

20 February 2018 | Corporate Update

## Bermaz Auto

### Earnings gap-up

#### INVESTMENT THESIS

- **Mazda TIV could test historical high**
- **CX5 pricing raised across the board**
- **We estimate >50%qoq improvement in 3Q18 earnings**
- **Re-affirm BUY at higher TP of RM2.70, 7% dividend yields attractive**

**Pricing raised.** Pricing for the new CX5 has been raised by RM1K across the board from Jan18. We estimate this will impact annual earnings by ~2% based on our conservative FY19F CX5 volume of 6K units. This is likely to trickle through meaningfully from 4QFY18.

**Volumes likely to test record high.** Despite the price hike, Mazda's Jan18 TIV could test historical high levels of 1300-1400 units as orders resume moving into the new year and given strong demand for the new CX5. We estimate BAuto's 3QFY18 TIV at 3K units, up 19% sequentially and a whopping 37%yoy. Outstanding bookings of the new CX5 currently stand at >900 units. More importantly, the strong TIV will come with improved margins given the price hike for the CX5 in Jan18 and minimal discounting. Half of the new CX5 sales are for special colors which are priced at RM2000 premium.

**Associates benefit from higher production.** Associate earnings comprising 30%-owned Mazda Malaysia Sdn Bhd (MMSB) and 29%-owned Inokom have been dismal in the past 2 quarters given low production and run-out of the old CX5. According to management, BAuto's 1HFY18 associate earnings only reflect Jul17-Sep17 contribution prior to the new CX5 launch in Nov17. We expect this to improve from 2HFY18 driven by launch of the new CX5 and commencement of exports of the same model to Thailand, Indonesia and Philippines. We gather CX5 export rate to Thailand is now ~1K units/month (vs. negligible amounts throughout 1HFY18) while production for Malaysia is at 900/month. At this rate we estimate total MMSB production could rise to ~23K/annum from 9.5K-10K in FY16-17.

**3Q18 earnings gap-up.** Given a combination of the above factors: (1) 19%qoq increase in Mazda TIV (2) Associates' return to profits (3) Absence of CX5 run-out – estimated to have impacted 2QFY18 by RM5m-RM6m; 25% of 2Q18 profit (4) Price hike for new CX5 from Jan18 (5) A weaker JPY; we estimate 3Q18 earnings to rise by >50%qoq, underpinning our view of an earnings gap-up from 2HFY18.

**Maintain BUY**  
**Revised Target Price (TP):RM2.70**  
**(from RM2.50)**

RETURN STATS	
Price (19 Feb 2018)	RM2.20
Target Price	RM2.70
Expected Share Price Return	+22.7 %
Expected Dividend Yield	+7.1%
<b>Expected Total Return</b>	<b>+29.8%</b>

STOCK INFO	
KLCI	1857.32
Bursa / Bloomberg	5248 / BAUTO MK
Board / Sector	Main/Automotive
Syariah Compliant	Yes
Issued shares (mil)	1,158.74
Market cap. (RM'm)	2,549.23
Price over NA	5.91
52-wk price Range	RM1.84 - RM2.47
Beta (against KLCI)	0.50
3-mth Avg Daily Vol	2.53m
3-mth Avg Daily Value	RM5.67m
Major Shareholders (%)	
Dynamic Milestone	15.0%
EPF	13.0%
KWAP	5.2%

