

Tan Chong Motor

Value emerging, proxy to strong Ringgit

- Value emerging after ~40% fall in the past 24 months
- Earnings recovery underway backed by strong Ringgit, normalisation of inventories & resumption of new launches
- FY18F revised from loss to profits, FY19F introduced
- Upgrade to contrarian BUY at higher TP of RM2.05; conservatively pegged to trough valuation of 0.5x FY18F BV.

Upgrade to contrarian BUY. We raise Tan Chong to BUY from HOLD and raise our TP to RM2.05 from RM1.85 previously, conservatively pegging Tan Chong to trough PBV of 0.5x. Tan Chong's earnings were previously hit by: (1) Loss in market share from a freeze in new launches (2) Weak Ringgit in the past 2 years (3) Heavy discounting to clear off old inventories. However, having seen share price fall some ~40% in the past 24 months, we see value emerging in the stock. Tan Chong now trades at just 0.4x FY18F PBV amid a potential turnaround in earnings over the next few years. This is premised on: (1) A much stronger Ringgit now (2) Successful inventory pare down in the past 12 months (3) Resumption of new model launch this year (not factored into projections yet). Our FY18F is revised up to a core net profit of RM21m from a net loss of RM81m previously and we introduce our FY19F earnings of RM61m.

Headed towards breakeven. Tan Chong has large exposure to USD imports (for CKD kits) estimated to account for 18%-20% of total cost. We forecast losses to narrow and gradually hit breakeven in FY18F followed by more meaningful earnings thereafter on the back of a stronger Ringgit now. Resumption of new model introductions from 2018 will drive a recovery in volumes and lower kit cost in USD terms as costing will be benchmarked against current forex levels (relative to ~RM3.10:USD levels when the Almera was introduced back in 2012). Furthermore, with the Almera having been in the market >5 years, the bulk of capex would have been fully depreciated now.

Inventory pare down progressing well. The significance of Tan Chong's successful inventory pare down is that it: (1) Reduces the magnitude of discounting given less need to do so (2) Reduces finance cost from lower working capital requirement (3) Increases Tan Chong's exposure to current forex levels (vs. mostly RM4.20:USD exposure currently due to old inventories). Tan Chong has been paring down these expensive inventories in the past 2 years (See Exhibit 3) which will see it gradually increasing exposure to the current, much lower forex levels (of ~RM4.00:USD) i.e. some 5% appreciation vs. the RM4.20:USD levels. Inventory levels (comprising mainly the Almera, X-Trail and Navara) have reduced by 30% as of 3Q17 (RM1.3b) against the peak of ~RM2b in 1Q16. Management targets to reduce this to <RM1b in 4Q17.

Upgraded to BUY

**Revised Target Price: RM2.05
(from RM1.85)**

RETURN STATS	
Price (8 Jan 2018)	RM1.72
Target Price	RM2.05
Expected Share Price Return	+19.2%
Expected Dividend Yield	+1.7%
Expected Total Return	+20.9%

STOCK INFO	
KLCI	1,832.15
Bursa / Bloomberg	4405 / TCM MK
Board / Sector	Main/Automotive
Syariah Compliant	Yes
Issued shares (mil)	652.66
Market cap. (RM'm)	1,122.6
Price over NA	0.39
52-wk price Range	RM1.66-1.99
Beta (against KLCI)	0.83x
3-mth Avg Daily Vol	0.09m
3-mth Avg Daily Value	RM0.16m
Major Shareholders (%)	
Tan Chong Consolidated	40.4
EPF	6.0
Nissan Motor	5.7

