Headwinds persist from Auto and O&G

We do not see any positive catalysts for us to upgrade the stock from our current SELL rating given the intensified competition within the automotive segment, the poor consumer spending and impact of weaker Ringgit. Moreover, O&G business will continue to face delays in recovery. After revisiting our forecasts, we lower our TP for UMW to RM4.23. We believe that UMW dropping out from the FBMKLCI constituent will likely garner less investor attention now.

Automotive sales would remain challenging

As we enter into 2017, we expect automotive sales will continue to face headwinds due to weak consumer spending. Apart from that, we also highlight that the recent weakening of RM against US dollar would work against UMW.

Rough road to O&G recovery

While the positive development in the oil market seems to have set the gears in motion, our view on its listed subsidiary UMWOG remain unchanged, as we believe earnings recovery will continue to be a laggard. UMWOG will see one jack up rigs come off charter in 2QCY17 (upon completion of 50 days contract), leaving only two rigs with a long time charter until 2019 while the rest of the six rigs will be left idle.

Unlocking value of Serendah land

In our view, business outlook could remain challenging in the near term. However, plans to develop the Serendah land, if materializes could potentially be a good growth story, and unlock value for investors. To date, only 30 acres out of the total land bank of 861 acres have been used to build a manufacturing plant for Rolls Royce fan cases. UMW has plans to transform it into an aerospace industrial park.

Maintain SELL with a lower TP of RM4.23

We maintain our SELL rating on the stock but lower our SOTP-based 12-month TP to RM4.23 (from RM4.52 previously) after making adjustments and rolling forward our valuation horizon to 2017. We value the automotive segment based on 12x P/E multiple, O&G business on 0.5x P/BV, and equipment, manufacturing and engineering business using 10x P/E multiple. Key risks to our call would be recovery in consumer spending and recovery in jack-up rigs demand.

Earnings & Valuation Summary

FYE 31 Dec	2014	2015	2016E	2017E	2018E
Revenue (RMm)	14,932.5	14,518.3	10,112.8	10,859.2	11,512.4
EBITDA (RMm)	1,821.4	537.2	469.7	776.9	908.4
Pretax profit (RMm)	1,621.5	269.7	(21.4)	270.1	319.3
Net profit (RMm)	658.3	(37.2)	(166.8)	151.9	221.8
EPS (sen)	56.3	(3.2)	(14.3)	13.0	19.0
PER (x)	8.2	n.m	n.m	35.5	24.3
Core net profit (RMm)	672.6	(37.2)	(166.8)	151.9	221.8
Core EPS (sen)	57.6	(3.2)	(14.3)	13.0	19.0
Core EPS growth (%)	(21.1)	(105.5)	(348.8)	191.1	46.0
Core PER (x)	8.0	n.m	n.m	35.5	24.3
Net DPS (sen)	41.0	20.0	-	10.0	10.0
Dividend Yield (%)	8.9	4.3	-	2.2	2.2
EV/EBITDA (x)	3.4	16.1	20.1	13.4	12.5
Chg in EPS (%)			(175.7)	(59.0)	(27.0)
Affin/Consensus (x)			18.8	0.7	0.9

Source: Company, Affin Hwang estimates

Company Update

UMW Holdings

UMW MK
Sector: Auto & Autoparts

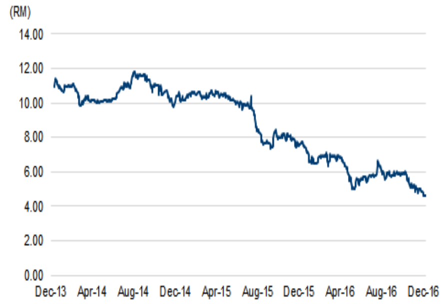
RM4.61 @ 29 December 2016

SELL (maintain)

Downside: 8.3%

Price Target: RM4.23

Previous Target: RM4.52



Price Performance

	1M	3M	12M
Absolute	-5.3%	-20.7%	-40.9%
Rel to KLCI	-6.0%	-19.1%	-39.2%

Stock Data

Issued shares (m)	1,168.3
Mkt cap (RMm)/(US$m)	5,385.8/1,200.5
Avg daily vol - 6mth (m)	0.7
52-wk range (RM)	4.6-7.94
Est free float	24.6%
BV per share (RM)	5.35
P/BV (x)	0.86
Net cash/ (debt) (RMm) (3Q16)	(3,209.1)
ROE (2017E)	(2.6%)
Derivatives	Nil
Shariah Compliant	Yes

