

## Car Assemblers

Sector Update

SELL INDU Rs178.43

SELL PSMC Rs102.22

### 'Downgraded to Under-Weight'

Indus Motor (INDU) and Pak Suzuki Motor Company (PSMC) from their trough levels this year have witnessed extraordinary returns of 244% and 163%, outperforming the market by 206% and 107%. Improving sector fundamentals at the back of sales recovery and declining cost pressures have been a major reason behind such a strong rally. However, we believe the positives have now been completely priced in. Resultantly, stock prices have exceeded our target prices for INDU and PSMC by 27% and 36% respectively. Hence, we are downgrading our stance on the scrips to 'Sell' from 'Hold' earlier. Consequently, we are also downgrading our outlook on the sector to 'Under-Weight'.

INDU and PSMC are currently trading at forward looking earning multiples of 12.4x and 10.9x which are at 77% and 55% premium to the market. Historically the two scrips have traded at a discount of 37% and 5%. Upside risks to our valuations are 1) relaxation in financing schemes by banks, 2) major cut in car prices and 3) further assistance from the government.

#### Indus Motor (INDU)

Target price Rs140

Market Price:  
Rs178.43

Market Cap:  
Rs14.0bn  
US\$0.2mn

1-yr Avg. Daily Volume:  
0.06mn shares  
Rs6.9mn  
US\$0.08mn

1-yr High/Low:  
Rs178.43/51.81

Estimated free float:  
19.7mn shares (25.0%)

#### Pak Suzuki Motor (PSMC)

Target price Rs75

Market Price:  
Rs102.22

Market Cap:  
Rs8.4bn  
US\$0.1mn

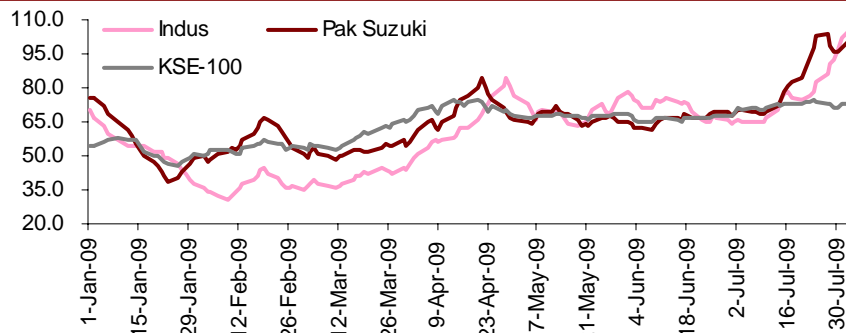
1-yr Avg. Daily Volume:  
0.06mn shares  
Rs4.5mn  
US\$0.05mn

1-yr High/Low:  
Rs103.94/38.86

Estimated free float:  
21.5mn shares (26.1%)

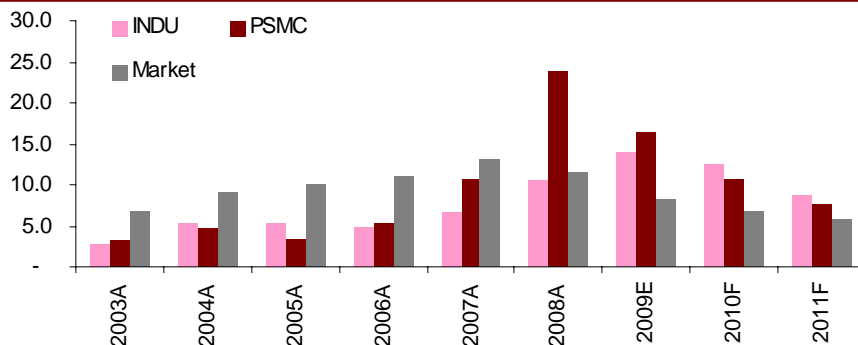
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Graph 1: Relative performance of INDU & PSMC vs Market



