

20 March 2018 | Corporate Update

UMW Holdings

Post-briefing takeaways

- **May look to dispose parts of MBM if acquisition successful**
- **Standing firm with offer price, opportunity to exit value-trap for MBM's minorities**
- **Earnings accretive for UMW provided valuation gap between acquirer vs. acquiree remains**
- **Re-affirm BUY at unchanged TP of RM7.11**

We attended UMW's briefing yesterday. Below are the key takeaways:

May look to dispose parts of MBM. UMW does not rule out disposing parts of MBM's businesses if its acquisition of the latter is successful. However, this is mainly to avoid conflict of interests particularly in the distribution/dealership units (vs. the current UMW stable), rather than engaging in a corporate raider-style buy-and-break up strategy, we think. In fact, we would not be surprised if an offer is made to sell back parts of MBM to members of MBM's current major shareholder.

Perodua will remain equity-accounted. At this point, it is likely that UMW will not consolidate Perodua, even if it reaches 70.6% ownership. UMW and other shareholders are bound by the original Perodua shareholders agreement, which gives equal rights to the Japanese partners (i.e. Daihatsu Motor/Mitsui), which means Perodua will likely remain equity accounted in UMW's books. Furthermore, the Japanese parties are in control of Perodua manufacturing while the Malaysian partners are in control of sales and distribution (See Exhibit 9). UMW will attempt to request for consolidation, but this requires undoing Perodua's original shareholders agreement and coming out with a new one, which we suspect could be a lengthy and complex process as this would involve ownership of critical technologies and years of process improvements that have been put in place at Perodua.

Standing firm with offer price. UMW does not intend to budge on its offer price, even if a 3rd party comes in with a better offer, or at least this is what management is trying to sound out. UMW has an advantage given that: (1) It is an existing partner in Perodua, which would have the first right of refusal if a 3rd party offers to buy out a stake in Perodua from any of the existing shareholders (2) A 3rd party acquisition is not entirely a straightforward process as existing Japanese partners in Perodua also has to agree if a new shareholder is to come into Perodua given the eventual business partnership (3) There is actually a scarcity of buyers given that this involves a stake in the national carmaker which is of strategic importance to the nation; a potential buyer requires the necessary "political clout" and "financial clout". Having said that, this is a business transaction and naturally UMW will not put out the highest offer the first round neither would it divulge its intention to raise offers.

Right issue to be fully underwritten. In regards to its RM1.1b rights issue to fund the acquisition, UMW will seek a written undertaking by PNB as the major shareholder of the former (55%-58% stake) to take up its share of the planned right issue. On top of this, it will also seek an underwriting arrangement for the remaining portion of the right issue.

Unchanged BUY

Unchanged Target Price (TP):RM7.11

RETURN STATS

Price (19 March 2018)	RM6.22
Target Price	RM7.11
Expected Share Price Return	+14.3%
Expected Dividend Yield	+4.0%
Expected Total Return	+18.3%

STOCK INFO

KLCI	1,843.92
Bursa / Bloomberg	4588 / UMW MK
Board / Sector	Main/Automotive
Syariah Compliant	Yes
Issued shares (mil)	1,168.29
Market cap. (RM'm)	6,951.35
Price over NA	2.46
52-wk price Range	RM4.70 – RM6.98
Beta (against KLCI)	1.41
3-mth Avg Daily Vol	1.64m
3-mth Avg Daily Value	RM10.2m
Major Shareholders (%)	
SKIM ASB	48.0%
EPF	9.2%
KWAP	7.1%

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INVESTMENT STATISTICS

FYE Dec	FY15	FY16	FY17	FY18F	FY19F
Revenue (RM'm)	14,419.8	10,965.1	11,046.5	10,013.6	11,121.3
EBIT (RM'm)	134.9	(2,202.8)	120.4	650.6	936.1
Pre-tax Profit (RM'm)	265.6	(2,153.8)	252.9	659.1	1,052.9
Core net profit (RM'm)	338.0	(401.8)	163.8	370.3	578.7
FD EPS (sen)	28.9	(34.4)	14.0	31.7	47.5
EPS growth (%)	(59.6)	NA	NA	126.1	56.3
PER (x)	21.5	NA	44.4	19.6	13.1
Net Dividend (sen)	20.0	0.0	0.0	15.8	24.8
Net Dividend Yield (%)	3.2	0.0	0.0	2.5	4.0

Source: Company, MIDF

Negative goodwill. A negative goodwill is clearly the case as UMW is proposing to acquire MBM at well below its book value of RM1.4b (unaudited as of Dec 17). This compares to UMW's offer of ~RM1b for 100% of MBM. Assuming the deal gets 100% take-up, UMW is estimated to book in slight above RM400m in negative goodwill.

