

10 July 2017 | Sector Update

# Automotive

**Upgraded OVERWEIGHT**

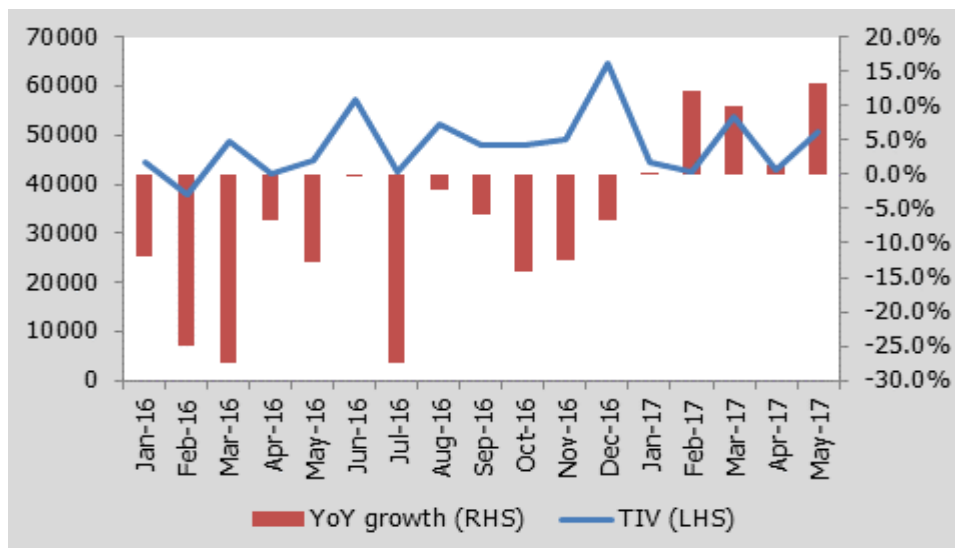
## Shifting into sixth gear

### INVESTMENT HIGHLIGHTS

- Sector earnings has reached an inflection point; upgrade to **OVERWEIGHT**
- A strengthening RM, improving macro outlook, a bottoming in consensus revision cycle and bombed out sector valuations underpin our upgrade
- Bermaz Auto (BUY, TP raised to RM2.60/share) is our top pick for a solid 41% earnings CAGR, attractive 8% yield and value crystallisation of its Philippines unit
- UMW is a contrarian BUY (TP raised to RM7.20/share) as a value play amid a turnaround in earnings, balance sheet deleveraging and a renewed focus on EEV-qualified models

**Sector earnings set for a recovery.** After establishing a firm trend of volume recovery, sector earnings looks set for a rebound from 3Q17 onwards. This is premised on: (1) A strengthening Ringgit against the USD and JPY (2) A more favourable macro outlook which will trickle down to consumer spend (3) More aggressive launches in 2H17 (4) Stabilising loan approval rates. A bottoming in earnings revision cycle and bombed out sector valuations will work as strong share price catalysts. Underpinning our positive sector view, the recently announced May17 TIV represented the 5<sup>th</sup> consecutive month of growth, growing by 13%yoy (+18%mom) to 50,600 units.

### EXHIBIT 1: TIV HAS ESTABLISHED A FIRM RECOVERY TREND



Source: MAA, MIDFR

**TIV forecast revised up.** We revise up our 2017 TIV forecast to 595,928 units (from 589K previously), on the back of an upward revision in our in-house GDP forecast to 5.1% (from 4.9% previously). Our forecasts are now pegged to the sector’s 15-year average GDP-TIV growth multiplier of 0.53x. We now expect 2017 TIV to grow by 2.7% (from +1.5% previously). Year-to-date, TIV registered at 234,185 units (+7.4%ytd), which if annualised, already accounts for 95% of our FY17F TIV ahead of a possibly stronger, new-launch driven 2H. Year-to-date TIV growth was led mainly by Honda, Toyota, Proton and Perodua. Echoing our more positive view, the Malaysia Automotive Association also indicated of possible upside to its 2017 TIV forecast of 590K units.

