Day Break

Monday, 17 September 2018

IGI Securities

COMPANY UPDATE

Pak Suzuki Motor Company Limited
Automobile Assembler

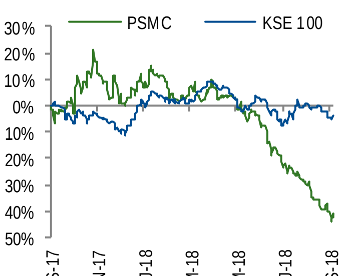
Recommendation	**BUY**
Target Price:	315.9
Last Closing: 14-Sep-18	269.0
Upside:	17.4
Valuation Methodology:	Discounted Cash Flow (DCF)
Time Horizon:	Dec-18

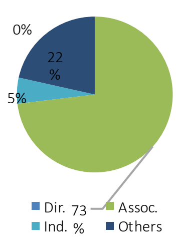
Market Data			
Bloomberg Tkr.			PSMC PA
Shares (mn)			82.3
Free Float Shares (mn)			21.7
Free Float Shares (%)			26.4%
Market Cap (PKRbn | USDmn)		22.1	179.8
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	(37.9)	(46.4)	(42.5)
Lo	260.3	260.3	260.3
Hi	434.0	514.2	566.6

Key Company Financials
Period End: Dec

PKRbn	**CY17A**	**CY18E**	**CY19F**	**CY20F**
Total Revenue	101.8	101.7	106.3	111.7
Net Income	3.8	2.7	2.4	2.7
EPS (PKR)	46.5	33.1	28.9	32.3
DPS (PKR)	19.0	7.0	6.0	6.0
Total Assets	37.9	50.9	45.9	48.3
Total Equity	29.5	31.7	33.6	35.7
Key Financial Ratios				
ROE (%)	12.9	8.6	7.1	7.4
P/E (x)	5.8	8.1	9.3	8.3
P/B (x)	5.4	0.7	0.7	0.7
DY (%)	7.1	2.6	2.2	2.2

Relative Price Performance





About the Company

The Company was incorporated in Pakistan as a public limited company in August 1983. The Company started commercial production in January 1984, and is engaged in the assembling, manufacturing and marketing of Suzuki vehicles and spare parts.

Source: Bloomberg, PSX & IGI Research

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Automobile Assembler

PSMC: Emerging headwinds entail moving the needle

- We revisit our investment case on scrip after incorporating 1HCY18 accounts and changes in sales assumption. For the 1HCY18 the company reported profitability of PKR 1.3bn down by 35%YoY, attributed to hefty decline of 43%YoY during the 2QCY18.
- The company recently announced to discontinue Mehran from March 2019. Earlier the company also stated to cease production of the VX-variant as well. The move comes at a time when a new entrant, United Motor has come up front with its United Bravo, providing neck to neck competition in small engine category segment.
- We have revised our earnings estimates downwards by 20% to (33/28/31)/share for CY18E/CY19F/CY20F. As a result, our valuation is downgraded by 30% to PKR 315/share.

We revisit our investment case on the scrip after incorporating 1HCY18 accounts and changes in sales assumption. The company reported decline in its earnings by 35%YoY to PKR 15.8/share during 1HCY18 despite witnessing strong growth in sales. Dwindling gross margins and ensuing exchange losses on the back of volatile PKR movement against USD dragged profitability. Overall, the stock underperformed by 45% against the benchmark index during CY18TD whereby, negative sentiments encircling the entire auto sector (ban on non-filers and USD/PKR depreciation) have dragged down valuations.
Moreover, the company has recently announced to discontinue Mehran; Alto (600cc) to replace it. The move comes at a time when United Motors have come on the ramp with its United Bravo which may disturb sales a bit. We have revised our earnings estimates downwards by 20% to PKR (33/28/31)/share for CY18E/CY19F/CY20F. As a result, our valuation is downgraded by 30% to PKR 315.9/share.

Earnings depressed by 35%YoY to PKR 15.8/share during 1HCY18

For the 1HCY18 the company reported profitability of PKR 1.3bn down by 35%YoY, attributed to hefty decline of 43%YoY during the 2QCY18. Net sales increased by +33%YoY to PKR 62.4bn owing to increase in volumes and series of price hikes. However, gross margins weakened by 300bps to 7% owing to changes in sales mix and rising input costs. Moreover, high admin expenses, low other income and increase in effective tax rate further dampened profitability.

Exhibit:
PSMC Result Highlights

PKRmn (Period end=Dec)	**2QCY18**	**2QCY17**	**YoY**	**1HCY18**	**1HCY17**	**YoY**
Net Sales	30,881	22,938	35%	62,392	46,829	33%
Cost Of Sales	29,132	21,017	39%	58,026	42,004	38%
Gross Profit	**1,749**	**1,921**	**-9%**	**4,365**	**4,825**	**-10%**
Selling & Dist.	642	675	-5%	1,446	1,382	5%
Admin.	517	416	24%	1,016	736	38%
Operating Profit	**589**	**830**	**-29%**	**1,904**	**2,707**	**-30%**
Other Income	213	260	-18%	389	445	-13%
Finance Cost	20	13	47%	93	41	1.25x
Profit Before Tax	728	1,002	-27%	2,048	2,896	-29%
Taxation	335	317	6%	750	904	-17%
Profit After Tax	**394**	**685**	**-43%**	**1,298**	**1,992**	**-35%**
EPS	4.8	8.3		15.8	24.2	

Source: IGI Research, Company accounts, PSX *No of shares(mn): 82.3*

Volumes to hit the skid in short to medium term

With impressive growth achieved in sales, to the tune of 86k units, the company achieved net sales of PKR 62.4bn during the 1HCY18. Growth in topline was also boosted by price hikes (8-12%/unit) during the six-month period. Going forward, we expect net sales to suffer backlash given slowdown in sales volume with the ban imposed on non-filers. Assuming, 100-150/month decrease in sales across all units, we expect volumes to hover around ~125k units by the year end, CY18. However, recovery in volumes can be expected in medium to short term with company launching better offerings in the small engine segment (new Alto in the making) so as to maintain its foothold and with non-filers customers entering into tax regime.

Macro headwinds may keep margins sensitive

The past six months have witnessed strong movements in PKR, as the currency tumbled by 23% against USD. In addition, volatility was also witnessed in JPY during the early half of the period as well with the currency touching 105 against USD. However, the company maneuvered the ensuing rising costs with series of price hat-trick. But even then, margins weakened by ~300bpsYoY to 7%, especially during the 1QCY18, wherein the impact worsened by 400bpsYoY. With PKR movement to remain sensitive in medium term, we expect margins to oscillate within range of 6-7%. Any further PKR depreciation would pose major setback for the company owing to its limited price-pass over capacity and most importantly with the competition to kick in this will become more challenging.

Exhibit:
Sales Composition on average

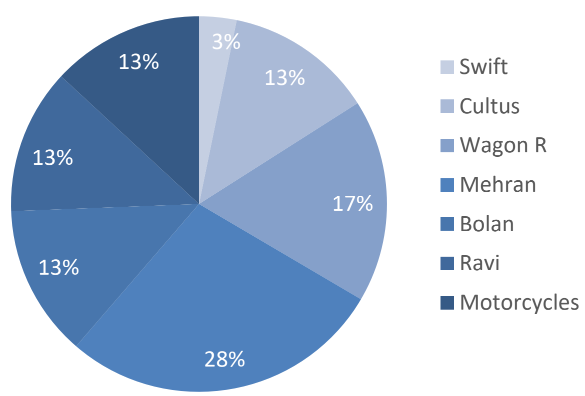
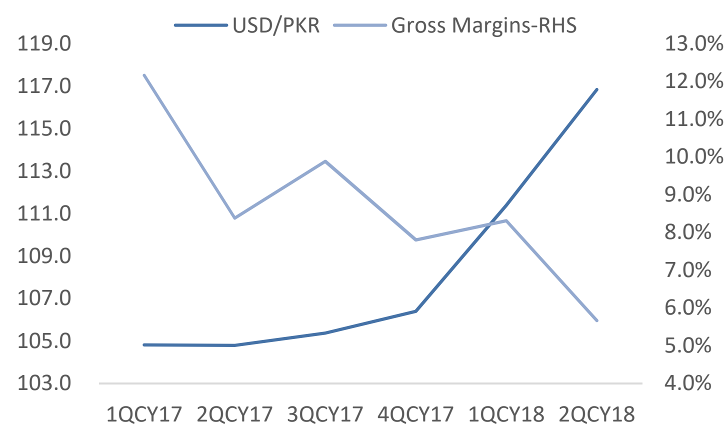


Exhibit:
USD/PKR and Gross margins (RHS) movement



Source: IGI Research, Company accounts, Bloomberg

Entry of United Bravo and closure of Mehran; Alto to rescue

The company recently announced to discontinue Mehran from April 2019. Earlier the company also stated to cease production of the VX-variant as well. The move comes at a time when a new entrant, United Motor has come up front with its United Bravo, providing neck to neck competition in small engine category segment. This will chip away company's share in this segment. However, with Alto (660 cc) to replace Mehran by next year, this may provide some respite to depleting sales volume. But, much depends on the value which the company has to offer to its customers and even that at a competitive pricing. Apparently, it seems quiet challenging to offer Alto at a price range (PKR .75-.85mn) of Mehran without compromising features offered in United Bravo. Hence, one can expect price of the vehicle to touch or cross PKR 1.0mn mark. More so, with spare parts availability also being a purchasing criterion for the customers the company in this regard can give an edge to United Bravo as the former has maintained its dominance in this market.

Downward revision in earnings by 20% for CY18E/CY19F/CY20F

Accordingly, our earnings estimates are marginally revised downwards by 15-20% to PKR (33/28/31)/share for CY18E/CY19F/CY20F. Tepid volumetric sales and shrinking gross margins will keep profitability subdued in short to medium term. More so, with relatively limited cash availability amongst other peers in the industry the company has minimal capacity to park in investments and garner sufficient support from other income.

Recommendation

We have a "BUY" call on scrip with our revised Dec-18 target price of PKR 315.9/share, offering +17% upside from its last closing. The company is currently trading at CY18E P/E of 8.1x and offers a dividend yield of 2.7%.

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Recommendation	Rating System
Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
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Time Horizon: Dec – 2018

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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