

08 September 2017 | Sector Update

Automotive

Maintain OVERWEIGHT

Forex is a friend

INVESTMENT HIGHLIGHTS

- Ringgit now at 10-months high; favourable forex underpins our bullish sector view
- **UMW, Bermaz Auto and Tan Chong are key beneficiaries of stronger Ringgit**
- **Bermaz Auto (BUY, TP: RM2.55/share) is our top pick for a solid 41% earnings CAGR, attractive 7% yield and value crystallisation of its Philippines unit**
- **UMW remains a contrarian BUY (TP: RM7.20/share) as a value play amid a turnaround in earnings, balance sheet deleveraging and early cycle play into EEV-driven structural cost reduction**

Ringgit at 10-months high. The Ringgit has strengthened further to USD:RM4.21 levels yesterday marking the strongest level reached in the past 10 months. This is already close to our in-house economics team's year-end target of USD:RM4.20. YTD average rates now stand at USD:RM4.36 and is inching closer to our FY17F assumption of an average USD:RM4.30 for auto stocks under coverage. In comparison, the recently reported 1H17 earnings came on the back of still inflated USD:RM4.39 levels (2Q17: USD:RM4.33). The current development underpins our bullish stance on the sector and our view that FY17F earnings will be backloaded on the back of more aggressive launches and the Ringgit strength in 2H17.

EXHIBIT 1: QUARTERLY USD:RM TRENDS



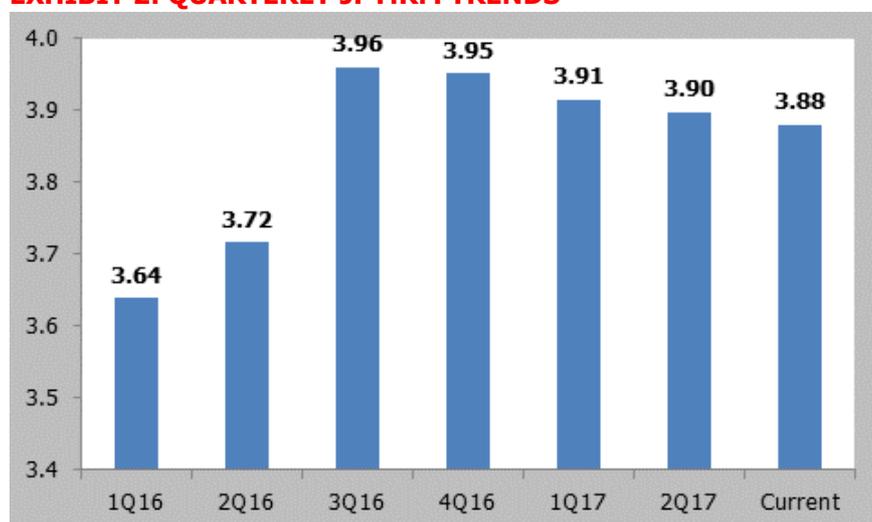
Source: Bloomberg, MIDFR

Who benefits? Of the auto players under coverage, UMW Toyota has the largest exposure to the USD given that all its imported CKD kits and CBUs from Thailand are transacted in USD. Given low localisation rates (of between 20%-60%) relative to the national makes (of 80%-95%), we estimate around half of total component costs are imported. Tan Chong meanwhile, is estimated to have circa 80% (of total imported cost) exposure to USD imports with the rest in JPY. Every 1% change in the USD impacts our FY18F by 4.7% for UMW (Group) and 16% for Tan Chong. As Tan Chong is loss making (relative to the steady state earnings of RM200m-300m/annum prior to the downcycle) it is more sensitive to forex changes now.

