UMW Holdings Berhad

(4588 | UMWH MK) Main | Consumer Products & Services

New Contract 'Rolls' In

***Maintain* BUY**

***Unchanged* Target Price: RM5.28**

KEY INVESTMENT HIGHLIGHTS

- **UMW Aerospace secures new contract from Rolls Royce**
- **Potential product expansion with new chemical milling capability**
- **Indirect play into air travel demand recovery**
- **Auto division keeping the momentum**
- **Re-affirm BUY at TP of RM5.28**

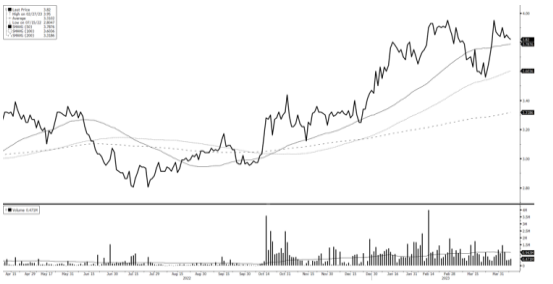
What's new? Wholly owned UMW Aerospace (UMWA) has secured a contract to manufacture rear fan cases for Trent 1000 (~30% of Boeing 787 Dreamliner engines are sourced from Rolls Royce) and Trent 7000 (used exclusively for A330 NEO) aircraft engines from Rolls Royce Plc (RR). The contract is reported by the media to be worth RM1b over a 15-year period. The rear fan case which forms part of the fan case assembly that is supplied to RR, is currently sourced from a third-party vendor. Localisation of the rear fan case portion will serve to reduce costs, hence improving margins for UMWA going forward. Based on our visit to UMW Aerospace back in February, the civil structure of the new rear case manufacturing plant is almost complete with the required equipment expected to be installed in 3QCY23. The plant is expected to be ready for commercial production sometime in 2025 after undergoing trial runs.

Potential product range expansion? A total RM65m capex is expected for the new rear case manufacturing plant – this should be easily manageable given UMW's gross cash of RM2.8b as of 4QFY22. Importantly, manufacturing of rear fan cases involves the acquisition of electro chemical milling capability which is lacking in ASEAN, whereas within Asia, is dominated by South Korea's LAKWOO Industry Co. Ltd and China's SinoGuide. UMWA will be the first ASEAN aero manufacturer to have this capability, which will allow it to expand its product range beyond fan cases to include other advanced aero components such as jet engine after burners and aircraft wing skin panels *(Exhibit 2)*.

Volume recovery. The new contract win and expansion in technical capability comes at an opportune time amid a post-Covid air travel recovery, which has led to a swift rebound in aircraft orders for Airbus and Boeing. Reflecting this trend, utilisation rate at the existing UMWA plant is expected to recover to 70%-80% levels in FY23 from ~50% in FY22 whereby FY23F earnings is expected to exceed pre-pandemic levels. The expansion into rear fan case manufacturing underpins earnings momentum beyond the current aviation cyclical recovery, in our opinion.

RETURN STATISTICS	
Price @ 10th April 2023 (RM)	3.82
Expected share price return (%)	+38.2
Expected dividend yield (%)	4.0
Expected total return (%)	**+42.2**

SHARE PRICE CHART



Price performance (%)	Absolute	Relative
1 month	3.8	4.2
3 months	-0.8	10.5
12 months	14.0	28.1

INVESTMENT STATISTICS

FYE Dec	2022A	2023F	2024F
Revenue	15,814.4	15,316.3	15,523.2
Operating Profit	605.5	578.0	569.4
Profit Before Tax	896.5	858.6	848.3
Core PATAMI	415.0	447.5	443.8
Core EPS	35.5	38.3	38.0
DPS	14.2	15.3	15.2
Dividend Yield	3.7	4.0	4.0

