

11 January 2018

Consumer Cyclical | Auto & Autoparts

UMW Holdings

Sell (Maintained)

Valuations Remain Stretched

We recently visited UMW's new aerospace manufacturing facility in Serendah and came away with a clearer appreciation of its maiden venture into high-value precision manufacturing. UMW Aerospace is also a catalyst to attract more high-technology manufacturing businesses into the area, which may help to re-rate the value of its 831-acre Serendah landbank. The recent strength of the MYR would help to lift margins at its auto businesses. While the new Toyota manufacturing plant, scheduled for commissioning in early 2019, would improve assembly flexibility and efficiencies, it could delay the introduction of new models. Despite lifting our forward estimates to reflect our latest USD/MYR forecasts, valuations are demanding and it is trading beyond peer and historical averages. We lift our TP to MYR5.44 (15% downside, 1.8x P/BV) but reiterate our SELL.

UMW Aerospace (UMWA) on track. UMW Aerospace (UMWA) delivered its first fan case for the Rolls Royce Trent 1000 engine, as scheduled, in Nov 2017. The high-precision manufacturing expertise being developed would enable UMWA to produce other aircraft engine parts as well as micro-electronics, healthcare and power generation components, going forward. Management is guiding for UMWA to be profitable by 2019, after reporting a pre-tax loss of MYR42.3m for 9M17.

New Toyota plant. The highly-anticipated new Toyota manufacturing plant in Bukit Raja would allow UMW-Toyota SB to offer more locally-assembled model variants, with the increased automation enabling smaller variant production volumes, and remain profitable. However, as the plant is only expected to be commissioned in early 2019, the planned local assembly launches of new models would only take place next year. Forthcoming new models include the C-HR small sport utility vehicle (SUV), Camry and Vios. Potential pre-operating costs may also dilute the margin improvement arising from the stronger MYR.

Non-core oil & gas businesses – the long goodbye. Despite UMW's long-standing intentions to exit the oil & gas business, there is still no visibility on when it will be able to completely exit and avoid the drag on earnings. For 9M17, UMW reported a segmental pre-tax loss of MYR121.3m.

Key risks and forecasts. Risks to our recommendation and TP include a firmer MYR, stronger-than-expected consumer sentiment, sooner-than-expected introduction of attractive new models and lower-than-expected start-up losses at its new aerospace venture. While 2017 estimates are broadly unchanged, we lift our 2018F-2019F earnings to MYR307.5m (+33.9%) and MYR391.8m (+18.9%). RHB's view for USD/MYR at end-2018 stands at 3.95.

Reiterate SELL. UMW still trades at unjustifiable P/E levels, even though we raised our earnings estimates. Our revised TP of MYR5.44 (from MYR4.62) is derived from applying a target P/BV of 1.8x (5-year average). We remain wary on its outlook, after persistent disappointments from its non-core oil & gas segment and possible pre-operating costs from the new automotive assembly plant that could drag on earnings in the coming quarters.

Target Price: MYR5.44
 Price: MYR6.42
 Market Cap: USD1,871m
 Bloomberg Ticker: UMWH MK

Share Data

Avg Daily Turnover (MYR/USD) 4.59m/0.99m
 52-wk Price low/high (MYR) 4.25 - 6.42
 Free Float (%) 25
 Shares outstanding (m) 1,168
 Estimated Return -15%

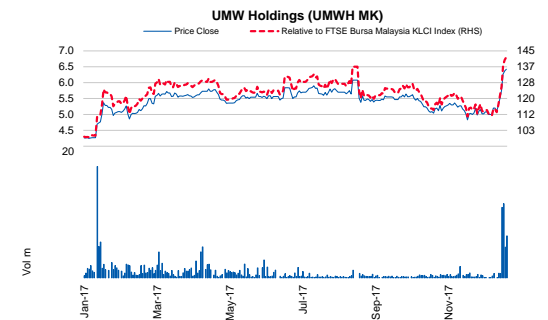
Shareholders (%)

PNB Funds 57.6
 Employees Provident Fund 16.5

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	23.5	27.9	15.7	16.7	50.7
Relative	22.0	22.0	12.2	13.0	41.7

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total turnover (MYRm)	14,442	10,965	11,638	12,446	13,411
Reported net profit (MYRm)	299	222	71	307	392
Recurring net profit (MYRm)	150	(213)	(212)	307	392
Recurring net profit growth (%)	(81.2)	(241.9)	(0.5)	0.0	27.4
Recurring EPS (MYR)	0.13	(0.18)	(0.18)	0.26	0.34
DPS (MYR)	0.20	na	0.10	0.10	0.10
Recurring P/E (x)	49.9	na	na	24.4	19.1
P/B (x)	1.17	1.59	2.15	2.11	2.03
P/CF (x)	12.8	na	7.6	54.9	14.8
Dividend Yield (%)	3.1	na	1.6	1.6	1.6
EV/EBITDA (x)	12.5	40.3	9.9	9.2	8.1
Return on average equity (%)	4.6	4.0	1.7	8.7	10.8
Net debt to equity (%)	34.8	61.2	net cash	14.3	21.7
Our vs consensus EPS (adjusted) (%)			(207.1)	(17.8)	(8.1)

Source: Company data, RHB

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Financial Exhibits

Financial model updated on : 2018-01-09.

