

16 February 2017

Consumer Cyclical | Auto & Autoparts

## UMW Holdings

**Neutral** (from Sell)

### Back To The Drawing Board

Target Price: MYR5.38  
 Price: MYR5.70  
 Market Cap: USD1,497m  
 Bloomberg Ticker: UMWH MK

**UMW's planned exit from the O&G industry marks an inglorious end to an ill-fated adventure as it refocuses on its core businesses in automotive, equipment and M&E. Nonetheless, all three core divisions face operational headwinds and gestational losses that could limit core earnings growth in the next two years. However, the elimination of O&G-related losses puts earnings and core valuations back on more stable footing. Hence, we upgrade our call to NEUTRAL (from Sell). We also revise our SOP-derived TP to MYR5.38 (from MYR4.09, 5.6% downside).**

#### Share Data

Avg Daily Turnover (MYR/USD) 5.53m/1.24m  
 52-wk Price low/high (MYR) 4.45 - 7.13  
 Free Float (%) 25  
 Shares outstanding (m) 1,168  
 Estimated Return -6%

#### Shareholders (%)

PNB Funds 57.6  
 Employees Provident Fund 16.5

**To exit the O&G business.** UMW intends to refocus on its core business of automotive, equipment and manufacturing & engineering (M&E). It will commence a planned strategic exit from the oil & gas (O&G) sector via:

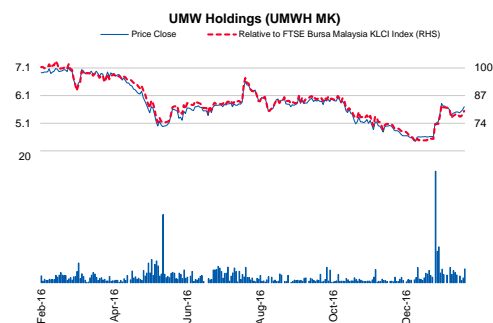
#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	24.7	23.9	10.7	(10.0)	(14.0)
Relative	20.6	21.7	5.8	(11.2)	(17.6)

Source: Bloomberg

- A distribution *in specie* of its entire shareholding in UMW Oil & Gas (UMWOG) to UMW shareholders;
- Followed by a progressive exit of non-listed O&G assets.

Following the exercise, UMW shareholders will own shares in two listed companies directly. The proposed distribution is expected to be completed by 2Q17. The distribution of UMWOG shares and deconsolidation of debt would more than halve UMW's gearing to 0.43x (from 0.91x). The non-listed O&G assets have been a significant drag on earnings (2015 net loss including partial impairments: MYR455.8m). UMW has highlighted the likelihood of impairment charges to the unlisted O&G assets in due course, most likely in the upcoming 4Q16 results announcement. These impairments would need to be comprehensive enough such that there would be no further need to account for future losses. Expect to see further substantial impairment charges relating to both the non-core O&G businesses and UMWOG in the 2016 results, which are scheduled to be announced on 27 Feb.



Source: Bloomberg

**Unexciting outlook for its remaining core businesses.** UMW's remaining core businesses in the auto, heavy equipment and M&E divisions continue to face operational headwinds. We expect the automotive industry to remain difficult through 2017, hobbled by soft consumer sentiment and a weak MYR that would crimp margins. In the equipment market, the recent pick-up in demand for heavy machinery in other markets has come from the coal mining industry, stemming from the recovery in coal prices. However UMW's ability to benefit from this upturn is limited as it has few customers from the coal mining industry in their key markets. Also, its aerospace component manufacturing venture has long-term potential but is unlikely to be profitable until 2019.

**Upgrade to NEUTRAL.** Assuming no further earnings drag from the non-core O&G business and from UMWOG (after May 2017) and updating our model, we cut our 2016 estimate to a MYR113m net loss but lift our 2017-20 numbers by 12% and 35% respectively. We value UMW using a SOP approach to derive a TP of MYR5.38 (from MYR4.09). We upgrade our call on the stock to NEUTRAL (from Sell), with the core business trading at close to the peer average. A cash dividend is unlikely to be declared for 2016.