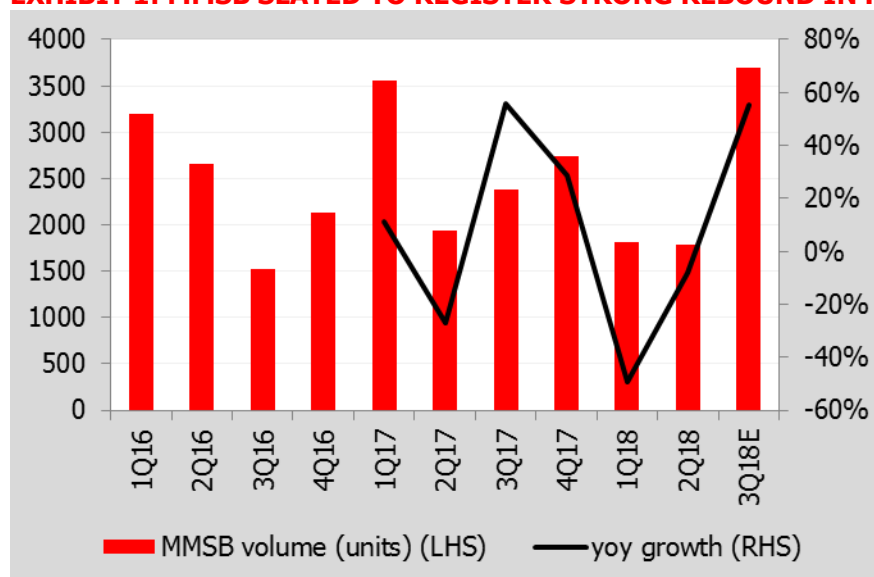
**The next CKD volume catalyst.** BAuto is expected to launch the new CX8 in 2QCY18 for the Malaysian market, initially to be sold in CBU form before local assembly in CY19F and eventually exported to the region. The CX8 will fill in a vacuum in the RM180K-RM280K SUV segment (CX8 likely be priced at sub-RM200K price points), positioned to compete mainly against Toyota's Fortuner. The CX8 is a 7-seater SUV which comes off the CX9 platform. Launched in Japan in Dec17 at a price tag of JPY3.2m-4.2m (RM120K-RM160K), Mazda was initially targeting monthly sales of 1.2K units, but ended up with a massive 12K bookings.

## INVESTMENT STATISTICS

FYE Apr	FY16	FY17	FY18F	FY19F	FY20F
Revenue (RM'm)	2,112	1,660	2,080	2,306	2,354
EBIT (RM'm)	262	162	171	291	306
Pre-tax Profit (RM'm)	279	177	188	320	335
Core net profit (RM'm)	202	119	129	226	236
FD EPS (sen)	17.5	10.3	11.2	19.5	20.4
EPS growth (%)	(7.8)	(41.1)	8.5	74.7	4.5
PER (x)	12.6	21.4	19.7	11.3	10.8
Net Dividend (sen)	16.9	11.7	8.9	15.6	16.3
Net Dividend Yield (%)	7.7	5.3	4.1	7.1	7.4