Rights issue to keep balance sheet in check. Management reasoned that while UMW could have proceeded with the purchase via debt, it intends to keep its balance sheet in check for future expansion of its core businesses. Our checks suggest that around half of UMW's RM1.2b gross cash sits at 51%-owned UMW Toyota. After deducting RM118m cash portion for the 10% Perodua stake acquisition from PNB, the group should still have a remaining RM380m at the holdings level. UMW intends to keep gross gearing at <50% levels in the long run.

EXHIBIT 1: ILLUSTRATION OF IMPACT ON TRANSACTION ON UMW GROSS GEARING

	Audited as at 31 Dec 2016 (RM '000)	After the Completed Transaction ⁽¹⁾ (RM '000)	Pro forma I After the Proposed MBMR Acquisition ⁽²⁾ (RM '000)	Pro forma II After Pro forma I and the Proposed Perodua Acquisition ⁽²⁾⁽³⁾ (RM '000)	Full Cash Scenario		Full Shares Scenario	
					Pro forma III(a) After Pro forma II and the Proposed MO ⁽⁴⁾ (RM '000)	Pro forma IV(a) After Pro forma III(a) and the Proposed Rights Issue (RM '000)	Pro forma III(b) After Pro forma II and the Proposed MO ⁽⁴⁾ (RM '000)	Pro forma IV(b) After Pro forma III(b) and the Proposed Rights Issue (RM '000)
Shareholders Funds	4,718,562	3,458,395	3,682,529	3,982,529	4,206,036	5,245,484	4,705,671	5,242,467
Non-controlling interests	2,145,713	1,144,679	2,134,405	2,134,405	1,411,263	1,411,263	1,411,263	1,411,263
Total equity	6,864,275	4,603,074	5,816,934	6,116,934	5,617,299	6,656,747	6,116,934	6,653,730
No. of UMW Shares in issue ('000)	1,168,294	1,168,294	1,168,294	1,217,555	1,217,555	1,461,066	1,299,526	1,429,479
NA per UMW Share	4.04	2.96	3.15	3.27	3.45	3.59	3.62	3.67
Total borrowings	6,355,106	2,582,588	3,453,247	3,453,247	3,952,882	2,952,210	3,453,247	2,952,210
Gearing (times)⁽⁵⁾	1.35	0.75	0.94	0.87	0.94	0.56	0.73	0.56

Notes

- (1) Adjusted to illustrate the effects of the distribution of 1,204,777,400 ordinary shares in UMW Oil & Gas Corporation Berhad ("UMW-OG"), being the entire shareholding of UMWH in UMW-OG.
(2) Assuming that the carrying values of MBMR and Perodua are equivalent to its fair value for illustrative purposes.
(3) Assuming that Perodua continues to be equity accounted from accounting perspective despite the increased stake for illustrative purposes.
(4) Assuming full acceptance under the Proposed MO.
(5) Calculated as total borrowings divided by equity attributable to owners of the Company.

