

Indus Motor (INDU PA)

Revving up - Buy

Company Update: **BUY**

Target Price: **Rs249**

Automobile Assembler

March 2010



JS Global Capital Limited

We upgrade our stance on Indus Motor Company (INDU) to 'Buy' from 'Hold' earlier with a revised DCF based target price of Rs249, offering a potential upside of 19%. Higher than expected volumetric sales and the company's ability to persistently pass through higher costs has resulted in an upward revision in earnings by 10-17%. As a result, sales revenue is expected to grow by a 4 year (FY09-13) CAGR of 13%, which in turn will result in earning's growth of 83% and 11% in FY10 and FY11, respectively. Easy availability of car financing is likely to provide further upside to our valuation, while higher than expected commodity prices and Rupee depreciation remain our key downside risks. Further validating our stance is INDU FY11F PE of 5.9x, which is trading at a discount of 25% and 58% to its 3-year historical and one year forward looking regional earnings multiples, respectively.

KATS Code:
INDU

Bloomberg Code:
INDU PA

Reuters Code:
INDM.KA

Market Price:
Rs209.67

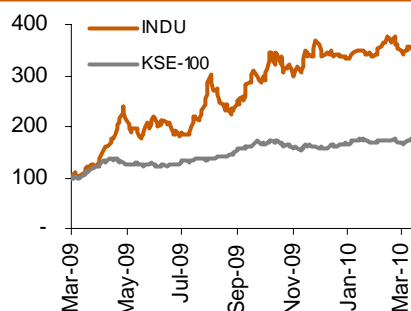
Market Cap:
Rs16.5bn
US\$196mn

1-yr Avg. Daily Volume:
0.1mn shares
Rs17mn
US\$0.2mn

1-yr High/Low:
Rs222.18/62.50

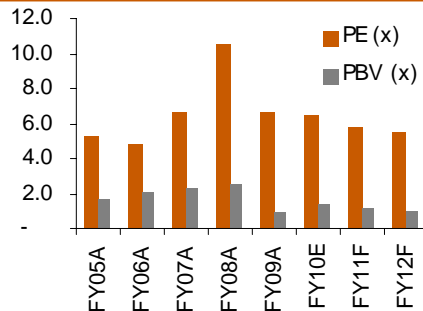
Estimated free float:
15.7mn shares (20%)

INDU vs KSE-100 index



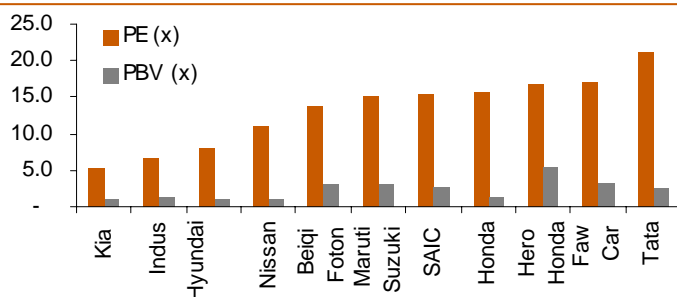
Source: KSE & JS Research

INDU PE and PBV trend



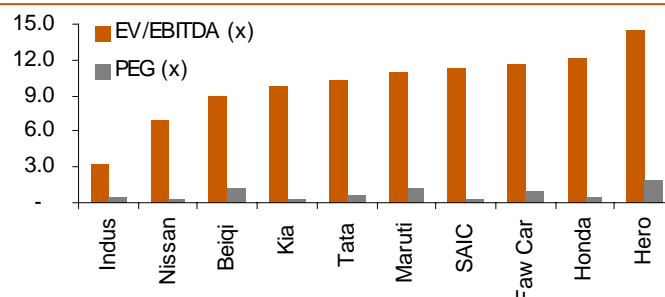
Source: JS Research

Regional PE and PBV for FY10



Source: Reuters & JS Research

Regional EV/EBITDA and PEG for FY10



Source: Reuters & JS Research

Key numbers

	FY08A	FY09A	FY10E	FY11F	FY12F
EPS (Rs)	29.1	17.6	32.3	35.8	37.9
PBV (x)	2.6	0.9	1.4	1.2	1.1
PE (x)	10.6	6.6	6.5	5.9	5.5
Dividend yield	3.4%	8.5%	6.7%	7.1%	7.6%

