21 January 2016 | Sector Update

Automotive

***Maintain* NEUTRAL**

Time to scrap?

INVESTMENT HIGHLIGHTS

- **Domestic autos looks set to enter its third straight year of earnings contraction.**
- **A relook at a vehicle scrapping policy is timely to address some of the headwinds and capitalise on the sizable pool of excessively old cars in Malaysia.**
- **Thailand's car buyers' incentive program revived its TIV off the 2011 lows caused by the great floods while a trial of a scrapping scheme for Proton during the financial crisis yielded positive results.**
- **Maintain NEUTRAL on autos. A scrapping scheme is a possible catalyst for us to turn less negative on the sector. Berjaya Auto (BUY, TP: RM2.60/share) is our top sector pick.**

Domestic autos in a lull. The domestic auto industry has suffered for two straight years from a combination of: (1) Skyrocketing cost from a weak RM, (2) Heavy price discounting as a result of excess inventories in 2014-15, (3) Softening underlying demand, and (4) Tighter loan approvals. While the heavy discounts have been partly rolled back, a weak RM and a weakening consumer sentiment persists. Sector earnings suffered a 14% fall in CY14, followed by another 42% contraction in CY15F. CY16F earnings is still expected to fall further on our forecast (-3%yoy) but this is before factoring in the potentially worse than expected TIV as a result of recent and upcoming price hikes by players as well as an even weaker RM relative to the past 2 years.

Time to scrap? A scrapping policy essentially allows the exit of excessively old cars, stimulates demand for new cars and indirectly enhances safety/roadworthiness of the Malaysian vehicle population. Such a policy was mulled in the past and to our understanding, was proposed (under the End of Life Vehicle policy) to be part of the NAP review in 2009 and 2014. However, it was deferred due to the lack of infrastructure and concerns on the reaction of the public if it were to be made compulsory. Given the tough operating conditions endured by the auto sector and the dire need to stimulate demand, we think it is timely for the policy to be relooked. To avoid raising the ire of certain quarters, a voluntary implementation probably looks more suitable at this point.

Voluntary scrapping is not new. In fact, a voluntary scrapping policy is not entirely new to Malaysia. A trial of a similar policy was run between March till October 2009, i.e. during the global financial crisis (called the "Proton X-Change program"), but this was limited to just Proton and was done merely as a trial run. The scheme was 100% funded by the Government, but with a limited allocation, whereby owners of cars above 15 years of age were allowed to scrap it in return for a RM5,000 rebate. The rebate can then be used to purchase a new Proton model.

Past implementation generated positive impact. Out of Proton's total volume in 2009, some 30% came from Proton's X-Change program participants, reflecting favourable take-up of the scheme. Proton's TIV in 2009 grew by 4% relative to a 2% contraction for the industry – this has to be taken in context with the general economic slowdown and the 2% GDP contraction during the year. The participants represented only circa 1.3% of the estimated 3.3m cars that are above 15 years of age in Malaysia, suggesting a lot more potential had the program been extended. More importantly, we think the policy entails a lot more potential should it be extended to all makes, as this would give consumers multiple choices in their new car purchase after participating in the scheme.

Massive potential to stimulate new demand. Based on our estimates (and JPJ statistics on the Malaysian vehicle population), some 49% of the existing cars on the road (or 5.7m) are above 10 years of age, 29% (or 3.4m) are above 15 years and 16% (or 1.8m) are above 20 years of age. Even if the policy were to be kick-started with just cars above 20 years of age, the potential participant pool of 1.8m is already equivalent to 2.7x Malaysia's annual TIV, suggesting massive potential for the policy to boost demand for new cars.

EXHIBIT 1: MASSIVE POOL OF OLD CARS IN MALAYSIA

Age (Years)	Malaysian Car Population (units)	Car population by Age Group (units)	Percentage of Car Population
>20	11,529,124	1,809,034	15.7%
>15	11,529,124	3,374,230	29.3%
>10	11,529,124	5,651,231	49.0%

Source: JPJ, MAA, MIDFR

Determining the beneficiaries. While the minimum age of cars allowed to participate determines the breadth of the target market of this policy, the amount of rebate plays a critical role in determining which price segments actually benefit from a scrapping policy implementation. At the RM5,000 rebate (assuming a similar amount as Proton's X-Change program) models in the national car price segment will likely be the biggest beneficiaries based on the assumption that participants will use only the proceed as downpayment for a new car.

