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FIXED INCOME RESEARCH

Sector Update

Malaysian Auto Component Manufacturers

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Summary

Rapid growth in the nation's automotive industry has created a network for components and parts. The auto parts industry consists of original equipment manufacturers (OEM) and replacement equipment manufacturers (REM). OEMs produce auto parts tailored to specifications set by car manufacturers while the REMs make parts for end users. At the time of writing, there are some 350 REMs producing up to 3,000 component parts with 70% of these manufacturers supplying to the OEMs.

This article discusses the business and operational challenges currently affecting the Malaysian auto components industry and how the four rated major auto component manufacturers: Ingress Corporation Bhd (A+), EP Manufacturing Bhd (A), Tracoma Holdings Bhd (A-), and Ace Polymer Sdn Bhd (A) have weathered the challenges.

The report goes on to show that, apart from Ingress, all the other rated auto parts makers have been slow in venturing overseas due to the bond with the Japanese OEMs that provided Proton and Perodua vendors the technical expertise. In return for the technology transfer, these vendors were prohibited from overseas ventures unless permitted by or at the discretion of the Japanese partners. At the same time, the smaller auto parts makers have limited funds, and their growth is constrained by lack of technical capabilities and over-reliance on sales to Proton and Perodua.

On 19 October 2005 the new National Automotive Policy (NAP) was introduced by the Government to drive the national automotive industry forward. While we acknowledge that this is a step in the right direction, we believe that for as long as Proton remains protected by the Government, no significant progress can be achieved by the industry.

Credit wise, local auto parts with outstanding bond issues are rated by Malaysian Rating Corporation Bhd in the 'A' category which indicates strong ability to repay principal and interest. We believe this partly stems from the vendors exclusive business relations with Proton and Perodua. However, given the high degree of concentration risk, these companies can expect to be negatively impacted should there be shift in preference for non-local automobiles.

Comparison of Key Characteristics Rated Automotive Components Manufacturers

	Ingress	EP Manufacturing	Tracoma	Ace Polymer
Issue	RM160 .0 mil Sukuk Al' Ijarah (A+)	RM150.0 mil MUNIF/IMTN (MARC-2/A)	RM100.0 mil Al Bai Bithaman Ajil Securities (A)	RM70.0 mil Al Bai Bithaman Ajil Securities (A)
Debt/Financial Service Reserve Account (DSRA/FSRA)	Used to fund an amount equal to the primary redemption of each series as follows: ▪ 3 months before due date: 50% ▪ 1 month before due date: 100% An amount equal to one secondary payment must be maintained at all times	100% of debt service to be deposited 1 month prior	Used to fund an amount equal to the primary redemption of each series as follows: ▪ 6 months before due date: 50% ▪ 1 month before due date: 100%	The required amount to be maintained in the FSRA shall be fully deposited into the account 6 months before the respective due dates of the financial obligations.
Coverage Ratio/ Distribution Test	▪ Adjusted DSCR 1.5x min ▪ Ingress shall not declare any dividends or make any other form of distribution, nor provide any loans to its shareholders should the ADSCR be less than 1.75x.	FSCR 1.5x min	FSCR 1.5x min	• FSCR 1.5x min • Ace shall not declare any dividends or make any other form of distribution, nor provide any loans to its shareholders should the FSCR be less than 2.0x.
Debt Related Ratio	1.75x max Debt-to-Equity	1.5x max Debt-to-Equity	1.5x max Debt-to-Equity	Debt-to-equity is subjected to following: ▪ 2.75x (1st two years) ▪ 2.00x (3rd year) ▪ 1.50x thereafter
Other Financial Covenants	▪ Ingress shall maintain its consolidated shareholders' funds at a minimum of RM 150 million	▪ 30% of proceeds from any warrants or rights conversion shall be used towards the repayment of the MUNIF/IMTN	N/A	N/A
Major Products	Door modules and roll-formed mouldings	Car Chassis modular parts	The manufacture and supply of metal-based parts and components for automobiles	Plastic based parts and components e.g. bumpers, instrument panels, etc
Revenue Mix	33% of revenue is derived from its operation in Thailand	Revenue is exclusively generated in Malaysia	Revenue is exclusively generated in Malaysia	Revenue is exclusively generated in Malaysia
Major Customers	PROTON, PERODUA, Isuzu, General Motors, Honda, Mitsubishi, Ford & Mazda	PROTON & PERODUA	PROTON, PERODUA, Honda (minimal)	PROTON & PERODUA