KEY STATISTICS

FBM KLCI	1,428.13
Issue shares (m)	1168.29
Estimated free float (%)	29.59
Market Capitalisation (RM'm)	4,462.88
52-wk price range	RM2.77 -
3-mth average daily volume (m)	0.94
3-mth average daily value (RM'm)	3.57
Top Shareholders (%)	
Amanah Saham Nasional Bhd	55.16
Employees Provident Fund Board	9.51
Kumpulan Wang Persaraan	9.26

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Exhibit 1: Chemical Milling Gives UMWA a Unique Competitive Edge

1. Market assessment on Tier 1 Complex Machining suppliers show real gap in the market for Chemical Milling capabilities
2. Many suppliers focus only on Machining, having both capabilities will be a key differentiator

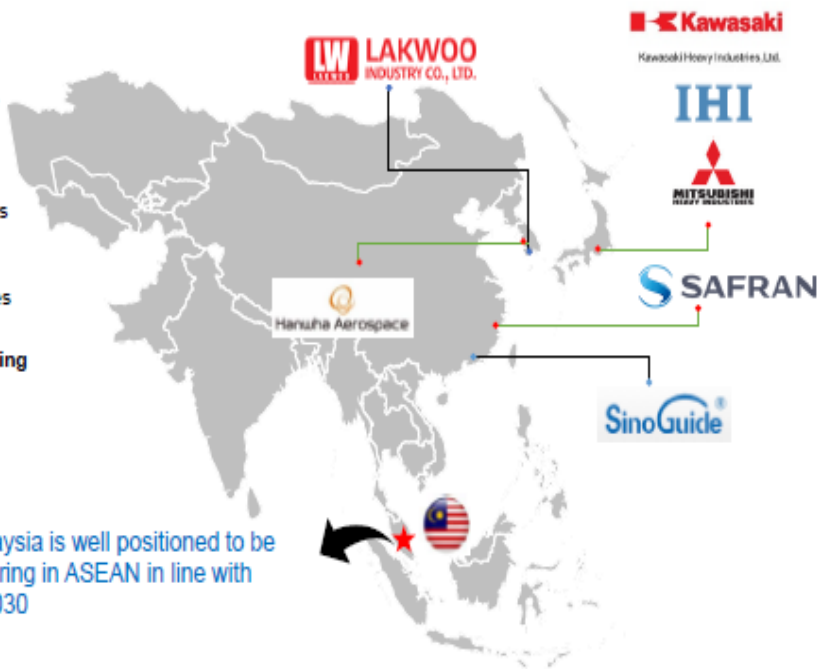
Aerospace Engine Component Suppliers – Complex Machining

1. South Korea – Hanwha Aerospace
2. China - Safran Aircraft Engines Suzhou
3. Japan – Kawasaki Heavy Industries
4. Japan – IHI
5. Japan – Mitsubishi Heavy Industries

