

**AmResearch**

21 January 2014

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# AUTO SECTOR

*The new NAP: Catalysing a super-cycle growth story***OVERWEIGHT**

(Maintained)

*Rationale for report : Thematic Research***Investment Highlights**

- **Stepping out of our recent meeting with the Malaysian Automotive Institute (MAI)** and following announcement of the updated National Automotive Policy (NAP), we sense that policies are now more outward looking, thrusted by Malaysia's EEV program, which encompasses a competitive tax incentive structure, a focus on scale creation (previously dragged by inward looking policies), and creation of a competitive export hub. These are key reasons why we think that the revised NAP will prove a strategic turning point for the local auto industry, riding on early cycle investments into "green car" production in ASEAN.
- **Positioned to grab new cycle investments:** Critical factors behind our view:- (1) A significantly more robust option for foreign OEMs to qualify for "green car" production tax incentives - Malaysia's EEV definition cuts across all passenger vehicle segments compared to extremely rigid criteria in Thailand (Eco Car program) and Indonesia (Low Cost Green Car program), which are A-segment centric (See Table 2, 7 and 9); (2) EEV tax incentives that gives a quantum leap to the current level of localisation-driven excise duty rebate i.e. up to 60% incremental savings in excise duty cost from the current base, via a modified Industrial Adjustment Fund (IAF) matching system (See Table 10 and11); (3) Huge spin-off impact; non-EEV models sharing common parts with EEV models (e.g. Jazz Hybrid and Jazz petrol variants) might indirectly benefit from ILP-based excise duty rebates; (4) Complete liberalisation of auto manufacturing license for EEV production vs. the current freeze on <1.8 litre segments; (5) Massive scale from new capacity to improve price competency of Malaysian auto parts sector, which will eventually benefit national cars which are highly localised (80%-90% localisation rate).
- **Latest developments underscore our conviction:** (1) Mazda has identified Malaysia as an export base for the CX5 (12K/annum export to Thailand) and Mazda 6; (2) Honda committed to more than double production to 100K by 2014-15 from 40K with a target localisation rate of >70%; (3) China's Great Wall has committed to invest RM2bil into regional production facilities in Malaysia, at indicative volume of 100K/annum. (4) Tan Chong is localising its Serena Hybrid by mid-FY14, with more new models in its 5-year strategic plan, including high volume A/B segments. Production volume to expand from 60K to 100K by 2015-2016; (5) Negotiations are ongoing for 3 more EEV manufacturing licenses to be issued to US, European and Korean marques; (6) Perodua is doubling capacity to 400K by mid-FY14 via a new state-of-the art plant, well positioned as a B-segment re-export hub for Daihatsu. Based on business plans submitted by various OEMs, Malaysia's total vehicle production (inclusive of exports) is projected to more than double from c.600k in FY13F to 1.3mil by 2020. The current sector's contribution to GDP of 3.5% is targeted to grow to 10% by 2020, equivalent to where Thailand's auto sector stands in its economy. While volume is smaller than Thailand, the focus of the EEV program is on value of cars produced.
- **Several ways players benefit from the EEV program:** (1) Lower duty cost via the adjusted IAF duty rebates – Indonesia and Thailand have no ILP-like system in place currently; (2) Exemption from corporate income tax via Pioneer Status or ITA; (3) Incremental production and export market penetration; (4) Increased depth of localisation; (5) Improved scale from influx of new capacity, particularly for the auto parts industry; (6) Manufacturers (national cars in particular given their high local content of 80%-90%), benefit from more competitively priced local auto parts.
- **Key play to ride this theme?:** Non-nationals are immediate beneficiaries of EEV tax incentives and improved price competitiveness. BAuto is our top pick as a play into this theme (BUY, FV: RM2.30/share) – all SkyActiv equipped models have pre-qualified for EEV. DRB-HICOM (BUY, FV: RM3.65/share) is a beneficiary via its stake in 34% owned Honda Malaysia. We upgrade APM to BUY from HOLD (FV: RM6.40/share) as part suppliers are key beneficiaries of the potential influx of new capacity. MBM (BUY, FV: RM4.35/share) is also a beneficiary via its safety system manufacturing (classified as critical component for OEMs to enjoy higher tax incentives) and wheel manufacturing units.

**TABLE 1 : SECTOR VALUATION MATRIX**

		Share Price	EPS (sen)		PE (x)		P/BV	ROE	ROE-to-	Div Yield	Target Price	Potential
	Rating	(RM)	CY13F	CY14F	CY13F	CY14F	(x)	(%)	P/BV (x)	(%)	(RM)	Upside (%)
APM	Buy	5.72	64.1	70.7	8.9	8.1	1.4	14.8	n/a	5.6	6.40	11.9
Berjaya Auto	Buy	1.9	6.3	13.4	29.2	13.8	n/a	n/a	n/a	n/a	2.30	24.3
DRB-Hicom	Buy	2.8	29.8	22.9	9.3	12.1	0.8	27.7	n/a	2.2	3.65	31.8
Tan Chong	Hold	5.6	47.9	48.5	11.7	11.5	1.9	8.4	n/a	1.6	6.00	7.1
UMW	Hold	11.6	76.2	89.4	15.2	12.9	2.8	21.1	n/a	3.5	13.10	13.1
MBM	Buy	3.4	36.5	39.1	9.3	8.7	1.0	11.3	n/a	1.1	4.35	27.5

Source: Company, AmResearch estimates

Share prices as at 21 January 2014

## SHIFTING TO OUTWARD LOOKING POLICIES

Our recent meeting with Malaysian Automotive Institute (MAI) shed some light on the underlying strategies in the revision of the National Automotive Policy (NAP), which was officially announced last night.

Stepping out of the meeting and following the announcement, we sense a big change in the tone of sector policy making; instead of inward looking policies seen for the past 8 years since the initial NAP, it seems that we are now significantly more outward looking.

This is a key reason why we think the revised NAP will prove a strategic turning point for the local auto industry, riding on early cycle foreign investment into energy efficient vehicle (EEV) production in ASEAN.

Among key issues discussed during the meeting, and key points under the new NAP are:-

- (1) **The opening up of the local auto sector to new foreign players;**
- (2) **Malaysia's positioning within the region via the EEV incentives;**
- (3) **Strategic incentives offered to entice new investments by foreign OEMs (both existing and new players);**
- (4) **Measures to attract critical technologies for production in Malaysia; and**
- (5) **Key targets of the revised NAP and some of the achievements of implementation of the EEV measures in the past 18 months.**

## POSITIONING MALAYSIA AS THE NEW HUB

At the core of the updated NAP is the attempt to position Malaysia as a regional production hub for EEVs – which is not only defined as hybrids/electric vehicles/alternative energy engines, but also conventional petrol engines, CNG, LPG, biodiesel, ethanol, hydrogen and fuel cell vehicles that can achieve a set minimum standard of fuel efficiency.

While Malaysian autos seemed to have lost out on foreign investments to Thailand over the past cycle of investments, Malaysia is now aggressively attempting to turn this around via new policies put in place to tap on new investments into green car production in the region.

A few critical factors why we think Malaysia could be successful, and may grab a meaningful slice of the new cycle investments into ASEAN:-

- (1) A target market for EEV incentives that cuts across all passenger vehicle segments compared to the extremely rigid criteria in Thailand (Eco Car program) and Indonesia (Low Cost Green Car program) (See Table 2);
- (2) EEV tax incentives that can give a quantum leap to the current level of localisation-driven excise duty exemption (via the Industrial Adjustment Fund system) – which could mean

massive savings of up to 60% in effective excise duties paid by manufacturers;

(3) Complete liberalisation of auto manufacturing license for EEV production vs. the current freeze on <1.8 litre passenger vehicle manufacturing;

### □ *Full liberalisation of manufacturing license*

Prior policies have been seen to be very inward looking and protectionist - in particular, the freeze on issuance of new manufacturing licenses, which has been perceived to protect the interest of national carmakers.

This started with a full-fledged freeze pre-2006, but was later followed by a gradual liberalisation in the 2009 NAP review, which allowed the issuance of new passenger car manufacturing license for cars with engine capacity higher than 1.8 litre and priced above RM150,000.

As national carmakers dominate the lower priced, high-volume A and B segments, especially in the <RM80,000 price segment, the partial liberalisation in 2009 did not make much difference to change the perception of industry players and foreign OEMs towards the local auto policy which was still somewhat, national car-centric.

This time around, new EEV manufacturing licenses will be issued with no restriction on foreign ownership, engine or price category, and is deemed to be a huge step towards liberalisation of the sector, in our opinion.

### □ *A much more comprehensive "green car" program versus competitors*

Thailand launched its Eco-Car initiative in 2007 under its 2nd Automotive Industry Masterplan. The Eco-car program is essentially Thailand's version of a "green car" program, but with a different structure and criteria compared to Malaysia's EEV program.

Thailand's Eco Car program rigidly defines an Eco-Car as a passenger car utilising a maximum 1.2 litre petrol engine or a maximum 1.5 litre diesel engine (this would be generally defined as an A or B-segment model) which can achieve minimum fuel efficiency of 5 km/litre.

Other than this, there are also outright investment criteria such as a minimum USD500mil investment and a minimum production volume of 100,000 units/annum to be achieved within five years of being qualified for the Eco-Car program.

In stark contrast, the Malaysian EEV program has no such limitation on product qualification. Malaysia's EEV definition cuts across all spectrum of passenger car segments such as A (mini-car, compact), B (sub-compact, small sedans), C (mid-sized sedans/hatchbacks), D (large family sedan), SUV (sports utility vehicle) and MPV (multi-purpose vehicles) segments.

While fuel efficiency is still a key qualifying criteria, the minimum fuel efficiency requirement varies according to the different segments and vehicle kerb weights.

**TABLE 2 : ASEAN “GREEN CAR” PROGRAM COVERAGE COMPARISON (GASOLINE ENGINES/EV/HYBRIDS)**

Segments	EEV coverage	Eco-Car coverage	LCGC coverage
A	Yes	Yes	Yes
B	Yes	Yes	Yes
C	Yes	No	No
D	Yes	No	No
E	Yes	No	No
F	Yes	No	No
SUV	Yes	No	No

Source: MITI, TAI, BOI, AmResearch

**TABLE 3 : EEV FUEL EFFICIENCY REQUIREMENT**

Segments	Kerb weight (kg)	Fuel efficiency requirement (litre/100km)	Details
A	<800	4.5	Micro Car
	801 - 1000	5.0	City car
B	1001 - 1250	6.0	Super Minicar
C	1251 - 1400	6.5	Small Family Car
D	1401 - 1550	7.0	Large Family Car/ Compact Executive Car
E	1550 - 1800	9.5	Executive Car
F	1801 - 2050	11.0	Luxury Car
J	2051 - 2350	11.5	Large 4x4
Others	2351 - 2500	12.0	Others

Source: MITI, AmResearch estimates

This way, the target market for the EEV program expands well beyond that of Thailand's Eco-Car program and provides a robust option to foreign OEMs to qualify for the tax incentives that comes with an EEV-status model. In fact, the fuel efficiency definition outlined in the EEV program is pretty loose, in our opinion, and many new generation models can meet the required fuel efficiency. As an example, the 4x4 / SUV segment has a fuel efficiency requirement of 11.5 litre/100km, in which the majority of mainstream SUVs sold in Malaysia can qualify (See Table 4).

**TABLE 4 : MOST SUV MODELS CAN MEET EEV FUEL EFFICIENCY REQUIREMENT**

	Fuel consumption (litre per 100km)
<b>Mazda CX5 2 litre SkyActiv</b>	<b>6.9</b>
Honda CRV (2.0)	7.8
Nissan X-Trail (2.0)	8.4
Hyundai Santa Fe (2.0)	8.5
Kia Sportage (2.0)	8.7

Source: Various, AmResearch estimates

The breadth of EEV program coverage and less restrictive product and investment criteria (Malaysia's EEV program has no minimum capacity requirement, export conditions, price conditions or minimal investment) are a key competitive edge for Malaysia to compete with the larger car producing countries in ASEAN in securing investments for green car production.

