

15 August 2018 | 2QFY18 Results Review

Tan Chong Motor

Strong 2Q18 underpins turnaround thesis

- **2Q18 results beats estimates**
- **Earnings strengthened further in 2Q18 after 2-years of losses, underpins our thesis of an earnings turnaround**
- **FY19F earnings raised by 36%**
- **Re-affirm our contrarian BUY at a higher TP of RM2.10**

Solid 2Q18 results. Tan Chong reported 2Q18 net profit of RM12m, which brought 1H18 earnings to RM17m. This is well ahead of both our and consensus expectations, partly due to the stronger than expected RM:USD levels during the quarter. A 2sen/share interim dividend was declared, representing 81% earnings payout (1H18).

Beneficiary of the strong RM. Tan Chong benefited from the strong RM in 2Q18 – EBITDA margins for its auto division expanded to 5% from 1.8% a year ago. We estimate 2Q18 average USD booked in at RM3.92:USD (vs. RM3.95:USD in 1Q18) assuming a 3-month delay against spot due to forward stocking.

Volume growth sequentially. On top of the forex factor, the 2Q18 earnings growth was also driven by a strong 25%qoq volume growth. The new Serena Hybrid (CKD) was launched in mid-May, whilst June captured the maiden month of the tax-holiday period as well as the typical pre-Raya festive purchases (See Exhibit 2). Nissan recorded TIV of 3008 units in Jun18, its strongest in the past 18 months. Market share loss looks to have bottomed and resumption of new launches this year (after a 2 year lull) underpins this.

New launches negotiated around latest rates. Inventories reduced further to RM1b (See Exhibit 4). Rundown of old, expensive inventories of the Almera in the past 2 years (and reached a tail end towards end-FY17) contributed to the improved results this year, on top of a new launch (Serena Hybrid) where kit pricing is negotiated based on current RM:USD rates (vs. Almera which was negotiated when the USD was at RM3.2:USD levels back in FY12). Tan Chong's net debt reduced to RM1.1b in 2Q18 while free cash flows improved 44%yoy in 1H18 post inventory pare down.

Encouraging backlog for S-Hybrid. The Serena S-Hybrid officially launched in mid-May received encouraging response with a booking bank of 1.3K units just a week after launch. This is well above expectations as the group was targeting monthly sales of 500/month (19% of FY18F Nissan TIV). The S-Hybrid is EEV qualified and we gather the incentives (typically excise duty rebates) it is receiving for the new model is higher than the outgoing model (also CKD and EEV). This contributed to the improved margins in 2Q18, on top of the catalyst from a stronger RM.

Maintain BUY

Revised Target Price: RM2.10
(from RM2.05)

RETURN STATS

Price (14 Aug 2018)	RM1.69
Target Price	RM2.10
Expected Share Price Return	+24.3%
Expected Dividend Yield	+1.8%
Expected Total Return	+26.1%

STOCK INFO

KLCI	1783.78
Bursa / Bloomberg	4405 / TCM MK
Board / Sector	Main/Automotive
Syariah Compliant	Yes
Issued shares (mil)	652.66
Market cap. (RM'm)	1103.0
Price over NA	0.40
52-wk price Range	RM1.29-1.87
Beta (against KLCI)	0.55x
3-mth Avg Daily Vol	0.07m
3-mth Avg Daily Value	RM0.13m
Major Shareholders (%)	
Tan Chong Consolidated	40.4
EPF	6.0
Nissan Motor	5.7