Aerospace Industry – Chemical Milling

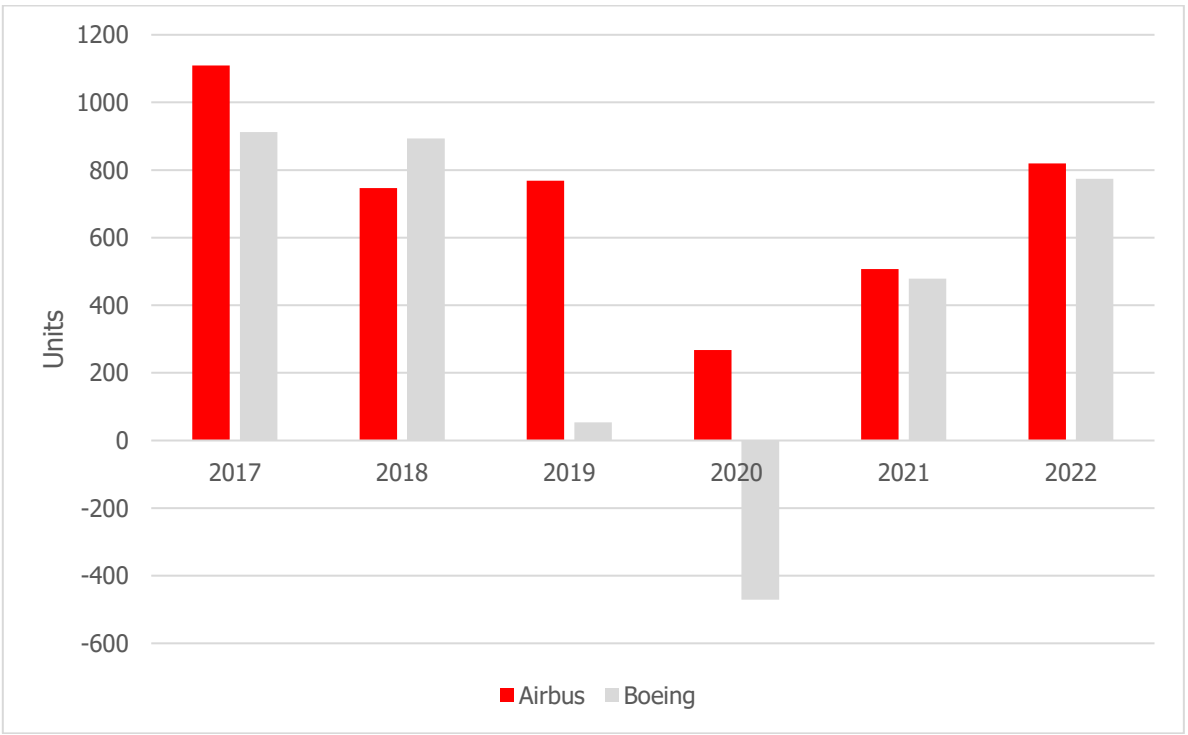
1. South Korea – LAKWOO
2. China – SinoGuide

With combined capabilities, Malaysia is well positioned to be the hub of Aero Parts Manufacturing in ASEAN in line with Malaysia Aerospace Blueprint 2030



Source: Company, MIDFR

Chart 1: Swift Rebound in (Net) Aircraft Orders at Airbus and Boeing



Source: Company, MIDFR

Exhibit 2: Chemical Milling Process (Top) and Parts (Bottom)



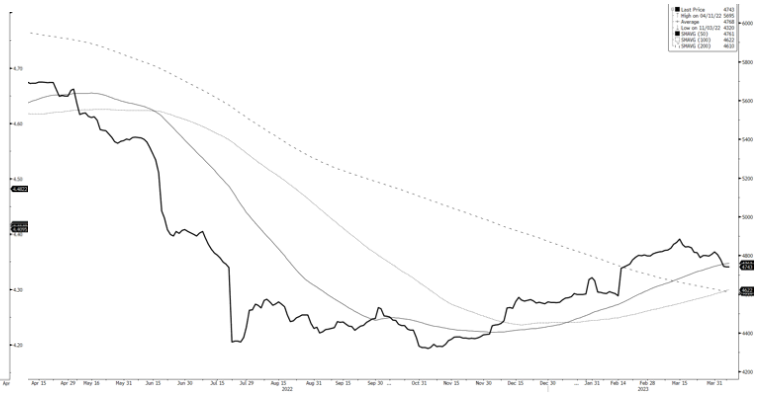
Source: Company, MIDFR

Auto division keeping the momentum. Separately, Perodua's preliminary March sales is looking good with 32,179 units delivered in March (+20%yoy). 1QCY23 Perodua TIV of an estimated 78,565 units (+27%yoy) is well in-line, making up 27% of our recently revised CY23F Perodua TIV of 296K (+4.8%yoy). Additionally, easing cost pressure on the back of declining raw material prices e.g., aluminium &, steel, suggests gradually improving margins over the next few quarters against a weak base in 4QCY22. For Toyota, an estimated 25,030 units were delivered in 1QCY23 (+12%yoy), also well -in-line accounting for 26% of our recently revised CY23F TIV of 96K units (-3.6%yoy). A stronger RM against the USD bodes well for UMW Toyota margins – we project the RM to strengthen to an average USD:RM4.20 this year (FY22: USD:RM4.40) on expectations of peaking Fed rate hike cycle. Order banks remain strong; as at February 2023, Perodua had 220K outstanding bookings (75% of our FY23F), while UMW Toyota had >50K bookings (54% of our FY23F).

