



Today's Daily

■ INDU: Stratification of the Corolla is crucial for added value

Backing-up our recent price target upgrade for INDU to PkR2,192/sh (hike of 5.9% over previous TP), we base our bullish stance on: 1) furthered market penetration for a lower-end flanker variant, 2) revival of 'bandwagon effect' demand through upgrading the lower end offering of the flagship Corolla (making ~71% of revenues over FY18-21F), and 3) fortifying INDU's product suite to fend-off upcoming competition. In this case, we refine our expectations of a possible new model in the 1,000CC to 1,300CC category (Toyota Vios - Oct'17 note "Toyota Corolla warrants an upgrade"), where we engrave our expectations based on channel checks, affirmative news flow and industry experts endorsing our case of the likelihood of an upgraded model announcement by 4QFY18-1QFY19. Looking at past product profiles, we highlight INDU's lack of offerings, making the case for INDU replacing the 1.3L Corolla variant exploring how INDU's margins move over a range of price points and expected demand from penetration/bandwagon-led demand, aiming to safeguard market share, while retaining profitability. While our workings remain preliminary, results indicate margins are augmented by brand segmentation, where a flanker could enhance gross margins by 25% and our fair value by a further ~16%. Currently, our BUY stance offers 22% upside, where 'likelihood' of new variants are sweeteners.

KSE100 - Index

| | |
|----------|-----------|
| Current | 46,103.61 |
| Previous | 46,013.34 |
| Chg. | 0.20% |

Mkt Cap. (PkRbn/US\$b)

| | |
|----------|---------------|
| Current | 9,450 / 81.76 |
| Previous | 9,438 / 81.65 |
| Chg. | 0.13% |

Daily Turnover (mn)

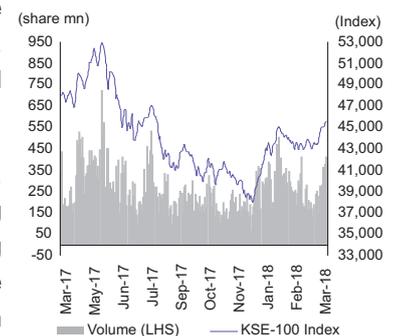
| | |
|----------|--------|
| Current | 270.18 |
| Previous | 282.64 |
| Chg. | -4.4% |

Value Traded (PkRmn/US\$m)

| | |
|----------|-----------------|
| Current | 13,775 / 119.17 |
| Previous | 12,895 / 111.56 |
| Chg. | 6.8% |

News and Views

- The federal government has deferred second phase of the Free Trade Agreement (FTA) with China on the demand of the business community. Commerce Minister said the talks will continue till a final draft is agreed upon.
- The Commerce Division, after receiving feedback from some industries, is considering further reduction in duty on raw materials in the upcoming budget at a cost of PkR20bn per annum. It was recommended to bring down duty to zero per cent from 3pc on 151 tariff lines and remove regulatory duty on 51 tariff lines where anti-dumping duty has been imposed. In another news, Commerce Minister specifically said gov't will consider abolishing regulatory duty on steel.
- The gov't has lifted the ban on furnace oil for running power plants directing PSO to place orders. Further, it has been decided that power producers will make payments to PSO in advance to avoid circular debt.



Ali Asghar Poonawala
ali.poonawala@akdsecurities.net
111-253-111 Ext:646

Bilal Ahsan Elahi
bilal.elahi@akdsecurities.net
111-253-111 Ext:685

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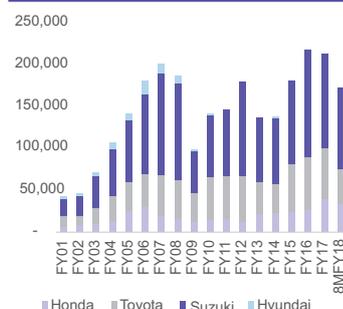
INDU: Stratification of the Corolla is crucial for added value

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Product mix diversity is vital: Analyzing data from FY01-17, we highlight the previously diverse product mix for the OEM, where the passenger economy segment was a priority with the Cuore till FY12, supplanted by the 4x4 Hilux. Recently the OEM has focused on premium SUV offerings, upgrading both the Hilux (with the Revo) and 2nd-gen Fortuner. We believe the OEMs absence from the mid-size sedan segment is an untapped, low-CAPEX (details of model specification in our Oct'17 note "Toyota Corolla warrants an upgrade") value enhancer, making it a 'no-brainer' product enhancement, in our view.