Downpayments typically consist of 10%-20% of a car's price, (which we have assumed in this case) and at an assumed RM5,000 rebate, works out to implied price points of between RM25,000-RM50,000 for the corresponding new car purchase. The majority of national car models fall within this price bracket and thus, is likely to benefit the most from implementation of the program.

A cost sharing mechanism might allow more flexibility. However, a rebate cost sharing between the Government and the auto players could create more flexibility (especially on the auto players' side) in the total amount of rebate to be offered to potential takers as this could raise the benefitting price bracket higher. If the total rebate is raised to say, RM10,000, beneficiaries will expand to models with price points of up to RM100,000 (See Exhibit 2), which will include the non-national B, C as well as the lower range pick-up and MPV segments.

EXHIBIT 2: BENEFICIARY PRICE SEGMENT VS. REBATE

Total rebate (RM)	Downpayment as percentage of car price	Implied new car price point (RM)
5,000	20%	25,000
	10%	50,000
6,000	20%	30,000
	10%	60,000
7,000	20%	35,000
	10%	70,000
8,000	20%	40,000
	10%	80,000
9,000	20%	45,000
	10%	90,000
10,000	20%	50,000
	10%	100,000
11,000	20%	55,000
	10%	110,000

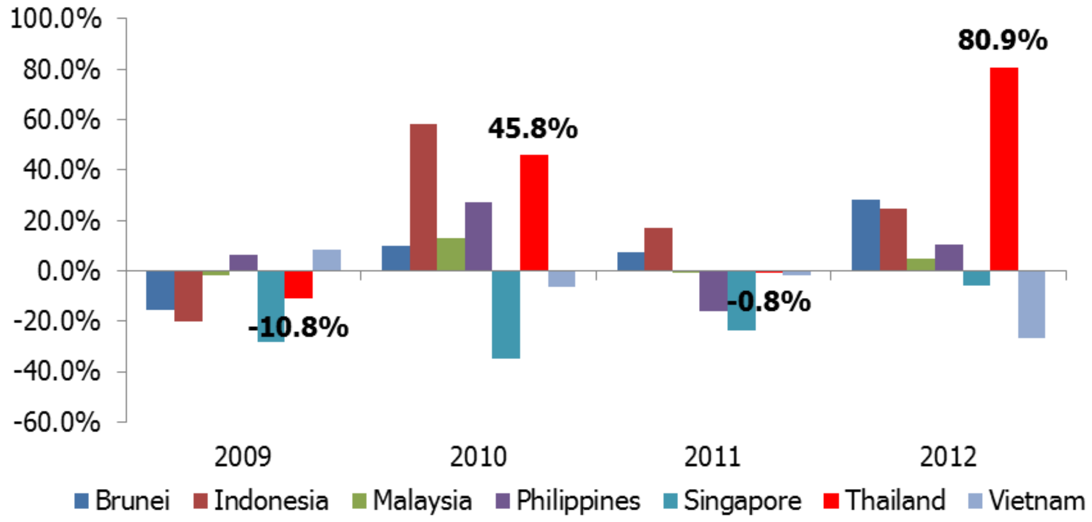
Source: MIDFR

Substituting promotional rebates. As it is, auto players are already practising overtrades, i.e. paying a premium over the actual second hand value of a traded in car as an incentive for consumers to change to a new car. Also, our ground checks suggests that discounts being offered in the market average at around RM4,000 per model (the actual amount varies from model to model). These costs can be substituted into a scrapping scheme rebate by the auto players, which in turn, entitles the buyer to an additional amount of rebate that is funded by the Government.

A way to support the EEV program perhaps? Thailand adopted a First Car Buyer (FCB) Scheme back in 2012 after the launch of its Eco-Car program. The Eco Car program is the equivalent of Malaysia's Energy Efficient Vehicle program but with a rigid target segment and differing incentives. The FCB scheme entailed tax refunds of up to THB100,000 for first time car buyers that bought Eco Car qualified models and was meant to drive Thailand's then, new green car program and more importantly to revive Thailand's auto market which was devastated by the big floods in 2011.

