

March 15, 2010

Pakistan Market**INDU: Revving up – Buy****MORNING BRIEFING**

KSE100 Index: Closing 10025.99 ↑ (+146.29)

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.

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

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.

Margins to hold firm

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.

Risks

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.

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

For more details please refer to our short report titled "Indus Motor: Revving up – Buy".

atif.zafar@js.com
92 (21) 111-574-111 (ext. 3118)

Also in focus**Government to inject Rs45bn in PSO**

Media reports suggest that the Government has decided to inject around Rs45bn in PSO so that the company could pay its dues to refineries and meet its LC obligations for oil imports. The government has planned to arrange funds from various sources including TFC issues and adjusting tariff differential claims of KESC and PEPCO at source and the transfer is expected to be finalized by April 25, 2010. We believe if materialized, this additional liquidity would improve PSO's financial situation reducing its reliance on borrowings and potential reduction in financial charges. Currently we maintain 'Buy' on PSO.

JS Global Capital Limited

6th Floor, Faysal House, Main Shahrah-e-Faisal, Karachi

Research:

Tel: +92 (21) 32799005
Fax: +92 (21) 32800163
js.research@js.com

Fixed Income Sales:

Tel: +92 (21) 32799541-44
Fax: +92 (21) 32800165
tariq.usman@js.com

Equity Sales:

Tel: +92 (21) 32799513
Fax: +92 (21) 32800166
junaid.iqbal@js.com

Corporate Finance:

Tel: +92 (21) 32799005
Fax: +92 (21) 22800163
azhar.iqbal@js.com

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