Forecasts and Valuations	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total turnover (MYRm)	14,959	14,420	10,374	10,281	10,530
Reported net profit (MYRm)	658	(39)	(113)	292	422
Recurring net profit (MYRm)	802	147	(113)	292	422
Recurring net profit growth (%)	(6.0)	(81.7)	(177.2)	0.0	44.4
Recurring EPS (MYR)	0.69	0.13	(0.10)	0.25	0.36
DPS (MYR)	0.41	0.20	na	0.12	0.15
Recurring P/E (x)	8.3	45.4	na	22.8	15.8
P/B (x)	1.01	1.04	1.09	1.09	1.07
P/CF (x)	6.3	11.3	10.3	9.3	8.8
Dividend Yield (%)	7.2	3.5	na	2.1	2.6
EV/EBITDA (x)	4.6	18.9	18.9	14.3	11.3
Return on average equity (%)	10.2	(0.6)	(1.8)	4.8	6.8
Net debt to equity (%)	7.6	34.8	32.2	36.6	42.3
Our vs consensus EPS (adjusted) (%)			19.9	40.2	53.0

Source: Company data, RHB

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## Financial Exhibits

Financial model updated on : 2017-02-15.

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	(0.10)	0.25	0.36
Consumer Cyclical	EPS (MYR)	0.56	(0.03)	(0.10)	0.25	0.36
<b>UMW Holdings</b>	DPS (MYR)	0.41	0.20	0.00	0.12	0.15
Bloomberg UMW MK	BVPS (MYR)	5.64	5.48	5.23	5.25	5.32
<b>Neutral</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 valuation	Recurring P/E (x)	8.3	45.4	na	22.8	15.8
<b>Key drivers</b>	P/E (x)	10.1	na	na	22.8	15.8
i. Introduction of attractive new car models;	P/B (x)	1.01	1.04	1.09	1.09	1.07
ii. Turnaround of various legacy non-core oil and gas businesses;	FCF Yield (%)	(15.3)	(23.0)	(8.3)	(4.3)	(3.7)
iii. Long-term growth potential from aerospace business.	Dividend Yield (%)	7.2	3.5	0.0	2.1	2.6
	EV/EBITDA (x)	4.6	18.9	18.9	14.3	11.3
	EV/EBIT (x)	6	79	235	42	21
<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. Weaker MYR;	Total turnover	14,959	14,420	10,374	10,281	10,530
ii. Weaker-than-expected economic growth;	Gross profit	4,114	3,965	2,853	2,827	2,896
iii. Higher start-up losses from aerospace venture.	EBITDA	1,806	563	537	718	943
	Depreciation and amortisation	(379)	(428)	(494)	(472)	(445)
	Operating profit	1,427	135	43	246	498
	Net interest	55	1	(78)	(80)	(95)
	Income from associates & JVs	140	130	112	107	117
	Pre-tax profit	1,621	266	78	273	520
	Taxation	(409)	(260)	(150)	(109)	(156)
	Minority interests	(554)	(45)	(41)	128	58
	Recurring net profit	802	147	(113)	292	422
<b>Company Profile</b>	<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>
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. UMW owns a 55% stake in listed UMW Oil & Gas.	Change in working capital	(205)	241	428	264	124
	Cash flow from operations	1,059	591	648	714	753
	Capex	(2,080)	(2,125)	(1,200)	(1,000)	(1,000)
	Cash flow from investing activities	(723)	(1,904)	(152)	(806)	(937)
	Dividends paid	(514)	(479)	(234)	0	(140)
	Cash flow from financing activities	(354)	407	(1,001)	(266)	(475)
	Cash at beginning of period	2,544	3,376	2,728	2,458	2,099
	Net change in cash	(19)	(906)	(504)	(358)	(659)
	Ending balance cash	3,376	2,728	2,458	2,099	1,580
	<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	2,458	2,099	1,580
	Tangible fixed assets	5,646	8,133	8,839	9,367	9,922
	Intangible assets	38	38	38	38	38
	Total investments	1,878	1,975	2,088	2,195	2,312
	Total other assets	344	365	365	365	365
	Total assets	16,439	18,081	16,474	16,460	16,611
	Short-term debt	2,177	3,159	2,250	2,250	2,250
	Total long-term debt	1,914	2,783	3,100	3,100	3,100
	Other liabilities	122	279	279	279	279
	Total liabilities	6,997	8,857	7,498	7,587	7,708
	Shareholders' equity	6,590	6,397	6,108	6,134	6,221
	Minority interests	2,853	2,827	2,868	2,740	2,682
	Total equity	9,443	9,224	8,976	8,873	8,903
	Net debt	715	3,213	2,892	3,251	3,770
	Total liabilities & equity	16,439	18,081	16,474	16,460	16,611
	<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)	(28.1)	(0.9)	2.4
	Recurrent EPS growth (%)	(6.0)	(81.7)	(177.2)	0.0	44.4
	Gross margin (%)	27.5	27.5	27.5	27.5	27.5
	Operating EBITDA margin (%)	12.1	3.9	5.2	7.0	9.0
	Net profit margin (%)	4.4	(0.3)	(1.1)	2.8	4.0
	Dividend payout ratio (%)	72.8	(600.3)	0.0	48.0	41.5
	Capex/sales (%)	13.9	14.7	11.6	9.7	9.5
	Interest cover (x)	17.4	1.1	0.3	1.6	3.1

