AKD Daily

Friday, Dec 09, 2016

Today's Daily

LUCK: King of the hill

We revisit our investment case of LUCK as it has formally announced to further expand its business portfolio. The new list of projects comprise of: 1) setting up of manufacturing plant of Kia motor vehicles (25-30K p.a. capacity), 2) expressing interest in acquiring DCL's 1.134mn tpa Hattar plant, 3) doubling capacity of Iraq JV to 1.742mn tpa and 4) indirect additional exposure in the pharmaceutical business through its subsidiary, ICI (expressed interest in acquiring certain assets of Wyeth Pakistan Ltd). Assuming the DCL acquisition is successful, LUCK's earnings can increase in the range PkR0.99-PkR4.95 per share (depending on DCL's GM profile post acquisition). Whereas, doubling Iraq JV's capacity can result in incremental earnings/TP of PkR3.23/PkR11 per share (assumed 100% utilization). While we have not incorporated the recently announced projects in our estimates (as they are in early stages), LUCK's forward 5-year earnings CAGR stands at 21.8%. That said, we upward revise our SOTP based Dec'17 TP to PkR801/share, incorporating its upcoming 1.25mn tpa Brownfield expansion and LEPL's higher ROE on indigenous coal.

KSE100 - Index

Current	44,494.99
Previous	44,199.40
Chg.	0.67%

Mkt Cap. (PkRbn/US$bn)

Current	8,980 / 85.73
Previous	8,940 / 85.35
Chg.	0.45%

Daily Turnover (mn)

Current	470.91
Previous	372.59
Chg.	26.4%

Value Traded (PkRmn/US$mn)

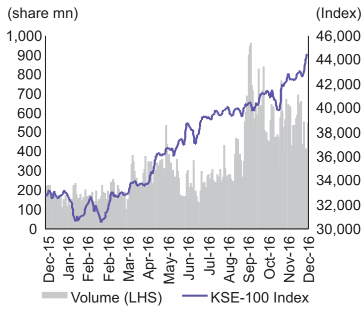
Current	20,847 / 199.03
Previous	19,726 / 188.33
Chg.	5.7%

News and Views

- ICI in a notice to the exchange today announced its intention to acquire certain assets associated with the life sciences business of WYETH. This increases ICI's exposure in the life sciences business, which makes up 24% of total turnover and 38% of gross profit.

- Third quarterly report of the SBP has stated that state bank has increased the required Capital Adequacy Ratio (CAR) for banks to 10.65% from the current 10.25% which will be implemented from the last day of the current calendar year. The SBP said the solvency profile of the banking system further strengthened in the third quarter of 2016 (July-September) as CAR improved to 16.8% at the end of September from 16.1% at the end June, well above the regulatory requirement of 10.25%.

- Pakistan and China have reportedly failed to evolve consensus on a methodology to further expand Free Trade Agreement (FTA) after both sides have dissimilar claims of impact on the bilateral trade at the second round of the second phase negotiations of China-Pakistan FTA (CPFTA) held on Dec 06-07'16.



Sharoon Ahmad
sharoon.ahmad@*akdsecurities.net*
111-253-111 Ext:602

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

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Scenarios for Auto investment: Using incumbents and their historical operations as a benchmark, the planned investment of PkR12bn gives LUCK significant leeway to penetrate the market. Between PSMC and INDU, two polar operational plans (mass market/high quality for PSMC/INDU), target markets (primarily 1,000cc and below for PSMC vs. 1,300cc and above for INDU) and financial metrics (5yr historical GM/EBITDA margin/ROE of 8.2%/7.2%/12.0% for PSMC vs. 11.8%/13.1%/28.6% for INDU) emerge underlying the wide variances prevailing in the sector. From our understanding, the plant is going to be situated in Port Qasim, where management is initially targeting 18-24months for COD and set up a dealer/after sales service network. Initially we believe the company will be launching CBU's under the Kia brand where the market segment and price points vary drastically. We believe FY17E/18F CBU unit sales of 500units is within reach, where our workings (based on Kia's regional offerings and CBU duty) suggests an average selling price of PkR5.18mn (vs. PkR10.8mn currently prevailing for HCAR & INDU) for 5 door hatchbacks/Sedans and PkR8.01mn (vs. prevailing average of PkR12.8mn) for SUVs would give significant room for margins and undercutting incumbents for market share. Post COD, channel checks suggest the company is targeting output of 30,000 units on single shift basis, and intends to run the plant at full capacity, i.e. on double shift (~50,000 units) the following year.

