23 March 2015 | Initiate Coverage

Berjaya Auto Berhad

High on expectations

***Initiate with* Buy**
Target Price (TP): RM4.70

INVESTMENT HIGHLIGHTS

- **We initiate coverage on Berjaya Auto (BAuto) with a Buy call on the stock and a TP of RM4.70. This implies an FY15 PER of 16.9x and 7.2x PBV before easing to 14.8x FY16 PER and 5.7x PBV.**
- **We like BAuto for its asset-light business model which translates into efficient capital structure, good earnings quality and strong earnings growth.**
- **Going forward, we expect Mazda's vehicle sales to increase to over 15k units in FY15 and over 18k units in FY16 driven by new model launches and introduction of CKD models.**
- **We expect BAuto's earnings to grow at 40.5% CAGR over FY14 to FY16. Apart from stronger sales, we also expect the Yen to remain at favourable level.**

Company background. BAuto is the exclusive distributor of Mazda vehicles in Malaysia and Philippines. Unlike its peers, the company operates an asset-light business model with only 7 outlets out of the entire network of 78 sales outlets in Malaysia. Meanwhile, in the Philippines, BAuto's is only limited to being the exclusive distributor of Mazda vehicles which garners better margin.

Earnings outlook. We expect BAuto's earnings to continue to post robust growth of 75% in FY15 to RM225m before it eases to 14% in FY16 to RM258m. The strong growth is driven by higher sales volume which is slated to grow 31% to over 15k units in FY15 and a further 22% to over 18k units in FY16. We expect demand to remain robust with introduction of new models and CKD versions of existing models.

Currency outlook. In addition, we expect the RM/¥100 exchange rate to remain at favourable levels over the medium to long term while further QE measures by the Japan Central Bank would be positive for the stock. We have assumed RM3.05/¥100 in FY15 before increasing to RM3.08/¥100 in FY16. The higher FY16 assumption is to reflect the Ringgit's weakness in view of the current volatile crude oil price.

Strong ROE and ROIC returns. As a result of its asset-light business model, BAuto generates strong ROE and ROIC returns of over 50% and 80% respectively in FY14. We expect these returns to remain at healthy levels in subsequent years driven by higher net margin and asset turnover.

BUY BAuto, TP: RM4.70. We initiate BAuto with a Buy call on the stock and a GGM-derived TP of RM4.70. Our GGM model assumes a sustainable ROIC of 69%, COE of 10% and a terminal growth rate of 3%. At our TP, the stock implies FY15 PER of 16.9x and 7.2x PBV before easing to 14.8x FY16 PER and 5.7x PBV. It also implies a 25% upside from current share price level. We also see further upside to BAuto's dividend payout going forward as we expect the stock's FCF generation to strengthen to over RM100m.

RETURN STATS	
Price (20 Mar '15)	RM3.74
Target Price	RM4.70
Expected Share Price Return	+25.2%
Expected Dividend Yield	+3.8%
Expected Total Return	**+29.0%**

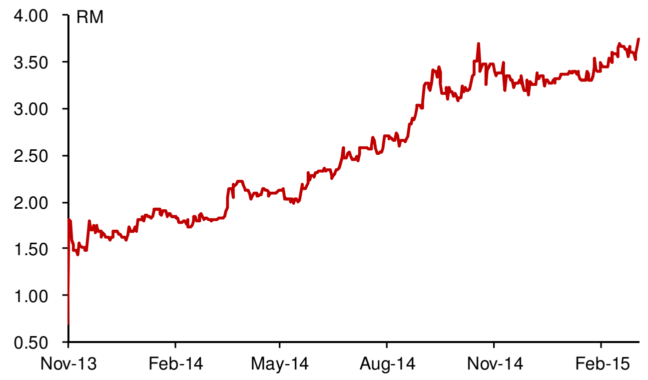
STOCK INFO	
KLCI	1,803.7
Bursa / Bloomberg	5248 / BAUTO MK
Board / Sector	Main / Consumer
Syariah Compliant	Yes
Issued shares (mil)	813.1
Par Value (RM)	0.50
Market cap. (RM'm)	3,041.1
Price over NA	8.78x
52-wk price Range	RM1.80-RM3.76
Beta (against KLCI)	NA
3-mth Avg Daily Vol	1.56m
3-mth Avg Daily Value	RM5.40m
Major Shareholders (%)	
Berjaya Group	35.23
Podium Success	6.14
EPF	5.59

INVESTMENT THESIS

Strong listing debut. BAuto made a strong listing debut on 18 Nov 2013 to raise RM57.9m which mostly went to finance its working capital and capital expenditure. Its share price rose by more than 3-fold from its issue price of RM0.70 to RM2.20 before settling at RM1.82 within the first day while it closed at RM1.65 at the end of CY13.

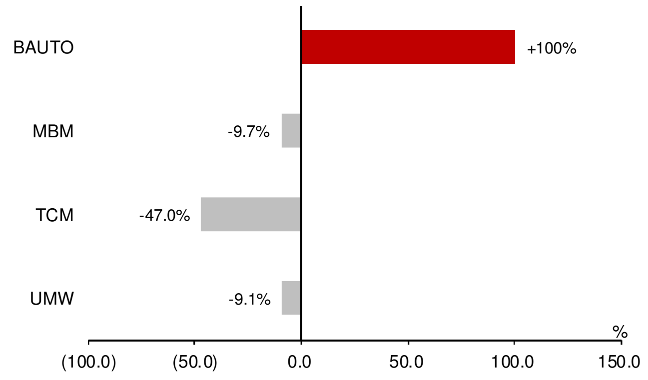
Outperformed peers in CY14. The momentum continued into 2014 with BAuto's share price doubling by the end of the year and outperformed other auto stocks within our coverage such as MBM Resources (-9.7%), Tan Chong Motor (-47%) and UMW Holdings (-9.1%).

BAuto share price performance since IPO



Source: Bloomberg

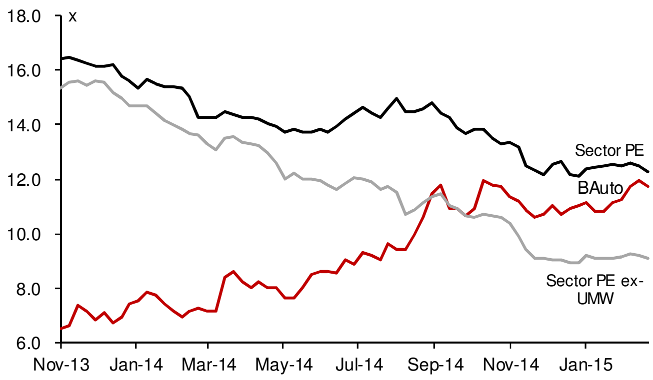
BAuto CY2014 performance vs other auto stocks



Source: Bloomberg

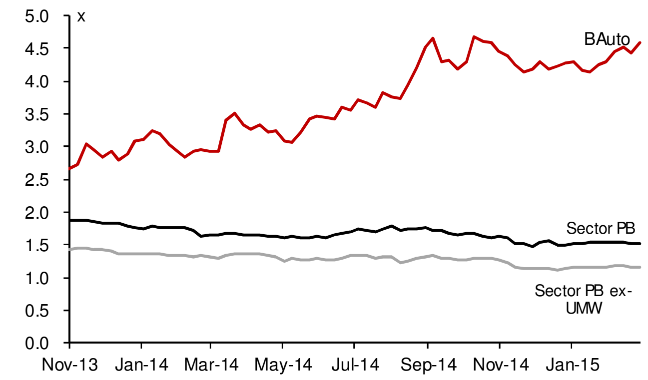
High expectations built in. Against our forecasts, the stock is currently trading at 12-month forward PER of 12.2x and PBV of 4.6x. The PER multiple is similar to the sector's 12.3x, based on our forecasts, but trades at a 33% premium over its smaller cap peers such as Tan Chong Motor (TCM) and MBM Resources (MBM).

BAuto 12-month forward PER



Source: Bloomberg, MIDFR

BAuto 12-month forward PBV



Source: Bloomberg, MIDFR

Time to take profit? While the PER multiple that BAuto trades at is toppish for a typical automotive stock, we argue that BAuto is anything but that given its good earnings quality. Furthermore, we believe that the PER is distorted by its zero gearing/net cash position. We estimate that based on its 9MFY15 cash pile of RM102m, the stock currently trades at only 13x FY15 PER and 11.4x in FY16, based on our forecasts.