Thailand spent a total of USD2.5b for the program, according to World Bank Estimates, benefitting some 1.2m Thai car buyers. Thailand's scheme was strictly targeted towards new car buyers, but nonetheless helped to drive Thailand's TIV growth by 81% in 2012 to 1.4m units, while auto production grew by 68% during the period (See Exhibit 3). In this context, we think a scrapping scheme rebate that is channelled towards the purchase of EEV qualified models would support the development of Malaysia's EEV program.

EXHIBIT 3: CAR BUYER'S SCHEME BOLSTERED THAILAND'S TIV RECOVERY IN 2012 (YOY GROWTH)



Source: AAF, MIDFR

So who are the beneficiaries? If the voluntary scrapping policy indeed comes through, we think Perodua (via MBM and UMW) and Proton (via DRB) would be the main beneficiaries. Nonetheless, depending on the structure of the scheme, i.e. flexibility of the amount of rebate & age of cars allowed to participate, we think the key non-nationals under our coverage such as UMW Toyota (UMW: NEUTRAL, TP: RM6.90/share), Honda Malaysia (DRB-Hicom: NON-RATED), Tan Chong (NEUTRAL, TP: RM2.90/share) and Berjaya Auto (BUY, TP: RM2.60/share) are also likely to benefit as volumes for these players are largely driven by the B-segment, MPVs and pick-ups that are priced below RM120,000 (See Exhibit 4).

EXHIBIT 4: POTENTIAL BENEFICIARIES OF SCRAPPING SCHEME: NON-NATIONALS UNDER COVG.

Make	Models (Potential Beneficiaries)	Price Range (RM)	Percentage of TIV
Mazda	Mazda 2 (B-segment sedan)	85,470	27%
	Mazda 3 CKD (C-segment sedan)	106,105 - 121,105	20%
	Mazda BT-50 (Pick-up)	80,528 - 104,067	6%
	Total		**53%**
Toyota	Vios (B-segment sedan)	72,459 - 92,103	36%
	Avanza (Compact MPV)	66,238 - 77,612	6%
	Innova (C-segment MPV)	93,691 - 105,780	4%
	Hilux (Pick-up)	73,999 - 108,787	30%
	Total		**76%**
Nissan	Almera (B-segment sedan)	64,960 - 77,622	57%
	Grand Livina (MPV)	86,894 - 99,895	13%
	Navara (Pick-up)	79,000 - 120,800	7%
	Total		**77%**

Source: Various, MAA, MIDFR

We maintain NEUTRAL on the auto sector given the persistently weak RM and a muted demand outlook, but the implementation of a vehicle scrapping policy is a much needed catalyst for us to turn less negative on the sector. Our top sector pick is Berjaya Auto (BUY, TP: RM2.60/share): (1) While there is considerable pressure from the stronger JPY, earnings is buffered by model mix expansion, i.e. the CBU CX3 and the upcoming Mazda 6 CKD which will expand margins and volume, (2) Potential market share wins in the near-term given its decision to remain status quo on pricing, and (3) An underleveraged balance sheet (FY16F net cash of RM252m which accounts for 10% of market cap) coupled with strong FCF yields of 7%-8% (given an asset light business model), suggests dividend upside and potential acquisitive growth. Ex-cash, BAuto trades at just 9.7x CY16F earnings.

VALUATION AND RECOMMENDATION

		Share Price	EPS (sen)		PE (x)		P/BV	ROE	Div Yield	Target	Potential
Companies	**Rating**	**(RM)**	**CY15F**	**CY16F**	**CY15F**	**CY16F**	**(x)**	**(%)**	**(%)**	**Price (RM)**	**Upside (%)**
B.Auto	Buy	1.99	19.0	19.8	10.5	10.1	3.5	35.7	4.2	2.60	30.7
Tan Chong	Neutral	2.55	11.4	10.1	22.4	25.2	0.6	2.7	1.5	2.90	13.7
UMW	Neutral	6.70	31.8	30.3	21.1	22.1	1.4	5.0	1.5	6.90	3.0

Source: Bloomberg, Companies, MIDFR

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

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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.