

12 March 2018 | Corporate Update

UMW Holdings

Consolidating position in Perodua

- Offers to buyout MBM and acquire Perodua stake from PNB
- Good deal for UMW if accepted given relatively cheap offer
- Net earnings accretion despite possible cash call for funding
- Upgrade to non-consensus BUY at unchanged TP of RM6.70

Consolidating position in Perodua. UMW made two non-interconditional deals last Friday: **(1) UMW has put in an offer to buyout MED-Bumikar-MARA's** (Medbumikar) controlling 50.07% stake in MBM Resources (MBM) for RM501m, valuing the group at RM2.56/share via cash consideration. MBM controls an effective 22.6% stake in Perodua. If Medbumikar accepts the offer, UMW will then do a mandatory offer to take out MBM's minority shareholders and take MBM private. **(2) Acquisition of PNB Equity Resource's (PNB) 10% stake in Perodua** for RM418m via a combination of RM118m cash and RM300m share swap valuing UMW at RM6.09/share - UMW will issue new shares amounting to 49.3m (4% of UMW's current share cap) to PNB. UMW currently holds a 38% stake in Perodua. The offer for MBM is subject to Medbumikar accepting the offer before 28th March.

Good deal for UMW if accepted. The offer of RM2.56/share for MBM values MBM at just 8x FY19F earnings - below our revised SOP-based valuation of RM3.10/share (which rolls over valuations to FY19F). UMW's offer is also at a steep 30% discount to FY17A BV of RM3.68/share and on our estimates, effectively values MBM's 22.6% stake in Perodua at just 8x FY19F earnings. However, "qualitative" factors beyond mere valuations may drive Medbumikar's board to accept the offer. Almost similarly, the offer to buyout PNB's 10% stake in Perodua values the stake at just 8.6x FY19F earnings.

Net earnings accretion despite possible cash call. To fund the MBM acquisition which may rise to RM1b if the mandatory takeover offer is taken up by minorities, we think UMW may have to resort to a right issue. Nonetheless, earning expansion from the acquisitions will more than offset any dilution from potential new share issuance to fund the acquisitions. Assuming the MBM acquisition is fully funded by a cash call at RM6.09/share (similar to the RM6.09 pricing of share swap for acquisition of 10% Perodua stake from PNB), we estimate a total share base expansion of 18%, which is much smaller compared to gross earnings expansion 39%/28% for FY18F/19F from the acquisitions.

Upgrade to non-consensus BUY. While we expect initial share price pressure given a potential cash call to partially fund the acquisition, we suggest investors buy into UMW as this would be a good deal if it is successful. Moreover, UMW's share price has retraced meaningfully since our recent downgrade. We raise UMW to BUY at unchanged SOP-derived TP of RM6.70/share with potential upside on the back of meaningful value and earnings accretion from the acquisitions, if successful. We estimate a 5% (FY19F) net earnings accretion from the 10% Perodua stake acquisition and this could expand by another 5% if the MBM acquisition is successful.

Upgraded BUY

Unchanged Target Price (TP):RM6.70

RETURN STATS

Price (9 March 2018)	RM5.90
Target Price	RM6.70
Expected Share Price Return	+13.0%
Expected Dividend Yield	+3.8%
Expected Total Return	+16.8%

STOCK INFO

KLCI	1,843.92
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	1,004.1
Core net profit (RM'm)	338.0	(401.8)	163.8	370.3	529.6
FD EPS (sen)	28.9	(34.4)	14.0	31.7	45.3
EPS growth (%)	(59.6)	NA	NA	126.1	43.0
PER (x)	22.4	NA	46.3	20.5	14.3
Net Dividend (sen)	20.0	0.0	0.0	15.8	22.7
Net Dividend Yield (%)	3.1	0.0	0.0	2.4	3.5

