

19 October 2017 | Sector Update

Automotive

Maintain OVERWEIGHT

Weak TIV but improving core operating environment

INVESTMENT HIGHLIGHTS

- **Weak September TIV could be temporary**
- **Core operating environment nonetheless; stronger Ringgit, roll back of rebates, improving HP loan approval rates**
- **Bermaz Auto (BUY, TP: RM2.55/share) is our top pick for a solid 41% earnings CAGR, attractive 6% yield and value crystallisation of Philippines unit**
- **UMW remains a contrarian BUY (TP: RM7.20/share) as a value play amid a turnaround in earnings, balance sheet deleveraging and early cycle play into EEV-driven structural cost reduction**

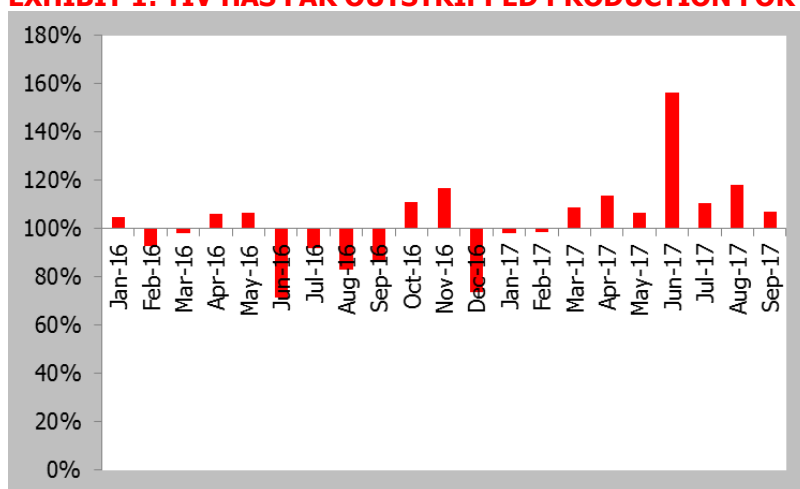
September TIV contracted. TIV registered a 15%yoy drop to 40,981 units September. The weakness was seen across the board. Perodua accounted for 39% of the year-on-year fall, followed by Proton (22%), Toyota (19%) and Nissan (13%). On a month-on-month basis, TIV was down 21% but this is off an inflated base in August which saw carry over deliveries from the prior month, which was impacted by a glitch in the registration system. While Perodua led the weakness in absolute terms, we suspect this could also be a knee jerk to the roll back in rebates by players as system inventory reduces.

Perodua weakness. We think Perodua is being impacted by customers' wait-and-see in anticipation of the new MyVi within the next 2 months - recall that Perodua was also the only player to show a sequential contraction in August versus an across the board recovery. Given that Perodua accounts for the largest share of TIV at 35%, and the fact that the MyVi accounts for some 27% of Perodua's sales, any weakness in Perodua sales has a bearing on overall TIV. In 2014, in anticipation of launch of the Axia towards year-end, sales of the Viva dropped significantly (this was also partly due to exhaustion of inventory of the model), and led to a 0.3% drop in Perodua TIV in the year, vs. the industry's 1.6% growth. We also suspect that this factor might be affecting sales of lower spec A/B segment non-nationals as well.

Forecasts intact, core operating environment improving. Despite the September weakness, TIV is still showing growth of 2%ytd and accounts for 71% of our full year forecast of 596k units. MAA expects October TIV to recover on a longer working month while the build-up to year-end sales campaigns should see improvement in TIV for the remainder of the year. Our forecasts remain unchanged at this juncture. Mazda sales have been weak so far, and September TIV has yet to reflect numbers from the new CX5 which is expected to trickle in from October onwards. However Mazda is a niche player with a ~2% market share. Meanwhile, the new MyVi is an important catalyst to stimulate TIV for the remainder of the year. More importantly, the sector's underlying core operating environment is turning positive: (1) Currency strength, (2) Roll-back of rebates, (3) Improving loan approval rate – HP loan approvals have held up above 50% for the past 3 months (*See Exhibit 2*), which underpins our OVERWEIGHT call on the sector.