Key Shareholders

Skim Amanah Saham Bumiputera	42.1%
EPF	16.0%
Permodalan Nasional Bhd	5.7%

Source: Affin Hwang, Bloomberg

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Automotive: Another lacklustre performance

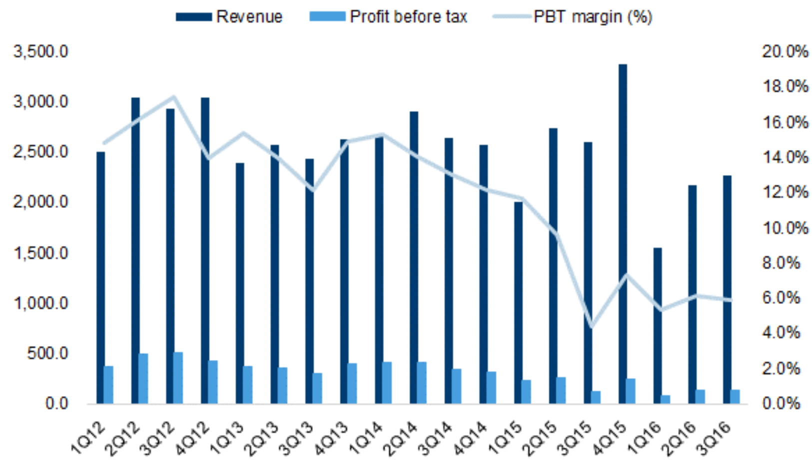
Toyota losing stream

According to Malaysian Automotive Association (MAA), 11M16 sales for Toyota fell by 30% yoy to 56.4k units. We expect vehicle sales for automotive segment to remain lacklustre in the near term given weak consumer spending. In addition, consumers are starting to feel the pinch given the recent weakening in Ringgit.

Expect a squeeze in EBIT margins for 2016 and 2017

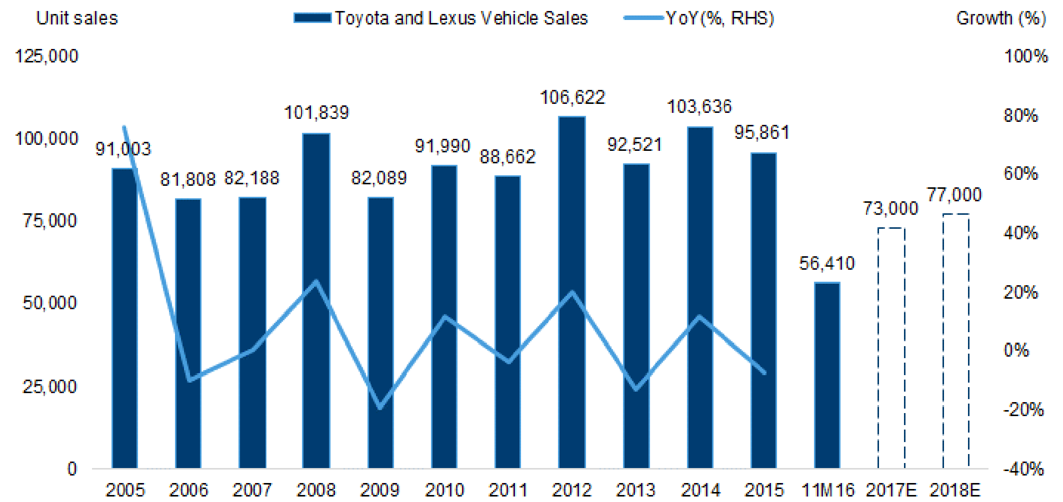
Automotive segment's contribution has increased to 76% of group's revenue in 9M16 as compared to 71% in 9M15. Meanwhile, the segment continues to face margin squeeze, and saw PBT margin fall by 2.5ppts to 5.8% during the 9M16 period. For 2016-18E, we assume the automotive segment's EBIT margins to be in the range of 6.1%-6.9%.

