AUTOMOTIVE

***Maintain* NEUTRAL**

Too early to Push the Panic Button?

KEY INVESTMENT HIGHLIGHTS

- **Hubei, the epicenter of the coronavirus outbreak is one of China's major automotive hubs. Contagion to other provinces increases possibilities of extended plant shutdowns; component supply is a risk given complex automotive value chain and impact on downstream output.**
- **However, unlike natural disaster-driven crisis such as the 2011 Japan earthquake and Thai floods, supply disruptions could recover quickly as infrastructure and inventories remain intact.**
- **Malaysia's major source of CKD kits and components i.e. Thailand, has exposure to auto part imports from China, but mainly for replacements and supply to Chinese OEMs' local assembly.**
- **Among listed auto players, Proton (50%-owned by DRB-Hicom; NON-RATED) and Sime Darby Bhd (NON-RATED) have direct exposure to China-based auto supply and demand, respectively. However, we are wary of the knock-on impact from a slowdown in the Chinese economy on Malaysia, overall.**
- **Maintain NEUTRAL on autos; MBM (BUY, TP: RM4.55) and BAuto (BUY, TP: RM2.70) remain our top sector picks.**

What has transpired so far? The coronavirus has now been declared a public health emergency. In China, the coronavirus has spread to all provinces from the epicenter of the outbreak in Hubei. China's Lunar New Year holidays were extended by 3 days to Feb 2nd in reaction to the outbreak causing extended plant shutdowns beyond the typical festive holidays with some plants extending the shutdowns till Feb 13th.

China's auto clusters. China's auto industry is concentrated into 6 key clusters (See Exhibit 1). The Hubei province, which is the epicenter of the coronavirus outbreak, is part of the Central South Industrial Zone consisting of Wuhan, Zhenzhou and Xiangtan cities (located in the Hubei, Henan and Hunan provinces). The Central South Zone is one of China's major automotive hubs with Hubei alone accounting for an estimated 7%-9% of China's production. It houses production bases of Peugeot-Citroen, Honda, Nissan, Kia and General Motors as well as its cluster of automotive suppliers. So far, the OEMs are adhering to the extended shutdown directives but there is no indication yet of a further extension beyond this.

Supply chain risk. The supply chain of an automotive industry is very complex. Every car entails at least 10,000 different parts, while vendors consist of multiple layers; Tier-1, Tier-2, Tier-3 and the supporting sub-component or material manufacturers, specializing in specific offerings. Shortage of any one of the sub-components will typically impact downstream output. During the 2011 Japan earthquake, it was only weeks after the incident that OEMs managed to gauge in detail the impact of the various component supplier shutdowns to their production, to give an illustration. In fact, it was the component supplier disruption that really caused the auto supply crisis back in 2011, which also saw Malaysia's TIV indirectly impacted.

Any buffers? Players typically keep an inventory buffer of 1-2 months' worth. If the plant shutdowns extend for more than one month, we think supply shortage could start to become a problem. In the 2011 Japan earthquake, what made the supply issue worse was the exclusivity of manufacturing of certain components in Japan e.g. micro controller chips as well as paint pigments. It is uncertain if such manufacturing exclusivity is retained within China for the Chinese marques.

COMPANY IN FOCUS

MBM Resources Bhd

Maintain **BUY |** Unchanged Target price: RM4.55

Price @ 4th February 2020: RM3.74

- Potential beneficiary of the fuel subsidy program as demand could gravitate towards small capacity models.
- Cheapest proxy to Perodua at just 7x CY20F earnings, attractive 6% yield

Share price chart

Bermaz Auto Bhd

Maintain **BUY |** Unchanged Target price: RM2.70

Price @ 4th February 2020: RM1.80

- Volumes to be catalyzed by launch of the CX8, facelift CX5 and CX30 in FY20F
- Solid dividend yields of 8.1%, net cash accounts for 7% of market cap, trades at just 10x CY20F earnings