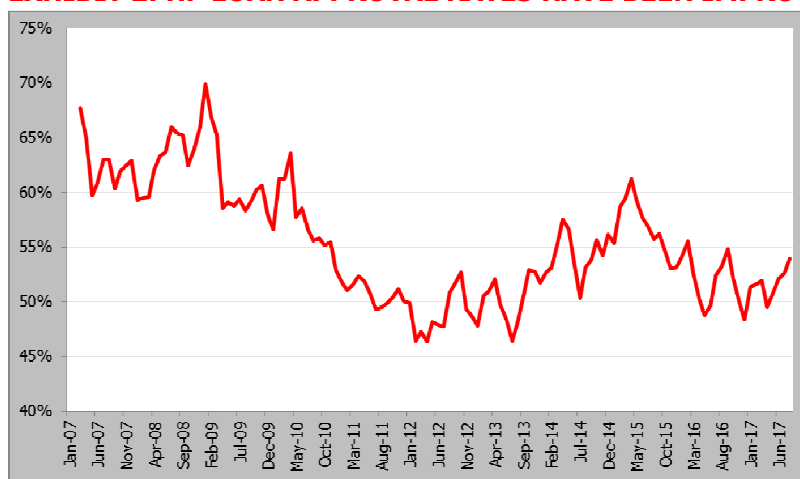
Rebates being rolled back. Our recent round of meetings with the auto players as well as ground checks suggests that most companies are rolling back rebates. Our chat with Toyota dealers in town suggests distributor rebates have reduced by 30%-50% while Tan Chong is also looking to reduce rebates for its models in return for longer warranty period (from 3 years to 7 years). Distributor rebates come direct from the distributors e.g. UMW Toyota or Tan Chong Motor whereas dealership rebates usually come out of the dealers' (3rd parties) own pockets. Bermaz Auto meanwhile, is in fact raising pricing for the new CX5 (by up to 2%); the CX5 accounts for 30%-40% of Mazda TIV. The consistently >100% sales-to-production ratio since early 2017 (*See Exhibit 1*) means that system inventories have been reducing and an end to this process is likely to result in the roll-back of rebates in the industry.

EXHIBIT 1: TIV HAS FAR OUTSTRIPPED PRODUCTION FOR MOST OF 2017



Source: MAA, MIDFR

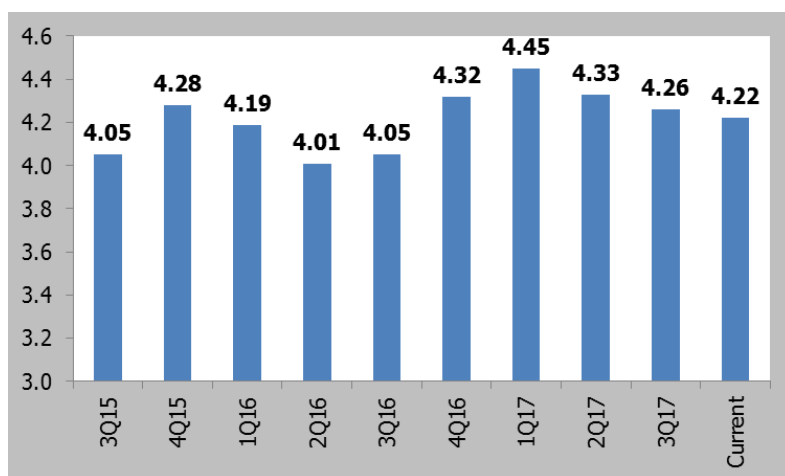
EXHIBIT 2: HP LOAN APPROVAL RATES HAVE BEEN IMPROVING



Source: MAA, MIDFR

Forex is now a friend. The Ringgit's strength, particularly in the past 2 month bodes well for the sector. Of the auto players under coverage, UMW Toyota has the largest exposure to the USD given that all its imported CKD kits and CBUs from Thailand are transacted in USD. Given low localisation rates (of between 20%-60%) relative to the national makes (of 80%-95%), we estimate around half of total component costs are imported. Tan Chong meanwhile, is estimated to have circa 80% (of total imported cost) exposure to USD imports with the rest in JPY. Every 1% change in the USD impacts our FY18F by 4.7% for UMW (Group) and 16% for Tan Chong. As Tan Chong is loss making (relative to the steady state earnings of RM200m-300m/annum prior to the downcycle) it is more sensitive to forex changes now.

