

30 August 2016

Consumer Cyclical | Auto &amp; Autoparts

## UMW

### More Pain No Gain

The operating environment for UMW's various business divisions remains extremely challenging for the foreseeable future. The main drag remains its core UMWOG and non-core oil & gas businesses that continue in the red brought about by low asset utilisation from depressed crude oil prices that could persist for some time to come. While Toyota sales should improve in 2H16, helped by new models, the weak MYR will cap the recovery in margins. With a cash crunch looming, UMW scrapped its interim DPS (1H15: 10 sen). We see few fundamental reasons to be holders of this stock. Maintain SELL, with a MYR4.25 TP (from MYR4.00, 27% downside).

**Outlook remains difficult.** There are few signs of a turnaround in the oil & gas industry, which will remain a drag on any nascent recovery in the automotive and equipment divisions.

**Capital commitments badly timed.** We estimate capital requirements to exceed MYR4bn over the next three years to fund the new Toyota assembly and aerospace component plants, plus UMWOG's debt restructuring.

**Interim dividend scrapped, reiterate SELL.** Good news remains a rare commodity at UMW. This is as deteriorating oil & gas industry conditions sent 2Q16 bottomline into the red. This was even without the help of impairment charges that could still rear its head by the year-end if industry conditions show no signs of improvement. Core valuations remain in stratospheric levels while significant capital commitments and the need to recapitalise UMW Oil & Gas (UMWOG) has necessitated the scrapping of its interim DPS to conserve cash. Our SOP-derived TP is now MYR4.25 (from MYR4.00) after leaving valuation metrics unchanged, but rolling forward the base year already implies a generous 0.78x P/BV.

#### 2Q16 earnings below expectations

(MYRm)	2Q16	1Q16	QoQ (%)	2Q15	YoY (%)	Comments
Revenue	2,847	2,199	29.4	3,485	(18.3)	Driven by higher automotive sales volume
EBIT	41	17	139.5	176	(76.7)	Higher automotive earnings offset by losses at core and non-core oil & gas
EBIT (%)	1.4%	0.8%		5.0%		
NI	-12	17	(173.1)	68	(117.7)	Higher-than-expected effective tax rate tipped the bottom line into negative territory
NI (%)	-0.4%	0.8%		2.0%		

Source: Company data, RHB

**Earnings and key risks.** We cut our 2016-18 earnings by 22.8-33.7% to reflect higher losses at UMWOG and lower Toyota sales. Upside risks to our recommendation and target price includes a rebound in the MYR, improvements in consumer sentiment, higher crude oil prices and a turnaround at the various legacy non-core oil & gas businesses.

Forecasts and Valuations	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total turnover (MYRm)	14,959	14,420	10,931	11,693	12,659
Reported net profit (MYRm)	658	(39)	234	268	325
Recurring net profit (MYRm)	802	147	234	268	325
Recurring net profit growth (%)	(6.0)	(81.7)	59.4	14.4	21.4
Recurring EPS (MYR)	0.69	0.13	0.20	0.23	0.28
DPS (MYR)	0.41	0.20	0.10	0.11	0.13
Recurring P/E (x)	8.5	46.5	29.2	25.5	21.0
P/B (x)	1.04	1.07	1.08	1.09	1.11
P/CF (x)	6.5	11.6	8.7	9.6	6.7
Dividend Yield (%)	7.0	3.4	1.7	1.9	2.2
EV/EBITDA (x)	4.7	19.1	16.3	14.6	12.1
Return on average equity (%)	10.2	(0.6)	3.7	4.3	5.2
Net debt to equity (%)	7.6	34.8	31.4	39.1	43.9
Our vs consensus EPS (adjusted) (%)			8.0	(20.9)	(13.3)

Source: Company data, RHB

**Sell** (Maintained)

Target Price:	MYR4.25
Price:	MYR5.85
Market Cap:	USD1,690m
Bloomberg Ticker:	UMWH MK

#### Share Data

Avg Daily Turnover (MYR/USD)	6.52m/1.61m
52-wk Price low/high (MYR)	4.98 - 8.54
Free Float (%)	25
Shares outstanding (m)	1,168
Estimated Return	-27%

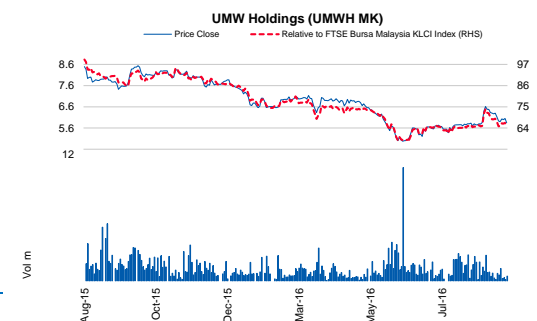
#### Shareholders (%)

