



AmInvestment Bank

Company report

UMW HOLDINGS

(UMWH MK EQUITY, UMWS.KL)

10 January 2018

Space for more

HOLD

(Maintained)

Al Zaquan

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Rationale for report: Company update

Price	RM6.37
Fair Value	RM5.50
52-week High/Low	RM6.44/RM4.23

Key Changes

Fair value	⬇️
EPS	⬇️

YE to Dec	FY16	FY17F	FY18F	FY19F
Revenue (RM mil)	10,958.5	11,131.1	12,200.2	12,812.7
Core net profit (RM mil)	(360.7)	(114.7)	309.3	506.1
FD Core EPS (sen)	(30.9)	(9.8)	26.5	43.3
FD Core EPS growth (%)	(273.6)	(68.2)	(369.7)	63.6
Consensus Net Profit (RM mil)	-	58.2	291.5	397.5
DPS (sen)	10.0	(2.9)	7.9	13.0
PE (x)	nm	nm	24.1	14.7
EV/EBITDA (x)	nm	29.9	11.8	9.1
Div yield (%)	1.6	(0.5)	1.2	2.0
ROE (%)	(29.2)	(2.5)	6.5	10.1
Net Gearing (%)	95.3	116.1	110.8	99.8

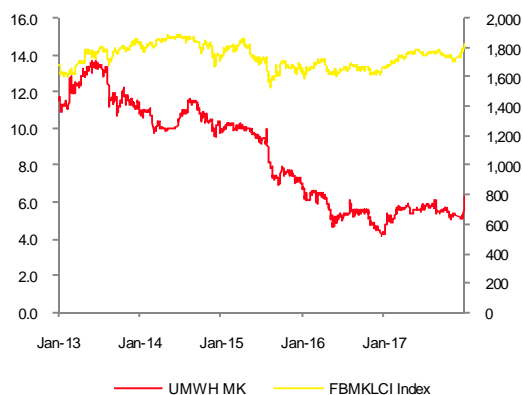
Stock and Financial Data

Shares Outstanding (million)	1,168.3
Market Cap (RMmil)	7,442.0
Book Value (RM/share)	4.04
P/BV (x)	1.6
ROE (%)	(29.2)
Net Gearing (%)	95.3

Major Shareholders	Skim ASB(42.1%) EPF(13.7%) Yayasan Pelaburan Bumiputera(5.7%)
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Free Float	32.6
Avg Daily Value (RMmil)	3.7

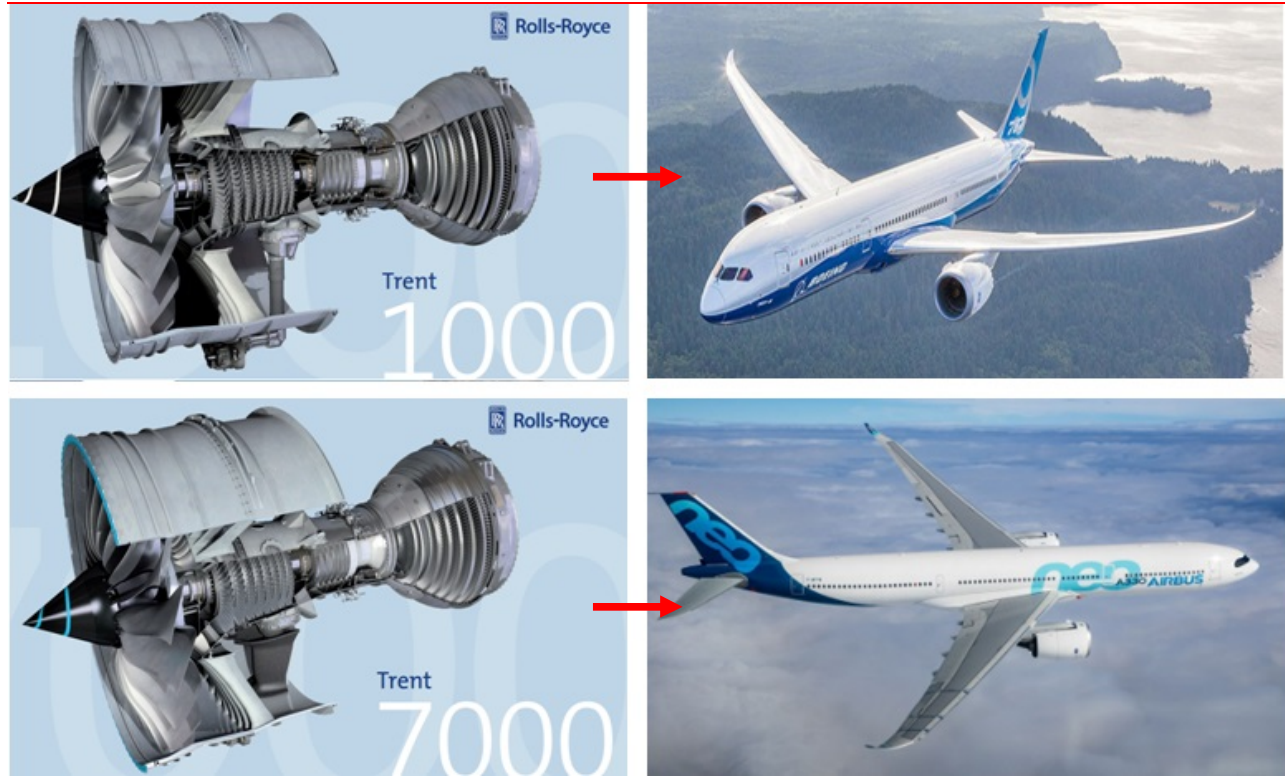
Price performance	3mth	6mth	12mth
Absolute (%)	16.5	12.5	49.9
Relative (%)	12.4	8.4	36.8