Asia		Financial summary	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Malaysia		Recurring EPS (MYR)	0.13	(0.18)	(0.18)	0.26	0.34
Consumer Cyclical		EPS (MYR)	0.26	0.19	0.06	0.26	0.34
UMW Holdings		DPS (MYR)	0.20	0.00	0.10	0.10	0.10
Bloomberg	UMWH MK	BVPS (MYR)	5.48	4.04	2.98	3.05	3.17
Sell		Weighted avg adjusted shares (m)	1,168	1,168	1,168	1,168	1,168
Valuation basis		Valuation metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
P/BV		Recurring P/E (x)	49.9	na	na	24.4	19.1
		P/E (x)	25	34	105	24	19
		P/B (x)	1.17	1.59	2.15	2.11	2.03
Key drivers		FCF Yield (%)	(20.5)	(14.3)	(0.3)	(11.5)	(3.9)
i. Introduction of attractive new car models;		Dividend Yield (%)	3.1	0.0	1.6	1.6	1.6
ii. Turnaround at various legacy non-core oil and gas businesses;		EV/EBITDA (x)	12.5	40.3	9.9	9.2	8.1
iii. Long-term growth potential from aerospace business.		EV/EBIT (x)	23.8	na	74.7	13.0	10.5
Key risks		Income statement (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
i. Weaker MYR;		Total turnover	14,442	10,965	11,638	12,446	13,411
ii. Weaker-than-expected economic growth;		Gross profit	3,971	3,015	3,200	3,423	3,688
iii. Higher start-up losses from aerospace venture.		EBITDA	900	264	478	606	752
		Depreciation and amortisation	(428)	(555)	(414)	(175)	(178)
		Operating profit	472	(291)	64	431	575
		Net interest	(0)	(106)	(22)	(18)	(42)
		Income from associates & JVs	134	155	148	189	194
		Pre-tax profit	606	(242)	190	603	727
		Taxation	(267)	(141)	(120)	(169)	(182)
		Minority interests	(39)	604	1	(127)	(153)
		Recurring net profit	150	(213)	(212)	307	392
Company Profile		Cash flow (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
UMW is the largest company in the automotive sector. Its 51%-owned subsidiary, UMW-Toyota SB, imports, assembles and distributes Toyota and Lexus vehicles in Malaysia.		Change in working capital	241	775	724	(216)	23
		Cash flow from operations	584	(151)	980	137	508
		Capex	(2,125)	(925)	(1,000)	(1,000)	(800)
		Cash flow from investing activities	(1,904)	(596)	(318)	(833)	(657)
		Dividends paid	(479)	(234)	0	(117)	(117)
		Cash flow from financing activities	414	(36)	(4,062)	(346)	(368)
		Cash at beginning of period	3,376	2,728	2,179	2,711	1,686
		Net change in cash	(906)	(783)	(3,399)	(1,042)	(516)
		Ending balance cash	2,728	2,179	2,711	1,686	1,187
		Balance sheet (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
		Total cash and equivalents	2,728	2,179	2,711	1,686	1,187
		Tangible fixed assets	8,133	7,639	3,064	3,889	4,511
		Intangible assets	38	0	0	0	0
		Total investments	1,975	2,081	2,226	2,415	2,609
		Total other assets	365	350	348	348	348
		Total assets	18,081	16,206	11,003	11,485	11,933
		Short-term debt	3,159	2,617	1,112	1,112	1,112
		Total long-term debt	2,783	3,789	1,413	1,413	1,413
		Other liabilities	279	803	803	803	803
		Total liabilities	8,857	9,297	5,335	5,613	5,766
		Shareholders' equity	6,397	4,722	3,482	3,560	3,701
		Minority interests	2,827	2,187	2,186	2,312	2,466
		Total equity	9,224	6,909	5,667	5,873	6,167
		Net debt	3,213	4,226	(186)	839	1,338
		Total liabilities & equity	18,081	16,206	11,003	11,485	11,933
		Key metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
		Revenue growth (%)	(3.5)	(24.1)	6.1	7.0	7.8
		Recurrent EPS growth (%)	(81.2)	(241.9)	(0.5)	0.0	27.4
		Gross margin (%)	27.5	27.5	27.5	27.5	27.5
		Operating EBITDA margin (%)	6.2	2.4	4.1	4.9	5.6
		Net profit margin (%)	2.1	2.0	0.6	2.5	2.9
		Dividend payout ratio (%)	78.1	0.0	164.3	38.0	29.8
		Capex/sales (%)	14.7	8.4	8.6	8.0	6.0
		Interest cover (x)	3.72	(1.56)	0.62	5.08	6.76