## EXHIBIT 2: MIDF REVISED TIV FORECAST

	2013	2014	2015	2016	2017F
Proton	138,683	115,783	102,175	72,290	86,748
Perodua	196,071	195,579	213,307	207,110	209,935
Toyota	91,185	102,035	93,760	63,757	71,981
Honda	51,544	77,495	94,902	91,830	100,000
Nissan	53,156	46,352	47,235	40,706	39,488
Mazda	9,197	11,382	14,325	12,493	12,956
Others	115,957	117,839	100,927	91,939	74,820
<b>Total</b>	<b>655,793</b>	<b>666,465</b>	<b>666,631</b>	<b>580,125</b>	<b>595,928</b>
<b>Market Share</b>					
Proton	21.1%	17.4%	15.3%	12.5%	14.6%
Perodua	29.9%	29.3%	32.0%	35.7%	35.2%
Toyota	13.9%	15.3%	14.1%	11.0%	12.1%
Honda	7.9%	11.6%	14.2%	15.8%	16.8%
Nissan	8.1%	7.0%	7.1%	7.0%	6.6%
Mazda	1.4%	1.7%	2.1%	2.2%	2.2%
Others	17.7%	17.7%	15.1%	15.8%	12.6%
<b>Growth</b>					
Proton	-1.7%	-16.5%	-11.8%	-29.2%	20.0%
Perodua	3.7%	-0.3%	9.1%	-2.9%	1.4%
Toyota	-13.3%	11.9%	-8.1%	-32.0%	12.9%
Honda	47.5%	50.3%	22.5%	-3.2%	8.9%
Nissan	46.6%	-12.8%	1.9%	-13.8%	-3.0%
Mazda	45.2%	23.8%	25.9%	-12.8%	3.7%
Others	1.1%	1.6%	-14.4%	-8.9%	-18.6%
<b>Total</b>	<b>4.5%</b>	<b>1.6%</b>	<b>0.0%</b>	<b>-13.0%</b>	<b>2.7%</b>

Source: MAA, MIDFR

**Ringgit strength underpins sector recovery.** Most importantly, sector earnings recovery will be underpinned by more favourable forex which will lower import cost. Imported components account for 25%-35% of total cost for the non-nationals. The Ringgit has strengthened from the year low of USD:RM4.5 to the current USD:RM4.3 levels (See Exhibit 3). Our in-house economics team had in fact raised our Ringgit forecast to USD:RM4.20, with consensus forecasting a range of RM4.0-RM4.3. Similarly, the Ringgit has also strengthened against the JPY to the current JPY:RM3.8 levels from up to RM4.1-4.2 back in 1Q17 (See Exhibit 4). All the auto players under our coverage will benefit from the stronger Ringgit i.e. BAuto mainly from the JPY and UMW / Tan Chong from the weaker USD. For BAuto, every 1% change in the JPY will impact FY18F (FYE Apr) earnings by 3%. For UMW and Tan Chong, every 1% change in the USD will impact FY17F by 6.5% and 35% respectively (Tan Chong is forecasted to register losses in FY17F/18F).

### EXHIBIT 3: RINGGIT STRENGTHENING AGAINST USD



Source: Bloomberg, MIDFR

### EXHIBIT 4: RINGGIT STRENGTHENING AGAINST JPY



Source: Bloomberg, MIDFR

**Earnings revisions have reached bottom.** The downward consensus earnings revisions in the past 2 years have reached a bottom (See Exhibit 5) and has in fact rebounded for selective stocks i.e. UMW and BAuto. This upward revision was driven largely by expectations of a rebound in sales volumes but has yet to factor in improvements in forex expectations, suggesting further possible upside to forecasts if the Ringgit strength sustains.