Source: Company data, RHB

## Back To The Drawing Board

### Challenging outlook for the automotive industry to persist

We expect the automotive sector to remain challenging in the upcoming year as consumer sentiment remains soft, especially for big ticket items such as vehicles and property. Persistent weakness in the MYR has crimped margins as companies' ability to pass on the higher costs to consumers are limited by tepid demand and stiff competition. We expect consumers to exhibit price-sensitive behaviour, with continued trends to down-trade to more affordable vehicles.

For the non-national carmakers, we expect demand for car models with high localisation content to remain resilient as they remain affordable, compared to models that are wholly imported from overseas principals. However, note that a weaker sales mix of cheaper models is likely to dilute margins further. Strict requirements in hire purchase financing applications continue to be an issue, as Bank Negara's efforts to curb household debt and banks' caution on asset quality matters lead to lenders becoming more stringent on loan approvals. This has led to discrepancies between the number of bookings and the number of deliveries.

Distributors which are able to schedule a steady stream of well-priced and new models enjoy a stable trend in terms of sales volume. The *C-HR*, a mini sport utility vehicle (SUV) that could compete with Honda's *HR-V* and Mazda's *CX-3* is highly anticipated – although media reports suggest a 2018 introduction, along with the all-new *Camry* and *Avanza*. The new *Innova/Hilux/Fortuner* was introduced in 2016 along with the new *Sienta* and facelifted *Vios* and *Corolla Altis*. The absence of compelling new models has been a contributing factor to Toyota's slide in market share rankings.

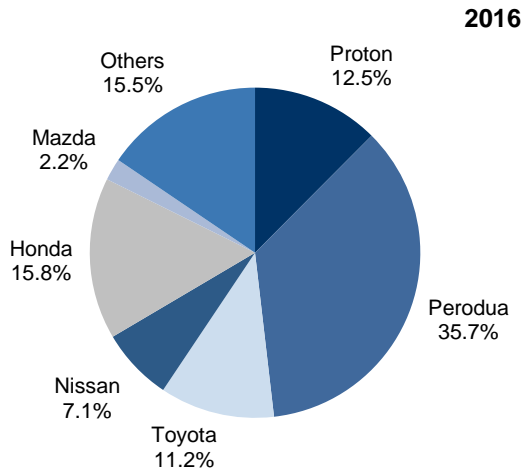
In the meantime, 38%-owned Perodua performed reasonably well in a soft market with the sales success of its maiden sedan model, the *Bezza*. We expect an all-new *Myvi* model to be introduced in 4Q17.

**Figure 1: UMW vehicle sales summary**

FYE Dec (units)	4Q15	3Q16	4Q16	QoQ (%)	YoY (%)	FY15	FY16	YoY (%)
<b>Toyota</b>	<b>32,398</b>	<b>17,605</b>	<b>19,625</b>	<b>11.5</b>	<b>(39.4)</b>	<b>95,861</b>	<b>65,110</b>	<b>(32.1)</b>
- Passenger	23,372	12,000	14,454	20.5	(38.2)	67,266	45,939	(31.7)
- Commercial	9,026	5,605	5,171	(7.7)	(42.7)	28,595	19,171	(33.0)
<b>Perodua</b>	<b>55,780</b>	<b>53,519</b>	<b>56,221</b>	<b>5.0</b>	<b>0.8</b>	<b>213,307</b>	<b>207,110</b>	<b>(2.9)</b>
- Passenger	55,780	53,519	56,221	5.0	0.8	213,307	207,110	(2.9)
- Commercial	0	0	0	0.0	0.0	0	0	0.0
<b>Total</b>	<b>88,178</b>	<b>74,436</b>	<b>75,846</b>	<b>1.9</b>	<b>(14.0)</b>	<b>309,168</b>	<b>272,220</b>	<b>(12.0)</b>