Sources: Malaysian Rating Corporation Berhad

Industry Dynamics Overview

A monopolistic competition industry structure

Rapid growth in the nation's automotive industry has created a network for components and parts. The auto parts industry consists of original equipment manufacturers (OEM) and replacement equipment manufacturers (REM). OEMs produce auto parts tailored to specifications set by car manufacturers while the REMs make parts for end users. At the time of writing, there are some 350 REMs producing up to 3,000 component parts with 70% of these manufacturers supplying to the OEMs.

Listed Auto-Component Manufacturers in Malaysia

APM Automotive Holdings Bhd	Sunchirin Industries (Malaysia) Bhd	Delloyd Ventures Bhd	Hirotako Holdings Bhd	New Hoong Fatt Holdings Bhd
Ingress Corporation Bhd	Autoair Holdings Bhd	EP Manufacturing Bhd	Mintye Industries Bhd	Tai Kwong Yokohama Bhd
BSA International Bhd	Tracoma Holding Bhd	SMIS Corp Bhd	Multi-Code Electronics Industries (M) Bhd	Sapura Motors Bhd
Kumpulan Belton Bhd	Autoindustries Ventures Bhd	Polymate Holdings Bhd		

Highly dependent on local automotive sector

The sector is highly dependent on the domestic automotive industry, which in turn, is highly susceptible to economic cycles; it is usually among the first industries to be affected by a down cycle. Additionally, the lack of economies of scale, research, and design capabilities has kept the sector domestically-oriented.

Players have to cope with stringent demands from car manufacturers

The local material content policy imposed by the government was abolished in 2002 while the mandatory deletion item programme is being phased out. With the abolishment of several items from the mandatory deleted items list, automotive assemblers can purchase parts from cheaper sources both internally and externally. As such, automotive component makers have to cope with more stringent demands from the car manufacturers whose decision to purchase would hinge largely on quality, reliability in supply, technological competency, and price.

Competition only arises when car manufacturers open for tender new modules or components for new models. Once a vendor is appointed by a car manufacturer to supply a module(s) or component(s) for one of its models, the vendor will usually be retained for the entire life of the model. Only if the vendor fails to comply with the specifications required by the manufacturer will new vendors be appointed.

Over reliance on Japanese partners expose the sector to foreign exchange risks

Generally, local auto parts makers for Proton and Perodua have been slow in venturing overseas due to the bond with the Japanese OEMs that provided Proton and Perodua vendors the technical expertise. In return for the technology transfer, these vendors were prohibited from overseas ventures unless permitted by or at the discretion of the Japanese partners. The smaller auto parts makers have limited funds, and their growth is constrained by lack of technical capabilities and over-reliance on sales to Proton and Perodua. Reliance on Japanese partners also leaves the sector significantly exposed to foreign exchange risk.

AFTA is a double-edged sword.

Looking ahead, AFTA liberalization will be a double-edged sword for the local automotive component sector. On one hand it will have a positive impact on the local automotive components sector, as it allows manufacturers access to a larger market. At the same time local auto parts makers will be forced to become more competitive to compete with cheaper parts from China as well its more advanced Thai rivals.