## EXHIBIT 5: EARNINGS REVISION CYCLE HAS REACHED INFLECTION POINT FOR UMW & BERMAZ AUTO



Source: Bloomberg, MIDFR



Source: Bloomberg, MIDFR

**An improving macro outlook.** Our in-house economics team recently revised upwards our GDP forecast to 5.1% (from 4.9%). This is the 2<sup>nd</sup> upgrade in the past 6 months – prior upgrade was from 4.3% to 4.9%. This is also in line with consensus which has seen a number of upgrades in the same period with the current consensus range of between 5% and 5.3%. Our latest upgrade was driven by much stronger trade forecast (+14.5%). As can be seen in the past 5 months, exports have been growing at solid double digit rates. Moreover, 2Q17 registered the highest business confidence ever recorded at +4.5% vs. -6.9% in the prior quarter. The much improved macro outlook should trickle down to consumer spending, especially non-discretionary consumer spend which has seen a multi-year lull.

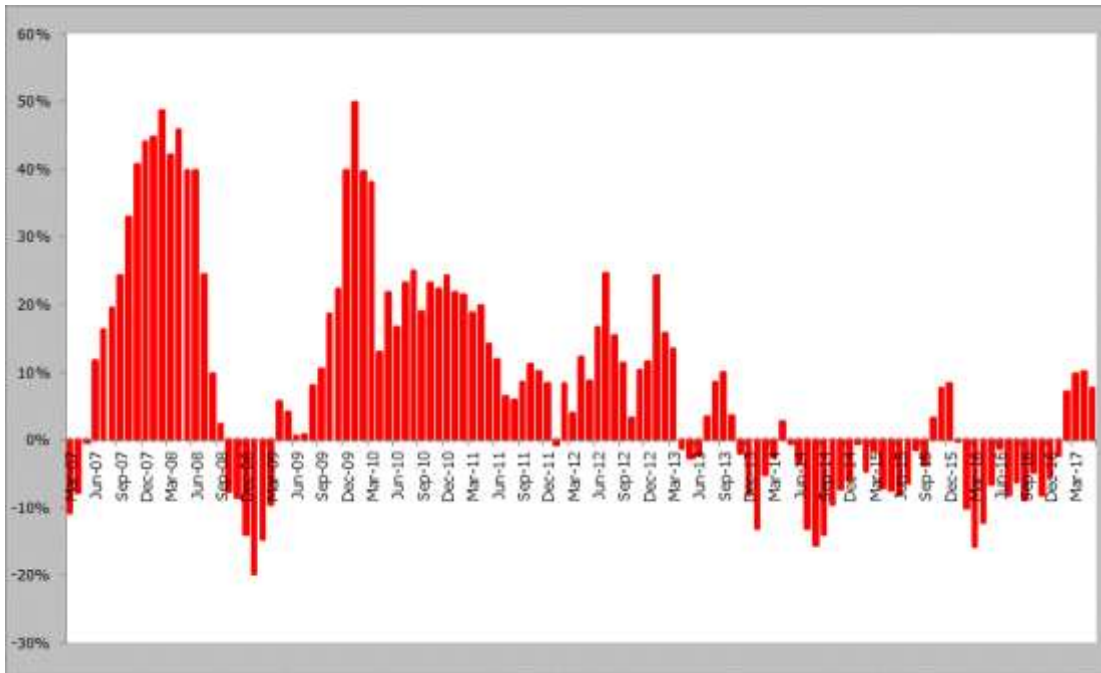
**Loan approvals stabilising.** Loan approval rates have stabilised at around 50%-60%, judging by trends in the past 12 months and more importantly car loan application trends have shown improvements, reflecting improving underlying demand (See Exhibit 7). Additionally, auto players have become more creative with financing solutions, introducing packages such as 2-Tier financing schemes or monthly instalment rebates which essentially allows for lower monthly instalments during the first 6 years of ownership (though this balloons towards the final 3 years, in the case of a 9 year loan tenure). The idea is to lower the monthly commitment of car buyers, allowing them to better qualify for financing, as approval by financial institutions places high priority on a borrowers monthly loan commitment relative to his/her net monthly income.