Source: Company, MIDF

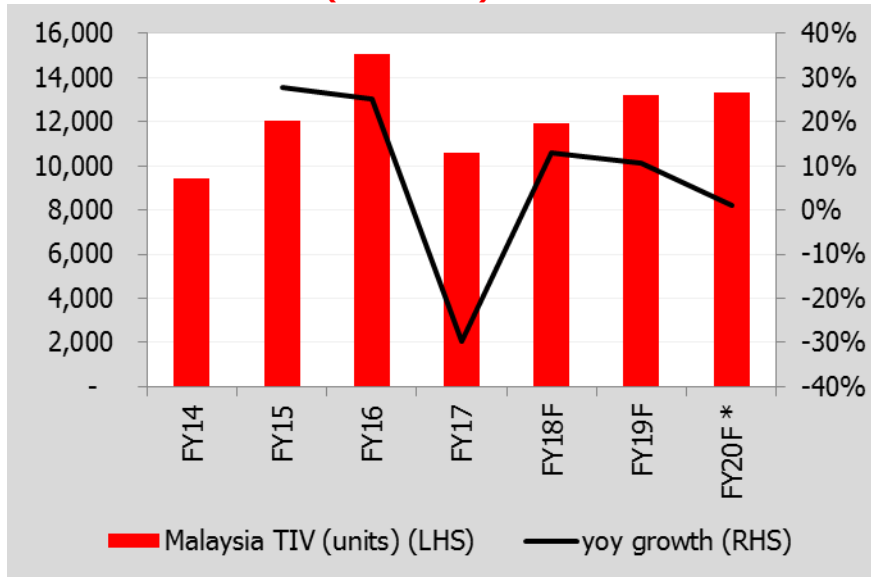
## EXHIBIT 1: MMSB SLATED TO REGISTER STRONG REBOUND IN PRODUCTION VOLUME



Source: Company, MIDF

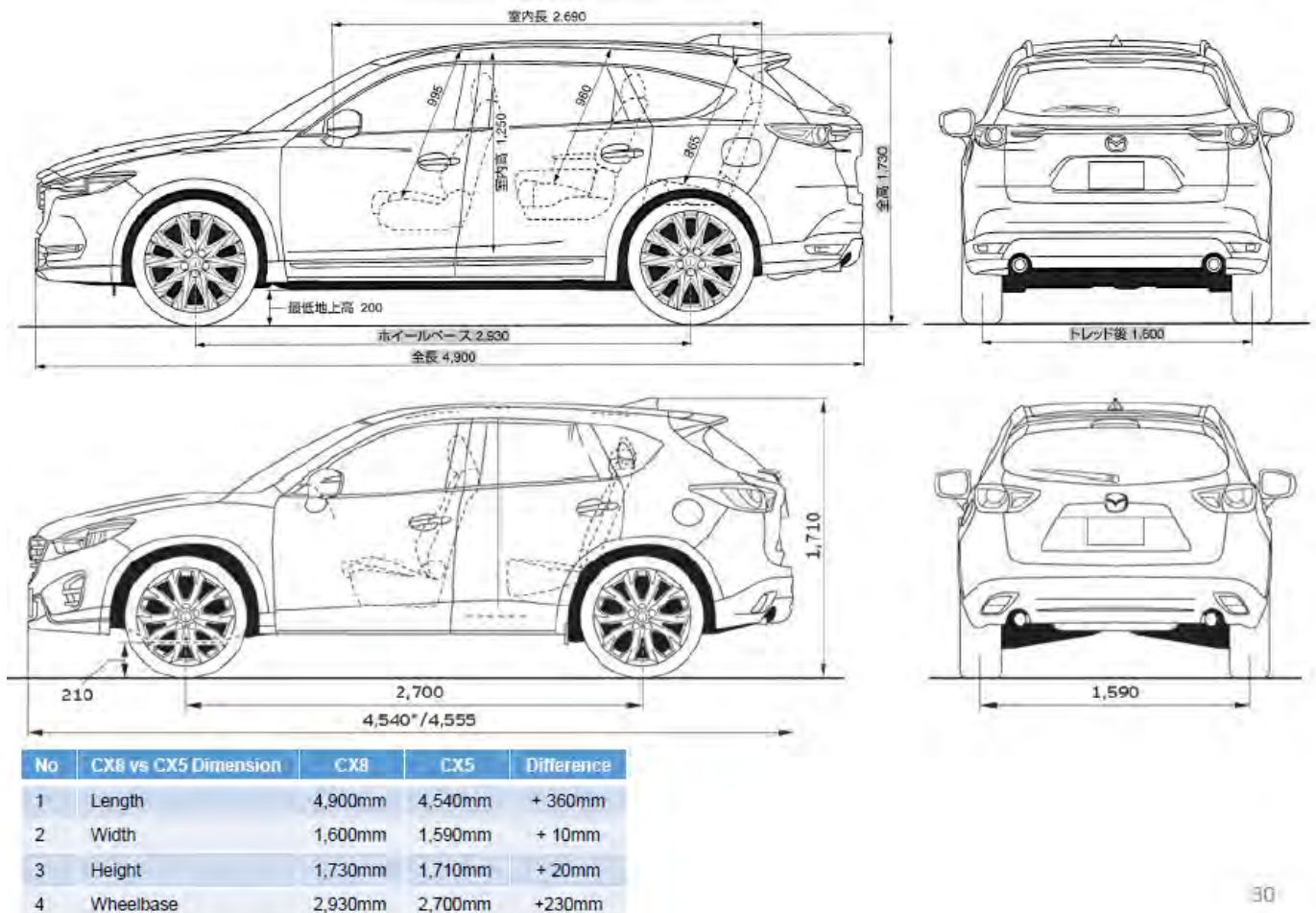
**Volume growth and margin recovery for Malaysia.** BAuto is targeting FY18F Malaysia sales volume of 11.5K – 12K before rising by 17%-30% to 14.5K-15K in FY19F, mainly driven by full year contribution of the new CX5 and in part, contribution by the CBU CX8 from 2HCY18. Once the CX8 is locally assembled, BAuto is targeting volumes of 1K-2K a year for the domestic market but a much larger 3K-4K for exports, mainly to the Philippines initially. We understand the CX8 is qualified for EEV (Energy Efficient Vehicle) incentives once localised and will be MMSB's 2<sup>nd</sup> export model after the CX5. Additionally, EBIT margins for domestic operations are likely to recover to >10% levels against the depressed levels of 7%-9% in the past few quarters as run-out of the old CX5 has reached an end, inventory levels normalise and exposure to more favourable spot Ringgit levels increase. Other than the CX8, BAuto is also scheduled to launch the new Mazda 6 (CBU) in 3QCY18.

