY14 run-rate of 54% and +6ppts increase from the 51% loan approval rate in September. Meanwhile, October loan disbursement rate eased to 92% from 99% in September. This implies that there could be some delay in vehicle deliveries which supports our argument of strong TIV figures in the last 2 months of the year.

TIV projection



Source: MAA, MIDFR calculations

HP Loan approval vs Loan disbursement rate



Source: BNM

- In FY15, we expect a marginal TIV growth of +0.3%yoy to 670k units. The easing growth compared to prior years largely reflects the potential impact on disposable income under the new consumption tax and subsidy structure. We are not expecting a contraction in TIV given that Malaysia's economic outlook is still positive with GDP growth expected to be in a range of between 5-6% for FY15.
- We also expect demand for new vehicles to be decent on full year contribution from key models launched in FY14 such as the Perodua Axia, Proton Iriz, Mazda 3, Nissan Sylphy, Nissan Teana, Toyota Altis, Honda City and Honda Jazz, to name a few. In addition, we expect buying interest to sustain with new model launches in FY15 such as:
  - **Passenger car:** Perodua Myvi facelift, Mazda 2, Mazda 3 CKD, and Mazda 6 CKD.
  - **SUV/4WD:** Nissan X-Trail, Honda HR-V, Mazda CX-3, Nissan Navara, Mitsubishi Triton, Toyota Vios facelift, Toyota Hilux, Toyota Innova, Toyota Fortuner, and Toyota Camry facelift.

Lower pump price may boost consumer sentiment. We believe there could be some respite in consumer confidence lending support from the lower fuel pump price and relatively stable fiscal health of the country. Recently, Tan Sri Zeti, the central bank governor, remarked that the depressed crude oil price is a positive development as cost of businesses could be reduced and it may also limit inflationary risk pressures. We also believe that discretionary spending could improve thus enhances GST collection.

Glimpse of healthy purchasing power. Moreover, recent removal of the fuel subsidy gave some anecdotal evidence of the still healthy purchasing power as some consumers took the opportunity to opt for the higher fuel grade RON97 as the price gap with the lower grade RON95 narrowed.

Currency risk. The USD/MYR rate spiked to as high as RM3.45 recently due to concerns over Malaysia's fiscal health going into 2015 amidst the depressed crude oil price which was affirmed by Petronas' dim profit outlook for FY15. We estimate that every 1% change in USD/MYR rate impacts the earnings of automotive companies under our coverage by 2-5%. On the flipside, the depressed Yen is positive for some of the companies under our coverage.

Possible mitigating step. The government could bring forth its subsidy rationalisation plan even further, particularly in the power sector, hence mitigating the impact from lower petroleum-derived revenues. This may also lend support to the ringgit which is at risk of being depressed against the dollar should the US Fed raised interest rates in FY15.

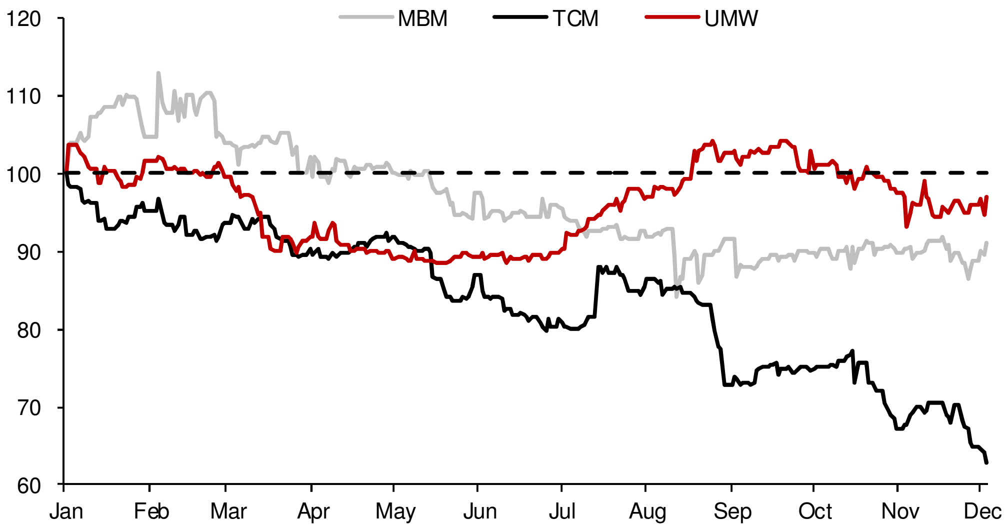
Ringgit relative to USD and Yen

Source: MAA, MIDFR calculations

INVESTMENT CASE

Sector has lagged the KLCI in 2014. By and large, the Auto sector has underperformed the KLCI since the start of 2014. TCM has been the worst performing stock, lagging the KLCI by 37%, amidst Nissan's declining market share which eroded earnings while concerns over its prospects remains. While UMW and MBM have performed relatively better compared to TCM, these stocks have lagged the Index by 3% and 9% respectively.