Furthermore, BAuto's low capital outlay could quickly translate into a strong FCF generation. Its FCF has turned positive in FY14 and we expect this to grow to RM82m in FY15 and RM180m in FY16. We believe that this could translate to higher dividend payout which is already at 32% in FY14. We have assumed payout to increase to 43% in FY15 (12sen per share) and over 57% in FY16 (18sen per share). As such, we recommend investors to Buy BAuto.

Valuing BAuto. We value BAuto using the Gordon Growth model (GGM) which assumes sustainable ROIC of 69% - the average ROIC returns over FY16 to FY17, Cost of Equity (COE) of 10% and terminal growth rate of 3%. All in, this gives a target price (TP) of RM4.70 which implies FY15 PER of 16.9x and 7.2x PBV before it eases to 14.8x PER and 5.7x PBV in FY16. Against current share price level, our TP implies a 25% upside to current share price level. We have opted to value BAuto based on its ROIC as we believe this best reflects its high returns on invested capital and cash position.

TP derivation for BAuto

Items	RM m
Sustainable ROIC (%) – average over FY16-17	69.3%
WACC (%)	10.0%
Long-term growth (%)	3.0%
Fair EV/IC (x)	**9.5**
Invested capital – average over FY16-17	363.0
Total enterprise value	**3,436.6**
Net (debt) / cash – average over FY16-17	389.0
Total equity value	**3,825.6**
No. of shares (m)	812.7
Equity value per share (RM)	**4.71**

Source: MIDFR

Our outlook. Briefly, we expect BAuto's earnings to grow at 41% CAGR over FY14 to FY16 from a normalised net profit of RM129m to RM258m. This is broken down to a 75% earnings growth in FY15 to RM225m before a further 14% growth in FY16. Underpinning our growth expectations are the following key assumptions:

- **Sales volume growth.** We forecast Mazda's sales volume to grow to over 15k units in FY15 before rising further to 19k units in FY16. This will be driven mainly by sales volume in the Malaysian market which is expected to grow 26% to 12k units in FY15 and a further 16% in FY16 to 14k units. Meanwhile, sales volume for the Philippines division is expected to grow to 3.5k units and 5k units in FY15 and FY16 respectively. Consequently, we expect BAuto's revenue to exceed RM2b in FY15 and FY16. For the 9MFY15 period, BAuto's revenue stood at RM1.4b with sales volume for the Malaysian market already exceeding 9k units.
- **Yen rate assumptions.** We have assumed RM/¥100 rate of RM3.05 in FY15 and RM3.08 in FY16. We believe our assumptions are fair given that it is similar to the financial year-to-date rate of RM3.04/¥100 in FY15 thus far. We estimate that every RM0.10 change in the rate would impact net profit by RM4.5-5m.

Consequently, we see BAuto's net margin to strengthen from 8.9% in FY14 to 11.0% and 11.1% for FY15 and FY16 respectively, primarily underpin by strong sales volume growth and favourable RM/¥100 exchange rate. We believe there could be additional earnings upside from stronger associate contribution following recent acquisition of Inokom in late CY14.

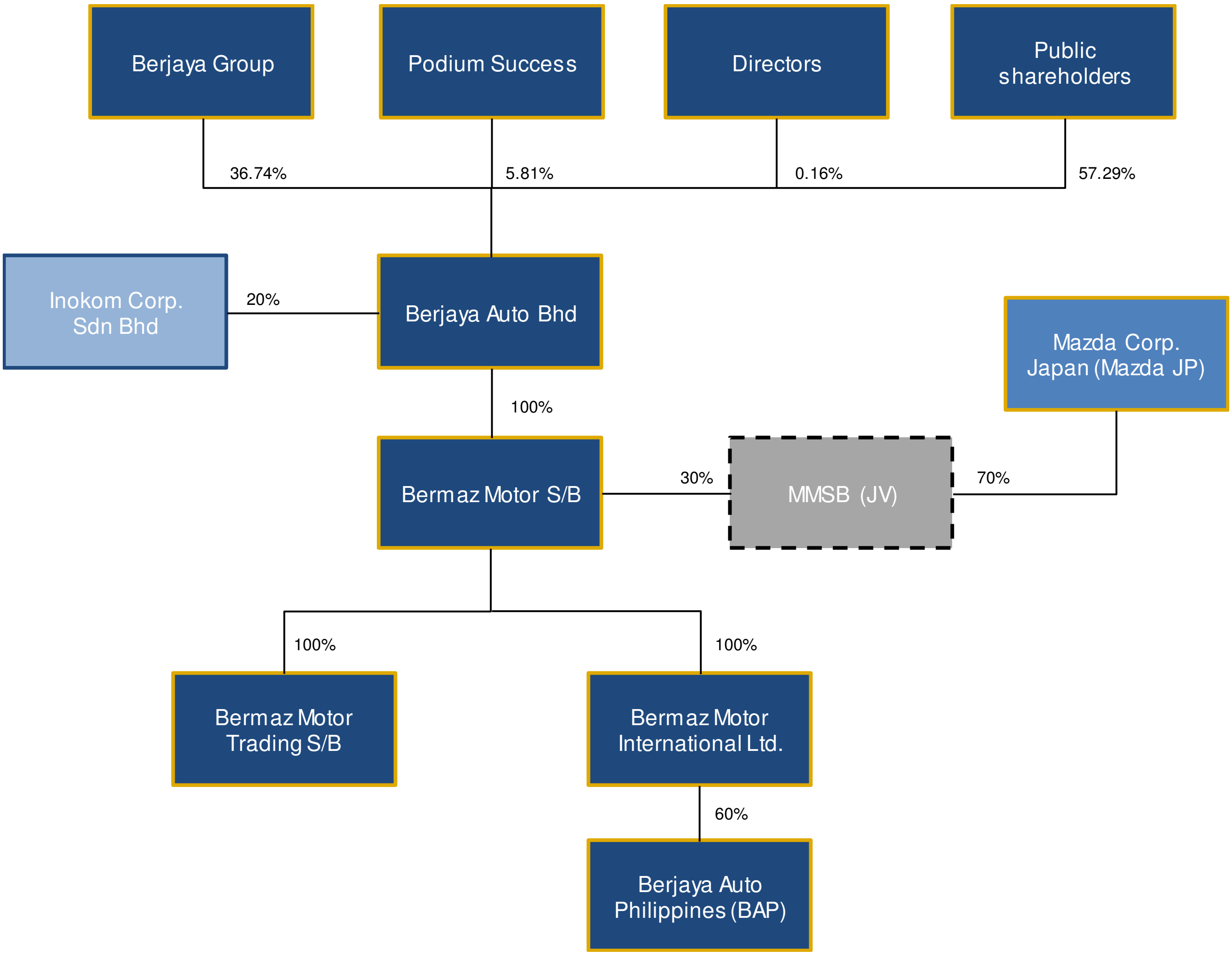
We are not overly concern over the possibility of slower sales volume setting in as we note that Mazda's sales volume have been robust despite most of its vehicles are positioned at the upper end of its respective segment. While its main volume driver, the Mazda CX-5, is one of the most affordable models in the segment, it is worth noting that by and large, Mazda's customer base are skewed towards the mid-to-upper income segment.

COMPANY BACKGROUND

An introduction. Berjaya Auto (BAuto) through its wholly-owned subsidiary, Bermaz Motor Sdn Bhd (Bermaz), is the exclusive distributor of Mazda vehicles in Malaysia and the Philippines. Prior to the IPO, Bermaz was acquired by BAuto for RM504m. BAuto also has a 20% stake in Inokom Corporation Sdn Bhd (Inokom), a local contract assembler, after acquiring the stakes from Berjaya Group and Pesumals (M) Sdn Bhd in Dec 2014 for RM30m.

Major shareholders. Berjaya Group remains the single largest shareholder of BAuto with 36.74% followed by Podium Success, owned by Dato' Ben Yeoh – the CEO/Executive Director of BAuto, with 5.81% share.