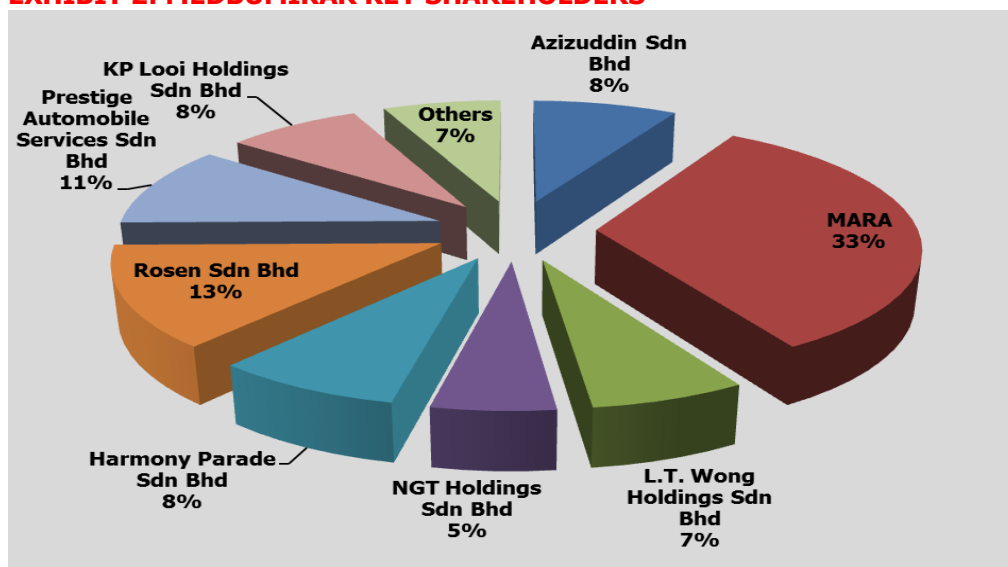
Source: Company, MIDF

Timeline. Medbumikar has until 28th March to accept UMW's offer. After that, the group will proceed with due diligence and an EGM for shareholders to approve the transaction. This is expected to take another 3 months to complete. Assuming all goes smoothly, the exercise is expected to essentially complete around mid-year.

How we think MBM's shareholders will reason out. From Medbumikar's perspective, there are actually not many suitors to takeout its stake in MBM lock-stock-and-barrel, which would be its only option out. As explained in above paragraphs there is actually a scarcity of buyers given that this involves a stake in the national carmaker which is of strategic importance to the nation; a potential buyer requires the necessary "political clout" and "financial clout". Secondly, if there is unresolved disagreements within Medbumikar (considering sudden departures of management and board members in the past 12-16 months), this is the opportunity for the members to liquidate Medbumikar's position in MBM and gives the opportunity for existing Medbumikar shareholders to buy directly into a listed vehicle. Moreover, Medbumikar was one of the original shareholders in Perodua; with Perodua having paid historical 50% payout as dividends in the past, these shareholders would have well broken even on their initial investment, we think.

For UMW, the intention is to privatise MBM and the MGO (assuming Medbumikar accepts UMW's offer) will only trigger a compulsory offer if acceptance crosses 90%. However if acceptance is less than 90% but free float is less than the minimum 25% under listing requirements, MBM will still be delisted.

EXHIBIT 2: MEDBUMIKAR KEY SHAREHOLDERS



Source: Various, MIDF

Opportunity to exit a value trap - cash or shares? For MBM's minorities, this is an opportunity to exit a value trap. For the MBM minorities which will get two options i.e. cash or share swap - a share swap deal will value UMW's shares at RM6.09/share. If UMW's market price is lower than this, it makes sense for MBM's minorities to buy directly into UMW at a cheaper entry price and eventually accept the cash offer for their MBM shares (at a fixed offer of RM2.56/share). Even if MBM's minorities accept the share swap deal, they will still be exposed to UMW's rights issue to finance the acquisition of Medbumikar's 50.07% stake in MBM.

Whichever way, its earnings accretive for UMW. Despite embarking on a fully new share-funded acquisition, earnings expansion from the acquisitions will more than offset any dilution from potential new share issuance to fund the acquisitions. Our sensitivity analysis suggests in a worst case, full cash payment scenario, UMW still attains earnings accretion of 4% (FY19F), whereas in a best case, full shares scenario, net earnings accretion rises to 6% (FY19F). This situation is possible given the large valuation gap between UMW (14x FY19F PE) vs. the offer for MBM at just 8x FY19F PE. This situation is possible given the large deviation in valuation between UMW (14x FY19F PE) vs. the offer for MBM at just 8x FY19F PE. However, if UMW has to offer a significantly higher price for MBM, a fully new share-funded acquisition of MBM may not be earnings accretive anymore, in our opinion, given the narrower valuation gap between the acquirer vs acquiree. This is unless the discount given for its rights issue is also reduced in tandem, or otherwise, UMW would have to resort to part debt-funding for the acquisition.

