

PAPS 2019 reflects a 'not-so-green light' for entrants

- PAPAM's Pakistan Auto Show 2019, held in Karachi over the weekend was filled with exhibitors from the auto industry cluster, parts manufacturers, allied equipment, service providers and OEMs.
- Refining our outlook for the competitive environment and forming a birds-eye-view of the sector we highlight the prevalence of Chinese origin brands, favouring shorter timespan brownfield entry over greenfield investments, and competitive pricing with enhanced features of PC segment offerings (both current and expected) as catalysts for organic growth
- That said, amongst Greenfield entrants, KIA put up a strong show laying out its intended CKD products (Sportage and Picanto to commence sales by Aug & Oct'19) while the new Alto offers substantive performance upgrades with advanced design characteristics, where we expect a new-model effect sales bump of 15%YoY for 2HCY19 sales (vs. 2HCY18 Mehran sales) could grow EPS for PSMC by ~3/8%YoY for CY19/20
- Channel checks and management remarks firmly doubt the GoP's motives behind adverse taxation measures enacted through the auto sector value chain (part imports and final product sale) as these levies send the wrong signals to investors, already wary of long-lead time, fixed outlays

Competitive forces come back to earth: This year's exhibition reflected a move past the rising anticipation over new-entrants (a series of developments ignited by the launch of AIDP-II on March'16), while dwindling of initial excitement has led to delayed CAPEX plans and subdued production ramp-ups, as new entrants contend with notoriously difficult Greenfield investments. In addition to on-the-ground challenges, last year's devaluation, coupled with haphazard policy actions over the last three years, have increased investor apathy, delaying CKD production and sale by new-entrants. That said, through bifurcating entrants based on their geographical origins, Chinese OEMs have remained prominent, where their cost-conscious pricing and aggressive entry tactics (brownfield incentives targeted through JV with existing players, 3yr incentive, 6-12 month production start) are clear, as Korean and European brands opt for Greenfield investments (higher tariff discount for five years, 2.5yrs expected time for COD of facilities)

CKD model launch dominated by Chinese origin OEMs: We develop a timeline of entrants since the AIDP-II, illustrating the aggressive nature of expansion by Chinese players. We note their preference for LCV and small PC segments as detrimental to PSMC. Based on our timeline for new CKD model launches, we highlight the accelerated new/upgraded variant launch cycles at PSMC while INDU and HCAR launch minor-facelifts (Honda Civic relaunch of Turbo offering) based on significant quality/performance specification upgrades (2.8L Diesel Fortuner, 1.5L City). SBP's latest sector-wise FDI data is a clear indicator of aggressive entrant investments, a trend mirrored by Japanese incumbents, with net FDI rising 7.5xYoY resting at US\$76.5mn during 8MFY19

Alto launch encouraging for demand extension: The launch of the 660CC 8th generation Alto through the opening of its order book (delivery from June'19 on down payment of Pkr500k indicating sale price near Pkr1mn for base variant) continues a five-year long product upgrade cycle for PC segment offerings of the OEM (beginning with the Wagon-R in April'14). Indicated localization for the new Alto of above ~50% remains encouraging, with a clear preference for low quality features linked with cost-competitive variants indicating that the entry-segment vehicle remains a cost-competitive market. We believe this preference for localization remains the only effective hedge against Pkr devaluations and is likely to be a strategy deployed by entrants as well.

KIA - cream of the Greenfield competitive field: Amongst non-Chinese origin players, Kia put up a strong showing, with the Picanto likely to be much-awaited. Sales plans disclosed by manage-

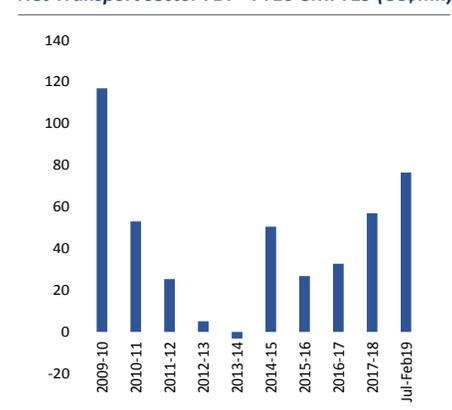
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CKD Model Launch timeline since AIDP-II

Variant	Launch Period
Honda BRV	Apr-17
Honda BRV manual	Apr-17
Facelift Corolla	Jul-17
FAW V2	Aug-17
1.5L city	Aug-17
Toyota Fortuner 2.8L Diesel Automatic	Jan-18
Shehzore	Feb-18
Hilux revo 2018	Feb-18
Toyota xli automatic	Aug-18
United Bravo	Sep-18
Changan Karavan	Oct-18
Changan M9	Nov-18
ISUZU D-MAX	Feb-19
1.8L i-VTEC CVT	Apr-19