Fig 1: Automotive segment revenue and profit trend



Source: Affin Hwang, Company

Fig 2: Toyota and Lexus Vehicle Sales



Source: Affin Hwang forecasts, MAA

Management is expecting combined Toyota and Lexus sales to reach 70k units in 2016 which we opine will likely to fall short of target. Moving forward, we continue to take a cautious stance and assume a conservative sales target of 73k units in 2017 and 77k units in 2018 which imply a 4.3% and 5.5% yoy growth respectively from target.

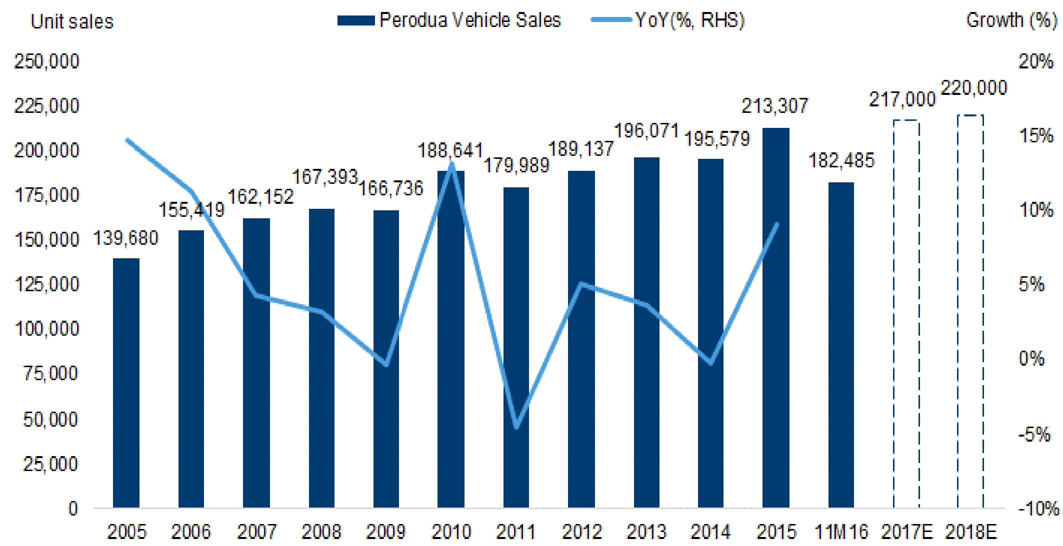
Expansion of plant capacity

In May 2016, UMW announced its plan to build a new manufacturing plant in Bukit Raja, Selangor which will add an initial capacity of 50k units. This is in addition to the current annual capacity of 75.7k units from existing plant in Shah Alam, Selangor. The new plant will focus on improving the Group's efficiency and productivity, as it introduces more automation processes which will reduce the reliance on manual labour. Upon completion in 2019, initial plan will be to move Vios and Camry productions to the new plant.

Perodua sales to offset topline pressure

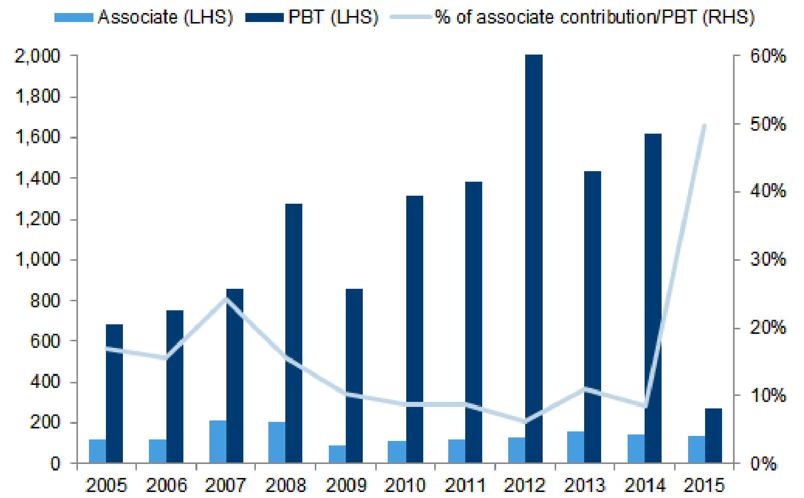
Based on historical trend as shown in Figure 4, associate line contributed an average of 18% to profit before tax (PBT) between 2005-2008 and 8% between 2009-2014. In 2015, associate contribution increased to 50% as UMW topline business suffered from challenging market environment particularly from the O&G segments. We expect associate to contribute around 50% to PBT moving into 2017-18E. We assume Perodua sales target forecast to be at 217k and 220k units for 2017-18E. The sales volume growth could potentially be driven by the launch of new Perodua Myvi next year to replace the current Gen-2 line which has been in the market for five years (introduced in 2011) and current facelift model which was introduced in January 2015.