This is underpinned by the fact that the majority of major carmakers such as Toyota, Honda, Nissan, VW, Peugeot and GM would naturally offer models across all passenger vehicle segments. Out of all the green car programs in ASEAN, Malaysia's EEV program is currently the only program that accommodates all these models comprehensively.

Other than this, volume requirements, parts localisation, investment requirement and tax incentives that come with an EEV qualification is directly negotiated with the OEMs instead of a standard across the board incentive policy like Thailand and Indonesia.

This is to allow flexibility and to accommodate different OEMs with different value proposition that they can offer to the local auto industry. Given the sensitivity of directly negotiated, or so called “customised incentives”, exact details are not explicitly announced in the NAP.

However, the list of incentives proposed by the various OEMs based on our chat with industry players and MAI over the past few months are listed in Table 5 and 6, of which excise duty rebate mechanisms will be discussed in detail in the later part of this report.

**TABLE 5 : EEV INCENTIVES PROPOSED BY PLAYERS****Non-nationals**

- Excise duty rebates for EEV- related manufacturing activities
- Machinery import duty exemption
- 0% corporate tax for 10-15 years
- R&D grants

**National cars**

- Support for vendor network to address capital constraint, access to financing
- R&D grants
- Support for technology transfer

Source: MAI, AmResearch estimates

**TABLE 6 : EEV INCENTIVES ANNOUNCED IN GENERAL**

**Incentives:** “Customized incentives” for both FDI and DDI such as:

- Pioneer Status, Investment Tax Allowance
- Grants (R&D, training)
- Infrastructure facilitation
- **“Lower taxes”**
- Expatriate positions

**Investment Criteria:** None

Source: MITI, AmResearch

### □ *Locking-in future investments*

During our discussions, we also gather that MAI is in talks to rope in a lithium-ion battery manufacturer (batteries used to power electric vehicles) to set up production in Malaysia – which would also be the first in ASEAN, if successful.

Given the lack of scale for electric vehicles currently, it may not be viable to have two battery manufacturers to serve the ASEAN region – which means that if we are successful in roping in the battery manufacturer here, Malaysia will attain a critical first mover advantage in creating a supply chain for electric vehicles (batteries are estimated to account for 30% to 50% of an electric car's cost).

What this also means is that future production of EVs for ASEAN will likely flow into Malaysia throughout the growth cycle of such vehicles given the lack of scale to allow multiple battery manufacturers within the region.

We are however, cognisant of the fact that Thailand too - which is now entering the second phase of its auto industry development plan - is aggressive in attempting to attract a battery manufacturer to set up production there, besides lobbying for foreign OEMs to set up R&D centres and testing centres in Thailand.

We note that this is part of their strategy to lock-in future investments, especially given the fact that they stand to lose out to Indonesia as the largest volume driver of auto sales in the region.

### □ *Why Malaysia is strategically positioned to offer across-the-spectrum incentives?*

Malaysia is a high-income nation relative to Thailand and Indonesia, albeit with a much smaller population, while the latter two countries are high population but lower income countries, hence the focus on mass market and small cars to attract green car investments.

In particular, Thailand and Indonesia attain massive two-wheeler markets, which can be converted to four-wheelers via their respective affordable small car programs. This will be a critical factor in driving volume growth for Indonesia and Thailand in the foreseeable future, we believe.

On the contrary, Malaysia has a pretty matured and well diversified passenger vehicle market with the majority of sales in the B, C and D passenger car segments.

Given the stark difference in income level, a relatively competitive (in terms of volumes) passenger car market and a well diversified demand structure, Malaysia is positioned to offer incentives across the whole spectrum of passenger cars capitalising on the domestic base of buyers, initially, before moving on to exports.

Thailand is still pretty much a pick-up truck market (accounting for 46% of TIV from up to 60% prior to the Eco-Car program) while Indonesia is still largely an MPV market (up to 52% of TIV)

Given that it is a lot smaller than its two neighbors in terms of population, Malaysia is not targeting outright production volumes for investments under its EEV program, but rather, is

focusing on value of vehicles being produced and exported out of the country.

As an example, Mazda is using Thailand as a regional production hub for its high volume B-segment model, the Mazda 2; but instead is using Malaysia as an export hub for the much higher value CX5 (SUV) and Mazda 6 (D-segment) models.

By 2020, MAI targets the auto sector to contribute up to 10% of GDP from 3.5% currently.

Total vehicle production is expected to more than double to 1.3mil by 2020 (inclusive of exports) from an estimated 600K in 2013, based on proposals submitted by players ahead of the official launch of the EEV program.

## **THAILAND: ECO-CAR PROGRAM**

Thailand launched its Eco-Car program in 2007 under its 2007-2011 Automotive Industry Masterplan, which outlined the aim of making Thailand a major auto production base in Asia.

The Thai government first offered tax incentives for the manufacturing of eco-cars in 2007. A preferential excise tax rate of 17% for eligible eco cars was introduced, which was a rate far less than the 30% excise tax imposed on conventional vehicles.

Producers who want to apply for the scheme must make a car that is small (maximum engine capacity of 1.3 litre) and energy efficient (at least 5km per litre fuel efficiency).

Additionally, a manufacturer must guarantee to invest more than THB5bil (MYR500mil) in eco car production and produce more than 10,000 vehicles annually, before hitting 100,000/annum production within five years of being granted the eco car status.

In the same year, Thailand's Board of Investment drew up a plan to introduce more tax incentives for eco car manufacturers. In this scheme, the manufacturers can enjoy a tax exemption on corporate tax for up to 8 years, a tax exemption on the import duty for machinery and equipment and up to 90% reduction in import duties on raw materials and finished parts for two years.

The tax incentives were formally introduced in 2009; five car manufacturers applied and were approved for the project. Under this first phase of the Eco Car project, Honda, Nissan, Mitsubishi, Suzuki and Toyota were qualified.

Although it is an on-going project, if all five manufacturers follow through, more than THB25bil is expected to be invested in the program, and more than 500,000 eco cars are to be produced by 2015. It is estimated that about 30% of all cars produced in Thailand would be eco cars by 2015.

Nissan began Eco Car production in 2010, Honda in 2011, Mitsubishi and Suzuki in 2012, while Toyota is expected to begin soon. A total of six Eco-Car models are currently being produced in Thailand currently (See Table 8).

It is estimated that Eco-cars now account for circa 30% of Thailand's TIP (Total Industry Production) and contribution of pick-up trucks has dropped to circa 40% from up to 60% previously.

#### ❑ *Eco Car program moving into 2<sup>nd</sup> Phase*

Thailand has now entered into Phase 2 of its Eco Car project, which saw an increase in the minimum investment requirement to THB6.5bil and a further cut in excise duty to 14% from 17% in the 1<sup>st</sup> Phase.

Production volume requirement is maintained at a minimum 100,000/annum but this time, within 4 years of start-up versus 5 years previously. Additionally, the cars now have to meet a minimum Euro 5 emission standards, minimum fuel efficiency of 4.3 litre per 100km (23km/litre) and achieve maximum CO2 emission of 100g per km.

There is however, growing concern that vehicle manufacturers are being pressured into making investment decisions in Thailand – to build excessive capacity for which local demand is limited at this juncture. Just over 164,000 eco cars were sold in Thailand last year and a further 80,000 were exported. LMC forecasts eco-car sales in Thailand to reach 273,000 units by 2020, just over 20% of anticipated capacity for that year.

#### ❑ *Thailand's incentive scheme – success or failure?*

To support its Eco Car program (Phase 1), Thailand launched a First Time Car Buyer scheme, which offered a tax refund of THB100,000 (RM10,000) for first time car buyers that buy Eco Cars (which has essentially become a new, cheap segment of Thailand's car market).

The program ended up costing Thailand USD2.5bil (according to World Bank estimates), but much like the US "cash for clunkers" program, the incentives distorted the market, creating a boom in demand that collapsed once the tax breaks expire. The key difference was, Thailand's USD2.5bil car-buying scheme was a "cash for clunkers" program, but without the clunkers.

The problem with encouraging low-income buyers is that they often cannot make their payments. It is reported that more than 100,000 new buyers have defaulted on their loans, with their cars seized by finance companies.

With the resulting used car glut – as a result of the seized cars which are barely used, being sold in the secondary market – on top of the absence of subsidies, demand for new cars in Thailand has cratered; threatening the very industry the scheme was meant to support.

**TABLE 7 : THAI ECO-CAR CRITERIA & DEFINITION**

#### Thailand Eco Car Program

##### *Product Criteria*

- Engine capacity no larger than 1.3 litres (gasoline) and 1.5 litres (diesel)
- Cars should consume less than 5 litres per 100km (20km/litre)
- Comply with Euro4 fuel standard
- Carbon emission of less than 120g of CO2 per km
- Satisfy safety standards, both for front and side impacts as specified by Europe Regulation 94 and Regulation 95 respectively
- **2<sup>nd</sup> Phase:** Comply with Euro 5 fuel standard, fuel efficiency of 4.3 litres per 100km, <100g/km carbon emission

##### *Investment Criteria*

- Investment should be more than THB5bil (RM500mil)
- Project should integrate car assembly, engine manufacturing and parts manufacturing
- Production capacity must not be smaller than 100K per annum from the 5th year of operation
- Project should produce a minimum of 4 out of 5 engine parts: cylinder heads, cylinder blocks, crankshafts, camshafts and connecting rods
- Materials and parts should be locally unavailable to apply for reduction on import duties
- **2<sup>nd</sup> Phase:** THB6.5bil investment (RM650mil), excise tax down to 14% from 17%

Source: BOI Thailand, AmResearch

**TABLE 8 : THAI ECO-CAR MODELS / INVESTMENTS**

Eco Car models	Committed capacity (annual)	Pricing (THB 000)	Investment (THBm)
Mitsubishi Mirage	200,000	380	6600
Nissan March	60,000	380	2250
Nissan Almera	60,000	429	2250
Honda Brio	120,000	399-508	6700
Toyota Yaris	100,000	469-599	7700
Suzuki Swift	138,000	599	9500

Source: BOI Thailand, AmResearch

#### ❑ *Impact of Eco Cars on Malaysia*

Our chat with key Malaysian auto players over the past month suggests risk of Eco cars flooding the Malaysian market, and we indeed acknowledge such risk. However, we are still bullish on Malaysian auto players.

First, while we acknowledge that Eco Car models are attempting to penetrate the Malaysian market e.g. the Mitsubishi Attrage, we note that Malaysian car buyers typically favour higher capacity models, compared to Eco Cars which are limited to a maximum 1.2 litre petrol engines.

As an example, the Nissan Almera, which qualifies as an Eco Car (based on the same platform as the Nissan March) is sold in <1.3 litre engine variants in Thailand, but comes in 1.5 litre variants for the Malaysian market.

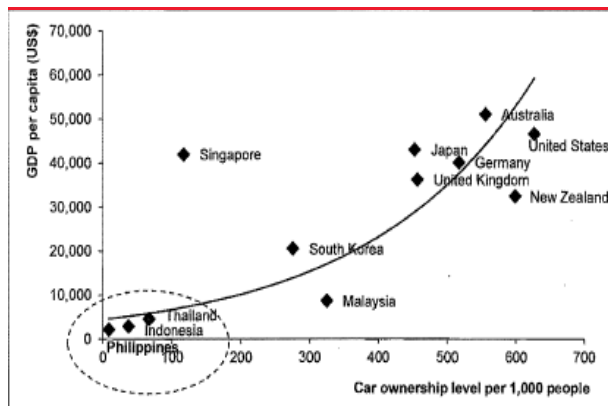
### □ Do we want us, or do we want them?