Investment Highlights

- We maintain HOLD on UMW Holdings but raise our SOP-based FV to RM5.50 (from RM5.00) as margins for its auto segment have recovered from rock-bottom while the rationalisation of its remaining O&G assets is expected to be completed by year-end, which would eventually remove losses from this segment.
- The group held a visit to the UMW Aerospace plant in Serendah on Tuesday. UMW Aerospace will manufacture fan cases for the Rolls-Royce Trent 1000 and Trent 7000 engines, which are used in the Boeing 787 Dreamliner and Airbus A330neo respectively.
- UMW Aerospace is the first tier-1 supplier for Rolls-Royce in Southeast Asia. It had invested RM750mil to build the plant and most of its own supply chain comprised parties picked by Rolls-Royce that met the strict quality controls and regulations applied to the aviation sector.
- Key points from the visit:
 - 1) We still do not have sufficient information to project earnings from its contract with Rolls-Royce. The operation is envisioned to breakeven by 2019 when it produces 160 fan cases a year (from 80 in 2018). Changes in the number of orders from Rolls-Royce could affect the production numbers and targeted breakeven date.
 - 2) The aerospace operation is expected to raise the revenue contribution from the group's M&E segment to at least 10% by 2019. We would require better visibility on the cash flows and output from the aerospace operation to gauge the role that the M&E segment could play in the longer term. This segment accounted for 6% of group's revenue in 9M17.
 - 3) Success with aerospace would equip UMW with the tools and expertise to expand its high-value manufacturing portfolio. We believe its position as a tier-1 supplier to Rolls-Royce is a precursor to more collaborations with global companies looking to ground their supply chains to Asia.
- With the M&E segment in the backseat for the immediate term, we believe the key priorities for UMW to be:
 - 1) To regain market share for Toyota. The C-HR and facelift Vios will be the first of several new Toyota models for this year. A stronger ringgit will provide some support as the group's auto segment accounted for a fifth of its costs in USD which saw the segment's margins hit rock-bottom last year.
 - 2) To complete its exit from O&G by year-end. It has 13 assets to dispose of by this self-imposed deadline. Losses from this segment will continue although the quantum should reduce over time.

EXHIBIT 1: ROLLS-ROYCE TRENT ENGINES



Source: Companies

BACKGROUND ON UMW AEROSPACE

What is UMW Aerospace?

UMW in August 2015 signed a 25-year agreement with Rolls-Royce to make fan cases for the Trent 1000 and Trent 7000 engines, which are used in the Boeing 787 Dreamliner and Airbus A330neo respectively.

The group spent RM750mil to build a 30-acre facility in Serendah, Selangor. The biggest allocation (about 30%) was for the equipment. UMW Aerospace is a tier-1 supplier for Rolls-Royce, of which there are reportedly about 100 globally and 3 in Asia.

