

19 January 2018 | Sector Update

Automotive

Maintain POSITIVE

Takeaways from MAI's 2018 Outlook

INVESTMENT HIGHLIGHTS

- MAI targeting 2% TIV growth in 2018
- EEV program performing better than expected
- CBU exports a disappointment, meaningful improvement only in 5 years
- Bermaz Auto (BUY, TP: RM2.50) is our top pick for a solid 41% earnings CAGR, attractive 6% yield and value crystallisation of Philippines unit

We attended MAI's (Malaysia Automotive Institute) 2017/2018 sector review/outlook briefing yesterday. Present were Datuk Seri Mustapa Mohamed, Minister of International Trade and Industry and Datuk Madani Sahari of MAI. Below are key takeaways from the briefing;

Targets 2% growth. MAI is targeting TIV growth of 2%yoy in 2018 to 586K-591K units in 2018, off and estimated base of 575K-580K for 2017. MAI's growth target is slightly higher than MIDF's 1.7%yoy TIV growth for 2018. We maintain our TIV forecast for now. While TIV growth forecast is not entirely exciting, FY18F sector earnings will be driven by margin expansion from a stronger Ringgit and a rollback in discounting as inventory pare down in the system stabilizes.

EEV development ahead of target. The Energy Efficient Vehicle (EEV) program which was launched in the 2014 NAP has been successful with 19 OEMs offering EEV-qualified models to the Malaysian market. To recap, the EEV program, meant to position Malaysia a manufacturing hub of energy efficient cars in the region, requires several different fuel efficiency criteria for different segments in the market. Qualified models are awarded customised incentives by the Government, which includes duty rebates. However, the models are required to be produced locally and the extent of incentives given depends on the value-add that the OEMs bring e.g. critical part localisation or R&D, exports, job creation etc. EEV penetration improved from 42.8% in 2016 to 52% in 2017. For both years, actual EEV penetration rates were ahead of targets of 40% and 50% respectively. MAI is targeting EEV penetration to increase further to 60% this year. EEV production is expected to increase 13% to 350K units this year. The Minister also highlighted of possibly one new vehicle assembler setting up shop here this year.

EXHIBIT 1: KEY 2018 TARGETS

Key Figures	2017	2018
Total Industry Production (units)	510,000-515,000	530,000-535,000
Total Industry Volume (units)	575,000-580,000	586,000-591,000
Realised/Committed Investments (2018-2022) (RMb)	7.6	4.0
GDP (%)	4.0%	4.5%
Workforce (no.)	736,632	755,632
Aftersales business companies (no.)	53,011	53,011
Vendors (no.)	641	650
Vehicle Manufacturers (no.)	27	28
EEV penetration	52%	60%
TIP of EEV	308,807	350,000
CBU exports (units)	20,604	34,000
Export of Remanufactured Parts (RMm)	750	800
Export of Parts & Components (RMb)	12.0	12.5