Source: Company, MIDF

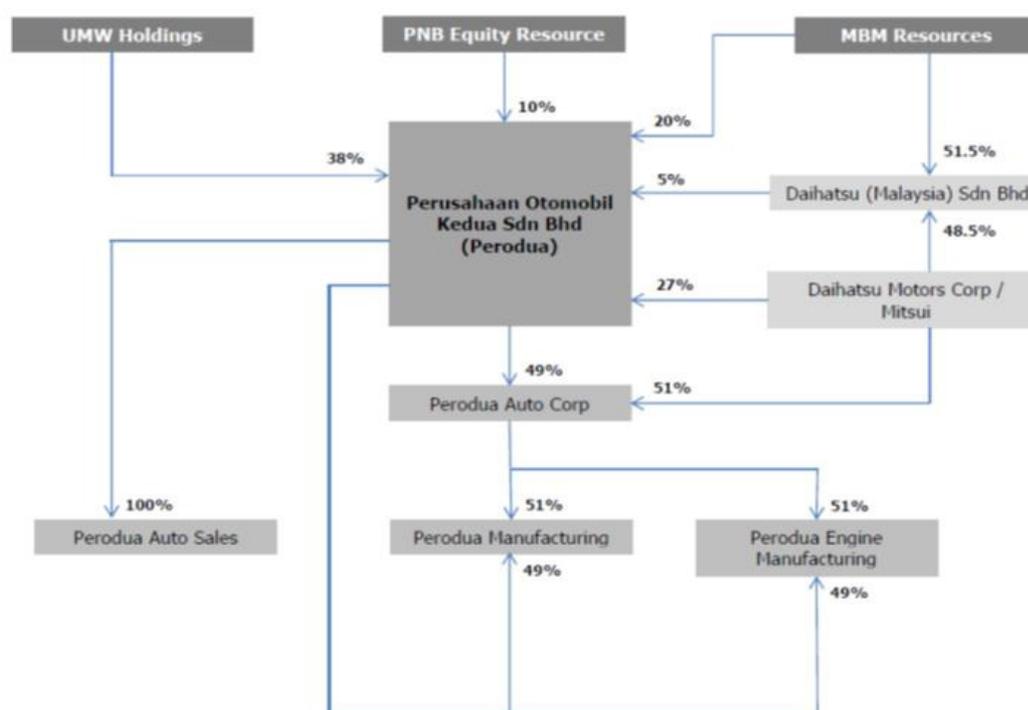
Consolidating position in Perodua. Two non-interconditional deals were announced by UMW last Friday:

(1) UMW has put in an offer to buyout MED-Bumikar-MARA's (Medbumikar) controlling 50.07% stake in MBM Resources (MBM) for RM501m, valuing the group at RM2.56/share via cash consideration. MBM controls an effective 22.6% stake in Perodua. If Medbumikar accepts the offer, UMW will follow through with a mandatory offer to take out MBM's minority shareholders and take MBM private.

(2) Acquisition of PNB Equity Resource's (PNB) 10% stake in Perodua for RM418m via a combination of RM118m cash and RM300m share swap valuing UMW at RM6.09/share - UMW will issue new shares amounting to 49.3m (4% of UMW's current share cap) to PNB.

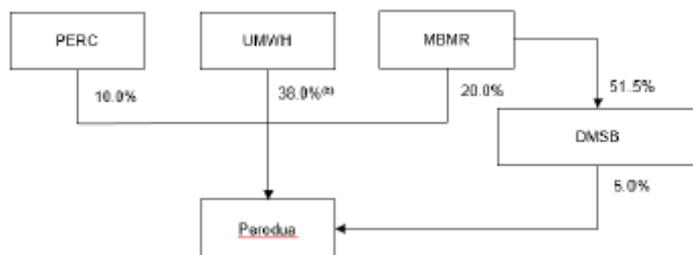
UMW currently holds a 38% stake in Perodua. The offer for MBM is subject to Medbumikar accepting the offer before 28th March, after which the offer will lapse unless both parties agree to extend.

EXHIBIT 1: PERODUA SHAREHOLDING STRUCTURE



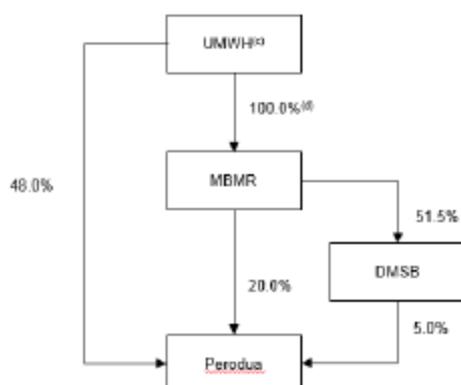
Source: Company, MIDF

EXHIBIT 2: PERODUA LOCAL SHAREHOLDERS PRE-ACQUISITIONS



Source: Company, MIDF * PERC: PNB Equity Resource, DMSB: Daihatsu Malaysia Sdn Bhd