Chart 1: Berjaya Auto corporate structure



Source: Company, MIDFR

Brief history of Bermaz. The distributorship of Mazda vehicles in Malaysia was previously held by Cycle and Carriage Bintang via its subsidiary, Hercules Automotive Engineers (HAE) since 1983. The company was then acquired by Bermaz in Feb 2008 for RM16.8m after the latter was appointed by Mazda Japan as the exclusive distributor of Mazda vehicles in Malaysia.

The initial appointment was for 3 years up to Apr 2011 before it was extended to Mar 2014. Just over a year before the agreement lapse, Bermaz received another 5-year extension in Jan 2013 which sees the agreement being extended further to Mar 2019. Bermaz was also appointed as the exclusive distributor of Mazda vehicles for the Philippines in Sept 2012 for a 3-year period up to Sept 2015.

BUSINESS MODEL

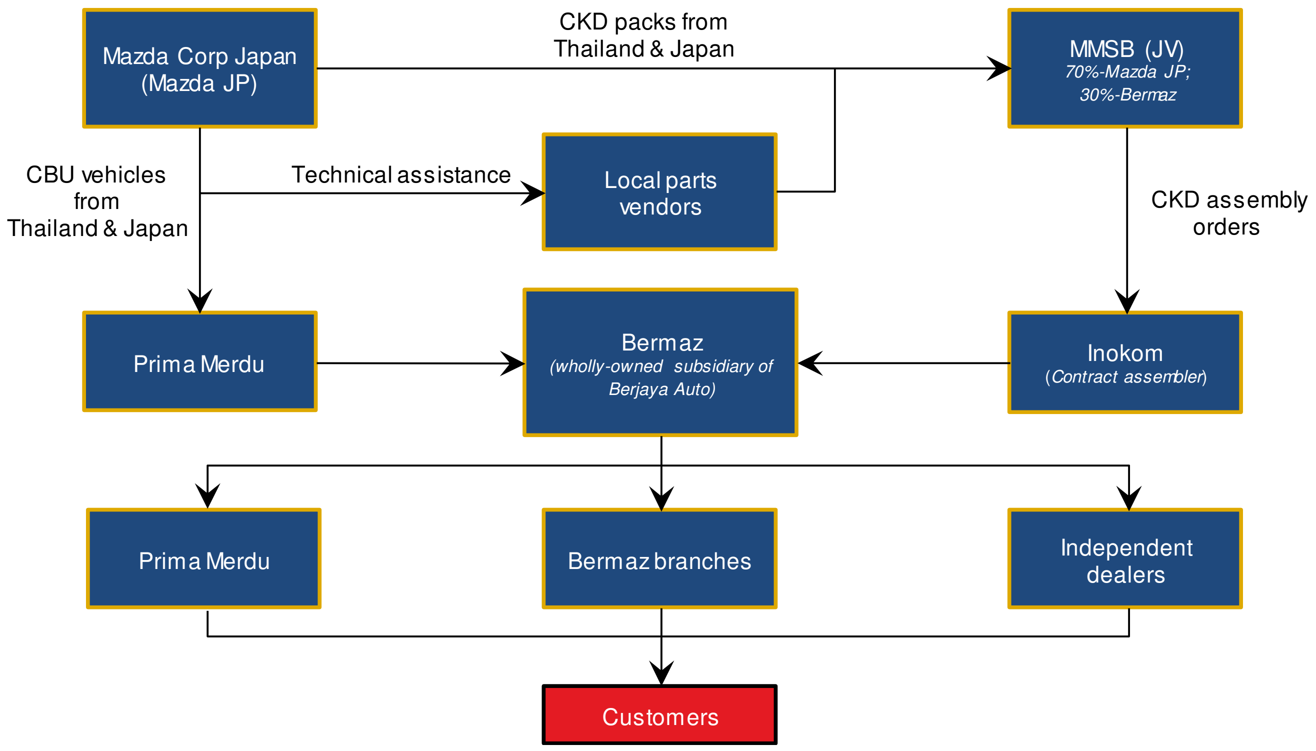
Asset-light distribution model. Currently, sales of Mazda vehicles in Malaysia are done through 78 outlets of which 8 are operated by Bermaz while the remaining are by third-party dealers which also includes the AP holder, Prima Merdu. The models sold in Malaysia are mostly imported (CBU) from Japan and Thailand by Prima Merdu except for the Mazda CX-5 2.0 variant which is locally assembled by Inokom. Meanwhile, sales of Mazda vehicles in the Philippines are all done through 16 third-party Mazda outlets with all the models sold are fully-imported by Berjaya Auto Philippines (BAP) from Japan. The high dependency on third-party dealers allows BAuto adopt an asset-light model and lower its risks of unsold stocks.

Available models. BAuto sells and distributes 9 Mazda models in Malaysia and 7 in the Philippines:

- **Passenger car:** Mazda 2, Mazda 3, Mazda 6, and Mazda MX-5 (only in the Philippines);
- **SUV/4WD:** Mazda CX-5 (the 2.0 variant is CKD in Malaysia) and Mazda CX-9;
- **MPV (Malaysia only):** Mazda Biante, Mazda 5 and Mazda 8;
- **Pick-up truck:** Mazda BT-50.

CKD activities. Pursuant to the acquisition of HAE in 2008, Bermaz signed up an agreement with Mazda Japan to undertake the local-assembly of the Mazda 3 SP23 model in Oct 2010 with Inokom appointed as the contract assembler. Imports of CKD packs were later transferred to MMSB, a JV company setup by Bermaz (30% stake) and Mazda Japan (70% stake) in 2012, with Inokom remaining as the contract assembler. Approximately 60-70% of the assembled volume is exported to Thailand while the rest is for the Malaysian market. Management plans to expand its CKD activities to include other models going forward.

Chart 2: Product flow of CKD and CBU vehicles



Source: Company

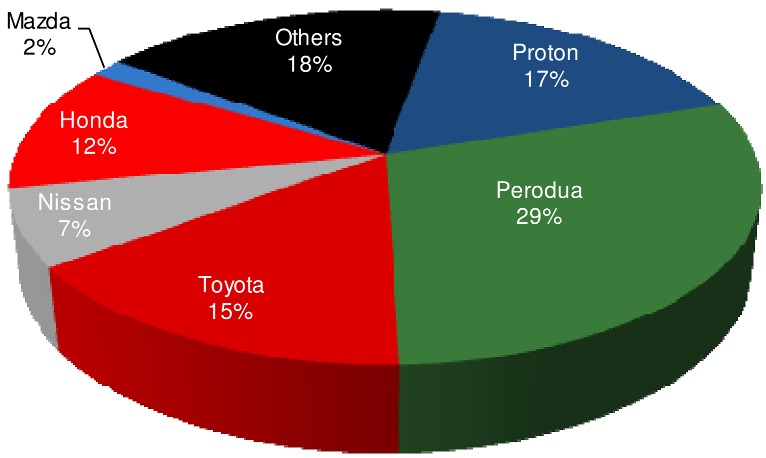
CBU imports done by Prima Merdu. The importation of Mazda CBU vehicles from Thailand and Japan are entrusted to Prima Merdu following its appointment by Bermaz and Mazda Japan in Feb 2009. Being the sole importer of Mazda vehicles for the Malaysian market, Prima Merdu is also the Franchise AP holder for Mazda vehicles. While annual allocation of Franchise APs is at no cost, the allocation is subject to MITI's approval with the amount being capped to encourage the growth in CKD activities.

INDUSTRY OUTLOOK: MALAYSIA

The Malaysian Automotive scene. Malaysia's automotive industry is tightly-regulated due to strong national interest through Proton and Perodua which undertakes the production of passenger vehicles, and Modenas which produces small motorcycles. These have created a sizeable ecosystem of supporting industries which, according to MITI, provides employment to at least 500k individuals.

On the outset, the Malaysian market is dominated by the local brands with ~47% market share in 2014, i.e. Perodua garners ~30% and Proton ~17%. Within the non-national space, Japanese marques dominated the market with Toyota being the largest at ~15% followed by Honda ~12% and Nissan ~7%. In essence, Perodua could be seen as an extension of Toyota's dominance through its subsidiary, Daihatsu, which is Perodua's technology partner.