UMW Aerospace is the group's first venture into high-value manufacturing (HVM) and is placed under its Manufacturing & Engineering (M&E) segment.

While the Serendah plant is devoted to its service for Rolls-Royce, we understand that a small part of the plant (an area dubbed "pre-production" and previously utilised for training staff to use the machinery) can serve as a launch pad for new clients in the future. UMW believes the aerospace venture could also open doors to sectors such as energy, high-end electronics and land transport.

The group also has extensive land within the Serendah area that has yet to be developed: the aerospace plant takes up only 40 acres of the total 861 acres.

What are fan cases?

The fan case is a major part of a plane engine and is made up of 4,000 components. Rolls-Royce sources the fan cases for its Trent engines from two of its own facilities in Britain and two external suppliers (UMW's Serendah plant and another in Italy).

EXHIBIT 2: FAN CASE



Source: Company

The fan cases made in Serendah comprise four main parts with key components that are imported from the US, UK and Italy: front fan case (from Italy), mount ring (from US), rear case (from US) and outer guide vane (from UK). About 90% of the supply chain for UMW Aerospace adheres to companies and suppliers named by Rolls-Royce as to comply with the various quality controls and regulations in place.

Rolls-Royce is in the process of reorganising its global supply chain and will spend US\$2bil within Asia-Pacific by 2020 to eventually outsource 80% from 30% today.

❑ **What is the production rate for UMW Aerospace?**

It delivered its first fan case in November 2017 and delivered a total of 6 by the end of the year. UMW aims to produce 80 fan cases in 2018 and double that number in the following year. It expects to reach its full capacity of 250 cases by the end of 2020, and further expansion can raise this to 320 cases annually.

UMW will only begin producing the Trent 7000 at end-2019, and the ratio between Trent 1000 and Trent 7000 will be at 90:10 initially.

The key number at this point is 250 cases. This is the number of engines that can be produced at the Rolls-Royce campus and test facility in Seletar, Singapore that receives the fan cases from UMW. Seletar is one of three locations where Rolls-Royce makes large civil aerospace engines, the other two are in Derby, Britain and Dahlewitz, Germany. It will reportedly reach full capacity this year.

Seletar assembles the Trent 900 engine (for the Airbus A390), the Trent 1000 (for the Boeing 787 Dreamliner) and will soon start on the Trent 7000 (for the Airbus A330neo). The plane engine is tested and assembled in Singapore within one month, and then shipped to Boeing (in Seattle, US) or Airbus (Toulouse, France).

❑ **When will it make a profit?**

UMW Aerospace is striving to be profitable by 2019 when production reaches the breakeven level of 160 fan cases annually. UMW intends for the M&E segment to contribute at least 10% of group revenue by then.

We emphasize that the production targets are still subject to change, as the number of orders from Rolls-Royce could alter on the demand for aircraft. The long gestation period of nearly four years to profit takes into account the considerable capex involved and the extensive duration of the contract.

Losses here spiked in 2017 and they are expected to have peaked last year. UMW Aerospace saw a loss before tax of RM42mil in 9M17 compared to RM14mil in the same period in the previous year.

UMW IN THE NEXT ONE YEAR

❑ **This is an important year for Toyota**

EXHIBIT 3: TOYOTA SALES IN ONE YEAR TO NOV '17



Source: MAA, AmInvestment Bank

2018 is a crucial year as Toyota aims to prop up sales before the second local plant comes on board next year. It saw a decent gain in 2017 after being one of two worst performers in the previous year (11MFY17: +11% YoY to 64K; 2016: -32% YoY to 94K), and losing much of its market share to Honda.

EXHIBIT 4: TOYOTA C-HR



Source: Company

Toyota will kick-start the year with the facelift Vios and C-HR. Possible additions include new versions of the Camry, Rush and Harrier.





We are projecting a moderate sales growth of 13% (80K) for Toyota this year. While new models serve to drum up some excitement, competition remains intense and banks are still especially stringent on loans for customers in the mass market segment.

While the stronger ringgit would provide some relief for UMW Toyota (which settles about a fifth of its COGS in USD), the cost of discounting and promotions could negate some of this. Sales grew in 2017 but margins shrank: the group's auto net margin dropped below 3% in 9M17 and performed worse than in 2016.