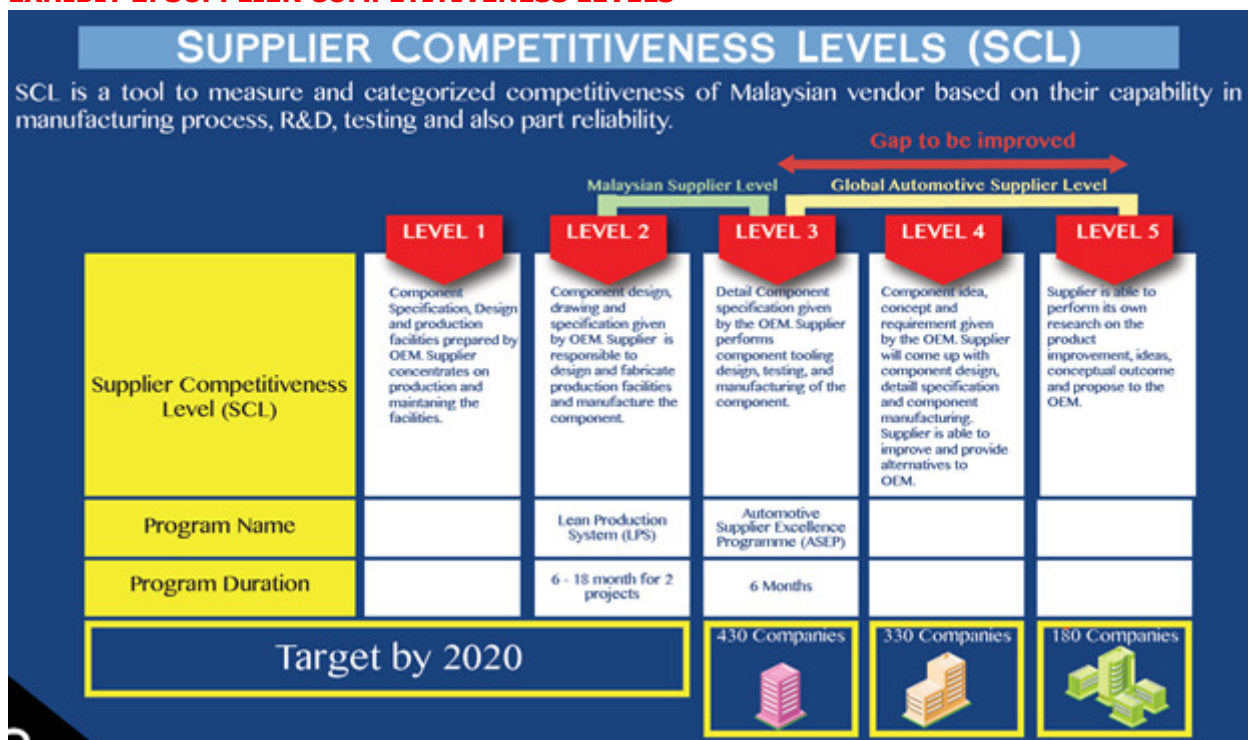
Source: MAI, MIDF

Solid performance for parts & component exports. Export of parts & components, which was a key focus under NAP 2014, was ahead of target by 2% in 2016 and is expected to grow by 7% to RM12b in 2017. MAI expects export of parts to increase further by 4% to RM12.5b in 2018.

Disappointment in CBU exports, possible pick-up only in 5 years. CBU vehicle exports have been a disappointment. The Government had targeted total exports of 31K CBUs in 2017 but as of Nov17, only 18,887 units of CBU export was achieved. The Minister indicated that growing exports of CBUs will be a key focus going forward, but material development is only likely to be achieved within the next 5 years, and not in the next 2-3 years. We would take cue from this in judging the pace of development of national car exports. For the meantime, one of the largest CBU exporters out of Malaysia is BAuto (BUY, TP: RM2.50), which is a manufacturing hub for the Mazda CX5 model for ASEAN ex-Vietnam.

Solid vendor development. Vendor development has been positive with a 14% growth in number of Level 3-5 vendors, where Level 4-5 vendors (+16%yoy to 117 vendors) are categorized as vendors with global standards in terms of research & development capability. For 2018, MAI expects to grow Level 3 vendors by 6% to 430 suppliers, Level 4 vendors by 33% to 120 suppliers and Level 5 vendors by 48% to 40 suppliers.

EXHIBIT 2: SUPPLIER COMPETITIVENESS LEVELS



Source: MAI, MIDF

Key global automotive trends: MAI highlighted several global automotive trends which will likely influence policies going forward, in particular, the NAP Review in 2018, which will encompass vehicle connectivity, mobility and big data;

(1) Focus on Green Cars – Green car policies geared towards growth of low emission and energy efficient cars. This will sow the seed for higher vehicle production and will continue to be the growth pillars of the region. Most key ASEAN auto markets have already implemented their respective green car policies. Malaysia launched the EEV program under NAP 2014, while Thailand and Indonesia had earlier launched their Eco-Car and Low Cost Green Car policies.

(2) Growth of electric vehicle and Plug-in hybrids – Government regulations, infrastructure and tax incentives will be key drivers for growth of EVs and plug-in hybrids in the region. Thailand and Malaysia are expected to act as main participants with efforts to become ASEAN's manufacturing hubs.

(3) Intelligent Mobility – Shared mobility solutions are the first to benefit from autonomous driving. There is a strong need to look beyond traditional sales models and shift towards strong leasing and shared mobility offerings.

Reaffirm OVERWEIGHT on auto sector. BAuto (TP: RM2.50) is our top sector pick. Key catalysts over the next 12 months:

- 1. A 20%yoy growth in FY18F Mazda TIV** coupled with margin expansion driven by the new CX5 from 3Q18
- 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. Attractive dividend yield of 5%** underpinned by net cash which accounts for 12% of market cap and solid 6% FCFE yield (FY18F). Potential listing of Philippines unit will bump yields up further given possible special dividends.
- 5. Value unlocking from the listing of BAuto Philippines (BAP).** Current market cap attributes just 7x CY18F PE to BAuto's stake in BAP relative to the 15x indicative IPO valuation and historical sector valuation of 12x (for Malaysian autos). Ex-cash, BAuto trades at just 9x CY18F earnings.

VALUATION AND RECOMMENDATION

Companies	Rating	Shr Price	EPS (sen)		PE (x)		P/BV	ROE	Div Yield	Target	Total
		(RM)	CY17F	CY18F	CY17F	CY18F	(x)	(%)	(%)	Price (RM)	Upside (%)
Bermaz Auto	BUY	2.34	15.0	21.2	15.6	11.1	4.7	35.2	6.3	2.50	15.0
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.	6.80	12.7	32.2	50.9	20.1	0.9	5.4	0.0	6.00 U.R.	-11.8
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

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

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(Bank Pelaburan)

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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.