Share price chart

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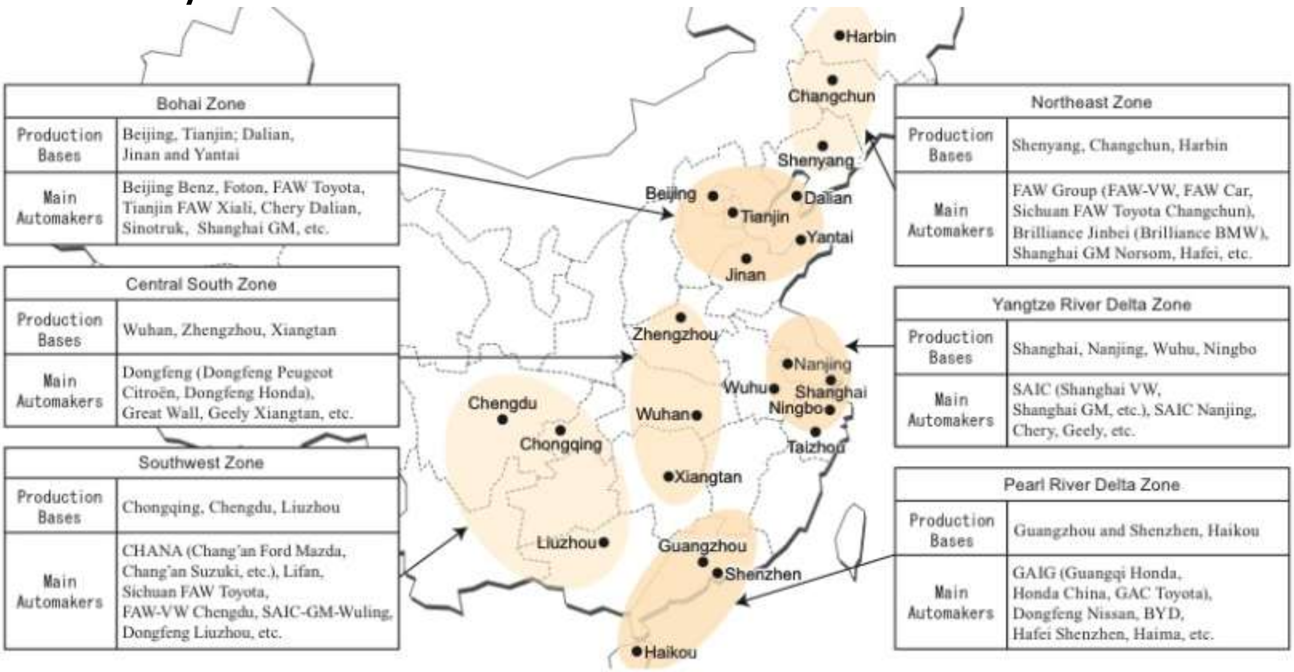
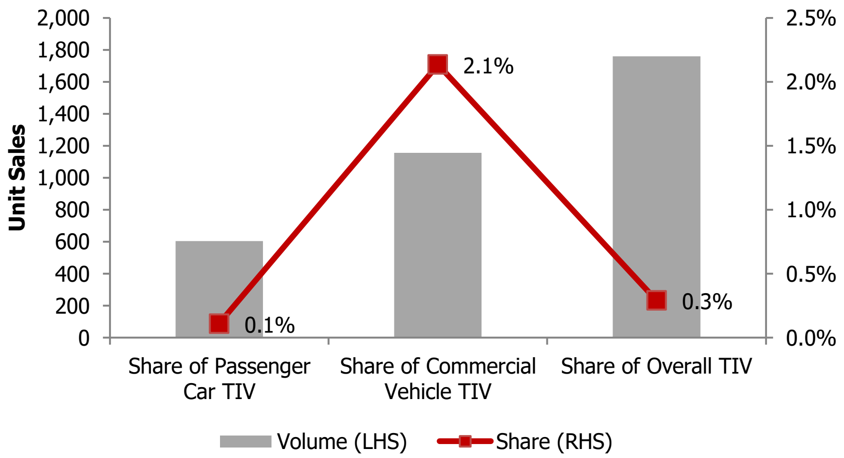
Exhibit 1: China's Key Automotive Clusters