Chart 2: USD:RM Trends



Chart 3: CRC Price Trends



Source: Bloomberg, MIDFR

Chart 4: Perodua TIV Trend

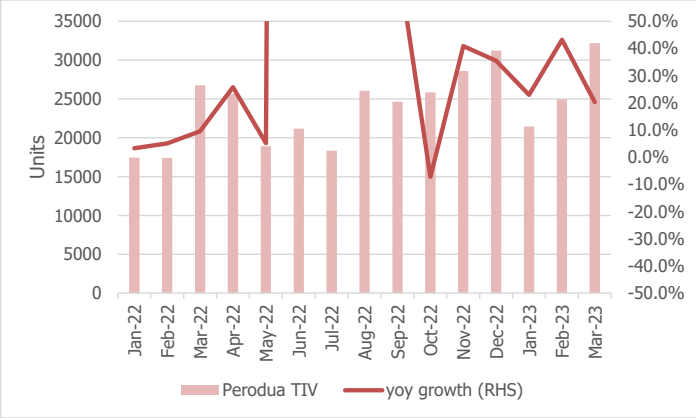
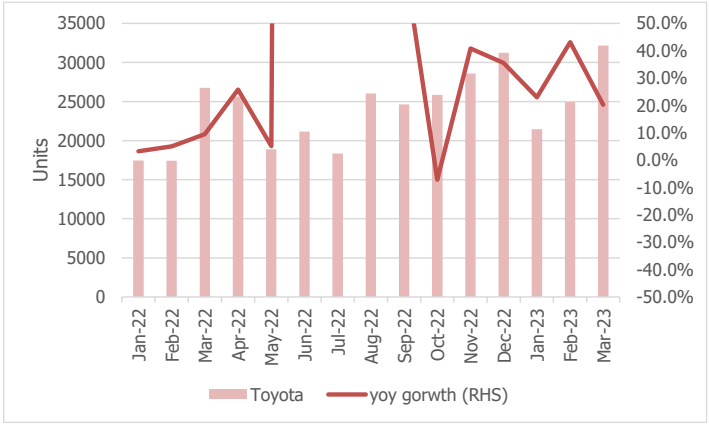


