Day Break

Thursday, 22 September 2016

Company Update

Indus Motor Company Limited

Automobile Assembler

Recommendation	HOLD
Target Price	1,263.4
Last Closing	1,300.2
Upside	-3%

Market Data

Bloomberg Tkr.	INDU PA
Shares (mn)	78.6
Market Cap (PKRbn | USDmn)	102.2 | 975.8
Exchange	KSE 100

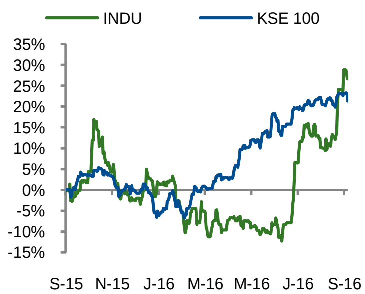
Price Info.	90D	180D	365D
Abs. Return	39.6	42.9	26.7
Low	899.7	899.7	899.7
High	1,322.3	1,322.3	1,322.3

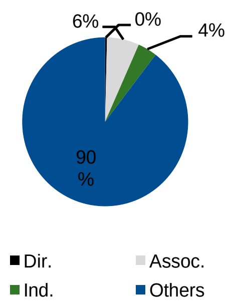
Key Company Financials

Period End: Jun

PKRbn	FY15A	FY16A	FY17F	FY18F
Total Revenue	96.5	108.8	98.3	94.1
Net Income	9.1	11.5	9.8	8.1
EPS (PKR)	115.9	145.7	124.1	103.1
DPS (PKR)	80.0	100.0	81.0	68.0
Total Assets	50.4	57.5	53.0	51.7
Total Equity	24.0	27.6	31.0	33.8
Key Financial Ratios				
ROE (%)	38%	41%	31%	24%
P/E (x)	11.2	8.9	10.5	12.6
P/B (x)	4.3	3.7	3.3	3.0
DY (%)	6.2	7.7	6.2	5.2

Relative Price Performance & Shareholding





About the Company

The Company was incorporated as a public limited company in Pakistan in December 1989 and started commercial production in May 1993. The company is the sole distributor of Toyota and Daihatsu vehicles in Pakistan.

Source: Bloomberg, KSE 100 & IGI Research

Analyst

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Automobile Assemblers

INDU: Expensive valuation multiples warrant a 'Hold' Call

- We have rolled over our price target for INDU to Jun-17 and tweaked our earnings estimates
- We highlight;
  a) Corolla volumes reached its inflection point, b) Launch of Hilux and Fortuner; unlikely to arrest, c) Gross margins likely to face headwinds owing to recovery in commodity prices and stronger JPY, and d) Payout policy likely to stiffen owing declining operating cash flows and capex requirements.
- Company earnings are estimated to register a 3yr-CAGR decline ~15% in FY17-20.
- Our Jun-17 target price for INDU using a Discounted Cash Flow (DCF) valuation comes at PKR 1,263/share. We recommend a '**Hold** 'stance. Forward valuations multiples in our view are stretched out, where the scrip is trading at FY17/18/19 P/E of 10.5x/ 12.6x / 13.4x, while offering ~6% dividend yield

We have rolled over our price target for INDU to Jun-17 and tweaked our earnings estimates to incorporate changes in our sales assumption for all three variants (Corolla, Hilux and Fortuner) and recent changes in exchange rate / commodity prices.

Corolla volumes reached its inflection point

After experience a robust volumetric sales growth in Corolla, ~ 57k units in FY16, up by +12%YoY – we estimate FY17-19 average sales to likely to drop to 48kunits/year, that's nearly a 16% drop from its peak sales in FY16. In two months leading to FY17 sales of Corolla have averaged 4.1kunits/month compared to 4.8kunits/month in FY16, this slowdown is due to launch of 10th Generation Honda Civic, which has taken up a sizeable volume chunk of Corolla volumes for the two months. Nevertheless, cheap bank financing schemes (recently HBL offered one of the lowest rates on auto financing) and growing auto demand we estimate Corolla sales at 51.7 units (4.3k units per month). Moreover, we see greater demand emanating for high end variants, which should support margins.