Source: JS Research

Syed Atif Zafar
atif.zafar@js.com
Analyst
92 (21) 111-574-111
(ext. 3118)

Valuation

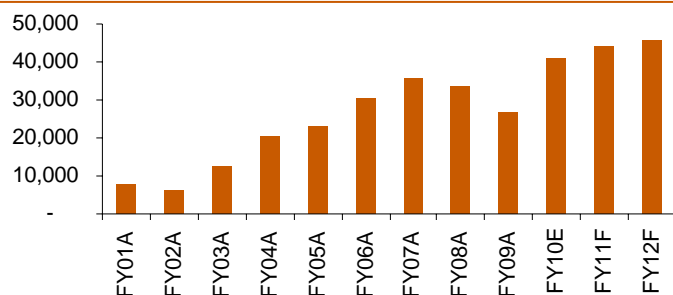
Based on the discounted cash flow methodology, our fair value for INDU arrives at Rs249 per share, offering a potential upside of 19%. Our valuation is based on a risk free rate of 11% and a terminal growth of 3%. Our cost of equity arrives at 15.3%, using a market risk premium of 6% and Beta of 0.72. Moreover, its one year forward looking earning multiple is at a discount of 25% and 58% to its 3 year historical average and one year forward looking of regional peers, respectively. The scrip also looks attractive on its FY11F PB valuation, as it is trading at a discount of 37% and 29% to its historical 3 year average and regional competition. Moreover, the scrip offers a decent FY11F dividend yield of 7.1%.

Volumes picking up

Corolla – Better Value for Money

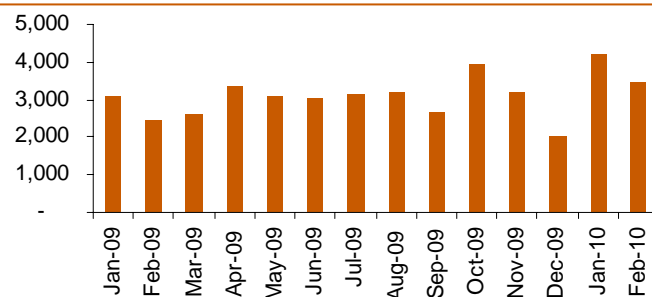
Indus Motor outperformed the industry sales by 50% during the first eight months of FY10. Corolla sales have been the primary determinant of an impressive 79%YoY growth for the company during this period. In our view, 1) last year's low base effect due to the phase out of the previous model (only 850 units produced in Jul-Aug FY09 vs 6,396 units in Jul-Aug FY10), 2) higher farm income and 3) better value for money are the drivers for stellar Corolla sales.

Corolla's annual sales (units)



Source: PAMA & JS Research

Corolla's monthly sales (units)



Source: PAMA

We expect Corolla sales to continue experiencing impressive growth in 2HFY10 based on historical trend, as sales are usually 1.3x times higher than the first half of the year. Hence, we expect Corolla sales to arrive at 40,840 units for the full year FY10, up 53%YoY. Further, improvement in the law and order situation, particularly in the Northern parts of the country should further stimulate sales, which according to the management have completely dried up.

Cuore – Subdued but monetary easing holds the key

Though Corolla sales have rebounded after declining 20%YoY in FY09, due to the high interest rate scenario and economic slowdown, INDU's other major product Cuore is yet to follow suit primarily owing to high competition from second hand imported cars. Cuore sales have remained subdued so far in FY10 (down 27%YoY in 8MFY10), and remain an area of concern for the company. With our economist expecting 250bps reduction in the discount rate in 2010, Cuore sales are expected to pick up going forward, as small car segment sales are more elastic towards the easy availability of car financing. Hence, we expect INDU to sell 4,123 units of Cuore during the full year FY10.