Source: KSE, JS Research

Graph 2: PE(x) trend



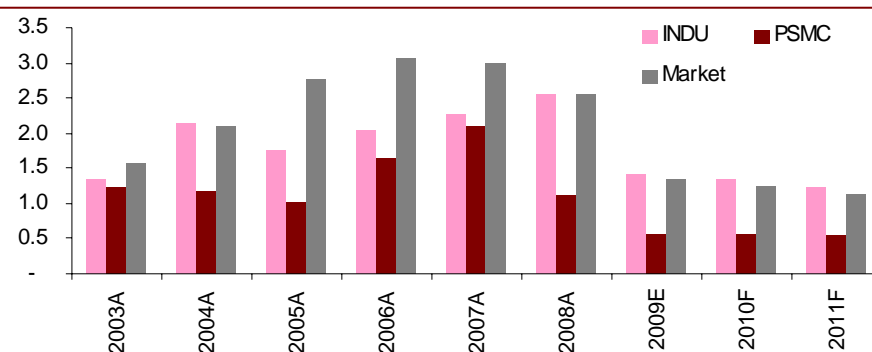
Source: JS Research

## Valuation: All positives are priced in

From their trough levels made this year, INDU and PSMC have posted extraordinary returns (adjusted) of 244% and 163% respectively while outperforming the market by 206% and 107% at the back of improving fundamentals of the auto sector. We believe the changing dynamics of the sector have now been completely priced in. Hence we are downgrading both the stocks to 'Sell'. Our target price is Rs140 for INDU and Rs75 for PSMC.

INDU and PSMC are currently trading at FY10F P/E of 12.4x and 10.9x which are at significant premium of 77% and 55% to the market's forward looking earnings multiple of 6.9x whereas, historically these stocks have traded at an average discount to the market of 37% and 5% respectively. Moreover, despite sectors average 25% earnings growth for FY11F, INDU and PSMC still look expensive as the scrips are trading at FY11F P/E of 8.7x and 7.5x (47% and 26% premium to the market). Though their FY10F P/BV looks reasonably attractive at 1.3x and 0.6x, against markets 1.2x, the stocks have historically traded at a discount of 17% and 48%. INDU and PSMC FY10F ROE of 10.7% and 5.1% disappoints further when compared to their historical four year average of 33% and 21% respectively.

**Graph 3: PBV(x) trend**



Source: JS Research

## Things to be wary of...

### MoM growth in sales may well be deceptive

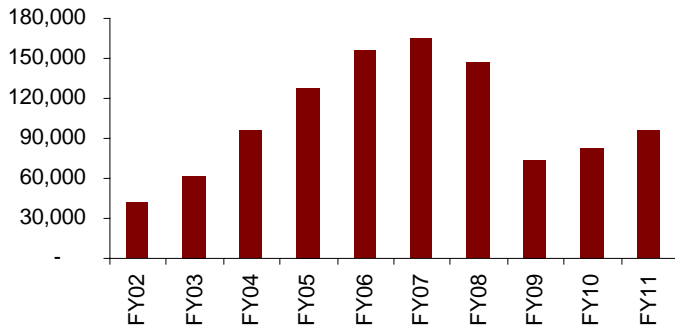
For car assemblers FY09 turned out to be a turbulent year as car sales declined by 50%YoY led by economic slowdown, inflated commodity prices and security concerns. Though, MoM growth witnessed in the past four months has given some ray of hope for the car assemblers, we believe a lot more has to be achieved in the shape of monetary easing and relaxation of stringent car financing terms by banks to stimulate car sales.