Fig 3: Perodua Vehicle Sales



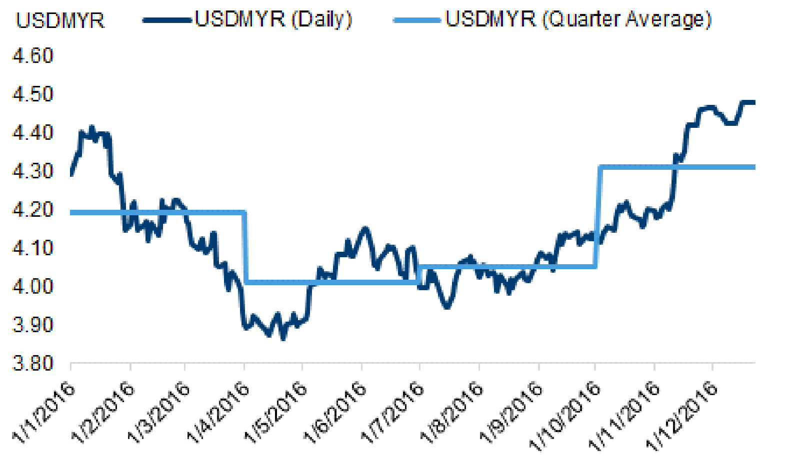
Source: Affin Hwang forecasts, MAA

Fig 4: Percentage (%) of associate contribution to PBT



Source: Affin Hwang, Company

Fig 5: Renewed concern on Ringgit weakening



Source: Affin Hwang, Bloomberg

The recent US presidential election outcome was a surprise to most market participants, and has resulted in US dollar strengthening against global currencies. The Ringgit which has depreciated against US dollar by 6.4% qoq should continue to affect the automotive segment's margin, in our view. We believe this risk is likely to persist until 1QCY17, and by then we expect RM to strengthen as Bank Negara measures to increase demand for local currency takes effect. Our sensitivity analysis indicates that every RM0.10 appreciation in USD against RM, would adversely impact UMW's earnings by ~5%.

Equipment: steady as she goes

Stable segment

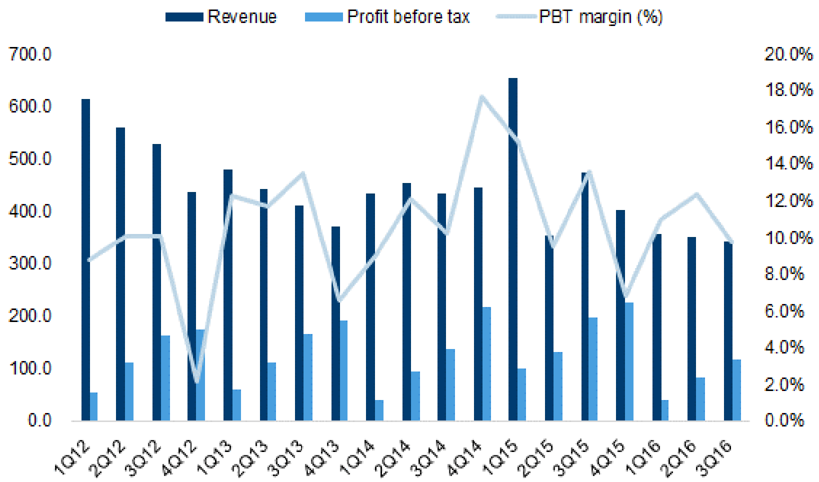
Within the equipment segment, UMW distributes three types of equipment namely heavy, industrial and marine/power equipment. Based on historical trend shown in Figure 6, Q1 is generally the weakest quarter for this segment before slowly ramping up until Q4.