Assumptions

Risk free rate	11%
Beta	0.72
Market Premium	6.0%
Terminal Growth	3%
Cost of Equity	15.3%

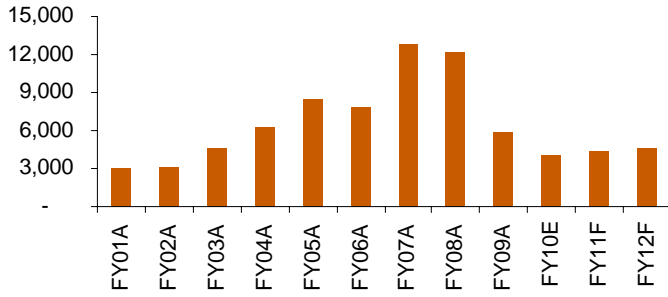
Source: JS Research & Bloomberg

Valuation

PV of cash flows (Rs mn)	8,468
PV of Terminal value (Rs mn)	11,089
Equity value (Rs mn)	19,556
No of shares (mn)	78.6
Target price (Rs)	249

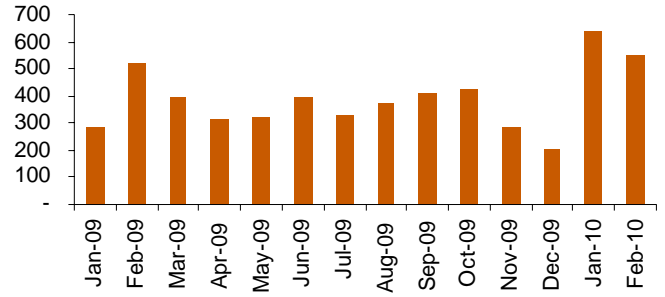
Source: JS Research

Cuore's annual sales (units)



Source: PAMA & JS Research

Cuore's monthly sales (units)

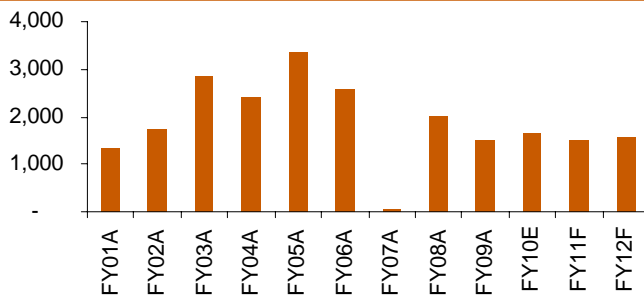


Source: PAMA

Hilux - Government purchase orders to look out for...

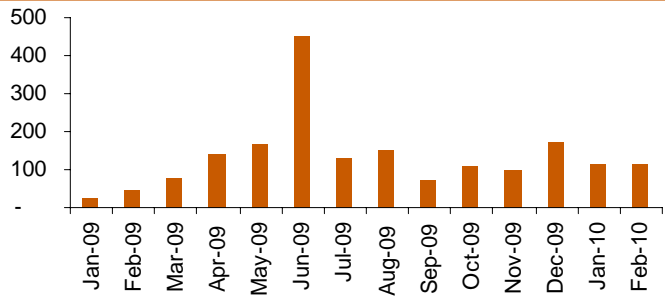
INDU's third product, Hilux, saw a rise of 40%YoY during the Jul-Feb period of FY10. Significant sales orders from the Police and the Army due to the military operation being conducted in the Northern Areas have been the major reasons for push up in sales of the product.

Hilux's annual sales (units)



Source: PAMA & JS Research

Hilux's monthly sales (units)

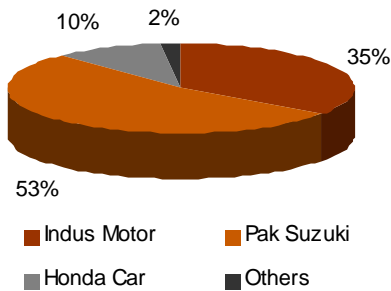


Source: PAMA

Corolla strengthening INDU's market share

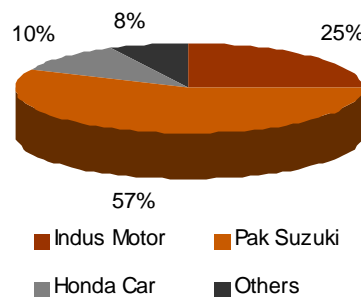
We expect the company's market share to increase to 35.2% in FY10 from 34.4%, a year earlier. Corolla is expected to regain its position in the 1300-1800CC segment. Its share is expected to rise to 72% in FY20 from 69%, a year earlier. Hence, we expect volumetric sales for the company to post a 4 year (FY09-13) CAGR of 12%.

