20 April 2017 | Sector Update

Automotive

***Maintain* NEUTRAL**

Uninterrupted growth

INVESTMENT HIGHLIGHTS

- **March marks the 3rd consecutive month of TIV growth**
- **Honda and Toyota led industry growth**
- **Bermaz Auto (BUY, TP: RM2.50/share) remains our top pick for company-specific catalysts and special dividends**
- **UMW remains a contrarian BUY (TP: RM6.50/share) as the stock is undervalued amid a turnaround in earnings, balance sheet deleveraging and management's renewed focus on EEVs for its auto division**

Uninterrupted growth. March 2017 is the 3rd consecutive month of growth registered by the auto industry. Mar17 TIV grew 10%yoy to 53,717 units and this growth now looks like an establishing trend. Growth on a sequential basis (+27%mom) was partly inflated by a weak base given a short working month in February. We stick to our 2017 TIV forecast of a 1.5%yoy growth for now, but we see possibilities of upward revisions. If annualised, 1Q17 TIV of 140,839 units (+7%ytd) already makes up 96% of our full year forecast of 589,033 units, despite the 1Q being the shortest and typically weakest quarter of the year.

Honda and Toyota led the growth. The two largest non-nationals led the industry growth in Mar17. Honda registered a 48%yoy growth, boosted by the City facelift launched on 2nd March and follow through deliveries of the BRV which was launched in Jan17. Despite the launch of the facelift Honda City (which is a competitor in its bread and butter segment), Toyota registered strong growth of 42%yoy and managed to lift market share to 11.5% vs. 8.9% a year ago.

But other non-nationals performed poorly. However, the rest of the non-nationals generally performed poorly. Nissan and Mazda saw contraction of 40%yoy and 42%yoy respectively. Mazda sales were weak ahead of launches of facelifts (Mazda 2/Mazda 3 in Apr-Jun period) and new models (CX5/CX9 from June onwards), but we are not too worried as bulk of Mazda's TIV recovery should come after launch of the new CX5 in the second half. For BAuto's (Mazda distributor) 4QFY17F (FYE Apr), our earnings forecast is already very conservative, expecting BAuto to register a RM15-20m net profit vs. recent historical quarterly earnings of ~RM30m, meaning there is very little chance of BAuto's results underperforming. There is still little visibility on Nissan's prospects given the freeze in new launches and Tan Chong's struggle to pare down inventories.

National cars in-line with industry growth. Both Proton and Perodua registered circa 10%yoy growth. Perodua launched the Axia facelift in Jan17 while the upgraded Bezza should provide a boost to Perodua TIV from Apr17 onwards.

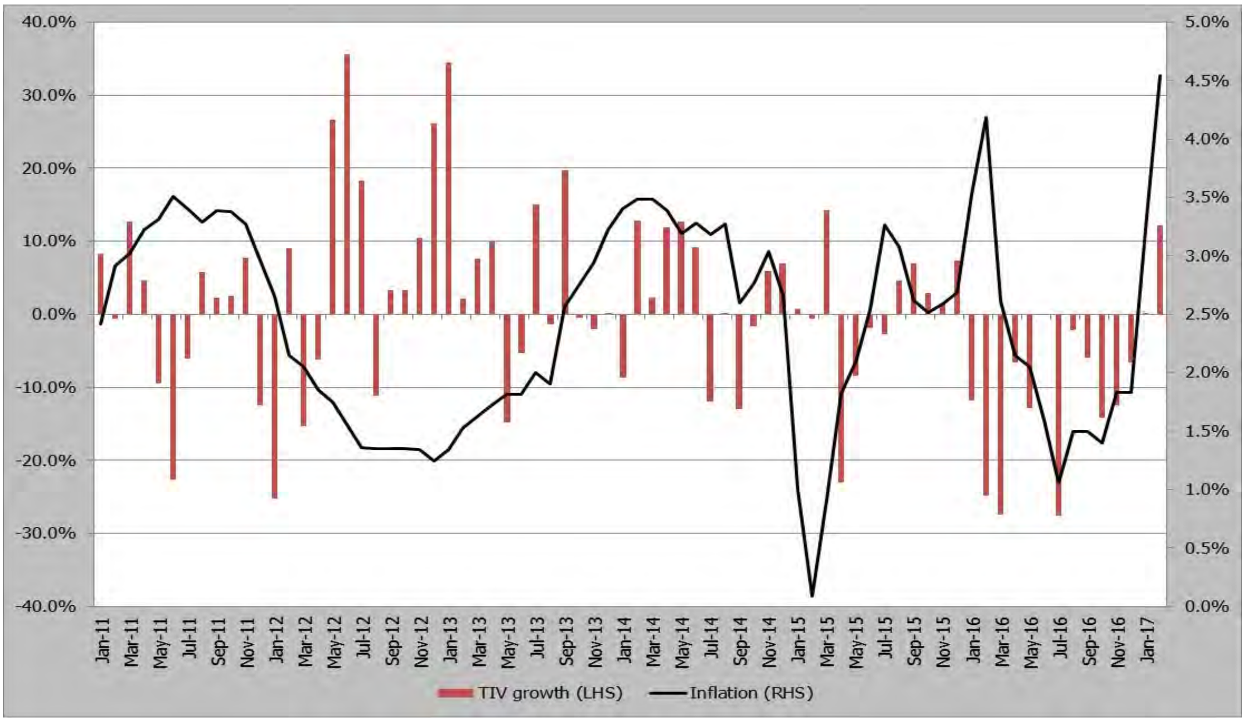
Our TIV forecast remains unchanged but we see possibilities of upward revisions. Our sector call too remains a NEUTRAL for now but notably, sector growth trends seem to have turned positive quite firmly now. The 1Q17 earnings season should paint a better picture on margin trends, though we note that earnings delivery by auto players under our coverage should be backloaded this year on expectations of a gradually improving Ringgit (in-house year end target of USD:RM4.30) vs. the USD:RM4.40 levels currently and gradual new launches.

