

PAKISTAN AUTOS

MARKET VISTA

REP-019

A paradigm shift in auto industry

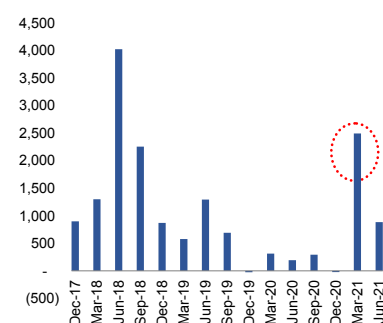
- As a proxy for latest developments, we breakdown the quarterly capex for the big three OEMs in order to highlight the paradigm shift in auto industry. So far, PSMC has incurred a capex of PkR3.4bn in 1HCY21 (+5.6xYoY), signaling new Swift in pipeline.
- INDU has spent PkR571mn in the latest quarter (FY21 capex: PkR2.5bn) whereas further PkR-5.1bn (US\$300mn) is underway for capacity expansion in addition to US\$100mn for the production of HEVs. In contrast, the capex for HCAR in the latest quarter has declined from PkR2.1bn to PkR234mn (-80%QoQ) after concluding its plant up gradation and finally starting the production of new Honda City in 1QMY22.
- The success of Kia's Sportage and Hyundai's Tuscon has heavily hampered the volumes of existing sedans. The local industry landscape has become competitive, hence, we can expect rising level of capex in upcoming quarters.
- Keeping in mind the resale value of Toyota, Suzuki and Honda cars, we expect the big 3 OEMs to sustain their position in the local industry landscape as the cars in Pakistan are not just a mode of transport but also an investment. On the other hand, we expect frequent new model rollouts by OEMs to fetch the ball back in their courts in terms of pricing power.
- Our preferred play for the sector remains INDU (TP: PkR1,774/sh), gearing up to penetrate the hybrid segment whereas PSMC (TP: PkR395/sh) remains our second best pick on the back of surging demand for small vehicles. We also have a positive stance on HCAR (TP: PkR325/sh) as the new model Euphoria is yet to subside.

Rising capex: As a proxy for latest developments, we breakdown the quarterly capex for the big three OEMs in order to highlight the paradigm shift in auto industry. So far, the latest financial statements of PSMC reflect a capex of PkR3.4bn in 1HCY21, increasing by 5.6xYoY which signals the development of new Swift in Pipeline. In contrast, the capex for HCAR in the latest quarter has declined from PkR2.1bn to PkR234mn (-80%QoQ) after concluding its plant up gradation and finally starting the production of new Honda City in 1QMY22. INDU on the other hand has spent PkR571mn in the latest quarter, taking the annual capex in FY21 to PkR2.5bn whereas further ~PkR5.1bn (US\$30mn) capex is expected in upcoming FY22 to enhance the capacity by 20%. In addition to this, the company has announced a capex of US\$100mn (~PkR17bn) over the period of next three years for the up gradation of its plant to produce a number of Hybrid Electric Vehicles (HEVs) in Pakistan. This came in the aftermath of reduction on duty structure for HEV specific parts whereas soaring prices of imported CBU alternatives is an added incentive.

The necessity to invest more: Although the industry has made handsome recovery in FY21, one thing to ponder upon is the losing competitiveness of big 3 OEMs to the new entrants. During the outgoing FY21, Kia has sold over 20k units, growing by 162%YoY whereas Hyundai has sold ~5.8k units higher by 16xYoY. The success of Kia's Sportage and Hyundai's Tuscon has heavily hampered the volumes of existing sedans, especially Civic as the total volumes of HCAR in FY21 stand at 29k units, just a little higher than the new entrant Kia. In addition to this, HCAR's City had to absorb cannibalization from Yaris and other Chinese players (Changan's Alsvin and Proton's Saga) making the phase out of City apparent. The new City for HCAR finally proved to be a sigh of relief as the order book of HCAR has become healthy and the company now seems confident to deliver 9k cars per quarter in FY22 whereas the new Civic in pipeline will further improve the company's positioning. INDU on the other hand made a smart move by introducing Yaris in the category of compact sedans in order to capture the market from the audience which preferred sedans but due to the depleted pricing power had to settle for the hatchbacks. The trickle-down effect of depleting purchasing power led the consumers shift from PSMC's Cultus and Wagon-R to the newly launched Alto which became the company's cash cow. The local industry landscape has become competitive, hence, we can expect rising level of capex in upcoming quarters.

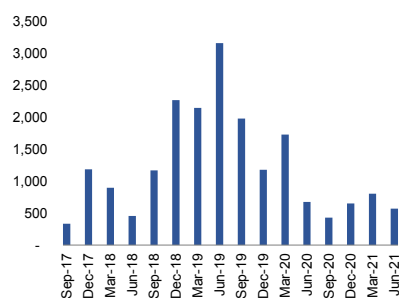
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PSMC: Capex being reflected for new Swift



Source: Company reports & AKD Research

INDU: Maintenance capex of PkR2.5bn in FY21



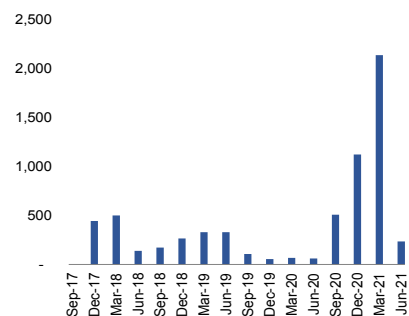
Source: Company reports & AKD Research



AKD Securities Limited

Investment Perspective: Keeping in mind the upcoming developments, we expect the competition to gear up, however, we believe the big 3 OEMs to weather out the competition and sustain their position in the local industry landscape. Our view is based on i) existing brand image, ii) extensive dealership network, iii) consistent resale value, and iii) frequent new model rollouts. The cars in Pakistan are not just a mode of transport but also an investment where a year old vehicle sells at the price of a new vehicle due to ON money. Keeping this in mind, the consumers prefer the vehicles from Toyota, Suzuki and Honda over new entrants, especially the Chinese players in case they fail which might plummet the resale value. On the other hand, big 3 OEMs have also realized the level of competition and hence have started to revamp their strategies. In light of limited cost pass-on, we expect frequent new model rollouts by OEMs to fetch the ball back in their courts in terms of pricing power. According to the sources, HCAR is expected to start the up gradation of its plant to launch the new model of Civic in FY23 whereas INDU and PSMC have already started their up gradation processes. Our preferred play for the sector remains INDU (TP: PkR1,774/sh), gearing up to penetrate the hybrid segment whereas PSMC (TP: PkR395/sh) remains our second best pick on the back of surging demand for small vehicles. We also have a positive stance on HCAR (TP: PkR325/sh) as the new model Euphoria is yet to subside.

HCAR: Capex for new City



Source: Company reports & AKD Research

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| | |
|----------------|---|
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