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INVESTMENT STATISTICS

FYE Dec	FY15	FY16	FY17	FY18F	FY19F
Revenue (RM'm)	5,716.7	5,510.7	4,341.2	4,809.1	4,916.3
EBIT (RM'm)	169.0	18.7	(18.7)	97.8	153.0
Pre-tax Profit (RM'm)	115.3	(43.1)	(72.8)	55.1	110.5
Core net profit (RM'm)	59.9	(58.8)	(88.6)	41.1	82.2
FD EPS (sen)	8.9	(8.8)	(13.2)	6.1	12.2
EPS growth (%)	(20.9)	NA	NA	NA	99.8
PER (x)	19.0	(19.3)	(12.8)	27.6	13.8
Net Dividend (sen)	5.0	2.0	2.0	3.0	3.0
Net Dividend Yield (%)	3.0	1.2	1.2	1.8	1.8

Source: Company, MIDF

More exposure to USD now. The majority of the group's purchases are now in USD with minimal exposure to JPY. The group estimates for every 1sen change in the RM:USD, pretax earnings is impacted by RM3m (or 11% of our FY18F). Previous JPY exposure was mainly for CBU purchases directly from Japan.

2nd CKD launch soon. The Urvan350 is expected to be the next CKD launch this year. Although the model is not entirely sexy, demand has been constant historically and is not too much impacted by volatile consumer sentiment. The Urvan, priced at ~RM130K is currently a CBU hence faces AP limitations but Tan Chong expects growth once it is locally assembled by end FY18F. More importantly, the Urvan is positioned in a segment with minimal competition and Tan Chong intends to capitalise on this.

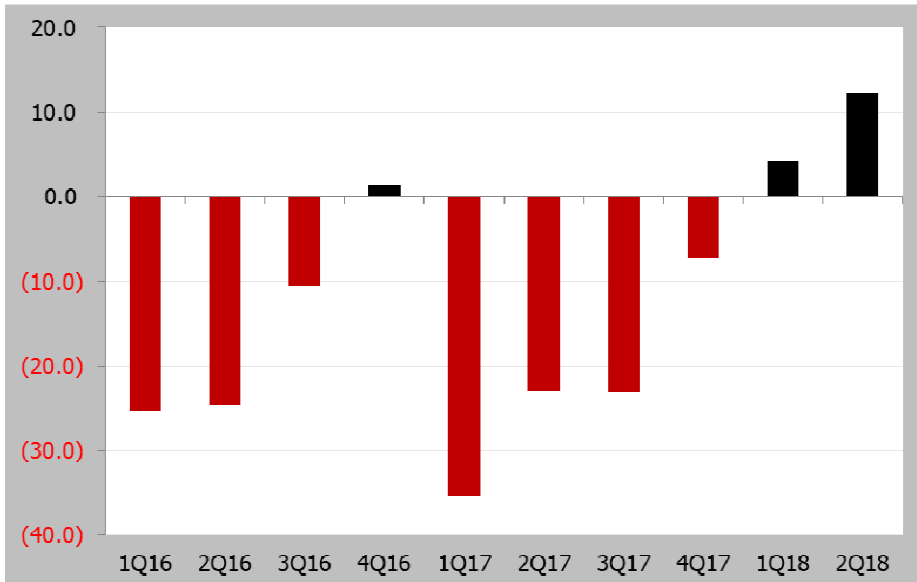
To focus more on profitability. Instead of embarking on a volume driven strategy as in the past e.g. Almera B-segment, Tan Chong is now shifting focus on profitability, specifically looking at segments that are less crowded e.g. the Urvan model. The group is comfortable with its 4%-5% market share and intends to grow in line with TIV – MAA's forecast +1.5% FY18F.

Vietnam breakeven post-FY19F. The core issue with Vietnam is Tan Chong's underutilised plant. The plant has a capacity of 5k-6k/annum on 1-shift and is currently running <50% utilisation rate producing the Sunny and X-Trail (launched late FY16). Utilisation rate needs to increase to ~80% for the plant to breakeven. Tan Chong is launching one new CKD model for Vietnam this year and is exploring contract assembly for 3rd parties. The group is looking at post FY19F for breakeven.