## EXHIBIT 2: MAZDA TIV (MALAYSIA) SET FOR 2-DIGIT GROWTH IN FY19F



Source: Company, MIDF \*Our FY20F has not factored in the CKD CX8

## EXHIBIT 3: CX8 VS. CX5 VEHICLE DIMENSION



Source: Company, MIDF

**EXHIBIT 4: THE NEW CX8**

Source: Company, MIDF

**IPO plans delayed.** For the Philippines operations, earnings has been negatively impacted by the weak Peso (the majority of imports are from Japan), despite strong volume growth (+16%yoy in 1HFY18). Meanwhile, pricing of models in the market has been raised by 4%-5% (by all players) from Jan18 as a result of the duty hike by the Philippines Government. Management is not too worried on the impact on demand as the hike in vehicle duties comes with income tax reduction for consumers. The IPO of 60%-owned BAuto Philippines has been pushed back, possibly to CY19F till after the new CX8 is launched in order to maximize values. We understand however that the previous IPO plan (valuing BAP at 15x PER) was up to 3 times covered suggesting scarcity-driven demand given the lack of automotive consumer stocks in the Philippines market.

**Earnings revision.** Though our thesis on BAuto's earnings improvement moving into FY19F remain intact, our FY18F earnings is trimmed to RM129m from RM170m to reflect more conservative expectations, specifically: (1) Higher JPY for FY18F – this is because BAuto had already locked in its JPY exposure up till Apr i.e. till end FY18 at RM3.85:JPY vs. spot rates of RM3.5-3.6. However, we gather that BAuto had locked in much more attractive rates of RM3.5-3.6 beyond Apr18 given 3-4 months forward hedging (2) Lower FY19F TIV for Philippines given 4%-5% price hike as a result of higher duties. (3) Weaker Peso (against JPY) hitting BAP earnings. Nonetheless, we expect group earnings to grow by a CAGR of 35% over FY18F - FY20F driven by: (1) FY19F Malaysia TIV growth of 11% from full year impact of the new CX5 – our FY19F Mazda TIV projection of 13.2K is conservative relative to management's 14.5K-15K (2) Margin expansion given the new CX5 price hike, absence of old CX5 run-out and weaker JPY (3) Launch of the new CX8 in 2QCY18. Our JPY assumptions for BAuto stands at RM3.9:JPY for FY18F and RM3.7:JPY for FY19F-20F.

**Recommendation.** Re-affirm BUY on BAuto and raise our TP to RM2.70 (from RM2.50) previously after rolling over our valuations to CY19F from CY18F. From a valuation standpoint, BAuto is cheap at just 11x CY19F earnings, relative to historical sector PE of ~12x, while dividend yield of 7% is attractive. BAuto is an entrepreneur driven, highly cash generative asset-light business while the capex-intensive manufacturing unit is parked under 30%-owned MMSB and is kept off-balance sheet. MMSB itself is already self-funding. Manufacturing capex has peaked having built up production capacity to 34K units/annum (on 2-shift) – FY19F-20F is mostly about monetising this incremental capacity via new models i.e. CX5 and CX8 and export expansion to South East Asia ex-Vietnam. Key share price catalysts in the next 12 months:



- (1) **An 11%yoy Mazda TIV growth** (FY19F) coupled with margin expansion driven by full year impact of new CX5 from 3QFY18 onwards
- (2) **Ringgit strength** against the JPY
- (3) **A more than doubling in associate earnings contribution** to group (via 30%-owned Mazda Malaysia SB and 29%-owned Inokom) given export market expansion to South East Asia (ex-Vietnam) and re-acceleration in production for the domestic market.
- (4) **Launch of CBU CX8** in 2QCY18 and CKD variants in CY19F.
- (5) **Attractive dividend yield of 7%** - net cash accounts for 10% of market cap coupled with solid 9% FCFE yield (FY19F). Our payout assumption is capped at 80% vs. historical 80%-113% payout.