Source: Fourin, MIDFR

Should we be worried? The national car, Perodua entails >90% localization rate, hence relies very little on imported components. The major non-nationals (i.e. the Japanese marques) have much lower localization rates and source imported components and CKD kits mainly from within ASEAN (from Thailand and Indonesia), while for selective players such as BAuto, CKD kits are imported directly from Japan. Passenger car CBUs are imported from 3 main countries i.e. Japan (47% of total), Germany (31%) and Thailand (4.5%), while the main source of commercial vehicles is Japan, China and Sweden. In terms of domestic sales, Chinese marques (excluding Geely-Proton) are estimated to collectively account for 0.1% of passenger car TIV, 2.1% of commercial vehicle TIV and 0.3% of overall Malaysia TIV.

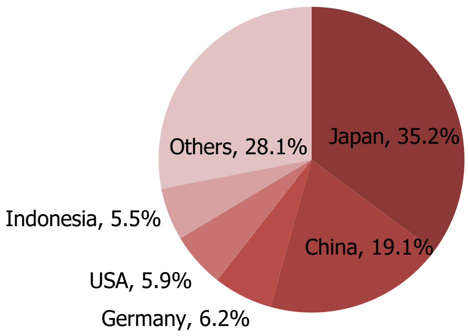
Exhibit 2: Chinese Marques' Collective Share of Malaysia's TIV (2019)



Source: MAA, MIDFR

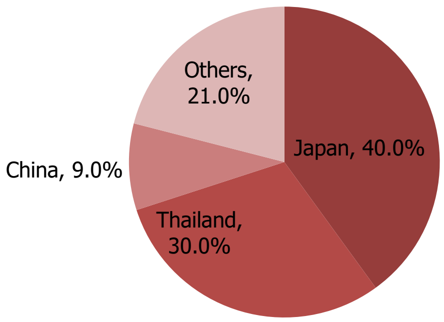
Are our key sources secure? Thailand itself imports automotive components and sub-components from various countries, and China notably, accounts for the 2nd largest share of Thailand's auto component imports at 19% of total (See Exhibit 2). Similarly, Indonesia also has exposure to auto component imports from China, but at a much smaller size of 9% of total auto parts imports. For Thailand, auto part imports from China have grown from 5% of total auto part imports in 2007 to 21% in 2016. However, these imports are both for low cost replacement parts and parts for use in the assembly of vehicles produced by Chinese OEMs based in Thailand e.g. DFSK trucks produced by Dongfeng Motors and Bestlin Group's Golden Dragon buses.

Exhibit 3: Thailand's Automotive Component Import by Region



Source: IPSOS Business Consulting, MIDFR

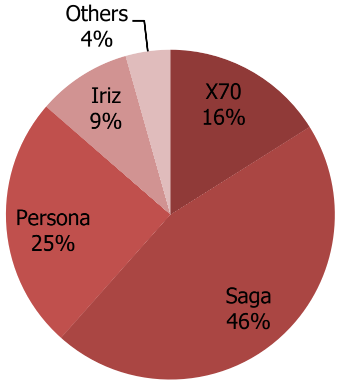
Exhibit 4: Indonesia's Automotive Component Import by Region



Source: IPSOS Business Consulting, MIDFR

Direct exposure to China. Proton Holdings (50% owned by DRB-Hicom; NON-RATED) and Sime Darby Bhd (NON-RATED) are two key Malaysian auto players that potentially have direct supply and demand exposure respectively, to China's automotive sector. Proton's current CBU (completely-built-up) X70 model is sourced from Geely's China plants. Even when locally assembled, there is high likelihood that parts of the CKD (completely-knocked-down) kits and components are still sourced from the Chinese supply chain, with localization rate reportedly only around 30%-40% (the remaining are essentially imported components). Two of Geely's plants namely the Baoji (Shaanxi province) and Chunxiao (Zhejiang province) plants produce the Boyue (the base model of the X70). Geely has large exposure to the China manufacturing base; it operates 12 plants in China and 1 JV plant in Belarus. So far Geely has not yet made any strong commitment to pause production. The X70 is estimated to account for 16% of Proton's monthly TIV.