Business Overview

With a proven track record overseas and a well-diversified revenue mix, Ingress leads the pack

Ingress Corporation Bhd ("Ingress")
Of the five, Ingress has the strongest credit profile. Its major customers are Proton, Perodua, Auto Alliance of Thailand, Mitsubishi Sittipol Corp, Isuzu/General Motors of Thailand, and Honda Thailand, and its supply contracts generally last for up to four years depending on the life of the vehicle model. Ingress has five production plants, of which two are located in Nilai and Rawang, Malaysia, three in Rayong, Thailand and one in Cikarang, Indonesia.

Unlike most other manufacturers in the industry, Ingress was quick to realise that sole dependency on local car manufacturers would limit its growth opportunities in the future. Hence, the company subsequently ventured forth into Thailand in 1998. That move proved to be significant as Thailand has since emerged as a worldwide vehicle production base for global automotive industry giants (Toyota, Nissan, Honda, Mitsubishi, Isuzu, Ford/Mazda, and General Motors) that have established large-volume plants in the country as part of their cost-saving programmes. Having proven its capabilities to these major players, Ingress' is expected to continue to benefit from its Thai operations for years to come. Encouraged by its success in Thailand, Ingress has since ventured into the Indonesian market where it currently supplies sash and mouldings to Mitsubishi and Suzuki.

Meanwhile, Ingress' existing business portfolio - with revenue contributions from Malaysia, Thailand and Indonesia - should shield the company against any possible surprises from Malaysia's local auto manufacturers such as PROTON. For financial year 2005, Ingress' automotive components manufacturing (ACM) segment derived 55% and 43% of its revenue from Malaysia and Thailand respectively, while Indonesia made up the balance (FY2004: Malaysia: 63%, Thailand: 37%). Going forward, the domestic market is anticipated to contribute approximately 60% of ACM's revenue in FY2006 largely due to the excellent response for Perodua "MyVi" coupled with its higher value of parts in the model. Ingress' value of parts in each MyVi is about RM1,000 as compared to RM60 in the Savvy.

Being the leading Tier-1 supplier in the country, EPMB's fortune is tied to that of the national car-makers.

EP Manufacturing Bhd ("EPMB")
EPMB manufactures and supplies automotive products to both the original and replacement markets. Its original markets mainly comprise national car makers, i.e. Proton's and Perodua's manufacturing plants, while its replacement markets covers both Proton's and Perodua's service centres.

EPMB has evolved significantly since its inception, from being a pure component/parts supplier to automakers to its current modular supplier and system integrator form. In the past, EPMB core products were plastic injection moulded products such as lamps and bumpers. Now, as a Tier-1 component supplier to both Proton and Perodua, EPMB manufactures metal stamped components and supplies assembled components in modular form as integrated systems. EPMB has a track record of successfully supplying components assembly to both Proton and Perodua for most of their models such as Iswara, Wira, Waja, Gen2 and Savvy (Proton); and Kancil, Kelisa and MyVi (for Perodua). With several other contracts being awarded for upcoming models of both Proton and Perodua, EPMB is expected to consolidate further its position as the leading Tier-1 supplier in the country.

Operationally, EPMB is dependent on the sales and performance of national cars since this segment contributes approximately 73% to its revenue. As such, EPMB is vulnerable to any shift in consumer preferences to other vehicle makes.

Although revenue contribution from non-national car makers is currently minimal, it is a step forward.

Tracoma Bhd ("Tracoma")
Like EPMB, Tracoma manufactures and supplies automotive products to both the original and replacement markets of Proton and Perodua. Like Ingress, Tracoma is aware of the dangers of over reliance on Proton and Perodua as a source of revenue. As such, they have begun producing automotive parts for foreign carmakers like Toyota, Honda, Nissan, Hyundai and Volvo. However, their contributions to Tracoma's revenue are minimal.

To further expand its geographical reach, we understand that Tracoma has entered into a joint venture agreement with Proton to manufacture and assemble Proton models aimed at the Indonesian automotive market as well as other ASEAN countries. We think, however, that the joint venture is not consistent with Tracoma's aim of being less dependent on the national carmaker for its revenue. Also, we believe it is unlikely that Proton could effectively compete with the other established Japanese marques in Indonesia such Honda and Toyota.

