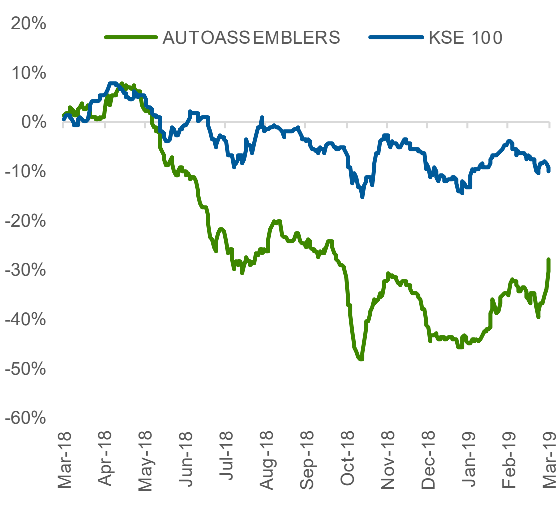
Day Break

Monday, 11 March 2019

Sector Update

Sym	Target Price	P/E 2019	D/Y2019	Recom.
INDU	1,663.0	7.4	9.4%	BUY
HCAR	326.0	9.7	4.1%	BUY
PSMC	277.0	13.4	1.6%	SELL

Relative Performance to KSE 100



Source: Bloomberg, PSX & IGI Research

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Automobile Assemblers

Tides turned in favour; recent policy changes to provide breather

- We revisit our investment case on the sector for the companies under our coverage (INDU, HCAR and PSMC) taking into account the recent amendments made in the policy measure where non-filers are allowed to purchase locally manufactured vehicles irrespective of the engine capacity. In addition, Federal Excise Duty (FED) have been increased to 10% for vehicles having engine capacity of 1700cc and above, bringing chances of further price hike.
- We believe the recent policy measure is positive for companies to regain their lost volumes and fueling their bottom line. As per se, we have revised our volumetric assumption slightly upwards for companies under over coverages, with the impact resulting in accretion to our earnings estimates. Consequently, our valuations are upgraded with INDU, HCAR and PSMC having a target price of PKR (1,662/326/277/share).
- We have a **"BUY"** call on INDU, based on our revised Dec-19 target price of PKR 1,662/share, offering +20% upside from its last closing. The company is currently trading at FY19E P/E of 7.44x and offers a dividend yield of 9.4%.

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Lifting of the ban was proposed earlier as well; recent amendment to provide a level playing field

To recall, the ban on non-filers became effective with the passing of Budget FY19 and since its inaction, the auto sector witnessed upheaval with share price of our coverage companies (INDU/HCAR/PSMC) under performing by 9%, 20%, and 26% against the benchmark index KSE-100 till date. It was subsequently proposed by the newly elected government in its first Mini-Budget (Sep-18) to revert back the restriction. Unfortunately, the talks ended in vain. Yet again, with the second Mini-Budget presented (Jan-19) it was then proposed to relax the restriction on cars having engine capacity less than 1300cc. Though it was positive for PSMC and INDU (only Corolla variant) while negative for HCAR, the recent amendment provides a level playing field allowing non-filers to purchase cars irrespective of engine capacity.

INDU: Valuation upgraded as earnings estimates revised upwards; remains our top pick

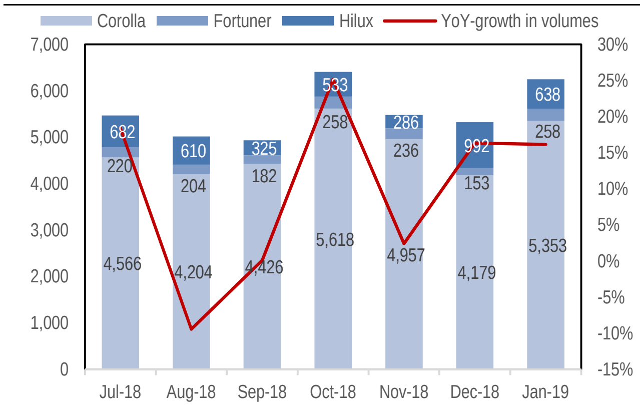
We have revised upwards our volumetric projection for the remaining FY19 and onwards. As a result, we expect company's sales volumes to marginally inch up by +2%YoY to PKR 64k units with Corolla maintaining its 80% share in the mix, with sales in high margin segment to normalize (average sales of Fortuner during 7MFY19 at 216 units versus 300 units). Already company has attained total sales volume of 38.8k units during 7MFY19, marking a rise of +9%YoY, despite the ban being set in motion. We therefore, see the revocation in the policy measure to add momentum to the sales (non-filer customer comprises of 40%).

On the flip side, the imposition of FED may bring a slight set back to volumes, in particular Corolla variant (Grande) with engine capacity of 1800cc. Nonetheless, with Xli and Gli (75% cumulative) comprising major share in sales mix and having engine size of 1300cc, the impact may be covered up with customer changing preference.

Incorporating the aforementioned changes results in upward revision in our earnings by 14% to PKR (187.8/197.6/212.2)/share for FY19-21. However, margin erosion still remains a concern with company witnessing a downfall of 400 bps YoY to 13.3% during 1HFY19. We believe, the volatility in exchange rate may persist, keeping margins unstable while any costs efficiency initiatives underway may provide some respite.

Target price raised: Our revised Dec-19 target price comes at PKR 1,662/share, up by PKR 210/share from our previous target price of PKR 1,458/share. We have a strong liking for the stock currently trading at FY19E P/E of 7.4x, offering a dividend yield of 9.4%

Exhibit: Corolla maintaining its share in the mix



Source: IGI Research, Company Accounts

Exhibit: Earning projections; relatively inexpensive P/E and high dividend yield

	FY18A	FY19E	FY20F	FY21F	FY22F
EPS	200.7	186.9	196.5	210.9	214.9
DPS	140.0	130.0	137.0	147.0	150
Div.Yield (%)	10.4%	9.7%	10.1%	10.9%	11.2%
P/E (x)	6.7	7.2	6.9	6.4	6.3

HCAR: Things may turn out well; from Hold to "BUY"

The company's non-filer customer base roughly stands around 9-10%. Currently company's sales volume for the 7 month period since the imposition are 28k units, marking a decline of 8%YoY, while we expect full year sales to reach 48k units by March 19. Incorporating the recent amendment in our assumptions will result in total volumes of 49k units for MY20. However, capacity constraints may limit growth in volumes going forward as HCAR is operating at 80%-90% utilization rate and therefore have restricted our assumption close to 50k units.

Considering the impact of increase in FED, we view this measure to be applicable on Civic and BRV (engine capacity of 1800cc) while City remains safeguarded as it comes in engine size of 1300-1500cc. With Civic having 40%-45% share in aggregate volume the said measure may have marginal impact on loosing sales from expected price pass-over as we think strong customer profile remains relatively insensitive to increase in prices.

Adding on the said changes results in upward revision in our earnings by 20% to PKR (31.5/32.2/34.1)/share for MY20-22. New launches that of City or Civic in the short-medium term (2020) may trigger potential upside as it deems necessary given company has already skipped generation of City. Nevertheless, volatility in exchange rate still looms keeping margins tricky, which have weakened by 500 bps YoY to 7.6% during 9MMY19. Although recovery in margins was seen on sequential basis (+130bpsYoY) during the 3QMFY19, thanks to low discounts offered. However, with additional demand from recent policy measure we think discounts (average PKR 200mn) on late deliveries may slightly heat up, hence further putting up pressure to the margins.

Valuation upgraded to "BUY": We have raised our Dec-19 target price to PKR 326/share from our previous target price of PKR 194/share, implying an upside of 26%

from its last closing. The company is currently trading at FY19E P/E of 9.6x and offers a dividend yield of 4.1%.