Auto sales (units)	FY09	FY08	Δ%	Jun-09	May-09	Δ%
Indus Motor	34,146	47,845	-29%	3,889	3,589	8%
Pak Suzuki	50,584	114,270	-56%	3,966	3,701	7%
Dewan Motor	2,287	9,075	-75%	198	260	-24%
Honda Car	11,144	15,487	-28%	862	701	23%
<b>Industry LCV/car sale</b>	<b>99,065</b>	<b>187,412</b>	<b>-47%</b>	<b>9,099</b>	<b>8,302</b>	<b>10%</b>
<b>Industry car sales</b>	<b>74,180</b>	<b>147,441</b>	<b>-50%</b>	<b>6,993</b>	<b>6,604</b>	<b>6%</b>

Source: PAMA, JS Research

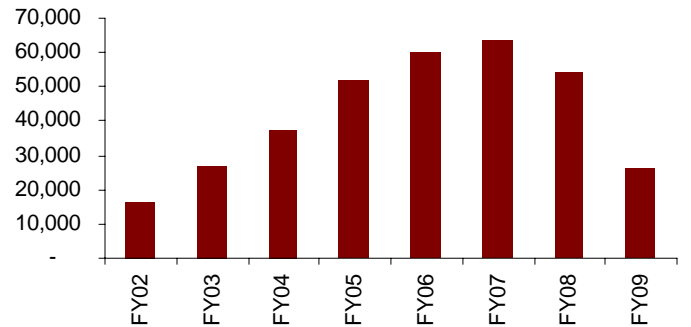
Car sales have depicted average monthly growth of 6% over the last four months with average monthly sales volume of 6,550 units. However looking at 5-year historical performance of car sales during Mar-Jun, average car sales have been recorded at 13,360 units with an average growth of 8%. Hence it can be derived that the growth witnessed in the past few months can be attributed to seasonality while average growth too has lagged behind. Though we are expecting 12% rise in volumetric sales for FY10, resultant sales will still be 44% lower than average sales achieved during FY05-FY08.

**Graph 4(a): Annual car sales (units)**



Source: PAMA, JS Research

**Graph 4(b): Mar-June car sales (units)**

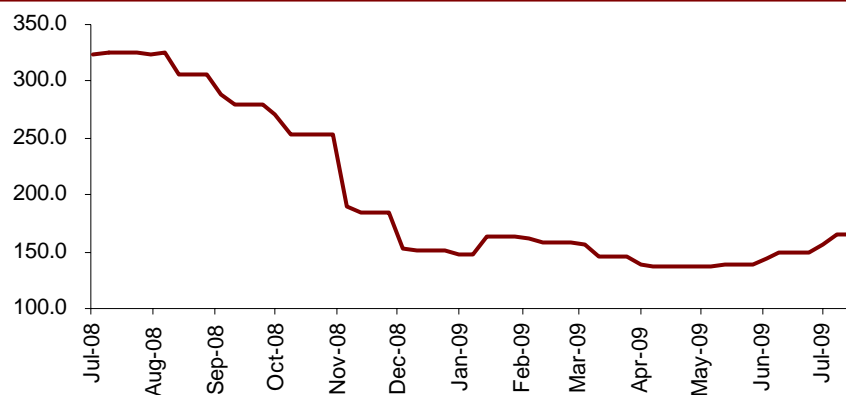


Source: PAMA, JS Research

### Steel prices seen reversing from its trough

Steel prices after dropping to 70% from its peak have started to gradually recover and are currently up 21% from trough prices. Persistent price escalation from here bodes negative for the car assembler's margins, as steel constitutes a major portion of the cost production.

