ABBASI SECURITIES

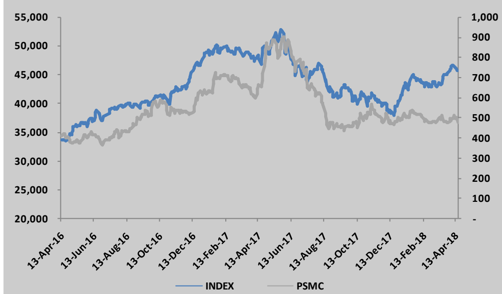
REP-091
April 20,2018

Pak Suzuki Motor Company Limited (PSMC)

- ***We initiate our coverage on PSMC with BUY call on the scrip with a DCF based TP of Rs587 (Dec-18), providing upside of ~22% from Last day closing price (LDCP)***
- ***Our recommendation is based on the following factors:***
- ***Industry's strong volumetric growth is well reflected in the company's bottom line which we estimate to remain upbeat due to a) low auto financing cost b) enhanced purchasing power of individuals due to lower income tax rates and continuously improving farmer economics***
- ***We foresee risk to pricing power will remain low in the medium term as new auto players are still at least 2 years away from commercial production which gives enough room to the company to pass on any possible currency devaluation and hike in raw material prices***
- ***Attempt to increase localization with a JV with Tecno Pak Telecom for manufacturing of Automobile glass will reduce exchange rate risk***
- ***We expect the company's Greenfield investment plan to go through***

KATS Symbol	**PSMC**
Reuters Symbol	**PKSU.KA**
Target Price	Rs587
LDCP	Rs482.72
Outstanding Shares (mn)	82.30
Free Float (mn)	21.73
Market Cap (mn Rs)	39,728

Price Performance Against KSE100 Index

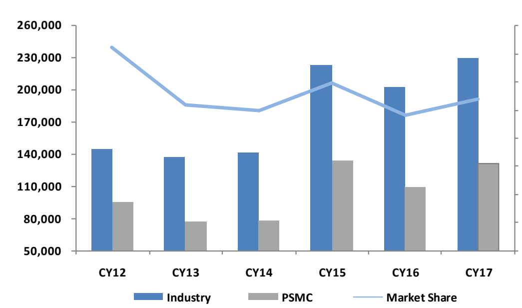


Source: PSX

Higher chunk of volumetric growth to keep bottom line strong

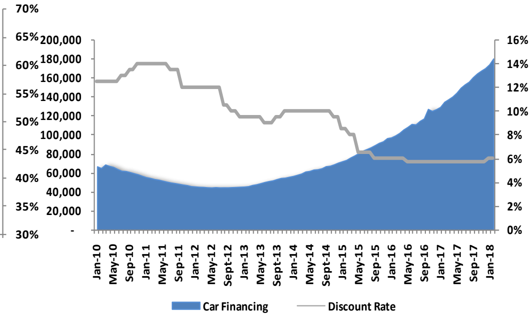
- PSMC is the only auto-maker in Pakistan which produces for the masses with 800cc-1300cc variants and hence enjoys a lion's share of 58% in the overall passenger car sales. Pakistan's increasing middle class with improvement in economy will help the company maintain its share in the medium term
- We expect the company's volumetric growth (5 Year CAGR) of around 7% to continue on back of i) low auto financing cost b) enhanced purchasing power of individuals due to lower income tax rates and continuously improving farmer economics iii) increase in urbanization rate iv) better transport related infrastructure with materialization of CPEC

Fig.1 Industry & PSMC Sales Volume



Source: PAMA, AS Research

Fig.2 Auto Financing (Rs in Mn) vs Discount Rate



Source: SBP, AS Research

PSMC KEY EARNING INDICATORS

Rs in mn	CY17A	CY18E	CY19E
Net Sales	101,812	118,114	121,932
Gross profit	9,653	11,149	12,287
PAT	3,826	4,480	5,024
EPS (Rs)	46.49	56.57	63.08
P/E x	10.38	8.53	7.65
GM	9.5%	9.7%	10.3%
NPM	3.8%	3.9%	4.3%

Source: Co Financials, AS Research

Lower risk to pricing power in the medium term

- Taking advantage of the favorable Auto Development Policy of 2016-2021, 6 new foreign players in JV with local partners (see figure 5 on next page) 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
- Pakistan's current battle with twin deficits is likely to keep the pressure on the local currency and based on consensus the rupee devaluation ride will continue over the next fiscal year
- Currently, Pakistan's auto assemblers rely on Japanese Yen and US dollar for their raw material imports and strong pricing power is the only lifebuoy for maintaining margins in case of any devaluation and/or increase in raw material prices (due to upward changing trend of global commodities)

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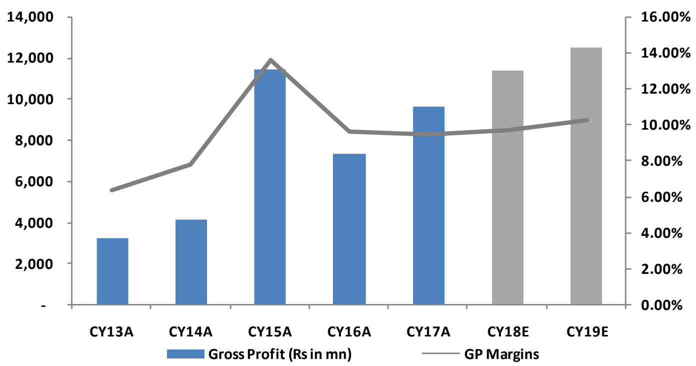
- Though we see existing auto-makers to not have the same power when the new auto-makers come in but in the medium term we do not see this risk materializing
- We estimate 1.5% -2.0% price increase will be required for PSMC to maintain its current gross margins ~10% in case of further 5% rupee devaluation

