

Day Break

Friday, 06 May 2016

Company Update

Indus Motor Company Limited

Automobile Assembler

Recommendation		HOLD
Target Price		1,020.0
Last Closing		935.0
Upside		9%

Market Data			INDU PA
Bloomberg Tkr.			78.6
Shares (mn)			702.2
Market Cap (PKRbn USDmn)	73.5		KSE 100
Exchange			

Price Info.			
	90D	180D	365D
Abs. Return	(8.7)	(16.5)	(18.7)
Low	910.0	910.0	910.0
High	1,060.0	1,156.7	1,309.2

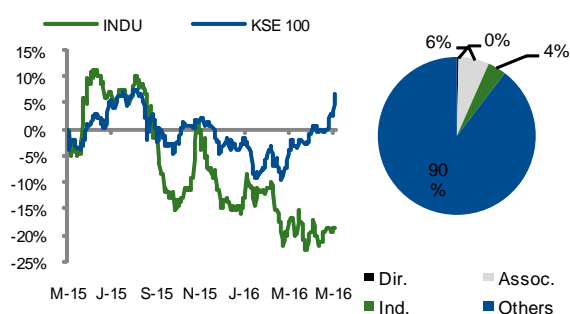
Key Company Financials

PKRbn	FY15A	FY16E	FY17F	FY18F
Total Revenue	96.5	108.5	108.4	113.9
Net Income	9.1	12.2	11.5	10.4
EPS (PKR)	115.9	155.8	146.6	132.1
DPS (PKR)	80.0	94.0	88.0	79.0
Total Assets	50.4	50.0	49.7	51.7
Total Equity	24.0	28.9	33.5	37.7

Key Financial Ratios

ROE (%)	38%	42%	34%	28%
P/E (x)	8.1	6.0	6.4	7.1
P/B (x)	3.1	2.5	2.2	2.0
DY (%)	8.6	10.1	9.4	8.4

Relative Price Performance & Shareholding



About the Company

The Company was incorporated as a public limited company in Pakistan in December 1989 and started commercial production in May 1993. The company is the sole distributor of Toyota and Daihatsu vehicles in Pakistan.

Source: Bloomberg, KSE 100 & IGI Research

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Automobile Assemblers

INDU: Stronger JPY and Recovering Steel Prices to Extend Pressure on Gross Margins

- JPY has appreciated by nearly 12% CYTD and breached the level of 106 on 3rd Mar-16, JPY/USD highest level in 18months.
- Looking ahead, market readings suggest BoJ may finally continue with its stimulus package in the near term, as a way to maintain its export competitiveness, leading to probable JPY depreciation.
- At current price of PKR 935/share we maintain our 'HOLD' rating, with Dec-16 target price of PKR 1,020/share offering a limited +9% upside. The scrip is trading at a FY17F P/E of 6.4x and offers a dividend yield (%) of 9.4%.

Event

Despite expansionary policies – Quantitative and Qualitative easing (QQE) along with negative interest rates – JPY surged and JPY/USD reached 105.8 on 3rd May-16 in response to no additional stimulus by Bank of Japan (BoJ) against the high expectation of market. This could easily spill out trouble for Japanese auto manufacturers - INDU, already faced with compressing margin in last two quarters due to recovery in international steel prices. Although JPY phenomenon is likely a short-term event, we view company could see further gross margin erosion in its 4QFY16.

JPY touched 18 months high reaching JPY/USD 105.8 level

JPY has appreciated by nearly 12% CYTD and reached the level of 105.8 on 3rd Mar-16, JPY/USD highest level in 18months. Primarily this rapid movement of JPY against USD was in response to BoJ unexpected decision of skipping stimulus on 28th Apr-16, as it continue to operate under negative interest rate environment, leaving lesser room for effectiveness of monetary policy as a tool.

Long-term JPY expected to hold parity relation

Looking ahead, market readings suggest BoJ may finally continue with its stimulus package in the near term, as a way to maintain its export competitiveness, leading to probable JPY depreciation. This leads to our FY17/18 average forecast for JPY/USD at 113/116 slightly stronger from its current average of 118 in FY16.