Market share in 8MFY10



Source: PAMA

Market share in 8MFY09



Source: PAMA

Margins to hold firm

Persistent increase in car prices

Indus Motor has continuously raised prices across its product line (average retention up 49% since Jan 2008) to pass through sharp increase in raw material costs, steel in particular and persistent Pak Rupee depreciation against international currencies. This strategy is reflective of the fact that the company is more comfortable with maintaining margins as against increasing volumetric sales. We believe this has been a strategic success for the company, as Pak Suzuki's profitability suffered when it opted otherwise. Price hikes coupled with growth in volumetric sales are likely to raise the company's revenues by 38% to Rs52bn in FY10. Hence, we expect the company top-line to grow at a 4-year (FY09-13) CAGR of 13% and reach Rs64bn in FY14.

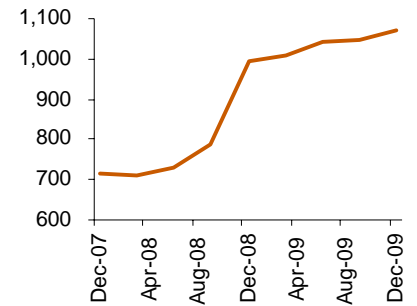
Steel prices to watch out for

Gross margin of the company bottomed out at 2.9% during the second quarter of FY09 amid all time high steel prices which peaked at US\$1,275 per ton. Since then, we have seen a steady recovery in the margins due to the global commodity meltdown. However, a gradual recovery in steel prices has been witnessed since it touched the trough of US\$425 per ton, and is currently being quoted at US\$645 per ton. This has started to exert pressure on the gross margins again but the company's ability to pass on cost strain will help it maintain margins, going forward.

Rupee depreciation a major concern

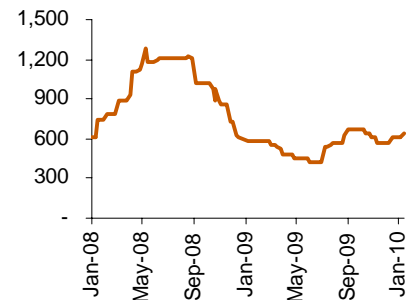
Pak Rupee depreciation is another prominent cost driver for the company. In FY09, rupee depreciated by 16% and 24% against US\$ and Japanese Yen, respectively. So far this year we have witnessed Rupee depreciation of 3% and 8%. However, with the State Bank of Pakistan (SBP) allowing 100% advance payment against imports, Pak rupee volatility is likely to be a lesser concern for INDU. This move now allows the company to make a complete payment at the date of placement of the order and remove the risk of Rupee devaluation. To recall, the SBP had reduced the limit by 50% to 25%, in 2008. Hence, we expect full year FY10 margins to arrive at 7.1%, and to remain stable in the future.

Retention price trend (Rs 000)



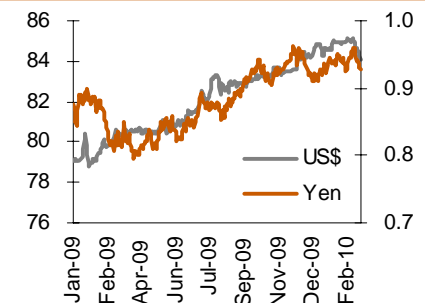
Source: Company accounts

Steel price trend (US\$/ton)