UMW has built a strong reputation in the construction industry over the years, where it holds Komatsu franchise in Malaysia, Singapore, Myanmar and Papua New Guinea. We expect stronger demand for heavy equipment driven by the higher infrastructure and construction activities amid strong competition in this segment.

Meanwhile, its industrial equipment focuses mainly on Toyota brand forklifts, where it holds 50% market share dominating the Malaysia market. Besides that, UMW has presence in China, Vietnam, Brunei and Singapore. We understand that demand for industrial equipment will see an increase in Vietnam as more business owners are allocating their factories operation to that region.

Generally, UMW does not hold inventory for these equipment and will only order when required from Japan (purchase cost denominated in Yen), Thailand and Indonesia (both purchase cost in US dollar).

Fig 6: Equipment segment revenue and profit trend



Source: Affin Hwang, Company

Manufacturing and Engineering (M&E): Potential growth story

Introduction of new sub-segment

Traditionally, key products under the M&E division comprised of lubricants and auto components, which has now been extended to include aerospace components, after the Group successfully ventured into aviation industry this year. UMW became the first Tier 1 Malaysian supplier to Rolls Royce, whereby the Group will manufacture and supply fan cases for Trent 1000 aero engines for 25 years (with extension option for another 5 years) value at RM830m. Prior to this, we understand that Rolls Royce manufactured its own fan cases in the United Kingdom.

Transforming to aerospace industrial park

UMW will take up around 30 acres to build a manufacturing plant in Serendah for the production of Rolls Royce fan cases. The plant being constructed is expected to have total capacity to manufacture 250 units per annum with first delivery targeted in October 2017. It was reported that UMW has planned to set aside RM750m as capex over 3 years period to expand its aerospace business and is looking to secure more outsourcing works from Rolls Royce relating to the manufacturing of aircraft engine parts. Moving forward, the Group's expansion plans for this place is a compelling growth story as it also intends to invite other aerospace industry players to set up their operations at the Serendah park.

Fig 7: Google image of Serendah land

Source: Affin Hwang, Google Map

O&G: Rusting drills bits

Main culprit of lower earnings

O&G segment, through its 55% equity stake in UMWOG, continues to be the main culprit for the lower earnings. Currently, UMWOG has only three NAGA jack-up drilling rigs with a charter contract, while the rest of the five jack up rigs are yet to secure a contract amid the challenging condition (Refer to figure 9). Despite Brent crude prices recovering from crisis low of USD28/bbl, O&G segment did not show any signs of improvement during the year as oil majors adopt a wait-and-see stance until clarity emerges in terms of the stabilization in oil prices. Also, as its NAGA drilling rigs are for exploration related work, we believe a further delay in recovery is unavoidable as compared to production rigs.

Expecting a rosier year? Not quite the case

Following the recent positive development in the oil market, whereby OPEC and non OPEC countries have joined force to cut output, we are of the view that UMWOG will face a 1-year earnings recovery lag before situations improve. Furthermore, 2017 could remain challenging as worldwide supplies of incoming drilling rigs are expected to outweigh sluggish demand. Our channel check suggests that 2017 could see an additional 61 jack up rigs added to the current supply.

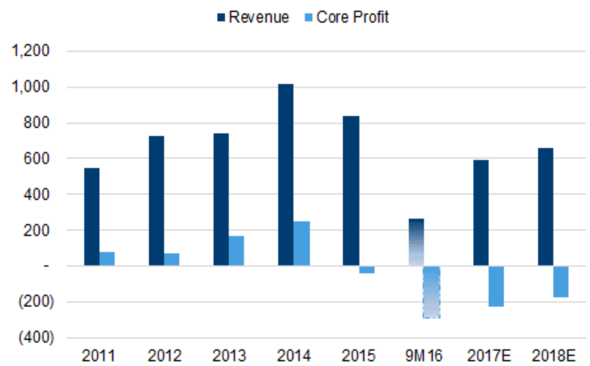
Parent loan provided

As O&G segment continues to deteriorate, UMW has extended RM308m in loans to ease UMWOG's short term financial stress, which will have to be repaid over a five year period. At its peak, UMWOG's short term debt constituted 67% of its total debt, but has since declined to current 38% level. However, looking at UMWOG's latest 4 quarter OCF and cash levels, we continue to see a shortfall of RM276m to repay its short term obligation that is worrying. From our recent meeting with the management, we understand that the Group is considering multiple funding alternatives to support its O&G unit.