□ *Rationalisation for O&G assets continue*

It has 13 assets (from a total of 16 previously) to dispose of by this self-imposed deadline. Losses from this segment will continue although the quantum should reduce over time.

EXHIBIT 5: O&G UNLISTED ASSETS

	No. of Assets	<u>Target</u> 2017	<u>Target</u> 2018
 Drilling & Exploration	3	1- Ceased operations, to dispose assets 2- Active negotiations	-
 OCTG & Line Pipe	5	1- Offer received, to exit 2- Active negotiations	2- active negotiations
 Fabrication	2	2 - Offer received, final negotiations	-
 Trading and Oilfield services	6	1 - Phased out exit (Phase 1 completed, Phase 2 by year end) 1 - Offer received, finalisation 1 - Restructure and exit 1 - To cease operations	2- exit
Total	16		

Source: Company

EXHIBIT 6: SUM-OF-PARTS VALUATION

Pegged to FY18F							
Segment	PBT	PAT	Ownership	PE Multiple	Value (RM mil)	Value (RM/share)	No. of Shares
Automotive	621.9	472.7	51%	12	3,001.2	2.57	1,168.3
Equipment	191.7	145.7		13	1,951.8	1.67	
Manu & Eng	(23.4)	(17.8)		8	(135.1)	(0.12)	
O&G	0.0					0.00	
Others	(70.0)				(70.0)	(0.06)	
Associates & JV		213.1		15	3,217.4	2.75	
Net Debt (Company level)					(1,536.2)	(1.31)	
Fair Value:						<u>5.50</u>	