Launch of Hilux and Fortuner; unlikely to support earnings

The management in its recent briefing, highlighted launch of Hilux (pick-up) before Dec-16 and expects to launch 2nd Generation Fortuner variant (SUV) before 1QCY17. Base price of Hilux (4x4 / 4x2) is estimated at PKR ~3.5 / 2.0mn and PKR ~5.0mn for Fortuner. Excluding the one-offs sales number for the month of Jun-16 (1,320 units) average monthly sale of Hilux was around ~418units (includes launch of new variant Vigo TRD and Vigo GSX+) in FY16 compared to 376units in FY15, up by +11%YoY. In FY17, we expect launch of new Hilux version would further accrete volumes (460units per month on average). Similarly, launch of Fortuner 2nd Generation is likely to increase volumetric sales to 58 units on average per month in FY17 compared to 50units same period last year. The growth Fortuner is likely to remain muted owing to increasing competition from imported used SUVs currently enjoying concessionary tax and regulatory duty.

Gross margins likely to face headwinds owing to recovery in commodity prices and stronger JPY

INDU's gross margins depend upon international steel prices (~60% of raw material cost) and the exchange rate parity relations between PKR, JPY and USD. Although during the year JPY appreciated against USD (+16%YoY), but its affect was negated by 35%YoY slump in international steel prices from USD 593/ton in FY15 to USD 438/ton and higher capacity utilizations, resulting in improved gross margins by +155bpsYoY to 16.3%. However, we believe gross margins have peaked out and will face attrition on the back of steel prices recovery and stronger JPY.

Payout policy likely to stiffen up owing declining operating cash flows and Capex requirements

INDU maintained its cash distribution practices and paid out dividend of PKR 100/share (payout averaged ~70% in FY13-16). However, going forward we expect payout policy to slightly stiffen up (average 65% in FY17-19) owing to declining operational cash flow (PKR 145/share in FY16 to PKR 62/share in FY17) along with additional capex requirements of PKR 2.5bn for launch of Hilux and Fortuner model.

Outlook: Earnings to decline post 'Golden Period'

After witnessing a superior growth period in FY15/FY16 with earnings of PKR 115 /145 per share (compared to PKR 40 per share in FY14), we expect INDU earnings to face attrition for the period FY17-20, based on lower Corolla volumes and mean reverting margins. Company's operating margins are estimated to average ~11.1% in the next five years, which is still higher than previous 5yr average of 9.7%. We expect company's operating profit to show 15% decline during FY17-20. In addition, growing proportion of cash and cash equivalents (PKR 36.4bn in FY16, where company earned average return of ~8.7% in FY16 on cash & cash equivalents compared to ~13.2% in FY12) to total assets is hampering overall profitability growth, given low interest environment. As a result, earnings are estimated to register a ~15% 3yr-CAGR decline.

Recommendation

Based on Company's updated financials and revised assumption, the company earnings are estimated to post a 3yr-CAGR decline ~15% in FY17-20, with topline showing a negative CAGR of 5% for FY16-19. Our Jun-17 target price for INDU using a Discounted Cash Flow (DCF) valuation comes at PKR 1,263/share. The stock has rallied nearly +39% in the past 90days (3months) compared to KSE +6% in the same period, to last close at PKR 1,311/share. Hence based on our target price, we recommend a '**Hold** 'stance. Forward valuations multiples in our view are stretched out, where the scrip is trading at FY17/18/19 P/E of 10.5x/ 12.6x / 13.4x, while offering ~6% dividend yield.