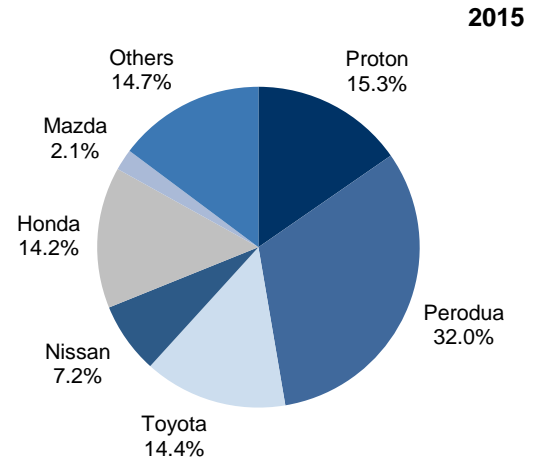
Source: MAA

Figure 2: 2016 automotive market shares



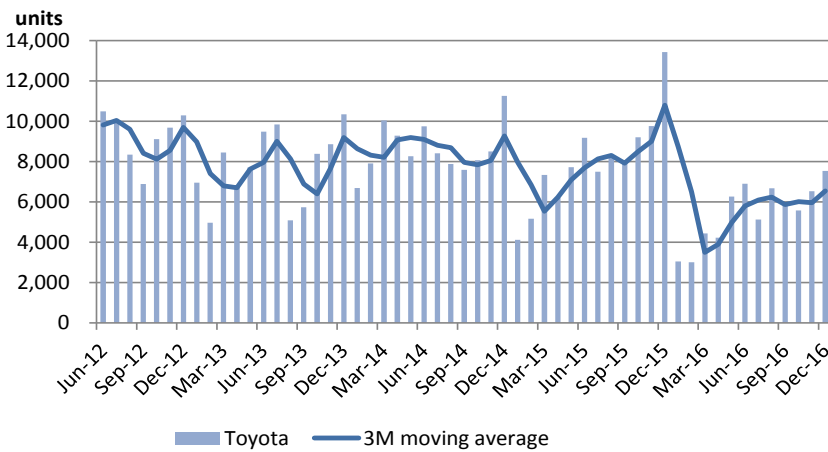
Source: RHB

Figure 3: 2015 automotive market shares



Source: RHB

Figure 4: Toyota sales in a low gear



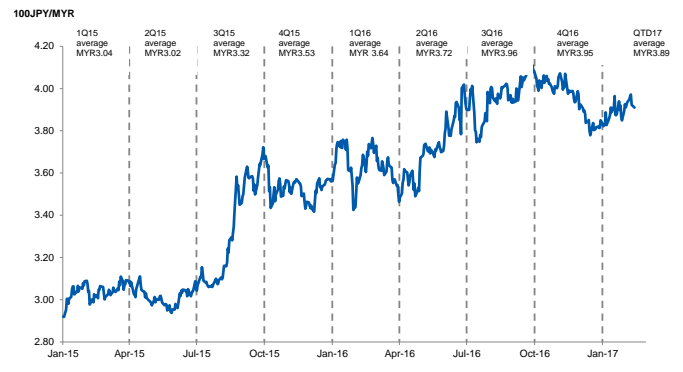
Source: Company data, RHB

Figure 5: USD/MYR



Source: Bloomberg

Figure 6: JPY/MYR



Source: Bloomberg

### Equipment: Organic growth in ASEAN markets

UMW's equipment division intends to focus on growth opportunities in the ASEAN region, repositioning away from the resource sector toward construction and infrastructure. The recent pick-up in demand for heavy machinery in other markets has come from the coal mining industry stemming from the recovery in coal prices. However UMW's ability to benefit from this upturn is limited as it has few customers from the coal mining industry in key markets in Malaysia, Singapore, Myanmar and Papua New Guinea.

### M&E: Moving toward higher value-added

The near-term focus would continue to be on the lubricant business. However, the future emphasis may be toward high-value manufacturing – exemplified by its aerospace component manufacturing business, making fan cases for the Rolls-Royce Trent 1000 (Boeing 787) and Trent 7000 (Airbus A330 Neo) engines. The venture is on track to make its maiden delivery to Rolls-Royce in Oct 2017.