Source: Company data, RHB

Valuations Remain Stretched

UMWA on track

UMWA delivered its first fan case for the Rolls Royce Trent 1000 engine, as scheduled, in Nov 2017. UMWA is the first local company to be designated a Tier-1 supplier to Rolls Royce, after receiving a 25+5-year contract to produce fan cases for the *Trent 1000* and *Trent 7000* engines that will be installed on Boeing 787 and Airbus A330 Neo aircraft respectively.

The high precision manufacturing expertise being developed would enable UMWA to produce other aircraft engine parts as well as micro-electronics, healthcare and power generation components. Six units were delivered in 2017, with the number set to rise to 80 in 2018 and 160 in 2019, before reaching the planned capacity of 250 units by 2020.

Management is guiding for UMWA to be profitable by 2019, after reporting a pre-tax loss of MYR42.3m for 9M17.

Meanwhile, UMW Land owns another 831 acres of land in Serendah that could be re-rated – if more high value manufacturing businesses can be enticed to set up operations there.

Figure 1: Rolls Royce Trent 1000 fan casing



Source: Company

New Toyota plant

The highly-anticipated new Toyota manufacturing plant, located in Bukit Raja, would allow UMW-Toyota to offer more locally-assembled model variants, with the increased automation enabling smaller production volumes to remain profitable. However, as the plant is only expected to be commissioned in early 2019, the planned local assembly launches of new models would only take place next year.

Forthcoming new models include the C-HR SUV, Camry and Vios. Potential pre-operating costs could also dilute the margin improvement arising from the stronger MYR. Our estimates now assume average USD/MYR rates of 4.00 and 3.95 for 2018 and 2019 respectively.

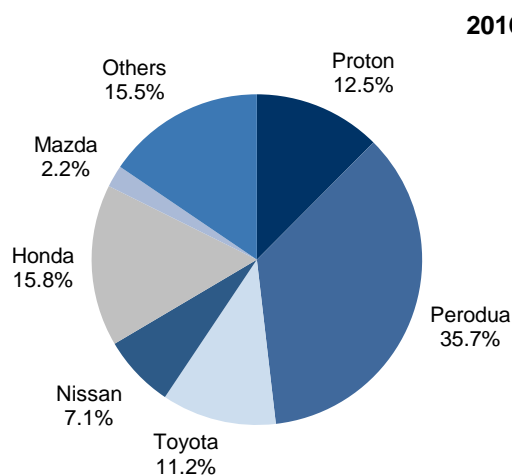
We understand that Toyota sales in 2017 met our forecast of 70,000 units. The striking Toyota C-HR SUV is unlikely to be a game changer for UMW in 2018, given the likely prohibitive price tag as a result of it being imported from Thailand.

Figure 2: UMW's vehicle sales summary

FYE Dec (units)	3Q16	2Q17	3Q17	QoQ (%)	YoY (%)	9M16	9M17	YoY (%)
Toyota	17,605	17,439	15,836	(9.2)	(10.0)	45,485	49,969	9.9
- Passenger	12,000	12,060	10,581	(12.3)	(11.8)	31,485	34,938	11.0
- Commercial	5,605	5,379	5,255	(2.3)	(6.2)	14,000	15,031	7.4
Perodua	53,519	49,410	51,905	5.0	(3.0)	150,889	151,580	0.5
- Passenger	53,519	49,410	51,905	5.0	(3.0)	150,889	151,580	0.5
- Commercial	0	0	0	0.0	0.0	0	0	0.0
Total	71,124	66,849	67,741	1.3	(4.8)	196,374	201,549	2.6

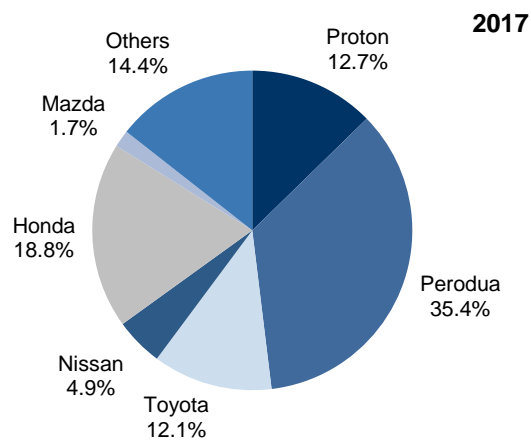
Source: Malaysian Automotive Association (MAA)