Relative performance to KLCI



Source: Bloomberg, MIDFR calculations

Markets continued to ignore the positives. We believe sentiment towards the sector remains poor due to growing concerns over the industry's prospects in FY15. Unfortunately, this has permeated to select stocks such as UMW and MBM which are largely less affected by strengthening of the dollar.

MBM is our sector top pick. Specifically on MBM, the stock has remained depress despite the collapse in Yen and encouraging sales of the new Perodua Axia – both factors should translate into a strong rebound in Perodua's earnings going forward. We nominate MBM as our stock top pick for the sector as we also expect its manufacturing businesses to see lower losses in FY15 as capacity at its alloy-wheel plant is ramped up and contribution from its vehicle trading business strengthens further.

EARNINGS REVISION

Earnings revision. We re-looked at our forecasts and currency assumptions and raised our average rates for USD/MYR in 2015 to RM3.40 and lowered our average ¥100/MYR rate for 2015 to RM2.95. We also took the opportunity to relook at our sales volume growth assumptions following recent feedbacks from management.

The earnings impact and changes to our views on the respective stocks are summarised as follow:

- **TCM – NEUTRAL, TP: RM4.00.** In a recent analyst briefing, management provided a brief outline on its strategy going into FY15 while remaining cautious on the outlook for the sector. It guided for 2 new models debuting in FY15 namely, the Nissan X-Trail and the Nissan Navara as well as a model update of the Almera. However, management also indicated that TCM would be adopting a different strategy in which the company is willing to forgo market share in return for better earnings quality. Coupled with full year sales contribution from Nissan Teana and Nissan Sylphy which were launched in FY14, we believe Nissan has a strong model line-up in FY15 and this may limit promotional activities. Nevertheless, we have reduced our FY15 earnings by -15% and tweaked our FY16 forecasts on higher USD/MYR rates and lower sales volume of Nissan vehicles. As a result, we downgrade TCM to NEUTRAL and reduce our TP to RM4.00 from RM4.60.
- **UMW – NEUTRAL, TP: RM12.00.** While the strengthening USD/MYR is negative for UMW which transacts with Toyota Motor in dollar terms, the impact is partially mitigated by stronger contribution from its O&G division which benefits from the dollar's strength. We also expect stronger contribution from the Heavy Equipment division and Perodua while earnings drag from legacy businesses should reduce following current restructuring efforts. The higher USD/MYR rate, lower sales volume, and lower ¥100/MYR rate assumed resulted in a net reduction of -5% and -2% for FY15 and FY16 earnings respectively. This lowers our TP to RM12.00 from RM12.20 while maintaining NEUTRAL on the stock given the limited upside.
- **MBM – BUY, TP: RM4.80.** Despite the encouraging newsflow of Perodua Axia's strong sales and the collapse in Yen, MBM's share price has hardly reacted. We have not made any changes to our growth assumptions other than lowering our average ¥100/MYR rate assumption for FY15. This raises our TP for MBM to RM4.80 from RM3.90 previously. We expect MBM's earnings to rebound strongly in FY15 led by Perodua's contribution, lower earnings drag from the alloy-wheel business and stronger performance of the motor trading business.

Summary Recommendations of Stocks Under Coverage

Stocks	Rec.	Price at 8/12 (RM)	TP (RM)	Net Profit (RM'm)		EPS (sen)		EPS Growth (%)		PER (x)		DPS (sen)		Div. Yield (%)	
				FY14F	FY15F	FY14F	FY15F	FY14F	FY15F	FY14F	FY15F	FY14F	FY15F	FY14F	FY15F
UMW	NEUTRAL	10.72	12.00	856	970	73.3	83.1	(1.2)	13.3	14.6	12.9	40	46	3.8	4.3
TCM	NEUTRAL	3.55	4.00	89	233	13.7	35.7	(67.9)	161.2	26.0	10.0	5	13	1.3	3.5
MBM	BUY	2.76	4.80	145	181	37.2	46.4	5.6	2.5	6.0	5.5	8	9	3.3	3.3

Source: Bloomberg, MIDF Research

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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 *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.