Source: Media reports & AKD Research

Net Transport sector FDI—FY10-8MFY19 (US\$m)



Source: SBP & AKD Research



AKD Securities Limited

ment indicate the beginning of sales with the MPV segment (Sportage CKD by Aug'19) followed by the mid-segment Picanto (CKD sales by Oct'19) leveraging its brand in both segments. Based on planned CAPEX outlay for the production facility, we understand that the new Port Qasim facility has a double-shift annual throughput of 25K-30K (to be raised to 50K over next three years). FY18 accounts for LUCK show a Pkr3.9bn investment in the venture (where the conglomerate raised its stake to 70%, cumulative equity contribution of Pkr14bn) where civil works reportedly commenced from March'19, indicating an aggressive launch cycle.

Auto entrants snapshot with CAPEX expectations

OEM	Local Partner	Segment	Production/Sales Commencement	CAPEX Details
FAW/ Hyundai heavy Commercial/ Proton	Al-Haj	1000cc & 1300cc passenger cars, heavy trucks & buses	NA	US\$35mn, beginning with CBU imports, manufacturing capacity of 5-15,000units
Renault	GHNL	1300cc & above	June'20	US\$140mn starting with 6,000units initially, increasing to 50,000units with upto 5 CKD variants
KOLAO Group, Ssang Yong, Daehan Motors	DFML	1000cc & 1300cc passenger cars & Light Commercial Vehicles	NA	Restarting production by seeking relief under 'sick unit' incentives in the AIDP-II granted in Jan'18, with Daehan/Shehzore pickup launched in Feb'18, yet to start passenger vehicle production
Audi	Premier Systems	1300cc & above	NA	US\$50mn plant for assembling Medium Knocked Down kits proposed, where BOI has declined approvals for concessionary tariffs under AIDP-II
Kia	LUCK, Yunus Brothers Group	1000cc & 1300cc and above passenger cars	Sept'19	US\$115mn investment outlay for plant in Port Qasim with COD by June'18, initial production capacity of 25-30,000 units in FY20, with a second phase ramp-up of 50,000 units by CY24
Hyundai	NML, Nishat Group	800-1000cc, 1300cc & above passenger cars, LCVs	Dec'19-Jan'20	JV Hyundai Nishat Motor Pvt Ltd, valued at Pkr100mn includes a 40% stake for Sojitz Corp, initial production capacity of 6,500 units, rising to 30,000 by CY24 beginning with the H-100 pickup truck
VW	Premier Systems	1300cc & above	March-June'21	US\$140mn project commencing production of LCV, SUV and passenger vehicles with initial capacity of 6,000 units ramped up to 30,000 by 2025

Source: Media reports & AKD Research

Alto launch and earnings impact: In the case of the new Alto, even though it comes with a hefty price tag hike (~32% over Mehran it replaces) its fuel efficient engine (660CC displacement 54hp engine) along with superior design characteristics keep us bullish on the launch coming where we expect a 15%YoY sales bump (CY19 sales forecast at 38k units, 30%YoY price hike over 2HCY18 Mehran sales). That said, until guidance on margins crystalize, we take Mehran's CY16-18 margins (extrapolated from sales-weighted manufacturing COGS) as the benchmark and forecast CY19 revenue/NPAT growth of 3.2/2.8%YoY from the Alto (lower due to 2HCY19 sales bump actually being lower by ~8%YoY for cumulative CY19 offtake). Understandably, these expectations may be rather conservative, highlighted in our implied GM for CY19 (8.2% for CY19 near the CY16-18 average of 8.3%) as the OEM finds that upgraded offerings are the core driver for top line growth, drive profitability higher.

Outlook: Instead of taking a hands-off approach to the Auto industry and implementing associated reforms to vehicle quality (formation of AIDC, conformity with UN vehicle quality export framework), the GoP's reliance on duties, levies and restrictions of PC segment vehicles remain major detriments. Additionally, channel checks and management remarks firmly doubt the GoP's motives behind adverse taxation measures enacted through the auto sector value chain (part imports and final product sale) as these applicable 10% FED levy on 1,700CClevies send the wrong signals to investors, already wary of long-lead time fixed outlays. The last of which (currently + displacement vehicles) sours an already tough outlook for demand (particularly for new entrants).

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