Figure 3: 2016 automotive market shares



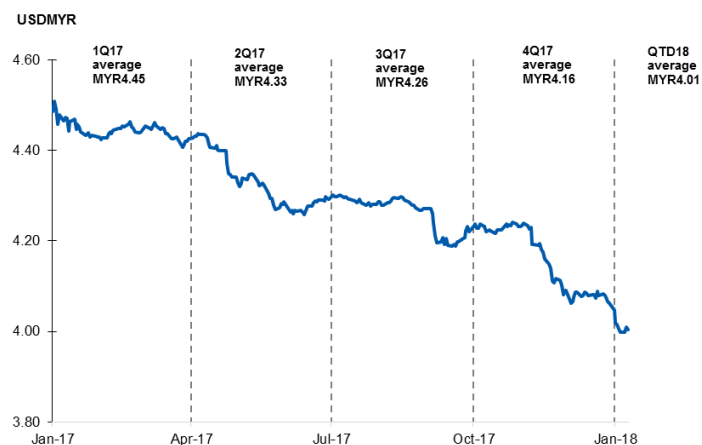
Source: RHB, MAA

Figure 4: YTD-Nov 2017 automotive market shares



Source: RHB, MAA

Figure 5: USD/MYR



Source: RHB

Figure 6: JPY/MYR



Source: RHB

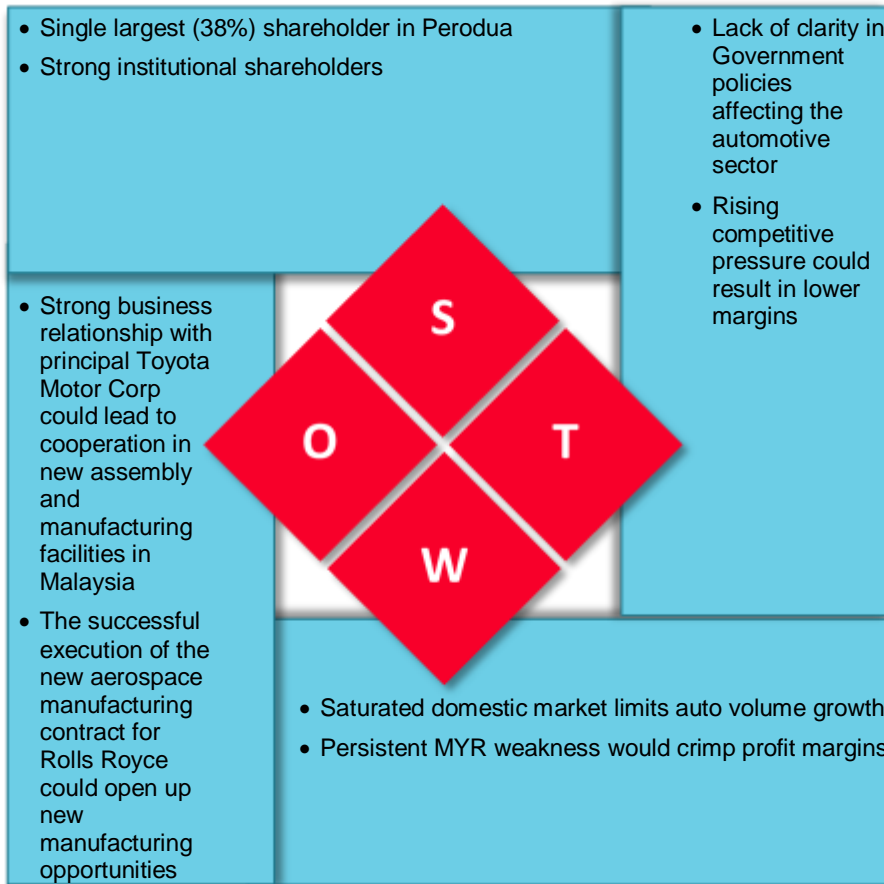
Figure 7: Forecast assumptions

FYE Dec	2016	2017F	2018F	2019F
Toyota / Lexus (units)	65,110	72,000	75,000	79,000
Perodua (units)	207,110	205,000	210,000	212,000
Forex (JPY/MYR)*	3.82	3.85	3.55	3.50
Forex (USD/MYR)*	4.14	4.30	4.00	3.95

*average rate

Source: RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2017-11-28	Sell	4.6	5.3
2017-08-29	Sell	4.9	5.6
2017-07-04	Sell	5.1	5.8
2017-05-24	Neutral	5.6	5.5
2017-02-28	Neutral	5.5	5.1
2017-02-16	Neutral	5.4	5.0
2016-11-03	Sell	4.1	5.4
2016-08-30	Sell	4.3	5.1
2016-05-25	Sell	4.0	4.8
2016-02-26	Sell	5.0	6.5

Source: RHB, Bloomberg

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