Struggling NAGAs

We have factored in latest assumptions into our O&G analysis, where 2016-18E losses is expected to widen further as the challenging oil market is expected to persist for another year. We expect average utilisation rate for 2017-18E to be at 46% and 51% respectively. Meanwhile, charter rate for NAGA jack up rigs are expected to remain low at an average of USD87k/day.

Fig 8: UMWOG's revenue and earnings trend



Source: Affin Hwang forecasts, Company

Fig 9: UMWOG's NAGA drilling rig status update

Rigs	Clients	Contract period	Contract expiry (include extension option)
NAGA 1	n.a	n.a	n.a
NAGA 2	Ophir Production S/B	min 50 days	2Q17
NAGA 3	n.a	n.a	n.a
NAGA 4	n.a	n.a	n.a
NAGA 5	n.a	n.a	n.a
NAGA 6	Petronas Carigali	2+1 year	3Q19
NAGA 7	n.a	n.a	n.a
NAGA 8	HESS	18+12 months	1Q19

Source: Affin Hwang, Company

Valuation and recommendation

Fig 10: UMW: SOTP-based 12-month TP

Segments	Equity stake	Valuation Method	Equity Value (RMm)	Equity value/share (RM)
Automotive				
- Toyota	51%	12x P/E	2,467.2	2.11
- Perodua	38%	12x P/E	425.0	0.36
Oil and Gas	55%	0.5x P/BV	755.9	0.65
Equipment	100%	10x P/E	1,389.9	1.19
Manufacturing and engineering (M&E)	100%	10x P/E	205.0	0.18
Others			(296.1)	(0.25)
Equity value / Price Target			**4,946.9**	**4.23**

Revision to our 2016-18E earnings

We now forecast UMW to register a loss of RM166.8m in 2016. This is mainly as a result of imputing a wider loss on UMWOG and unlisted oil and gas business. Further on, we reduce our associate contribution by half to RM116.4m as we assume lower margins for its 38% stake in Perodua business and assume a loss making year for the rest of its associate business.

For 2017-18E, we lower our earnings forecast by 59% and 27% respectively. This is premised on our revised car sales target base assumptions of i) Toyota/Lexus estimated sales of 73k and 77k units (as compared to 81k and 83k units previously) and ii) Perodua estimated sales of 217k and 220k units (as compared to 213k and 223k units previously). Besides, our downward revisions to earnings are mainly due to our widening loss assumption for UMWOG and unlisted oil and gas business.

Maintain SELL with lower TP of RM4.23

After revising our forecasts by taking into account the above, we lower our TP to RM4.23, which represent a 8.3% downside to current share price. We do not see any upward re-rating catalyst for the stock for the time being, as we expect automotive sales to remain challenging due to weak consumer spending and sentiment. Apart from that, business outlook for its O&G arm will likely remain depressed for the time being. We do not expect UMW to pay any dividend in FY16 and a 10sen/share dividend for both FY17/18E which represent 2.1% dividend yield. Maintain our **SELL** rating.

Risks to our call

Key upside risks to our call would be: i) recovery in consumer spending, ii) recovery in jack up rigs demand, iii) RM strengthening against USD, and iv) earnings recovery from its listed subsidiary – UMWOG.