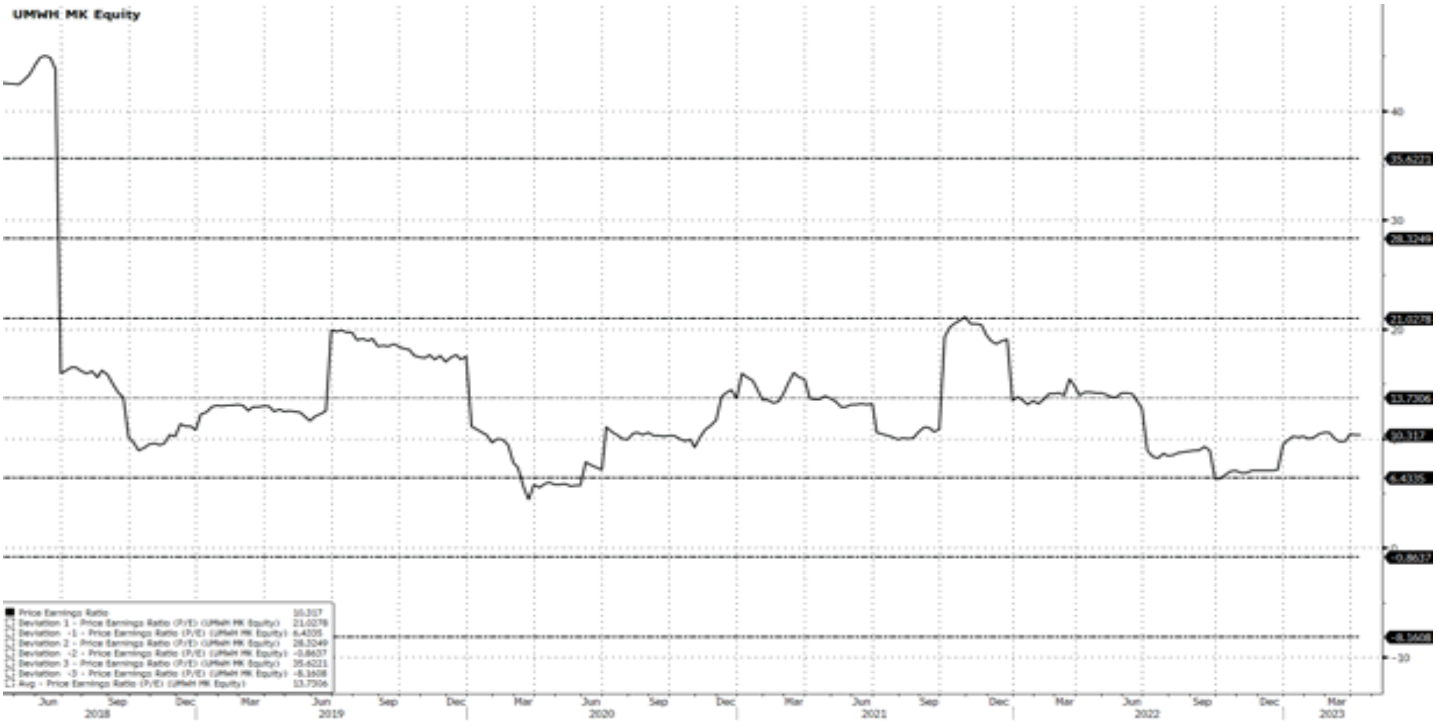
Chart 5: Toyota TIV Trend



Source: MAA, MIDFR

Recommendation. We re-affirm our **BUY** call at unchanged **TP of RM5.28**. We like UMW as it is a prime beneficiary of a strong recovery in auto demand given its dominant market share of ~52% (via 51%-owned UMW Toyota and 38%-owned Perodua). The equipment division meanwhile, is a proxy to recovering business momentum, rising infrastructure projects and commodity demand, whereas aerospace is an indirect reopening play on the back of a recovery in global air travel. While aerospace currently makes up a small portion of our sum-of-parts, we see this as a strategic exposure with room for both horizontal and vertical growth from the expansion of its aero manufacturing capabilities and the strong platform it has as a Tier-1 supplier to Rolls Royce. Meanwhile, UMW's net cash position has grown to RM1.26b (RM1.08/share, 28% of market cap) which underpins higher dividend payout and M&A potential. Valuations are undemanding at just 10x FY23F PER, at 27% discount to historical mean. Key risk to our call is a significant weakening of the Ringgit, further lockdowns and a worse than expected component shortage situation.

