

20 August 2018 | Sector Update

Automotive

Maintain POSITIVE

Strength sustained in July

INVESTMENT HIGHLIGHTS

- **TIV strength sustained in July**
- **Players still unclear on SST rate to be reinstated, divided on post-SST rebates**
- **Two Chinese companies proposes to invest in Malaysia**
- **Bermaz Auto (BUY, TP: RM2.70/share) is our top pick for a solid 35% earnings CAGR and attractive 7% yield, followed by UMW (BUY, TP: RM7.11), Tan Chong (BUY, TP: RM2.10) and MBM (BUY, TP: RM3.20)**

Strength sustained in July. July TIV remained strong, but this is not entirely unexpected – we expect the strength sustain till end-August, pending actual SST rate and mechanism to be implemented for the auto sector from September. Our recent round of meeting with industry players suggests there is still no clarity on this front. July TIV registered at 68,465 units, a 41%yoy growth and a 6%mom improvement. As earlier anticipated, production improved to 55,164 units in July (+26%yoy/+40%mom) as production resumed full scale post-Raya holidays to meet the overwhelming short-term demand. On a YTD basis, TIV was up 7.6%yoy at 358,719 units. This is 61% of our full year forecast but we leave our TIV forecast of 585K (2018) unchanged in anticipation of weakness in 4Q18.

Share price has hardly reacted. Despite the strength in TIV in the past 2 months, share price of auto stocks have hardly moved. This is likely given anticipation of the weakness post-tax holiday period. Our channel checks suggests players expect weakness through Sep-Oct, a typical stock clearance-driven strength in Nov-Dec period and normalisation thereafter (assuming SST is reinstated at the previous 10% rate).

To compensate or not? Our recent meetings also suggest players are still divided on whether to continue compensating for an SST rebate for bookings that cannot be delivered before 1st September. The only player that has committed to this is BAuto, which has a very long waiting list up till end of the year – this will be partly made up by lowering dealer incentives and not entirely from profit margins. By doing this, BAuto is essentially locking in sales volume ahead of an anticipated fall in industry volumes post-tax holiday period, particularly in 4Q18. We anticipate other players might follow suit if this results in market share shifts. Tan Chong (5000-6000 bookings for the new Serena Hybrid) and BAuto have booking banks to last till year-end while UMW Toyota has a 2-3 months waiting list.

Countered by improving spending power? In 2017, GST collection was reported at RM44b which is a considerably larger amount compared to SST collection of RM17b (back in 2014). The differential is essentially being put back into consumers' pockets. We see this as a strong structural factor to lift consumer sentiment/spending power and drive TIV improvement beyond the temporary demand volatility during the transition from GST to SST.

Nissan's unit participating in 3rd National Car? It was reported over the weekend that 2 companies from China (with partnership of Malaysia's Concept Fields Sdn Bhd) have proposed to invest USD10b (RM41b) in Malaysia's 3rd national car project and build a regional hub near Proton City. The two companies are GSR Capital and Envision Energy, where the latter holds a 75% stake in Nissan Motor's electric vehicle unit Automotive Energy Supply Corp (AESC). AESC owns battery plants in the US, England and Japan. So far there is no indication if Tan Chong (Nissan's Malaysian franchise holder) will be in the picture. Nissan is one of the leading Japanese makes in the EV industry being one of the first commercial producers of EVs via the Nissan Leaf.

BAuto (TP: RM2.70) remains our top sector pick. Key catalysts over the next 12 months:

- (1) **A 17%-30%yoy Mazda TIV growth (FY19F)** coupled with margin expansion driven by full year impact of new CX5
- (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 the CKD CX8** in mid-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: RM7.11) is maintained. Key catalysts: (1) **A deleveraged balance sheet post UMWOG demerger** allows room for acquisitive growth and resumption of dividend payouts; (2) **Successful acquisitions of Perodua stake from PNB and MBM** are strong share price catalysts (3) **Reversal of prior years' market share loss**, structural cost reduction and pricing advantage from UMW Toyota's EEV-focused strategy (4) **Redevelopment of UMW's 830 acres Serendah land** which will unlock value of the asset – easily worth 40sen/share on our estimates (5) **A more than quadrupling of M&E division earnings** once its aerospace division reaches full scale production.

MBM Resources (BUY, TP: RM3.20) 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 vacuum in its model mix (2) A recovery in industry production driven by new national car launches.

Tan Chong is also our non-consensus BUY (TP: RM2.10) 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 from FY18F (2) Narrowing in losses from Indochina operations.