Sedan & SUV CBU Offerrings Snapshot

	INDU VARIANT	EX-FACTORY PRICE	HCAR VARIANT	EX-FACTORY PRICE	KIA VARIANT	EX-FACTORY PRICE
Sedan	Toyota Camry - 2.5	10,949,000	Accord	10,667,000	Rio Sedan - 1,396CC	2,686,286
		-	-	-	Cerato - 1600CC	4,438,553
		-	-	-	Optima - 2,000CC	8,400,803
SUVs & 4X4	Land Cruiser GX/VX Average	22,932,667	CRV-2.4	8,200,000	Sorento 2,200-2,359CC	8,679,227
	Toyota Avanza	2,999,000	HRV-1.5CVT	3,633,000	Sportage 2000CC	7,342,958
	Land Cruiser Prado	16,674,000	-	-	-	-
	(Turbo, MT/AT Average)	-	-	-	-	-

Source: Co Websites, KIA Thailand, Malaysia and Global

Valuation Snap shot

	FY15A	FY16F	FY17F	FY18F
EPS (PkR)	38.4	40.0	42.5	45.8
EPS Growth	10%	4%	6%	8%
Dividend yield	1%	1%	1%	1%
PER (x)	19.2	17.7	15.2	13.5
EV/EBIDTA (x)	13.4	11.2	10.6	9.8
ROE	21%	19%	17%	16%
ROA	17%	15%	14%	13%
EPS*	42.5	46.0	53.6	60.4
EPS Growth*	16%	8%	17%	13%

*Consolidated EPS

Source: Co. Reports & AKD Research

Gains from Greenfield incentives: Under the terms of the AIDP-II, LUCK's venture with Kia amounts to a Greenfield investment, with accompanying benefits being concessional duty rates of 10%/25% for non-localized/localized parts, ~20% reduction from prevailing tariff rates of 30%/45% for incumbents. While the reduced tariffs for CBU's kick in for all players during FY18-19 allowing for 10% lower margins for CBU categories between 800-1800cc, the incremental benefits from CBU segment remain limited. While we await the release of concrete details regarding planned model launches, price points and target market for CKD's, we believe the period before achieving COD on the main plant is crucial for gauging market demand for the Kia brand (we believe, brand awareness is already present as DFML used to offer Kia variants in the late 90s). Additionally, the company may have to cut into its margin advantage in initial years to secure market share.

Vying for DCL's Hattar plant acquisition: LUCK has expressed interest in acquiring DCL's 1.134mn tpa Hattar Plant. We believe that LUCK will not be the only bidding party as a Chinese manufacturer has also reportedly shown interest in DCL's acquisition. Besides, PIOC is another acquiring candidate as the company has earlier expressed intent in potential cement plant acquisitions. In this backdrop, we believe that DCL can fetch a significant premium (where DCL has returned 146% since FYTD) akin to Lafarge Cement Pakistan's acquisition. Benchmarking Lafarge's valuation of US$80/ton, we estimate DCL (DCL EV: US$79/ton) acquisition price to stand at PkR17.59bn (PkR36.24/share, 2% premium over its current price). The corresponding acquisition price of DCL's Hattar plant can be PkR9.53bn which should also require further capex for the plant's rehabilitation as DCL's FY16 GM stood at 20.55% compared with LUCK/AKD Cement Universe's 48.21%/44.71% in FY16. If LUCK successfully acquires this plant, it would be able to gain additional 2.0% market share (at assumed 75% utilization of acquired plant). While it is early to project its impact, we estimate that the said plant will result in incremental earnings/TP of PkR0.99/PkR15 per share (with forecasted average GM of 14%). The incremental earnings/TP could go up to PkR4.95/PkR67 per share if GM improves by average 30ppt post required capex for plant's rehabilitation.

Doubling Iraq JV's capacity: LUCK has been quick to realize the potential of Iraq's domestic demand as it reels from war affected insurgencies. In this backdrop, LUCK has announced to double its Iraq's JV capacity to 1.742mn tpa with project financing (expected US$35mn) through internally generated cash flows of the existing plant. Iraq's cement deficit stands at 7-8mn tpa which was previously bridged through imports from Iran. However, recent ban on cement imports in Iraq due to unstable security situation has opened avenues for domestic industry. Thus, LUCK would be well placed to mobilize additional output contributing incremental earnings/TP of PkR3.23/PkR11/share (assumed 100% utilization and 50% holding discount).

Investment Perspective: While we have not incorporated the recently announced projects in our estimates (as they are in early stages), we expect LUCK's 5-year earnings CAGR to stand at 21.8% attributable to LUCK's existing business portfolio diversification. We revise up our SOTP based Dec'17 TP to PkR801/share, incorporating its upcoming 1.25mn tpa Brownfield expansion (incremental earnings/TP of PkR3.35/PkR46 per share at assumed 50% utilization) and LEPL's higher ROE of 29.5% on indigenous coal vs. 27.2% on imported coal (resulting in incremental earnings/TP of PkR2.35/PkR9 per share).

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