AKD Daily

Monday, Feb 12, 2018

Today's Daily

Autos: Earnings growth underpins resilience of incumbents

INDU is scheduled to announce earning for 2QFY18 on 23rd Feb, where we expect the company to post NPAT of PkR3.85bn (EPS: PkR49.03) in 2QFY18 vs. net profit of PkR3.03bn (EPS: PkR38.51) in 2QFY17 - up 27%YoY. Earnings growth is largely from a shift to high margin, big-budget SUV sales, while below the line expenses are relatively tepid. For PSMC, we expect the company to post consolidated NPAT of PkR3.97bn (EPS: PkR49.39) in CY17 vs. NPAT of PkR2.77bn in CY16; up 43%YoY. The 32%YoY climb in sales, owing to organic sales growth based on strong fleet sales, and significant uptick in recently launched product offerings, despite the higher price tag associated with these offerings. Prominence of these models in PSMC's sales stands contrary to the widely held perception of PSMC having low quality products, competing solely on price. Factoring in the link between earnings growth and cash flows being diverted to growth initiatives, we believe local OEMs are fortifying their operational fundamentals for the next leg of long term industry rivalry. With improving fleet sales (Wagon-R & Cultus), upgraded models (consistent CAPEX on localization) and expectations of newer offering, PSMC comes up to be our top pick in the sector; offering an upside of 35.9% to our DCF based TP of PkR691.51/sh.

KSE100 - Index	
Current	43,808.80
Previous	43,679.87
Chg.	0.30%

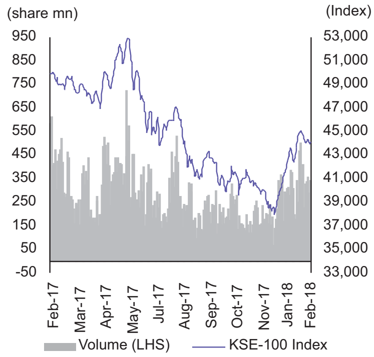
Mkt Cap. (PkRbn/US$bn)	
Current	9,099 / 82.31
Previous	9,077 / 82.10
Chg.	0.25%

Daily Turnover (mn)	
Current	225.63
Previous	246.02
Chg.	-8.3%

Value Traded (PkRmn/US$mn)	
Current	9,240 / 83.58
Previous	9,482 / 85.77
Chg.	-2.6%

News and Views

- Despite having firm commitments of roughly $26 billion, the government is unlikely to get any major injection from traditional lenders in the next four months. Dr Miftah Ismail says the option to float Eurobond still remains on the table, although the Ministry of Finance withdrew its summary for the issue from the federal cabinet this week.
- Trade deficit widened 24.4% year-on-year to US$3.64bn in January as imports increased more than the exports during the month. In January, exports rose 11.04% from US$1.78bn in the same month a year earlier while imports increased 19.37% YoY to US$5.607bn. Exports have jumped 11.11% to US$12.97bn in July-January period of FY18 but imports have also climbed 18.92% to US$34.51bn during the period under review.
- A proposal to cut the cost of energy for textile exporters, especially from Punjab seems not to be implemented any time before the budget as an official said the GoP is not in a position to upset IMF.
- In a major policy decision, the federal government has decided to allow import of three-year old used cars in accordance with previous policy on the demand of importers.



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

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

Autos: Earnings growth underpins resilience of incumbents

INDU is scheduled to announce earning for 2QFY18 on 23rd Feb, where we expect the company to post NPAT of PkR3.85bn (EPS: PkR49.03) in 2QFY18 vs. net profit of PkR3.03bn (EPS: PkR38.51) in 2QFY17 - up 27%YoY. Earnings growth is largely from a shift to high margin, big-budget SUV sales, while below the line expenses are relatively tepid. For PSMC, we expect the company to post consolidated NPAT of PkR3.97bn (EPS: PkR49.39) in CY17 vs. NPAT of PkR2.77bn in CY16; up 43%YoY. The 32%YoY climb in sales, owing to organic sales growth based on strong fleet sales, and significant uptick in recently launched product offerings, despite the higher price tag associated with these offerings. Prominence of these models in PSMC's sales stands contrary to the widely held perception of PSMC having low quality products, competing solely on price. Factoring in the link between earnings growth and cash flows being diverted to growth initiatives, we believe local OEMs are fortifying their operational fundamentals for the next leg of long term industry rivalry. With improving fleet sales (Wagon-R & Cultus), upgraded models (consistent CAPEX on localization) and expectations of newer offering, PSMC comes up to be our top pick in the sector; offering an upside of 35.9% to our DCF based TP of PkR691.51/sh.