Malaysia new vehicle market split by brands



Source: MAA

The National Automotive Policy (NAP). In anticipation of the ASEAN Free Trade Area (AFTA) which came into effect from Jan 2010, the NAP was introduced in 2006. The policy saw some liberalisation pertaining to tax treatment on vehicles sold in Malaysia while taking into account the need to attract investments, especially from foreign automakers and parts makers, to expedite the development of the local automotive industry.

Nevertheless, Malaysia's success rate in attracting foreign investments have been less successful compared to neighbouring countries such as Thailand and Indonesia which have seen huge investments into their respective automotive industries. In light of this, the government have made periodical revisions to the NAP in 2009 and most recently, in 2014, to take into consideration the evolving regional automotive scene.

NAP 2014. We view the latest iteration of the NAP being a huge improvement from earlier policy frameworks, possibly due largely to the establishment of the Malaysia Automotive Institute (MAI) which undertook a thorough review and understanding of the local automotive scene. As such, we observe that the measures introduced have been more holistic, identifying the gaps in the industry needs to be addressed. The NAP 2014 highlighted three key directions that the industry would need to focus on: Investment, Technology, and Market Expansion; and three key strategies: Human Capital Development, Supply Chain Development, and Safety, Security, and Environment.

Moreover, the policy also saw relaxation in the issuance of new Manufacturing License while introducing bespoke incentives to accommodate the varying needs of global automakers that are looking to invest and/or already heavily-invested in Malaysia.

The EEV (Energy-efficient vehicle) policy. The NAP 2014 placed great emphasis in positioning Malaysia as a regional automotive hub for the production of Energy-efficient Vehicles (EEV). It is also aimed at capturing the additional capacity needed for the region as ASEAN TIV is expected to hit 6 mil vehicles in 2020 while current capacity is only at 4.5 mil vehicles per annum with the bulk of this production taking place in Thailand. The policy also introduced the specifications for vehicles to qualify as an EEV:

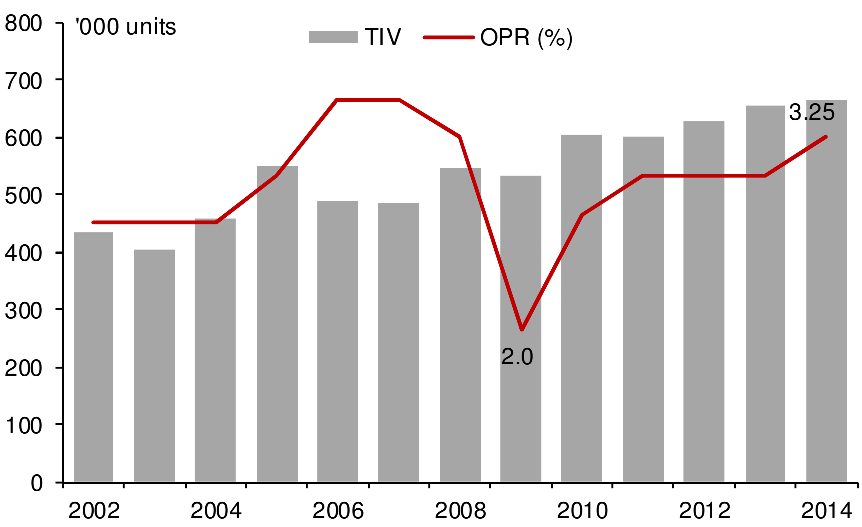
EEV specifications for Passenger & Commercial Vehicles

Segment	Description	Kerb Weight (kg)	Fuel Consumption (l/100km)
A	Micro Car	<800	4.5
	City Car	801 – 1,000	5.0
B	Super Mini Car	1,001 – 1,250	6.0
C	Small Family Car	1,251 – 1,400	6.5
D	Large Family Car	1,401 – 1,550	7.0
	Compact Executive Car		
E	Executive Car	1,551 – 1,800	9.5
F	Luxury Car	1,801 – 2,050	11.0
J	Large 4x4	2,051 – 2,350	11.5
Others	Others	2,351 – 2,500	12.0

Source: NAP 2014

TIV trends over the years. The annual TIV has grown strongly from 400k units per annum over 2001 to 2004, to over 600k units per annum from 2010 onwards. The growth was driven by several factors such as young and growing population, evolving lifestyle, underdeveloped public transport system, and good economic growth. We believe the easy access to vehicle financing with up to 9-year loan tenure also contributed to TIV growth. Since the central bank's reduction in interest rate in mid-2008, TIV has risen at 4.6% CAGR over 2007 to 2014.

Annual TIV vs OPR

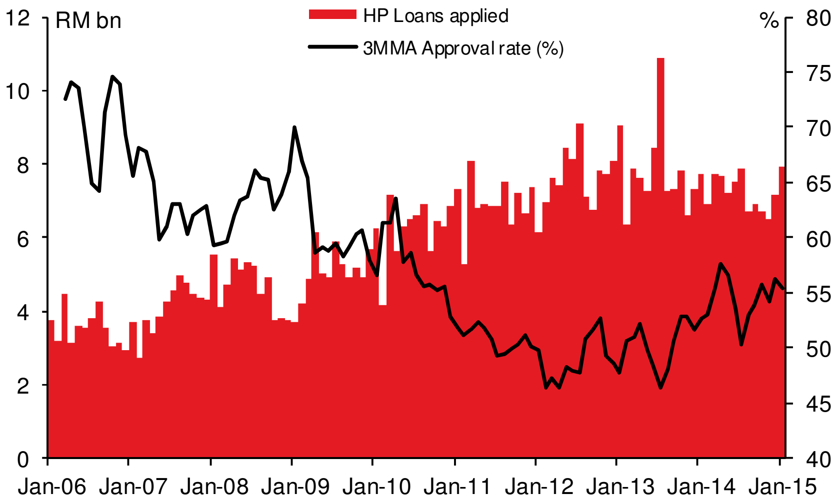


Source: MAA, BNM

TIV moderated in 2014. However, TIV growth moderated from +4.6% and +4.5% in 2012 and 2013 respectively to just +1.6% in 2014. We see the easing TIV growth being partly attributed to the economic outlook uncertainty, rising living costs and timing of new model launches. Furthermore, the tightening lending guidelines have also contributed to the easing TIV growth.

Tighter lending guidelines. We noted that the central bank has been proactive in managing the growth of household debt which rose from 57% of GDP in 2002 to 88% in 2014. Consequently, HP loan approval rates have moderated from over 70% in 2006 to 55% in 2014. Nevertheless, we believe this mostly affected the buyers of lower-end/entry level vehicles which are priced below RM100k while we also note that the consumers and industry players have adjusted to the stricter guidelines.

HP Loan approval



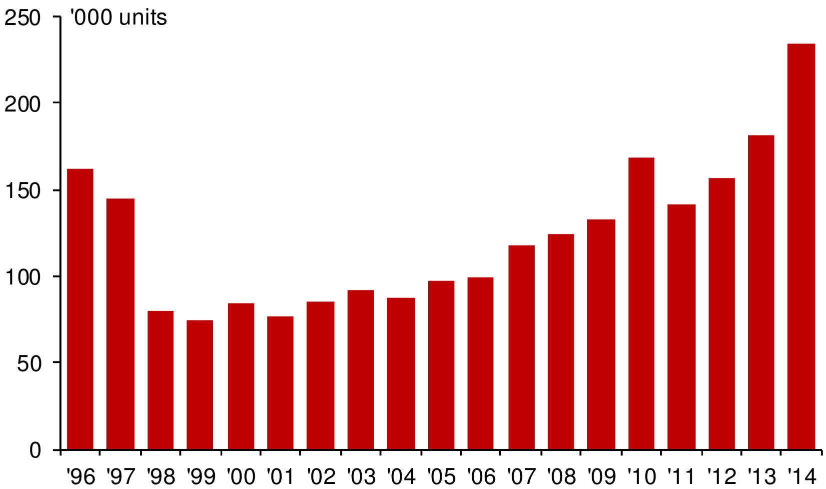
Source: BNM

INDUSTRY OUTLOOK: PHILIPPINES

The Philippines automotive scene. The Philippines automotive industry remains relatively small compared to other regional automotive hubs in the ASEAN region. Based on the data provided by the Philippines Automotive Competitiveness Council Incorporated (PACCI), local production was at 72k units in 2012, much smaller than Malaysia's 570k vehicle production in the same year. The Philippines Trade Secretary, Gregory Domingo was quoted in a news report that the President is set to issue an order implementing the Comprehensive Automotive Resurgence Strategy (CARS) program later in 2015. The program is expected to reinvigorate Philippines automotive industry and create another regional production hub, replicating the success of Thailand's auto sector.

Meanwhile, Philippines annual TIV have regained the pre-Asia financial crisis levels only in 2010 when it exceeded 168k units (TIV stood at 160k units in 1996). However, it dipped to 140k in 2011, resulting from the global economic slowdown before accelerating to 234k units in 2014, to imply an 18% CAGR over the 3 years.

Philippines TIV since 1996



Source: CAMPI

PRODUCT PIPELINE AND POSITIONING

Steady stream of new model launches. Management has guided for a slew of new model launches over the next few years. In 4QFY15, BAuto launched the Mazda 2, a B-segment passenger car which is fully-imported (CBU) from Thailand. This completes the update on Mazda's model line-up. The 2 compete against the Toyota Vios, Honda City, Honda Jazz and Nissan Almera, amongst others.

Against its peers, we believe the Mazda 2 pales in comparison mainly due to its tight cabin space – a prerequisite within the competitive passenger car B-segment market. However, the shortcoming is compensated by the 2's best-in-the-class fuel economy thanks to the automated engine start/stop system fuel-saving technology which is mostly found in higher-end passenger cars.

Recently-launched Mazda 2, priced at RM88k for both variants

Mazda 2 sedan

Mazda 2 hatchback

Source: Various sources

Management also guided for several more model launches in CY15 such as: a) the Mazda 3 CKD variant in Apr 2015; b) the Mazda CX-3 in 2HCY15; c) Mazda 6 CKD variant which would also coincide with the launching of the facelift in 2HCY15; and d) tentatively, the Mazda CX-5 2.5 variant for CKD. Should the CKD of CX-5 2.5 variant materialise, we expect the launching to coincide with introduction of the model's facelift.

New model launches

Mazda 3 CKD variant, debuting Apr 2015 (i.e. FY16)

Mazda CX-3, debuting in 2HCY15

Mazda CX-5 facelift, debuting mid-2015

Mazda 6 facelift & CKD, debuting end-2015

Source: Various sources

Mazda vehicles are mostly priced at a premium to its peers… We note that the pricing of most Mazda vehicles are at the premier-end of the respective segments as summarised below:

- **Within the D-segment.** The Mazda 6 is priced from RM159k while comparable 2.0 variants by Toyota, Honda and Nissan could be had from as low as RM139k.
- **Within the C-segment.** Similarly for the Mazda 3 which is only cheaper than the Toyota Altis that comes with additional safety option.
- **Within the B-segment.** The premium imposed on Mazda 2 is not as glaring but we note that the product packaging (i.e. in terms of interior space) is inferior to its peers such as the Honda City and Nissan Almera which boasts class-leading interior space and could be had from as low as RM67k.
- **Within the SUV segment.** The Mazda CX-5 2.0 2WD variant is the only outlier and has also been the best-seller for the brand. Priced from as low as RM137k, it is the cheapest mid-size SUV compared to its key competitors such as the Honda CR-V (from RM139k) and the recently-introduced Nissan X-Trail (from RM142k) which are also assembled locally. However, within the higher engine capacity, the CX-5 2.5 variant, a CBU unit from Japan, is the most expensive. This is also due to its peers being locally-assembled.

…but sales growth has been robust. Despite the premium positioning of Mazda vehicles, sales volume has grown at a staggering 46% CAGR over FY10 to FY14. While the pace is arguably driven by its value-for-money CX-5 2.0 variant, Mazda's sales growth is still at a staggering pace of 31% CAGR without that particular model.

We believe this implies that Mazda's client base is mostly made up of medium-to-high net worth customers. With the impending GST imposition and rising living costs coupled with introduction of CKD variants for 2-3 key models in FY16, we expect demand for Mazda vehicles to remain healthy.

RRP of other key models within Malaysia's market

D-segment		C-segment		B-segment		SUV (mid-size)	
Variants	Price (RM) Pen. M'sia	Variants	Price (RM) Pen. M'sia	Variants	Price (RM) Pen. M'sia	Variants	Price (RM) Pen. M'sia
Toyota Camry		**Toyota Altis**		**Toyota Vios**			
2.0 E	149,931	1.8 E	115,900	1.5 J MT	74,700		
2.0 G	158,931	1.8 G	119,900	1.5 J AT	75,321		
2.0 G X	159,900	2.0 V	136,015	1.5 E	84,300		
2.5 V	180,934	2.0 V Safety	139,915	1.5 G	89,990		
				1.5 TRD	94,800		
Honda Accord		**Honda Civic**		**Honda City / Jazz**		**Honda CR-V**	
2.0 VTi	139,815	1.8 S	113,800	1.5 S	75,800 / 72,800	2.0 2WD	139,800
2.0 VTi-L	149,815	2.0 S	125,800	1.5 S+	78,800	2.0 4WD	150,800
2.4 VTi-L	174,817	2.0 Navi	132,800	1.5 E	83,800 / 79,800	2.4 4WD	169,800
				1.5 V	90,800 / 87,800		
Nissan Teana		**Nissan Sylphy**		**Nissan Almera**		**Nissan X-Trail**	
2.0 L XE	139,800	1.8 E	115,817	1.5 E MT	66,978	2.0 2WD	142,800
2.0 L XL	149,800	1.8 VL	126,093	1.5 E AT	69,976	2.5 4WD	165,800
2.5 L XV	169,900			1.5 V AT	76,971		
				1.5 VL AT	79,969		
Mazda 6		**Mazda 3**		**Mazda 2**		**Mazda CX-5**	
2.0	159,471	2.0	138,951	1.5	87,956	2.0 2WD (MID)	136,959
2.5	189,746					2.0 2WD (HIGH)	144,141
2.5 Touring	193,850					2.0 4WD (HIGH)	154,401
						2.5 2WD	165,084
						2.5 4WD	175,344

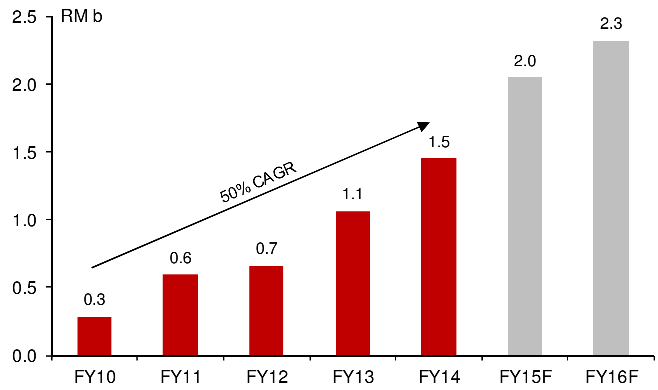
Source: Company websites

BEHIND THE NUMBERS

Meteoric revenue growth. BAuto's revenue has grown strongly at 50% CAGR over FY10 to FY14 from RM287m to RM1.4b. The growth was mainly driven by the Malaysia operations which posted 3.5x increase in sales volume from 2.1k units to 9.5k units over the period on the back of new model launches. Meanwhile, contribution from the Philippines operations also boosted BAuto's revenue with its maiden contribution of RM56m in FY13 which then doubled to RM176m in FY14. Sales volume growth in the Philippines was equally robust as BAP recorded sales of 659 units in its first year before it increases to 2.3k units in the subsequent year.

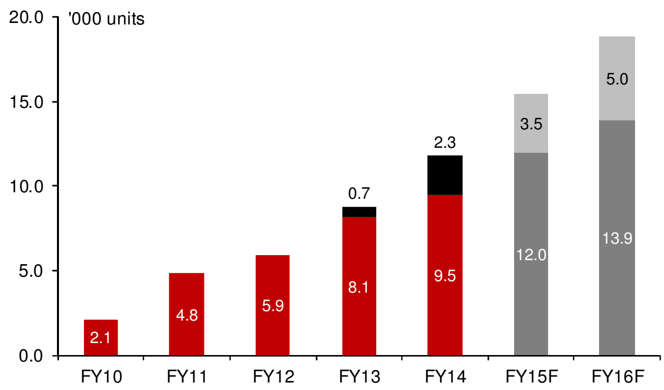
We expect sales momentum to sustain in FY15 with annual sales expected to hit over 15k units before increasing to more than 18k units in FY16. The growth in sales volume is expected to be propelled by new model launches and introduction of CKD variants. The CKD variants command lower prices than the CBU models due to localisation of certain parts which reduces the effective excise duty incurred. Overall, we expect FY15 group revenue to grow by +41% to RM2.0b and a further +14% to RM2.3b in FY16.

Revenue trend over FY10 to FY16F



Source: Company, MIDFR

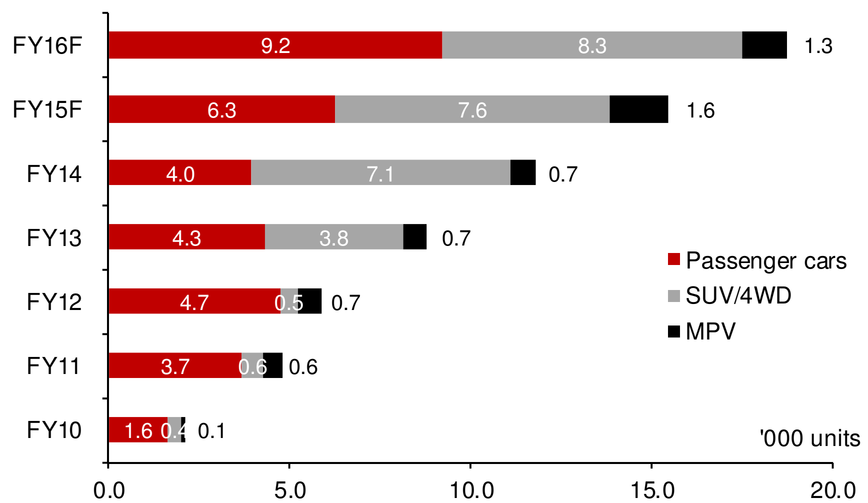
Sales volume trend over FY10 to FY16F



Source: Company, MIDFR

Sales by the segments. Over the years, Mazda's sales volume has evolved from one which concentrates on the passenger car segment to the SUV/4WD segment. The transition saw passenger car sales tapering from as high as 80% of total sales volume in FY12 to just 49% and 34% in FY13 and FY14 respectively, usurped by the strong demand of the Mazda CX-5 (SUV model) especially in Malaysia, and the absence of new launches of passenger car models. Going forward, we expect sales to be more equally distributed with passenger cars constituting 40%/49% of FY15/16 annual sales and the SUV segment making up 49%/44% of annual sales over both years.

Sales volume trend by the segments over FY10 to FY16F

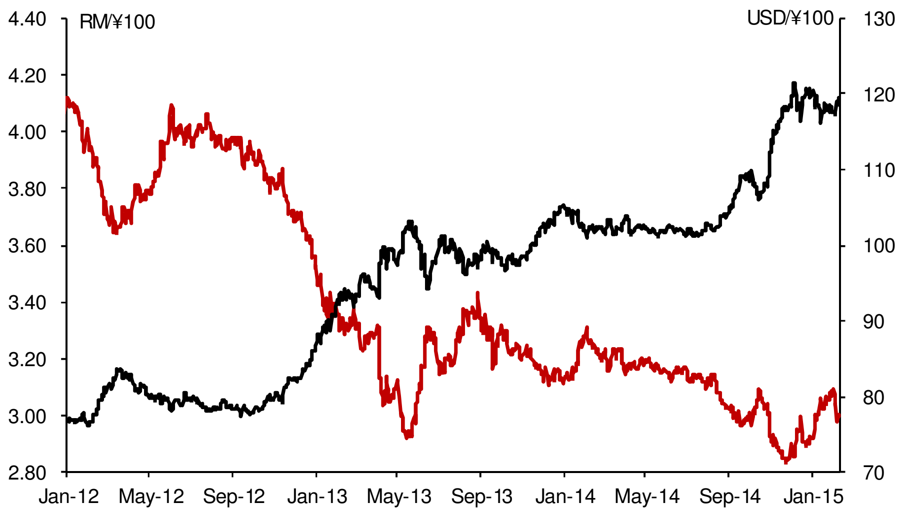


Source: Company, MIDFR

Currency exposure. BAuto is indirectly exposed to the yen via Prima Merdu and MMSB for the purchases of CBU units and CKD parts respectively from Mazda Japan. Management guided that every RM0.10 change in the RM/¥100 exchange rate would impact BAuto's earnings by c.RM4.5-5m.

The yen vs the dollar. The shift in Japan's economic policy following the introduction of the quantitative easing (QE) measures in Apr 2013 to boost its economy has led to considerable weakening of the yen. Prior to this, the yen traded strongly, at less than ¥80 to the dollar up to Oct 2012, before weakening to as high as ¥105 to the dollar. The currency consolidated to ¥101-102 to the dollar before the second QE measure was launched in Oct 2014. This saw the yen weakening further to over ¥120/USD in 2015 so far. In total, the Japan Central Bank (JCB) QE measures has seen purchases of ¥140-150tr worth of the Japan Government Bond (JGB).

RM/¥100 and USD/¥100 rate since Jan 2012



Source: Bloomberg

The yen versus the ringgit. Against the ringgit, the weakness has been beneficial for the domestic auto industry especially for Perodua, BAuto and, to a lesser extent, Tan Chong Motor. Over the period, the MYR/¥100 exchange rate fell from over RM4 to as low as RM2.92 in May 2013 following the first wave of JCB's QE measure. The ringgit later weakened to RM3.43/¥100 in 2H13, affected by the outflow of foreign funds on speculation of a possible cessation in the US Fed's QE measures then.

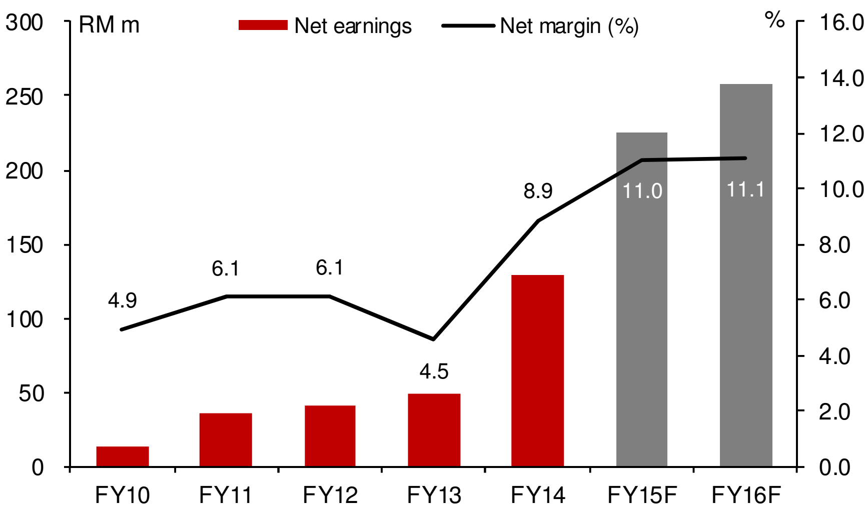
The trend had reversed thereafter with the MYR/¥100 exchange rate easing to as low as RM2.83/¥100 in late Nov 2014 resulting from JCB's second QE measure in Oct 2014. However, the RM/¥100 exchange rate has crept up to as high as RM3.09 and averaged at RM3.02/¥100 year-to-date despite the yen stabilising at about ¥120 to the dollar in late 2014/early 2015. This was largely due to the ringgit weakening against other currencies, including the yen, due to concerns over Malaysia's fiscal health following the collapse in crude oil prices since mid-2014.

Ringgit to stabilised, assume RM3-3.05/¥100 over FY15 and FY16. The ringgit remains volatile in tandem with the depressed crude oil prices. However, we believe the currency would stabilise as the supply-demand dynamics of crude oil improves while foreign fund outflow moderates. Our internal target expects the ringgit to gyrate between RM3.50-3.60/US$ in 2HCY15. We expect the stability against the dollar would largely reflect ringgit's performance against other currency, including the yen. In our model, we have assumed average rate of RM3.05/¥100 for FY15 before increasing to RM3.08/¥100 in FY16 to reflect the current volatility.

