BUY
Rating

IMI
Price: P19.74
Target: P24.60
Upside: +25%

NIKL
Price: P6.68
Target: P7.95
Upside: +19%

12 October 2017
Report Date

8,358.47
PSEi

IMI.PS
NIKL.PS
Reuters Code

IMI.PM
NIKL.PM
Bloomberg Code

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Profiting From Automotive Revolutions

Megatrends. Ever since John Naisbitt's book "Megatrends – Ten New Directions Transforming Our Lives" was published in 1982, analysts have taken pains to identify new megatrends which have the potential to influence the investment landscape over a long period of time. Pinpointing and catching such megatrends just as they are emerging can result in sustained outperformance for investment portfolios. Although automobiles have been around for more than a century, they are currently being transformed due to the convergence of two different but complementary megatrends.

Autonomous EVs. With billions of dollars being poured into R&D by tech giants and major car manufacturers alike, the car of the (not too distant) future looks like it will be powered by electric batteries and will need little or no human intervention. Autonomous electric vehicles will no longer be confined to science fiction. In the last twelve months alone, several countries have passed regulations that will prohibit the sale of gasoline and diesel powered cars as early as 2025. Last month, China (the biggest car market in the world) shocked markets when it said that it, too, would soon adopt the tectonic shift away from fossil fuel vehicles.

Meanwhile, Amazon, Apple, Google (Waymo) and, of course, Tesla are all developing autonomous car technology. Ford, which is considered by some industry watchers as well ahead of its peers, hopes to commercially produce self-driving cars by 2021. General Motors, however, may be trying to steal the thunder from the competition. Its stock jumped to a record last month after Deutsche Bank issued a report saying that GM will launch an autonomous car fleet as soon as 2020.

GASOLINE CAR BAN

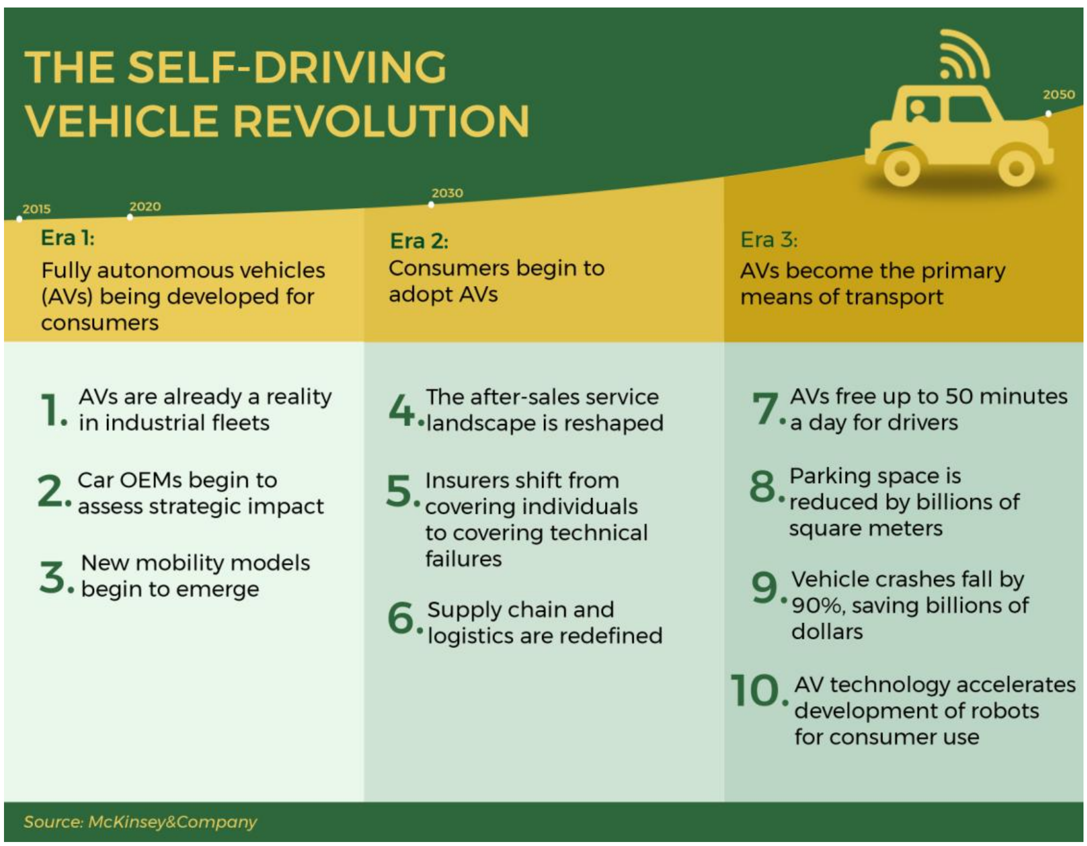
Country	Time	Detail
Netherlands	2025	Holland is actively promoting and investing in the development of autonomous driving vehicle. It passed a proposal to ban the sales of diesel and gasoline cars in 2025.
Norway	2025	Norway passed an agreement on the gasoline cars ban in 2025. Electric vehicles account for 24% of the total sales of automobiles in the country.
Germany	2030	The German Federal Senate passed a resolution to ban gasoline cars in 2030.
India	2030	India plans to ban sales of gas-powered cars in 2030, but the goverment think tank drafted another proposal to suggest delaying the ban to 2032.
UK	2040	UK is taking actions to promote all-electric and hybrid vehicles and plans to fully ban gasoline cars production in 2040.
France	2040	France's diesel cars ban in 2040 is in response to the call of Paris Climate Accord. To accelerate the phase-out of gasoline cars, Paris government levies substantial tax on them.