Bagan Datuk paves way for Segambut redevelopment. Tan Chong is spending an initial RM100m to setup a commercial vehicle (CV) plant in Bagan Datuk. RM40m is cost of the freehold land there and another RM60m is for the build-up and equipment. This is given that its existing CV production (Silverbus) in Seri Kembangan is seeing surging volumes, plus Tan Chong plans to expand exports further beyond Singapore, HK and Myanmar currently to target Thailand, Philippines, Sri Lanka and Bangladesh. The plan is also to relocate the existing Segambut plant where the land it sits on (total 47acres, easily worth RM400m-500m) is prime land and targeted for redevelopment.

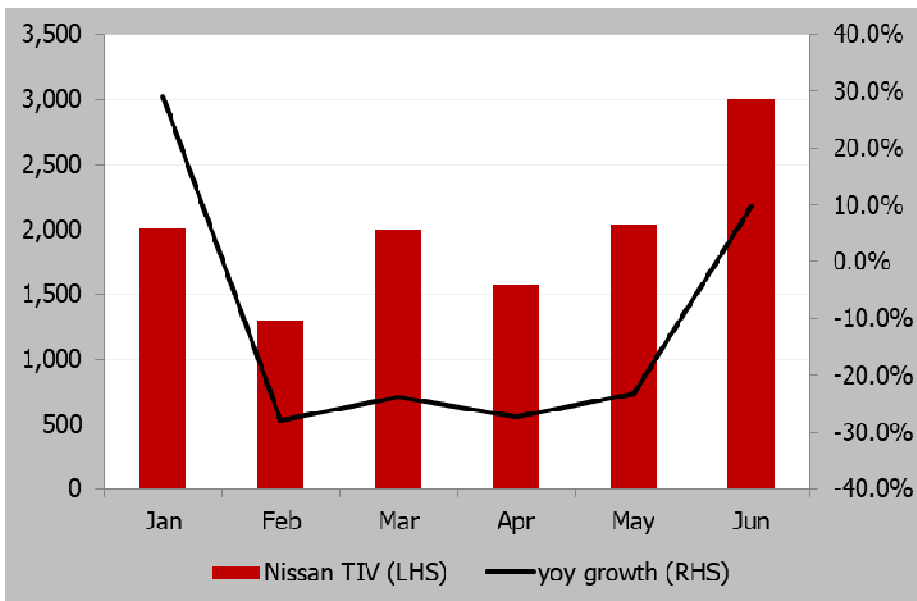
Re-affirm contrarian BUY. We tweak higher our FY18F/19F earnings to RM41m/82m given the stronger than expected results – mainly to factor in better margins from Tan Chong's new launch, in particular the CKD Serena Hybrid. Re-affirm our contrarian BUY at higher TP of RM2.10 (from RM2.05) after rolling over our valuations to FY19F and post-earnings upgrade in this report. Our valuations conservatively peg Tan Chong to trough PBV of 0.5x. Having seen share price fall some 40% in the past 24 months, Tan Chong now trades at just 0.4x FY18F PBV (which is lower than even its historical trough PBV of 0.5x) amid a turnaround in earnings from FY18F onwards. Key catalysts: (1) Resumption of new model launch from FY18F (2) Sustained Ringgit strength (3) A narrowing in losses from Indochina operations (4) A bottoming in market share.

EXHIBIT 1: SUSTAINED EARNINGS TURNAROUND IN 1H18 (RM MIL)



