

21 September 2017 | Sector Update

Automotive

Maintain OVERWEIGHT

An improving core operating environment

INVESTMENT HIGHLIGHTS

- **August TIV recovers against weak July**
- **Core operating environment improving; stronger Ringgit, rolling back of rebates**
- **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**

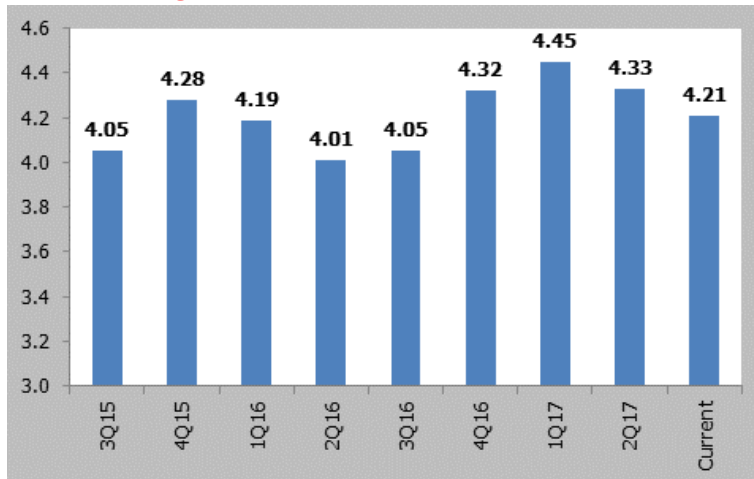
Recovers against weak July. August 2017 TIV recovered 6.5%mom to 51,720 units given spill over deliveries from July which was impacted by a glitch in the online registration system. On a year-on-year basis, TIV was down slightly by 1%yoy but this is off an exceptionally high base in August 2016 which captured the initial response to Perodua's Bezza. August 2016 was one of only 2 months (the other being December) in 2H16 which saw monthly TIV exceed 50K units. The improvement in sequential sales was across the board except for Perodua which saw a 1%mom contraction and a 12%yoy decline.

Forecasts still intact. Year-to-date, TIV registered at 384,734 units, or a 3.9%yoy growth. This is still well above our forecasted growth of +2.7%yoy (596K units). We see possibilities of further upside to our target but this would very much depend on the build-up to the year-end sales campaigns. Toyota launched four facelift models and additional variants for the Vios / Camry / Fortuner / Hilux / Innova, mostly in September 2017. Mazda is expected to launch its new generation CX5 within the next 2 weeks (most of the numbers to trickle in from October) while a big launch, we think, would be Perodua's new MyVi in 4Q17. These launches could stimulate further strength into the 4Q17.

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 6%); the CX5 accounts for 30%-40% of Mazda TIV.

Forex is now a friend. The Ringgit's strength, particularly in the past 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.

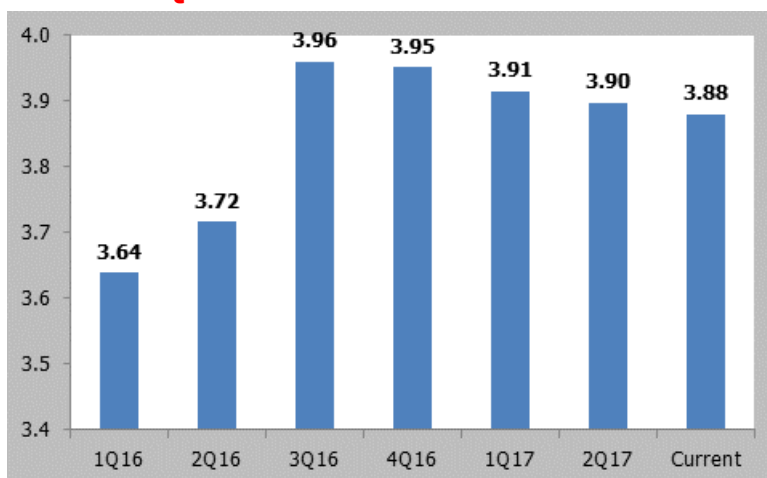
EXHIBIT 1: QUARTERLY USD:RM TRENDS



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 RM3.88: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 2: QUARTERLY JPY:RM TRENDS



Source: Bloomberg, MIDFR

EXHIBIT 3: 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 4: AUGUST 2017 TIV SUMMARY

