

Sazgar Engineering Works Limited

Initiating Coverage

Recommendation BUY
Fair Value PKR 145

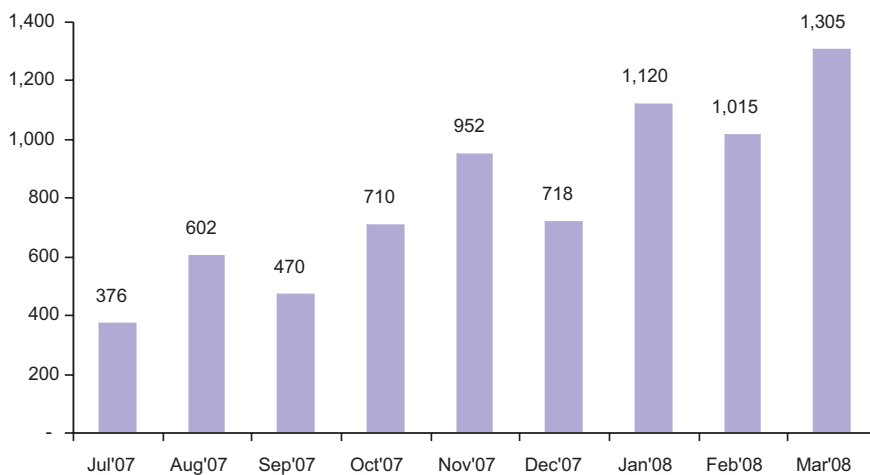
Incorporated in 1996, Sazgar Engineering Works Ltd. (SAZEW) started operations as a manufacturer of wheel rims for tractors. Later on, the company expanded its operations and began making rims and certain other minor parts for other types of vehicles as well, including passenger cars. By the end of FY06, SAZEW had finished setting up a 4 stroke CNG rickshaw manufacturing plant.

The company is one of the first local producers of 4-stroke CNG fitted rickshaws. The ban on sale of 2-stroke rickshaws by the government has greatly turned the consumer's focus on 4-stroke ones. Moreover, the President's Rozgar Scheme and government's efforts to control environmental pollution are also facilitating the sale of CNG rickshaws. Consequently, 4-stroke CNG rickshaw sales have generally been increasing exponentially, particularly of SAZEW.

Past Unit-Sales Performance

The company sold 2,046 rickshaws during FY07 against just 267 units sold during FY06. 3,828 rickshaws were sold during 1HFY08, which implies that sales have already surpassed last year's total sales within the first half of the current financial year. Maintaining the company's growth story, rickshaw sales have reached 3,440 during 3QFY08, resulting in total 9mo FY08 rickshaw sales to reach 7,268 units.

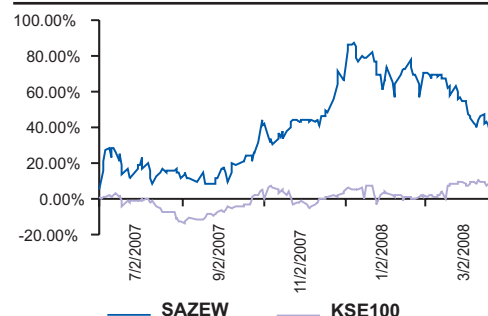
SAZEW Unit Sales Performance



Source: PAMA Records & IGI Research

Bloomberg Code	SAZEW PA
Current Price (PKR per share)	89.10
Average daily Volume (shares)	17,620
Market Capitalization (PKR mn)	780.05
Shares Outstanding (mn)	8.67
Average Price Per Share (PKR)	84.63

Price Performance



Source: Bloomberg & IGI Research

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Financial Growth Performance

The tractors' and passenger cars' production has declined marginally by 0.7%YoY and 0.1%YoY respectively during the 1HFY08. As vehicle production levels remained stable, the top line growth of 174%YoY during 1HFY08 was largely driven by the rickshaw manufacturing business.