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Gross Margins to revert towards last 5 yrs mean of ~10%

Although the company does take forward hedging position against JPY to minimize impact of exchange rate appreciation, however excessive appreciation in JPY could easily exhausts hedge reserves, leaving the company more exposed to currency risk. For INDU, who is already facing sequential gross margin compression from last two quarters owing to sharp recovery in international steel prices, recent JPY appreciation could easily spill out trouble for the company gross margins. As per our estimates, gross margin could easily shrink by another 70bpsQoQ to 15% in 4QFY16 that roughly translates into PKR ~2.0/share bottom line impact.

Exhibit: Gross Margins peaked out and reverting to mean

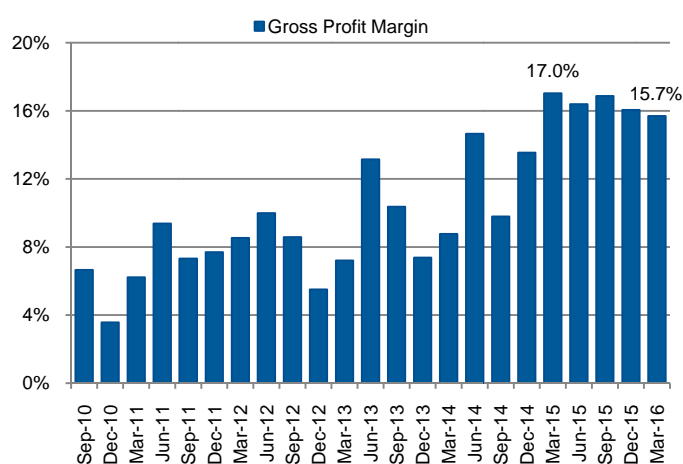
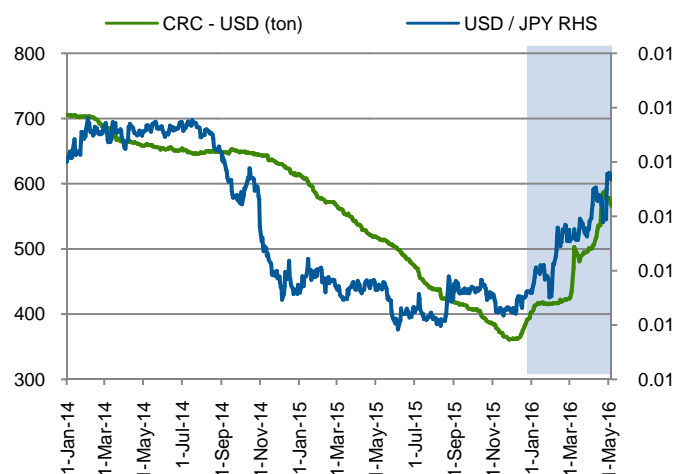


Exhibit: Steel prices are in recovery phase while JPY has appreciated against USD despite expansionary policies of BoJ



Source: IGI Research, Company's Financial, Bloomberg

Outlook

Going forward we maintain our assumption of softer JPY from FY17 onwards, with our FY17/18F average forecast for JPY/USD at 113/116 along with gradual recovery in international steel prices (~3% on annual average increase), leading to gross margins reverting to its mean average of ~10% in the next 5Yrs.

Recommendation

At current price of PKR 935/share we maintain our '**HOLD**' rating, with Dec-16 target price of PKR 1,020/share offering +9% upside. The scrip is trading at a FY17F P/E of 6.4x and offers a dividend yield (%) of 9.4%.

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Hold	If return on aforementioned security(ies) is in between -10% and 10%, from its last closing price(s)
Sell	If return on aforementioned security(ies) is more than -10%, from its last closing price(s)

Valuation Methodology

The analyst[^] has used following valuation methodology to arrive at the target price of the said security (ies):

- DCF (Discounted Cash Flow)

Time Horizon

- Dec - 2016

Risk

- Changes in State Bank of Pakistan Policy Rate
- Changes in country (Pakistan) macro-economic environment
- Changes in Company(ies) operating structure
- Change in Exchange Rate (USDPKR)

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