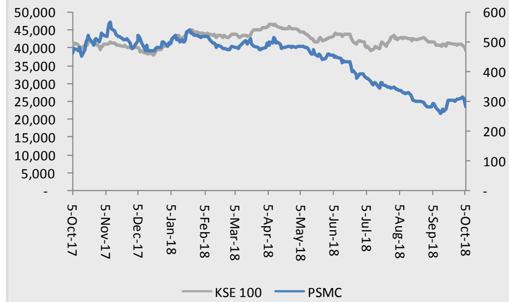
Pak Suzuki Motor Company Limited (PSMC)

REP-091
Oct 08, 2018

- ***We revise our stance on PSMC from BUY to SELL due to the changed dynamics of the overall sector with the target price of Rs246, providing downside potential of 13% from the last day closing price (LDCP)***
- ***Despite of increase in volumetric growth by 22%, the 1HCY18 EPS has plunged by 34.86% due to rising input cost.***
- ***Ban on non-tax fillers for buying new cars has caused the sales of the company to decline by 12% YoY in 2MFY19***
- ***Rising cost of auto finance due to increasing interest rates would also limit the volumetric growth of the company***
- ***It would be difficult for the company to pass on the impact of PKR devaluation and increasing steel prices completely due to limited volumetric growth and immense competition going ahead***

KATS Symbol	**PSMC**
Reuters Symbol	PKSU.KA
Target Price	**Rs. 246**
LDCP	Rs. 282
Outstanding Shares (mn)	82.30
Free Float (mn)	21.73
Market Cap (mn Rs)	23,238.19

Price Performance vs. KSE100 Index



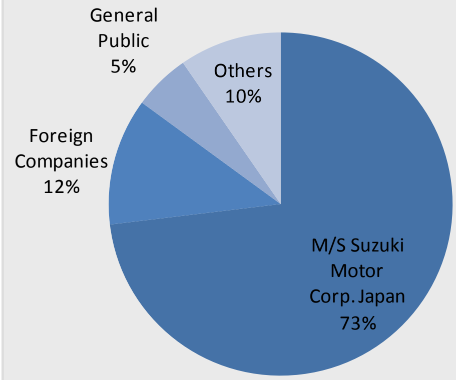
Source: PSX, ASL Research

EPS Estimates

	CY17	CY18E	CY19E	CY20E
EPS	46.49	29.28	30.69	28.87
P/E	6.07	9.63	9.19	9.77
GM	9.50%	7.90%	8.60%	7.40%
NM	3.80%	2.50%	3.00%	2.40%