Source: AmInvestment Bank Bhd

EXHIBIT 7: PB BAND CHART

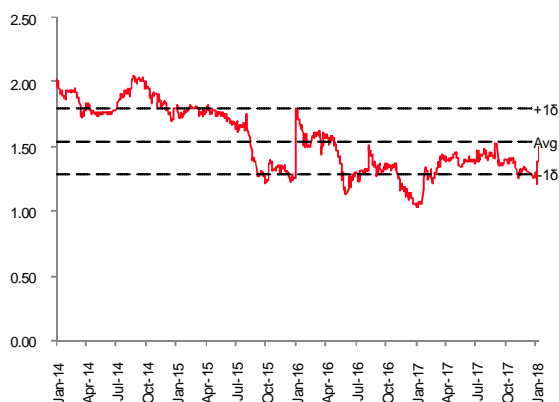


EXHIBIT 8: PE BAND CHART

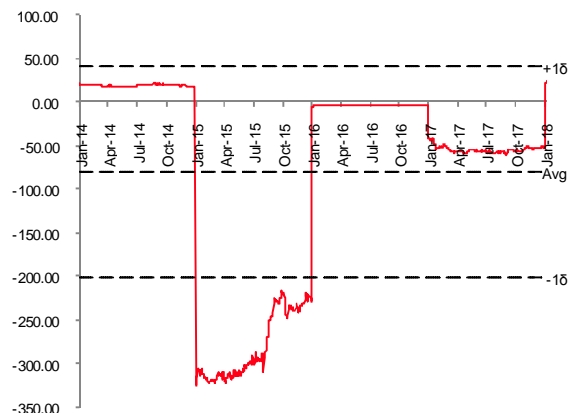


EXHIBIT 9: FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	FY15	FY16	FY17F	FY18F	FY19F
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Revenue	14,441.6	10,958.5	11,131.1	12,200.2	12,812.7
EBITDA	646.3	(1,612.0)	428.5	1,090.6	1,395.7
Depreciation/Amortisation	(510.7)	(569.5)	(604.3)	(644.6)	(687.7)
Operating income (EBIT)	135.6	(2,181.5)	(175.9)	446.0	707.9
Other income & associates	134.4	156.4	148.2	213.1	230.8
Net interest	(0.4)	(105.1)	21.0	(8.9)	6.1
Exceptional items	-	-	-	-	-
Pretax profit	269.7	(2,130.2)	(6.7)	650.2	944.8
Taxation	(267.5)	(131.0)	38.7	(109.3)	(178.5)
Minorities/pref dividends	(39.4)	611.7	(146.7)	(231.6)	(260.2)
Net profit	(37.2)	(1,649.5)	(114.7)	309.3	506.1
Core net profit	207.8	(360.7)	(114.7)	309.3	506.1
Balance Sheet (RMmil, YE 31 Dec)	FY15	FY16	FY17F	FY18F	FY19F
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Fixed assets	8,102.8	7,678.5	7,976.6	8,317.7	8,666.7
Intangible assets	25.2	-	-	-	-
Other long-term assets	2,429.9	2,463.0	2,396.0	2,425.0	2,465.8
Total non-current assets	10,557.9	10,141.5	10,372.7	10,742.6	11,132.5
Cash & equivalent	2,734.1	1,857.4	1,510.2	2,060.0	2,786.5
Stock	1,890.0	1,931.2	1,445.1	1,614.0	1,673.9
Trade debtors	1,833.4	988.5	1,332.7	1,460.7	1,534.0
Other current assets	1,209.9	1,008.0	1,008.0	1,008.0	1,008.0
Total current assets	7,667.4	5,785.1	5,295.9	6,142.6	7,002.4
Trade creditors	2,241.2	1,878.6	1,865.9	2,075.2	2,158.3
Short-term borrowings	3,725.0	2,639.3	3,893.9	4,420.9	4,947.9
Other current liabilities	371.8	234.0	194.3	199.9	203.0
Total current liabilities	6,338.0	4,752.0	5,954.2	6,696.0	7,309.3
Long-term borrowings	2,289.8	3,715.8	3,003.0	3,020.0	3,037.1
Other long-term liabilities	213.7	931.0	117.1	126.8	131.6
Total long-term liabilities	2,503.4	4,646.7	3,120.1	3,146.9	3,168.7
Shareholders' funds	6,584.5	4,718.6	4,638.3	4,854.8	5,209.1
Minority interests	2,799.4	2,145.7	2,292.4	2,524.0	2,784.3
BV/share (RM)	5.64	4.04	3.97	4.16	4.46
Cash Flow (RMmil, YE 31 Dec)	FY15	FY16	FY17F	FY18F	FY19F
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Pretax profit	269.7	(2,130.2)	(6.7)	650.2	944.8
Depreciation/Amortisation	510.7	569.5	604.3	644.6	687.7
Net change in working capital	67.9	200.7	(691.8)	(73.8)	(43.1)
Others	100.8	945.7	(202.3)	(397.9)	(512.3)
Cash flow from operations	949.1	(414.3)	(296.5)	823.1	1,077.2
Capital expenditure	(2,280.4)	(1,181.6)	(834.8)	(915.0)	(961.0)
Net investments & sale of fixed assets	12.0	225.3	-	-	-
Others	528.0	188.0	207.9	190.5	218.0
Cash flow from investing	(1,740.3)	(768.2)	(627.0)	(724.5)	(742.9)
Debt raised/(repaid)	1,322.6	380.1	541.8	544.0	544.0
Equity raised/(repaid)	-	-	-	-	-
Dividends paid	(805.2)	(212.7)	34.4	(92.8)	(151.8)
Others	-	-	-	-	-
Cash flow from financing	517.3	167.4	576.2	451.2	392.2
Net cash flow	(273.9)	(1,015.1)	(347.3)	549.8	726.4
Net cash/(debt) b/f	2,830.4	2,621.1	1,857.4	1,510.2	2,060.0
Net cash/(debt) c/f	2,621.1	1,464.8	1,510.2	2,060.0	2,786.5
Key Ratios (YE31 Dec)	FY15	FY16	FY17F	FY18F	FY19F
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Revenue growth (%)	(3.3)	(24.1)	1.6	9.6	5.0
EBITDA growth (%)	(64.3)	(349.4)	(126.6)	154.5	28.0
Pretax margin (%)	1.9	(19.4)	(0.1)	5.3	7.4
Net profit margin (%)	(0.3)	(15.1)	(1.0)	2.5	3.9
Interest cover (x)	336.5	(2,075.8%)	nm	50.3	nm
Effective tax rate (%)	99.2	6.1	579.2	16.8	18.9
Dividend payout (%)	nm	nm	nm	22.5	22.5
Debtors turnover (days)	49	47	38	42	43
Stock turnover (days)	47	64	55	46	47
Creditors turnover (days)	56	69	61	59	60

Source: Company, AmInvestment Bank Bhd estimates

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