Chart 6: UMW Currently Trading at ~0.5SD below historical mean PER



Source: Bloomberg, MIDFR

FINANCIAL SUMMARY

Income Statement (RMm)	2020	2021	2022	2023F	2024F
Revenue	**9,554.6**	**11,060.8**	**15,814.4**	**15,316.3**	**15,523.2**
Operating expenses	(10,423.7)	(10,547.1)	(15,031.0)	(14,738.3)	(14,953.7)
Operating profit	**257.7**	**274.2**	**605.5**	**578.0**	**569.4**
Net interest expense	(115.5)	(108.2)	(114.1)	(71.4)	(71.4)
Associates	204.1	268.0	334.9	352.1	350.3
PBT	**400.7**	**482.8**	**896.5**	**858.6**	**848.3**
Taxation	(77.7)	32.9	(218.6)	(126.6)	(124.5)
Minority Interest/PERP	118.3	247.4	262.8	284.5	280.0
Net profit	204.6	268.2	415.0	447.5	443.8
Core net profit	**240.9**	**196.8**	**415.0**	**447.5**	**443.8**
Balance Sheet (RMm)	**2020**	**2021**	**2022**	**2023F**	**2024F**
PPE	2,463.0	2,531.4	2,706.2	2,910.4	3,089.0
Investments in associate	2,015.9	2,170.6	2,362.3	2,714.4	3,064.7
Others	976.5	1,090.7	983.2	983.2	983.2
Non-current assets	**5,455.3**	**5,792.7**	**6,051.7**	**6,608.0**	**7,136.9**
Inventories	1,439.3	1,752.2	2,045.7	1,531.6	1,552.3
Receivables	1,059.1	904.2	1,124.3	1,279.7	1,297.0
Others	1,442.5	782.2	387.2	387.2	387.2
Cash & equivalent	2,050.9	2,941.4	2,808.1	2,963.3	2,915.1
Current assets	**5,991.8**	**6,380.0**	**6,365.4**	**6,161.9**	**6,151.6**
Share capital	584.1	584.1	584.1	584.1	584.1
Minority Interest	2,549.0	2,646.1	2,789.9	3,004.6	3,214.7
Reserves	3,284.0	3,532.3	3,765.9	4,034.4	4,300.7
Total Equity	**6,417.2**	**6,762.5**	**7,140.0**	**7,623.1**	**8,099.5**
Long-term borrowings	1,942.3	2,095.0	1,339.9	1,340.1	1,340.2
Deferred tax liabilities	47.8	48.4	60.8	60.8	60.8
Others	243.6	247.0	274.3	274.3	274.3
Non-current liabilities	**2,233.7**	**2,390.4**	**1,675.1**	**1,675.2**	**1,675.4**
Short-term borrowings	523.8	638.1	212.3	212.3	212.3
Payables	2,156.2	2,248.8	3,292.8	3,182.8	3,225.8
Others	116.2	132.9	96.9	76.4	75.6
Current liabilities	**2,796.2**	**3,019.8**	**3,602.1**	**3,471.5**	**3,513.7**

Cash Flow Statement (RMm)	2020	2021	2022	2023F	2024F
PBT	400.7	481.0	929.8	858.6	848.3
Depreciation & Amortization	374.1	343.5	340.6	351.8	378.3
Chgs in working capital	419.9	(232.4)	524.8	262.2	4.2
Others	(248.3)	(330.8)	(591.7)	(478.7)	(474.8)
Operating cash flow	**946.3**	**261.4**	**1,203.4**	**993.9**	**756.1**
Capex	(700.0)	(406.2)	(509.9)	(700.0)	(700.0)
Others	589.5	790.9	559.4	144.0	143.0
Investing cash flow	**(110.5)**	**384.8**	**49.5**	**(556.0)**	**(557.0)**
Dividends paid	(23.4)	(46.7)	(168.8)	(179.0)	(177.5)
Net movement in borrowings	0.2	0.2	(880.0)	0.2	0.2
Others	(214.3)	86.0	(483.8)	(103.9)	(69.9)
Financing cash flow	**(237.5)**	**39.4**	**(1,532.6)**	**(282.8)**	**(247.2)**
Net changes in cash	**598.3**	**685.6**	**(279.7)**	**155.2**	**(48.2)**
Beginning cash	1,411.5	2,006.5	2,700.3	2,808.1	2,963.3
Forex, Overdrafts & Deposits	41.2	249.3	387.6	0.0	0.0
Ending cash	**2,050.9**	**2,941.4**	**2,808.1**	**2,963.3**	**2,915.1**

Key Ratios	2020	2021	2022	2023F	2024F
Operating profit margin	2.7%	2.5%	3.8%	3.8%	3.7%
Core net profit margin	2.5%	1.8%	2.6%	2.9%	2.9%
ROE	5.4%	6.7%	10.0%	10.0%	9.3%
ROA	2.3%	2.3%	5.9%	4.6%	4.4%
Net gearing (%)	6.5%	-3.1%	-17.6%	-18.5%	-16.8%
Book value/share (RM)	3.31	3.52	3.72	3.95	4.18
PBV (x)	1.2	1.1	1.0	1.0	0.9
PER (x)	18.5	22.7	10.8	10.0	10.1

Source: Company, MIDFR

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STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% 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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology