OSK

MALAYSIA EQUITY
Investment Research
Daily

Company Update

EP Manufacturing

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Rolling on with Perodua

BUY

Fair Value	**RM1.38**
Previous	**RM0.89**
Price	**RM0.85**

AUTOMOTIVE

EPMB is a leading tier 1 auto parts supplier of Proton and Perodua vehicles

Stock Statistics

Bloomberg Ticker		EPMB MK
Share Capital (m)		166.0
Market Cap (RMm)		141.9
52 week H│L Price (RM)	0.91│	0.45
3mth Avg Vol ('000)		670.0
YTD Returns		51.3
Beta (x)		1.14

Major Shareholders (%)

Mutual Concept	37.21
Horizon Growth Fund VA	5.24
Hamidon Bin Abdullah	5.09

Share Performance (%)

Month	Absolute	Relative
1m	23.0	23.8
3m	50.0	49.8
6m	66.0	63.4
12m	74.2	52.0

6-month Share Price Performance

While supply disruptions are likely to impact Perodua in the near term, expectations of a sharp recovery as early as July reinforces our view that EPMB's production of parts for Perodua will continue to be at normalized levels in order to attain sufficient inventories for the carmaker. The 3% upward revision in revenue in view of the higher number of Perodua units supplied to coupled by the improved operating efficiencies achieved providing a boost to margins prompts us to increase our earnings by 28.4% for FY11. We upgrade our FV from RM0.89 to RM1.38 premised on 7x PE (from 6x) with our BUY call retained. We expect dividends to be higher at 4sen, yielding 4.7% for FY11.

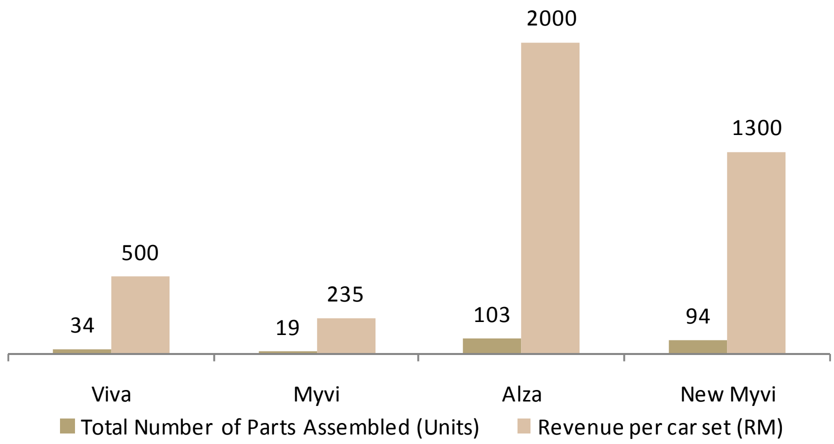
A key Tier-1supplier of Perodua. While EPMB has been a key OEM supplier of Perodua since 1999, it was only recently (end 2009) that it started procuring more parts for Perodua thanks to the latter's localization initiatives. Initially only procuring 3 assembly parts for the Kancil's subframe and trailing arm, the increase number of parts supplied now include the complex stamping structures for Perodua's entire body frame that was previously imported from Daihatsu Motor Corp. We understand some 60% of the subcontract of stamping components for Perodua is done by EPMB alone, making it the biggest tier 1 supplier of Perodua's stamping components. This also makes EPMB the company with the largest stamping tandem line amongst automotive vendors in Malaysia.

Getting a kick from the Alza. The Alza provided most of the kicker for EPMB's earnings last year thanks to the higher volume churned from the higher localization content (Perodua's first MPV), which is estimated at 90% as opposed to the Myvi's 80%. This saw EPMB benefiting from significantly higher number of parts procured for the Alza totaling 103 assembly parts. This is higher than the 19 assembly parts supplied to the Myvi and 34 assembly parts for the Viva (see figure 1 overleaf).

New earnings kicker in 2HFY11 from the new Myvi. For this year the supply of parts for the new Myvi will be 94 parts, which is substantially higher than the 19 parts currently supplied for the existing Myvi, thus nudging up significantly the revenue per car set generated by more 5 fold from RM235 to RM1,300. The Alza currently generates RM2,000 per car set due to the higher number of parts procured (103 parts) given its MPV based body structure (see figure 1 below). We expect the supply of parts for the new Myvi will significantly boost EPMB's revenue base over the next few year, enabling the company to achieve a well balanced portfolio mix between Proton and Perodua for which management is targeting a balanced 50:50 mix over the near term.

FYE Dec (RMm)	FY09	FY10	FY11f	FY12f	FY13f
Turnover	468.0	587.5	628.9	676.4	703.8
Core Net Profit	12.2	20.4	31.6	43.3	48.1
% chg y-o-y	185.1	67.4	55.0	37.0	11.2
Consensus			-	-	-
Core EPS (sen)	7.6	12.7	19.7	27.0	30.0
DPS (sen) *	1.0	2.0	4.0	5.0	5.0
Dividend Yield (%)	1.2	2.3	4.7	5.8	5.8
ROE (%)	3.3	10.0	11.7	14.1	13.9
ROA (%)	1.3	4.3	5.7	7.7	8.4
PER (x)	11.3	6.7	4.3	3.2	2.9
NTA Per Share (RM)	0.67	0.83	1.03	1.29	1.60
P/NTA (x)	1.3	1.0	0.8	0.7	0.5
EV/EBITDA (x)	4.2	2.5	1.9	1.4	0.7

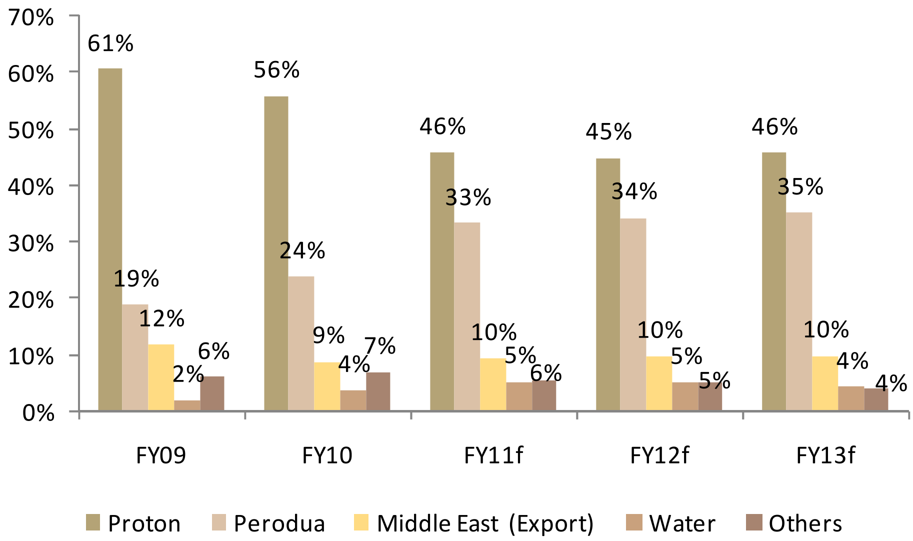
Figure 1: Number of parts assembled (units) and revenue per car set for Perodua's model line-up (RM/unit)



Source: OSK, Company Data

The balancing act. Currently, Proton's revenue share still represents a disproportionately sizeable chunk of 56% (see figure 2 below) and Management intends to reduce it to 44% for 2011 (we expect 46%) once the higher revenue contribution from Perodua's new Myvi kicks in noting that production of parts has started to commence since April. Perodua's higher localization initiative which kicked off since the Alza has enabled EPMB to increase its revenue contribution from Perodua by almost 90% in 2 years, as average revenue per car set contributed increases by 70% to RM747 (see figure 3 overleaf). Going forward we expect revenue contributed from Perodua to grow by a CAGR of 15% with Proton staying relatively flat over the next 3 years in view of our rather conservative forecasts given its uncertain model pipeline visibility.

Figure 2: Segmental revenue % breakdown



Source: OSK, Company Data

Production goes on. Our latest checks with management reaffirms that Perodua remains committed to its forecasted volume of 195,000 units for 2011 despite the turn of event from the Japanese earthquake. As Perodua has the benefit of a higher localization rate compared to other Japanese vehicle assemblers, the likelihood of a protracted supply disruption have somewhat been overestimated by management. In a press briefing last week, Perodua's management cited strong confidence that production is expected to normalize by July, of which was faster than they had earlier expected. Perodua remains committed of its initial sales target of 195,000 units this year whereby any shortfall in volume delivery is to be made up for once operations across its supply chain resumes back to normalize levels.

Myvi mostly affected. It is understood that production running throughout April and June is expected to decline by 11%, the bulk of which is from the Myvi (down by 15.7%) due to insufficient inventory noting that the existing one is ceasing production sometime by the end of the 1H. The shortage of procuring parts for the Myvi has therefore resulted in the delay of the upcoming launch of the new Myvi, which has been postponed from April to sometime in the 2H. We think management would likely push its targeted launching before the Hari Raya festive season during the time when vehicle sales tend to be buoyant beforehand.

Key tier 1 vendors unlikely to be affected. As Perodua management expects a full recovery by July with its projected volume for 2011 retained at 195,000 units, we anticipate that Perodua's key tier 1 vendors such as EPMB who are supplying platform related body structures (and others who are involved in the initial production of a vehicle) to be likely unaffected noting that Perodua will need ample inventory (despite the vehicle being partially completed due to shortage of components and parts from Japan) in anticipation of a full swing recovery by July.

Figure 3: Revenue contribution, volume and average revenue per car set

Segmental revenue breakdown (RM'm)	**FY07**	**FY08**	**FY09**	**FY10**	**FY11f**	**FY12f**	**FY13f**
Proton	167	325	284	329	289	305	323
Perodua	68	74	89	141	210	233	249
Middle East (Export)	50	56	56	53	60	67	71
Water	0	13	10	23	34	36	31
Others	18	15	29	42	35	35	30
Revenue	303	484	468	587	629	676	704
Volume ('000)	**FY07**	**FY08**	**FY09**	**FY10**	**FY11f**	**FY12f**	**FY13f**
Proton (incl. export)	135.5	160.4	173.1	189.3	198.8	210.4	216.7
Perodua	162.2	167.4	166.7	188.6	193.8	211.8	220.1
Average revenue per car set (RM)	**FY07**	**FY08**	**FY09**	**FY10**	**FY11f**	**FY12f**	**FY13f**
Proton	1,233	2,029	1,641	1,738	1,454	1,448	1,492
Perodua	419	443	534	747	1,084	1,101	1,129

Source: OSK, Company Data

EPMB starts its engine. EPMB is unlikely to see any halt in demand from Perodua in anticipation of a full swing recovery by July in order to maximize inventory. Hence we only make changes on EPMB's volume parameters but leave our volume parameters for both UMW and MBM unchanged in the meantime as automakers are likely to see continued shortages notably on key critical items such as metallic paint pigments, brake systems, electronic control units and electronic transmission systems that would potentially put some bottleneck to the final delivery of vehicles to customers.

We understand that EPMB has already started production of body structures for the new Myvi with a monthly average production over the next 4 months averaging at 8000 units per month to fulfill Perodua's inventory noting that the automaker is anticipating a full swing recovery before Hari Raya to capture the festive season spending spree, of which typically would see a strong uptrend in volume from both Proton and Perodua. 8000 units of Myvis per month are typically higher than the monthly average of the total Myvis sold last year (which averages at 6400 units monthly).

Factoring the higher volume assumption for Perodua that will be supplied by EPMB, of which we take Perodua's forecasted production numbers of 194,000 units; we have since then revised our revenue and earnings forecast (for FY11-FY13) as detailed in figure 4 below.

Figure 4: Changes in earnings forecast

	Previous	Revised	Variance
Revenue			
FY11f	612.0602	628.9278	2.8%
FY12f	693.6453	676.3859	-2.5%
FY13f	735.1819	703.8272	-4.3%
Earnings			
FY11f	24.61042	31.59151	28.4%
FY12f	30.78327	43.27344	40.6%
FY13f	28.57271	48.11434	68.4%

Source: OSK, Company Data

Earnings catalyst on improved operating efficiencies. Key earnings catalyst moving forward is EPMB's foreseeable expanding operating margins, of which EPMB has already started to reflect its results on a Q-o-Q and Y-o-Y basis. According to Management, despite churning a lower revenue base for the first quarter in 2011 given the lower volume contribution from Perodua; thanks to EPMB's continued effort in efficiently managing its day to day operations, EPMB has been able to stage better margins both y-o-y and q-o-q. A bumper of our earnings kicker is attributed to significant improvement in operating margins as witnessed in Q1FY12, where earnings for the quarter alone represented 40% of our full year forecast.

Staying on the conservative end. We note that we are staying on the conservative side to our forecasted key assumptions in deriving our projected revenue growth for 2012 and 2013 as we have assumed that revenue per car set for the upcoming model by both Proton and Proton remains relatively unchanged although we are optimistic that EPMB will likely be able to procure more parts per car set as it moves to the upper value chain as a leading tier 1 automotive supplier. Hence, this should give more room for further upside in our forecasts going forward, pointing out that EPMB are already undergoing the planning stage with both Proton and Perodua for the Persona and Viva replacement respectively which is slated to be launched sometime in 2012.

We believe that the upcoming Viva (which is based on the Kancil's and current Viva's platform) will be a striking resemblance to the Daihatsu e:S concept car which is slated to be launched in Japan sometime this year (see picture below), although we cannot discount the possibility of a likely delay due to the supply disruptions caused by the recent earthquake in Japan.

Investing for the future. As of end 2010, a total investment of RM231m has been made by EPMB for Perodua's line of which over RM150m has been poured since their localization initiative back in 2007-2008. Surprisingly, investments made in Perodua have now exceeded the RM216m investment made in Proton (since as far back in 1994) given the high investments on dies and stamping machineries.

Due to the highly strict quality standards maintained by Perodua's Japanese principles, the whole stringent process in securing the contract took EPMB almost 2 years (including R&D). Dies and stamping machineries are of the highest standards which are mostly imported from Korea and tested by Daihatsu's quality engineers. Noting that a vehicle platform can have a lifespan of more than 5 years with several kinds of models developed on it, the fact that EPMB supplies platform related body frames just points out that EPMB's orderbook from Perodua shows high visibility in volume of at least over the next 5 years.

Figure 5: The Daihatsu e:S concept car

Source: OSK, Company Data

Possibly expanding into Indonesia. Following the earthquake and tsunami disaster that struck Japan, we note that recently it has been reported that Toyota Motor Corp is seriously considering into shifting some of its plant operations from Japan to Indonesia given the sizeable volume potential. Daihatsu Motor Corp, which in turn is also owned by Toyota Motor Corp has a total manufacturing capacity of 330,000 units of which 70% of the volume are catered for Toyota models sold in Indonesia.

Meanwhile we also understand that Indonesia's existing Perodua look-alike there in Indonesia dubbed the Daihatsu Sirion is also being manufactured and imported by Perodua SB, though volume as of now is insignificant at just over 8,000-10,000 units since 2006 given the popularity of Daihatsu MPVs there overshadowing demand for its own compact cars.

More importantly, what could follow suit going forward is the possibility of EPMB expanding its horizon and expertise to Daihatsu Indonesia considering that the automaker will potentially be collaborating jointly with Toyota Motor Corp to develop a compact car dedicated to the Indonesian and ASEAN market. This move is expected to create an additional capacity of 100,000 units per annum for Daihatsu Indonesia with an investment commitment of RM800m for the new plant which is expected to run sometime in 2013. Like Perodua Malaysia, the upcoming Indonesia Daihatsu plant will also have similar stamping and welding, assembly and painting facilities. We foresee over the longer term, this represents a sizeable opportunity for EPMB to capitalize on Daihatsu's growing potential in Indonesia's compact car segment.

Supplying Bosch components to DRB's localized Volkswagen (VW) plant. With Bosch (a leading auto-parts supplier globally) as a key technical partner, another possible venture that EPMB would be able to participate is VW's upcoming localized production of the Passat. Completion of the plant, according to media reports is slated to be sometime as early late 2011. However, as initial localization will be at minimal levels; taking the time involved for the development grounds as determining factor (as was the case with its manufacturing deal contracts secured for the Alza and Perodua) we do not see EPMB riding on this revenue contribution yet.

VALUATION AND RECOMMENDATION

Upgrading FV, Maintain BUY. We expect FY11 earnings to grow by 55% on the back of a revenue growth of 7%. Key earnings driver for this year is the stark improvement in operating efficiencies across EPMB's production lines. This was witnessed in its 1Q results announced recently where earnings for the quarter alone represented 40% of our full year forecast as EBIT margins inched up strongly from 4.96% to 8.68%. Our checks with management revealed that operations were optimized at its cost efficient level with further reduction on production line downtimes. Following the upgrade in earnings by 28.4% for FY11, this nudges up our fair value from RM0.89 to RM1.38 with our BUY call retained of which our valuation parameter is now pegged at 7x (previously 6x) FY11 EPS. We think 7x is justifiable as it is the stock's 5 year average forward multiple. Staged to grow earnings by a CAGR of 33%, net gearing is expected to improve from 69% to 36% this year and we also foresee that the counter is ripe for a higher dividend over the next few years as hinted by Management. We forecast dividends this year to be at 4sen net this year, which yields attractively at 4.7%. Maintain BUY with a higher fair value offering an upside of 61%. Furthermore, the stock is supported by strong buy back activities on a daily basis over the past couple of weeks, signaling strong conviction by management on the outlook of the company moving forward.

FYE Dec (RMm)	FY09	FY10	FY11f	FY12f	FY13f
Key Assumptions					
Volume					
Perodua	166,736	188,638	193,840	211,763	220,093
Proton (incl. its Exports)	173,051	189,274	198,788	210,391	216,702
Average Revenue Per car (Perodua)	534	747	1,084	1,101	1,129
Average Revenue Per car (Proton)	1,641	1,738	1,454	1,448	1,492
Income Statement (RM'm)					
Revenue	468.0	587.5	628.9	676.4	703.8
EBITDA	85.6	118.4	128.8	134.2	139.4
Depreciation & Amortization	-58.8	-80.3	-85.8	-77.7	-78.1
EBIT	26.8	38.0	43.0	56.4	61.3
Interest Expense	-14.1	-10.5	-4.2	-3.4	-2.5
Interest Income	0.1	0.3	0.7	1.0	1.4
Profit before EI	12.8	27.8	39.5	54.1	60.1
EI	-4.9	3.9	0.0	0.0	0.0
PBT	7.9	31.6	39.5	54.1	60.1
Taxation	0.0	-6.4	-7.9	-10.8	-12.0
MI	-0.6	-1.1	0.0	0.0	0.0
Net Profit	7.3	24.2	31.6	43.3	48.1
Core Net Profit	12.2	20.4	31.6	43.3	48.1
Margin (%)					
EBITDA	18.3	20.1	20.5	19.8	19.8
EBIT	5.7	6.5	6.8	8.3	8.7
PBT	2.7	4.7	6.3	8.0	8.5
Net Profit	1.6	4.1	5.0	6.4	6.8
Core Net Profit	2.6	3.5	5.0	6.4	6.8
Effective Tax Rate (%)	0.0	22.9	20.0	20.0	20.0
Y-o-Y % change					
Revenue	-3.2	25.5	7.1	7.5	4.1
EBITDA	37.1	38.2	8.9	4.1	3.9
EBIT	40.0	41.8	13.1	31.1	8.6
PBT	153.2	117.8	42.1	37.0	11.2
Net Profit	-3.5	232.3	30.3	37.0	11.2
Core Net Profit	185.1	67.4	55.0	37.0	11.2
Per Share Data					
Sales / Share (RM)	2.9	3.7	3.9	4.2	4.4
Core EPS (sen)	7.6	12.7	19.7	27.0	30.0
BV/ Share (RM)	1.38	1.51	1.68	1.91	2.16
NTA/ Share (RM)	0.67	0.83	1.03	1.29	1.60
Dividend/ Share (sen)	1.0	2.0	4.0	5.0	5.0
FCFF/ Share (sen)	43.4	47.1	38.1	34.7	48.0
FCFE/ Share (sen)	-2.4	14.6	8.5	6.1	23.4
Valuations					
P/ Sales (x)	0.3	0.2	0.2	0.2	0.2
PER (x)	11.3	6.7	4.3	3.2	2.9
P/ Book (x)	0.6	0.6	0.5	0.4	0.4
P/ NTA (x)	1.3	1.0	0.8	0.7	0.5
Dividend Yield (%)	1.2	2.3	4.7	5.8	5.8
P/ FCFF	2.0	1.8	2.2	2.5	1.8
P/ FCFE	-35.7	5.8	10.0	14.0	3.6
EV/EBITDA	4.2	2.5	1.9	1.4	0.7

FYE Dec (RMm)	FY09	FY10	FY11f	FY12f	FY13f
Balance Sheet					
PPE	327.4	270.2	232.7	207.0	171.4
Intangibles	112.6	110.1	104.7	98.9	90.2
Others	5.4	5.5	5.5	5.5	5.5
Total Fixed Assets	445.4	385.8	342.9	311.4	267.1
Receivables	81.7	98.5	120.6	139.0	144.6
Others	28.9	40.1	32.1	34.8	36.3
Cash	16.8	38.2	56.6	74.7	121.7
Total Current Assets	127.4	176.8	209.3	248.5	302.5
Total Assets	572.7	562.6	552.1	559.8	569.6
LT Borrowings	100.1	72.8	52.8	32.8	12.8
Others	2.6	10.2	6.4	8.3	7.4
Total LT Liabilities	102.7	83.0	59.2	41.1	20.1
Payables	107.3	110.0	114.2	124.2	129.3
ST Borrowings	130.9	121.9	101.9	81.9	66.9
Others	5.0	4.9	6.6	6.3	6.9
Total ST Liabilities	243.1	236.9	222.7	212.5	203.1
Total Liabilities	345.8	319.9	281.9	253.6	223.2
Total Shareholder's Equity	226.9	242.7	270.2	306.3	346.4
Cash Flow					
PBT	-0.1	31.6	39.5	54.1	60.1
Non Cash items	105.3	115.4	88.7	80.3	78.3
Net Chg in Working Capital	3.7	-32.2	-19.7	-21.7	-13.1
Others	0.7	-6.4	-7.9	-10.8	-12.0
CF from Operations	109.6	108.5	100.6	101.9	113.3
Net Capex	-50.5	-40.9	-42.7	-48.8	-38.2
Others	0.0	-4.6	0.7	1.0	1.4
CF from Investing	-50.6	-45.5	-42.0	-47.7	-36.8
Dividends Paid	-0.3	2.8	4.0	7.2	8.0
Net Change in Borrowings	-62.9	-44.1	-44.2	-43.4	-37.5
Others	0.0	0.0	0.0	0.0	0.0
CF From Financing	-63.3	-41.3	-40.2	-36.1	-29.5
Net Cash Inflow (Outflow)	-4.2	21.7	18.4	18.1	47.0
Beg Cash	9.0	4.8	32.7	51.1	69.2
Ending Cash	4.8	32.7	51.1	69.2	116.2
Other Restricted Cash	12.1	5.5	5.5	5.5	5.5
Total Cash in Balance Sheet	16.8	38.2	56.6	74.7	121.7
FCFF	69.7	75.5	61.1	55.7	77.0
FCFE	-3.8	23.5	13.7	9.8	37.6
Net Cash / (Net Debt)	-214.2	-156.5	-98.1	-40.1	41.9
Other Ratios					
ROE (%)	3.3	10.0	11.7	14.1	13.9
ROA (%)	1.3	4.3	5.7	7.7	8.4
Net Gearing	96.9	64.5	36.3	13.1	-12.1
Interest Coverage	1.9	3.6	10.2	16.8	24.6
Dividend Payout Ratio (%)	13.2	15.7	20.3	18.5	16.7

OSK Research Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months	
Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain	
Neutral: Share price may fall within the range of +/- 10% over the next 12 months	
Take Profit: Target price has been attained. Look to accumulate at lower levels	
Sell: Share price may fall by more than 10% over the next 12 months	
Not Rated (NR): Stock is not within regular research coverage	

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