PNB Funds	57.6
EPF	16.5

#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(25.7)	2.6	12.9	(17.4)	(31.2)
Relative	(25.0)	0.9	10.2	(19.0)	(35.5)

Source: Bloomberg



Source: Bloomberg

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## More Pain No Gain

Figure 1: UMW's earnings review

FYE Dec (MYRm)	2Q15	1Q16	2Q16	QoQ (%)	YoY (%)	1H15	1H16	YoY (%)	Comments
Revenue	3,485.3	2,199.2	2,846.8	29.4	(18.3)	6,725.7	5,046.0	(25.0)	Sequential improvement in revenue led by higher Toyota sales volumes. Persistent losses at its core and non-core oil & gas businesses continue to be a drag on earnings.
EBIT	176.0	17.1	41.1	(139.5)	(76.7)	459.5	58.2	(87.3)	
EBIT margin (%)	5.0	0.8	1.4			6.8	1.2		
Finance costs	(27.8)	(43.3)	(41.3)	(4.7)	48.6	(60.0)	(84.6)	41.0	Associate losses from non-core interest in oil & gas pipe manufacturing and pipe coating companies in China have diluted the improvements in Perusahaan Otomobil Kedua SB's (Perodua) contributions.
Associates	29.5	22.1	26.5	20.2	(10.2)	63.0	48.6	(22.8)	
Investment income	29.9	25.2	18.5	(26.6)	(38.2)	65.1	43.6	(33.0)	
Pretax profit	207.6	21.1	44.8	(112.6)	(78.4)	527.6	65.9	(87.5)	
Pretax margin (%)	6.0	1.0	1.6			7.8	1.3		
Tax	(74.3)	(26.0)	(48.5)	86.6	(34.6)	(158.3)	(74.5)	(52.9)	The effective tax rate was significantly higher than expected.
Eff tax rate (%)	(35.8)	(123.4)	(108.3)			(30.0)	(113.1)		
MI	(64.9)	21.5	(8.4)	(139.1)	(87.1)	(135.8)	13.1	(109.7)	
Net profit	68.4	16.6	(12.1)	173.1	(117.7)	233.6	4.5	(98.1)	
Net margin (%)	2.0	0.8	(0.4)			3.5	0.1		