Source: Co Financials, ASL Research

Shareholding Pattern As of Dec-17

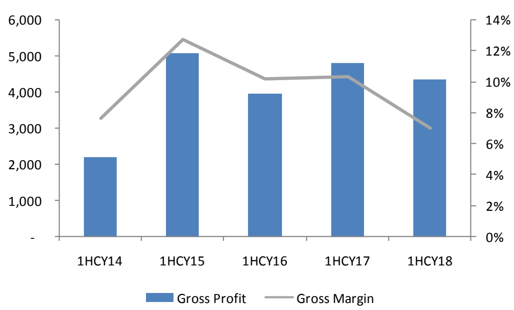


Source: Co Financials, ASL Research

1HCY18 Result Highlights

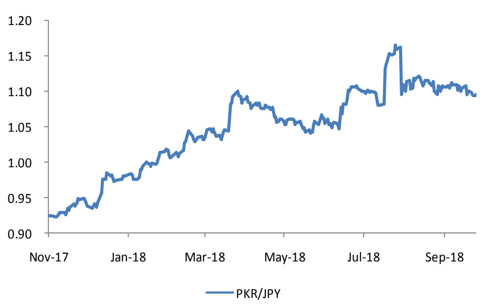
PSMC has announced its 1HCY18 result in which it posted an EPS of Rs15.77, recording a decline of 34.86% YoY against the EPS of Rs24.2 during same period last year. The company has posted a revenue of 62.39bn in 1HCY18, recording a growth of 33.23% YoY against the revenue of 46.83bn during SPLY. We note that the increase in sales is attributed to the volumetric growth of 22% YoY in 1HCY18 as well as to the increase in prices of various car models three times during the period. A significant surge of 38.15% YoY in cost of goods sold is witnessed which has brought the gross margins down to 7% from 10.3% (See Fig.1), especially in 2QCY18, the gross margin has squeezed to 4.8%. The hike in cost of goods sold is attributed to the increased input cost due to devaluation of PKR/JPY by about 16% (See Fig.2) and rising steel prices during the period which the company couldn't pass on completely. Finance cost has increased by 125% from Rs41mn to Rs93mn on account of exchange losses during the period. Company earned a net profit of Rs1.3bn, recording a decline of 34.86% YoY as compared to Rs1.9bn during the same period last year, resulted into depressed net margins from 4.23% to 2.07%, especially in 2QCY18, the net margin has squeezed to 1.27%

Fig.1 PSMC Gross Profit (Rs. Mn) & Gross Margins



Source: Co. Financials, ASL Research

Fig.2 JPY Movement



Source: SBP, ASL Research

Limited Upside Potential in Volumetric Growth

- According to recent statement by Pak Suzuki Motor Company Ltd's spokesperson, the advance booking of Suzuki vehicles up to 1,000cc fell by 42% during July to mid-September period due to ban on non-filers to purchase cars. Recent PAMA numbers for the month of Aug-18 support the above statement in which the sales of PSMC have plunged by 20% MoM and 12% YoY in 2MFY19 (See Fig.3 on Next Page)
- SBP has increased the interest rate from the bottom of 5.75% to 8.5% during the year. Going forward, further hike in interest rate is also expected in order to control the rising inflation rate which would hamper the overall growth of the economy. Between the period of 2006-11, when the interest rate increased from 9% to 15%, the auto finance loan was declined by around 56%. Later on, during 2011-18, the auto finance loan increased by around 300% as the interest rate came down to 5.75% from 15%. Going forward, we expect the similar trend and anticipate that the current auto finance loan of Rs197bn would be decreased by a significant amount as the interest rate would move towards north.

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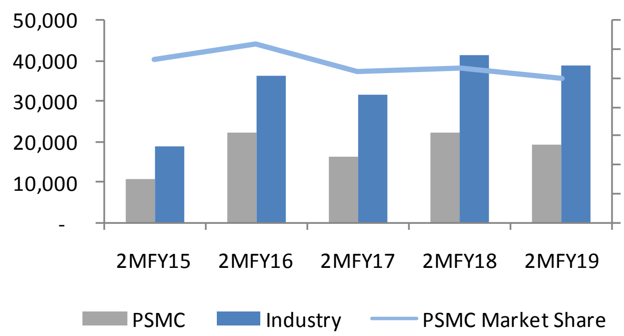
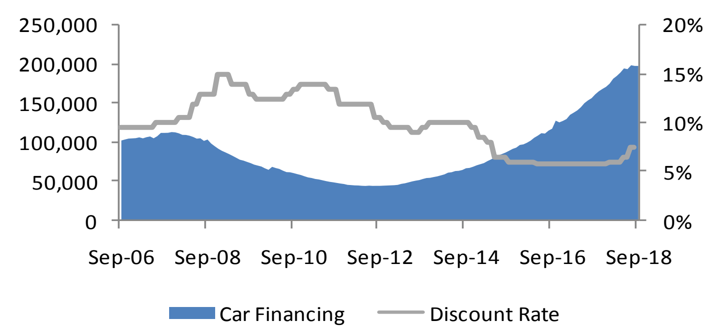
Fig.3 Industry & PSMC Sales Volume