UMW Holdings – FINANCIAL SUMMARY

Profit & Loss Statement

FYE 31 December (RMm)	2013	2014	2015	2016E	2017E	2018E
Revenue	13,951.5	14,932.5	14,518.3	10,112.8	10,859.2	11,512.4
Operating expenses	(11,553.4)	(12,273.9)	(12,645.8)	(8,808.5)	(9,458.7)	(10,027.6)
EBITDA	1,821.1	1,821.4	537.2	469.7	776.9	908.4
Depreciation	(325.3)	(379.7)	(401.6)	(507.1)	(563.3)	(630.8)
EBIT	1,495.9	1,441.7	135.6	(37.4)	213.6	277.6
Net int inc/(exp)	(18.3)	54.5	(0.4)	(100.5)	(80.2)	(112.6)
Associates' contribution	157.5	139.5	134.4	116.4	136.7	154.3
Exceptional items	(199.4)	(14.3)	0.0	0.0	0.0	0.0
Pretax profit	1,435.7	1,621.5	269.7	(21.4)	270.1	319.3
Tax	(351.5)	(409.1)	(267.5)	(5.4)	(67.5)	(79.8)
Minority interest	(431.3)	(554.1)	(39.4)	(140.0)	(50.6)	(17.6)
Net profit	**652.9**	**658.3**	**(37.2)**	**(166.8)**	**151.9**	**221.8**

Balance Sheet Statement

FYE 31 December (RMm)	2013	2014	2015	2016E	2017E	2018E
Fixed assets	3,898.9	5,669.7	8,101.8	8,595.6	9,532.3	10,401.5
Other long term assets	2,177.6	2,256.2	2,456.2	2,456.2	2,456.2	2,456.2
Total non-curr assets	**6,076.4**	**7,925.9**	**10,557.9**	**11,051.8**	**11,988.5**	**12,857.7**
Cash and equivalents	2,557.7	3,370.7	2,734.1	1,928.4	1,305.1	617.1
Stocks	1,754.2	1,830.4	1,890.0	1,800.9	1,636.3	1,734.7
Debtors	1,855.1	2,078.5	1,833.4	1,277.1	1,371.3	1,453.8
Other current assets	2,351.8	1,314.1	1,209.9	1,209.9	1,209.9	1,209.9
Total current assets	**8,518.7**	**8,593.7**	**7,667.4**	**6,216.3**	**5,522.6**	**5,015.4**
Creditors	2,070.1	2,217.0	2,241.2	1,561.1	1,554.8	1,648.4
Short term borrowings	1,464.3	2,386.7	3,725.0	3,075.0	3,075.0	3,075.0
Other current liabilities	451.5	465.8	371.8	371.8	371.8	371.8
Total current liab	**3,986.0**	**5,069.6**	**6,338.0**	**5,007.9**	**5,001.7**	**5,095.2**
Long term borrowings	1,524.2	1,803.0	2,289.8	2,918.0	3,218.0	3,518.0
Other long term liabilities	152.5	214.0	213.7	213.7	213.7	213.7
Total long term liab	**1,676.6**	**2,017.0**	**2,503.4**	**3,131.7**	**3,431.7**	**3,731.7**
Shareholders' Funds	**8,932.5**	**9,433.1**	**9,383.9**	**9,128.5**	**9,077.7**	**9,046.3**

Cash Flow Statement

FYE 31 December (RMm)	2013	2014	2015	2016E	2017E	2018E
PBT	1,435.7	1,621.5	269.7	(21.4)	270.1	319.3
Depreciation & amortisation	325.3	378.7	499.0	507.1	563.3	630.8
Working capital changes	(423.7)	(149.1)	67.9	(34.7)	64.1	(87.4)
Cash tax paid	(374.4)	(418.3)	(273.8)	(5.4)	(67.5)	(79.8)
Others	(15.3)	(67.9)	386.3	(195.7)	(213.8)	(206.5)
Cashflow frm operation	**947.6**	**1,364.9**	**949.1**	**249.9**	**616.1**	**576.4**
Capex	(999.9)	(2,185.5)	(2,409.4)	(1,000.0)	(1,500.0)	(1,500.0)
Disposal/(purchases)	1,358.6	2,363.0	1,210.1	0.0	0.0	0.0
Others	(1,156.5)	(492.5)	(541.1)	79.3	77.1	52.2
Cash flow frm investing	**(797.8)**	**(315.0)**	**(1,740.3)**	**(920.7)**	**(1,422.9)**	**(1,447.8)**
Debt raised/(repaid)	(784.4)	(157.5)	(234.7)	(21.8)	300.0	300.0
Equity raised/(repaid)	0.0	0.0	0.0	0.0	0.0	0.0
Net int inc/(exp)	0.0	0.0	0.0	0.0	0.0	0.0
Dividends paid	(584.1)	(514.0)	(479.0)	0.0	(116.6)	(116.6)
Others	557.6	875.1	1,231.0	0.0	0.0	0.0
Cash flow from financing	**(811.0)**	**203.6**	**517.3**	**(21.8)**	**183.4**	**183.4**
Free Cash Flow	**(52.4)**	**(820.6)**	**(1,460.3)**	**(750.1)**	**(883.9)**	**(923.6)**