**EXHIBIT 6: HP LOAN APPROVAL RATES STABILISING AT AROUND 50% LEVEL**



Source: MAA, MIDFR

## EXHIBIT 7: GROWTH TREND IN HP LOAN APPLICATION SIGNAL IMPROVING UNDERLYING DEMAND

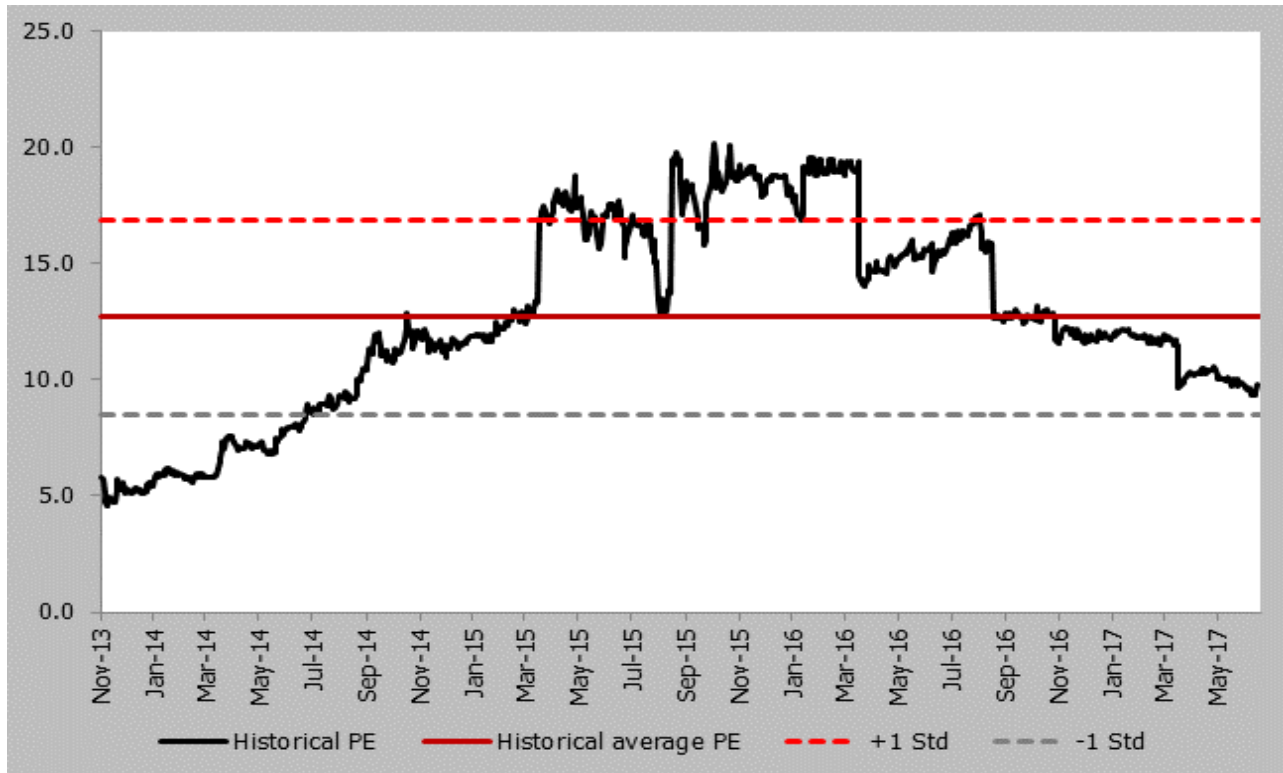


Source: MAA, MIDFR

**Aggressive launches in 2H17.** Another key driver for sector earnings in 2H17 is a pickup in new product launches, particularly volume drivers for the key players. Among the key new models to come include the Honda Jazz (launched in June), Mazda’s new CX5 and CX9 (in October and July respectively), Toyota’s indicative four new models (all in 2H17) and possibly a new MyVi from Perodua (also in 2H17, based on our channel checks). Proton meanwhile has tied up with Geely and the first model to be born out of this partnership is Proton’s first SUV model to be based on Geely’s Boyue. No timeline has been given for the launch but our guess is this is likely to come earliest in late 2017, depending on depth of localisation. Proton also launched an improved version of the Iriz (more refined comfort, minor exterior and interior enhancements and a retuned ECU, TCU and a new exhaust system) in June. We expect these to drive a marked improvement in TIV from July onwards.