MyTRADE By Abacus Securities

Source: VehicleTrend

Local Winners. It is impossible to predict which of the above-mentioned tech companies or car manufacturers will eventually come out as victorious. However, as the Wall Street Journal pointed out last year, suppliers to the automobile industry may turn out to be the real winners. After all, whether it is a Tesla, Ford, Apple, Amazon or GM, all autonomous cars will need navigation systems, cameras, sensors and other equipment. The Philippines may seem to be an unlikely place to look for companies that will benefit from these megatrends but we believe there is at least one and maybe two.

Integrated Microelectronics has more than tripled year-to-date. Given the huge impact technology has on electronics manufacturing services (EMS) companies, we have tended to watch the stock (and the sector) with a wary eye. We now believe, however, that IMI is well-positioned to benefit from the wide adoption of self-driving technology over the next decade. The evolution of cars from human driven to fully autonomous will be incremental in any given year but the megatrend is that vehicles will become more and more automated. The chart below (adopted from McKinsey and Company) shows the expected adoption of the technology through 2050.



Sensor modules form the backbone of any autonomous driving technology and according to one estimate, this market will grow from $2.5 billion in 2015 to $35 billion by 2030. Of the various kinds of sensors being used, cameras (stereo, surround and long distance) are forecast to account for the bulk of spending. IMI has been producing and developing cameras for the past few years and this has been bearing fruit in the last few quarters. Automotive related clients now account for 42% of revenues in 1H17 from about 30% in 1H12. Also, bids won in 1H17 surged 210% YoY to over $530m with automotive related contracts accounting for 83% of this total. With gross margins in the high teens (versus 12% on average), the growth in automotive revenues will have a significant positive impact on profit margins going forward and especially by 2019-2020.

Going forward, we have a higher degree of confidence in IMI's profitability in the near to medium term compared to other semiconductor/electronics manufacturers in the country. This is reinforced by Ayala Corporation's announcement, earlier this year, that it will invest $100 million in a car manufacturing venture with a still unnamed foreign partner. IMI probably has little upside left this year but with growth expected to accelerate through 2019, we believe that the stock will rise to Php24.60 next year on the back of 25% EPS growth and a target multiple of 20x earnings. **Buy IMI**. Better yet, switch from **TECH** (see inset).