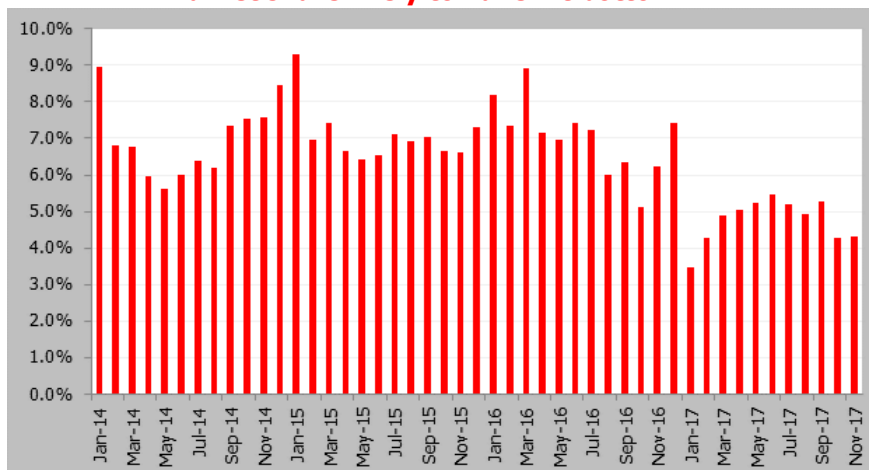
INVESTMENT STATISTICS

FYE Dec	FY15	FY16	FY17F	FY18F	FY19F
Revenue (RM'm)	5,716.7	5,510.7	4,640.6	4,809.1	4,916.3
EBIT (RM'm)	169.0	18.7	(61.8)	70.0	124.4
Pre-tax Profit (RM'm)	115.3	(43.1)	(111.6)	27.2	81.2
Core net profit (RM'm)	59.9	(58.8)	(96.9)	20.5	60.5
FD EPS (sen)	8.9	(8.8)	(14.4)	3.1	9.0
EPS growth (%)	(20.9)	NA	NA	NA	194.7
PER (x)	19.3	NA	NA	56.3	19.1
Net Dividend (sen)	5.0	2.0	3.0	3.0	3.0
Net Dividend Yield (%)	2.9	1.2	1.7	1.7	1.7

Source: Company, MIDF

Market share has hit bottom? Tan Chong's market share deteriorated significantly in the past year, primarily due to a freeze in new model launches since 2016 coupled with aggressive launches by competition to drive sales. This should reverse from 2018 as Tan Chong resumes new model introductions; rumoured models include the Nissan Kicks (compact SUV priced well under USD19K (RM76K) in the US), new Serena Hybrid and the new Leaf. Our recent meeting with management suggests Tan Chong's 2018 launch will involve an entirely new model not currently in Tan Chong's Nissan line-up and management has been indicating of the market's fast changing preference towards SUVs. Tan Chong's model line-up currently entails a large vacuum in the compact SUV segment where the Honda HRV and Mazda CX3 have been thriving. While the 2018 launch may not necessarily return Tan Chong to 2014-2017 market share of 7%-8%, it will almost definitely drive an improvement in earnings from an exceptionally depressed base (given costing at latest forex levels) and off a low base market share of just 4.8% in FY17F.

EXHIBIT 1: Market share likely to have hit bottom in FY17F



Source: Company, MAA, MIDF

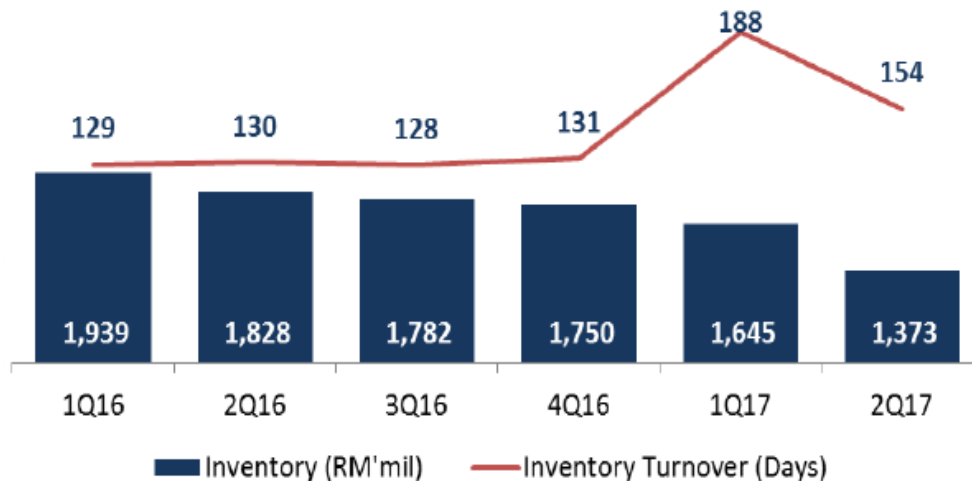
EXHIBIT 2: The 2018 Nissan Kicks is positioned to compete against the likes of Honda HRV/Toyota CHR



Source: Various, MIDF

On track for balance sheet improvement. In line with lower inventories, we expect debt levels and finance cost to reduce in tandem. We forecast net gearing to reduce to ~40% in FY18F from as high as 55% in FY16 which captured peak inventory levels. Interest cover is expected to improve to 5x-6x over FY18F/19F from just 1.5x in FY17F.

EXHIBIT 3: Management has successfully reduced inventory levels from the peak in 1Q16



Source: Company, MIDF

Earnings revised up. On the back of: (1) Stronger Ringgit assumption of RM4.10:USD/RM4.00:USD over FY18F/19F from RM4.20:USD previously (2) Lower finance cost and reduced discounting from an expected improvement in inventory levels; our FY18F is revised up to a core net profit of RM21m from a core net loss of RM81m previously and we introduce our FY19F earnings of RM61m. Our FY18F forex assumption is conservative as we expect part of FY18F to still reflect inventories purchased at RM4.20:USD forex levels previously. Every 1% change in our USD assumption impacts FY18F earnings by 64% - high sensitivity as earnings is close to break-even point. On top of this, our TIV forecast has yet to factor in potential improvements from Tan Chong's FY18F new model launch. For now, we forecast a conservative 1.8%/2.1% growth in FY18F/19F Nissan TIV.

Recommendation. We raise Tan Chong to BUY from HOLD and raise our TP to RM2.05 from RM1.85 previously, still conservatively pegging 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 potential turnaround in earnings over the next few years. Key catalysts include: (1) Resumption of new model launch in FY18F (2) Sustained Ringgit strength (3) Further reduction in inventory levels.

