

Profit seen to improve for New Hoong Fatt

BCT Asia Advisory Research / The Edge Financial Daily

New Hoong Fatt Holdings Bhd (April 16, RM3.32)

Maintain buy with a target price (TP) of RM5.70: We recently met up with management for an update. Total industry volume (TIV) sales in Malaysia have contracted since peaking in calendar year 2015 (CY15) at 666,677 units. The down-cycle has continued due to the implementation of GST in April 15, weakening ringgit in 2016, stricter lending policy by financial institutions and cautious consumer sentiment. From CY15, TIV sales declined by 14% to 576,635 units in CY17. The outlook for the local automotive market will remain subdued as Malaysian Automotive Association (MAA) expects TIV sales to grow marginally by 2% to 590,000 units in CY18 driven by a higher projected gross domestic product (GDP) growth in 2018.

Despite the decline in the overall new car sales, New Hoong Fatt Holdings Bhd's (NHF) local sales are not impacted as its products cater only for the replacement equipment market (REM).

NHF has restructured by broadening its range of trading parts and expanding products' pipeline to cater for wider model varieties and non-national makes. It has also put more emphasis on service and maintenance (wear and tear) segment. NHF commands certain competitive advantages over its local competitors, which are mainly trading companies. NHF is better positioned in terms of cost competitiveness, faster response and service (due to in-house manufacturing), extensive product coverage and distribution network. Despite the still subdued REM market, its local sales grew sustainably in FY16 and FY17. By segment, in-house manufactured items account for around 70% of local sales. The sales of external trading items contribute the remaining 30%.

Sales to Thailand account for more than half of its export sales to Asean of RM42.95m in FY17. This is underpinned by Thailand's long-established automotive hub within this region and a sizeable and growing car population.

Other potential markets for growth are the Philippines and Vietnam, which have also experienced growing TIV sales in recent years. While the Malaysian market provides a steady and recurring base, its growth potential is limited considering the maturing car population, total population of 32 million and high car ownership. The broader Asean market with a population base of 600 million, TIV sales of over three million units per annum and comparatively lower car ownership will be the key growth drivers.

NHF has proposed a bonus issue of 1 for 10. The proposed bonus issue will be from capitalising RM4.21 million from the company's share premium account and RM3.31 million from the retained earnings account. On April 6 2018, Bursa Securities approved the listing and quotation of bonus shares on the Main Market.

The local sales are expected to grow steadily due to the maturing car population and recurring demand for replacement parts. Additional growth impetus would come from export sales (especially Indonesia market).

Profitability is expected to improve in FY18 to FY19 due to the cost pass-through from gradual price increases.

We like NHF's unique positioning in REM for its steady and recurring demand. Its longer-term growth prospects will be driven by growing car population and rising middle-income class within the Asean region and NHF's more aggressive expansion into the Indonesia market.

We are maintaining our buy recommendation on the stock for its cheap valuations. The stock is trading at a discount to its book value of RM5.68 per share as at end-FY17 (after incorporating an additional book value increase of 63 sen per share on revaluation surplus). As such, we have increased our target price to RM5.70 to reflect its higher book value per share.

Based on our earnings per share forecast of 36.4 sen and 40.4 sen for FY18 and FY19, the stock is currently trading at a price-earnings ratio (P/E) of 9.1 times and 8.2 times. The stock also provides a yield of 4.2% based on a total dividend of 14 sen for FY17. — *BCT Asia Advisory Research*, April 16.

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