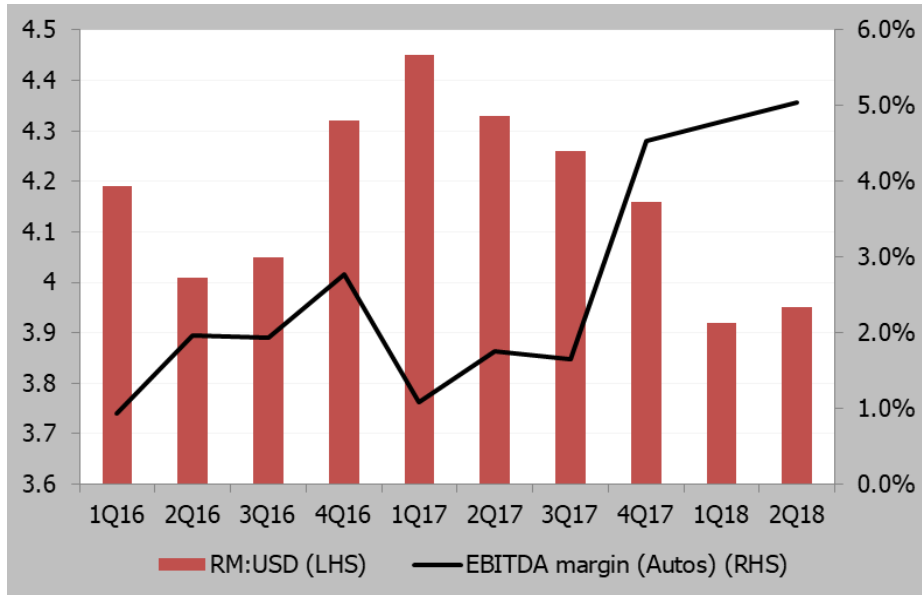
Source: Company, MIDF

EXHIBIT 2: NISSAN TIV GROWTH



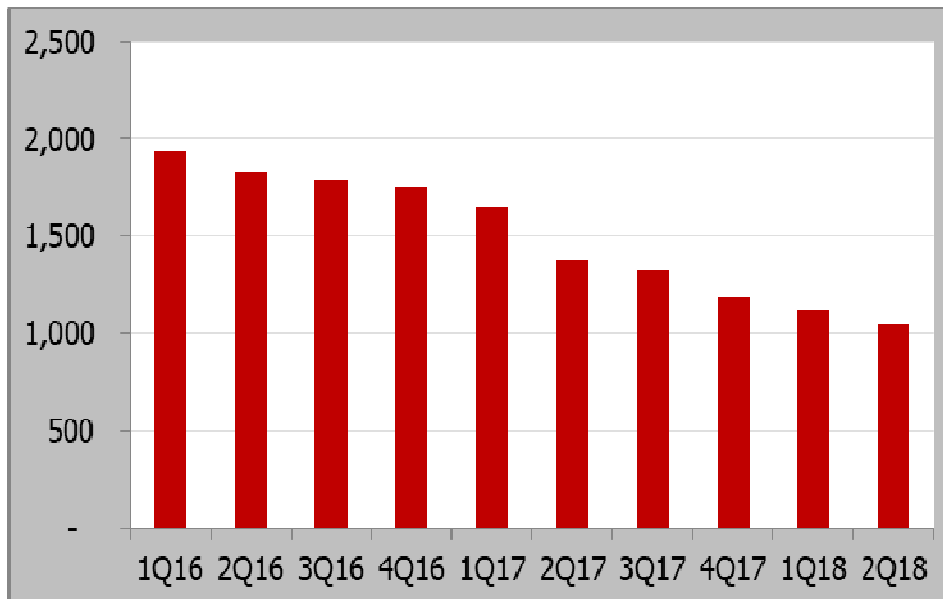
Source: MAA, MIDF

EXHIBIT 3: EBITDA MARGIN IMPROVEMENT ON THE BACK OF A STRONGER RM



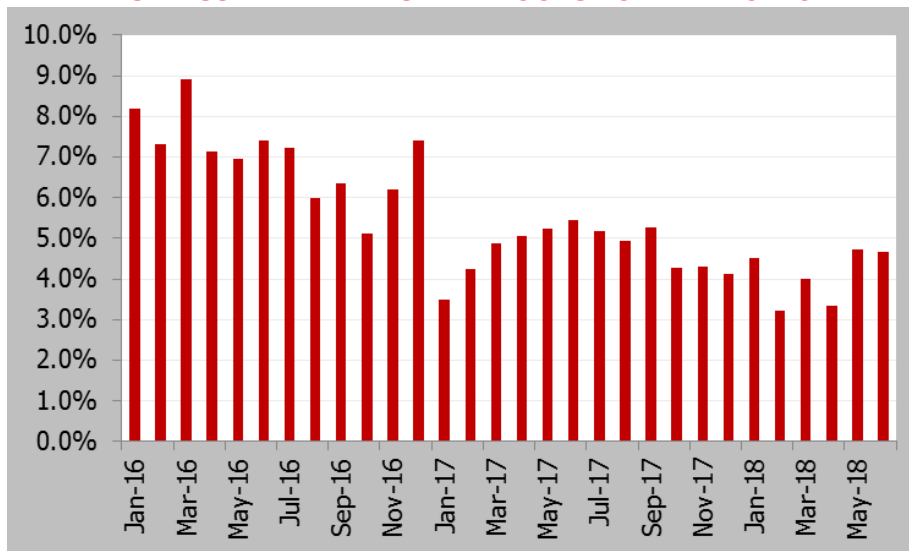
Source: Company, Bloomberg, MIDF

EXHIBIT 4: INVENTORIES SUCCESSFULLY REDUCED IN PAST 2 YEARS (RM MIL)



Source: Company, MIDF

EXHIBIT 5: NISSAN MARKET SHARE LOOKS TO HAVE BOTTOMED



Source: MAA, MIDF

EXHIBIT 6: TAN CHONG 2Q18 RESULT SUMMARY

YE Dec (RMmil)	2Q17	1Q18	2Q18	QoQ	YoY	1H17	1H18	YTD
Revenue	1,196.4	1,034.6	1,088.3	5.2%	-9.0%	2192.0	2122.9	-3%
Operating profit	(10.9)	23.6	39.7	67.7%	NA	(33.1)	63.3	NA
Interest expense	(17.4)	(16.1)	(20.0)	24.3%	14.9%	(34.1)	(36.1)	NA
Interest income	4.2	4.2	4.9	15.9%	15.5%	7.1	9.1	27.4%
Associates	1.4	1.7	0.3	-83.2%	-79.9%	1.8	2.0	8.7%