Source: Company data, RHB

Figure 2: UMW's earnings review – segmental breakdown

FYE Dec (MYRm)	2Q15	1Q16	2Q16	QoQ (%)	YoY (%)	1H15	1H16	YoY (%)	Comments
Automotive	2,732.7	1,556.0	2,177.1	39.9	(20.3)	4,738.2	3,733.1	(21.2)	Higher sales boosted by the new Toyota <i>Hilux</i> and <i>Fortuner</i> .
Oil & gas	183.4	87.7	130.0	48.3	(29.1)	495.9	217.7	(56.1)	Low oil prices have resulted in low utilisation rates of its rigs with just <i>Naga 1, 7 and 8</i> chartered out during the quarter.
Equipment	353.6	358.0	351.2	(1.9)	(0.7)	1,006.6	709.1	(29.6)	Equipment sales affected by slowdown in construction and mining and restrictions on the importation of equipment into Myanmar.
Mfg & eng	165.4	145.4	157.0	7.9	(5.1)	336.5	302.4	(10.1)	Improved sales of absorbers and lubricants.
Others	50.2	52.1	31.5	(39.4)	(37.2)	148.5	83.6	(43.7)	
<b>Revenue</b>	<b>3,485.3</b>	<b>2,199.2</b>	<b>2,846.8</b>	<b>29.4</b>	<b>(18.3)</b>	<b>6,725.7</b>	<b>5,046.0</b>	<b>(25.0)</b>	
Automotive	263.4	82.7	133.3	61.1	(49.4)	496.9	216.0	(56.5)	Toyota sales continue to lag behind Honda on the back of slow introduction of new models and uninspiring product line-up.
Oil & gas	8.0	(68.4)	(64.0)	6.5	(900.5)	50.5	(132.4)	(362.4)	
Equipment	33.7	39.2	43.3	10.4	28.7	133.0	82.6	(37.9)	
Mfg & eng	0.4	6.6	10.9	65.5	2,627.0	2.2	17.5	694.3	
Others	(97.8)	(39.1)	(78.7)	(101.5)	19.5	(154.9)	(117.8)	(23.9)	
<b>PBT</b>	<b>207.6</b>	<b>21.1</b>	<b>44.8</b>	<b>112.6</b>	<b>(78.4)</b>	<b>527.6</b>	<b>65.9</b>	<b>(87.5)</b>	
<b>PBT margins</b>									
Automotive	9.6	5.3	6.1			10.5	5.8		
Oil & gas	4.4	(78.0)	(49.2)			10.2	(60.8)		
Equipment	9.5	11.0	12.3			13.2	11.6		
Mfg & eng	0.2	4.5	6.9			0.7	5.8		
Others	<i>nmf</i>	<i>nmf</i>	<i>nmf</i>			<i>nmf</i>	<i>nmf</i>		
	<b>6.0</b>	<b>1.0</b>	<b>1.6</b>			<b>7.8</b>	<b>1.3</b>		
Automotive	130.6	55.5	69.5	25.2	(46.8)	247.3	124.9	(49.5)	Unfavourable exchange rates continue to drag on auto margins.
Oil & gas	2.3	(36.2)	(37.5)	3.7	(1,712.0)	20.2	(73.7)	(464.2)	
Equipment	26.6	30.2	32.8	8.7	23.4	105.3	63.0	(40.2)	
Mfg & eng	0.5	1.1	3.4	200.1	649.2	1.8	4.6	158.9	
Others	(91.5)	(34.0)	(80.3)	136.1	(12.3)	(141.0)	(114.3)	(19.0)	
<b>NP</b>	<b>68.4</b>	<b>16.6</b>	<b>(12.1)</b>	<b>173.1</b>	<b>(117.7)</b>	<b>233.6</b>	<b>4.5</b>	<b>(98.1)</b>	
<b>NP margins</b>									
Automotive	4.8	3.6	3.2			5.2	3.3		
Oil & gas	1.3	(41.3)	(28.9)			4.1	(33.9)		
Equipment	7.5	8.4	9.3			10.5	8.9		
Mfg & eng	0.3	0.8	2.2			0.5	1.5		
Others	<i>nmf</i>	<i>nmf</i>	<i>nmf</i>			<i>nmf</i>	<i>nmf</i>		
	<b>2.0</b>	<b>0.8</b>	<b>(0.4)</b>			<b>3.5</b>	<b>0.1</b>		

Source: Company data, RHB

Figure 3: UMW's vehicle sales summary

FYE Dec (units)	2Q15	1Q16	2Q16	QoQ (%)	YoY (%)	1H15	1H16	YoY (%)
<b>Toyota</b>	<b>23,087</b>	<b>10,488</b>	<b>17,392</b>	<b>65.8</b>	<b>(24.7)</b>	<b>39,690</b>	<b>27,880</b>	<b>(29.8)</b>
- Passenger	16,257	7,316	12,746	74.2	(21.6)	27,341	20,062	(26.6)
- Commercial	6,830	3,172	4,646	46.5	(32.0)	12,349	7,818	(36.7)
<b>Perodua</b>	<b>51,349</b>	<b>47,181</b>	<b>50,189</b>	<b>6.4</b>	<b>(2.3)</b>	<b>108,502</b>	<b>97,370</b>	<b>(10.3)</b>
- Passenger	51,349	47,181	50,189	6.4	(2.3)	108,502	97,370	(10.3)
- Commercial	0	0	0	0.0	0.0	0	0	0.0
<b>Total</b>	<b>74,436</b>	<b>57,669</b>	<b>67,581</b>	<b>17.2</b>	<b>(9.2)</b>	<b>148,192</b>	<b>125,250</b>	<b>(15.5)</b>

Source: Malaysian Automotive Association (MAA)

Figure 4: UMW's forecast assumptions

FYE Dec	2015	2016F	2017F	2018F
Toyota/Lexus (units)	95,861	70,000	75,000	80,000
Perodua (units)	213,307	216,000	218,000	218,000
Forex (JPY/MYR)*	3.25	3.90	3.80	3.80
Forex (USD/MYR)*	3.90	4.00	3.80	3.80
*average rate				

Source: RHB

Figure 5: UMW's SOP valuations

	P/E (x)	Valuation (MYR)	Stake (%)	Discount (%)	Per UMW share (MYR)
UMWOG		MYR 0.90	55.15	10	0.83
Other businesses	11				3.42
					<b>4.25</b>