2QFY18E Preview for INDU: INDU is scheduled to announce earning for 2QFY18 on 23rd Feb, where we expect the company to post NPAT of PkR3.85bn (EPS: PkR49.03) in 2QFY18 vs. net profit of PkR3.03bn (EPS: PkR38.51) in 2QFY17 - up 27%YoY. This uptick in earning is on the back of: 1) increase in GP due to increasing sales revenue (forecasted to rise +20%YoY to PkR31.45bn), gross margins standing firm (17.9% for the quarter vs. 18.3% SPLY) despite increasing input prices (steel prices up 21%CYTD), 2) dampening administrative & distribution expenses to sales (-14bpsYoY for 2QFY18 to 1.89%) and 3) increased other income to PkR863mn (up 15%YoY) earned through proper cash management and short term investments. On a half year basis, INDU earnings are expected to clock in at PkR7.54bn (EPS:95.95) vs. NPAT of PkR6.07bn (EPS: 77.28) for 1HFY17. Along with the result, we expect a cash dividend of PkR30/sh translating into a 60% payout ratio vs. historic 65%, a minor contraction,

INDU: Income Statement

(PkR (lnmn)	2QFY18E	1QFY18	2QFY17	YoY%	QoQ%	1HFY18E	1HFY17	YoY%
Net Sales	31,451.53	31,219.74	25,647.83	23%	1%	62,671.26	51,399.70	21.93%
Cost of sales	25,811.32	25,776.88	20,951.16	23%	0%	51,588.20	42,524.55	21.31%
Gross profit	5,640.21	5,442.85	4,696.67	20%	4%	11,083.06	8,875.14	24.88%
Distribution expenses	297.84	311.21	290.35	3%	-4%	609.05	494.13	23.26%
Administrative expenses	253.01	279.05	230.08	10%	-9%	532.05	450.59	18.08%
Operating profit	5,089.36	4,852.60	4,176.25	22%	5%	9,941.96	7,930.42	25.36%
Other operating income	905.86	856.37	750.02	21%	6%	1,762.22	1,624.23	8.50%
Finance costs	230.71	152.67	106.56	117%	51%	383.38	117.96	225.01%
NPBT	5,761.75	5,168.13	4,457.43	29%	11%	10,929.88	8,753.59	24.86%
Taxation	1,848.70	1,539.41	1,430.20	29%	20%	3,388.11	2,679.00	26.47%
NPAT	3,913.05	3,628.72	3,027.23	29%	8%	7,541.77	6,074.59	24.15%
EPS	49.78	46.17	38.51	29%	8%	95.95	77.28	24.15%

Source: Co. Report & AKD Research

likely from liquidity burdens imposed from planned CAPEX outlays.

CY17E PSMC Preview: For CY17E, we expect the company to post consolidated NPAT of PkR3.97bn (EPS: PkR49.39) vs. NPAT of PkR2.77bn in CY16; up 43%YoY. Expected key highlights of CY17 results are: 1) 32%YoY climb in sales owing to organic sales growth (+20.7%YoY to 130,813 units for CY17 vs. 108,312 for CY16) and sales prices rise (5-11% increase on existing offering during the year), 2) 27bpsYoY improvement in the gross margins settling at 9.9% for CY17E, 3) increase in operating profits with diminishing operating expenses to sales ratio for the current year (4.3% vs. 4.6% for CY16) and 4) decrease in other operating income/rise in finance cost (-14%/+158%) due to the GoP's auto policy for only 50% upfront payment on booking leading to lesser cash for short term investments and interest payments to customers on late deliveries. On payouts, we believe the OEM has little choice, but to comply with recently notified tax regulations imposing punitive measures on profitable entities with payout ratios below 40%. Thus, we flag the upcoming full year results to accompany a dividend of PkR22.5/sh (payout 45%), marking a lagging D/Y of 4.4%.