Source: Bloomberg

Rupee vs US\$ and Yen

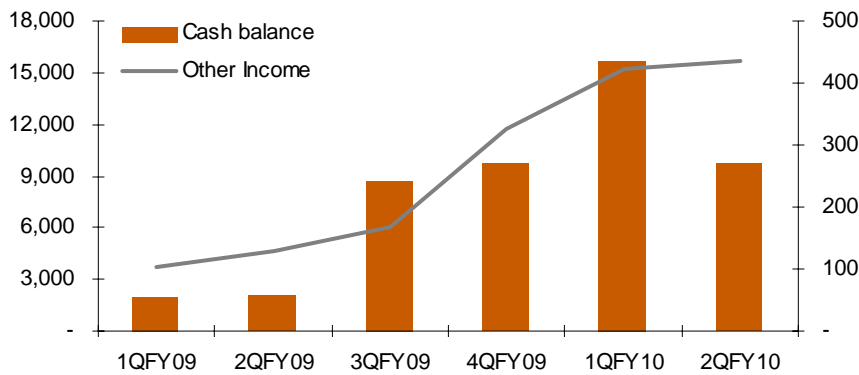


Source: JS Research

Higher cash balances bolstering bottom-line

High demand for 1300CC Corolla has enabled INDU to retain advance balances from customers for 60 days, which has boosted overall cash balances for the company. This has in turn boosted other income of the company, which normally invests its surplus cash in fixed income instruments. In 1HFY10, INDU booked other income worth Rs857mn, which is up 270% from the corresponding period last year. Cash per share for the company currently stands at Rs125, which is still 29% higher from its historical average. Even if advances from customers are netted against the cash balance, INDU's cash per share arrives at Rs47.

Cash balance and other income trend (Rs mn)



Source: Company accounts

Risks

Car Financing

During FY06-07 when auto sales were at their peak levels, car financing constituted a significant portion (70-75%) of the sales. However, owing to the tight monetary policy stance (discount rate increased by 500bps to 15% since Aug 2007) of the SBP, car leasing share contracted to 25-30%. Despite, monetary easing by 250bps in 2009, auto financing has not picked up substantially. We expect the trend in car financing to improve in FY10 and onwards as our economist expects a further 250bps reduction in the discount rate in 2010. Higher than expected reduction in the discount rate will provide further upside to our valuation while any unexpected tightening by the SBP is a downside risk.

Steel prices and Rupee depreciation

Steel prices and Pak rupee parity are the primary cost drivers for any car assembler in Pakistan and will be the key factor to watch out for, going forward. So far in FY10, steel prices have surged by 52% to US\$645 per ton, which is at par with our full year assumption of US\$666 per ton. On the other hand, our economist expects rupee to depreciate by 4% against US\$ in FY10. Higher than expected rise in steel prices and rupee depreciation are key downside risks to our valuation.

Deterioration in law and order situation

Stable law and order situation plays a pivotal role in the sales of car assemblers. Law and order concerns during last year had hampered auto sales significantly, particularly in the Northern parts of the country. We foresee significant improvement in the situation on the back of successful military operations in the upper parts of the country. Any deviation in this assumption will serve as a downside to our valuation.

Indus Motor – Financial Highlights

(Rs mn)	FY08A	FY09A	FY10E	FY11F	FY12F
Income Statement					
Net sales	41,424	37,865	52,264	56,789	60,319
CGS	37,575	35,540	48,555	52,553	55,678
Gross profit	3,848	2,324	3,709	4,236	4,641
Other income	787	727	1,548	1,492	1,391
EBIT	3,632	2,147	4,114	4,502	4,741
Financial charges	3	27	167	125	113
PBT	3,542	2,046	3,905	4,330	4,579
Tax	1,251	661	1,367	1,516	1,602
PAT	2,291	1,385	2,538	2,815	2,976
Balance Sheet					
Paid up capital	786	786	786	786	786
Reserves	8,650	9,511	10,949	12,584	14,303
Shareholder's Equity	9,436	10,297	11,735	13,370	15,089
Long term liabilities and others	532	504	414	398	372
Current liabilities	3,780	9,885	10,430	11,022	11,459
Total Liabilities & Equity	13,748	20,686	22,579	24,790	26,920
Total Fixed Assets	4,034	3,934	3,941	3,994	4,042
Other assets	50	36	49	49	49
Total current assets	9,665	16,715	18,589	20,747	22,830
Total Assets	13,748	20,686	22,579	24,790	26,920
Ratio Analysis					
Valuation					
Earning per share	29.1	17.6	32.3	35.8	37.9
Dividend per share	10.5	10.0	14.0	15.0	16.0
Book value per share	120.1	131.0	149.3	170.1	192.0
Price to earning ratio (x)	10.6	6.6	6.5	5.9	5.5
Dividend yield (%)	3.4%	8.5%	6.7%	7.1%	7.6%
Price to book value (x)	2.6	0.9	1.4	1.2	1.1
Profitability					
Gross margin	9%	6%	7%	7%	8%
Operating margin	9%	6%	8%	8%	8%
Pretax margin	9%	5%	7%	8%	8%
Net margin	6%	4%	5%	5%	5%
Return on assets	17%	7%	11%	11%	11%
Return on equity	24%	13%	22%	21%	20%
Momentum					
Sales growth	6%	-9%	38%	9%	6%
Net profit growth	-17%	-40%	83%	11%	6%