SAZEW P&L Statements		(PKR)	
	1HFY08	1HFY07	YoY
Sales	633,879,478	230,937,819	174%
Cost of sales	502,765,115	187,169,863	169%
Gross profit	131,114,363	43,767,956	200%
Gross profit margin	20.68%	18.95%	
Operating income	96,757,425	31,008,469	212%
Profit after tax	59,624,080	18,404,097	224%
Net profit margin	9.41%	7.97%	
EPS	6.88	2.12	

Source: KSE Notice & IGI Research

Future Expectations

The surge in sales of Sazgar's rickshaws could be attributed to the President's unemployment alleviation scheme. However, unit sales of other local CNG rickshaw manufacturers have not been equally impressive during the period. Unit sales of Qingqi rickshaws have declined by 14%QoQ from Jan-Mar08. Unit sales of Sohrab rickshaws have increased by 63%QoQ but after falling by 16%QoQ during the previous quarter and because of low sales base. On the other hand, SAZEW has been enjoying increasing customer preference since the introduction of its rickshaws. The growing popularity of Sazgar rickshaws suggests that the company's sales growth is sustainable and not just a fad.

Moreover, the company has also filed a petition in court alleging certain other rickshaw manufacturers to be infringing the patent designs of the company. If the company succeeds, it can further improve its sales once the copyright infringers are out of the picture. We, thus, expect continued growth in unit sales of the company.

Gross Margins

The company's profit margins have also improved since the addition of CNG rickshaws to the production queue. Despite 19%YoY increase in average prices of steel during FY07, SAZEW's gross profit margin during the period remained stable at 19.66% compared to 20.76% during FY06. The company had secured its margin through upward price revisions and inelastic demand for SAZEW rickshaws. Despite price increases, the company's sales growth has remained undisturbed. Steel prices rose further by 21% during 9mo FY08 but the company was able to pass-on the increased cost of production to the consumer and yield a gross margin of 20.68%.

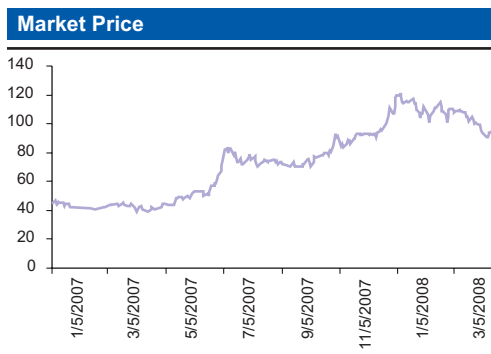
SAZEW relies on domestically produced parts for making rickshaws, except for certain sophisticated parts such as vehicle engines and CNG kits. PKR depreciation of over 7% against the US dollar since Jun07 has eroded the margins of many imports-dependent industries. However, SAZEW's high localization level has reduced the impact of the weakening PKR. The company's gross profit margin during 2QFY08 was 21.63%, higher than the average gross margin of 20.68% during 1HFY08.

A key threat to the gross margins of the company during 3QFY08 is high domestic inflation and the rising prices of commodities, such as steel. CPI has increased by 9.49% YoY during 9mo FY08 and steel prices have soared by almost 18% during the 3QFY08, which may have an adverse effect on the company's gross margins during 3QFY08. However, we believe that the company would be able to pass-on the increasing cost of production through its price revision during the period and its gross margins are expected to remain intact.

Valuation

SAZEW's 52-week average volume is of 17,620 shares being traded daily at an average price of PKR 84.60 per share. A low share turnover increases the liquidity risk for the scrip. However, because of the foreseeable growth potential in the company, we expect an upside to current prices.

The average regional P/E multiple of the industry is approximately 8 times. We expect SAZEW to announce an EPS of PKR 12 for 9mo FY08. The full year FY08 EPS of the company is expected to reach PKR 18. The target price of the company based on expected FY08 earnings is computed to be PKR 145 per share. The stock is currently trading at a discount of 60% from our target price. Consequently, we recommend 'Buy' for SAZEW.



Source: Bloomberg & IGI Research

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Analyst Certification

I, Muhammad Ashar Khaliq, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject, securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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