Exhibit: Changing Passenger car pattern

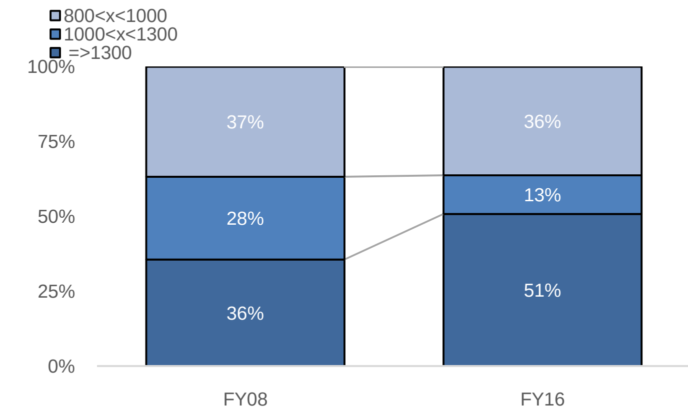


Exhibit: Reduce market share of INDU Corolla Model post Civic launch

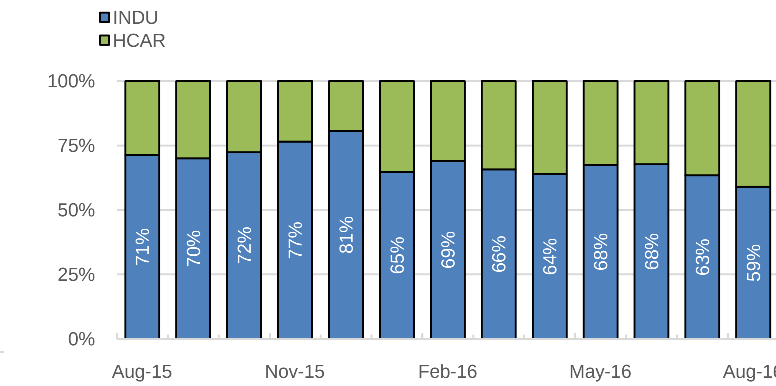


Exhibit: Sales growth (base year FY13)

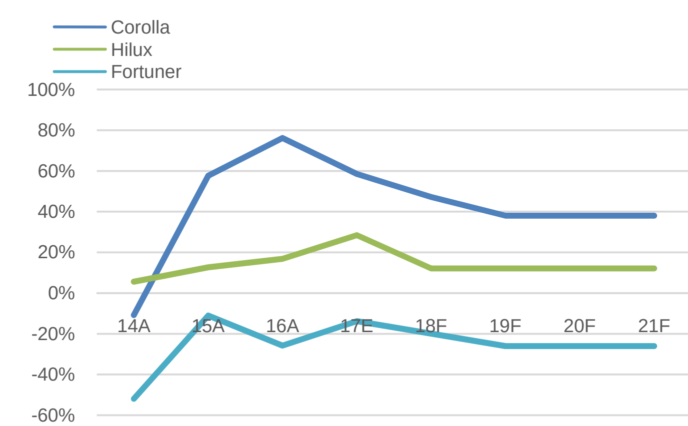
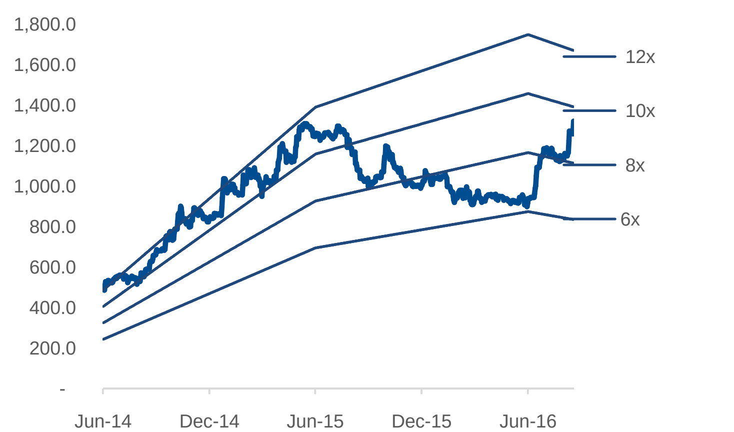


Exhibit: P/E band



Source: IGI Research, Company Financial

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Recommendation	Rating System
Buy	If return on aforementioned security(ies) is more than 10%, from its last closing price(s)
Hold	If return on aforementioned security(ies) is in between -10% and 10%, from its last closing price(s)
Sell	If return on aforementioned security(ies) is more than -10%, from its last closing price(s)

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

- DCF (Discounted Cash Flow)

Time Horizon

- Jun - 2017

Risk

- Changes in State Bank of Pakistan Policy Rate
- Change in Country (Pakistan) macro-economic environment
- Changes in Company(ies) operating structure
- Changes in Exchange rate

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