Source: PAMA, ASL Research

Fig.4 Auto Financing (Rs in Mn) vs. Discount Rate



Source: SBP, ASL Research

Rising Input Cost

- Auto assemblers in Pakistan have a huge reliance on imported parts used in the assembling of new cars whose cost is directly related to the exchange rate (PKR/JPY). A huge devaluation of PKR against YEN (See Fig.2 on Previous Page) (~16%) during the period of 9 months has significantly increased the cost of the company. Going forward, further devaluation of PKR is also expected in coming days especially in case of the government opting for the bail out package from IMF which would slash the margins of the company as the pricing power of the company is expected to remain weaker
- The price of steel, which is a key raw material, has also increased by around 18% on a yearly basis. Furthermore, the regulatory duty imposed on steel in Pakistan has also contributed to greater costs for the company
- Despite increasing prices by Rs10,000-20,000 in January, followed by another hike of Rs20,000-50,000 in March and then Rs20,000-30,000 in June this year, the company couldn't be able to maintain its margins. PSMC has again increased the prices of various car models for fourth time in Aug-18 whose impact would be reflected in the result of 3QCY18. As per our estimate, company's cost per unit has increased by 7.9% but the company has increased the prices by only 4% (net of sales tax). Going ahead, we don't expect the company to be able to pass on the impact of rising cost completely to the end consumers

Immense Competition Coming Ahead

- Taking advantage of the favorable Auto Development Policy of 2016-2021, 9 new foreign players in JV with local partners (See Fig.5) are at various stages of entering the local auto landscape which threatens the decades old strong hold of Japanese auto makers over the Pakistan's auto-mobile industry
- Mehran has a major share of about 33% in the sales of the company (See Fig. 6). Inspite of the fact, the company has announced the discontinuation of both of the models of Mehran i.e. VX and VXR, by Nov-18 and Apr-19 respectively. There is no official statement by the company but it is expected that the Mehran will be replaced by the new 8th Generation Suzuki Alto 660cc in Apr-19 and the expected price of the new Alto would be around Rs800,000—Rs950,000
- On the other hand, United Auto has launched a new 800cc car with the name of "Bravo" on 8th September 2018. Being one of the most searched cars in Pakistan, Bravo is a direct competitor to Suzuki Mehran and the upcoming model of Suzuki Alto 660cc. It has the same engine as Mehran but with more features at the same price. With a price of Rs850,000, Bravo is another very decent option for those on the lookout for a budget vehicle

Fig.5 New Entrants

Sr. No.	Brand Name	Type of Car
1	BAIC Motos	Compact
2	Datsun Motors	Sedan/Hatch
3	Al Haj FAW Motors	Hatch
4	Hyundai Nishat Motors	Sedan/Compact/LCV
5	KIA Lucky Motors	Sedan/Compact/SUV/Hatch
6	United Motors	Sedan/Compact
7	Khalid Mushtak Motors	LCV/Mini Passenger Vans
8	Regal Automobiles	LCV/Van
9	Habib Rafique	LCV/SUV

Source: PSX, Co. Financials, BR, ASL Research

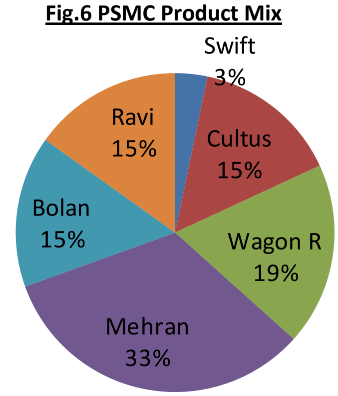
Valuation & Recommendation

- PSMC is currently trading at CY19E P/E of 9.19x. We have a **SELL** stance on the scrip with the target price of Rs246, providing downside potential of 13% from the last day closing price

Risks to Our Valuation

- Lifting of ban on non-filers to buy new vehicles, discouraging response of consumers towards new entrants in the market, delay in the arrival of new competitors, decrease in steel prices, higher than expected movement of exchange rate parity, lower than expected increase in interest rates

Fig.6 PSMC Product Mix



Source: PAMA, ASL Research

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Valuation Methodology

To arrive at period end target price, Abbasi Securities uses different valuation methodologies:

- Comparable Method (P/E, P/B, Justified P/B & P/E etc.)
- Discounted Cash flow Method
- Equity and Asset based valuation

Rating

BUY	Total return more than 20% from last closing of market price
HOLD	Total return is in between 10% and 20% from last closing of market price
REDUCE	Total return is less than 10% from last closing market price

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