Is inflation a threat? Though logically it would crimp disposable income, there has been little –ve correlation between inflation rates and Malaysian TIV growth rates historically (See Exhibit 1). Inflation rate has been relatively low throughout 2016, yet TIV contracted by some 13% during the year, as an example. Similarly when inflation rates were rising towards 2014, TIV still registered healthy growth of 1.6%. It is important to note that the TIV contraction throughout 2011 was driven by a major supply crisis as two of Malaysia's largest source of CKDs and CBUs i.e. Japan and Thailand suffered major natural disasters in the same year which crippled the entire supply chain. This was eventually resolved in 2012 and resulted in the strong TIV recovery.

Loan rollover. Replacement car buyers (which form the bulk of buyers in the market) after all, are already carrying monthly commitment on existing Hire Purchase instalments and getting a replacement car is not necessarily, if at all, an issue of expanding the existing commitment, e.g. an existing Vios owner who buys a new replacement model Vios will end up with similar monthly instalments as the existing one; because the new Vios is likely to be priced similar to the previous generation, or in fact lower, given duty exemptions under our EEV program incentives now. Therefore getting a new car will not change a buyer's monthly loan expense.

Secondly, 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. Because car owners typically replace their cars every 5 years, the buyers will have already sold the car before the monthly instalments balloon from the 6th year onwards. More importantly, keeping a car beyond the warranty period is in fact, even worse for consumers' pockets (especially the non-savvy car owners), as maintenance cost will build up as the car ages, especially every 5 years. Replacing an old car with a new one, with the same monthly loan instalment, but which comes with peace of mind given manufacturer's warranty hence, makes a lot more sense.

EXHIBIT 1: HISTORICAL TIV GROWTH VS. INFLATION RATE



Source: MAA, MIDFR

Bermaz Auto (BUY, TP: RM2.50/share) is still our top sector pick: Key share price catalysts over the next 12 months: **(1) Attractive dividend yield of 9%** underpinned by net cash which accounts for 12% of market cap and solid 8% FCFE yield (FY17F). The listing of BAuto Philippines will bump yields up further given potential one-off special dividends. **(2) 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 9x CY17F earnings. **(3) 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. **(4) Launch of the new CX5 and new CX9** which will drive a recovery in volumes and margins.

UMW remains a contrarian BUY at unchanged TP of RM6.50/share. (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 12x FY18F earnings, trades below its historical average PER of 13.5x.

EXHIBIT 2: MARCH 2017 TIV SUMMARY

									Market share	
Marques	**Mar-16**	**Feb-17**	**Mar-17**	**YoY**	**MoM**	**YTD16**	**YTD17**	**YTD %**	**Mar-16**	**Mar-17**
Proton	5,535	6,099	6,070	9.7%	-0.5%	19,225	19,376	0.8%	11.3%	11.3%
Perodua	17,629	16,603	19,459	10.4%	17.2%	47,181	50,265	6.5%	36.1%	36.2%
Toyota	4,319	4,530	6,162	42.7%	36.0%	10,216	16,503	61.5%	8.9%	11.5%
Honda	7,418	7,695	10,994	48.2%	42.9%	18,777	27,283	45.3%	15.2%	20.5%
Nissan	4,350	1,808	2,626	-39.6%	45.2%	10,773	5,989	-44.4%	8.9%	4.9%
Mazda	1,416	460	818	-42.2%	77.8%	3,552	2,082	-41.4%	2.9%	1.5%
Others	8,133	5,260	7,588	-6.7%	44.3%	21,531	19,341	-10.2%	16.7%	14.1%
Total	**48,800**	**42,455**	**53,717**	**10.1%**	**26.5%**	**131,255**	**140,839**	**7.3%**	**100.0%**	**100.0%**