More importantly, the aim of the Malaysian EEV program, we believe, is to penetrate the much larger export market in Thailand and Indonesia, which entail population more than triple that of Malaysia but with only 30%-40% vehicle penetration currently.

This compares to the Malaysian market which entail a much smaller population size (28mil) and a vehicle market that is relatively mature (penetration rate of 75%).

More importantly, the comprehensive definition of an EEV in Malaysia and the tax incentives that comes with it, allows foreign OEMs to export more model variants to other ASEAN countries at more competitive pricing – something that cannot be obtained in Thailand and Indonesia as their definition of “green cars” are limited to mini and compact cars.

**CHART 1 : LOW CAR OWNERSHIP LEVEL IN ASEAN PROVIDES EXPORT OPPORTUNITY FOR MALAYSIA**



Source: Frost & Sullivan / AmResearch

## INDONESIA: LOW COST GREEN CAR PROGRAM

Indonesia officially launched its “green car” initiative called the Low Cost Green Car program (LCGC) in October 2013, after much delay in the signing of the presidential decree on the policy. The basic criteria suggest that the LCGC program will look similar to Thailand’s eco car program.

### □ Low Cost Green Car (LCGC) program criteria

Among others, the LCGC program has a product criteria such as vehicles with engine capacity of between 980cc to a maximum of 1.2 litres (for spark ignition or commonly known as petrol engines) and <1.5 litre for compression ignition engines (or diesel engines).

Based on its product criteria, Indonesia’s LCGC program seems to be targeting the production of minicars (versus Thailand’s Eco Car which is sub-compact car centric).

The LCGC program has a price ceiling of a maximum IDR95mil/unit (RM26,000 – RM27,000), something which is unique to the LCGC program as Eco Car program does not have such a criteria. Both gasoline and diesel engine LCGCs need to have a minimum fuel economy of 20-22km/litre (or 4.5 to 5 litre per 100km), similar to Eco Car requirement.

To qualify for the LCGC program, manufacturers need to have a localisation rate of at least 40%, rising to 80% within five years. Components that are to be localised need to include power train components and bodywork.

A system of tax breaks were put in place, which includes reductions in import duties for parts and machinery for OEMs and cuts in luxury/consumption tax (equivalent to Malaysia’s excise duty) for consumers.

Among others, the luxury tax drops by up to 25% for cars achieving the 20km/litre fuel efficiency requirement, and more if they exceed 22km/litre.

At this point, there is no explicit requirement for export production nor any requirement for minimum production capacity suggesting that LCGCs are mainly to stimulate local demand – Indonesia only has a vehicle penetration rate of c.30% (vs. Thailand’s 40% and Malaysia’s 75%), create employment and conserve energy.

The key conditions that stand out are the requirement to localise the LCGCs up to 80% and the selling price ceiling imposed.

Five carmakers have already applied for the LCGC program including Daihatsu, Toyota, Honda, Nissan and Suzuki. Currently, there are six LCGC models on sale in Indonesia and it is expected that three more new LCGC models will be introduced next year.

Despite higher interest rates and a generally weaker domestic economic environment, Gaikindo (Association of Indonesian Automotive Manufacturers) expects a 10% rise in car sales in Indonesia driven primarily by the recent entrance of LCGC models into the market.

**TABLE 9 : INDONESIA LCGC CRITERIA & DEFINITION**

### Indonesia Low Cost Green Car (LCGC) Program

#### Product Criteria

- Engine capacity no larger than 1.2 litres (gasoline) and 1.5 litres (diesel)
- Cars should consume less than 5 litres per 100km (20km/litre)
- Comply with Euro3 Standard
- Minimum RON92 for gasoline engines and CN 51 for diesel engines
- Pricing of LCGC models capped at IDR95mil (RM26,400)
- Must have "premium" features such as airbags

#### Investment Criteria

- 80% localization rate required within 5 years, 40% initial localization rate
- Localisation has to include powertrain or drivetrain

Source: MOI, AmResearch

## HOW PLAYERS BENEFIT FROM EEV PROGRAM?

There are several ways in which the Malaysian auto players will benefit from the EEV program:-

1. **Lower duty cost via the adjusted IAF system – Indonesia and Thailand has no IAF-like system in place currently;**
2. **Exemption from corporate income tax for 10-15 years via Pioneer Status or Investment Tax Allowance;**
3. **Incremental production and export market penetration;**
4. **Increased depth of localisation;**
5. **Scale from massive influx of production capacity, particularly for the auto parts industry; and**
6. **Manufacturers (national cars in particular given their high local content of 80%-90%), benefit from more competitively priced local auto parts, which rides on this improved economies of scale.**

### □ *Latest developments underscore our conviction*

The impact from unofficial implementation of the EEV program and direct negotiations with OEMs (in the past 12-24 months prior to the official launch yesterday) is already bearing fruit:-

(1) Honda has committed to more than double production to 100K by 2014-15 (including for exports) from 40K prior to joining the program. Malaysia has been earmarked as a hybrid vehicle production hub for the ASEAN region and Oceania, while localisation rate is targeted to increase to above 70% from 30%-40%;

(2) Mazda has identified Malaysia as a regional export base for the CX5 (at a run-rate of 1000/month) and Mazda 6 (at a run-rate of 300-400 units/month) (i.e. 2 out of 6 core models sold by Mazda Corporation). Almost all key models for the domestic market will be produced locally versus a CBU-centric business model previously;

(3) China based Great Wall has committed to invest RM2bil into production facilities in Malaysia, with a targeted volume of 100K/annum, including for exports;

(4) Tan Chong is localizing its Serena Hybrid around mid FY14, with more new models in the pipeline in its 5-year strategic plan. Production capacity (for Nissan marque) is targeted to expand from 60K to 100K within the next 2-3 years;

(5) We understand that the regulators are close to issuing three more new EEV manufacturing licenses to a US, European and Korean marque respectively;

(6) Perodua is doubling capacity to 400K by 1H14 via a new state-of-the art plant, which will be well positioned as a B-segment re-export hub for Daihatsu Motor Corporation (Japan). The group had also invested in the first transmission manufacturing plant, operational from 1Q13; and

(7) Proton is targeting to increase capacity to 500K from 360K currently, of which 10% are targeted for exports.

### □ *How do the duty incentives work?*

Auto manufacturers and distributors are the key beneficiaries of the duty incentives offered under the EEV program. Under a modified IAF (Industrial Adjustment Fund) system, instead of the dollar-to-dollar excise duty rebate system, regulators are expected to extend the matching system on a multiplier basis.

As an example, assuming a particular model achieves 50% localisation rate, but is awarded an IAF multiplier of 1.5x; the model is considered to have a localisation rate of 75% and therefore only 25% of the content of the vehicle is chargeable by excise duties. In short every Ringgit value of component that is localised will be matched by RM1.50 in excise duty rebate (in the case of a 1.5x IAF multiplier).

To be more specific, say for example, a car that entails ex-factory cost of RM100,000, of which RM50,000 of the cost is derived from Malaysia (i.e. a 50% localisation rate); under the current IAF system, the amount of excise duty charged on the car would be 75% (i.e. we use the duty rate for a 1.5 litre B-segment model) on the value of imported kits (in this case, RM50,000), translating into an absolute excise duty charge of RM37,500.

However, with an IAF multiplier of 1.5x, the localisation rate is artificially increased to 75%, meaning only RM25,000 (or 25%) of the vehicle content is charged with the 75% excise duty rate, translating into total excise duty cost of just RM18,750.

This is 50% lower than the excise duty payable of RM37,500 without the IAF multiplier, as explained in the prior paragraph. This also translates into an effective excise duty rate of just 18.8% (i.e. RM18,750/RM100,000) versus the average 40%-50% that most non-nationals are paying currently (See Table 10).

With the adjustment to the IAF system, Malaysia's vehicle excise duty structure becomes a lot more competitive relative to that of Thailand's 17%-40% and Indonesia's 30%-75% (See Table 14), which does not practice a localisation-driven excise duty rebate system like Malaysia.

**TABLE 10 : EXAMPLE ON IMPACT OF IAF ADJUSTMENT**

Current scenario (RM) - typical localisation rate of 50% for non-national		
A	Total cost of a car	100,000
B	of which: Local cost	50,000
C	of which: Imported cost	50,000
B / A	Localisation rate	50.0%
D	Excise duty rate	75.0%
E = D x C	Excise duty paid	37,500
F = E / A	<b>Effective excise duty rate</b>	<b>37.5%</b>
EEV scenario (RM) - typical localisation rate of 50% for non-national		
A	Total cost of a car	100,000
B	of which: Local cost	50,000
C	of which: Imported cost	50,000
D = B / A	Localisation rate	50.0%
E	Excise duty rate	75.0%
F	IAF multiplier	1.5
G = F x D	Localisation rate post-IAF	75.0%
H = (1 - G) x A	Effective imported cost post-IAF	25,000
I = E x H	Excise duty paid	18,750
J = I / A	<b>Effective excise duty rate</b>	<b>18.8%</b>

Source: Company, AmResearch estimates

As the IAF multiplier to be offered under the EEV incentive scheme ranges from 1.1x to 1.6x, this means that local players have the opportunity to lower excise duty cost by up to 60% from the current base.

The incentive will have a significant impact on cost saving (and potentially car pricing if passed on to consumers) as excise duty cost accounts for up to 30%-40% of the cost of sales of a car manufacturer currently.

More importantly, if a manufacturer increases an EEV model's "base" localisation rate to circa 65% (using the same example), the effective excise duty rate paid by manufacturers can reduce to almost zero (See Table 11).

The Honda Jazz Hybrid as an example, (which is understood to be qualified as an EEV-status model), entails a localisation rate of up to 72%.

**TABLE 11 : EFFECTIVE DUTY CAN REDUCE TO ALMOST 0%**

EEV scenario (RM) - assuming localisation rate increases to 65%		
A	Total cost of a car	100,000
B	of which: Local cost	65,000
C	of which: Imported cost	35,000
D = B / A	Localisation rate	65.0%
E	Excise duty rate	75.0%
F	IAF multiplier	1.5
G = F x D	Localisation rate post-IAF	97.5%
H = (1 - G) x A	Effective imported cost post-IAF	2,500
I = E x H	Excise duty paid	1,875
J = I / A	<b>Effective excise duty rate</b>	<b>1.9%</b>

Source: Company, AmResearch estimates

□ *The tax incentive doesn't end there - common parts creates huge multiplier affect*

It is important to note that car models are mostly introduced in multiple variants. As an example, the Honda Jazz or the Honda Civic or the Nissan Serena, entail both hybrid variants as well as conventional combustion engine variants.

While the IAF tax incentive is awarded to EEV-qualified models e.g. the Honda Jazz hybrid; the petrol engine variants of the Jazz might also benefit from the tax incentives as these models would have many common parts such as bodywork, seats, interior panels etc. In fact, the key difference is merely an additional electric motor + battery system + engine management system to power a hybrid vehicle.

Additionally, one should bear in mind that Malaysia's EEV incentives is not limited to just hybrids or electric vehicles, but also conventional combustion engine vehicles that will also come in many variants.

A good example would be Mazda's new generation SkyActiv technology, which basically optimises the existing internal combustion engine to achieve much better fuel efficiency (See Table 12 and 13). All of Mazda's SkyActiv equipped models have been pre-qualified for EEV status.

As such, the spill over impact of the tax/duty incentives under the EEV program is massive and would be an important part of the measures to drive car pricing lower for the local market and allow a more competitive cost structure for foreign OEMs to export out of Malaysia.