UMW's bankers argue that it is actually valuing MBM's non-Perodua businesses at RM57m equity value and EV of RM148m. This compares to our valuation of MBM's non-Perodua businesses at RM115m. Regardless, even at UMW's banker's valuation, the implied valuation for UMW's 22.6% stake in Perodua is around 8.5x forward FY19F PE, and gives UMW an effective 6% dividend yield (FY19F) assuming Perodua maintains a 50% payout.

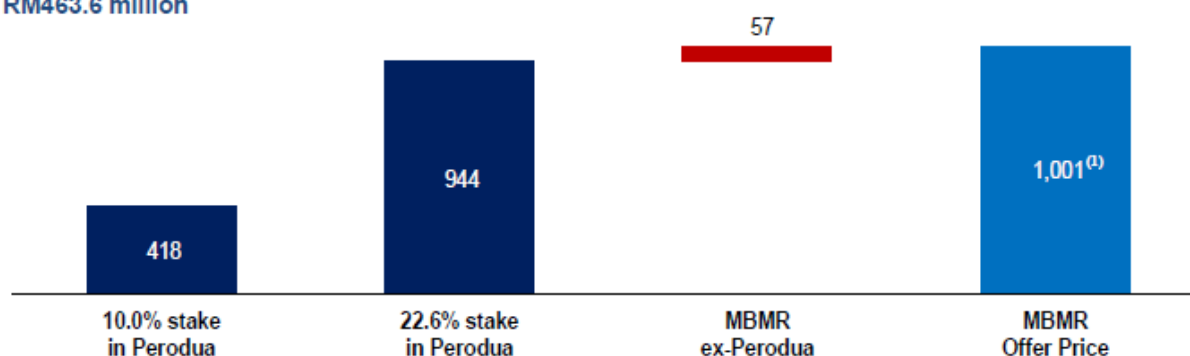
EXHIBIT 3: UMW'S RATIONALE FOR ITS OFFER TO MBM

THE OFFER PRICE FOR PERODUA AND MBMR

Valuation Build-up

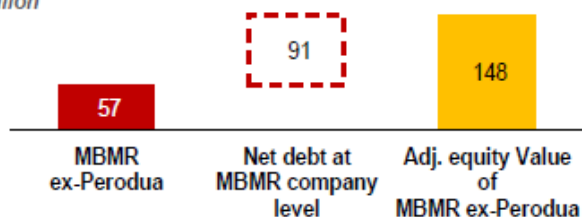
RM million

- Offer price for Perodua reflects a c.9.0x earnings multiple over Perodua's 2016 audited net income of RM463.6 million



Exposed to holding company debt and business risks of MBMR Group

RM million



- Equity value of remaining businesses at MBMR (ex-Perodua) estimated at RM148 million – includes the loss-making alloy wheels segment

Note:

(1) Rounded from the offer price of RM2.56 per MBMR Share

Financials in this section are based on MBMR's and Perodua's audited 2016 financials, including the net debt at MBMR company level

Source: Bloomberg as at 14 March 2018

Source: Company, MIDF

EXHIBIT 4: UMW'S OFFER VALUES MBM'S PERODUA STAKE AT JUST 8X FY19F – MIDF VALUATIONS

	RMmil
MBM market cap at UMW' offer price of RM2.56/share	998.9
Value of MBM other business ex-Perodua *	115
Implied value of Perodua	884
Perodua FY19F earnings (@ 22.6% stake)	110
Implied PE valuation of Perodua stake (x)	8.0

*Refer to SOP valuation

	RMmil
Implied value of Perodua at UMW's offer price*	884
Perodua FY19F earnings (@ 22.6% stake)	110
Dividends from Perodua (@22.6% stake) (@50% payout)	55
Implied dividend yield	6.2%

Source: Company, MIDF

Recommendation. Re-affirm BUY on UMW (TP: RM7.11/share) as this would be a good deal if it is successful given UMW's potentially cheap entry into MBM at just 8x FY19F earnings and effective 6%-7% dividend yields attained from Perodua at the entry price. Our SOP and forecasts factor in strictly, only the 10% Perodua stake acquisition from PNB Equity Resource as this is the only firm deal at this point. There is further significant upside if Medbumikar accepts the offer and UMW proceeds with its takeover of MBM.

