23 March 2016 | Sector Update

Automotive

***Maintain* NEUTRAL**

Weakest since 09' crisis, Toyota hits decade low

INVESTMENT HIGHLIGHTS

- **Total industry volume contraction widened further in February.**
- **Toyota sales hits a decade low, but managed to regain 2nd spot in non-national segment.**
- **Maintain NEUTRAL on autos given a muted demand outlook, while recent strength in the Ringgit is still insufficient to trigger a change in our assumptions for now.**
- **Berjaya Auto (BUY, TP: RM2.60/share) is our top sector pick and we remain NEUTRAL on UMW (TP: RM6.00/share).**

Contraction widened in February. The auto sector registered a further drop in total industry volume (TIV) to 37,864 units, a 15%mom drop and an even deeper 25%yoy contraction. While this is probably the weakest volume seen since the 2008/09 financial crisis, it is more of timing and a downcycle that the sector is facing. As we had forewarned in prior reports, this weakness is a repercussion of consumers bringing forward purchases into 4Q15 ahead of the price hikes in January 2016, which resulted in the drying up of the market and weaker-than-usual pre-Chinese New Year demand. However, a recovery may not come that quickly as March numbers are still expected remain depressed year-on-year as it should reflect the initial impact of Proton's price hike, i.e. between RM312 and RM2021 depending on model (which was implemented post-Chinese New Year).

Crossing fingers for a 2H recovery, but downside bias to forecasts. Annualised 2M16 TIV would have only accounted for 74% of our 2016F TIV of 666K units, but it is too early to conclude the extent of a downgrade that is required at this point until there is more stability in the market. Our recent meetings suggest that players are expecting demand to recover in 2H16 and the weak TIV to persist up till March-April period. Most of the new launches by the major players are targeted from 2Q16 onwards, i.e. Toyota's IMV models. Mazda too, is only likely to launch CKD (completely knocked down) models from mid-2016 onwards.

Toyota sales hits decade low. While UMW Toyota managed to tip-toe around Tan Chong to regain 2nd place in the non-national segment, Toyota's sales volume contraction deepened in February, down a further 2%mom and -42%yoy to 2,917 units, its lowest in at least the past decade. The only reason for the market share gain was because Tan Chong did worse, and the 7% market share in February is still a far cry from the 14%-15% it commanded in the past decade. The new Hilux is scheduled to be launched in April and we expect to see some sort of volume recovery in Apr-May. Nonetheless, we see potential downside to our FY16F Toyota TIV of 92,572 units. Toyota needs to register average monthly sales of 8,668 units for the remainder of the year to meet our forecast vs. the average 2,949 units/month so far this year.

Temporary gap for Mazda. Mazda sales volume (-21%yoy), like we warned, saw a temporary gap in CX5 sales as the run-out of the old model was mostly done in Dec-Jan period, while the short month and CNY festive holidays compounded the weakness. Nonetheless, the new CX5 facelift was already launched in March and we expect sales momentum to recover in the March-April period. Moreover, CBU CX3 deliveries should accelerate from March onwards as shipments gradually pick up post-CNY. Year-to-date, Mazda is the only marque to register a growth (+14%).

Currency is still a drag, but getting less so. The comparatively weaker Ringgit is expected to have an impact on sector earnings in FY16F. To give a perspective, USD/MYR averaged at 3.90 in 2015 but the mean figure thus far this year stands at 4.22. Second, the key listed players, i.e. UMW and Tan Chong, hedged on a 3-month rolling basis, which merely delays the impact of currency volatility by a 3-month period. After a 49% earnings contraction in FY15, sector aggregate earnings is expected to decline further by 3% in FY16F. The earnings contraction is buffered by our expectation of a hike in pricing, but any worse than expected volume impact underpins our less than sanguine view on the sector.

However, the good news is that the spot USD/MYR rates briefly broke below the 4.00 level yesterday and if there is further Ringgit strength, this could work in favour of the sector. For the meantime, we maintain our assumption of USD/MYR4.00 and JPY/MYR3.45 for FY16F/17F vs. YTD average rates of USD/MYR4.22 and JPY/MYR3.65. Notwithstanding the recent pockets of strength, the current spot levels are unlikely to trigger any change in our assumptions (and ultimately earnings) as yet.

We maintain NEUTRAL on the auto sector given a muted demand outlook. Our top sector pick is Berjaya Auto (BUY, TP: RM2.50/share): (1) While there is considerable pressure from the stronger JPY, exposure to JPY imports is limited to CBUs while almost half of CY16 JPY exposure is fixed at RM3.45, (2) Aggressive model mix expansion, i.e. the CBU CX3, Mazda 6 CKD and upcoming CKD CX3, which will expand margins and volume, and (3) An underleveraged balance sheet (FY16F net cash of RM252m which accounts for 10% of market cap) coupled with strong FCF yield of 7%, suggests special dividends and potential acquisitive growth. Ex-cash, BAuto trades at just 9.7x CY16F earnings.

We are still cautious on UMW (NEUTRAL, TP RM6.00/share). Valuation at 24x FY16F earnings is excessive amid rising cash flow and forecast risks. O&G losses are expected to extend into early FY16 at least, while Toyota TIV has remained weak and is suffering market share loss. Key earnings risk in the near-term will come from: (1) Renewal of rig contracts at unfavourable rates, i.e. spot rates are now 30%-35% lower than current contracts, (2) Extended idling of rigs which is a drain on cash flows and is driving losses for the O&G division, (3) Weak underlying demand for autos especially after the recent price hikes and plant diseconomies of scale which will pressure margins, and (4) Possible cash call at UMWOG which may require UMW to gear up to avoid dilution of its stake in the former.