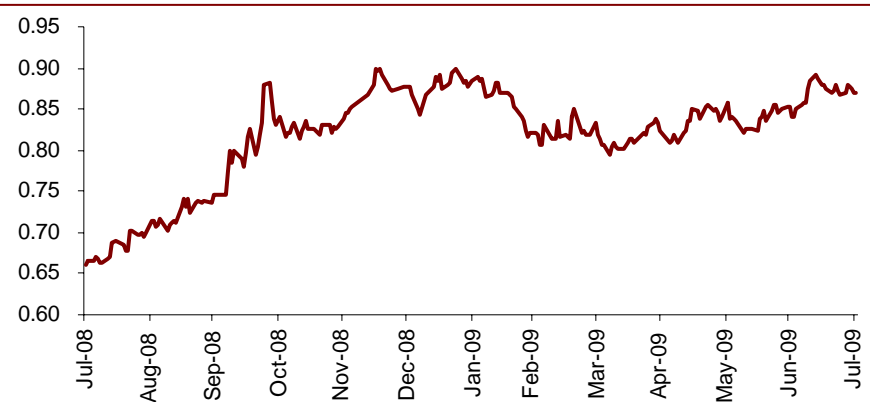
**Graph 5: CRU Asian Steel Index**



Source: Reuters

### Depreciating rupee, another cause of concern

As most of the high valued components are imported from parent company in Japan, Rupee/yen parity plays a pivotal role in driving gross margins. Yen has appreciated by 9% since Apr 06, 2009 which along with rising steel prices would squeeze margins of the car assemblers. Hence, restricting room for any future price cuts.

**Graph 6: Rupee-Yen parity**

Source: JS Research

## Upside risks to our valuations

### Banks to relax car financing facilities

Monetary easing and relaxation in car financing by banks will be the key in stimulating car sales. It is estimated that 70-75% of car sales during peak years of FY06 and FY07 were through car financing whereas only 20-25% of the cars are currently being financed through these schemes. Though 6M KIBOR has come down 378bps since the start of the year, it has failed to drive car sales as banks have taken a conservative approach towards providing car financing at back of rising Non performing loans (NPLs). However, relaxation of financing facility is the upside risk to valuation.

### Major cut in car prices

Amid measure of removing 5% FED in the Budget FY10, we saw reduction in car prices on 850CC and above segments. Moreover, PSMC has decreased its 800CC segment car prices in the range of 4-5% though for a limited time period only. These reductions have not resulted in any major shift in consumer buying. However any further cut in prices may help generate some volumes which in turn will help auto stocks perform strongly. Strong volumetric growth in the past has resulted in auto stocks outperformance vis-à-vis the market.

### Further assistance from the government

In recent times, government has been very kind to the car assemblers. Government have provided relief in the shape of removal of 5% FED, deferment of AIDP, removal of 35% LC Margin and reduction in depreciation rate on imported cars to 1%. Further relief in the shape of reduction in age limit on imported cars is a possibility. Such measures will be positive for the car assemblers.

## Indus Motor Company

(Rs mn)	FY07A	FY08A	FY09E	FY10F	FY11F
<b>Income Statement</b>					
Net sales	39,061	41,424	35,176	37,773	43,283
CGS	34,621	37,575	33,258	35,371	39,996
<b>Gross profit</b>	<b>4,441</b>	<b>3,848</b>	<b>1,918</b>	<b>2,402</b>	<b>3,287</b>
Other income	956	787	714	496	538
EBIT	3,553	2,811	4,123	5,598	5,843
Financial charges	44	3	2	2	2
PBT	4,229	3,542	1,562	1,739	2,481
Tax	1,484	1,251	547	609	868
<b>PAT</b>	<b>2,746</b>	<b>2,291</b>	<b>1,015</b>	<b>1,130</b>	<b>1,613</b>
<b>Balance Sheet</b>					
Paid up capital	786	786	786	786	786
Reserves	7,258	8,650	8,997	9,772	10,762
<b>Shareholder's Equity</b>	<b>8,044</b>	<b>9,436</b>	<b>9,783</b>	<b>10,558</b>	<b>11,548</b>
Current liabilities	7,411	3,780	2,071	1,838	1,914
<b>Total Liabilities &amp; Equity</b>	<b>15,665</b>	<b>13,748</b>	<b>11,885</b>	<b>12,430</b>	<b>13,509</b>
Total Fixed Assets	2,094	4,034	3,863	3,853	3,919
Other assets	35	50	49	49	49
Total current assets	13,536	9,665	7,973	8,528	9,540
<b>Total Assets</b>	<b>15,665</b>	<b>13,748</b>	<b>11,885</b>	<b>12,430</b>	<b>13,509</b>
<b>Ratio Analysis</b>					
<b>Valuation</b>					
Earning per share	34.9	29.1	12.9	14.4	20.5
Dividend per share	13.0	10.5	4.5	5.8	9.2
Book value per share	102.3	120.1	124.5	134.3	146.9
Price to earning ratio (x)	6.6	10.6	13.8	12.4	8.7
Dividend yield (%)	5.6%	3.4%	2.2%	3.2%	5.2%
Price to book value (x)	2.3	2.6	1.4	1.3	1.2
<b>Profitability</b>					
Gross margin	11.4%	9.3%	5.5%	6.4%	7.6%
EBIT margin	9.1%	6.8%	11.7%	14.8%	13.5%
Pretax margin	10.8%	8.5%	4.4%	4.6%	5.7%
Net margin	7.0%	5.5%	2.9%	3.0%	3.7%
Return on assets	17.5%	16.7%	8.5%	9.1%	11.9%
Return on equity	34.1%	24.3%	10.4%	10.7%	14.0%
<b>Momentum</b>					
Sales growth	10.9%	6.0%	-15.1%	7.4%	14.6%
Net profit growth	3.7%	-16.6%	-55.7%	11.4%	42.7%