EXHIBIT 3: PERODUA LOCAL SHAREHOLDERS POST-ACQUISITIONS



Source: Company, MIDF

Less-than-attractive offer but qualitative factors may drive acceptance. The offer of RM2.56/share for MBM values MBM at just 8x FY19F earnings - below our revised SOP-based valuation of RM3.10/share (which rolls over valuations to FY19F). UMW's offer is also at a steep 30% discount to FY17A BV of RM3.68/share and on our estimates, effectively values MBM's 22.6% stake in Perodua at just 8x FY19F earnings. However, "qualitative" factors beyond mere valuations may drive Medbumikar's board to accept the offer. After all, the block is of a strategic national asset (2nd national car) and only a limited number of potential acquirers would naturally qualify. Secondly, "factors" within Medbumikar itself could entice its shareholders to liquidate Medbumikar's position in MBM. Moreover, Medbumikar was one of the original shareholders in Perodua; with Perodua having paid historical 50% payout as dividends in the past, these shareholders would have well broken even on their initial investment, we think.

EXHIBIT 4: UMW'S OFFER VALUES MBM AT 8.1X FY19F PE

FYE Dec – MBM Resources	FY15	FY16	FY17	FY18F	FY19F
Revenue (RM'm)	1,816.7	1,680.7	1,732.6	1,654.8	1,709.3
EBIT (RM'm)	21.3	(48.5)	(257.6)	8.8	17.1
Pre-tax Profit (RM'm)	123.0	79.4	(148.5)	138.8	168.6
Normalised PATAMI (RM'm)	80.4	84.8	86.1	101.0	122.9
FD EPS (sen)	20.6	21.7	22.1	25.9	31.5
EPS growth (%)	(29.6)	5.4	1.6	17.4	21.7
PER (x)	12.4	11.8	11.6	9.9	8.1
Net Dividend (sen)	10.0	6.0	3.0	6.5	7.9
Net Dividend Yield (%)	3.9	2.3	1.2	2.5	3.1

Source: Company, MIDF

EXHIBIT 5: UMW'S OFFER VALUES MBM'S PERODUA STAKE AT JUST 8X FY19F

	RMmil
MBM market cap at UMW' offer price of RM2.56/share	998.9
Value of MBM other business ex-Perodua *	115
Implied value of Perodua	884
Perodua FY19F earnings (@ 22.6% stake)	110
Implied PE valuation of Perodua stake (x)	8.0

*Refer to SOP valuation

Source: Company, MIDF

May require further capital to turnaround auto parts? That said, we gather that Hirotako may require further investments to upgrade its technology to be at par to Autoliv's expectations while OMI Alloy requires a different set of staff given different technologies and processes involved in alloy wheel manufacturing (vs. steel wheel), which may prolong its break-even. On top of this, Proton's requirement for its vendors (of which includes MBM's auto parts unit) to reduce pricing by 30% may lead to margin compression, though we understand that the industry is more or less agreeable that such a sharp reduction is not an easy feat to achieve and may seek for more lenient terms. Nonetheless, this potentially means that there could be further required investments beyond the amount UMW is paying for MBM's equity in the announced offer. However, this is nothing that MBM itself cannot fund as a company given a lean balance sheet with just 2.8% net gearing and RM1.7b in total equity as at end FY17A.

Good deal for UMW if accepted. If Medbumikar accepts the offer, this looks like a good deal for UMW given a relatively cheap entry point that it gets for MBM at just 8x FY19F PE and 0.7x FY19F PBV. The offer is also at 17% discount to our TP and just 13% premium to VWAP of RM2.26. We would have thought a larger premium is attributable given that:

(1) MBM's block in Perodua is a swinging block allowing control of Perodua

(2) Value accretion – UMW trades at 13x FY19F PE vs MBM's 8x (at UMW's offer price). We estimate net value accretion of RM590m (or RM0.50/share) from the deal just from the higher valuation that UMW is trading at.

(3) Scarcity premium to valuations as UMW becomes the only local proxy to Perodua and an alternative to listing Perodua directly given a sizeable effective 70.5% stake in Perodua post acquisitions.

(4) Immediately earnings accretive. MBM is already profitable as a group with the bulk of earnings coming from its 22.6% associate stake in Perodua. Post-acquisitions (MBM and 10% stake from PNB), we estimate UMW's earnings to expand 39%/28% over FY18F/FY19F on a full year basis and Perodua FY18F/19F contribution to UMW earnings will rise to 61%/51% from 46%/35% currently.