EXHIBIT 1: JULY 2018 TIV SUMMARY

Marques	Jul-17	Jun-18	Jul-18	YoY	MoM	YTD17	YTD18	YTD %	Market share	
									Jul-17	Jul-18
Proton	5,954	6,173	8,102	36.1%	31.2%	45,347	35,208	-22.4%	12.3%	11.8%
Perodua	18,920	19,611	23,830	26.0%	21.5%	118,595	140,928	18.8%	39.0%	34.8%
Toyota	5,547	11,482	9,130	64.6%	-20.5%	39,266	40,839	4.0%	11.4%	13.3%
Honda	8,576	11,418	12,808	49.3%	12.2%	61,103	64,162	5.0%	17.7%	18.7%
Nissan	2,518	3,008	3,303	31.2%	9.8%	16,055	15,229	-5.1%	5.2%	4.8%
Mazda	701	1,514	1,200	71.2%	-20.7%	5,472	7,896	44.3%	1.4%	1.8%
Others	6,337	11,296	10,092	59.3%	-10.7%	47,172	53,917	14.3%	13.1%	14.7%
Total	48,553	64,502	68,465	41.0%	6.1%	333,010	358,179	7.6%	100.0%	100.0%

Source: MAA, MIDF

EXHIBIT 2: JULY 2018 TIV SUMMARY BY VEHICLE TYPE

Segment	Jul-17	Jun-18	Jul-18	YoY	MoM	YTD17	YTD18	YTD %
Passenger cars	43,524	57,744	61,211	40.6%	6.0%	299,273	322,254	7.7%
Commercial vehicles	5,029	6,758	7,254	44.2%	7.3%	33,737	35,925	6.5%
Total	48,553	64,502	68,465	41.0%	6.1%	333,010	358,179	7.6%

Source: MAA, MIDF

EXHIBIT 3: JULY 2018 TIV SUMMARY BY VEHICLE TYPE

Segment	Jul-17	Jun-18	Jul-18	YoY	MoM	YTD17	YTD18	YTD %	Market share	
									Jul-17	Jul-18
National cars	24,874	25,784	31,932	28.4%	23.8%	163,942	176,136	7.4%	51.2%	46.6%
Non-nationals	23,679	38,718	36,533	54.3%	-5.6%	169,068	182,043	7.7%	48.8%	53.4%
Total	48,553	64,502	68,465	41.0%	6.1%	333,010	358,179	7.6%		

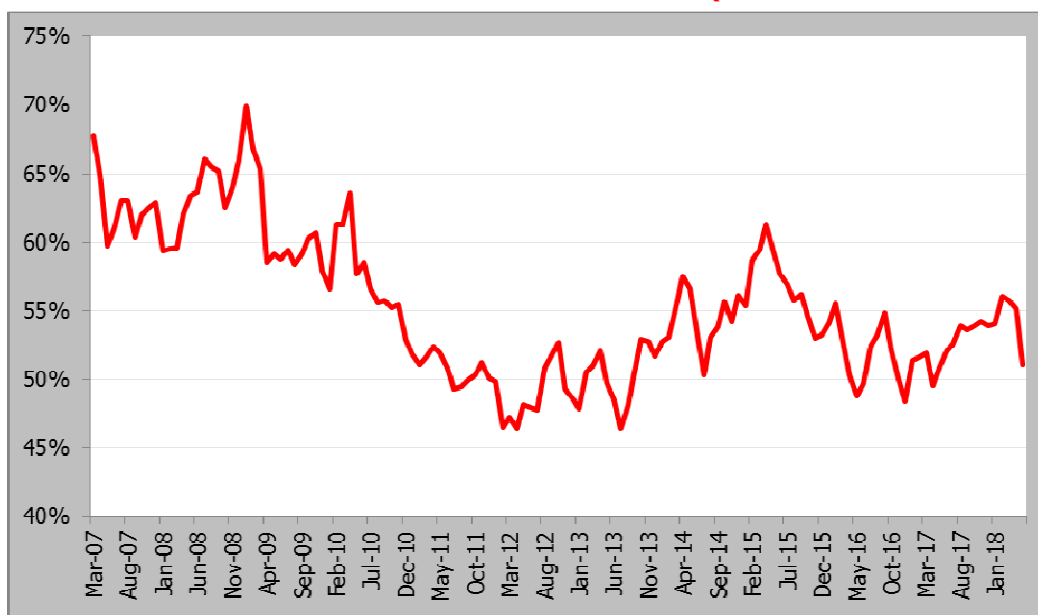
Source: MAA, MIDF

VALUATION AND RECOMMENDATION

Companies	Rating	Shr Price (RM)	EPS (sen)		PE (x)		P/BV (x)	ROE (%)	Div Yield (%)	Target Price (RM)	Total Upside (%)
			CY18F	CY19F	CY18F	CY19F					
Bermaz Auto	BUY	2.12	16.7	20.1	12.7	10.5	4.6	35.2	7.4	2.70	34.7
Tan Chong	BUY	1.71	3.1	9.0	56.0	19.0	0.4	1.1	1.8	2.10	24.6
UMW	BUY	5.85	31.7	47.5	18.5	12.3	1.0	5.4	2.7	7.11	24.2
MBM	BUY	2.38	25.9	31.5	9.2	7.6	0.5	5.5	2.9	3.20	37.4
Average					13.4	10.1	1.6	11.8	3.7		