Source: RHB

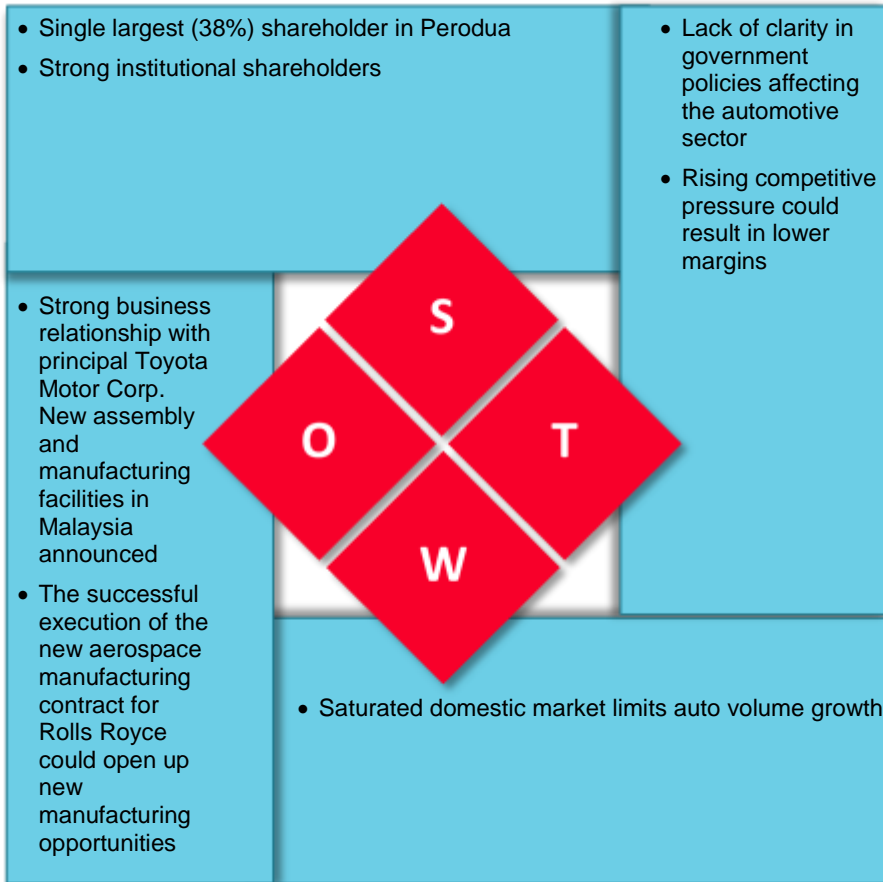
## Financial Exhibits

Financial model updated on: 2016-08-29.