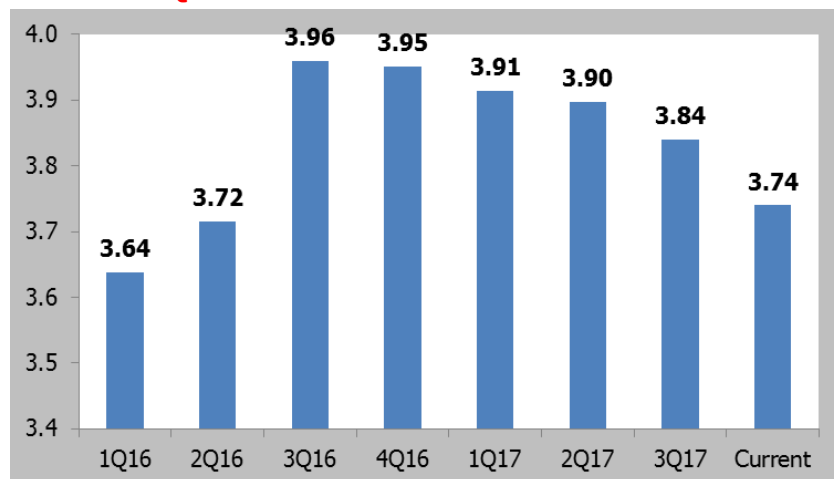
EXHIBIT 3: QUARTERLY USD:RM TRENDS



Source: Bloomberg, MIDFR

JPY-exposed beneficiaries. The Ringgit had also strengthened against the JPY in the past 6 months and currently stands at RM3.72:JPYx100. Notably, YTD17 rate of RM3.86:JPYx100 is already above our CY18/19F assumption of RM3.90:JPYx100. Bermaz Auto is a key beneficiary of the Ringgit strength against the JPY as its imports are 100% exposed to the latter; BAUTO is exposed to the JPY via CBU imports, whereas CKDs i.e. the CX5 and Mazda 3 models are purchased at a fixed Ringgit price from 30%-owned Mazda Malaysia Sdn Bhd (MMSB), which is the importer of Mazda CKD kits and assembler. To make this possible, MMSB absorbs JPY volatilities from CKD imports; which means that MMSB also benefits from the current Ringgit strength. We estimate that every 1% strengthening of the Ringgit against the JPY impacts BAUTO's FY18F (FYE April) earnings by 3%. Perodua is another beneficiary given its exposure to the JPY (and partly USD). Every 1% change in the JPY impacts our FY17F by 1%. UMW is the largest shareholder of Perodua with a 38% stake.

EXHIBIT 4: QUARTERLY JPY:RM TRENDS



Source: Bloomberg, MIDFR

EXHIBIT 5: EARNINGS SENSITIVITY TO FOREX

	FY18F earnings impact for every 1% change in USD/JPY
UMW Holdings	4.7%
Tan Chong	16.0%
Bermaz Auto	3.0%
Perodua	1.0%

Source: MIDFR

BAuto remains our top sector pick at unchanged TP of RM2.55/share. Key catalysts over the next 12 months: **(1) A 30%yoy increase in FY18F TIV** driven mainly by launch of the new CX5 in Sep17 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 6%** underpinned by net cash which accounts for 10% of market cap and solid 7% 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 15x 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.


UMW Holdings remains a contrarian BUY at unchanged TP of RM7.20/share. Key catalysts: **(1) Demerger of O&G units** deleverages balance sheet, drives UMW back into the black and allows better focus on core divisions **(2) Reversal of prior years' market share loss**, structural cost reduction and pricing advantage from UMW Toyota's EEV-focused strategy **(3) Monetisation of UMW's 861 acres Serendah landbank** which will unlock value of the asset – easily worth 39sen/share, or 6% of our SOP valuation **(4) A more than quadrupling of M&E division earnings** once its aerospace division reaches full scale production **(5) An underleveraged balance sheet** post UMWOG de-merger suggests room for acquisitive growth. 