KINDLY REFER TO THE LAST PAGE OF THIS PUBLICATION FOR IMPORTANT DISCLOSURES

JPY-exposed beneficiaries. The Ringgit had also strengthened against the JPY in the past 6 months and currently stands at RM3.88:JPYx100. Notably, YTD17 rate of RM3.89:JPYx100 is already above our CY18/19F assumption of RM3.90:JPYx100. Bermaz Auto is a key beneficiary of the Ringgit strength against the JPY as its imports are 100% exposed to the latter; BAuto is exposed to the JPY via CBU imports, whereas CKDs i.e. the CX5 and Mazda 3 models are purchased at a fixed Ringgit price from 30%-owned Mazda Malaysia Sdn Bhd (MMSB), which is the importer of Mazda CKD kits and assembler. To make this possible, MMSB absorbs JPY volatilities from CKD imports; which means that MMSB also benefits from the current Ringgit strength. We estimate that every 1% strengthening of the Ringgit against the JPY impacts BAuto's FY18F (FYE April) earnings by 3%. Perodua is another beneficiary given its exposure to the JPY (and partly USD). Every 1% change in the JPY impacts our FY17F by 1%. UMW is the largest shareholder of Perodua with a 38% stake.

EXHIBIT 2: QUARTERLY JPY:RM TRENDS



Source: Bloomberg, MIDFR

2QCY17 earnings already showing improvements. The recently reported 2Q17 earnings have already showed improvements for the auto sector. UMW autos' pretax improved 14%qoq to RM99m while Tan Chong's losses narrowed 35%qoq to a net loss of RM23m in 2Q17 on the back of improved volumes and slight improvement in forex. BAuto will release its 1QFY18 (quarter ended July 2017) result next week. The group should benefit immediately from the sharp forex improvement since April 2017 in the upcoming results as it no longer hedges its forex position. Mazda TIV has been weak YTD due to run-out of the current generation CX5 but we expect this to improve significantly once the 2ng generation CX5 is launched by month end. The CX5 is one of BAuto's biggest sellers accounting for 30%-40% of Mazda TIV.

EXHIBIT 3: EARNINGS SENSITIVITY TO FOREX

	FY18F earnings impact for every 1% change in USD/JPY
UMW Holdings	4.7%
Tan Chong	16.0%
Bermaz Auto	3.0%
Perodua	1.0%

Source: MIDFR

Non-nationals turning more aggressive. Volume recovery has been healthy at YTD TIV growth of 4.7%; Honda (+29%ytd) and Toyota (+22%ytd) are leading this TIV growth. Given the strong performance, Honda will be launching two additional models on top of the four (i.e. BRV, Jazz Hybrid, City Hybrid, CRV) that were planned and already launched. Toyota is launching 4 facelifts i.e. the Vios, Fortuner, Hilux and Camry models in 2H17. Toyota has also opened registration of interest for the popular CH-R model (B-segment SUV, competes with the CX3 and HRV) and is currently touring the Klang Valley to showcase the model prior to an expected launch in FY18. Our recent visit to a CH-R showbooth suggests a possible 3Q18 launch of the CBU-spec CH-R, to be available in two specs i.e. 1.8 litre and 2 litre hybrid with indicative initial import batch of 500 units. The first round of showcase at Setia City Convention Centre back in May already generated registration of interest by over 3,000 potential buyers. CKD of the CH-R is likely after UMWT's Bukit Raja plant is completed by early FY19F, which could bring down cost of the CH-R substantially. The new Camry and the CH-R are expected to be Toyota's key models for FY18F. On the national car front, Perodua (38%-owned by UMW) is speculated to launch the new MyVi in 2H17.