**TABLE 12 : SKYACTIV CX5 SUPERIOR FUEL EFFICIENCY**

	Fuel consumption (litre per 100km)
Mazda CX5 (2.0) SkyActiv	6.9
Honda CRV (2.0)	7.8
Nissan X-Trail (2.0)	8.4
Hyundai Santa Fe (2.0)	8.5
Kia Sportage (2.0)	8.7

Source: Various / AmResearch

**TABLE 13 : SKYACTIV MAZDA 3 FUEL EFFICIENCY**

	Fuel consumption (litre per 100km)
Mazda 3 (2.0) SkyActiv	6.6
Mazda 3 (1.5) SkyActiv	4.7*
Toyota Vios (1.5)	6.3
Nissan Almera (1.5)	6.7
Honda City (1.5)	7.1
* Exact technical information yet to be released by Mazda, based on various external reviews	

Source: Various / AmResearch



**TABLE 14 : ASEAN DUTY STRUCTURE**

Tax description	Vietnam		Malaysia		Thailand		Indonesia		Philippines	
	CKD	CBU	CKD	CBU	CKD	CBU	CKD	CBU	CKD	CBU
Import duty										
- MFN rate	5%-45%	83%	10%	30%	0-30%	80%	10%	40%	10%	30%
- CEPT rate	5%	83%	0%	0%	0%	0%	0%	0%	0%	0%
Excise tax/SCT/LST	45%-60%	45%-60%	75%-105%	75%-105%	17%-40%	17%-40%	30%-75%	30%-75%	2%-60%	2%-60%
VAT/Sales tax	10%	10%	10%	10%	7%	7%	10%	10%	12%	12%
Interior tax					10%	10%				
Source: BOI Thailand, AmResearch		138%-								14%-
<b>Total tax</b>	<b>60%-120%</b>	<b>236%</b>	<b>85%-125%</b>	<b>85%-145%</b>	<b>34%-87%</b>	<b>34%-137%</b>	<b>40%-95%</b>	<b>40%-125%</b>	<b>14%-82%</b>	<b>102%</b>

**Auto parts sector potential beneficiary of massive scale creation**

The auto part sector is an indirect beneficiary of the scale created by the influx of new production capacity into the country, and at the same time, plays an important role in creating the foundation of a competitive export base for vehicle manufacturers.

At present, the local auto part industry significantly lacks scale which indirectly causes pricing to be on average 20% to 30% higher than key competitors in Thailand. As a result of the inward looking policies in the past, local vendors have been very reliant on national car manufacturers to drive scale,

However, the stumbling blocks faced by the national cars to penetrate the export market in a big way, and their reliance on the increasingly saturated local car market is dragging the development of local vendors.

The change in policies that are now more liberalised will result in the induction of massive amounts of new capacity, including for exports. Such scale creation will help drive down unit costs for local vendors and allow significantly more competitive pricing of vehicle parts.

While national car makers might initially be hit by increased competition, they will eventually be the biggest beneficiaries of lower parts pricing given very high localisation rates of 80%-90%.

Based on the 5-year business plans submitted by players, MAI estimates more than a doubling of total vehicle production in Malaysia to 1.3mil/annum by 2020 from an estimated 600,000 in FY13F.

**Localisation depth at levels never seen before**

Besides benefiting from scale, the depth of localisation encouraged by the EEV program will also benefit the auto parts industry. As an example, the Jazz hybrid entails a localisation rate of up to 72% (a level never seen before for a non-national model) versus a typical non-national localisation rate of 20%-50% currently.

More importantly, the IAF multiplier system is determined by several key factors:- (1) The technology level of the components localised i.e. localisation of a highly critical component such as hybrid systems or safety systems can allow a manufacturer to qualify for IAF multiplier of 1.4x-1.5x; (2) The level of localisation rate; (3) The amount of new production capacity and investment to be committed under the EEV program.

**TABLE 15 : IAF MULTIPLIER - GENERAL CLASSIFICATION**

<b>1x</b>	Current localization matching system
<b>1.1x-1.3x</b>	Localisation of EEV model
<b>1.4x-1.5x</b>	Localisation of critical components (e.g. hybrid management system, powertrain, <b>safety system</b> )
<b>1.6x</b>	Localize R&D of components

Source: MAI, AmResearch

**Developing vendor capabilities**

Another key thrust in the NAP review for the auto part sector is to increase the number of Level 4 and Level 5 vendors by upgrading their development capabilities.

At present, only 40-50 vendors in Malaysia qualify as Level 4 vendors (i.e. capable of tooling development, but requires OEM assistance for product design) and only 2 to 3 players qualify as Level 5 vendors (i.e. capable of product design). The rest are merely Level 3 vendors i.e. vendors that can only manufacture but require assistance for product design and tooling (for production line) development.

The development of vendor capability is critical in sustaining Malaysia's competitiveness as an export hub. Local auto part companies such as APM has already begun such transformation, making headway into component R&D and being involved in the early stages of a vehicle development.

APM had in 2010 embarked on a technical partnership with US based AltAir and later in 2012, embarked on a JV in Malaysia and Thailand with a renowned European parts maker, IAC Automotive. Both partnerships were meant to

deepen APM's R&D capability besides penetrating a new set of clientele, particularly US based and European based OEMs that have only started to expand in ASEAN in a big way.

As part of the new NAP, MAI has set a target of establishing at least 150 Level-4 vendors and 100 Level-5 vendors to support the development of a production hub in Malaysia.

Over RM2bil fund has been allocated under the new NAP for various development activities (See Table 16). Auto part players are positioned well to capitalise on most of the allocations e.g. human capital development, component technology pre-commercialisation and development of tools, dies and moulds.

Export of auto parts is targeted to double to RM10bil by 2020 from RM5bil in 2013. Export of remanufactured components is expected to contribute RM2bil to the total amount from zero currently.

**TABLE 16 : FUND ALLOCATION FOR NAP**

	Soft Loan	Amount (RMm)
1	Development of tool, die, mould	765
2	Component technology pre-commercialization	575
3	Competitiveness related activities	295
4	Establishment of distribution infrastructure	125
5	Development of EEV infrastructure	130
	<b>Total</b>	<b>1890</b>
	<b>Grants</b>	
1	Human capital development	100
2	Bumiputera development	75
	<b>Total</b>	<b>175</b>

Source: MAI, AmResearch estimates

#### □ *New foreign players entering the market*

We gather that the regulators are looking to issue 3 to 4 EEV manufacturing licenses to new foreign OEMs in the near-term. Recent newsflows suggests that China's Great Wall is one of them - committed to invest up to RM2bil to setup a regional production hub in Malaysia with an indicative 100K/annum production capacity. Great Wall is expected to commence investments by June 2014.

Besides Great Wall, we gather that the regulators are currently in talks with three other OEMs from Korea, US and Europe to setup production here. Our best guess here would be Hyundai from Korea, US based General Motors and Renault, a French carmaker.

None of the four carmakers are currently producing in Malaysia, nor have meaningful production capacity in ASEAN. While GM has a plant in Thailand, it mainly produces commercial vehicles and diesel engines.

#### □ *Exemption on duties for hybrids and EVs extended*

The exemption of excise duties and import taxes for hybrids and electric vehicles (EVs) will be extended for models that are assembled in Malaysia i.e. up to 31 Dec 2015 for hybrids and 31 Dec 2017 for EVs. Beyond these dates, the exemptions will be determined based on the strategic value of these CKD assembly investments.

#### □ *ELV policy reintroduction*

The End-of-Life Vehicle Policy (ELV) has been re-introduced under the new NAP. As a recap, the ELV policy was initially introduced in the 2009 NAP review – entailing mandatory annual inspection for cars above 15 years of age.

However, it received a political backlash as the majority of the lower income, rural community was using old cars and the ELV policy would have meant a sudden surge in cost for them to acquire new cars and the hassle to go through the annual inspection process.

This time around, the ELV policy will be implemented on a voluntary basis, while the inspection centres will be expanded to include qualified workshops. Currently, only DRB-owned Puspakom centres were certified to run the annual inspections. Puspakom only runs 55 inspection centres currently versus a required 300 centres.

### KEY PLAYS TO RIDE THIS THEME

#### □ *Non-nationals are immediate-term beneficiaries*

The non-national players are likely to be the immediate beneficiary of Malaysia's EEV program. This will come mainly from excise duty rebates for qualifying models, as well as the spillover impact on other variants that share common parts with the qualifying model.

The financial impact will come in two forms:-(1) Improved margins from lower duty cost; (2) Improved price positioning if part of the duty savings is passed on to consumers. The impact from duty savings can be significant as duty and tax accounts for up to 40% of a non-national manufacturer's cost of sales.

Key non-national players under our coverage that are likely to benefit are:

#### □ *1) Berjaya Auto (BUY, FV: RM2.30/share)*

Berjaya Auto distributes Mazda models for the Malaysian market and exports selective models to Thailand. Riding on the global rollout of Mazda's new generation fuel efficient SkyActiv technology, new Mazda models (starting with the CX5 launched in 2011) have been pre-qualified for Malaysia's EEV program.

Margins are expected to expand to 7% (net margin) in FY14F from 4.8% in FY13 despite introducing cheaper variants of the CX5 thanks to excise duty rebates under the EEV program. Two more SkyActiv equipped models are expected to be localised in FY15F, driving a massive earnings CAGR of 68% over FY13-16F.

As part of its strategy to increase overseas production, Malaysia has been identified by Mazda Japan as a regional export hub for the CX5 and Mazda 6 models, both of which will be initially exported to Thailand.

Mazda currently has no participation in Thailand's Eco Car program and Indonesia's LCGC program.

❑ **2) DRB-Hicom (BUY, FV: RM3.65/share)**

DRB-Hicom is an assembler of multiple non-national brands, of which two more prominent ones are Honda (34% owned – distribution and manufacturing) and VW (contract assembly and dealership). The group is also a distributor of Mitsubishi models and contract manufacturer of Mercedes makes in Malaysia.

Under its 5-year business plan submitted for the EEV program, Honda Malaysia is targeting to increase capacity by 150% to 100K (from 40K). Honda Japan has identified Malaysia as a hub to manufacture hybrids for the region. Its first locally manufactured hybrid model, the Jazz hybrid, went on sale in 2013. In the mid-term, Honda's global strategy is to introduce a hybrid variant for all sedan models that it produces.

In Indonesia, Honda has outlined the Brio Satya (a 1.2 litre compact city car) model to be produced under the LCGC program, while the base Honda Brio is manufactured under Thailand's Eco Car program.

❑ **3) Tan Chong Motors (HOLD, FV: RM6.00/share)**

Tan Chong manufactures and distributes Nissan models in Malaysia. It also contract manufactures various 3<sup>rd</sup> party passenger and commercial vehicles, including Mitsubishi.

Under its mid-term plan (up to end 2015), Tan Chong aims to increase production capacity for Nissan vehicles by close to 70% to 100K. As part of this, Tan Chong aims to introduce several new models including a high-volume A/B segment model. This will be the second model aimed to penetrate the national car segment after the Almera.

The group also aims to locally assemble the Nissan Serena Hybrid by 3Q14 to maintain excise duty exemption for the model.

Nissan is currently producing the March and Almera (1.2 litre variant) for domestic sale and exports under the Eco-Car program in Thailand.

In Malaysia, Nissan only owns 30% of the production plant and we think there is less motivation to use Malaysia as an outright export hub like Thailand, which is controlled by Nissan Japan. At the moment, there are no plans to export from Malaysia yet.

Nonetheless, Tan Chong also houses the Renault marque, which is looking to start local assembly of its models. We do not rule out possibilities of Renault coming in via the EEV route, which will benefit TCM as the sole distributor and potential partner in the manufacturing plant.

Should Renault qualify for EEV incentives, we see possibilities of Renault making Malaysia its regional hub, similar to its European counterparts VW (partnership with DRB-Hicom) and Peugeot (partnership with Naza Group).

❑ **4) UMW (HOLD, FV: RM13.10/share)**

While we understand that UMW has faced initial stumbling blocks in qualifying for the EEV program, Toyota's breadth of models positions UMW well to benefit from the program.

