JS Research

June 16, 2009

Pakistan Market

MORNING BRIEFING

Car Assemblers: Upgraded to 'Market-Weight'

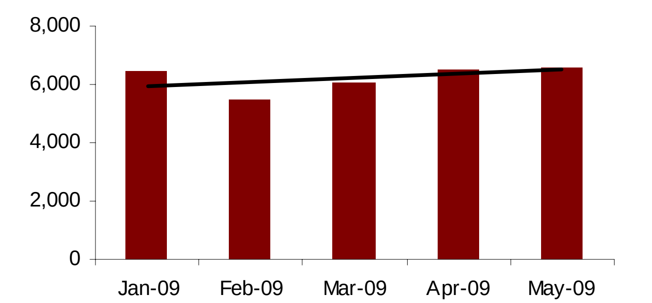
KSE100 Index: Closing 6953.09 ↓ (-103.22)

The 5% FED relieve in the budget, improved Rupee-yen parity, and reduced steel prices have turned things around for the car assembler's off late. Additionally, improved MoM car sales for three consecutive months, also highlights the improved fundamentals for domestic demand. Keeping in mind these updates, we are changing our stance on the sector to "Market- Weight" from "Under-Weight". However, we wait monetary easing to turn bullish on the sector. Within auto sector we upgrade PSMC to "Hold" from "Sell" and we have hold recommendation for Indus motors.

Is there any light at the end of the tunnel?

Yes. Car sales have shown a positive (on average +7%) MoM growth for three consecutive months, highlighting the worst may be over. However, we believe, lot more to be achieved to turn bullish on the sector. The average monthly car sales for 2009 stands at 6,222 units, compared to the peak sales of 13,355 units in 2006. The elimination of FED would be welcomed by car assemblers; however, we still believe monetary easing will play the key role to stimulate the car sales. Our economist expects 300bps cut in policy rate by December 2009, which should definitely stimulate the car sales in the month to follow.

Graph: Monthly car sales

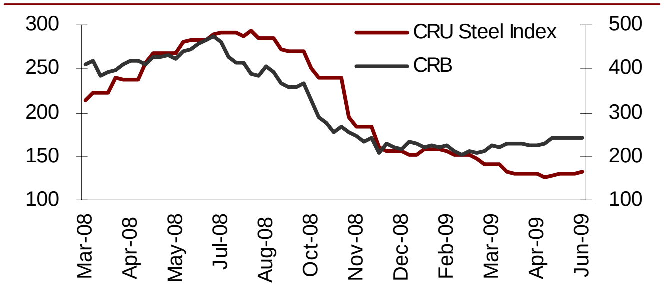


Source: PAMA, JS Research

Cost pressures are easing

Steel prices are down 55% from the peak it hit in August 2008, inline with CRB index. On the back of global recessionary woes unlike other commodities steel prices have remained sticky as compared to 13% recovery of the CRB Index from its trough (see chart below).

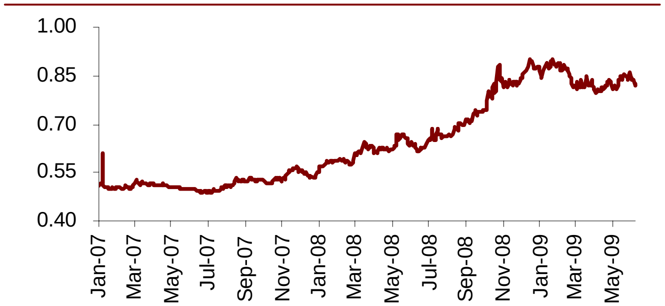
Graph: World CRU Steel index and CRB index



Source: Thomson Reuters, Bloomberg

This should help auto manufacturer to at least maintain the margins. Though global economy is on earlier than expected recovery path, we believe, the steel prices will remain subdued on the back of substantial contract price reversal of iron and manganese ores. Hence we expect elevated cost pressures to ease substantially.

Graph: PKR-Yen parity



Source: JS Research

What else to be gauged?

Yen exchange: Since January rupee-yen parity has improved substantially to Rs0.82/yen compared to Rs0.88/yen on January 1st. This will help auto assemblers to reduce prices.

FY10 Budget: In addition to FED relieve, the deferment of AIDP will keep duty of imported parts at 32.5% instead of 50% planned.

We believe the benefit of above will be visible in the coming quarter's results.

Outlook: Upgraded to 'Market-Weight'

Since we changed our stance to Under-Weight in July 2008, the car assemblers (Pak Suzuki, Indus Motors, Honda Atlas and Dewan Farooque) have recorded combined losses of Rs345mn, compared to profits of Rs2.8bn (9MFY08). We are expecting 25% earnings growth for the auto sector in general and hence we are upgrading our sector outlook to "Market-Weight" from "Under- Weight". Within auto sector, we expect Pak Suzuki margins and sales to improve substantially, as they deal in small and economical cars. PSMC is trading at 7.1x PE 2010, compared to Indus Motor 8.6x PE. We are upgrading Pak Suzuki Motors to 'Hold' from 'Sell' while maintaining our 'Hold' recommendation on Indus Motors.

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