Exhibit: Combined sales of Civc/City remains strong

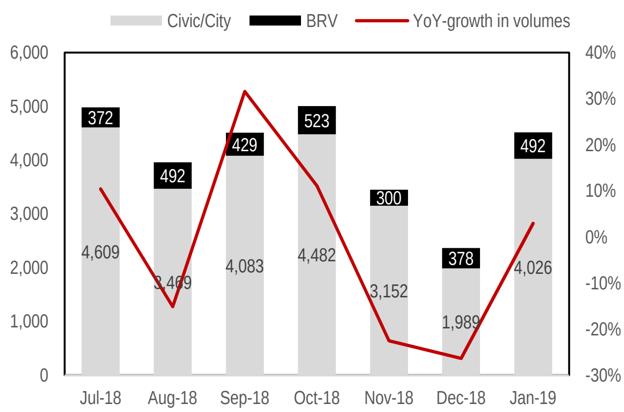


Exhibit: Earning estimates revised upwards by 20%

	MY18A	MY19E	MY20F	MY21F	MY22F
EPS	45.5	25.2	31.5	32.2	33.3
DPS	22.8	10.1	12.6	12.9	13.4
Div.Yield (%)	9.3%	4.1%	5.2%	5.3%	5.6%
P/E (x)	5.4	9.7	7.7	7.6	7.3

Source: IGI Research, Company Accounts

PSMC: Earning estimates marginally revised upwards; still a "Sell"

The company has yet to announce its full year result for Dec-18, which we expect to clock in at PKR 19.00/share. The impact of recent amendment will be visible from the 2QCY19 onwards and we have marginally revert back our volumetric assumption to 158k units for CY19, slightly down by 2% YoY. The revised policy measure comes at crucial time given the company is planning to launch Alto in April-19 and this could spur up demand a bit. More so, with the ban still in place for imported CBUs non-filers may switch given imported cars mostly comprises of low-engine capacity.
With reference to increase in FED, PSMC is in a better position with its offering in low engine capacity segment (800-1300 cc) and hence chances are slim for resulting price increase. This is beneficial for customers given interest rates are already high and any price hike may negatively impact demand.

Our earnings estimates are marginally revised upwards by +5% to PKR (23.4/22.5/20.5)/share for CY19-21. Moreover we think PSMC is in weak position given limited pricing power and unstable margins which have dropped substantially by 340bps YoY to 6.80% during 9MCY18. More so, increased competition from new entrants may effect growth in volumes in the long term.

Valuation upgraded slightly: We have raised our Dec-19 target price to PKR 276.5/share from our previous target price of PKR 200/share, implying a "Sell" call. The company is currently trading at CY19E P/E of 13.4x and offers a dividend yield of 1.6%.

Exhibit: Sales mix during the 7-month period

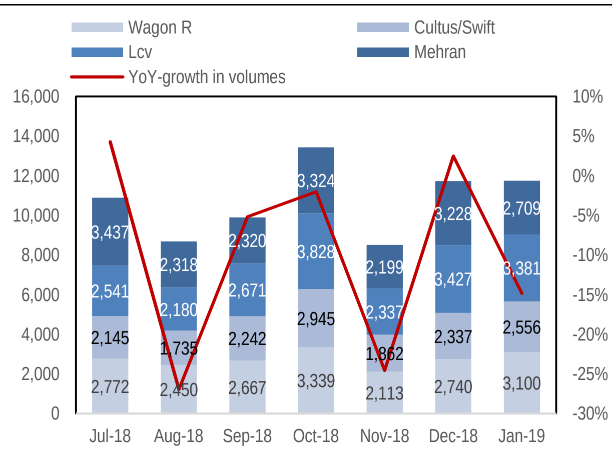


Exhibit: Earning projections; Low dividend yield and expensive P/E

	CY17A	CY18E	CY19E	CY20F	CY21F
EPS	46.5	22.6	23.4	22.5	20.5
DPS	19.0	5.0	5.0	4.0	4.0
Div.Yield (%	6.1%	1.6%	1.6%	1.3%	1.3%
P/E (x)	6.7	13.9	13.4	14.0	15.3

Source: IGI Research, Company Accounts

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Time Horizon: Dec – 2019

Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):
(Discounted Cash Flow)

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