## EXHIBIT 5: MARKET ATTRIBUTING MINIMAL VALUE TO BAUTO'S STAKE IN BAP

BAuto current market cap (RMm)	2,520
Value of domestic operations @ 12x CY18F PE (RMm)	2,383
Implied value of BAUTO's 60% stake in BAP (RMm)	136.6
BAP contribution to BAUTO net profit (CY18F) (RMm)	33.8
<b>Implied PE valuation of BAP at current market cap (x)</b>	<b>4.0</b>
BAP IPO PER valuation (x)	15

Source: Company, MIDFR

## EXHIBIT 6: BAUTO SUM-OF-PARTS VALUATION

	CY19F net profit (RMm)	PE (x)	Value (RMm)
Malaysia	198.6	13	2,522
Philippines	33.8	18	609
<b>Total value</b>			<b>3,132</b>
Shares out (m) (fully diluted)			1,157
<b>Value/share (RM)</b>			<b>2.70</b>

Source: Company, MIDFR

## DAILY PRICE CHART



Source: Bloomberg, MIDFR

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<b>Income Statement</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18F</b>	<b>FY19F</b>	<b>FY20F</b>
<b>Revenue</b>	<b>1,830</b>	<b>2,112</b>	<b>1,660</b>	<b>2,080</b>	<b>2,306</b>	<b>2,354</b>
Operating expenses	(1,544)	(1,850)	(1,838)	(1,910)	(2,015)	(2,048)
<b>EBIT</b>	<b>286</b>	<b>262</b>	<b>162</b>	<b>171</b>	<b>291</b>	<b>306</b>
Net interest expense	6	5	1	-	-	-
Associates	9	11	14	18	29	29
<b>PBT</b>	<b>301</b>	<b>279</b>	<b>177</b>	<b>188</b>	<b>320</b>	<b>335</b>
Taxation	(78)	(68)	(43)	(43)	(73)	(76)
Minority Interest	(7)	(13)	(14)	(17)	(22)	(23)
<b>Net profit</b>	<b>215</b>	<b>198</b>	<b>119</b>	<b>129</b>	<b>226</b>	<b>236</b>
<b>Core net profit</b>	<b>215</b>	<b>202</b>	<b>119</b>	<b>129</b>	<b>226</b>	<b>236</b>
<i>Consensus net profit</i>	215	198	128	143	209	236
<b>Balance Sheet</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18F</b>	<b>FY19F</b>	<b>FY20F</b>
<b>Non-current assets</b>	<b>130.8</b>	<b>163.5</b>	<b>181.0</b>	<b>189.0</b>	<b>217.5</b>	<b>246.2</b>
PPE	23.6	24.0	23.2	21.7	21.0	20.4
Investments in associate	79.3	98.2	112.2	126.0	155.2	184.5
Others	27.9	41.3	45.6	41.3	41.3	41.3
<b>Current assets</b>	<b>601.2</b>	<b>788.6</b>	<b>773.1</b>	<b>804.5</b>	<b>867.9</b>	<b>914.4</b>
Inventories	215.6	310.2	432.2	270.4	299.8	306.0
Receivables	103.5	105.7	84.5	83.2	92.2	94.1
Others	1.2	1.2	11.7	1.2	1.2	1.2
Cash & equivalent	280.8	371.6	244.8	449.7	474.7	513.2
<b>TOTAL ASSETS</b>	<b>732.0</b>	<b>952.1</b>	<b>954.2</b>	<b>993.5</b>	<b>1,085.3</b>	<b>1,160.6</b>
Share capital	406.8	403.6	403.6	403.6	403.6	403.6
Minority Interest	18.9	31.7	42.8	59.4	81.2	104.2
Reserves	69.9	128.0	47.9	153.6	199.4	246.7
<b>TOTAL EQUITY</b>	<b>495.6</b>	<b>563.4</b>	<b>494.4</b>	<b>616.6</b>	<b>684.3</b>	<b>754.4</b>
<b>Non-current liabilities</b>	<b>60.5</b>	<b>82.5</b>	<b>67.1</b>	<b>82.5</b>	<b>82.5</b>	<b>82.5</b>
Long-term borrowings	-	-	-	-	-	-
Deferred tax liabilities	-	-	-	-	-	-
Others	60.5	82.5	67.1	82.5	82.5	82.5
<b>Current liabilities</b>	<b>175.9</b>	<b>306.3</b>	<b>392.7</b>	<b>294.2</b>	<b>319.0</b>	<b>324.2</b>
Short-term borrowings	-	-	58.9	-	-	-
Payables	118.5	241.0	265.5	228.9	253.7	258.9
Others	57.4	65.3	68.4	65.3	65.3	65.3
<b>TOTAL LIABILITIES</b>	<b>236.4</b>	<b>388.8</b>	<b>459.8</b>	<b>376.6</b>	<b>401.5</b>	<b>406.7</b>