Exhibit 5: Proton TIV Breakdown by Models (estimates)



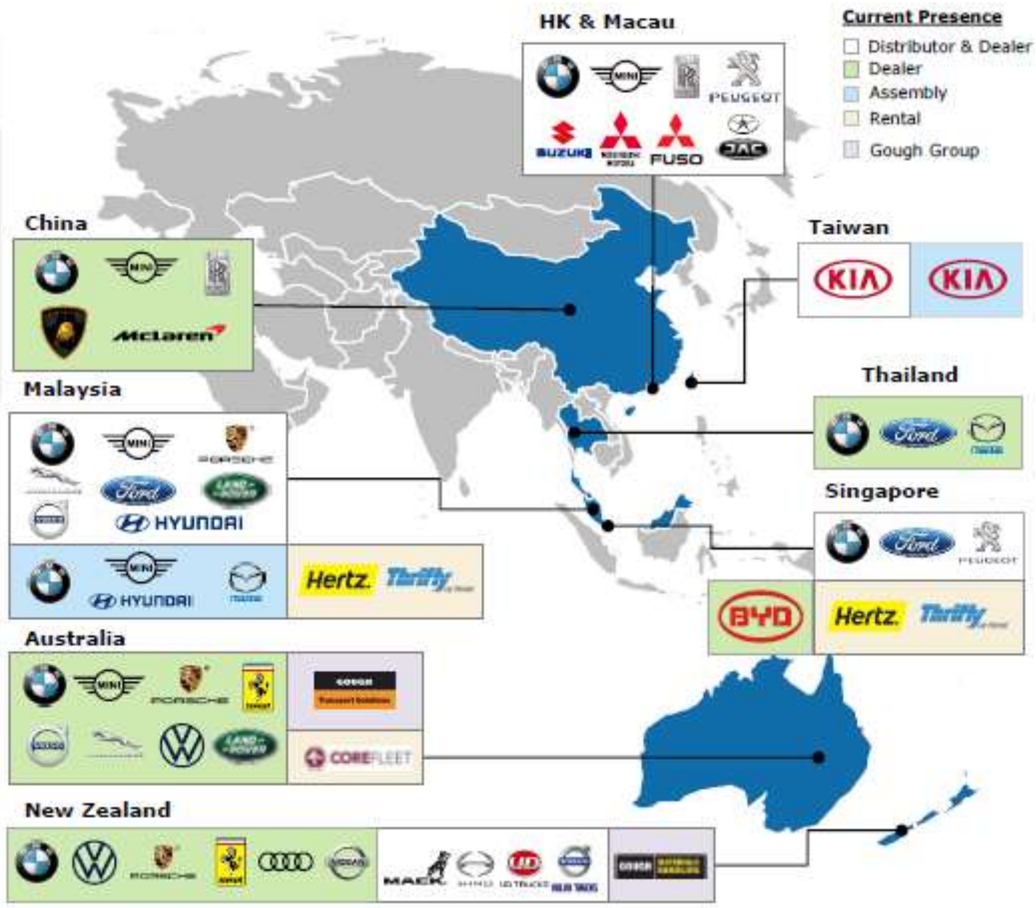
Source: Starbiz, MAA, MIDFR

Meanwhile, Sime Darby Bhd runs automotive dealership operations in China, carrying the BMW, Mini, Lamborghini, Rolls Royce and McLaren marques. The China, HK (Hong Kong), Macau & Taiwan operations collectively account for 47% of Sime Darby's motor segment revenue (54% of PBIT). Sime Darby Motors in turn, contributes some 57% to group revenue.