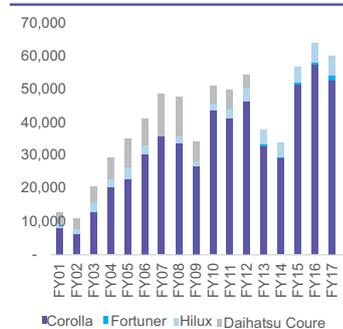
Recent valuation upgrade: Following the financial results (1HFY18) and the analyst briefing that took place last month, we raised our TP case for INDU to PKR2,192/sh (March 26th note "Catalysts under the hood demand buy!") on the back of new 3.0 Fortuner/Hilux Diesel variants, upcoming debottleneck activity online (4QFY18) taking total capacity to ~75K units/annum and the pickup in demand for LCVs as CPEC development continues, we explore additional product enhancements that INDU might introduce. Basing our bullish stance on channel checks, affirmative news flow and industry experts endorsing our case of the likelihood of an upgraded model announcement by 4QFY18-1QFY19. Moreover, we note news flow of management comments regarding additional investment inflow in the domestic auto assembling industry to match enhanced local

Auto: Historical Industry sales



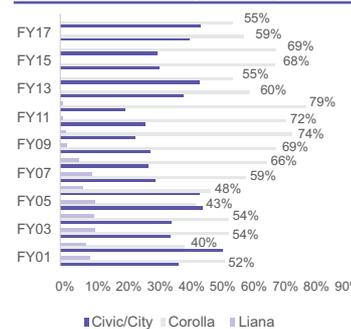
Source: PAMA & AKD Research

INDU: Historical sales break-down



Source: PAMA & AKD Research

Historical sales comparison (Corolla vs. Civic/City & Liana)



Source: PAMA & AKD Research



demand while competing with new entrants. In this regard, with excess capacity on the production side, the case for a model extension to its current portfolio is reinforced.

Revisiting our expectations for replacing the 1.3L variant: In addition to identifying the need for a lower-end model in order to cater the upcoming competition (Oct'17), we now discuss the possible financial impacts on INDU of such addition to their existing offering. The sensitivity illustrates the impacts on gross profit for the OEM (assuming costs are maintained at projected levels for the 1.3L offerings in FY19F) as the new model is brought in the specified range of possible list prices. We posit the new variant (likely the Toyota Vios) replacing the 1.3L Corolla variant varying prices in the range of -10% to +15% impacting gross profits by -PKR5.9bn (26% of total gross profit for FY19E) to +PKR15.2bn (66% of total gross profit for FY19E) on our base case, where a range of possibilities can be seen.

Gross Profit sensitivity to price and quantity assumptions for new 1.3L sedan model replacing 1.3L Corolla (PKRMN)

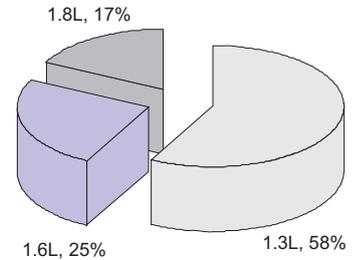
| | Change in price for new variant vs. 1.3L Corolla model | | | | | | |
|--------------------------------------|--|---------|---------|-------|-------|--------|--------|
| | -10% | -5% | 0% | 5% | 10% | 15% | |
| Change in Sales for new 1.3L variant | -15% | (5,986) | (3,138) | (289) | 2,560 | 5,409 | 8,258 |
| | -10% | (5,830) | (2,814) | 203 | 3,219 | 6,236 | 9,252 |
| | -5% | (5,674) | (2,490) | 694 | 3,878 | 7,062 | 10,246 |
| 0% - Base 1.3L Corolla sales | | (5,518) | (2,166) | 1,186 | 4,537 | 7,889 | 11,240 |
| | 5% | (5,361) | (1,842) | 1,677 | 5,196 | 8,715 | 12,234 |
| | 10% | (5,205) | (1,518) | 2,168 | 5,855 | 9,542 | 13,229 |
| | 15% | (5,049) | (1,194) | 2,660 | 6,514 | 10,368 | 14,223 |
| | 20% | (4,892) | (871) | 3,151 | 7,173 | 11,195 | 15,217 |

Source: AKD Research

Risks: Limitations of this analysis include: 1) lack of information regarding specific, high cost component (engine block, power train) that are likely to be lower for a 1,000CC or below offering, where the possibility of a such a variant at a lower price point is high, 2) factoring any hike in below the line expenses (specifically higher marketing expenses) at this stage had to be avoided for the sake of conciseness and 3) CAPEX plans could vary to a large degree, impacting total contribution to NPAT from a new model.

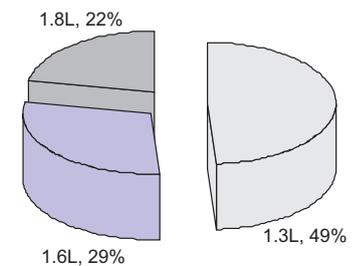
Investment perspective: Based on these results, we believe the OEM's entry into additional segments opens room for margin accretion, where the new 1.3L variant could capture up to 20% of gross profits (vs. 15.8% for the 1.3L forecasted for FY19F) adding additional ~16% upside to our current valuation. Awaiting confirmation of these developments, where management remains tight-lipped as new variant timeline are considered by the industry to be a crucial source of competitive intelligence, we retain our BUY stance, offering 22% upside at current price levels.

FY17E: Corolla sales break-down



Source: Channel checks & AKD Research

FY19F: Corolla sales break-down



Source: AKD Research



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| | |
|------------|------------------------------------|
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| Reduce | < -5% to > -20% downside potential |
| Sell | ≤ -20% downside potential |



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