Day Break

Tuesday, 15 May 2018

COMPANY UPDATE

Indus Motor Company Limited
Automobile Assembler

Recommendation		**BUY**
Target Price:		2,419.4
Last Closing:	14-May-18	1,672.2
Upside:		44.7
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data

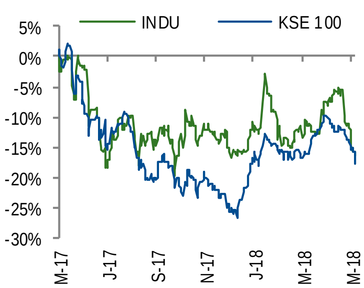
Bloomberg Tkr.		INDU PA
Shares (mn)		78.6
Free Float Shares (mn)		13.4
Free Float Shares (%)		17.0%
Market Cap (PKRbn | USDmn)	131.4	1,136.3
Exchange		KSE 100

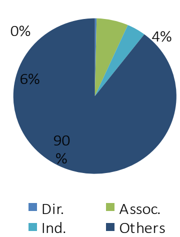
Price Info.	90D	06M	12M
Abs. Return	(2.4)	(5.9)	(16.3)
Lo	1,672.2	1,662.0	1,603.4
Hi	1,896.6	1,942.0	2,001.5

Key Company Financials
Period End: Jun

PKRbn	FY17A	FY18E	FY19F	FY20F
Total Revenue	112.3	137.6	137.0	137.7
Net Income	13.0	15.2	15.0	14.8
EPS (PKR)	165.4	193.6	191.0	188.3
DPS (PKR)	115.0	135.0	133.0	131.0
Total Assets	63.9	69.7	74.6	79.4
Total Equity	31.2	35.8	40.4	44.9
Key Financial Ratios				
ROE (%)	41.7	42.5	37.2	33.0
P/E (x)	10.1	8.6	8.8	8.9
P/B (x)	31.9	4.2	3.7	3.3
DY (%)	6.9	8.1	8.0	7.8

Relative Price Performance





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 vehicles in Pakistan.

Source: Bloomberg, PSX & IGI Research

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Automobile Assemblers

INDU: Budgetary implications and challenges ahead; "BUY" call intact

- We revisit our investment case on the scrip wherein we have revised our earnings estimates after incorporating, financial accounts of 9MFY18, tax measures proposed in the budget and changes in our assumption for the current fiscal year.
- For the 9MFY18 the Company reported earnings of PKR 11.6bn (EPS: PKR 148), up by +14%YoY wherein high margin segment showcased robust sales performance.
- With respect to budget (FY18-19), the tax measures proposed will have negative impact on our earnings estimates in the short-term but in the long term gradual decrease in corporate tax rate will provide some breather.
- Going forward, restriction imposed on non-filers will have major repercussions for the auto industry, impacting local demand as customers (non-filers) will switch to imported used cars. As such, we have evaluated impacts to our earnings estimates under different demand scenarios in case the measure gets implemented
- We still prefer INDU as our top pick in IGI Auto universe with our revised Dec-18 target price of PKR 2,419.4/share offering +45% upside from its last closing. The company is currently trading at FY18E P/E of 8.6x and offers an estimated dividend yield of 8.1%.

We revisit our investment case on the scrip wherein we have revised our earnings estimates after incorporating financial accounts of 9MFY18, tax measures proposed in the budget and changes in our assumption for the current fiscal year. For the 9MFY18 the Company reported earnings of PKR 11.6bn (EPS: PKR 148), led by strong growth in high margin segment. With respect to budget (FY18-19), the tax measures proposed will have negative impact to our earnings estimates in the short-term but in the long term gradual decrease in corporate tax rate will provide some breather. All in all, our earnings estimates are revised upwards by PKR 2.3/share to PKR 193.6/share for FY18E, while witnessing negative impact (PKR 3.4/share) for FY19F owing to super tax charge. However, from FY20F onwards we see earnings to gain some traction with gradual phase-out of super tax and reduction in corporate tax rate. Hence, our target price will be revised upwards by 4% (PKR~98/share) to PKR 2,419.4/share. Going forward, restriction proposed on non-filers will have major repercussions for the auto industry, impacting local demand as customers (non-filers) will switch to imported used cars. As such, we have evaluated impacts to our earning estimates under different demand scenarios in case the measure gets implemented.