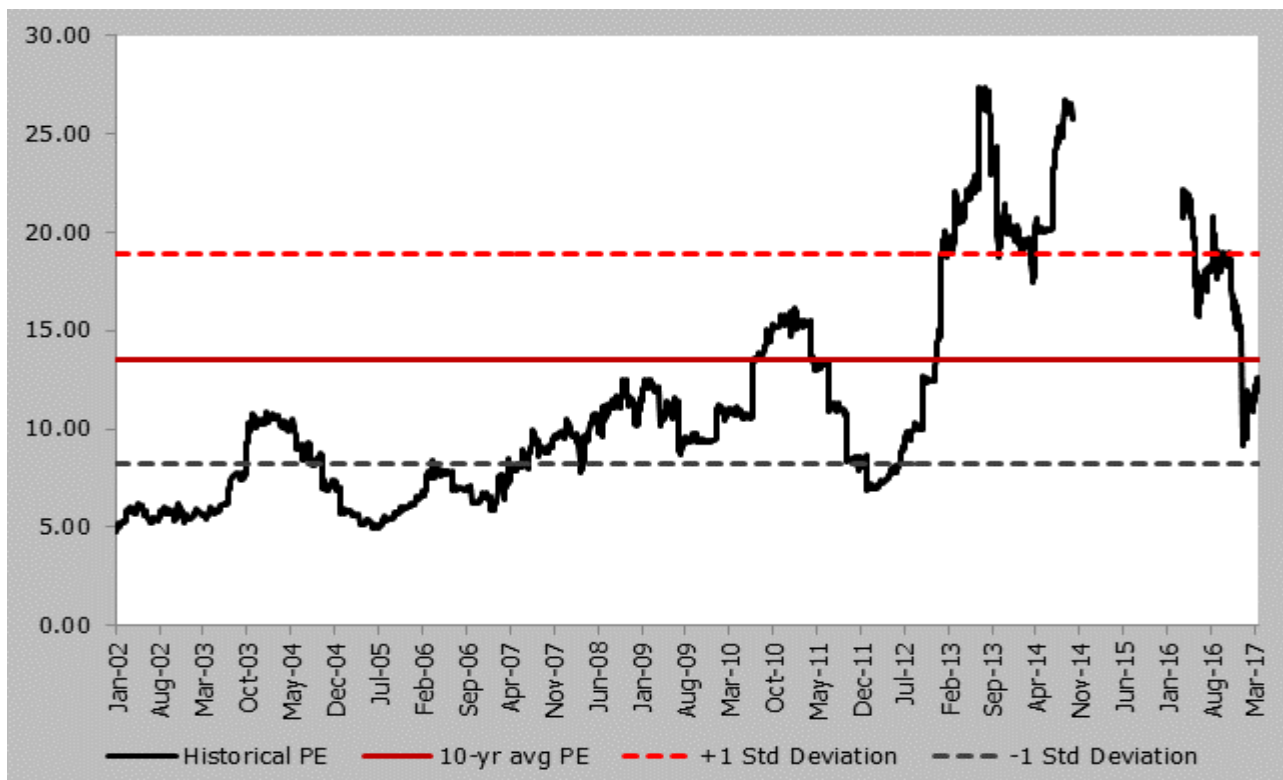
**Bombed out sector valuations.** From a valuation standpoint, key auto stocks under our coverage are now trading at very undemanding valuations relative to historical trends. BAUTO is now trading at an 18% discount and close to 1 standard deviation below its historical average PE of 12.7x while UMW now trades at a 12% discount to its historical average PE of 13.5x. On the back of a meaningful resumption in earnings growth, the sector looks set for a valuation re-rating in the immediate term. Tan Chong (Neutral, TP: RM5.90/share) is expected to remain in losses throughout our forecast horizon but is already trading at a deep 54% discount to FY18F NTA of RM3.99/share.