Valuation Summary	**2015**	**2016**	**2017f**	**2018f**	**2019f**	**Share data**		
Revenues ($'m)	814	843	1,040	1,227	1,411	52-wk Hi/Lo		20.20 / 5.70
Net income ($'m)	28.8	29.9	35.4	44.2	52.9	Relative Performance	1 mo	21.2
EPS (US cents)	1.55	1.61	1.90	2.38	2.85		6 mo	138.0
EPS growth (%)	1.9%	4.0%	18.1%	24.9%	19.8%		12 mo	212.3
PER (x)	28.0	25.8	20.6	16.0	13.2	Shares out (m)		1,856.9
EBITDA ($'m)	61	67	83	101	119	Market Cap (P'm)		36,655
EBITDA %	7.5%	8.0%	8.0%	8.2%	8.4%	3M Ave daily T/O (P'm)		51.6
EV/EBITDA	13.46	12.87	11.06	9.90	9.15	Major shareholders		
Yield (%)	0.9%	1.1%	1.2%	1.5%	1.9%	Ayala Corp		50.6
BV/share (US cents)	12.5	12.7	13.7	14.7	15.7	Resins Inc.		12.8
Price/BV (x)	3.5	3.3	2.9	2.6	2.4	EPIQ NV		10.7
Net D/E (x)	0.1	0.4	0.7	1.1	1.3	Public		20.3

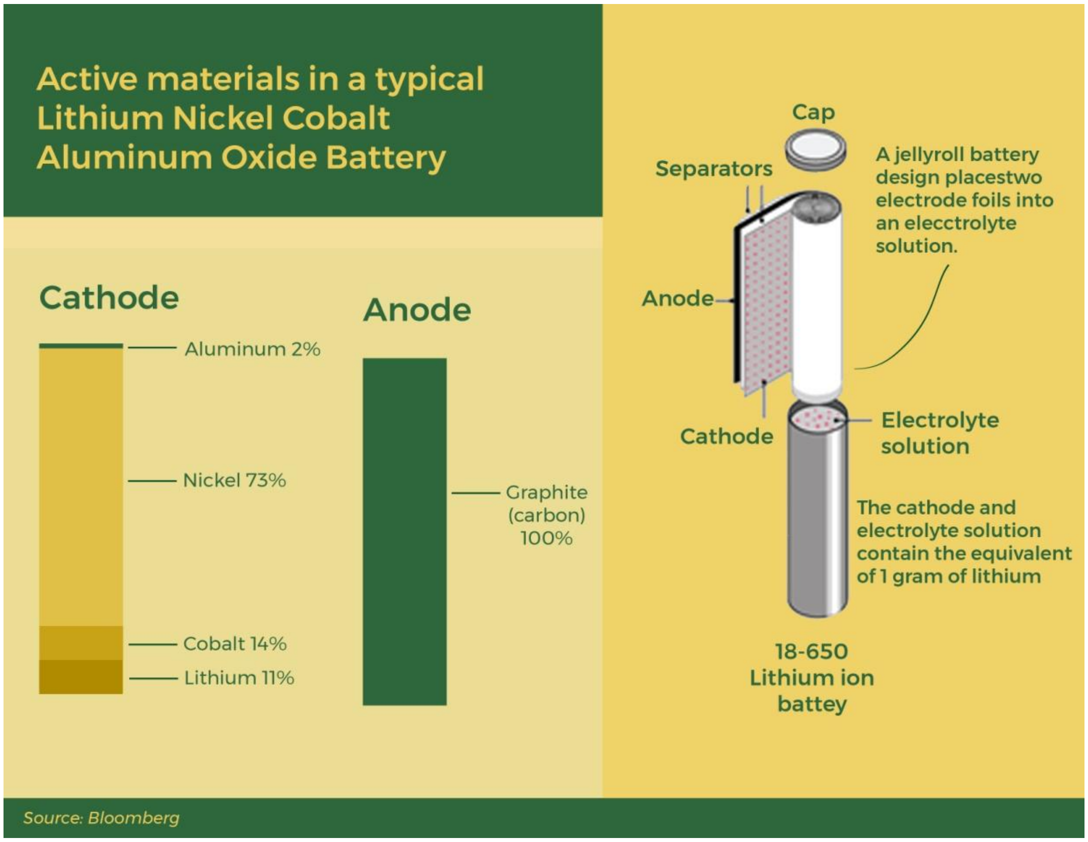
Source: Abacus estimates

Nickel Asia is the other potential winner that will likely benefit from increased demand and/or higher prices of nickel, cobalt and scandium.

Morgan Stanley recently stated in a report that increased demand for electric vehicle batteries will not drive nickel prices much higher as the metal is too bountiful and easy to mine with little investment required. However, management disagrees, noting that other forecasters estimate that up to 40% of future nickel demand will come from battery manufacturers and that prices, as a result, will rise in the longer term. Officials further argue that the quality of metal produced by NPI makers don't meet the requirements of EV battery makers.