9MFY18 result review

The company for the nine-month period recorded profitability of PKR 11.6bn (EPS: PKR 148), up by +14%YoY. The volumes remained relatively flattish at 46k units (slightly up by +1%YoY) as Corolla sales dived down by 6%YoY to 38k units, countered by healthy growth in Hilux and Fortuner sales, up by +28%/ 3.0xYoY to 5.4k/2.7k units. In particular, rolling out new models triggered demand during the period, starting off with Corolla face-lift, launched in Aug-17. In addition, the momentum continued as new models (slight upgradation) of Hilux and Fortuner were launched during the start of CY18. However, the Company witnessed a decline of 500bps YoY in its margins to 17.5% owing to increase in CRC prices (USD/ton) and exchange rate (USD/PKR and USD/JPY) volatility. Nevertheless, healthy sales in high margin segment and price hike were able to nullify the impact to an extent. With ample liquidity backed by strong cash flow generation the Company declared a cash dividend of PKR 32.5/share during 3QFY18 taking total cash payout to PKR 95/share for 9MFY18 as against PKR 80/share in the same period last year.

Earnings revised by PKR ~2.3/share to PKR 203/share for FY18E

We have revised our earnings estimate upwards by PKR~ 2.3/share to PKR 193.6/share after taking into account super-tax and amendments in our sales assumption given favorable demand in the upcoming quarter. With the election period approaching we expect demand for the units (Hilux in particular) to pick up pace, partially resisted by purchase behavior (seasonal effect) during the holy month. We therefore, have increased our sales assumption by +6% (+400 units) for Hilux and Fortuner to 2.2k and 1.1k units for the upcoming quarter. Our earnings estimates are revised upwards by PKR 12/share to PKR ~203/share for FY18E from our previous estimate of PKR ~191/share. However, incorporating super tax charge will drag down our earnings by PKR 9.3/share to PKR 193.6/share, resulting in net positive impact of PKR ~2.3/share from our initial estimates.

Budgetary measures proposed for FY18-19

To recall, the government in its FY18-19 budget announced various measures for the auto industry. As such these pertained to a) restriction on non-filers to buy new cars both domestic and imported ones, b) continuation of supertax with 1% decline thereof and c) gradual reduction in corporate tax by 1% each year to 25% by FY23. We have incorporated the tax measures in our model to gauge impact on our earnings estimates.

Increase in effective tax rate will hurt earnings in the short-term

Continuation of super tax will result in downward revision in our earnings estimates for FY18-FY19. In particular, for FY18, earnings will drag down by PKR ~9/share to PKR 193.6/share at the effective tax rate of 33%. However, for FY19, the impact of super tax will be partially offset by corresponding reduction in corporate tax rate at 29%, resulting in a negative change of PKR~3.4/share to our earnings from our previous estimate of PKR ~194/share. Nevertheless, from FY20F onwards we see earnings to pick up pace, supported by declining corporate tax rate by 1% each year.

Exhibit:

Revised earnings estimates after incorporating super-tax and corporate tax rate

	FY18E	FY19F	FY20F	FY21F
EPS (Pre-budget)	191.4	194.5	186.1	177.0
EPS	202.9*	194.5	186.1	177.0
Corporate tax	30%	29.0%	28.0%	27.0%
Super tax	3%	2.0%	1%	-
Effective tax	33%	31%	29%	27%
EPS (Post-budget)	193.6	191.0	188.3	184.6
Net Impact	2.1	(3.4)	2.3	7.5

SOURCE: IGI Research, Finance Bill (FY18-19) ** =revised sales assumption*

Restriction imposed on non-filers will hamper demand dragging down earnings

In order to enhance tax base, the government imposed restriction on non-filers for the purchase of new cars both imported and domestic. This will supposedly hurt our local auto industry as non-filers will switch towards used imported cars, thereby impacting demand of locally produced vehicles. The industry stakeholders have voiced concern over the issue, suggesting gradual implementation on this measure rather than being spontaneous. Unfortunately, the government is adamant to implement this measure.

For INDU, taking cue from the recent analyst briefing, the proportion of filers to non-filers is roughly 60 to 40. Under these circumstances we weigh possible impact to the company's sales volumes and its implications to our earnings. As such, taking into account sales of all units (Corolla, Hilux and Fortuner), a 10% decrease in our sales assumption for each category will result in earnings estimates to deteriorate by PKR ~21/share or 11% on average going forward. Similarly, for every 10% decrease in volumes thereof the impact may worsen, with earnings to drag down substantially by PKR ~100/share (57%) on average at 50% demand cut.

Exhibit:

Impact on earnings estimates under different demand scenarios

Demand ↓	FY19F	FY20F	FY21F
Base case	**191.1**	**188.3**	**184.6**
10%	-10%	-12%	-12%
20%	-21%	-23%	-24%
30%	-31%	-35%	-37%
40%	-41%	-46%	-49%
50%	-52%	-58%	-61%

SOURCE: IGI Research

Recommendation

We still prefer INDU as our top pick in IGI Auto universe with our revised Dec-18 target price of PKR 2,419.4/share offering +45% upside from its last closing. The company is currently trading at FY18E P/E of 8.6x and offers an estimated dividend yield of 8.1%.

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Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
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Time Horizon: Dec – 2018

Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):
(Discounted Cash Flow)

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