Ace Polymer Sdn Bhd (ACE)

ACE is one of the few vendors with "end-to-end" capability. Nonetheless, poor revenue diversification given its high reliance on national car-makers

ACE is primarily involved in the manufacturing and supplying of plastic-based parts and components for the automotive sector.

As a Tier-1 vendor for PROTON, PERODUA and Naza Automotive Manufacturing Sdn Bhd, competition from other local manufacturers is minimized, since the car manufacturers usually appoint a single vendor for each module or component for their various models. In this instance, ACE is the main producer and supplier of several plastic-based modules for PROTON models (i.e. Arena, Wira (facelift), Iswara (facelift), Gen-2), PERODUA models (kancil and kelisa) and the Naza Ria.

To distinguish itself from its competitor, ACE has established itself as one of the few automotive component vendors with "end-to-end" capability. That is to say that ACE has the ability to design and develop a product all the way to mass production. That aside, ACE is still highly dependent on the national carmakers for its revenue.

Auto Manufacturers and The National Automotive Policy

On 19 October 2005 the new National Automotive Policy (NAP) was introduced by the Government. Listed below are some of the measures under the NAP that we expect to have an impact on local autoparts manufacturers:

Measures	**Comments**
• The setting-up of an Industrial Adjustment Fund (IAF) to assist Malaysian manufacturers by offering interest free loans or grants. The funding of automation, upgrading of machinery, research and development is expected to be IAF main area of focus.	• Thus far, there has been no indication of the size of the IAF.
• The provision of incentives to components and parts manufacturers which includes: i) Cooperation projects with bilateral free trade agreement partners. Areas of cooperation include improving quality, greater market access and the establishment of test centres in Malaysia. ii) A global supply programme will be implemented to facilitate autoparts manufacturers' expansion into the global supply chain of major auto companies. iii) Provision of training grants	• We don't think items (i) and (ii) can be achieved easily. Generally, local auto parts manufacturers fail to meet the stringent quality control of major auto companies or they lack to the technology to produce the required parts. So far, only Ingress has made a significant track in the overseas market. • The setting of the training grants may increase the proficiency of local autoparts manufacturers. Nonetheless, the size of the grant is yet to be determined.
• Provision of Research and Development grants.	• Again, no size has been mentioned. But it should be beneficial to autoparts manufacturers.
• The promotion of export-oriented Malaysian component and parts vendors. The NAP will extend support to these vendors to equip them with the necessary skills to succeed in the export market.	• Nothing new here, after close to a decade only Ingress have made any significant inroad in the overseas market.

Financial Highlights

Consolidated Accounts of Rated Automotive Component Manufacturers				
	FY2005*	FY2004*	FY2005*	FY2003**
	Ingress	EPMB	Tracoma	ACE
	A+	A	A	A
(RM'000)				
Sales	213,160	239,149	87,895	72,626
Pre-tax profit	14,440	23,804	13,056	16,671
Cash from Operations (CFO)	937	18,449	31,703	n.a
Total Debt	244,920	155,301	53,679	29,860
Cash	74,438	35,903	7,281	94
Shareholders' funds	213,725	187,411	101,441	28,491
Ratios				
OPBIT margin	9.06%	12.10%	16.9%	25.89%
OPBIT interest coverage	3.12x	5.48x	8.17x	8.82
CFO debt coverage	0.01x	0.27x		1.09x
Gearing	1.15x	0.83x	0.52x	1.05x

**Annual reports*

**Latest figures are not available*

Comparison between Ingress and EPMB's automotive component manufacturing segment only		
	Ingress 05	**EPMB 04**
Revenue	173,362	233,626
Profit from operations	35,073	30,727
Operating Profit Margin	20.23%	7.60%

Source: Company Data, Analysis by AmResearch

For AmResearch Sdn Bhd

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