EXHIBIT 6: SEPTEMBER 2017 TIV SUMMARY

Marques	Sep-16	Aug-17	Sep-17	YoY	MoM	YTD16	YTD17	YTD %	Market share	
									Sep-16	Sep-17
Proton	6,062	6,452	4,498	-25.8%	-30.3%	50,091	56,297	12.4%	12.6%	11.0%
Perodua	17,147	18,630	14,355	-16.3%	-22.9%	150,889	151,580	0.5%	35.7%	35.0%
Toyota	5,680	5,705	4,348	-23.5%	-23.8%	44,520	49,319	10.8%	11.8%	10.6%
Honda	7,498	9,733	7,906	5.4%	-18.8%	63,262	78,742	24.5%	15.6%	19.3%
Nissan	3,049	2,551	2,153	-29.4%	-15.6%	30,398	20,759	-31.7%	6.3%	5.3%
Mazda	1,020	802	728	-28.6%	-9.2%	10,084	7,002	-30.6%	2.1%	1.8%
Others	7,631	7,847	6,993	-8.4%	-10.9%	69,095	62,016	-10.2%	15.9%	17.1%
Total	48,087	51,720	40,981	-14.8%	-20.8%	418,339	425,715	1.8%	100.0%	100.0%

Source: MAA, MIDFR

EXHIBIT 7: SEPTEMBER 2017 TIV SUMMARY BY VEHICLE TYPE

Segment	Sep-16	Aug-17	Sep-17	YoY	MoM	YTD16	YTD17	YTD %
Passenger cars	42,644	46,010	36,517	-14.4%	-20.6%	371,460	381,800	2.8%
Commercial vehicles	5,443	5,710	4,464	-18.0%	-21.8%	46,879	43,915	-6.3%
Total	48,087	51,720	40,981	-14.8%	-20.8%	418,339	425,715	1.8%

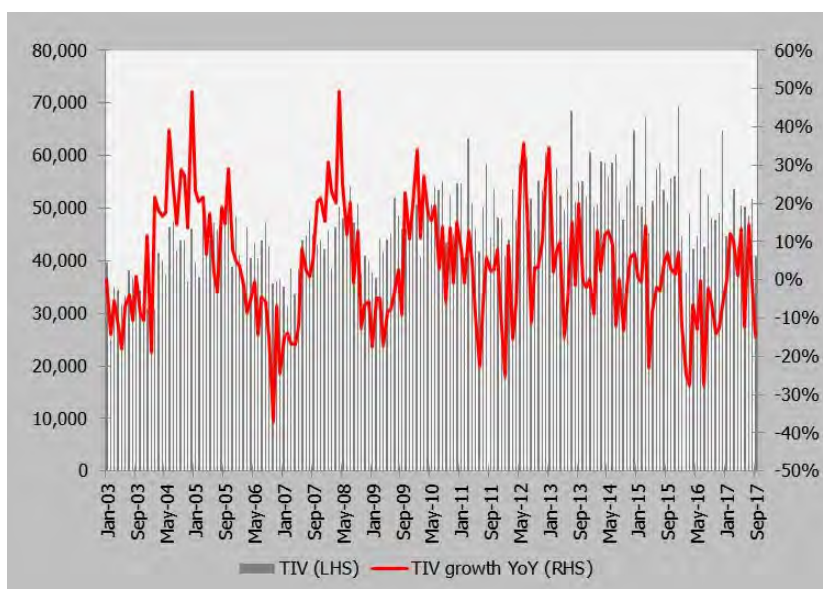
Source: MAA, MIDFR

EXHIBIT 8: SEPTEMBER 2017 TIV SUMMARY BY VEHICLE TYPE

Segment	Sep-16	Aug-17	Sep-17	YoY	MoM	YTD16	YTD17	YTD %	Market share	
									Sep-16	Sep-17
National cars	23,209	25,082	18,853	-18.8%	-24.8%	200,980	207,877	3.4%	48.3%	46.0%
Non-nationals	24,878	26,638	22,128	-11.1%	-16.9%	217,359	217,838	0.2%	51.7%	54.0%
Total	48,087	51,720	40,981	-14.8%	-20.8%	418,339	425,715	1.8%		

Source: MAA, MIDFR

EXHIBIT 9: 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)	CY17F	CY18F	CY17F	CY18F	(x)	(%)	(%)	Price (RM)	Upside (%)
B.Auto	BUY	2.08	17.1	20.5	12.1	10.2	4.5	40.2	6.3	2.55	28.9
Tan Chong	NEUTRAL	1.70	(19.8)	(16.2)	(8.6)	(10.5)	0.4	(1.5)	0.0	1.85	8.8
UMW	BUY	5.45	31.7	48.6	17.2	11.2	0.9	5.4	0.0	7.20	32.1
Sector average					14.7	10.7	2.0	14.7	2.1		

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 <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.