

20 April 2018 | Corporate Update

## UMW Holdings

**Capitalising on RR's Asian supply chain build-up**

- **M&E revenues targeted to double from aerospace venture**
- **Scope for further expansion in high value manufacturing**
- **Catalyst to unlock value of vast Serendah land**
- **Re-affirm BUY at unchanged TP of RM7.11**

***We visited UMW Aerospace's plant in Serendah this week. Present were UMW M&E Division President, En. Megat Shahrul, Head of Plant, Mr Trevor Peacock and key management of the plant. Below are the key takeaways:***

To recap, UMW Aerospace (UMWA) had invested RM750m (land is leased from the parent company) into the aerospace plant. UMWA has secured a 25+5 year contract to supply fan cases to Rolls Royce's (RR) Trent 1000 / Trent 7000 engine final assembly facility in Seletar, Singapore. The plant commenced operations and delivered its first fan case in 4Q17. UMWA is involved in the manufacturing of the major frontal portion of the fan case, welding of fan blades to its core and assembly of the entire fan case itself with the rest of the parts procured from RR appointed suppliers. This is then transported to RR's Seletar final assembly facility via land transport (6-hour drive). The Trent 1000 engines are supplied for the Boeing 787, while the Trent 7000 is for the Airbus A330 NEO.

**Sole Tier 1 supplier in SEA.** UMWA is RR's sole Tier-1 supplier in the region and also the only external supplier for the Trent 1000 and Trent 7000 fan case. Prior to this, the fan case operations were largely run from RR's base in the UK. Production volume is expected to gradually tilt towards the Asian operations going forward given that a large part of aircraft orders (~30%) are coming from this region. This follows the setting up of RR's Seletar operations in 2012 and is in-line with RR's strategic plans to build a supply chain in the region.

**In the midst of production ramp-up.** UMWA's plant is designed for a capacity of 250 fan cases per annum (which ties in with Seletar's final assembly capacity) but is planned for ramp-up over the next few years. For FY18, UMWA is targeted to deliver 80 fan cases, doubling to 160 units in FY19F, 235 units in FY20F and 250 units in FY21F. At stretched operations, the plant can actually hit around 320 units/annum.

**M&E revenue targeted to double.** UMWA is estimated to have incurred a loss of RM50m-60m in FY17 given only 6 fan cases delivered as the plant only commenced operations in 4Q17. However, at the 80 units/annum delivery target for FY18F, UMWA should be able to halve the losses before breaking even in FY19F at 160 units/annum production. The group targets to double UMW's M&E (manufacturing & engineering) division revenue (of RM646m in FY17) over the next 3-4 years driven by UMWA's fan case contract. Extrapolating the targeted revenue, we estimate circa USD600K-700K/fan case pricing. Benchmarked at a slight discount to SAM Engineering's (non-rated) net margins of 8%-10%, we estimate UMWA's earnings at RM50m-60m/annum once it reaches full production capacity. To give a magnitude, this is 14%-16% of our FY18F net profit, but UMWA is only expected to hit this number in the mid-term.

**Maintain BUY**

**Unchanged Target Price (TP):RM7.11**

### RETURN STATS

Price (19 April 2018)	RM6.15
Target Price	RM7.11
Expected Share Price Return	+15.6%
Expected Dividend Yield	+4.0%
<b>Expected Total Return</b>	<b>+19.6%</b>

### STOCK INFO

KLCI	1,895.18
Bursa / Bloomberg	4588 / UMWK MK
Board / Sector	Main/Automotive
Syariah Compliant	Yes
Issued shares (mil)	1,168.29
Market cap. (RM'm)	6,951.35
Price over NA	2.46
52-wk price Range	RM4.70 – RM6.98
Beta (against KLCI)	1.41
3-mth Avg Daily Vol	1.64m
3-mth Avg Daily Value	RM10.2m
Major Shareholders (%)	
SKIM ASB	48.0%
EPF	9.2%
KWAP	7.1%

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Kindly refer to the last page of this publication for important disclosures