Asia	<b>Financial summary</b>	<b>Dec-14</b>	<b>Dec-15</b>	<b>Dec-16F</b>	<b>Dec-17F</b>	<b>Dec-18F</b>
Malaysia	Recurring EPS (MYR)	0.69	0.13	0.20	0.23	0.28
Consumer Cyclical	EPS (MYR)	0.56	(0.03)	0.20	0.23	0.28
<b>UMW</b>	DPS (MYR)	0.41	0.20	0.10	0.11	0.13
Bloomberg UMW MK	BVPS (MYR)	5.64	5.48	5.43	5.35	5.28
<b>Sell</b>	Weighted avg adjusted shares (m)	1,168	1,168	1,168	1,168	1,168
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-14</b>	<b>Dec-15</b>	<b>Dec-16F</b>	<b>Dec-17F</b>	<b>Dec-18F</b>
Sum-of-parts valuations.	Recurring P/E (x)	8.5	46.5	29.2	25.5	21.0
	P/E (x)	10.4	na	29.2	25.5	21.0
	P/B (x)	1.04	1.07	1.08	1.09	1.11
<b>Key drivers</b>	FCF Yield (%)	(14.9)	(22.4)	(6.0)	(7.2)	(2.6)
i. Introduction of attractive new car models;	Dividend Yield (%)	7.0	3.4	1.7	1.9	2.2
ii. Turnaround at various legacy non-core oil & gas businesses;	EV/EBITDA (x)	4.7	19.1	16.3	14.6	12.1
iii. Long-term growth potential from the aerospace business.	EV/EBIT (x)	5.9	79.8	79.7	43.7	25.1
<b>Key risks</b>	<b>Income statement (MYRm)</b>	<b>Dec-14</b>	<b>Dec-15</b>	<b>Dec-16F</b>	<b>Dec-17F</b>	<b>Dec-18F</b>
i. Stronger MYR;	Total turnover	14,959	14,420	10,931	11,693	12,659
ii. Better-than-expected economic growth;	Gross profit	4,114	3,965	3,006	3,216	3,481
iii. Recovery in crude oil prices.	EBITDA	1,806	563	622	724	893
	Depreciation and amortisation	(379)	(428)	(494)	(481)	(462)
<b>Company Profile</b>	Operating profit	1,427	135	128	243	431
UMW is the largest company in the automotive sector. Its 51%-owned subsidiary UMW-Toyota imports, assembles and distributes Toyota and Lexus vehicles in Malaysia. It also owns a 55% stake in listed UMW Oil & Gas.	Net interest	55	1	(41)	(50)	(72)
	Income from associates & JVs	140	130	126	131	128
	Pre-tax profit	1,621	266	213	323	487
	Taxation	(409)	(260)	(64)	(97)	(146)
	Minority interests	(554)	(45)	85	41	(16)
	Recurring net profit	802	147	234	268	325
	<b>Cash flow (MYRm)</b>	<b>Dec-14</b>	<b>Dec-15</b>	<b>Dec-16F</b>	<b>Dec-17F</b>	<b>Dec-18F</b>
	Change in working capital	(205)	241	376	219	389
	Cash flow from operations	1,059	591	789	709	1,019
	Capex	(2,080)	(2,125)	(1,200)	(1,200)	(1,200)
	Cash flow from investing activities	(723)	(1,904)	(136)	(998)	(1,019)
	Dividends paid	(514)	(479)	(234)	(117)	(129)
	Cash flow from financing activities	(354)	407	(1,117)	(478)	(531)
	<b>Balance sheet (MYRm)</b>	<b>Dec-14</b>	<b>Dec-15</b>	<b>Dec-16F</b>	<b>Dec-17F</b>	<b>Dec-18F</b>
	Total cash and equivalents	3,376	2,728	2,498	1,847	1,445
	Tangible fixed assets	5,646	8,133	8,839	9,557	10,295
	Intangible assets	38	38	38	38	38
	Total investments	1,878	1,975	2,102	2,233	2,360
	Total other assets	344	365	365	365	365
	Total assets	16,439	18,081	16,658	16,747	16,932
	Short-term debt	2,177	3,159	2,250	2,250	2,250
	Other liabilities	122	279	279	279	279
	Total liabilities	6,997	8,857	7,576	7,800	8,046
	Shareholders' equity	6,590	6,397	6,340	6,246	6,169
	Minority interests	2,853	2,827	2,742	2,701	2,717
	Total equity	9,443	9,224	9,082	8,947	8,886
	Net debt	715	3,213	2,852	3,503	3,905
	Total liabilities & equity	16,439	18,081	16,658	16,747	16,932
	<b>Key metrics</b>	<b>Dec-14</b>	<b>Dec-15</b>	<b>Dec-16F</b>	<b>Dec-17F</b>	<b>Dec-18F</b>
	Revenue growth (%)	7.2	(3.6)	(24.2)	7.0	8.3
	Recurrent EPS growth (%)	(6.0)	(81.7)	59.4	14.4	21.4
	Gross margin (%)	27.5	27.5	27.5	27.5	27.5
	Operating EBITDA margin (%)	12.1	3.9	5.7	6.2	7.1
	Net profit margin (%)	4.4	(0.3)	2.1	2.3	2.6
	Dividend payout ratio (%)	72.8	(600.3)	49.9	48.0	46.7
	Capex/sales (%)	13.9	14.7	11.0	10.3	9.5
	Interest cover (x)	17.4	1.1	0.9	1.8	3.1

Source: Company data, RHB

## SWOT Analysis



## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2016-05-25	Sell	4.0	5.2
2016-02-26	Sell	5.0	7.0
2016-01-17	Sell	5.0	7.3
2015-11-27	Sell	5.0	8.0
2015-10-06	Sell	5.0	7.6
2015-08-27	Sell	5.4	8.5
2015-05-26	Sell	8.7	10.7
2015-02-27	Sell	9.7	11.1
2014-11-27	Neutral	11.0	11.3
2014-08-28	Neutral	12.4	12.3

Source: RHB, Bloomberg

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**Buy:** Share price may exceed 10% over the next 12 months

**Trading Buy:** Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

**Neutral:** Share price may fall within the range of +/- 10% over the next 12 months

**Take Profit:** Target price has been attained. Look to accumulate at lower levels

**Sell:** Share price may fall by more than 10% over the next 12 months

**Not Rated:** Stock is not within regular research coverage

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