Pretax profit	(22.7)	13.5	24.8	84.3%	NA	(58.3)	38.3	NA
Tax expense	(3.3)	(11.4)	(14.9)			(5.2)	(26.3)	
Minorities	(3.0)	(2.2)	(2.5)			(5.1)	(4.7)	
Net profit	(23.0)	4.3	12.4	190.8%	NA	(58.3)	16.6	NA
Core net profit	(23.0)	4.3	12.4	190.8%	NA	(58.3)	16.6	NA
EPS (sen)	(3.4)	0.6	1.8			(8.7)	2.5	
Gross DPS (sen)	1.0	0.0	2.0			1.0	2.0	
Operating margin (%)	-0.9%	2.3%	3.6%			-1.5%	3.0%	
Pretax profit margin (%)	-1.9%	1.3%	2.3%			-2.7%	1.8%	
Net profit margin (%)	-1.9%	0.4%	1.1%			-2.7%	0.8%	
Tax rate (%)	14.5%	-84.5%	-60.2%			8.9%	-68.8%	
Nissan TIV (units)	7,548	5,310	6,616	24.6%	-12.3%	13,537	11,926	-12%
RM:USD (Delayed by 3-mth)	4.29	4.16	3.92	-5.8%	-8.6%	4.37	4.04	-7.6%
Revenue/vehicle (RM000)	155.9	189.7	160.6	-15.3%	3.0%	159.1	173.6	9.1%

Source: Company, MIDF

EXHIBIT 7: TAN CHONG 2Q18 RESULT SUMMARY (BREAKDOWNS)