EXHIBIT 4: TOYOTA CH-R



Source: Various, MIDFR

EXHIBIT 5: NEW-GENERATION TOYOTA CAMRY



Source: Various, MIDFR

EXHIBIT 6: RINGGIT STRENGTHENING AGAINST USD



Source: Bloomberg, MIDFR

EXHIBIT 7: RINGGIT STRENGTHENING AGAINST JPY

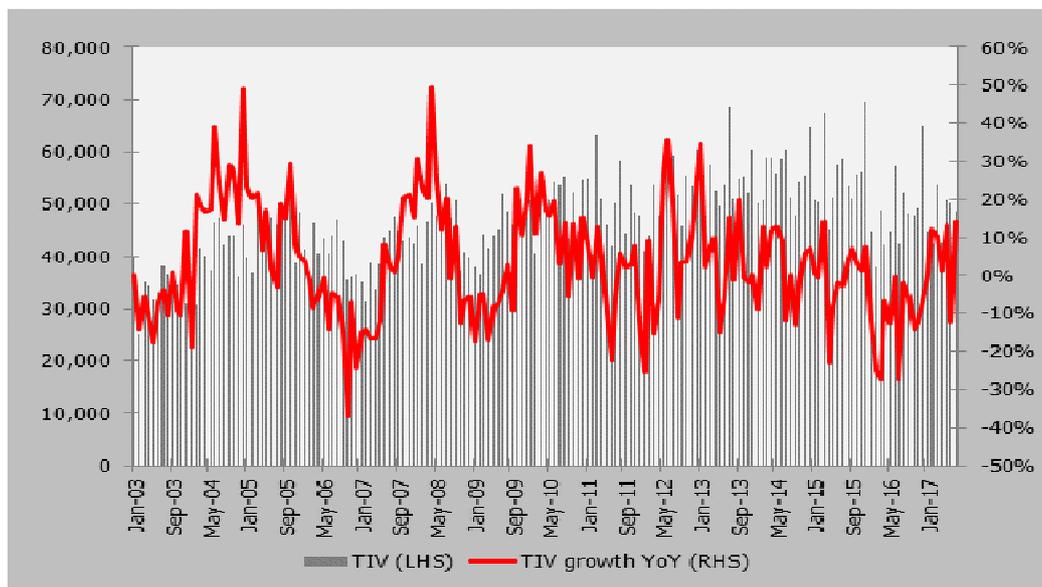


Source: Bloomberg, MIDFR

BAuto is our top sector pick at unchanged TP of RM2.55/share. Key catalysts over the next 12 months: **(1) A 30%yoy increase in FY18F TIV** driven mainly by launch of the new CX5 in Sep17 and CX9 in Jul17 **(2) A more than doubling in associate earnings contribution** to group (via 30%-owned Mazda Malaysia SB and 29%-owned Inokom) given a massive export market expansion which will triple MMSB's prospective market. **(3) Attractive dividend yield of 8%** underpinned by net cash which accounts for 12% of market cap and solid 8% FCFE yield (FY18F). The listing of BAuto Philippines will bump yields up further given potential one-off special dividends. **(4) Value unlocking from the listing of BAuto Philippines (BAP).** Current market cap attributes practically no value to BAuto's stake in BAP relative to the 15x indicative IPO valuation and historical sector valuation of 12x (for Malaysian autos). Ex-cash, BAuto trades at just 8.6x CY18F earnings. **(5) A stronger Ringgit** against the JPY from Apr17.

UMW Holdings remains a contrarian BUY at unchanged TP of RM7.20/share. Key catalysts: **(1) Demerger of O&G units** deleverages balance sheet, drives UMW back into the black and allows better focus on core divisions **(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 711 acres Serendah land** which will unlock value of the asset – easily worth 39sen/share on our estimates **(4) A more than quadrupling of M&E division earnings** once its aerospace division reaches full scale production **(5) An underleveraged balance sheet post UMWOG de-merger** suggests room for acquisitive growth. 🚀

EXHIBIT 8: HISTORICAL TIV TREND



Source: MAA, MIDFR

VALUATION AND RECOMMENDATION

		Shr Price	EPS (sen)		PE (x)		P/BV	ROE	Div Yield	Target	Total
Company	Rating	(RM)	CY17 F	CY18 F	CY17 F	CY18 F	(x)	(%)	(%)	Price (RM)	Upside (%)
B.Auto	BUY	1.92	17.1	20.5	11.2	9.4	4.2	40.2	7.0	2.55	39.8
Tan Chong	NEUTRAL	1.68	(19.8)	(16.2)	(8.5)	(10.4)	0.4	(1.5)	0.0	1.85	10.1
UMW	BUY	5.59	31.7	48.6	17.6	11.5	1.0	5.4	0.0	7.20	28.8
Sector average					14.4	10.4	1.9	14.7	2.3		

Source: Bloomberg, Companies, MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% 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.