## EXHIBIT 8: BAUTO NOW TRADING AT CLOSE TO 1-STD BELOW HISTORICAL PE OF 12.7x



Source: Bloomberg, Company, MIDFR

## EXHIBIT 9: UMW TRADING AT DISCOUNT TO HISTORICAL PE OF 13.5x



Source: Bloomberg, Company, MIDFR



## PLAYING INTO THIS RECOVERY

UMW Holdings (UMW) is one of the key beneficiaries of an improving macro outlook and a stronger Ringgit given that it has one of the largest share in the local market via Toyota and a 38% stake in Perodua. Combined, UMW effectively controls a 47% market share of Malaysian autos. The stronger Ringgit will lower import cost for UMW Toyota (which is 100% denominated in USD) and Perodua (imports are predominantly in JPY). **We re-affirm our contrarian BUY on UMW and raise our TP to RM7.20/share** (from RM6.50/share previously) as we now value its auto unit at 13x PE (from 12x previously), closer to its historical average on the back of an improved sector outlook. We also incorporate the value of its 711 acres of unencumbered land in Serendah (*See company update for details*), which is slated for development. Key catalysts include: (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 underowned and at 11.7x FY18F earnings, trades below its historical average PER of 13.5x. (5) An attractive 7% dividend yield if investors were to realise the value of UMWOG shares to be redistributed to UMW's shareholders by end-Jul17.

## EXHIBIT 10: UMW SUM-OF-PARTS VALUATION

Segments	FY18F net profit attributable to UMW (RMm)	PE (x)	Value (RMm)	Comments
Auto related	482	13	6,264	
Equipment	140	12	1,681	
Serendah land		RNAV	452	RNAV of Serendah land (711acres@RM16psf)
M&E / Others / O&G	(89)	NA		Attribute no value given lack of details on segmental book value
<b>Total value</b>	<b>533</b>		<b>8,397</b>	
No of shares (m)			1,168	
<b>Fair value (RM)</b>			<b>7.20</b>	

Source: Company, MIDFR

**Bermaz Auto is our top sector pick.** Our target price is raised to RM2.60/share (from RM2.50/share) as we now value its domestic business at 12.7x, at par to historical average valuations. Key catalysts over the next 12 months: **(1) A 30% increase in FY18F TIV** driven by launch of the new CX5 in Oct17 and CX9 in Jul17 **(2) 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. **(3) Attractive dividend yield of 8%** underpinned by net cash which accounts for 12% of market cap and solid 8% FCFE yield (FY18F). The listing of BAUTO Philippines will bump yields up further given potential one-off special dividends. **(4) 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 8.6x CY18F earnings. **(5) A stronger Ringgit** against the JPY since May17.

## EXHIBIT 11: BAUTO SUM-OF-PARTS VALUATION

	CY18F net profit (RMm)	PE (x)	Value (RMm)
Malaysia	199.1	12.7	2,529
Philippines	24.9	18.0	449
<b>Total value</b>			<b>2,978</b>
Shares out (m) - fully diluted			1,157
<b>Value/share (RM)</b>			<b>2.60</b>



Source: Company, MIDFR

## 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	1.97	17.1	20.5	11.5	9.6	4.5	40.2	8.5	2.60	40.5
Tan Chong	NEUTRAL	1.82	-19.8	-16.2	-9.2	-11.3	0.5	-1.5	0.0	1.90	4.4
UMW	BUY	5.66	31.7	48.6	17.9	11.6	0.9	5.4	0.0	7.20	27.2
<b>Sector average</b>					<b>14.7</b>	<b>10.6</b>	<b>2.0</b>	<b>12.8</b>	<b>2.8</b>		

Source: Bloomberg, Companies, MIDFR

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

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).

(Bank Pelaburan)

(A Participating Organisation of Bursa Malaysia Securities Berhad)

## DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. This document may not be reproduced, distributed or published in any form or for any purpose.

### 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 <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.