EXHIBIT 6: PERODUA TO ACCOUNT FOR >50% OF UMW EARNINGS POST-ACQUISITIONS

RMm	FY18F	FY19F
UMW - Perodua earnings contribution @ 38% stake	168.7	185.4
MBM – Perodua earnings contribution @ 22.6% stake	100.3	110.3
Perodua earnings @ 10% stake	44.4	48.8
Total Perodua earnings	313.4	344.5
Perodua contribution to group earnings (pre-acquisitons)	45.5%	35.0%
Perodua contribution to group earnings (post-acquisitons)	60.8%	50.7%

Source: Company, MIDF

(5) Attractive dividend yields Perodua historically paid out 50% of earnings as dividends. At UMW's implied offer for MBM's stake in Perodua, UMW will be getting an effective 6.2% dividend yields (See Exhibit 7) which is very attractive.

EXHIBIT 7: ATTRACTIVE DIVIDEND YIELDS AT UMW'S ENTRY PRICE

MBM Resources	RMmil
Implied value of Perodua at UMW's takeover offer price*	884
Perodua FY19F earnings (@ 22.6% stake)	110
FY19F Perodua dividend (@22.6% stake) (@50% payout)	55
Implied dividend yield	6.2%

Source: Company, MIDF

(5) Gains exposure to MBM's 51%-owned Hirotako which is the only local manufacturer of airbags and a major supplier of safety restraint systems locally via a JV with Autoliv of Sweden.

Perodua to remain an associate. Separately, even if the deal is successful and UMW obtains an effective 70.6% stake in Perodua, we understand the latter will remain accounted for as an associate in UMW's books given equal rights given to the Japanese partners.

PNB consolidating position in Perodua via UMW. UMW is also acquiring PNB equity Resource's 10% direct stake in Perodua for RM417.5m, valuing Perodua at FY19F PE of 8.6x and FY16A PE of 9x. Again, this is a good deal for UMW given cheap valuations to acquire the leading local auto player with a xx% market share with a solid balance sheet. The deal also values Perodua at an effective 0.95x FY19F PBV and 1.1x FY16A PBV. From an earnings multiple standpoint, the deal with PNB is almost similarly valued as the deal with MBM, which values the latter's stake in Perodua at an effective 8.6x FY19F PE. The RM418m consideration will be funded via a combination of RM118m cash and RM300m share swap valuing UMW at RM6.09/share - UMW will issue new shares amounting to 49.3m (4% of UMW's current share cap) to PNB.

EXHIBIT 8: OFFER FOR PNB'S PERODUA STAKE AT AN EFFECTIVE 8.6X FY19F EARNINGS

RMm	FY18F	FY19F
Perodua earnings @ 10% stake	44.39	48.79
Consideration	NA	417.50
PE (x)	NA	8.6

Source: Company, MIDF

EXHIBIT 9: NET EARNINGS ACCRETION DESPITE SHARE SWAP FOR PART FUNDING OF ACQUISITION

RMm	FY18F	FY19F
Group earnings post-10% Perodua stake acquisition	414.71	578.38
Gross earnings accretion	12.0%	9.2%
Dilution from new share issuance @ RM6.09/share) to fund acquisition	4.2%	4.2%
Net earnings accretion from acquisition	7.8%	5.0%

Source: Company, MIDF

Attractive dividend yield at entry price. More importantly, Perodua pays out 50% of earnings as dividends. At the entry price of RM417.5m (for 10% stake) and FY19F Perodua dividends of RMxxm (or RMxxm based on 10% stake), UMW is effectively getting an attractive xx% dividend yield going forward at its entry price (See Exhibit xx).

EXHIBIT 10: ATTRACTIVE YIELDS AT UMW'S OFFER FOR PNB'S PERODUA STAKE

RMm	FY18F	FY19F
Perodua earnings @ 10% stake	44.39	48.79
Perodua dividends at 50% payout (based on 10% stake)	22.19	24.40
Consideration	417.50	417.50
Dividend yield	5.3%	5.8%

Source: Company, MIDF

Net earnings accretion despite possible cash call. Post-acquisition of PNB's 10% stake in Perodua, group's cash position will reduce to ~RM1b. To fund the MBM acquisition which may rise to RM1b if the mandatory takeover offer is taken up by minorities, we think UMW may have to resort to a right issue. Nonetheless, earning expansion from the acquisitions will more than offset any dilution from potential new share issuance to fund the acquisitions. Assuming the MBM acquisition is fully funded by a cash call at RM6.09/share (similar to the RM6.09 pricing of share swap for acquisition of 10% Perodua stake from PNB), we estimate a total share base expansion of 18%, which is much smaller compared to gross earnings expansion 39%/28% for FY18F/19F from the acquisitions.