Source: MAA, MIDFR

EXHIBIT 3: MARCH 2017 TIV SUMMARY BY VEHICLE TYPE

Segment	**Mar-16**	**Feb-17**	**Mar-17**	**YoY**	**MoM**	**YTD16**	**YTD17**	**YTD %**
Passenger cars	43,247	38,881	48,355	11.8%	24.4%	117,373	127,530	8.7%
Commercial vehicles	5,553	3,574	5,362	-3.4%	50.0%	13,882	13,309	-4.1%
Total	**48,800**	**42,455**	**53,717**	**10.1%**	**26.5%**	**131,255**	**140,839**	**7.3%**

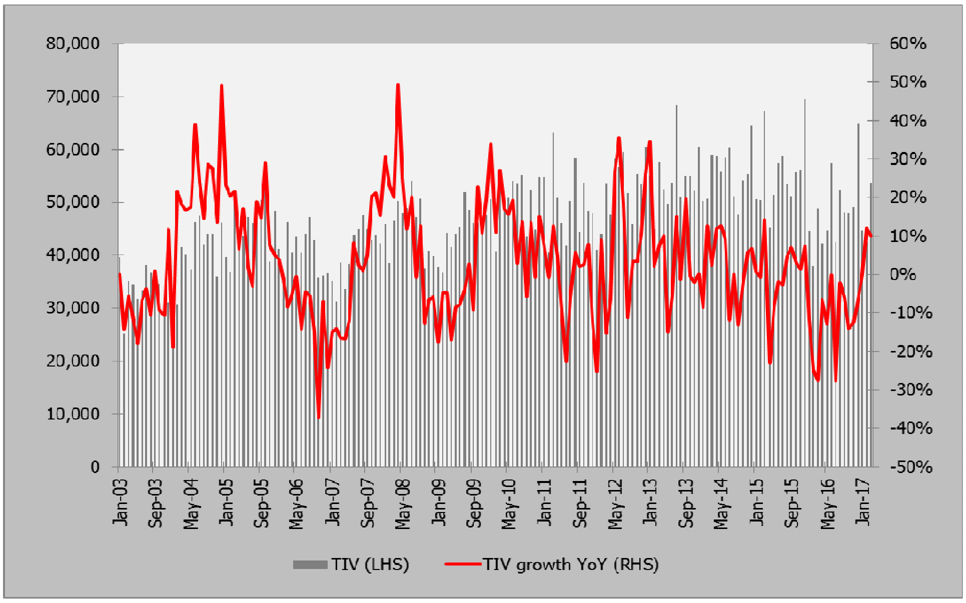
Source: MAA, MIDFR

EXHIBIT 4: MARCH 2017 TIV SUMMARY BY VEHICLE TYPE

									Market share	
Segment	**Mar-16**	**Feb-17**	**Mar-17**	**YoY**	**MoM**	**YTD16**	**YTD17**	**YTD %**	**Mar-16**	**Mar-17**
National cars	23,164	22,702	25,529	10.2%	12.5%	66,406	69,641	4.9%	47.5%	47.5%
Non-nationals	25,636	19,753	28,188	10.0%	42.7%	64,849	71,198	9.8%	52.5%	52.5%
Total	**48,800**	**42,455**	**53,717**	**10.1%**	**26.5%**	**131,255**	**140,839**	**7.3%**		

Source: MAA, MIDFR

EXHIBIT 5: HISTORICAL TIV TREND



Source: MAA, MIDFR

VALUATION AND RECOMMENDATION

		Shr Price	EPS (sen)		PE (x)		P/BV	ROE	Div Yield	Target	Total
Company	**Rating**	**(RM)**	**CY16 F**	**CY17 F**	**CY16 F**	**CY17 F**	**(x)**	**(%)**	**(%)**	**Price (RM)**	**Upside (%)**
B. Auto	BUY	2.08	17.1	20.5	12.1	10.2	4.5	40.2	8.6	2.50	28.8
Tan Chong	NEUTRAL	1.81	-19.8	-16.2	-9.1	-11.2	0.5	-1.5	0.0	1.90	5.0
UMW	BUY	6.08	31.7	48.6	19.2	12.5	0.9	-0.2	0.0	6.50	6.9
Sector average					***15.7***	***11.3***	***2.0***	***12.8***	***2.9***		

Source: Bloomberg, Companies, MIDFR

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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 *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.