Source: JS Research and Company Accounts

## Pak Suzuki Motor Company

(Rs mn)	2007A	2008A	2009F	2010F	2011F
<b>Income Statement</b>					
Net sales	50,845	39,670	30,846	37,823	43,117
CGS	46,084	39,079	30,077	36,367	41,119
<b>Gross profit</b>	<b>4,760</b>	<b>591</b>	<b>769</b>	<b>1,457</b>	<b>1,999</b>
Other income	921	1,343	898	737	845
EBIT	4,425	1,046	912	1,318	1,863
Financial charges	144	53	118	121	125
PBT	4,281	992	794	1,197	1,738
Tax	1,507	367	279	421	612
<b>PAT</b>	<b>2,775</b>	<b>625</b>	<b>514</b>	<b>775</b>	<b>1,127</b>
<b>Balance Sheet</b>					
Paid up capital	823	823	823	823	823
Reserves	13,154	13,330	13,891	14,337	15,011
<b>Shareholder's Equity</b>	<b>13,977</b>	<b>14,153</b>	<b>14,714</b>	<b>15,160</b>	<b>15,834</b>
Current liabilities	7,125	2,657	7,753	8,064	8,389
<b>Total Liabilities &amp; Equity</b>	<b>21,201</b>	<b>16,956</b>	<b>22,566</b>	<b>23,323</b>	<b>24,322</b>
Total Fixed Assets	4,986	4,962	4,767	4,589	4,343
Total current assets	16,216	11,808	17,799	18,734	19,979
<b>Total Assets</b>	<b>21,201</b>	<b>16,956</b>	<b>22,566</b>	<b>23,323</b>	<b>24,322</b>
<b>Ratio Analysis</b>					
<b>Valuation</b>					
Earning per share	33.7	7.6	6.2	9.4	13.7
Dividend per share	5.0	2.5	3.0	4.0	5.5
Book value per share	169.8	172.0	178.8	184.2	192.4
Price to earning ratio (x)	10.7	24.0	16.4	10.9	7.5
Dividend yield (%)	1.4%	1.3%	2.9%	3.9%	5.4%
Price to book value (x)	2.1	1.1	0.6	0.6	0.5
<b>Profitability</b>					
Gross margin	9.4%	1.5%	2.5%	3.9%	4.6%
Operating margin	8.7%	2.6%	3.0%	3.5%	4.3%
Pretax margin	8.4%	2.5%	2.6%	3.2%	4.0%
Net margin	5.5%	1.6%	1.7%	2.1%	2.6%
Return on assets	13.1%	3.7%	2.3%	3.3%	4.6%
Return on equity	19.9%	4.4%	3.5%	5.1%	7.1%
<b>Momentum</b>					
Sales growth	5.5%	-19.6%	-24.6%	22.6%	14.0%
Net profit growth	-17.3%	-75.7%	-23.8%	50.8%	45.3%

Source: JS Research and Company Accounts

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