Strong growth on higher sales volume. BAuto's earnings over FY10 to FY14 grew at a staggering 74% CAGR from RM14mil to RM123mil in tandem with the higher sales volume and favourable exchange rate. While net margin expanded from 4.9% to 9% during the period, it dipped to as low as 4.5% in FY13.

The pullback in margin was due to several factors, namely: i) consumers holding back purchases running up to GE13 in May in anticipation of lower vehicle prices post-election; ii) intensifying competition in the market which led to higher discounts offered especially for Mazda 2; and iii) running out of Mazda 6 MK2 stocks ahead of the Mazda 6 MK3 which debuted in Mar 2013, (i.e. late FY13).

Earnings and net margin trend over FY10 to FY16F



Source: Company, MIDFR

The margin expansion in FY14 coincided with strong sales of new models launched in FY13. During the period, sales were also boosted by strong demand for the CX-5, especially for the CKD 2.0 variant, as well as demand for the Mazda 6 MK3 and Mazda 3 MK3 which debuted in late FY13. The devaluation of the yen also helped as the average RM/¥100 rate declined -16%yoy from RM3.82/¥100 in FY13 to RM3.21/¥100 in FY14.

Set to grow stronger. Going forward, we expect BAuto's earnings to grow at a 41% CAGR over FY14 to FY16 while net margin to expand further to as high as 11.1%. The earnings and margin expansion are expected to be driven by: i) a steady stream of new model launches; ii) introduction of CKD variants; and iii) the RM/¥100 exchange rate remaining at favourable levels.

STRONG CAPITAL STRUCTURE

DuPont analysis. BAuto boasts the highest ROE and ROIC returns within the industry due to its asset-light business model. ROE increased to 73% in FY11 due to higher inventories as a result of higher sales volume. It has since eased to 36% in FY13 on lower net margins as well as asset turnover and equity multiplier moderating to 2.8x. In FY14, BAuto's ROE rebounded to 51% driven by net margins which expanded to 8.9%. We expect BAuto's ROE to strengthen further in FY15 to 52% on better net margins and higher asset turnover achieved. Thereafter, our forecasts imply ROE moderating to 42% in FY16 due to lower asset turnover and equity multiplier as a result of BAuto's growing cash pile.

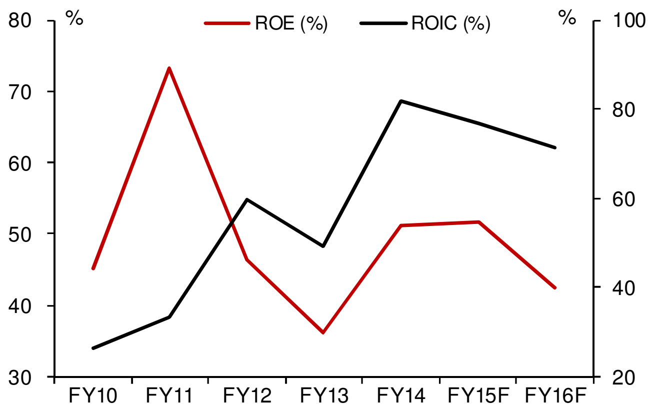
3-step DuPont analysis

Items	FY10	FY11	FY12	FY13	FY14	FY15F	FY16F
Profit margin (%)	4.9%	6.1%	6.1%	4.5%	8.9%	11.0%	11.1%
Total asset turnover (x)	2.4	2.8	2.3	2.8	2.6	2.8	2.4
Equity multiplier (x)	3.8	4.2	3.2	2.8	2.2	1.7	1.6
ROE %	**45.1**	**73.1**	**46.3**	**36.2**	**51.3**	**51.7**	**42.4**

Source: Company, MIDFR

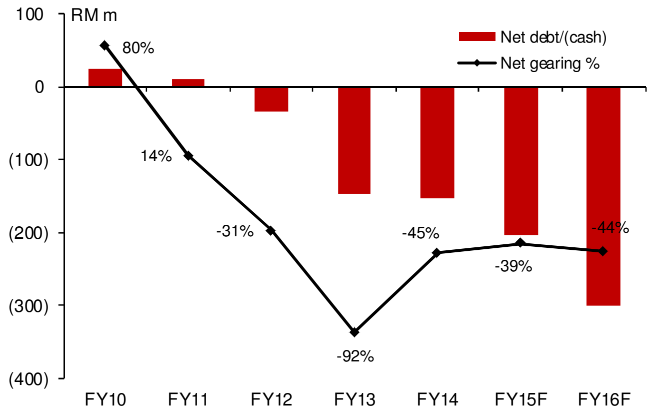
ROIC continues to strengthen on growing cash pile. Since FY10, BAuto's ROIC has grown from as low as 27% to 82% in FY14 in tandem with the company's net gearing level which eased from 80% to a net cash position of RM153m as of FY14. We expect further expansion in BAuto's ROIC to over 75% in FY15 and FY16 with net cash position increasing to more than RM200m due to the limited CAPEX commitment as a result of BAuto's asset-light business model.

ROE/ROIC trend over FY10 to FY16F



Source: Company, MIDFR

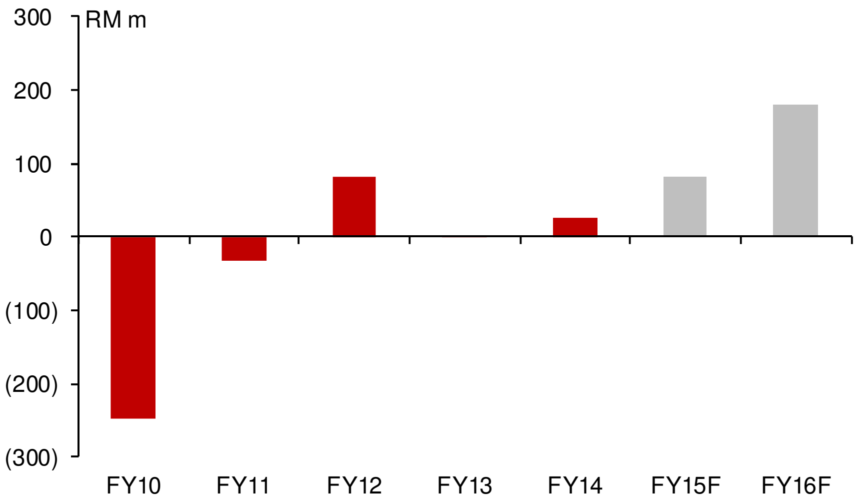
Net gearing and net debt/(cash) position



Source: Company, MIDFR

FCF generation has improved and is set to be stronger. Consequently, BAuto's FCF generation has also improved from a negative -RM248m in FY10 to as high as RM82m in FY12 before moderating to RM26m in FY14. BAuto's FCF eased to as low as RM1m in FY12 on higher working capital requirements. Going forward, we expect BAuto's FCF generation to strengthen further to RM82m in FY15 and RM180m in FY16 driven by strong EBITDA growth and minimal capital outlay. We have assumed a CAPEX of RM20m in FY15 and RM30m in FY16. We also reflected the acquisition of a 20% stake in Inokom which amounted to RM30m under investing activities in FY15.

FCF generation over FY10 to FY16F



Source: Company, MIDFR

EARNINGS RISKS

Hiatus in new model launches. Despite BAuto's strong track record and bright earnings prospects, we note several risks that could impact its earnings. Given the highly competitive nature of Malaysia's auto industry off late, the sales impact from the absence of new model launches in the year could be severe as evident below:

- In 2013, Toyota's sales were impacted when the aging Toyota Vios was faced with the re-entry of Nissan into the B-segment passenger car market following the introduction of the Nissan Almera. Consequently, Toyota's sales volume for the year fell -13.3% to 91k units while market share shrank to 14% from 13.7% in the preceding year.
- Fast forward to 2014, Nissan's sales took a dive with sales volume contracting -12.7% to 46k units after a record year of 51k units sold in 2013. Sales of the Nissan Almera paled against the latest iteration of the Honda City which was launched in Mar 2014.
- We noted similar trend with Perodua running up to the launch of the Perodua Axia with unit sales declining by -5%yoy to 140k units in the 9M14 period. However, the impact was less prevalent for the favourite national carmaker as FY14 TIV ended flat at 195.5k units vs 196.1k units in FY13.