## INVESTMENT STATISTICS

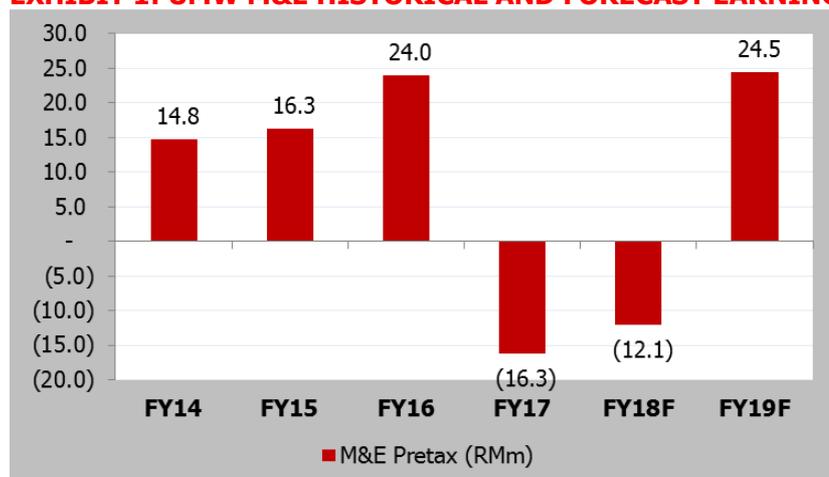
FYE Dec	FY15	FY16	FY17	FY18F	FY19F
Revenue (RM'm)	14,419.8	10,965.1	11,046.5	10,013.6	11,121.3
EBIT (RM'm)	134.9	(2,202.8)	120.4	650.6	936.1
Pre-tax Profit (RM'm)	265.6	(2,153.8)	252.9	659.1	1,052.9
Core net profit (RM'm)	338.0	(401.8)	163.8	370.3	578.7
FD EPS (sen)	28.9	(34.4)	14.0	31.7	47.5
EPS growth (%)	(59.6)	NA	NA	126.1	56.3
PER (x)	21.3	NA	43.9	19.4	12.9
Net Dividend (sen)	20.0	0.0	0.0	15.8	24.8
Net Dividend Yield (%)	3.3	0.0	0.0	2.6	4.0

Source: Company, MIDF

**Scope for expansion.** UMW's entry into the aerospace sector gives it a step up in engineering capabilities.

3 possible growth areas: (1) Further expansion of RR component manufacturing – the manufacturing processes that UMWA is currently undertaking accounts for 70% of the entire fan case value; there is room to further expand this utilising UMWA's current facilities (2) Expansion of aerospace clientele to include other engine OEMs e.g. Safran-GE, as Tier 2 if not as Tier 1 vendor (3) Vertical expansion into industries which require high precision manufacturing e.g. power plant turbines, medical equipments, advanced land transportation.

## EXHIBIT 1: UMW M&E HISTORICAL AND FORECAST EARNINGS



Source: Company, MIDF

**Asset value unlocking.** UMWA's plant takes up just 30 acres of UMW's 863 acres land in Serendah. However, the plant is central to UMW's plan to develop a chunk of the Serendah landbank as a high value manufacturing park. UMW's Serendah land is valued at just ~RM2psf in its books, whereas market value of land (of similar size) in the area are estimated to be 6x-8x higher. UMW's plan to setup a high value manufacturing park is likely to involve smaller transactions which are likely to fetch higher pricing. We estimate the value of UMW's Serendah landbank at RM500m-RM600m (40sen-50sen/share), accounting for 5%-7% of our SOP valuation. To strengthen the case, UMW has worked with MIDA to provide incentives for aerospace-related companies setting up operations in Serendah. The group is in talks with a few parties and had already sold its first 2 acre plot to T7 recently.