At this juncture, UMW has only unveiled plans to localise the hybrid variant of the Camry, of which the petrol engine variant is already being assembled here – albeit with a very low localisation rate of circa 30%.

Toyota Motor Corporation (Japan) has outlined the Toyota Agya and Daihatsu Ayla (a compact model) to be produced in Indonesia under the LCGC program, while a hatchback version of the Vios will be produced under Phase Two of Thailand's Eco Car program.

❑ **Beneficiaries of production scale creation**

The auto part sector and national car players are key beneficiaries of the scale created by the influx of local production capacity (both from new and existing players) and deeper localisation rates, albeit the benefits will only likely be felt a few years down the road for the national cars.

Total vehicle production is targeted to increase to 1.3mil from circa 600K in 2013, while a key criteria to qualify for IAF multipliers under the EEV incentive scheme is depth of localisation and critical components that are produced and developed locally.

❑ **1) APM (BUY, FV: RM6.40/share) – moving up the value chain**

APM is a key auto parts player in Malaysia and is likely to be the biggest beneficiary of the influx of new capacity. APM is one of the more diversified vendors that have a strong track record of supplying to non-national OEMs.

The group is moving up the value chain to be involved with OEMs at a new model's design stage and has struck a technical partnership with US based Altair and equity partnership with European based IAC Automotive for R&D expertise and access to new clients in new geographies.

As part of this move up the value chain, APM is gradually morphing into a supplier of modules (rather than single parts previously), which increases its value-add to OEMs and reduces the car assembly process done at the OEMs' plants.

❑ **2) MBM Resources (BUY, FV: RM4.35) – safety systems, wheels**

Hirota Holdings, 100% owned by MBM Resources, is the only airbag manufacturer in Malaysia and is potentially a big beneficiary.

To qualify for higher IAF multipliers of 1.4x-1.5x, OEMs are required to localise critical components which include safety systems such as airbags and seatbelts. To qualify for even

higher multiplier of 1.6x, an OEM is required to localise the R&D of such components.

Besides safety systems, MBM's subsidiaries are also involved in the manufacturing of alloy wheels and steel wheels, which is typically one of the basic components that are localised besides tyres and normal car batteries.

Meanwhile, the national car makers Proton and Perodua are eventual beneficiaries of more competitively priced local parts given their already high localisation rates.



**AmResearch**

**Company report**

# BERJAYA AUTO BHD

(BAUTO MK, BJAU.KL)

21 January 2014

*The new NAP: Catalysing a super-cycle growth story*

**BUY**

(Maintained)

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*Rationale for report: Company Update*

Price	RM1.73
Fair Value	RM2.30
52-week High/Low	RM1.82/RM0.70

**Key Changes**

Fair value	Unchanged
EPS	Unchanged

YE to Apr	FY13	FY14F	FY15F	FY16F
Revenue (RMmil)	1,064.4	1,433.4	1,851.2	2,007.2
Core net profit (RMmil)	50.9	107.4	136.7	152.0
EPS (Sen)	6.3	13.4	17.0	18.9
EPS growth (%)	n/a	110.8	27.3	11.2
Consensus EPS (Sen)	n/a	n/a	n/a	n/a
DPS (Sen)	0.0	4.0	4.3	4.7
PE (x)	27.3	12.9	10.2	9.1
EV/EBITDA (x)	15.4	8.2	6.6	5.5
Div yield (%)	0.0	2.3	2.5	2.7
ROE (%)	47.9	42.9	40.3	34.0
Net Gearing (%)	n/a	n/a	n/a	n/a

**Stock and Financial Data**

Shares Outstanding (million)	802.8
Market Cap (RMmil)	1,388.8
Book value (RM/share)	0.26
P/BV (x)	6.5
ROE (%)	47.9
Net Gearing (%)	n/a

Major Shareholders: Berjaya Group (67.6%), Podium Success (7.1%)

Free Float (%)	25.0
Avg Daily Value (RMmil)	9.3

**Price performance** 3mth 6mth 12mth

Absolute (%)  
Relative (%)



**Investment Highlights**

- We re-affirm our BUY call on BAUTO as the best proxy and immediate-term beneficiary of the new NAP riding on the global rollout of Mazda's new generation fuel efficient, SkyActiv equipped models which have all been pre-qualified for Malaysia's EEV program. Our fair value is maintained at RM2.30/share, based on 13x FY15F (YE April) earnings.
- Scope for earnings upside in the immediate-term:-
  - (1) BAUTO is applying for a second round of EEV incentives as it increases localisation and qualifies for higher excise duty rebates via the IAF system. The EEV duty incentives that BAUTO is currently enjoying are at the mid-to-lowest level of incentives and entail a lot of room to be enhanced; and
  - (2) Potential for further reduction in docket price for Mazda 6, following partial reduction in 2QFY14, which will result in further reduction in excise duties – excise duties for CBUs are charged against docket price which is determined by the customs.
- Introduction of the new generation, SkyActiv equipped Mazda 3 (C-segment sedan and hatchback) is a key near-term volume catalyst. The model will initially be introduced in higher capacity CBU variants within the next one month. A locally assembled 1.5 litre variant will be introduced when it is locally assembled by mid-CY14 and is expected to be priced in the high-volume B-segment price bracket.
- Additionally, the Mazda 6, introduced as CBU in May 2013, will also be locally assembled in 2HCY14, enabling more competitive pricing and incremental EEV tax incentives to kick-in. We project group EBITDA margins to improve to 11% in FY14F from 8% (FY13).
- Meanwhile, production hiccups faced by the CX5 is targeted to be resolved by end-3QFY14F, which will bring production volume up to 1,000 – 1,200 units a month from circa 300 - 400 units a month back in 2QFY14.
- Given that BAUTO is mainly exposed to the JPY, the stronger USD will have little impact on earnings, relative to non-national peers – UMW imports entirely in USD while Tan Chong has c.70% import exposure to the USD. The JPY is weakening against the MYR and is a positive earnings catalyst for BAUTO. Every 1% change impacts earnings by 6%.
- BAUTO is still deeply undervalued at 10x FY15F earnings relative to sector average of 12x given its strong earnings trajectory, status as a proxy to the upcoming EEV program, and exposure to high growth ASEAN auto markets. Key catalysts include:- (1) Launch of CBU Mazda 3 towards 4QFY14; (2) CKD Mazda 3 in 1Q- 2QFY15; (3) Launch of CKD Mazda 6 in 2QFY15, which will be accompanied by exports; (4) Incremental EEV tax incentive application.

CHART 1 : PB BAND CHART

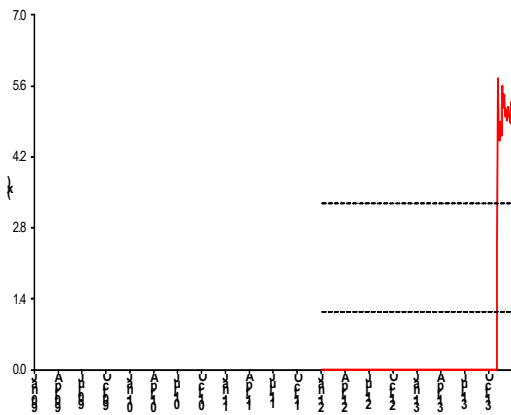


CHART 2 : PE BAND CHART

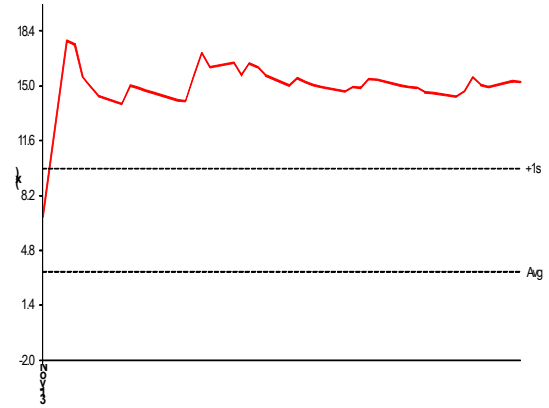


TABLE 1 : FINANCIAL DATA

Income Statement (RMmil, YE 30 Apr)	2013	2014F	2015F	2016F
Revenue	1,064.4	1,433.4	1,851.2	2,007.2
EBITDA	81.7	152.0	181.5	202.7
Depreciation	(6.1)	(9.4)	(11.9)	(13.7)
Operating income (EBIT)	75.6	142.6	170	189.0
Other income & associates	(1.5)	8.1	18.3	19.7
Net interest	(4.8)	(4.1)	(3.3)	(2.6)
Exceptional items	0.0	0.0	0.0	0.0
<b>Pretax profit</b>	<b>69.3</b>	<b>146.7</b>	<b>184.6</b>	<b>206.1</b>
Taxation	(17.2)	(34.6)	(41.6)	(46.6)
Minorities/pref dividends	(1.2)	(4.7)	(6.3)	(7.6)
<b>Net profit</b>	<b>50.9</b>	<b>107.4</b>	<b>136.7</b>	<b>152.0</b>
Core net profit	50.9	107.4	136.7	152.0
<b>Balance Sheet (RMmil, YE 30 Apr)</b>	<b>2013</b>	<b>2014F</b>	<b>2015F</b>	<b>2016F</b>
Fixed assets	20.3	30.2	37.5	43.0
Intangible assets	0.5	0.5	0.5	0.5
Other long-term assets	41.8	54.4	72.7	92.4
<b>Total non-current assets</b>	<b>62.6</b>	<b>85.1</b>	<b>110.7</b>	<b>135.9</b>
Cash & equivalent	240.0	228.2	235.7	291.2
Stock	193.8	261.0	337.0	365.4
Trade debtors	31.4	42.3	54.6	59.2
Other current assets	15.6	15.6	15.6	15.6
<b>Total current assets</b>	<b>480.8</b>	<b>547.1</b>	<b>643.0</b>	<b>731.5</b>
Trade creditors	83.2	112.0	144.6	156.8
Short-term borrowings	126.6	106.6	86.6	66.6
Other current liabilities	79.2	79.2	79.2	79.2
<b>Total current liabilities</b>	<b>288.9</b>	<b>297.7</b>	<b>310.4</b>	<b>302.5</b>
Long-term borrowings	2.4	2.4	2.4	2.4
Other long-term liabilities	32.2	32.2	32.2	32.2
<b>Total long-term liabilities</b>	<b>34.7</b>	<b>34.7</b>	<b>34.7</b>	<b>34.7</b>
<b>Shareholders' funds</b>	<b>212.6</b>	<b>287.8</b>	<b>390.3</b>	<b>504.3</b>
Minority interests	7.3	12.0	18.3	25.9
BV/share (RM)	0.26	0.36	0.49	0.63
<b>Cash Flow (RMmil, YE 30 Apr)</b>	<b>2013</b>	<b>2014F</b>	<b>2015F</b>	<b>2016F</b>
Pretax profit	69.3	146.7	184.6	206.1
Depreciation	6.1	9.4	11.9	13.7
Net change in working capital	126.3	(49.2)	(55.8)	(20.8)
Others	(148.6)	(42.0)	(59.1)	(65.6)
<b>Cash flow from operations</b>	<b>53.1</b>	<b>64.9</b>	<b>81.6</b>	<b>133.5</b>
Capital expenditure	(14.2)	(20.0)	(20.0)	(20.0)
Net investments & sale of fixed assets	(25.5)	(4.5)	0.0	0.0
Others	0.9	0.0	0.0	0.0
<b>Cash flow from investing</b>	<b>(38.8)</b>	<b>(24.5)</b>	<b>(20.0)</b>	<b>(20.0)</b>
Debt raised/(repaid)	89.6	(20.0)	(20.0)	(20.0)
Equity raised/(repaid)	64.2	0.0	0.0	0.0
Dividends paid	0.0	(32.1)	(34.2)	(38.0)
Others	(5.2)	0.0	0.0	0.0
<b>Cash flow from financing</b>	<b>148.5</b>	<b>(52.1)</b>	<b>(54.2)</b>	<b>(58.0)</b>
<b>Net cash flow</b>	<b>162.8</b>	<b>(11.7)</b>	<b>7.4</b>	<b>55.5</b>
<b>Net cash/(debt) b/f</b>	<b>77.2</b>	<b>240.0</b>	<b>228.2</b>	<b>235.7</b>
<b>Net cash/(debt) c/f</b>	<b>240.0</b>	<b>228.2</b>	<b>235.7</b>	<b>291.2</b>
<b>Key Ratios (YE 30 Apr)</b>	<b>2013</b>	<b>2014F</b>	<b>2015F</b>	<b>2016F</b>
Revenue growth (%)	n/a	34.7	29.1	8.4
EBITDA growth (%)	n/a	86.1	19.3	11.7
Pretax margins (%)	6.5	10.2	10.0	10.3
Net profit margins (%)	4.8	7.5	7.4	7.6
Interest cover (x)	15.7	35.1	51.1	73.4
Effective tax rate (%)	24.8	23.6	22.5	22.6
Net dividend payout (%)	0.0	29.9	25.0	25.0
Debtors turnover (days)	n/a	9	10	10
Stock turnover (days)	n/a	58	59	64
Creditors turnover (days)	n/a	25	25	27