UMW intends to build on this business as a platform to develop new high-value manufacturing opportunities in the aerospace and non-aerospace industries. This would be a catalyst to attract more high-value manufacturing activities to Serendah, where the company owns 861 acres of land earmarked for industrial and mixed development. In the near term, its existing M&E business only contributes modestly to group earnings. While the aerospace component manufacturing venture has long-term potential, it is unlikely to be profitable until 2019.

### Key risks

Risks to our recommendation and TP include:

- i. A persistent weakness in the MYR;
- ii. Weaker-than-expected consumer sentiment;
- iii. Later-than expected introduction of attractive new models;
- iv. Higher-than-expected start-up losses at its new aerospace venture.

### Figure 7: Forecast assumptions

FYE Dec	2014	2015	2016F	2017F	2018F
Toyota / Lexus (units)	103,636	95,861	65,110	67,000	70,000
Perodua (units)	195,579	213,307	216,000	218,000	218,000
Forex (JPY/MYR)*	3.15	3.25	3.82	3.80	3.80
Forex (USD/MYR)*	3.25	3.90	4.14	4.43	4.30

\*average rate

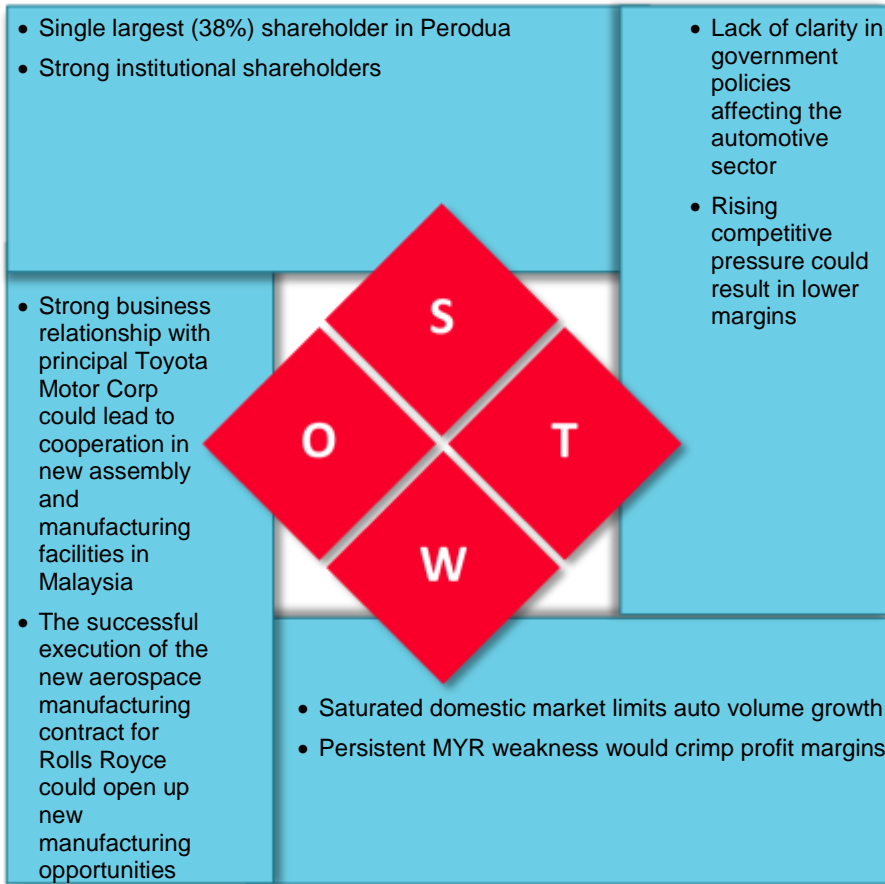
Source: RHB

### Figure 8: SOP valuation

	P/E (x)	Valuation (MYR)	Stake (%)	Discount (%)	Per UMW share (MYR)
UMWOG		MYR 0.70	55.73%	0	0.72
Auto	13				4.24
Other	12				0.42
					<b>5.38</b>

Source: RHB

## SWOT Analysis



## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2016-11-03	Sell	4.1	5.8
2016-08-30	Sell	4.3	5.6
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

Source: RHB, Bloomberg

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