Fig.3 PSMC Gross Profit and GP Margins



Source: Co. Financials, AS Research

Fig.4 JPY Movement

Source: SBP

JV with Tecno Pack Telecom to further increase localization

- Amongst the 3 Japanese automakers, PSMC has the highest localization ratio of around 70% and a JV agreement with Tecno Pack Telecom to manufacture auto glass depicts company's intention to increase this
- PSMC will invest Rs 344.4 mn in this project for a 40% equity stake, the company has already invested Rs 220 mn from the total investment amount
- Our estimations suggest that this project which is expected to start commercial production from middle of CY19 will add Rs 0.80/ share to the bottom line of PSMC
- We have not incorporated this in our earnings estimates for now as we await further clarity

Fig5 . New Entrants

Brand Name	Local Partner	Type of Car
BAIC	Sazgar Engineering	Compact
Datsun	Ghandhara Nissan	Sedan/Hatch
FAW	Al Hajj	Hatch
Hyundai	Nishat Group	Sedan/Compact
KIA	Lucky Group	Sedan/Compact
United	N/A	Sedan/Compact

Source: PSX, Co. Financials & BR

Greenfield Investment is expected to materialize

- Post announcement of the Auto Development Policy 2016-2021, PSMC shared its plan to invest USD460mn in a new plant and will also launch a new model. However, the execution of this plan was contingent on the Government offering same incentives to the company as being offered to the new entrants under the auto policy.
- So far the company has not received any positive response from the government on this and as per the company the investment plan is currently on hold
- However, keeping in mind that PSMC's current plant is operating at 100% utilization and with new entrants PSMC's non-capacity to produce more will hinder company's growth in the future
- Based on the above we strongly feel that the company will go through with its expansion plan with/without the desired incentive

Valuation & Recommendation

- We have a BUY call on PSMC with a TP of Rs587 (Dec-18) providing an upside of 22% from LDCP
- Our target price is based on DCF, where we have discounted FCFE using 14.78% as cost of equity and 2.5% sustainable growth rate for the terminal value

Cost of Equity	
Risk Free Rate (RFR)	8.18%
Market Risk Premium	6.00%
Beta	1.10
Cost of Equity	**14.78%**

(Amount in PKR '000)	CY18E	CY19E	CY20E	CY21E	CY22E	Terminal Yr.
Profit After Tax	4,656,005	5,191,697	5,515,015	5,876,530	6,263,171	
Add: Depreciation & Amortization	1,612,171	1,784,697	1,927,268	2,083,347	2,279,990	
Working Capital Changes	(2,233,595)	(301,578)	(492,427)	(516,425)	(691,468)	
Net Borrowing	-	-	-	-	-	
Less: Capital Expenditure	(2,049,431)	(2,254,374)	(1,735,868)	(1,857,379)	(1,987,396)	
Free Cash Flow to Equity	**1,985,149**	**4,420,441**	**5,213,987**	**5,586,072**	5,864,298	48,936,783
PV of Free Cash Flow	**2,128,031**	**4,128,316**	**4,240,681**	**3,958,172**	**3,620,150**	**30,209,667**

DCF Valuation	
Equity Value	48,285,017
No of Shares	82,300
Per Share Equity Value (PKR)	587
Market Price 20-04-2018 Closing Price	483
Upside/ (Downside)	**21.54%**

Risk to our Valuation

- Slow down in auto sales
- More than expected fluctuation in prime currency
- Early commencement of similar variant production by competitors

About Company

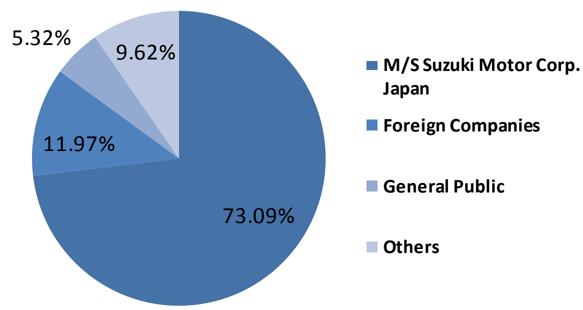
PSMC is the largest automobile manufacturer in Pakistan with the production capacity of 150,000 units and 44,000 units of cars and motor cycle respectively. PSMC has the market share of ~57% and only company in Pakistan which produce 1,000CC and less the 1,000CC cars. PSMC was formed in 1983 with the JV between Pakistan Automobile Corporation Limited and Suzuki Motor Corporation Japan. PSMC start commercial production in 1984. In 1992 company was privatized under Govt. Privatization Policy and placed under the Japanese management in September 1992. PSMC management after privatization started expansion of the existing plant to increase its installed capacity to 50,000 units per annum which was completed in July 1994. With the increase in demand overtime PSMC increased capacity in different phases. The first phase was completed in January 2005 when capacity was enhanced to 80,000. The second phase was completed in January 2006 and capacity was raised to 120,000 units. The third phase was completed on 6th February 2007 with the production capacity of 150,000 units.

Fig.1 Shareholding Pattern

Shareholding Pattern as of Dec 17	
M/S Suzuki Motor Corp. Japan	73.09%
Foreign Companies	11.97%
General Public	5.32%
Others	9.62%

Source: Co. Financials, AS Research

Fig.2 Shareholding Pattern



Source: Co. Financials, AS 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 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

ABBASI SECURITIES

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