Source: Company, AmResearch estimates



AmResearch

Company report

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APM AUTOMOTIVE

(APM MK)

20 January 2014

The new NAP: Catalysing a super-cycle growth story

BUY

(Upgraded)

Rationale for report: Thematic Research

Price RM5.72
Fair Value RM6.40
52-week High/Low RM6.06/RM4.90

Key Changes

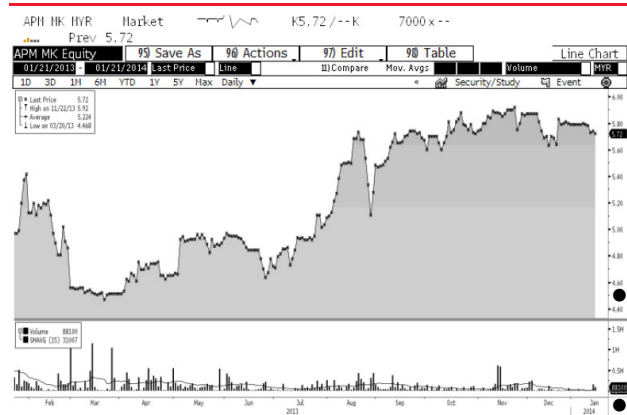
Fair value Raised
EPS Raised

Table with 5 columns: YE to Dec, FY12, FY13F, FY14F, FY15F. Rows include Revenue, Core net profit, EPS, EPS growth, Consensus EPS, DPS, PE, EV/EBITDA, Div yield, ROE, and Net Gearing.

Stock and Financial Data

Shares Outstanding (million) 201.6
Market Cap (RMmil) 1,153.2
Book value (RM/share) 4.20
P/BV (x) 1.4
ROE (%) 14.8
Major Shareholders: Parasand Limited (20.0%), Tan Chong Consolidated (17.0%)
Free Float (%) 15.0
Avg Daily Value (RMmil) n/a

Price performance table with columns: 3mth, 6mth, 12mth. Rows: Absolute (%), Relative (%).



Investment Highlights

We raise APM to BUY from HOLD and raise our fair value to RM6.40/share (from RM5.40/share previously), after raising our projections by 10%-16%. Our valuation pegs APM at 9x FY14F earnings at a 25% discount to auto manufacturer peers.

APM is a key beneficiary of the expected influx of new capacity into the market, riding on the launch of Malaysia's Energy Efficient Vehicle (EEV) program. MAI targets total vehicle production to more than double to 1.3mil by 2020 from an estimated 600,000 in 2013. In the immediate term, the volume growth will be primarily driven by:-

(1) Honda Malaysia's capacity expansion to 100K from 40K-50K following Honda Japan's decision to make Malaysia its regional hybrid production hub. Targeting localisation rate to increase to over 70% from 40% currently;

(2) System supplies to Mazda Malaysia - CX5 and upcoming Mazda 3 and 6. Both the CX5 and Mazda 6 are also slated for exports out of the Malaysian plant which APM supplies to. Honda and Mazda are two of APM's top 10 customers;

(3) Proton's capacity expansion to 420,000 units/annum from 360,000 driven by its Global Small Car launch with a targeted initial volume of 5,000/month (60,000/annum on average). In the mid-term, Proton plans to sell up to 500,000 cars per annum (2017/18 target); and

(3) Doubling in Perodua's capacity within the next 12 months; new plant to be operational by mid-FY14, but it might encounter teething problems initially. By 2H14, launch of the new Viva with a targeted volume of 4.5K-5.5K/month.

APM's Indonesian unit, which is a Tier-1 supplier to Daihatsu is likely to see earnings catalysed by Indonesia's recently launched Low Cost Green Car (LCGC) program, which focuses on making Indonesia a production hub for cheap, fuel efficient minicars. Daihatsu, via its Ayla model, is the first to participate in the program. Around 5mil Indonesian household is expected to be able to afford a car by 2020, more than double the 2010 figure, thanks to the LCGC initiative. APM's overseas units and exports currently account for 9% of revenue.

Meanwhile, the impact of vendor cost-down since late 2012 is likely to reach a bottom by mid-FY14 and takes away a key earnings risk which led to our downgrade previously.

At 8x FY14F earnings, APM is a cheap proxy to the new NAP, despite being one of the key indirect beneficiaries of the measures announced. Attractive dividend yield of 5.6% (45% payout ratio) provides cushion to any share price weakness. Renault, which has been exploring local assembly of its models (likely via APM's sister company, Tan Chong) is a potential upside catalyst in the near-term.



TABLE 17 : FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	2011	2012	2013F	2014F	2015F
Revenue	1,267.4	1,299.8	1,138.7	1,243.0	1,347.1
EBITDA	228.2	222.1	240.5	258.5	283.9
Depreciation	(41.7)	(44.6)	(50.2)	(47.6)	(55.3)
Operating income (EBIT)	186.4	177.6	190.2	211	228.6
Other income & associates	0.0	0.0	0.0	0.0	0.0
Net interest	10.4	10.4	10.4	10.4	10.4
Exceptional items	0.0	0.0	0.0	0.0	0.0
<b>Pretax profit</b>	<b>196.8</b>	<b>188.0</b>	<b>200.7</b>	<b>221.3</b>	<b>239.0</b>
Taxation	(50.8)	(48.9)	(52.2)	(57.5)	(62.1)
Minorities/pref dividends	(19.0)	(18.1)	(19.3)	(21.3)	(23.0)
<b>Net profit</b>	<b>127.1</b>	<b>121.0</b>	<b>129.2</b>	<b>142.4</b>	<b>153.9</b>
Core net profit	127.1	121.0	129.2	142.4	153.9
<b>Balance Sheet (RMmil, YE 31 Dec)</b>	<b>2011</b>	<b>2012</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>
Fixed assets	307.9	313.3	363.1	485.5	600.2
Intangible assets	1.5	1.5	1.5	1.5	1.5
Other long-term assets	53.2	53.2	53.2	53.2	53.2
<b>Total non-current assets</b>	<b>362.7</b>	<b>368.1</b>	<b>417.9</b>	<b>540.2</b>	<b>655.0</b>
Cash & equivalent	308.7	375.8	242.6	288.3	261.9
Stock	204.5	209.7	318.8	248.6	269.4
Trade debtors	221.0	226.6	227.7	248.6	269.4
Other current assets	0.0	0.0	0.0	0.0	0.0
<b>Total current assets</b>	<b>734.2</b>	<b>812.2</b>	<b>789.2</b>	<b>785.5</b>	<b>800.7</b>
Trade creditors	222.9	231.7	190.7	210.1	227.7
Short-term borrowings	4.1	4.1	4.1	4.1	4.1
Other current liabilities	6.8	6.8	6.8	6.8	6.8
<b>Total current liabilities</b>	<b>233.8</b>	<b>242.6</b>	<b>201.6</b>	<b>221.0</b>	<b>238.6</b>
Long-term borrowings	0.0	0.0	0.0	0.0	0.0
Other long-term liabilities	18.3	18.3	18.3	18.3	18.3
<b>Total long-term liabilities</b>	<b>18.3</b>	<b>18.3</b>	<b>18.3</b>	<b>18.3</b>	<b>18.3</b>
<b>Shareholders' funds</b>	<b>789.4</b>	<b>845.9</b>	<b>894.4</b>	<b>972.3</b>	<b>1,061.7</b>
Minority interests	55.4	73.5	92.8	114.1	137.1
BV/share (RM)	3.92	4.20	4.44	4.82	5.27
<b>Cash Flow (RMmil, YE 31 Dec)</b>	<b>2011</b>	<b>2012</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>
Pretax profit	196.8	188.0	200.7	221.3	239.0
Depreciation	41.7	44.6	50.2	47.6	55.3
Net change in working capital	(5.0)	(2.1)	(151.3)	68.8	(24.0)
Others	(50.8)	(48.9)	(52.2)	(57.5)	(62.1)
<b>Cash flow from operations</b>	<b>182.8</b>	<b>181.6</b>	<b>47.4</b>	<b>280.2</b>	<b>208.1</b>
Capital expenditure	(80.0)	(50.0)	(100.0)	(170.0)	(170.0)
Net investments & sale of fixed assets	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0
<b>Cash flow from investing</b>	<b>(80.0)</b>	<b>(50.0)</b>	<b>(100.0)</b>	<b>(170.0)</b>	<b>(170.0)</b>
Debt raised/(repaid)	0.0	0.0	0.0	0.0	0.0
Equity raised/(repaid)	0.0	0.0	0.0	1.0	2.0
Dividends paid	(64.5)	(64.5)	(80.6)	(64.5)	(64.5)
Others	0.0	0.0	0.0	(1.0)	(2.0)
<b>Cash flow from financing</b>	<b>(64.5)</b>	<b>(64.5)</b>	<b>(80.6)</b>	<b>(64.5)</b>	<b>(64.5)</b>
<b>Net cash flow</b>	<b>38.3</b>	<b>67.1</b>	<b>(133.2)</b>	<b>45.6</b>	<b>(26.4)</b>
<b>Net cash/(debt) b/f</b>	<b>270.0</b>	<b>308.3</b>	<b>375.4</b>	<b>242.2</b>	<b>287.8</b>
<b>Net cash/(debt) c/f</b>	<b>308.3</b>	<b>375.4</b>	<b>242.2</b>	<b>287.8</b>	<b>261.4</b>
<b>Key Ratios (YE 31 Dec)</b>	<b>2011</b>	<b>2012</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>
Revenue growth (%)	5.0	2.6	n/a	9.2	8.4
EBITDA growth (%)	n/a	n/a	8.3	7.5	9.8
Pretax margins (%)	15.5	14.5	17.6	17.8	17.7
Net profit margins (%)	10.0	9.3	11.3	11.5	11.4
Interest cover (x)	325.3	309.9	332.0	367.9	399.0
Effective tax rate (%)	25.8	26.0	26.0	26.0	26.0
Net dividend payout (%)	50.8	53.3	62.4	45.3	41.9
Debtors turnover (days)	62	63	73	70	70
Stock turnover (days)	57	58	85	83	70
Creditors turnover (days)	62	64	68	59	59

Source: Company, AmResearch estimates


**AmResearch**
**Company report**
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# TAN CHONG MOTOR

(TCM MK, TNCS.KL)

21 January 2014

*The new NAP: Catalysing a super-cycle growth story*
**HOLD**

(Downgraded)