DAILY PRICE CHART



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Income Statement	FY15	FY16	FY17F	FY18F	FY19F
Revenue	5,716.7	5,510.7	4,640.6	4,809.1	4,916.3
Operating expenses	(5,547.6)	(5,492.0)	(4,702.4)	(4,739.1)	(4,792.0)
EBIT	169.0	18.7	(61.8)	70.0	124.4
Net interest expense	(56.1)	(65.0)	(51.3)	(44.2)	(44.6)
Associates	2.4	3.2	1.5	1.5	1.5
PBT	115.3	(43.1)	(111.6)	27.2	81.2
Taxation	(45.4)	(16.0)	13.6	(6.4)	(19.9)
Minority Interest	(5.0)	4.1	1.1	(0.3)	(0.8)
Net profit	74.9	(54.9)	(96.9)	20.5	60.5
Core net profit	59.9	(58.8)	(96.9)	20.5	60.5
Consensus net profit	74.9	(49.0)	19.8	20.8	21.8
Balance Sheet	FY15	FY16	FY17F	FY18F	FY19F
Non-current assets	2,406.6	2,684.7	2,538.1	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	664.7	664.7	664.7
Current assets	2,762.3	2,881.8	2,830.9	2,711.6	2,926.7
Inventories	1,645.2	1,762.8	1,392.2	1,058.0	1,229.1
Receivables	818.8	774.8	696.1	721.4	737.5
Others	132.4	121.7	200.5	204.8	207.9
Cash & equivalent	165.9	222.5	542.2	727.5	752.2
TOTAL ASSETS	5,169.0	5,566.5	5,368.9	5,260.1	5,484.9
Share capital	336.0	336.0	336.0	336.0	336.0
Minority Interest	(1.6)	(1.8)	(2.9)	(2.6)	(1.8)
Reserves	2,457.6	2,530.1	2,410.1	2,410.7	2,438.4
TOTAL EQUITY	2,792.0	2,864.3	2,743.2	2,744.1	2,772.6
Non-current liabilities	1,013.7	974.2	953.7	923.7	893.7
Long-term borrowings	818.7	747.6	758.7	728.7	698.7
Deferred tax liabilities	144.0	168.2	144.0	144.0	144.0
Others	51.1	58.3	51.1	51.1	51.1
Current liabilities	1,363.2	1,728.1	1,672.0	1,592.2	1,805.1
Short-term borrowings	670.8	1,059.7	1,100.0	1,000.0	1,200.0
Payables	677.6	652.4	557.2	577.4	590.3
Others	14.9	16.0	14.9	14.9	14.9
TOTAL LIABILITIES	2,376.9	2,702.2	2,625.7	2,516.0	2,698.9

Cash Flow Statement	FY15	FY16	FY17F	FY18F	FY19F
Operating activities					
PBT	115.3	(15.1)	(111.6)	27.2	81.2
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	(6.4)	(19.9)
Others	65.7	(92.5)	22.5	57.9	64.4
CF from Operations	(217.5)	(144.5)	283.0	484.1	23.5
Investing activities					
Capex	(119.2)	(250.0)	(150.0)	(150.0)	(150.0)
Others	158.0	173.7	1.4	1.4	1.4
CF from Investments	38.8	(76.3)	(148.6)	(148.6)	(148.6)
Financing activities					
Dividends paid	(32.6)	(26.4)	(20.2)	(20.2)	(20.2)
Net proceeds in borrowings	25.7	301.2	(30.0)	(130.0)	170.0
Others	(0.6)	(0.0)	-	-	-
CF from Financing	(7.6)	274.8	(50.2)	(150.2)	149.8
Net changes in cash	(186.3)	54.0	84.2	185.3	24.8
Beginning cash	341.5	165.9	219.8	304.1	490.4
Overdrafts & Deposits	10.6	-	-	-	-
Ending cash	165.9	219.8	304.1	490.4	517.1
Ratios	FY15	FY16	FY17F	FY18F	FY19F
Revenue growth	20.1%	-3.6%	-15.8%	3.6%	2.2%
EBIT growth	-19.4%	-88.9%	-430.6%	-213.2%	77.8%
Core net profit growth	-20.9%	-198.2%	64.7%	-121.2%	194.7%
PBT margin	2.0%	-0.8%	-2.4%	0.6%	1.7%
Core net profit margin	1.0%	-1.1%	-2.1%	0.4%	1.2%
ROE	1.2%	-1.1%	-1.8%	0.4%	1.1%
ROA	2.1%	-2.1%	-3.5%	0.7%	2.2%
Net gearing (%)	47.4%	55.3%	48.0%	36.5%	41.3%
Book value/share (RM)	4.15	4.26	4.08	4.08	4.13
PBV (x)	0.41	0.40	0.42	0.42	0.42
Interest Cover (x)	4.4	2.7	1.5	4.8	6.0

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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.