YE Dec (RMmil)	2Q17	1Q18	2Q18	QoQ	YoY	1H17	1H18	QoQ
Total revenue	1,196	1,035	1,088	5%	-9%	2,192	2,123	-3%
Autos	1,176.9	1,007.1	1,062.7	6%	-10%	2,153.4	2,069.9	-4%
Financial Services	17.5	24.8	22.6	-9%	29%	34.3	47.4	38%
Others	2.0	2.7	3.0	9%	46%	4.3	5.7	33%
Total EBITDA	27.1	54.0	70.5	31%	160%	43.1	124.5	189%
Autos	20.7	48.2	53.6	11%	159%	31.3	101.8	225%
Financial Services	3.8	7.9	4.5	-43%	19%	10.3	12.4	21%
Others	2.6	(2.1)	12.4	NA	371%	1.5	10.3	571%
EBITDA margins	2.3%	5.2%	6.5%			2.0%	5.9%	
Autos	1.8%	4.8%	5.0%			1.5%	4.9%	
Financial Services	21.6%	31.8%	19.8%			29.9%	26.1%	
Others	128.8%	-76.9%	415.0%			35.6%	179.7%	
COUNTRY BREAKDOWN								
Total revenue	1,196	1,035	1,088	5%	-9%	2,192	2,123	-3%
Malaysia	1,022.7	834.4	952.7	14%	-7%	1,848.9	1,787.0	-3%
Vietnam	135.1	152.1	73.5	-52%	-46%	266.0	225.6	-15%
Others	38.6	48.1	62.2	29%	61%	77.1	110.3	43%
Total EBITDA	27.1	54.0	69.1	28%	155%	43.1	123.1	186%
Malaysia	34.6	54.6	73.9	35%	113%	59.1	128.5	117%
Vietnam	(6.0)	(4.2)	(8.8)	112%	46%	(12.9)	(13.0)	0%
Others	(1.5)	3.5	4.1	15%	NA	(3.1)	7.6	NA
EBITDA margins	2.3%	5.2%	6.4%			2.0%	5.8%	
Malaysia	3.4%	6.5%	7.8%			3.2%	7.2%	
Vietnam	-4.5%	-2.7%	-12.0%			-4.9%	-5.8%	
Others	-3.9%	7.4%	6.6%			-4.0%	6.9%	

Source: Company, MIDF

Income Statement	FY15	FY16	FY17	FY18F	FY19F
Revenue	5,716.7	5,510.7	4,341.2	4,809.1	4,916.3
Operating expenses	(5,547.6)	(5,492.0)	(4,359.9)	(4,711.3)	(4,763.3)
EBIT	169.0	18.7	(18.7)	97.8	153.0
Net interest expense	(56.1)	(65.0)	(57.5)	(44.2)	(44.0)
Associates	2.4	3.2	3.4	1.5	1.5
PBT	115.3	(43.1)	(72.8)	55.1	110.5
Taxation	(45.4)	(16.0)	(23.6)	(13.4)	(27.3)
Minority Interest	(5.0)	4.1	(7.8)	(0.5)	(1.1)
Net profit	74.9	(54.9)	(88.6)	41.1	82.2
Core net profit	59.9	(58.8)	(88.6)	41.1	82.2
Consensus net profit	74.9	(49.0)	(93.7)	(1.6)	47.6
Balance Sheet	FY15	FY16	FY17	FY18F	FY19F
Non-current assets	2,406.6	2,684.7	2,933.9	2,548.4	2,558.1
PPE	1,704.2	1,863.0	1,832.6	1,841.5	1,849.7
Investments in associate	37.8	42.9	40.8	42.3	43.8
Others	664.7	778.8	1,060.5	664.7	664.7
Current assets	2,762.3	2,881.8	2,466.3	2,732.5	2,969.6
Inventories	1,645.2	1,762.8	1,186.0	1,058.0	1,229.1
Receivables	818.8	774.8	696.1	721.4	737.5
Others	132.4	121.7	266.2	204.8	207.9
Cash & equivalent	165.9	222.5	318.0	524.9	571.7
TOTAL ASSETS	5,169.0	5,566.5	5,400.1	5,280.9	5,527.7
Share capital	336.0	336.0	336.0	336.0	336.0
Minority Interest	(1.6)	(1.8)	(2.9)	(2.4)	(1.3)
Reserves	2,457.6	2,530.1	2,448.3	2,431.6	2,481.3
TOTAL EQUITY	2,792.0	2,864.3	2,781.4	2,765.2	2,816.0
Non-current liabilities	1,013.7	974.2	985.1	923.7	893.7
Long-term borrowings	818.7	747.6	748.1	728.7	698.7
Deferred tax liabilities	144.0	168.2	161.2	144.0	144.0
Others	51.1	58.3	75.8	51.1	51.1
Current liabilities	1,363.2	1,728.1	1,633.6	1,592.2	1,805.1
Short-term borrowings	670.8	1,059.7	1,029.7	1,000.0	1,200.0
Payables	677.6	652.4	592.1	577.4	590.3
Others	14.9	16.0	11.8	14.9	14.9
TOTAL LIABILITIES	2,376.9	2,702.2	2,618.8	2,516.0	2,698.9