*Rationale for report: Company Update*

Price	RM5.60
Fair Value	RM6.00
52-week High/Low	RM7.01/RM4.93

**Key Changes**

Fair value	Downgraded
EPS	Downgraded

YE to Dec	FY12	FY13F	FY14F	FY15F
Revenue (RMmil)	4,086.1	5,759.5	6,397.5	6,702.9
Core net profit (RMmil)	158.1	322.2	326.1	369.9
EPS (Sen)	23.5	47.9	48.5	55.0
EPS growth (%)	n/a	103.8	1.2	13.3
Consensus EPS (Sen)	n/a	n/a	n/a	n/a
DPS (Sen)	8.7	10.5	10.5	10.5
PE (x)	23.8	11.7	11.5	10.2
EV/EBITDA (x)	15.4	7.7	7.1	6.1
Div yield (%)	1.6	1.9	1.9	1.9
ROE (%)	8.4	13.1	14.4	14.5
Net Gearing (%)	28.7	19.2	10.7	2.0

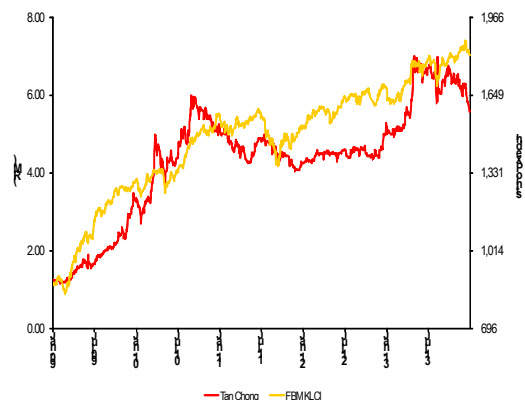
**Stock and Financial Data**

Shares Outstanding (million)	672.0
Market Cap (RMmil)	3,763.2
Book value (RM/share)	2.88
P/BV (x)	1.9
ROE (%)	8.4
Net Gearing (%)	28.7

Major Shareholders	Tan Chong Consolidated (46.0%) Nissan Motor Co Ltd (6.0%)
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Free Float (%)	30.0
Avg Daily Value (RMmil)	2.0

Price performance	3mth	6mth	12mth
Absolute (%)	(16.6)	(14.4)	5.9
Relative (%)	(17.4)	(15.8)	(2.0)


**Investment Highlights**

- We downgrade Tan Chong Motor (TCM) to HOLD from BUY and lower our fair value to RM6.00/share (from RM7.30/share previously) as we cut earnings by 7%-9% in this report.
- We now expect flattish earnings growth in FY14F, primarily driven by the strengthening USD, which will have a negative bearing on earnings. We now model in USD:MYR rate at RM3.20 (from RM3.10 previously) over FY14F-15F. Every 1% change in USD impacts earnings by 3.5%. The upward earnings revision cycle seen for TCM over the past 12 months is now peaking.
- Furthermore, the earnings kicker from the Almera is reaching a tail-end given new competition from the new Vios, launched in late-2013 and the upcoming new City (which may come in hybrid variants as well). Price for the Almera was discounted by up to RM3,000 since 3Q13, while Honda has been giving even higher RM5,000 rebates for its City – likely to clear off existing inventory before the launch of the new generation City.
- While TCM is a beneficiary of the NAP, which outlined further extension of duty exemptions for locally assembled hybrids up to end FY15, this simply means status quo in terms of tax benefits accruing to the group as hybrids have been enjoying excise and import duty exemptions over the past three years.
- The CKD Serena Hybrid is likely to be introduced sometime in 2H14 and may possibly entail some downward price adjustments (less than 15% on our estimates) via the introduction of new variants.
- In the medium-term, the introduction of a high volume A/B segment model in FY15F could turn out to be a strong volume catalyst and we do not rule out possibilities that this model will be qualified as an EEV. However, there is no firm indication on launch of the model yet.
- The rollout of EEV qualified models e.g. potentially the new Honda City and the new Mazda 3 will put a dent on volume growth momentum for Nissan in the near-term.
- However, on the bright side, possibilities of Renault embarking on local assembly (TCM is the official distributor of Renault models in Malaysia currently), capitalising on the EEV program is an upside catalyst. We think this could kick-off pretty quickly via TCM's Segambut plant, if it materialises, but new model rollout and volume indications are likely to be mediocre in the immediate-term, relative to TCM's total sales volume.

CHART 1 : PB BAND CHART



CHART 2 : PE BAND CHART

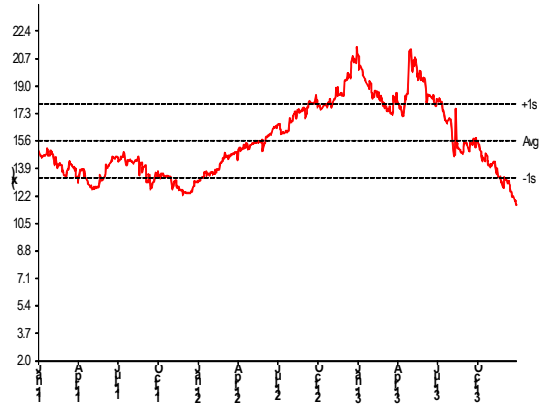


TABLE 1 : FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	2011	2012	2013F	2014F	2015F
Revenue	3,585.4	4,086.1	5,759.5	6,397.5	6,702.9
EBITDA	327.2	293.9	549.3	567.2	627.3
Depreciation	(32.3)	(49.8)	(65.8)	(104.2)	(103.4)
Operating income (EBIT)	294.9	244.2	483.5	463	523.9
Other income & associates	1.5	1.5	1.5	1.5	1.5
Net interest	(19.9)	(27.9)	(22.8)	(24.4)	(26.1)
Exceptional items	0.0	0.0	(56.0)	0.0	0.0
<b>Pretax profit</b>	<b>276.5</b>	<b>217.8</b>	<b>406.2</b>	<b>440.1</b>	<b>499.3</b>
Taxation	(52.3)	(61.4)	(136.0)	(109.7)	(124.5)
Minorities/pref dividends	(2.8)	1.8	(4.0)	(4.4)	(5.0)
<b>Net profit</b>	<b>221.5</b>	<b>158.1</b>	<b>266.2</b>	<b>326.1</b>	<b>369.9</b>
Core net profit	221.5	158.1	322.2	326.1	369.9
<b>Balance Sheet (RMmil, YE 31 Dec)</b>	<b>2011</b>	<b>2012</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>
Fixed assets	632.6	858.4	1,257.0	1,302.8	1,349.5
Intangible assets	0.0	0.0	0.0	0.0	0.0
Other long-term assets	435.7	353.8	438.7	440.2	441.7
<b>Total non-current assets</b>	<b>1,068.2</b>	<b>1,212.2</b>	<b>1,695.7</b>	<b>1,743.0</b>	<b>1,791.1</b>
Cash & equivalent	474.0	634.4	332.7	548.5	775.2
Stock	717.1	1,412.2	748.7	831.7	871.4
Trade debtors	215.1	417.8	460.8	511.8	536.2
Other current assets	551.1	261.3	613.0	629.0	640.2
<b>Total current assets</b>	<b>1,957.4</b>	<b>2,725.8</b>	<b>2,155.2</b>	<b>2,520.9</b>	<b>2,823.0</b>
Trade creditors	322.7	502.6	518.4	639.8	670.3
Short-term borrowings	427.3	1,052.5	471.1	494.6	519.4
Other current liabilities	197.9	10.0	320.1	358.2	379.0
<b>Total current liabilities</b>	<b>947.8</b>	<b>1,565.0</b>	<b>1,309.5</b>	<b>1,492.6</b>	<b>1,568.7</b>
Long-term borrowings	200.6	365.2	370.6	340.6	310.6
Other long-term liabilities	31.0	64.5	31.0	31.0	31.0
<b>Total long-term liabilities</b>	<b>231.6</b>	<b>429.6</b>	<b>401.6</b>	<b>371.6</b>	<b>341.6</b>
<b>Shareholders' funds</b>	<b>1,842.1</b>	<b>1,937.2</b>	<b>2,135.4</b>	<b>2,395.3</b>	<b>2,699.5</b>
Minority interests	4.4	6.1	4.4	4.4	4.4
BV/share (RM)	2.74	2.88	3.18	3.56	4.01
<b>Cash Flow (RMmil, YE 31 Dec)</b>	<b>2011</b>	<b>2012</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>
Pretax profit	276.5	217.8	406.2	440.1	499.3
Depreciation	32.3	49.8	65.8	104.2	103.4
Net change in working capital	118.1	52.8	(392.0)	(149.9)	(75.4)
Others	(81.4)	(314.6)	143.4	42.6	(80.3)
<b>Cash flow from operations</b>	<b>345.6</b>	<b>5.7</b>	<b>223.5</b>	<b>437.0</b>	<b>447.0</b>
Capital expenditure	(250.0)	(290.4)	(490.0)	(150.0)	(150.0)
Net investments & sale of fixed assets	0.0	125.0	0.0	0.0	0.0
Others	5.7	(88.4)	5.7	5.7	5.7
<b>Cash flow from investing</b>	<b>(244.3)</b>	<b>(253.8)</b>	<b>(484.3)</b>	<b>(144.3)</b>	<b>(144.3)</b>
Debt raised/(repaid)	(9.7)	(8.6)	222.4	(6.4)	(5.3)
Equity raised/(repaid)	0.0	0.0	0.0	0.0	0.0
Dividends paid	(65.5)	(58.8)	(70.6)	(70.6)	(70.7)
Others	0.0	626.5	0.0	0.0	0.0
<b>Cash flow from financing</b>	<b>(75.2)</b>	<b>559.1</b>	<b>151.9</b>	<b>(77.0)</b>	<b>(75.9)</b>
<b>Net cash flow</b>	<b>26.1</b>	<b>311.1</b>	<b>(108.9)</b>	<b>215.7</b>	<b>226.8</b>
<b>Net cash/(debt) b/f</b>	<b>447.9</b>	<b>474.0</b>	<b>785.1</b>	<b>676.1</b>	<b>891.9</b>
<b>Net cash/(debt) c/f</b>	<b>474.0</b>	<b>785.1</b>	<b>676.1</b>	<b>891.9</b>	<b>1,118.6</b>
<b>Key Ratios (YE 31 Dec)</b>	<b>2011</b>	<b>2012</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>
Revenue growth (%)	n/a	14.0	41.0	11.1	4.8
EBITDA growth (%)	n/a	n/a	86.9	3.3	10.6
Pretax margins (%)	7.7	5.3	7.1	6.9	7.4
Net profit margins (%)	6.2	3.9	4.6	5.1	5.5
Interest cover (x)	10.2	5.7	15.2	13.9	14.9
Effective tax rate (%)	18.9	28.2	33.5	24.9	24.9
Net dividend payout (%)	29.6	37.2	26.5	21.6	19.1
Debtors turnover (days)	26	28	28	28	29
Stock turnover (days)	75	95	68	45	46
Creditors turnover (days)	34	37	32	33	36

Source: Company, AmResearch estimates



# UMW HOLDINGS

(UMWH MK, UMWS.KL)

20 January 2014

The new NAP: Catalysing a super-cycle growth story

**HOLD**

(Maintained)

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Rationale for report: Company Update

Price	RM11.58
Fair Value	RM13.10
52-week High/Low	RM14.76/RM11.50

**Key Changes**

Fair value	Increased
EPS	Reduced

YE to Dec	FY12	FY13F	FY14F	FY15F
Revenue (RMmil)	13,862.0	13,456.1	14,192.0	14,767.7
Core net profit (RMmil)	951.7	890.6	1,044.9	1,102.4
EPS (Sen)	81.5	76.2	89.4	94.4
EPS growth (%)	63.0	n/a	17.3	5.5
Consensus EPS (Sen)	n/a	n/a	n/a	n/a
DPS (Sen)	40.7	38.1	44.7	47.2
PE (x)	14.2	15.2	12.9	12.3
EV/EBITDA (x)	6.2	6.6	4.8	4.1
Div yield (%)	3.5	3.3	3.9	4.1
ROE (%)	21.1	17.9	18.1	16.6
Net Gearing (%)	14.8	13.8	3.4	n/a