EXHIBIT 5: UMW SHARE BASE EXPANSION – FULL CASH VS. FULL SHARE SWAP SCENARIO

(m shares)	Full cash scenario #	Full shares scenario ##
Current share base	1,168.3	1,168.3
New shares for 10% Perodua stake acquisition from PNB	49.26	49.26
New shares under Rights issue (for Medbumikar buyout and Mandatory Offer if minorities opt for cash) *	243.51	129.95
New shares to fund proposed Mandatory Offer (if minorities take share swap option) **		81.97
Enlarged share base	1,461.07	1,429.48
Share base expansion (%)	25.1%	22.4%

* At Rights Price to be determined later but based on illustration, at >20% discount to VWAP.

** Fixed at RM6.09/share

^ Actual Rights Price to be determined at 20%-30% discount to TERP of 5-day VWAP preceding price fixing day

^^ In full cash scenario where more rights shares are to be issued, discount to TERP likely to be larger

Based on Rights Price assumption of RM4.40

Based on Rights Price assumption of RM4.30

Source: Company, MIDF

EXHIBIT 6: EARNINGS ACCRETION IF MBM MINORITIES ACCEPT CASH

Full cash scenario (RMm)	FY18F	FY19F
UMW Group earnings - Current	370.3	578.7
UMW Group earnings - Enlarged *	515.7	750.4
UMW Group EPS (RM) - Current	0.32	0.50
UMW Group EPS (RM) - Enlarged	0.35	0.51
Net earnings accretion to UMW from acquisitions	11.4%	3.7%

Source: Company, MIDF * includes 10% Perodua stake from PNB and 100% of MBM

EXHIBIT 7: MORE EARNINGS ACCRETION IF MBM MINORITIES ACCEPT SHARE SWAP

Full shares scenario (RMm)	FY18F	FY19F
UMW Group earnings - Current	370.3	578.7
UMW Group earnings - Enlarged	515.7	750.4
UMW Group EPS (RM) - Current	0.32	0.50
UMW Group EPS (RM) - Enlarged	0.36	0.52
Net earnings accretion to UMW from acquisitions	13.8%	6.0%

* Less earnings dilutive for UMW if MBM minorities opt for full shares scenario as share swap fixed at a higher price of RM6.09/share