Cash Flow Statement	FY15	FY16	FY17	FY18F	FY19F
Operating activities					
PBT	115.3	(15.1)	(111.6)	55.1	110.5
Depreciation & Amortization	133.3	131.2	140.4	141.1	141.8
Chgs in working capital	(424.6)	(95.9)	283.3	324.8	(177.5)
Interest expense	(52.8)	(66.1)	(65.1)	(60.5)	(66.5)
Tax paid	(54.4)	(6.1)	13.6	(13.4)	(27.3)
Others	65.7	(92.5)	3.4	57.9	64.4
CF from Operations	(217.5)	(144.5)	264.0	505.0	45.5
Investing activities					
Capex	(119.2)	(250.0)	(110.8)	(150.0)	(150.0)
Others	158.0	173.7	(120.8)	1.4	1.4
CF from Investments	38.8	(76.3)	(231.5)	(148.6)	(148.6)
Financing activities					
Dividends paid	(32.6)	(26.4)	(13.1)	(20.2)	(20.2)
Net proceeds in borrowings	25.7	301.2	79.8	(130.0)	170.0
Others	(0.6)	(0.0)	(0.3)	-	-
CF from Financing	(7.6)	274.8	66.5	(150.2)	149.8
Net changes in cash	(186.3)	54.0	98.9	206.2	46.7
Beginning cash	341.5	165.9	219.8	318.7	524.9
Overdrafts & Deposits	10.6	-	-	-	-
Ending cash	165.9	219.8	318.7	524.9	571.7
Ratios	FY15	FY16	FY17	FY18F	FY19F
Revenue growth	20.1%	-3.6%	-21.2%	10.8%	2.2%
EBIT growth	-19.4%	-88.9%	-200.1%	-622.8%	56.5%
Core net profit growth	-20.9%	NA	NA	NA	99.8%
PBT margin	2.0%	NA	NA	NA	2.2%
Core net profit margin	1.0%	-1.1%	-2.0%	0.9%	1.7%
ROE	1.2%	-1.1%	-1.6%	0.8%	1.5%
ROA	2.1%	-2.1%	-3.2%	1.5%	2.9%
Net gearing (%)	47.4%	55.3%	52.5%	35.5%	39.2%
Book value/share (RM)	4.15	4.26	4.14	4.11	4.19
PBV (x)	0.41	0.40	0.41	0.41	0.40
Interest Cover (x)	4.4	2.7	1.4	5.4	6.7
FCF (RMm)	(178.7)	(220.8)	32.4	356.4	(103.1)

DAILY PRICE CHART



Source: Bloomberg, MIDFR

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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.