

May 19, 2010

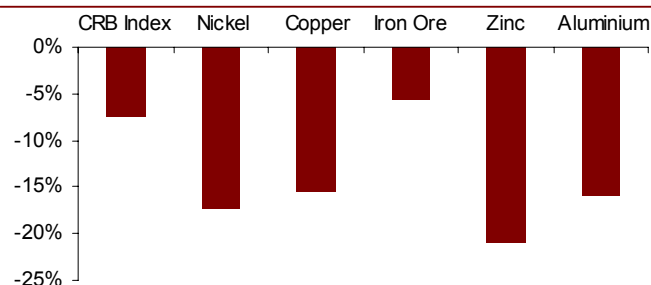
Pakistan Market**Autos: Cost respite around the corner?****MORNING BRIEFING**

KSE100 Index: Closing 10082.04 ↑ (+48.28)

In the wake of concerns of falling commodity demand emanating from the European debt crisis, commodity prices have fallen sharply worldwide, while the Pak Rupee has strengthened against international currencies, both of which could act as key catalysts for the local auto assemblers' profitability, going forward. Though prices of steel (the major constituent of cost) remain largely unchanged, it is likely to imitate the declining trend of other metals' prices. However, any movement in steel prices takes an average of 4-6 months to show effect in the auto companies' profitability. We currently have a 'Market-Weight' stance on the sector with Indus Motor (INDU), trading at an FY11F PE of 6.3x, being our preferred play.

Likely steel price decline to boost autos earnings

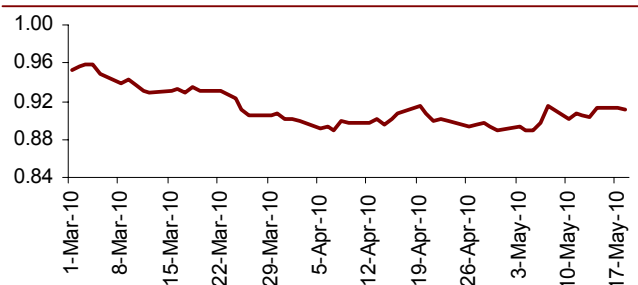
For our analysis, we have used Cold Rolled Steel as a benchmark, as it constitutes more than 85% of the steel used in the auto industry. Trading at US\$745 per ton, prices have stayed mostly unchanged in recent times. However, with the CRB Index and prices of iron ore down 7% and 6%, respectively, since the beginning of April, we expect international steel prices to follow suit. However, with steel contracts made in advance by local auto assemblers, it takes an average 4-6 months for any change in prices to become visible in auto assemblers' profitability.

Decline in commodities since April 1, 2010

Source: Bloomberg

Rupee strengthens, auto assemblers to gain

On the back of a contained C/A deficit (down 66%YoY) amid higher exports (8%YoY) and home remittances (15%YoY), Pak Rupee has gained strength against international currencies, particularly Japanese Yen (JPY). So far on a QoQ basis, the average Rupee parity against the US\$ and JPY has improved by 1% and 3% respectively. However, the actual impact of Rupee appreciation is dependent upon the timing of the opening of Letter of Credit's (L/Cs) for imports and their subsequent payments.

Rupee Yen parity

Source: SBP

Outlook: INDU our top pick in the auto sector

With auto sales rising by 36%YoY during the first 10 months of FY10, we expect the full year (FY10) sales volume to arrive at 137,000 units – up 38%YoY. However, relaxation in the auto import policy in the upcoming budget remains a key concern, going forward. With INDU trading at an FY11F PE of 6.3x, we reiterate our 'Buy' call on the scrip, while a 'Hold' stance is maintained on Pak Suzuki (PSMC), which trades at 2010E PE of 8.8x.

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Also in focus**OGRA submits revision decision to the govt.**

After reviewing SSGC and SNGPL's request petition for a raise in gas tariffs, OGRA has made and forwarded its decision (effective July 1, 2010) to the Federal Govt for final approval. OGRA has recommended changes in the consumer prices for various consumer categories of the companies, which would translate to these prices being provisionally revised down by an average 2.55% or Rs4.53/mmbtu. Apart from being welcoming news to all direct gas consumers, it would provide relief to some costs of the fertilizer (↓ Rs9.74/mmbtu), cement (↓ Rs13.67/mmbtu), power (↓ Rs10/mmbtu), textile etc companies. The cement companies in general use minimal gas for production, but for fertilizer giants like ENGRO, FFC and FFBL, there will be a likely positive EPS impact of Rs0.13, Rs0.06 and Rs0.02 respectively, if the decision materializes as is.

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