At this juncture, the visibility of Mazda's new model launches (highlighted above) is up to FY16 while shelf-life cycle of passenger vehicle-based platforms is typically over a 5-year cycle. This could put FY17 earnings at risk should there be insufficient new model launches to attract consumers' interest towards the brand. Should BAuto's earnings outlook dims, we believe the interest on the stock could be sustained through higher dividend payout given BAuto's strong FCF generation.

Currency risk. Currency volatility remains a pertinent risk to the stock as trades between BAuto and Mazda Japan via MMSB and Prima Merdu are satisfied in yen. We estimate that every RM0.10 change in the RM/¥100 exchange rate would impact earnings by RM4.5-5m. However, the exposure could be mitigated by expanding the range of models being locally-assembled while sustaining localisation content at healthy levels of 40-50%.

Brand/Product risk. Thus far within the Malaysian market, there have been two recent examples of consumers losing interest on the brand and/or product almost immediately after strong sales trend. These were:

- **Volkswagen.** Volkswagen initially entered the Malaysian market with the sales of CBU-only units as early as 2004/05 with sales growing at 82% CAGR over 2007 to 2012 from 652 units to a peak of 13k units. As of FY14, VW sales have declined to 8.9k units due to the lack of after sales support and mechanical issues with its products. Following a change in its management team, VW aims to reinvigorate the brand and regain customer confidence.
- **Nissan Almera.** When it first launched in late 2012, the Nissan Almera managed to garner strong interest in the market, boosting Nissan's monthly passenger car sales to 2,800 units per month from less than 1,000 units per month prior to that. However, it was soon outdone by new models from its competitors which were also competitively priced. While Nissan's monthly passenger car sales only dipped to 2,400 units per month in 2014, this was done at heavy discounts which led to a sharp drop in the profit margins for Tan Chong Motor.

In our view, BAuto's management has proven to be very committed in strengthening the Mazda brand in Malaysia. This could be seen with controlled discounting measures during seasonal periods and ensuring sales outlets adhering to the Mazda brand standards. The limited discounts not only safeguard BAuto's margins but could also ensure the residual value of Mazda vehicles remain strong. We believe management's strong success has been through leveraging on the strength of Mazda's existing product line-ups which have seen shortages worldwide due to strong demand. Should the next generation of Mazda products fail to live up to the current excitement, BAuto's earnings could be impacted.

PROFIT & LOSS STATEMENT

FYE Apr (RM m)	2011	2012	2013	2014	2015F
Turnover	593	664	1,064	1,451	2,047
Operating costs	(539)	(602)	(985)	(1,280)	(1,747)
EBITDA	**54**	**62**	**79**	**170**	**301**
Depreciation	(3)	(5)	(7)	(5)	(6)
EBIT	**51**	**57**	**72**	**165**	**294**
Net interest	(2)	(2)	(4)	2	6
Exceptional items	-	-	2	2	-
Associates	-	-	(2)	11	11
Pretax profit	**49**	**55**	**69**	**180**	**312**
Taxation	(13)	(15)	(17)	(46)	(81)
Minority interest	-	-	(1)	(3)	(6)
Net profit	**36**	**41**	**51**	**131**	**225**
Normalised net profit	**36**	**41**	**48**	**129**	**225**

Source: Company, Forecasts by MIDFR

BALANCE SHEET

FYE Apr (RM m)	2011	2012	2013	2014	2015F
Non-current assets					
Property, plant and equipment	19	17	20	20	34
Associates	-	-	23	34	75
Deferred tax assets	7	9	19	31	31
Other non-current assets	1	1	1	1	1
Total non-current assets	**27**	**27**	**63**	**86**	**141**
Current assets					
Inventories	204	130	194	288	402
Trade & other receivables	36	34	47	54	76
Other current assets	1	0	0	0	0
Cash and bank balances	34	77	182	186	237
Total current assets	**275**	**241**	**423**	**528**	**716**
Total assets	**303**	**267**	**485**	**614**	**857**
Current liabilities					
Trade and other payables	127	89	124	134	188
Short term borrowings	69	29	127	-	-
Deferred revenue	7	8	18	29	29
Other current liabilities	8	5	16	32	32
Total current liabilities	**212**	**130**	**285**	**195**	**248**
Non-current liabilities					
Long term borrowings	11	11	2	-	-
Deferred taxation	1	0	-	0	0
Other long term liabilities	11	18	32	65	65
Total non-current liabilities	**23**	**29**	**35**	**65**	**65**
Financed by:					
Share capital	40	40	360	404	406
Share premium	-	-	144	163	163
Reserves	-	-	(424)	(419)	(421)
Retained profit	28	68	79	196	379
Shareholders' equity	**68**	**108**	**159**	**344**	**527**
Minority interest	-	-	7	11	16
Total liabilities and shareholders' funds	**303**	**267**	**485**	**614**	**857**

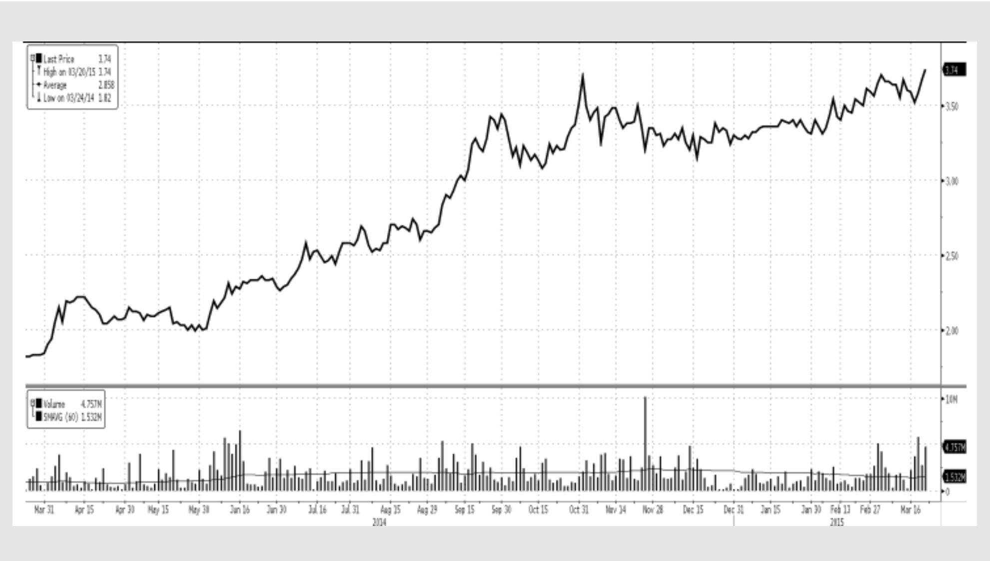
Source: Company, Forecasts by MIDFR

CASH FLOW STATEMENT

FYE Apr (RM m)	2011	2012	2013	2014	2015F
Cashflow from operations (CFO)					
Pretax profit	49	55	69	180	312
Depreciation	3	5	7	5	6
Net interest income	2	2	4	(2)	(6)
Share of profit of associates	-	-	2	(11)	(11)
Exceptional Items	-				
Net change in working capital	(61)	33	(64)	(96)	(101)
Tax paid	(16)	(18)	(21)	(41)	(81)
Others	14	12	56	50	18
CFO	**(9)**	**88**	**53**	**85**	**136**
Cashflow from investing (CFI)					
Purchase of fixed assets	(10)	(3)	(14)	(6)	(20)
Investment in JV / associate	-	-	(15)	-	(30)
Interest received	0	0	1	3	7
Others	1	0	(10)	8	-
CFI	**(10)**	**(2)**	**(38)**	**6**	**(43)**
Cashflow from financing (CFF)					
Dividends paid	-	-	-	(14)	(45)
Interest paid	(2)	(2)	(6)	(1)	(0)
Changes in borrowings	41	(95)	90	(130)	-
Net proceeds from issue of capital	(0)	54	6	59	3
CFF	**39**	**(43)**	**91**	**(87)**	**(42)**
Net change in cash / cash equivalents	**20**	**43**	**105**	**4**	**51**

Source: Company, Forecasts by MIDFR

DAILY PRICE CHART



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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% 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.