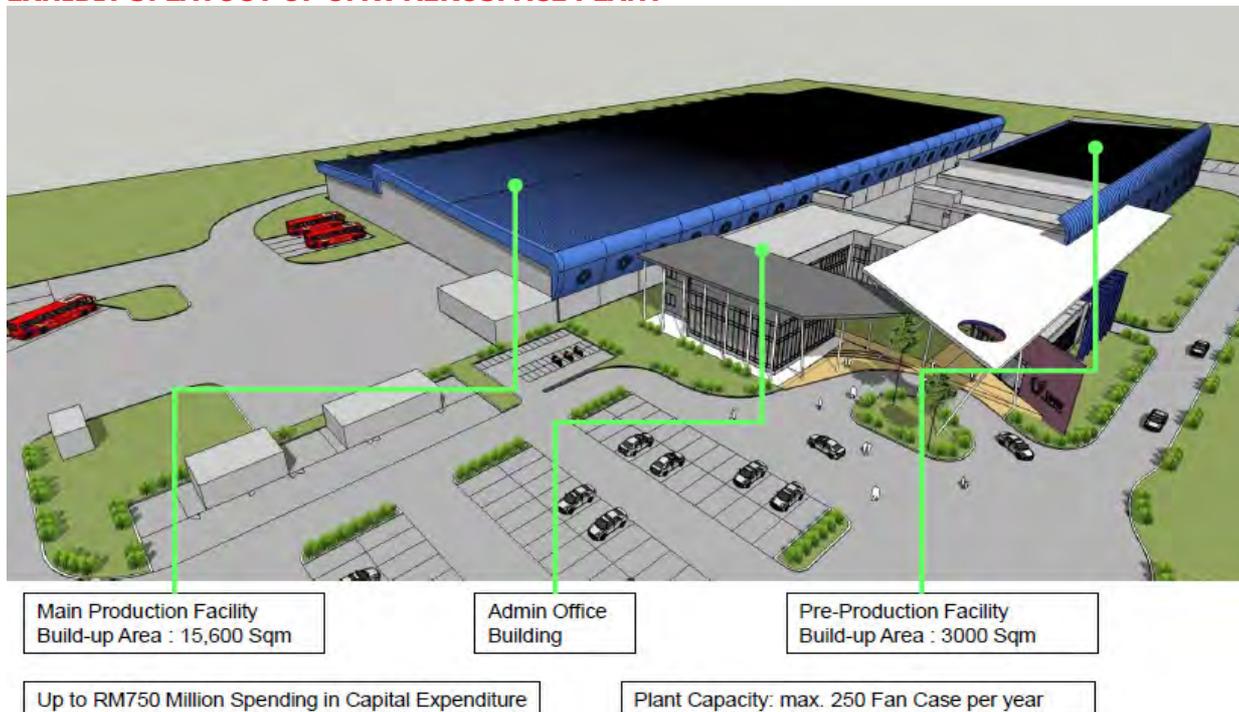
## EXHIBIT 2: UMW'S VAST SERENDAH LANDBANK

- Serendah Land – 861 acres
- Opportunity exist for unlocking of value.
- Part of the land currently housed the Rolls-Royce fan casing project which acts as a catalyst for further development of Serendah.



Source: Company, MIDF

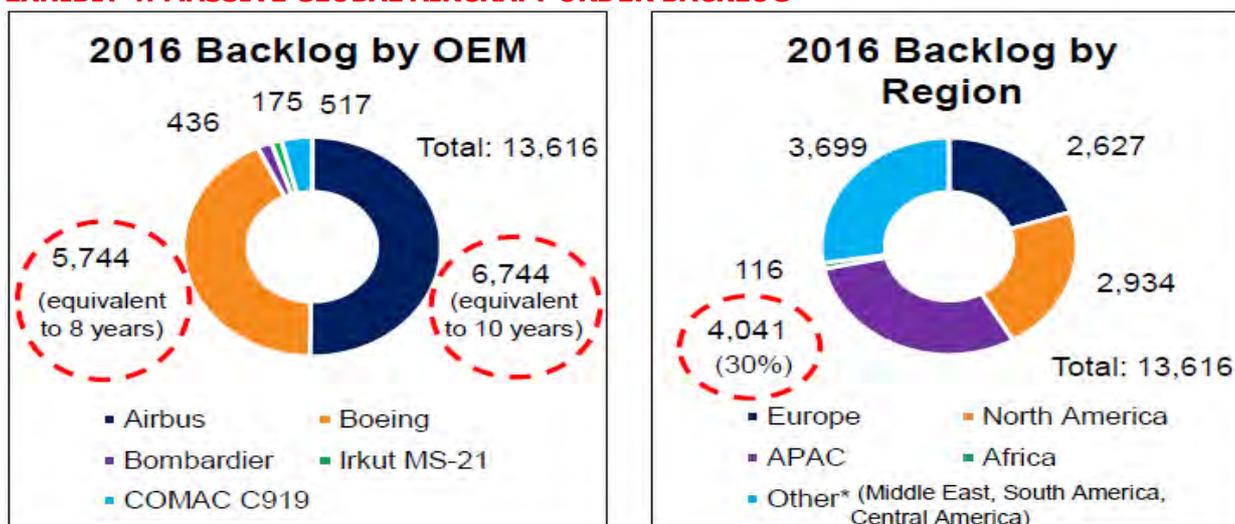
## EXHIBIT 3: LAYOUT OF UMW AEROSPACE PLANT