Source: JS Research and Company accounts

Research Team

Muzzammil Aslam	Economy & Politics	(92-21) 111574111 (ext. 3035)	muzzammil.aslam@js.com
Farhan Rizvi, CFA	Banks, Strategy & Insurance	(92-21) 111574111 (ext. 3096)	farhan.rizvi@js.com
Umer Bin Ayaz	E&P, Refinery & Power	(92-21) 111574111 (ext. 3103)	umer.ayaz@js.com
Syed Atif Zafar	OMCs, Cement, Autos & Chemicals	(92-21) 111574111 (ext. 3118)	atif.zafar@js.com
Mustufa Bilwani	Banks, Telecom & Paper&Board	(92-21) 111574111 (ext. 3100)	mustufa.bilwani@js.com
Bilal Qamar	Fertilizer & Textile	(92-21) 111574111 (ext. 3099)	bilal.qamar@js.com
Sana Hanif	Chemicals	(92-21) 111574111 (ext. 3102)	sana.hanif@js.com
Rabia Tariq	Textile	(92-21) 111574111 (ext. 3119)	rabia.tariq@js.com
Raheel Ashraf	Technical Analyst	(92-21) 111574111 (ext. 3098)	raheel.ashraf@js.com
Adeel Jafri	Database Manager	(92-21) 111574111 (ext. 3098)	adeel.jafri@js.com
Angela Yousuf	Research Trainee	(92-21) 111574111 (ext. 3097)	angela.memon@js.com
Muhammad Furqan	Librarian	(92-21) 111574111 (ext. 3105)	muhammad.furqan@js.com

Equity Sales

Junaid Iqbal	(92-21) 32799511	junaid.iqbal@js.com
Atif Malik	(92-21) 32799513	atif.malik@js.com
Raza Abbas	(92-21) 32799563	raza.abbas@js.com
Faiza Naz	(92-21) 32799505	faiza.naz@js.com
Muzammil Mussani	(92-21) 32799508	muzammil.mussani@js.com
Sameer Danawala	(92-21) 32799569	sameer.danawala@js.com
Asim Ali	(92-21) 32799509	asim.ali@js.com
Samar Iqbal	(92-21) 32800152	samar.iqbal@js.com
Irfan Iqbal	(92-21) 32799502	irfan.iqbal@js.com
Ahmed Abdul Rauf	(92-21) 32799518	ahmed.rauf@js.com
Abdul Aziz	(92-21) 32799507	abdul.aziz@js.com
Irfan Ali	(92-21) 32462567	irfan.ali@js.com

Main Office

6th Floor, Faysal House,
Main Shahrah-e-Faisal
Karachi. Pakistan
Tele: 92-21-111-574-111
Fax: 92-21-32800163-66
Website: www.js.com

KSE Office

2nd Floor, Room No. 75,
Karachi Stock Exchange Building,
Stock Exchange Road, Karachi.
Tele: 92-21-32425692 (2427458)
Fax: 92-21-32418106

Lahore Office

307 – Upper Mall,
Lahore – 54000
Pakistan
Tele: 92-42-111-574-111
Fax: 92-42- 5789109

Islamabad Office

Chaudhary Plaza, 65 West,
Fazal-e-Haq Road, Blue Area
Islamabad, Pakistan.
Tele: 92-51-111-574-111
Fax: 92-51-2806328

JS Global Capital Limited



ANALYST CERTIFICATION

I, Syed Atif Zafar, the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

DISCLAIMER

This report has been prepared for information purposes by the Research Department of JS Global Capital Limited. The information and data on which this report is based are obtained from sources which we believe to be reliable but we do not guarantee that it is accurate or complete. In particular, the report takes no account of the investment objectives, financial situation and particular needs of investors who should seek further professional advice or rely upon their own judgment and acumen before making any investment. This report should also not be considered as a reflection on the concerned company's management and its performances or ability, or appreciation or criticism, as to the affairs or operations of such company or institution. JS Global does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Warning: This report may not be reproduced, distributed or published by any person for any purpose whatsoever. Action will be taken for unauthorized reproduction, distribution or publication.