EXHIBIT 11: NET EARNINGS ACCRETION DESPITE NEW SHARE ISSUANCE TO FUND ACQUISITIONS

RMm	FY18F	FY19F
UMW Group earnings	370.32	529.59
MBM earnings	101.02	122.90
Perodua @ 10%	44.39	48.79
Post-acquisitions earnings	515.72	701.28
Gross earnings accretion	39.3%	32.4%
Dilution from new share issuance @ RM6.09/share) to fund acquisitions	18.3%	18.3%
Net earnings accretion from acquisitions	21.0%	14.1%

Source: Company, MIDF

EXHIBIT 12: SHARE-BASE EXPANSION FROM NEW SHARES TO FUND 10% PERODUA STAKE ACQUISITION

	RMm
Funding requirement	300.00
Share swap price (RM)	6.09
New shares to be issued	49.26
Current share base	1,168.30
Share base expansion	4.2%

Source: Company, MIDF

EXHIBIT 13: SHARE BASE EXPANSION FROM NEW SHARES TO FUND MBM ACQUISITION (ASSUMING 100% TAKE-UP)

	RMm
Funding requirement	1,000.60
Rights price (RM) <i>MIDF assumption</i>	6.09
New shares to be issued	164.30
Current share base	1,168.30
Share base expansion	14.1%

Source: Company, MIDF

Possibility of a competing offer? We would not rule this out, particularly given UMW's relatively low offer. However existing Perodua shareholders would have the first right of refusal to match any higher offer by a 3rd party buyer.

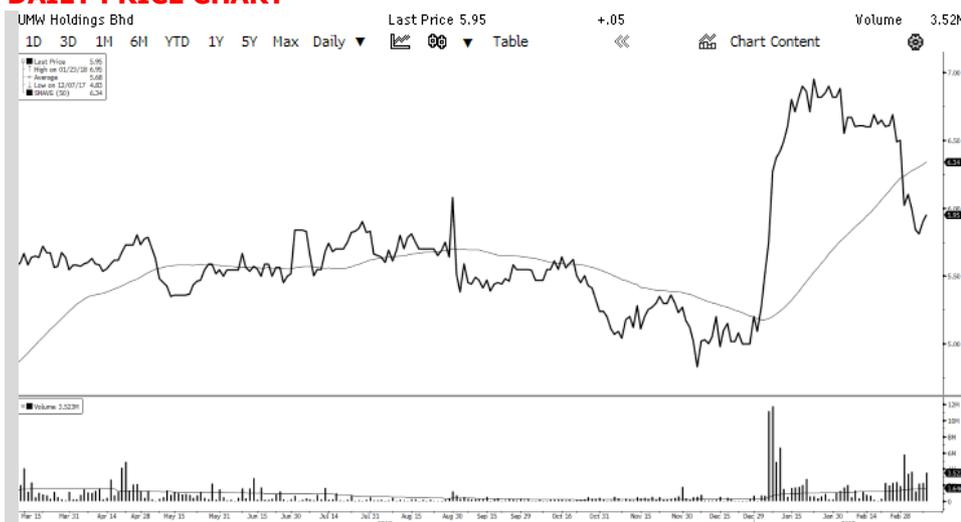
Upgrade to a non-consensus BUY. While we expect initial share price pressure on UMW given a potential cash call to partially fund the acquisition, against conventional reactions, we suggest investors buy into UMW as this would be a good deal if it is successful. Moreover, UMW's share price has retraced by 10% since our downgrade to HOLD previously. Any rights issue will likely be underwritten by UMW's major shareholder, which holds ~60% of UMW. We raise UMW to BUY at unchanged SOP-derived TP of RM6.70/share with potential upside on the back of meaningful value and earnings accretion from the acquisitions, if successful. That said, the 10% Perodua stake acquisition is likely to go through and is not conditional upon the MBM acquisition being accepted by existing shareholders. We estimate a 5% (FY19F) net earnings accretion to UMW from the 10% Perodua stake acquisition and this could expand by another 9% if the MBM acquisition is successful.

EXHIBIT 14: UMW SUM-OF-PARTS VALUATION

Segments	FY19F net profit (RMm)	Valuation	Multiple (x)	Value (RMm)	Comments
Automotive	424	PER	13	5,511	
Equipment	116	PER	12	1,390	
Serendah land		RNAV		586	RNAV of Serendah land (830acres@RM16psf) (net of debt)
Aerospace		DCF		189	Equity NPV of 25-year Rolls Royce contract (WACC: 8.7%)
Non-listed O&G		Book Value		114	Based on BV of assets net of 4Q17 impairment
Total value				7,789	
No of shares (m)				1,168	
Fair value (RM)				6.70	

Source: Company, MIDF

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.