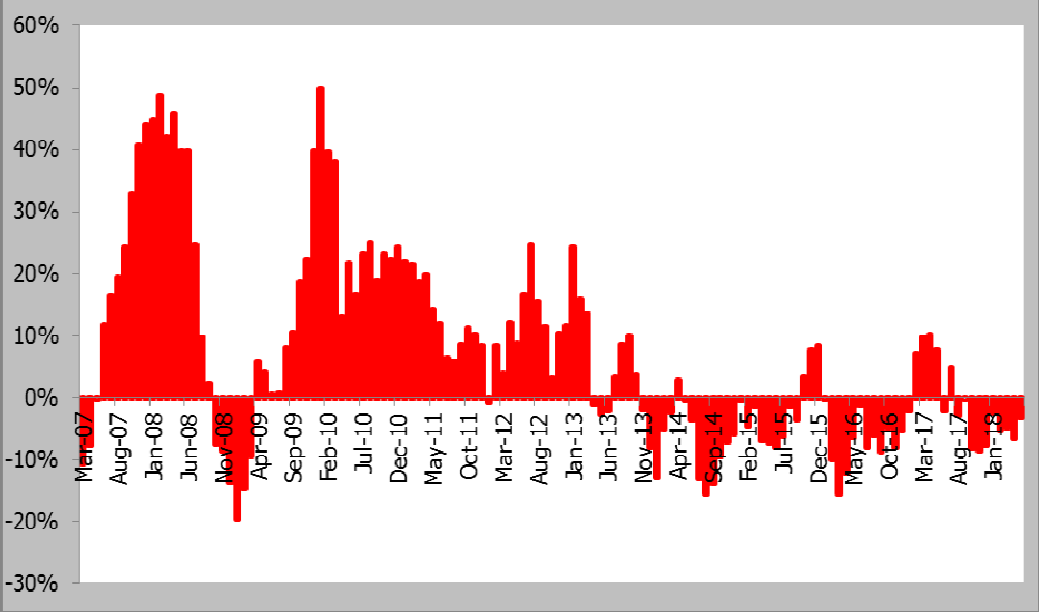
Source: Bloomberg, Companies, MIDF

EXHIBIT 4: HIRE PURCHASE LOAN APPROVAL RATE (3-MTH MOVING AVERAGE)



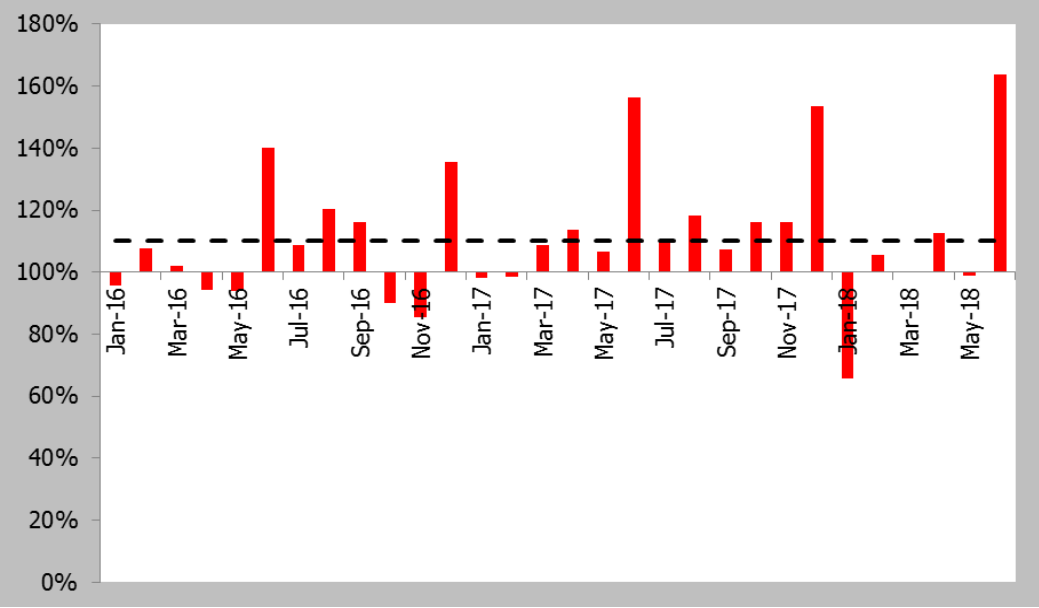
Source: BNM, MIDF

EXHIBIT 5: HIRE PURCHASE LOAN APPLICATION GROWTH (3-MTH MOVING AVERAGE)



Source: BNM, MIDF

EXHIBIT 6: SALES-TO-PRODUCTION RATIO SPIKED IN JUNE AS PRODUCTION FELL BEHIND SALES



Source: MAA, MIDF

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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 <i>rise</i> 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 <i>fall</i> 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.