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PAKISTAN
AUTOS

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MARKET
VISTA

Autos: Revisions in regulations

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- **Local auto manufacturers have been increasingly halting new bookings with Kia motors being the latest inductee in the club, notifying dealers to draw down the booking for Picanto and Sportage. The semi-conductor chip shortage has been one of the factors cited for the change in operational dynamics of local OEMs.**
- **Halt in new bookings also signals robust demand for new vehicles — strengthening prospects for the sector. This is also vetted by growth in auto sales jumping 93%YoY in 2MFY22 and auto loans hitting PkR326bn (+27% CYTD). We expect volumes to reflect low-altitude in the near term, only to recoup later as input shortage ease and business dynamics improve.**
- **The govt. is considering increasing Regulatory Duty (RD) on imported CBUs from 15% to 50% to contain the massive increase in current account deficit while revised financing regulations have already been communicated by SBP. The revised regulations are likely to be positive for local OEMs with PSMC gaining the most given stronger competition from imported CBUs whereas sales in 1300CC+ premium segment are unlikely to be materially impacted.**
- **While recent developments are likely to be margins decretive, OEMs with strong pipeline of new models (and a consequent gain in pricing power) and healthy cash flow profile are likely to fare better. In this backdrop, we continue have preference for INDU where our FY22TP stands at PkR1,774/sh.**

Supply struggling to meet demand: Local auto manufacturers have been increasingly halting new bookings with Kia motors being the recent inductee in this club, notifying dealers to draw down new sales booking for Picanto and Sportage. As detailed in our report, "Supply Chain disruptions" dated 17th Jun'21, semi-conductor shortage globally pulling up risks of possible slowdown in local auto sales, is panning out. To highlight, demand of semi-conductors have surged lately with US imports — one of the largest importers of semi-conductors globally — increasing by 60%YoY. The situation is likely to be balanced in later part of 2022 where major players have already signaled on ramping up productions such as Intel which have already announced US$20bn spend of two new chip factories while TSMC — world's largest chip manufacturers — sees its new capacity coming online in FY23. On the flip side, halt in new booking also signals robust demand for new vehicles — strengthening prospects for the sector. This is also vetted by growth in auto sales jumping 93%YoY in 2MFY22 and auto loans hitting PkR326bn (+27% CYTD). We expect the volumes to reflect low-altitude in the near term, only to recoup later as input shortage ease or business dynamics improve.

Revision in regulations: In the aftermath of strong surge in demand for autos, the State Bank of Pakistan (SBP) has revised the Prudential Regulations (PRs) for consumer financing loans. The maximum tenure of the auto financing facility has been reduced from 7-years to 5-years whereas imported CBUs will no longer be eligible for financing facilities. Similarly, the minimum down payment for financing arrangement has been increased from 15% to 30% in addition to a cap of PkR3mn. On the other hand, the govt. is considering to increase the Regulatory Duty (RD) on import CBUs (in all segments) from 15% to 50% to discourage the imports of vehicles and contain the current account deficit whereas the increase in FED by 5% is under consideration on cars above 1500cc. We believe the change in regulations further puts local assemblers in bright spot with PSMC gaining the most given stronger competition with CBUs in <1000CC segment. Further, premium segment sales are unlikely to be materially impacted due to smaller share in overall financing whereas the demand in this segment is less prone to price changes.

INDU our preferred play in this scenario: From financial blueprint, we believe OEMs margins likely to reflect a lower base in coming quarters, with low pricing power amidst GoP's pricing interventions profoundly dampening margins with higher freight costs compounding the pressure in the near term. That said, we believe lower volumes are likely to smoothen some of the impact, in-part through lower carry of raw material inventories and higher financial cost on ad-

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vances received from consumers against deliveries. In this backdrop, we believe OEMs with a strong pipeline of new models are likely to wither current business dynamics through strong pricing arrangements, and a healthy cashflow profile. Hence, we have our liking for INDU where the company has recently announced expansion in HEV segment (thus possibly gaining first mover advantage), launch of new Corolla, Fortuner and REVO facelifts, plans to introduce new model of Corolla, and lastly has piled PkR83bn in cash and short term investments (contributing 25-30% in earnings).

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