PSMC: Income Statement

(PkR (lnmn)	4QCY17E	3QCY17	4QCY16	YoY%	QoQ%	CY17E	CY16	YoY%
Net Sales	27,917	25,973	17,771	57%	7%	100,720	76,516	32%
Cost of sales	25,370	23,408	16,520	54%	8%	90,782	69,167	31%
Gross profit	2,548	2,565	1,251	104%	-1%	9,938	7,349	35%
Distribution expenses	737	588	492	50%	25%	2,707	2,004	35%
Administrative expenses	562	386	327	72%	46%	1,684	1,540	9%
Operating profit	1,249	1,591	432	189%	-22%	5,547	3,805	46%
Other operating income	235	219	253	-7%	7%	899	1,040	-14%
Finance costs	107	99	3	3629%	7%	247	96	158%
NPBT	1,263	1,593	635	99%	-21%	5,753	4,415	30%
Taxation	402	474	197	104%	-15%	1,780	1,643	8%
NPAT	861	1,120	438	97%	-23%	3,973	2,773	43%
EPS	11.76	13.43	5.32			49.39	33.69	

Source: Co. Report & AKD Research

Investment Perspective: Time and again, we have presented our thesis for why new models, upgraded offerings and recurring CAPEX are expected to be the norm for domestic assemblers. Either in terms of fending off new entrants (where price competition for incumbents may prove to be difficult) or preserving market shares (as import market undergoes regulatory overhaul, particularly commercial dealers in import aftermarket), we believe medium term earnings growth solidify our liking for incumbents. Factoring in the link between earnings growth and cash being diverted to growth initiatives, we believe local OEMs are fortifying their operational fundamentals for the next leg of long term industry rivalry. With improving fleet sales (Wagon-R & Cultus), upgraded models (consistent CAPEX on localization) and expectations of newer offering, PSMC comes up to be our top pick in the sector; offering an upside of 35.9% to our DCF based TP of PkR691.51/sh.

Disclosure Section

Neither the information nor any opinion expressed herein constitutes an offer or a solicitation of an offer to transact in any securities or other financial instrument and is for the personal information of the recipient containing general information only. AKD Securities Limited (hereinafter referred as AKDS) is not soliciting any action based upon it. This report is not intended to provide personal investment advice nor does it provide individually tailored investment advice. This report does not take into account the specific investment objectives, financial situation/financial circumstances and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. AKDS recommends that investors independently evaluate particular investments and strategies and it encourages investors to seek the advice of a financial advisor.

The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. The securities or strategies discussed in this report may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them.

Reports prepared by AKDS research personnel are based on public information. AKDS makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. Facts and views presented in this report have not been reviewed by and may not reflect information known to professionals in other business areas of AKDS including investment banking personnel. AKDS has established information barriers between certain business groups maintaining complete independence of this research report.

This report has been prepared independently of any issuer of securities mentioned herein and not in connection with any proposed offering of securities or as agent of any issuer of any securities. Neither AKDS, nor any of its affiliates or their research analysts have any authority whatsoever to make any representation or warranty on behalf of the issuer(s). AKDS Research Policy prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer prior to the publication of a research report containing such rating, recommendation or investment thesis.

We have taken all reasonable care to ensure that the information contained herein is accurate, up to date, and complies with all prevailing Pakistani legislations. However, no liability can be accepted for any errors or omissions, or for any loss resulting from the use of the information provided as any data and research material provided ahead of an investment decision are for information purposes only. We shall not be liable for any errors in the provision of this information, or for any actions taken in reliance thereon. We reserve the right to amend, alter, or withdraw any of the information contained in these pages at any time and without notice. No liability is accepted for such changes.

Stock Ratings

Different securities firms use a variety of rating terms as well as different rating systems to describe their recommendations. A rating system which uses similar terms such as Buy, Accumulate, Neutral, Reduce and Sell is not equivalent to our rating system. Investors should carefully read the definitions of all ratings used in each research report. In addition, research reports contain information carrying the analyst's view and investors should carefully read the entire research report and not infer its contents from the rating ascribed by the analyst. In any case, ratings or research should not be used or relied upon as investment advice. An investor's decision to buy, sell or hold a stock should depend on individual circumstances (such as the investors existing holdings or investment objectives) and other considerations. Please see our table below for ratings definitions which are based on price returns.

Rating Definitions

Buy	≥ 20% upside potential
Accumulate	> 5% to < 20% upside potential
Neutral	≤ 5% to ≥ -5% potential
Reduce	< -5% to > -20% downside potential
Sell	≤ -20% downside potential

Analyst Certification of Independence

The analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

The research analysts, strategists or research associates principally having received compensation responsible for the preparation of this AKDS research report based upon various factors including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

Disclosure of Interest Area

AKDS and the authoring analyst do not have any interest in any companies recommended in this research report irrespective of the fact that AKD Securities Limited may have, within the last three years, served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the previous 12 months, significant advice or investment services in relation to the investment concerned or a related investment.

Regional Disclosures (Outside Pakistan)

The information provided in this report and the report itself is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject AKDS or its affiliates to any registration or licensing requirements within such jurisdiction or country.