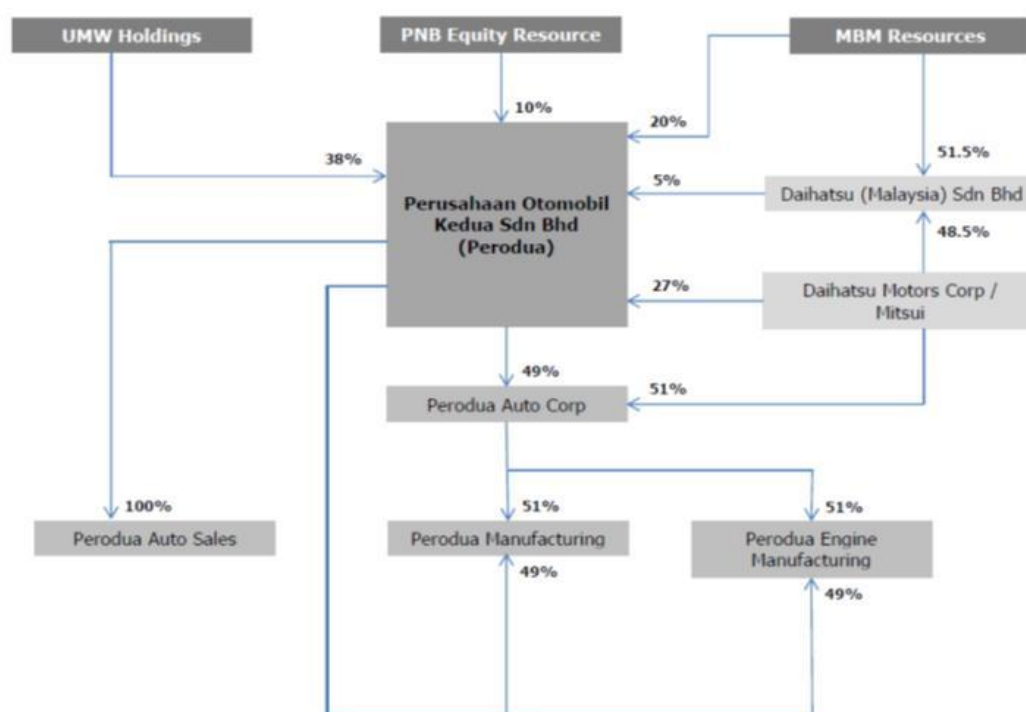
Source: Company, MIDF

EXHIBIT 8: UMW'S OFFER VALUES MBM AT 8.1X FY19F PE

FYE Dec – MBM Resources	FY15	FY16	FY17	FY18F	FY19F
Revenue (RM'm)	1,816.7	1,680.7	1,732.6	1,654.8	1,709.3
EBIT (RM'm)	21.3	(48.5)	(257.6)	8.8	17.1
Pre-tax Profit (RM'm)	123.0	79.4	(148.5)	138.8	168.6
Normalised PATAMI (RM'm)	80.4	84.8	86.1	101.0	122.9
FD EPS (sen)	20.6	21.7	22.1	25.9	31.5
EPS growth (%)	(29.6)	5.4	1.6	17.4	21.7
PER (x)	12.4	11.8	11.6	9.9	8.1
Net Dividend (sen)	10.0	6.0	3.0	6.5	7.9
Net Dividend Yield (%)	3.9	2.3	1.2	2.5	3.1

Source: Company, MIDF

EXHIBIT 9: PERODUA SHAREHOLDING STRUCTURE



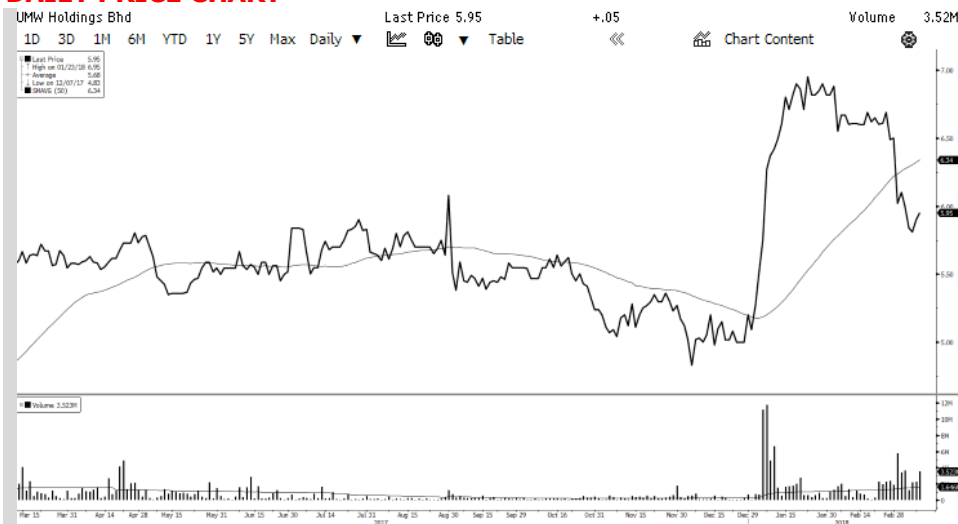
Source: Company, MIDF

EXHIBIT 10: UMW SUM-OF-PARTS VALUATION

Segments	FY19F net profit (RMm)	Valuation	Multiple (x)	Value (RMm)	Comments
Automotive – UMW Toyota	238	PER	12	2,851	
Automotive - Perodua	234	PER	15	3,513	
Equipment	117	PER	12	1,407	
Serendah land		RNAV		586	<i>RNAV of Serendah land (830acres@RM16psf) (net of debt)</i>
Aerospace		DCF		189	<i>Equity NPV of 25-year Rolls Royce contract (WACC: 8.7%)</i>
Non-listed O&G		Book Value		114	<i>Based on BV of assets net of 4Q17 impairment</i>
Total value				8,659	
No of shares (m)				1,218	

Source: Company, MIDF

DAILY PRICE CHART



Source: Bloomberg, MIDFR

Hafriz Hezry
 hafriz.hezry@midf.com.my
 03-2173 8392

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.