Source: Company, Affin Hwang forecasts

Key Financial Ratios and Margins

FYE 31 December (RMm)	2014	2015	2016E	2017E	2018E
Growth					
Revenue (%)	7.0	(2.8)	(30.3)	7.4	6.0
EBITDA (%)	0.0	(70.5)	(12.6)	65.4	16.9
Core net profit (%)	(21.1)	(105.5)	(348.8)	191.1	46.0
Profitability					
EBITDA margin (%)	12.2	3.7	4.6	7.2	7.9
PBT margin (%)	10.9	1.9	(0.2)	2.5	2.8
Net profit margin (%)	4.4	(0.3)	(1.6)	1.4	1.9
Effective tax rate (%)	25.2	99.2	(25.0)	25.0	25.0
ROA (%)	4.0	(0.2)	(1.0)	0.9	1.2
Core ROE (%)	13.0	10.2	(0.6)	(2.6)	2.3
ROCE (%)	10.0	(0.6)	(2.6)	2.4	3.4
Dividend payout ratio (%)	72.7	(627.6)	-	76.8	52.6
Liquidity					
Current ratio (x)	1.7	1.2	1.2	1.1	1.0
Op. cash flow (RMm)	1,821.4	537.2	469.7	776.9	908.4
Free cashflow (RMm)	(820.6)	(1,460)	(750.1)	(883.9)	(923.6)
FCF/share (sen)	(70.2)	(125.0)	(64.2)	(75.7)	(79.1)
Asset management					
Debtors turnover (days)	50.8	46.1	46.1	46.1	46.1
Stock turnover (days)	44.7	47.5	65.0	55.0	55.0
Creditors turnover (days)	65.9	64.7	64.7	60.0	60.0
Capital structure					
Net gearing (%)	12.4	49.8	63.3	77.3	91.1
Interest cover (x)	22.2	4.2	2.6	4.9	5.5

Quarterly Profit & Loss

FYE 31 December (RMm)	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16
Revenue	3,533.2	4,160.9	2,199.2	2,846.8	2,856.8
Operating expenses	(3,350.1)	(4,520.5)	(2,182.0)	(2,805.7)	(2,992.8)
EBIT	183.1	(359.6)	17.1	41.1	(136.0)
Int expense	(24.8)	(41.9)	(43.3)	(41.3)	(41.1)
Associates' contribution	(0.3)	35.8	22.1	26.5	40.8
Investment income/ (expenses)	30.5	31.5	25.2	18.5	14.6
Exceptional items	(116.3)	0.0	0.0	0.0	0.0
Pretax profit	72.2	(334.2)	21.1	44.8	(121.6)
Tax	(44.3)	(57.3)	(26.0)	(48.5)	(41.3)
Minority interest	(14.4)	105.5	21.5	(8.4)	34.0
Net profit	13.5	(286.0)	16.6	(12.1)	(128.8)
Core net profit	129.8	(286.0)	16.6	(12.1)	(128.8)
Margins (%)					
EBIT	5.2	(8.6)	0.8	1.4	(4.8)
PBT	2.0	(8.0)	1.0	1.6	(4.3)
Net profit	0.4	(6.9)	0.8	(0.4)	(4.5)

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

This report is printed and published by:
Affin Hwang Investment Bank Berhad (14389-U)
(formerly known as HwangDBS Investment Bank Berhad)
A Participating Organisation of Bursa Malaysia Securities Bhd
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