Marques	Aug-16	Jul-17	Aug-17	YoY	MoM	YTD16	YTD17	YTD %	Market share	
									Aug-16	Aug-17
Proton	4,436	5,954	6,452	45.4%	8.4%	44,029	51,799	17.6%	8.5%	12.5%
Perodua	21,251	18,920	18,630	-12.3%	-1.5%	133,742	137,225	2.6%	40.6%	36.0%
Toyota	6,563	5,543	5,705	-13.1%	2.9%	38,840	44,971	15.8%	12.5%	11.0%
Honda	8,283	8,576	9,733	17.5%	13.5%	55,764	70,836	27.0%	15.8%	18.8%
Nissan	3,133	2,518	2,551	-18.6%	1.3%	27,349	18,606	-32.0%	6.0%	4.9%
Mazda	1,032	701	802	-22.3%	14.4%	9,064	6,274	-30.8%	2.0%	1.6%
Others	7,614	6,341	7,847	3.1%	23.8%	61,464	55,023	-10.5%	14.6%	15.2%
Total	52,312	48,553	51,720	-1.1%	6.5%	370,252	384,734	3.9%	100.0%	100.0%

Source: MAA, MIDFR

EXHIBIT 5: AUGUST 2017 TIV SUMMARY BY VEHICLE TYPE

Segment	Aug-16	Jul-17	Aug-17	YoY	MoM	YTD16	YTD17	YTD %
Passenger cars	46,223	43,524	46,010	-0.5%	5.7%	328,816	345,283	5.0%
Commercial vehicles	6,089	5,029	5,710	-6.2%	13.5%	41,436	39,451	-4.8%
Total	52,312	48,553	51,720	-1.1%	6.5%	370,252	384,734	3.9%

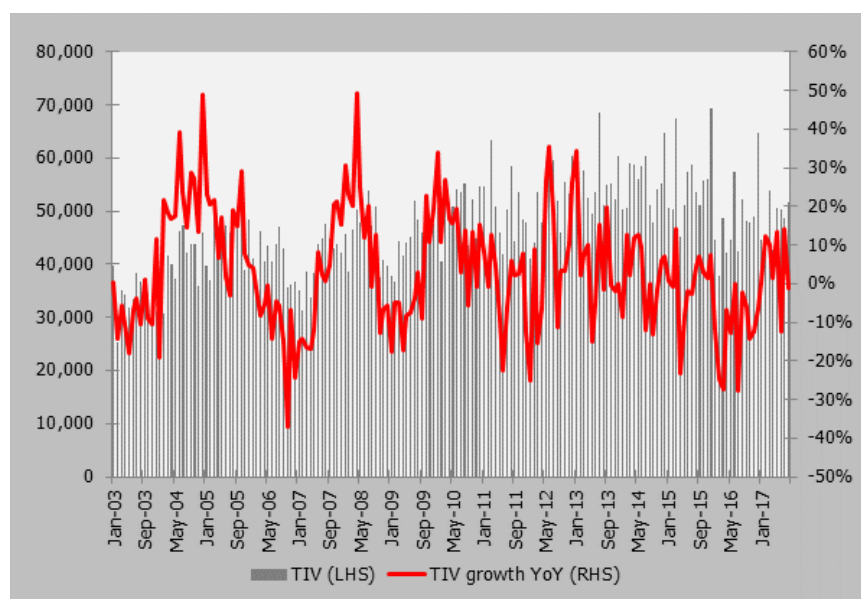
Source: MAA, MIDFR

EXHIBIT 6: AUGUST 2017 TIV SUMMARY BY VEHICLE TYPE

Segment	Aug-16	Jul-17	Aug-17	YoY	MoM	YTD16	YTD17	YTD %	Market share	
									Aug-16	Aug-17
National cars	25,687	24,874	25,082	-2.4%	0.8%	177,771	189,024	6.3%	49.1%	48.5%
Non-nationals	26,625	23,679	26,638	0.0%	12.5%	192,481	195,710	1.7%	50.9%	51.5%
Total	52,312	48,553	51,720	-1.1%	6.5%	370,252	384,734	3.9%		

Source: MAA, MIDFR

EXHIBIT 7: HISTORICAL TIV TREND



Source: MAA, MIDFR

VALUATION AND RECOMMENDATION

Company	Rating	Shr Price (RM)	EPS (sen)		PE (x)		P/BV (x)	ROE (%)	Div Yield (%)	Target Price (RM)	Total Upside (%)
			CY17 F	CY18 F	CY17 F	CY18 F					
B.Auto	BUY	2.04	17.1	20.5	11.9	10.0	4.4	40.2	6.3	2.55	31.3
Tan Chong	NEUTRAL	1.73	(19.8)	(16.2)	(8.7)	(10.7)	0.4	(1.5)	0.0	1.85	6.9
UMW	BUY	5.45	31.7	48.6	17.2	11.2	0.9	5.4	0.0	7.20	32.1
Sector average					14.6	10.6	1.9	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.