Cash Flow Statement	FY15	FY16	FY17	FY18F	FY19F	FY20F
<b>Operating activities</b>						
PBT	300.9	278.7	176.6	188.5	320.3	335.2
Depreciation & Amortization	(6.4)	(1.9)	(0.2)	1.2	1.9	2.6
Chgs in working capital	(10.1)	28.6	55.0	(4.9)	(13.5)	(2.8)
Interest expense	(6.2)	-	-	-	-	-
Tax paid	-	-	-	-	-	-
Others	(56.1)	(61.0)	(204.3)	(54.3)	(96.8)	(101.5)
<b>CF from Operations</b>	<b>222.1</b>	<b>244.4</b>	<b>27.1</b>	<b>130.5</b>	<b>211.9</b>	<b>233.5</b>
<b>Investing activities</b>						
Capex	(44.7)	(13.9)	(13.9)	(6.4)	(6.4)	(6.4)
Others	6.5	5.3	17.8	-	-	-
<b>CF from Investments</b>	<b>(38.3)</b>	<b>(8.5)</b>	<b>3.9</b>	<b>(6.4)</b>	<b>(6.4)</b>	<b>(6.4)</b>
<b>Financing activities</b>						
Dividends paid	(98.1)	(147.2)	(119.0)	(103.4)	(180.6)	(188.7)
Net proceeds in borrowings	-	-	-	-	-	-
Others	4.5	2.2	(32.3)	-	-	-
<b>CF from Financing</b>	<b>(93.6)</b>	<b>(145.1)</b>	<b>(151.3)</b>	<b>(103.4)</b>	<b>(180.6)</b>	<b>(188.7)</b>
Net changes in cash	90.3	90.7	(120.3)	20.8	25.0	38.5
<b>Beginning cash</b>	<b>186.2</b>	<b>280.8</b>	<b>371.6</b>	<b>251.3</b>	<b>272.0</b>	<b>297.0</b>
Overdrafts & Deposits	4.4	-	-	-	-	-
<b>Ending cash</b>	<b>280.8</b>	<b>371.6</b>	<b>251.3</b>	<b>272.0</b>	<b>297.0</b>	<b>335.5</b>
<b>Ratios</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18F</b>	<b>FY19F</b>	<b>FY20F</b>
Revenue growth	26.1%	19.7%	-8.8%	4.1%	10.9%	2.1%
EBITDA growth	69.7%	-9.2%	-39.6%	5.8%	70.6%	4.9%
Net profit growth	64.9%	-7.8%	-40.1%	8.6%	74.7%	4.5%
EBITDA margin	16.0%	12.1%	8.0%	8.1%	12.5%	12.9%
PATAMI margin	11.8%	9.1%	6.0%	6.2%	9.8%	10.0%
ROE	52.5%	39.4%	22.4%	23.7%	38.9%	37.6%
Operating ROA	42.4%	31.3%	16.9%	17.6%	28.0%	27.2%
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash	Net cash
Book value/share (RM)	0.41	0.46	0.46	0.48	0.52	0.56
PBV (x)	5.0	4.5	4.5	4.3	4.0	3.7
EV/EBITDA (x)	4.9	5.1	8.1	7.5	4.3	4.0
FCF yield (%)	7.7	9.8	1.3	5.2	8.6	9.5

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### MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

#### STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> 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 <i>fall</i> 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.