NIKL is actually benefitting already from the higher price of cobalt, another metal that is a critical component of EV batteries. Over the past 12 months, cobalt has more than doubled to over $26 per pound on the LME. This has helped turn around the financial performance of THPAL and CBNC which, together, produce about 6,000 tons of cobalt (as a byproduct) annually. With limited supply, mainly coming from the Democratic Republic of Congo, cobalt is likely to move higher in the long run.

Lastly, THPAL will begin producing an intermediate scandium product at Taganito by January at the annual rate of 7.5 tons. Scandium is an important element because it can be combined with aluminum and other metals to produce some of the strongest alloys which will be in great demand due to the rise of electric vehicles. These alloys are used in the chassis and frames to strengthen and reduce EVs' weights in order to help improve both battery life and range (maximum distance traveled on one charge). Scandium also has applications in the manufacture of electric fuel cells.



Predicting how quick electric vehicle adoption will be is impractical. Nevertheless, Nickel Asia's bottom line should gradually receive a boost from 2018 onwards. The EV play for NIKL will unfold slowly but the benefits will be long term. In the meantime, we forecast an EPS of Php0.507 next year. At a target multiple of 16x, our FV for NIKL stands at Php7.84. This provides little upside at current levels and we would therefore advise to wait for lower levels.

Valuation Summary	2015	2016	2017f	2018f	2019f	Share data		
Revenues (P'm)	15,432	14,123	15,464	17,243	19,053	52-wk Hi/Lo		8.85 / 5.56
Net income (P'm)	2,035	1,966	3,312	3,779	4,271	Relative Performance	1 mo	(14.5)
EPS (P)	0.27	0.26	0.44	0.50	0.56		6 mo	0.7
EPS growth (%)	-76.3%	-3.4%	68.4%	14.1%	13.0%		12 mo	(18.0)
PER (x)	24.9	25.8	15.3	13.4	11.9	Shares out (m)		7,594.0
EBITDA (P'm)	6,344	5,313	6,880	7,568	8,325	Market Cap (P'm)		50,728
EBITDA %	41.1%	37.6%	44.5%	43.9%	43.7%	3M Ave daily T/O (P'm)		48.5
EV/EBITDA	6.7	7.6	5.8	5.2	4.6	Major shareholders		
Yield (%)	7.5%	1.2%	1.2%	1.2%	1.2%	Zamora group		39.1
BV/share (P)	3.36	2.89	3.82	4.73	5.78	Sumitomo		26.4
Price/BV (x)	2.0	2.3	1.7	1.4	1.2	Pacific Metals		2.8
Net D/E (x)	net cash	net cash	net cash	net cash	net cash	Public		18.6

Source: Abacus estimates

TECH *has rallied since June, primarily on the back of its recent acquisition. Quintel, which produces antennas for wireless communications networks of AT&T and Verizon, is forecast by management to help Cirtek's revenues double next year. We believe, however, that the share price has gone well ahead of fundamentals.*

First, the company does not have a track record with large acquisitions. Prior to Quintel, its biggest prior acquisition was Remec Broadband for only $7.0 million. Moreover, the company's prospectus for its dollar-denominated preferred share offering reveals that Quintel lost money in the first half of 2017. Pro-forma financial statements, in fact, show that the combined entity would have posted a loss in the first semester. Investors may therefore receive a rude awakening when TECH posts a loss for the previous quarter.

Second, TECH swung from a healthy net cash position as late as 3Q16 to a net debt level of $50 million at end-2Q17. This, in turn, appears to be a result of inventories and receivables rising faster than sales in the past few years. Bloomberg data shows that the firm's cash conversion cycle has deteriorated by over 50% since the end of 2013 to 122 days.

Third, we are wary that the Quintel acquisition is being financed through debt. Despite management's assertion, the $200 million in dollar-denominated preferred shares currently being marketed are more like debt than equity due to the redemption feature.

Meanwhile, these preferreds will reduce earnings to common by as much $11.5 million per year (which is well above trailing 12-month net income of around $9.0 million), diluting, even further, the positive impact of consolidating Quintel's revenues.

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