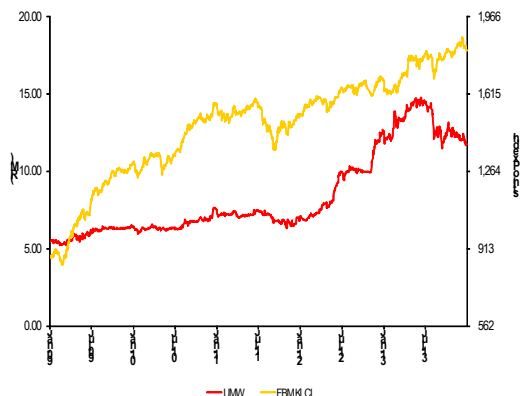
**Stock and Financial Data**

Shares Outstanding (million)	1,168.3
Market Cap (RMmil)	13,528.9
Book value (RM/share)	4.07
P/BV (x)	2.8
ROE (%)	21.1
Net Gearing (%)	14.8

Major Shareholders	Skim ASB (36.0%) EPF (15.0%)
--------------------	---------------------------------

Free Float (%)	25.0
Avg Daily Value (RMmil)	19.3

Price performance	3mth	6mth	12mth
Absolute (%)	(4.6)	(19.5)	(5.7)
Relative (%)	(7.4)	(22.3)	(14.7)



**Investment Highlights**

- **UMW remains a HOLD but we raise our fair value to RM13.10/share (from RM11.70/share previously) as we rollover our valuations to end-FY14F and following earnings revisions in this report.**
- **While UMW benefits from having a very strong principal in Toyota Motor Corp to funnel it with models to qualify for the EEV program, there is little clarity on UMW's strategy at this juncture.**
- **While UMW had indicated that it is trying to qualify its Camry Hybrid model for the program – which if approved, could allow its base Camry model to be priced more competitively given the common part benefits – we understand from channel checks that it has not been entirely approved for the EEV program yet. The Camry is estimated to account for 14% of Toyota TIV.**
- **Furthermore, UMW Toyota's plant in Shah Alam has little room to be expanded beyond the 90K units/annum capacity currently (estimated to be running at 80%-90% utilisation), suggesting that UMW may need to invest in a new plant in order to become a full-fledged participant of the EEV program. This will likely entail some gestation period before it is reflected in earnings.**
- **For FY14F, we expect Toyota sales to rebound slightly to 102K units (+8.7% YoY) following a weak 2013; FY13F sales volume is estimated at 93,656 units (-7% YoY). The new Vios launched in October 2013 has now garnered 20,000 bookings versus management's target of 3,000/month. However, the upcoming launch of the new Honda City, which may come in hybrid variants and qualify for EEV incentives, is likely to pose serious competition in the immediate-term.**
- **The new generation C-segment Altis to be launched this year (priced at RM114K-136K) will also see competition from the all new Mazda 3, which has been pre-qualified as an EEV model and will benefit from the accompanying duty incentives. The higher variant (2 litre) Mazda 3 is positioned in the core C-segment (competing head-on with the Altis) while a much cheaper 1.5 litre variant will be positioned within the B-segment price bracket (potentially giving the higher spec variants of the Vios a run for their money).**
- **On top of this, the strengthening USD will put a dent on earnings momentum in the near-term as UMW Toyota imports entirely in USD. We now model in USD:MYR rate at RM3.20 (versus RM3.10 previously), resulting in 3%-5% reductions in earnings over FY14F-15F. Every 1% change in USD impacts earnings by 3%.**

CHART 1 : PB BAND CHART

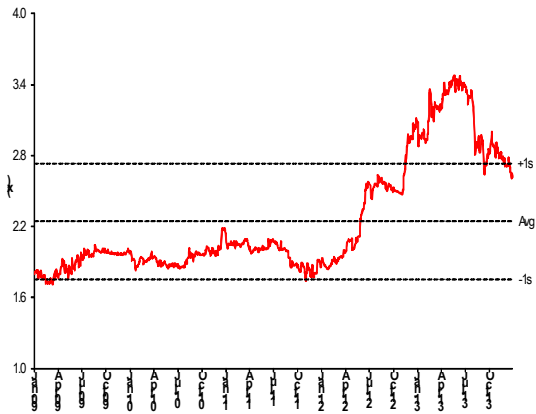


CHART 2 : PE BAND CHART

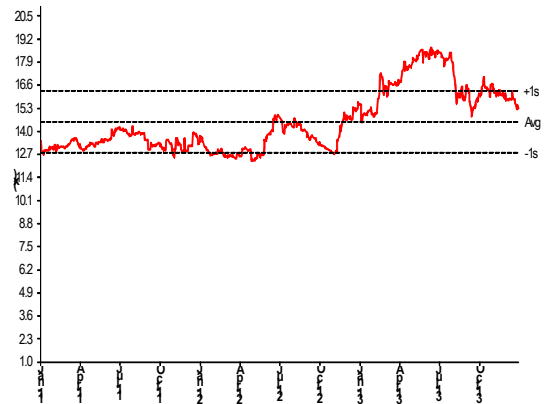


TABLE 1 : FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	2011	2012	2013F	2014F	2015F
Revenue	11,374.8	13,862.0	13,456.1	14,192.0	14,767.7
EBITDA	1,480.7	2,267.4	2,111.1	2,756.8	2,988.0
Depreciation	(347.1)	(359.5)	(434.2)	(498.0)	(553.7)
Operating income (EBIT)	1,133.6	1,907.9	1,676.9	2,259	2,434.3
Other income & associates	228.0	177.2	247.1	267.7	295.2
Net interest	(4.6)	(4.3)	(3.9)	(3.6)	(3.3)
Exceptional items	0.0	0.0	0.0	0.0	0.0
<b>Pretax profit</b>	<b>1,357.0</b>	<b>2,080.9</b>	<b>1,920.1</b>	<b>2,522.9</b>	<b>2,726.2</b>
Taxation	(372.6)	(475.9)	(418.3)	(563.8)	(607.8)
Minorities/pref dividends	(400.7)	(653.2)	(611.3)	(914.2)	(1,016.1)
<b>Net profit</b>	<b>583.8</b>	<b>951.7</b>	<b>890.6</b>	<b>1,044.9</b>	<b>1,102.4</b>
Core net profit	583.8	951.7	890.6	1,044.9	1,102.4
<b>Balance Sheet (RMmil, YE 31 Dec)</b>	<b>2011</b>	<b>2012</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>
Fixed assets	2,765.6	3,340.1	3,830.9	4,258.9	3,959.2
Intangible assets	247.4	247.4	247.4	247.4	247.4
Other long-term assets	2,161.8	2,339.0	2,586.1	2,853.8	3,149.0
<b>Total non-current assets</b>	<b>5,174.8</b>	<b>5,926.5</b>	<b>6,664.4</b>	<b>7,360.1</b>	<b>7,355.6</b>
Cash & equivalent	1,458.0	1,547.7	1,492.3	2,239.2	3,129.1
Stock	1,365.0	1,663.4	1,614.7	1,703.0	1,772.1
Trade debtors	1,137.5	1,386.2	1,345.6	1,419.2	1,476.8
Other current assets	1,341.5	1,341.5	1,341.5	1,341.5	1,341.5
<b>Total current assets</b>	<b>5,301.9</b>	<b>5,938.8</b>	<b>5,794.1</b>	<b>6,702.9</b>	<b>7,719.5</b>
Trade creditors	1,365.0	1,524.8	1,614.7	1,703.0	1,772.1
Short-term borrowings	289.0	289.0	289.0	289.0	289.0
Other current liabilities	1,217.6	1,275.5	1,262.7	1,310.9	1,327.2
<b>Total current liabilities</b>	<b>2,871.6</b>	<b>3,089.3</b>	<b>3,166.4</b>	<b>3,302.9</b>	<b>3,388.3</b>
Long-term borrowings	1,773.8	2,338.5	2,288.5	2,238.5	2,188.5
Other long-term liabilities	247.2	247.2	247.2	247.2	247.2
<b>Total long-term liabilities</b>	<b>2,021.0</b>	<b>2,585.7</b>	<b>2,535.7</b>	<b>2,485.7</b>	<b>2,435.7</b>
<b>Shareholders' funds</b>	<b>4,273.3</b>	<b>4,749.2</b>	<b>5,194.5</b>	<b>6,364.8</b>	<b>6,916.0</b>
Minority interests	1,320.9	1,451.2	1,573.0	1,913.0	2,323.4
BV/share (RM)	3.66	4.07	4.45	5.45	5.92
<b>Cash Flow (RMmil, YE 31 Dec)</b>	<b>2011</b>	<b>2012</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>
Pretax profit	1,357.0	2,080.9	1,920.1	2,522.9	2,726.2
Depreciation	347.1	359.5	434.2	498.0	553.7
Net change in working capital	(162.7)	(329.4)	166.3	(25.4)	(41.3)
Others	(600.6)	(653.2)	(665.4)	(831.5)	(902.9)
<b>Cash flow from operations</b>	<b>940.8</b>	<b>1,457.8</b>	<b>1,855.3</b>	<b>2,164.0</b>	<b>2,335.7</b>
Capital expenditure	(593.0)	(1,083.0)	(1,073.0)	(1,073.0)	(400.0)
Net investments & sale of fixed assets	96.5	108.8	117.9	124.4	129.1
Others	0.0	0.0	0.0	0.0	1.0
<b>Cash flow from investing</b>	<b>(496.5)</b>	<b>(974.2)</b>	<b>(955.1)</b>	<b>(948.6)</b>	<b>(269.9)</b>
Debt raised/(repaid)	(50.0)	564.7	(50.0)	(50.0)	(50.0)
Equity raised/(repaid)	0.0	0.0	0.0	647.9	0.0
Dividends paid	(733.4)	(998.9)	(934.7)	(1,096.6)	(1,156.9)
Others	53.5	40.2	29.2	30.2	31.2
<b>Cash flow from financing</b>	<b>(729.9)</b>	<b>(394.0)</b>	<b>(955.5)</b>	<b>(468.6)</b>	<b>(1,175.8)</b>
<b>Net cash flow</b>	<b>(285.6)</b>	<b>89.7</b>	<b>(55.3)</b>	<b>746.8</b>	<b>889.9</b>
<b>Net cash/(debt) b/f</b>	<b>1,743.6</b>	<b>1,458.0</b>	<b>1,547.7</b>	<b>1,492.3</b>	<b>2,239.2</b>
<b>Net cash/(debt) c/f</b>	<b>1,458.0</b>	<b>1,547.7</b>	<b>1,492.3</b>	<b>2,239.2</b>	<b>3,129.1</b>
<b>Key Ratios (YE 31 Dec)</b>	<b>2011</b>	<b>2012</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>
Revenue growth (%)	4.0	21.9	n/a	5.5	4.1
EBITDA growth (%)	n/a	53.1	n/a	30.6	8.4
Pretax margins (%)	11.9	15.0	14.3	17.8	18.5
Net profit margins (%)	5.1	6.9	6.6	7.4	7.5
Interest cover (x)	30.2	50.8	44.7	60.2	64.9
Effective tax rate (%)	27.5	22.9	21.8	22.3	22.3
Net dividend payout (%)	44.9	37.5	37.5	37.5	(12.5)
Debtors turnover (days)	36	33	37	36	36
Stock turnover (days)	43	40	44	43	43
Creditors turnover (days)	45	38	43	43	43

Source: Company, AmResearch estimates

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