EXHIBIT 1: FEBRUARY 2016 TIV SUMMARY

									Market share	
Marques	**Feb-15**	**Jan-16**	**Feb-16**	**YoY**	**MoM**	**YTD15**	**YTD16**	**YTD %**	**Feb-15**	**Feb-16**
Proton	8,254	7,743	5,947	-28.0%	-23.2%	17,154	13,690	-20.2%	17.0%	16.6%
Perodua	18,589	15,538	14,014	-24.6%	-9.8%	34,656	29,552	-14.7%	34.3%	35.8%
Toyota	4,990	2,980	2,917	-41.5%	-2.1%	9,054	5,897	-34.9%	9.0%	7.2%
Honda	6,042	5,743	5,616	-7.1%	-2.2%	12,564	11,359	-9.6%	12.4%	13.8%
Nissan	3,515	3,650	2,773	-21.1%	-24.0%	8,221	6,423	-21.9%	8.1%	7.8%
Mazda	994	1,354	782	-21.3%	-42.2%	1,869	2,136	14.3%	1.9%	2.6%
Others	8,006	7,583	5,815	-27.4%	-23.3%	17,474	13,398	-23.3%	17.3%	16.2%
Total	**50,390**	**44,591**	**37,864**	**-25%**	**-15%**	**100,992**	**82,455**	**-18%**	**100.0%**	**100.0%**

Source: MAA, MIDFR

EXHIBIT 2: FEBRUARY 2016 TIV SUMMARY BY SEGMENT

Segment	Feb-15	Jan-16	Feb-16	YoY	MoM	YTD15	YTD16	YTD %
Passenger cars	44,917	40,000	34,126	-24.0%	-14.7%	89,614	74,126	-17.3%
Commercial vehicles	5,473	4,591	3,738	-31.7%	-18.6%	11,378	8,329	-26.8%
Total	**50,390**	**44,591**	**37,864**	**-24.9%**	**-15.1%**	**100,992**	**82,455**	**-18.4%**

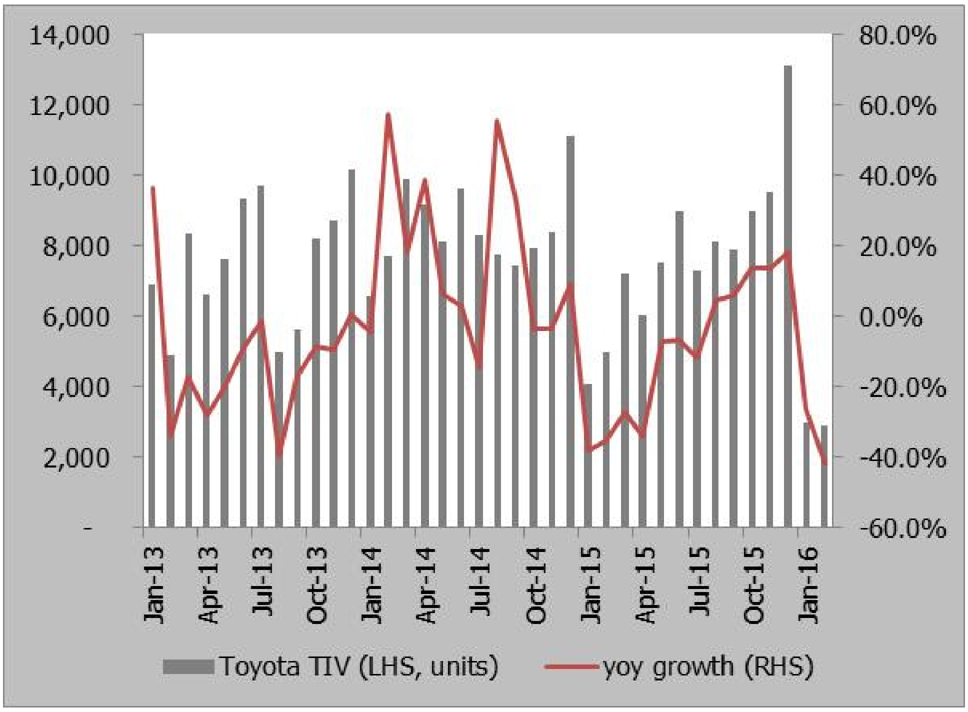
Source: MAA, MIDFR

EXHIBIT 3: FEBRUARY 2016 TIV SUMMARY BY SEGMENT

									Market share	
Segment	**Feb-15**	**Jan-16**	**Feb-16**	**YoY**	**MoM**	**YTD15**	**YTD16**	**YTD %**	**Feb-15**	**Feb-16**
National cars	26,843	23,281	19,961	-25.6%	-14.3%	51,810	43,242	-16.5%	51.3%	52.4%
Non-nationals	23,547	21,310	17,903	-24.0%	-16.0%	49,182	39,213	-20.3%	48.7%	47.6%
Total	**50,390**	**44,591**	**37,864**	**-25%**	**-15%**	**100,992**	**82,455**	**-18%**		

Source: MAA, MIDFR

CHART 1: TOYOTA TIV HITS DECADE LOW



Source: MAA, MIDFR

VALUATION AND RECOMMENDATION

		Shr Price	EPS (sen)		PE (x)		P/BV	ROE	Div Yield	Target	Total
Companies	**Rating**	**(RM)**	**CY16F**	**CY17F**	**CY16F**	**CY17F**	**(x)**	**(%)**	**(%)**	**Price (RM)**	**Upside (%)**
B.Auto	Buy	2.19	19.0	19.8	11.6	11.1	3.5	35.7	4.2	2.50	18.4
Tan Chong	Neutral	2.42	5.2	8.1	46.5	29.9	0.6	2.7	0.8	2.50	4.1
UMW	Neutral	7.04	27.6	27.1	25.5	26.0	1.4	5.0	1.5	6.00	-13.3

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.