Exhibit 6: Sime Darby Motor Revenue (Left) and PBIT (Right) by Region

*Source: Company, MIDFR * Based on 1QFY20*

Exhibit 7: Sime Darby Motor Operations

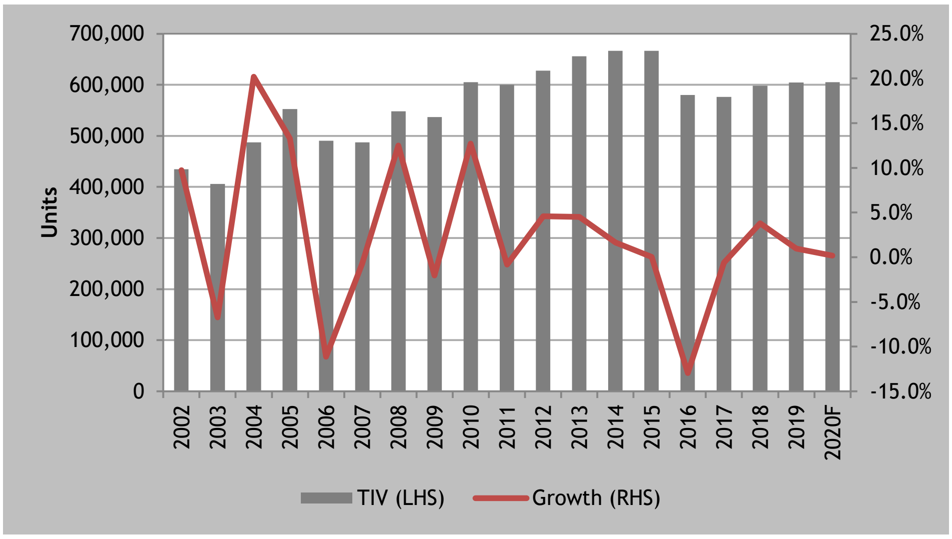


Source: Company, MIDFR

Alternative options. There is always the possibility of existing vendors shifting production to overseas plants if this option is available, especially for multinational OEMs. Temporary outsourcing/supplier substitution is another option, though this means limited volumes over a specific period and may increase unit cost. The requirement to share blueprints of components to external manufacturers complicates the exercise however. On the bright side, unlike the magnitude of disruptions caused by natural disasters such as the previous Japan earthquake or the Thai floods in 2011, operations can come back on stream much quicker once China's coronavirus outbreak is contained given that supporting infrastructure and inventories remain intact.

Demand issue. In the context of the coronavirus outbreak, a demand slowdown for car sales in Malaysia might only come indirectly e.g. knock-on impact of a potential disruption/slowdown in the Chinese economy and tourism restrictions on the Malaysian economy. Still, it is too early to make a call on this depending on how long the outbreak lasts. The expected slowdown in China within this short period so far, might still be able to be compensated later in the year if the outbreak is contained in a timely manner. During the SARS outbreak in 2003 (November 2002–July 2003), Malaysia's TIV fell by 6.7%yoy to 405,745 units. However, it is important to note that it was only Malaysia among the Big 4 auto markets in ASEAN (which also consists of Thailand, Indonesia and the Philippines) that saw a TIV contraction back then given a Malaysia-specific issue; consumers adopted a "wait and see" attitude on expectations of a fall in car prices as the Government back then revised its tariff structure in preparation for AFTA (ASEAN Free Trade Agreement).

Exhibit 8: Malaysia Historical TIV Trends



Source: MAA, MIDFR

Maintain Neutral on autos. On preliminary assessment, it looks like the coronavirus outbreak does not entail significant supply risk for the majority of key listed Malaysian auto players, other than Proton. From a domestic demand standpoint, we think it is too early to make a conclusive call at this juncture, though any impact is likely to be indirect in nature with the exception of perhaps, Sime Darby, which is exposed to sales operations in China. That said, share prices of local auto players have retraced significantly in the past week, presenting attractive entry points.

MBM remains our top pick. We maintain our BUY on MBM Resources Bhd at unchanged TP of RM4.55. At just 7x FY20F earnings coupled with an attractive 6.7% yield, MBM remains a cheap proxy to Perodua's volume expansion and the spillover on its parts manufacturing and Perodua dealership units. Key catalysts: (1) Launch of Perodua's new B-segment SUV in FY20F (2) A recovery in industry production driven by the new national car launches (3) Disposal of OMI Alloy assets. Risk to our call is weaker than expected demand and a weaker than expected Ringgit.