Source: Company, MIDF

**Attractive returns.** UMW typically sets a hurdle rate of 2%-3% above WACC for its new ventures. Using this as a benchmark, we estimate UMWA's 25-year RR contract to yield circa 12% IRR to derive an equity NPV valuation of RM189m, accounting for 2% of our SOP value for UMW. While volumes under the RR contract are not guaranteed on paper, the massive aircraft order backlog i.e. 8-10 years backlog (30% coming from Asia) gives it a lot of visibility. Additionally, UMWA will be compensated for shortfalls in volumes e.g. manufacturing of other components for RR.

## EXHIBIT 4: MASSIVE GLOBAL AIRCRAFT ORDER BACKLOG



Source: Company, MIDF

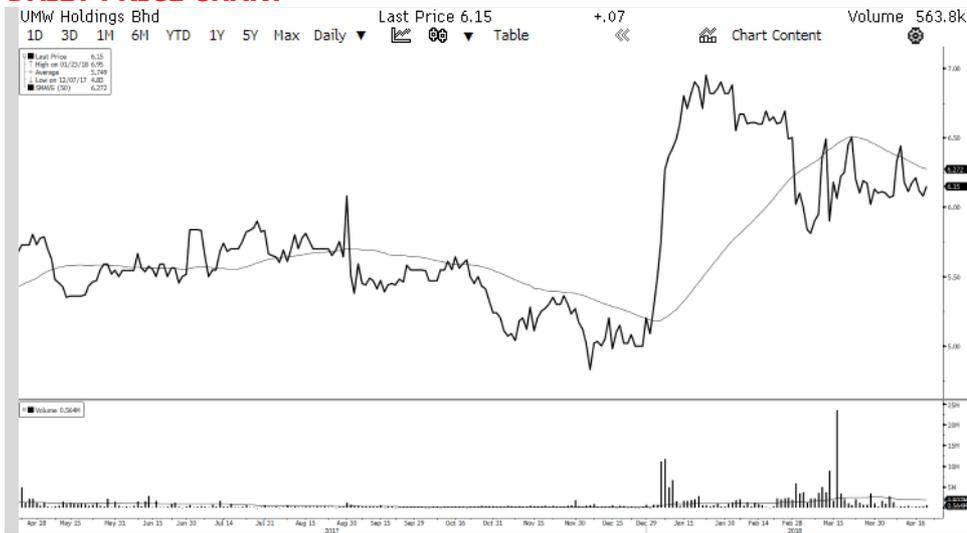
**Recommendation.** Re-affirm BUY on UMW at unchanged TP of RM7.11/share. Key catalysts: **(1) A deleveraged balance sheet post** UMWOG demerger allows room for acquisitive growth and possible resumption of dividend payouts – successful acquisitions from PNB and MBM to increase Perodua stake are strong share price catalysts **(2) Reversal of prior years' market share loss**, structural cost reduction and pricing advantage from UMW Toyota's EEV-focused strategy **(3) Redevelopment of UMW's 830 acres Serendah land** which will unlock value of the asset – easily worth 40sen/share on our estimates **(4) A more than quadrupling of M&E division earnings** once its aerospace division reaches full scale production.

## EXHIBIT 5: UMW SUM-OF-PARTS VALUATION

Segments	FY19F net profit (RMm)	Valuation	Multiple (x)	Value (RMm)	Comments
Automotive – <b>UMW Toyota</b>	238	PER	12	2,851	
Automotive - <b>Perodua</b>	234	PER	15	3,513	
Equipment	117	PER	12	1,407	
Serendah land		RNAV		586	<i>RNAV of Serendah land (830acres@RM16psf) (net of debt)</i>
Aerospace		DCF		189	<i>Equity NPV of 25-year Rolls Royce contract (WACC: 8.7%)</i>
Non-listed O&G		Book Value		114	<i>Based on BV of assets net of 4Q17 impairment</i>
<b>Total value</b>				<b>8,659</b>	
No of shares (m)				1,218	
<b>Fair Value (RM)</b>				<b>7.11</b>	

Source: Company, MIDF

## DAILY PRICE CHART



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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.