Bermaz Auto (TP: RM2.70) remains a BUY. Key catalysts: (1) Launch of the CX8, facelift CX5 and CX30 in 2QFY20-3QFY20 (2) Dividend outperformance (3) Over 50% increase in FY20F export volumes driven by the CX8 (4) Potential NAP incentives to drive CBU exports (5) Potential introduction of a 3rd CKD model (6) Potential brand expansion riding on Inokom's enlarged capacity and BAuto's solid balance sheet.

PEER COMPARISON TABLE

		Shr Price	PE (x)		P/BV	ROE	Div Yield	Target	Total
Companies	**Rating**	**(RM)**	**CY19F**	**CY20F**	**(x)**	**(%)**	**(%)**	**Price (RM)**	**Upside (%)**
Bermaz Auto	BUY	1.80	10.1	9.5	3.8	29.8	9.1	2.70	59.1
Tan Chong	NEUTRAL	1.31	17.2	11.2	0.3	2.7	3.1	1.40	9.9
UMW Holdings	NEUTRAL	4.20	14.6	12.7	1.3	10.4	2.0	4.50	9.1
MBM Resources	BUY	3.74	7.2	6.7	0.7	10.7	6.7	4.55	28.3
Sector average			**12.3**	**10.0**	**1.5**	**13.4**	**5.2**		

Source: Companies, MIDFR

Table 1: December 2019 TIV Summary

									Market share	
Marques	**Dec-18**	**Nov-19**	**Dec-19**	**YoY**	**MoM**	**YTD18**	**YTD19**	**YTD %**	**Dec-18**	**Dec-19**
Proton	5,598	9,643	11,117	98.6%	15.3%	64,744	100,183	54.7%	10.8%	16.6%
Perodua	18,402	20,422	18,357	-0.2%	-10.1%	227,243	240,341	5.8%	38.0%	39.8%
Toyota	4,310	6,956	8,046	86.7%	15.7%	65,551	69,091	5.4%	10.9%	11.4%
Honda	8,021	6,694	7,235	-9.8%	8.1%	102,282	85,418	-16.5%	17.1%	14.1%
Nissan	2,870	1,730	2,124	-26.0%	22.8%	28,610	21,239	-25.8%	4.8%	3.5%
Mazda	1,451	803	901	-37.9%	12.2%	16,038	11,651	-27.4%	2.7%	1.9%
Others	7,536	6,336	7,062	-6.3%	11.5%	94,130	76,364	-18.9%	15.7%	12.6%
Total	**48,188**	**52,584**	**54,842**	**13.8%**	**4.3%**	**598,598**	**604,287**	**1.0%**	**100.0%**	**100.0%**

Source: MAA, MIDFR

Table 2: December 2019 TIV Summary by Vehicle Type

Segment	**Dec-18**	**Nov-19**	**Dec-19**	**YoY**	**MoM**	**YTD18**	**YTD19**	**YTD %**
Passenger cars	42,426	47,754	49,318	16.2%	3.3%	533,198	550,182	3.2%
Commercial vehicles	5,762	4,830	5,524	-4.1%	14.4%	65,400	54,105	-17.3%
Total	**48,188**	**52,584**	**54,842**	**13.8%**	**4.3%**	**598,598**	**604,287**	**1.0%**

Source: MAA, MIDFR

Table 3: December 2019 TIV Summary by Vehicle Type

									Market share	
Segment	**Dec-18**	**Nov-19**	**Dec-19**	**YoY**	**MoM**	**YTD18**	**YTD19**	**YTD %**	**Dec-18**	**Dec-19**
National cars	24,000	30,065	29,474	22.8%	-2.0%	291,987	340,524	16.6%	48.8%	56.4%
Non-nationals	24,188	22,519	25,368	4.9%	12.7%	306,611	263,763	-14.0%	51.2%	43.6%
Total	**48,188**	**52,584**	**54,842**	**13.8%**	**4.3%**	**598,598**	**604,287**	**1.0%**		

Source: MAA, MIDFR

Exhibit 9: A Car Contains At Least 10,000 Different Parts

Source: Various, MIDFR

DISCLOSURES AND DISCLAIMER

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 *rise* 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 *fall* 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.