Indus Motor Company Limited

Margin stability & volumes to drive earnings growth; "OW"

Monday, September 11, 2017

INDU - Overweight

Target Price: PKR 2,297

Current Price: PKR 1,725

INDU Performance

	3M	6M	12M
Absolute %	-13%	4%	48%
Relative to KSE %	65%	16%	-3%

Bloomberg	INDU PA
Reuters	INDM.KA
MCAP (USD mn)	2,295
12M ADT (USD mn)	0.7
Shares Outstanding (mn)	79

Source: PSX, BMA Research

INDU-Valuation Snapshot (PKRmn)

	FY17	FY18F	FY19F
Net Sales	112,272	127,675	133,505
Growth	3%	14%	5%
PAT	13,001	16,513	17,145
Growth	13%	27%	4%
EPS (PKR)	165.4	210.1	218.1
P/E (x)	10.4	8.2	7.9
DPS (PKR)	115.0	125.0	130.0
D/Y (%)	6.7%	7.2%	7.5%
EBITDA	21,293	25,875	27,216
EV/EBITDA	4.2x	3.2x	2.7x

Source: Company Accounts, BMA estimates

Sarah Kamran
Sarah.kamran@bmacapital.com
+9221-111-262-111 Ext: 2058

REP-005

- **INDU's FY17 performance (13% YoY earnings growth) reflects its continued margin improvement streak (up 110bp), thanks to popular face-lifts of Hilux and Fortuner and improved sales mix.**
- **Following soft patch in sales in FY17 (-6% YoY vs healthy 14% industry growth excluding taxi scheme), we eye 8-10% volume growth to drive earnings in FY18.**
- **We highlight INDU remains better positioned to potentially brace itself from a potential sharp PKR/USD move, given (1) superior pricing power vs peers (2) INDU's excellent cash & investment position indicates its ability to bank on higher investment income (higher interest rates).**
- **At TP of PKR2,297, we have an Overweight stance on INDU, offering return of 33% at last closing exclusive of best- amongst-peers D/Y (FY18E is 7.2%).**
- **Risks to our investment case include (1) unprecedented sharp FX movement (2) delay in completion of debottlenecking (currently scheduled for 3Q18) and (3) any risk to rising demand dynamics from slowdown in economic growth.**

A remarkable growth in earnings despite soft sales patch: Indus Motors posted healthy FY17 earnings of PKR165.4/sh (13% YoY growth) despite a soft patch in sales in FY17 as opposed to industry trend (6% YoY decline in volumes for INDU vs strong 14% growth in sector excluding impact of taxi scheme). The sequential earnings growth is primarily supported by continued margin improvement from 16.3% in FY16 to 17.9% in FY17. This was backed by popular face-lifts of Hilux and Fortuner leading to price increases and margin benefit of 110bp over last year on account of improved sales mix. Going forward, INDU remains in sweet spot with our estimate of 8-10% sales growth in FY18E following a soft patch in FY17 (-6% YoY decline). We highlight INDU remains better positioned to potentially brace itself from a sharp PKR/USD movement in coming months, given (1) superior pricing power compared to peers and (3) INDU's excellent cash and investment position indicates its ability to bank on higher investment income (higher interest rates) and (3) best amongst peers dividend yield (FY18E is 7.2%) to capture market interest.

#1. Pricing power is better than peers: Keeping in mind risk of sharp exchange rate deval, our sensitivity analysis indicates that a 10% sharp deval in FY18/19 each (vs our base case assumption of 4%) would increase per unit cost from our base case by 2-2.2% each year for INDU. While we are less optimistic on volumes front, Indus has historically been more pro-active in raising prices and can be expected to hike prices to pass on the cost. Just to put it into perspective, a 10% decline in volumes of Corolla alone in each year (post pass-on) is likely to eat away profitability by 6% in FY18/19E (from our base case) though we expect adverse impact on volumes (on Corolla, Hilux and Fortuner combined) to be visible with a lag having minimum impact on FY18 and larger impact on FY19/20. Actual impact on volumes will, in our view, be dependent on impact of (1) potential increase in fuel cost as exchange rate move is passed on, (2) increase in financing rates in in case of swift interest rate reversal, and (3) potential delay in CPEC projects to address macro concerns could hurt the pace of sales growth in vehicles used for transportation as well as for security forces (including Hilux and Fortuner).

#2. Investments to keep non-core income growth intact: Indus's strong liquid assets position (cash and short term investment stood at PKR42.8bn in Mar'17 vs PKR36.4bn in Jun'16) is unlikely to be hurt much, with management dismissing any rumors of additional plant/capacity expansion apart from ongoing bottleneck removal at paint shop. This should provide stability to other income in future, up by 13.6%YoY in FY17 to PKR3.6bn (18.8% of PBT).

#3. Dividend yield to keep stock price in check: At FY18E D/Y of 7.2%, the stock offers attractive yield with interim payouts. Our payout assumption of 60% is already conservative compared to last 3 years average payout ratio of 69%. Given strong cash (equivalents) position, we see low probability of the company trimming its dividend payout from our base case in case of slowing profitability.

FY17 review- 13% earnings growth: INDU posted strong FY17 earnings of PKR165.4/sh (13% YoY growth) with a cumulative dividend of PKR115/sh, backed by price increases (Face-lifts of Hilux and Fortuner) and margin benefit of 110bp over last year on account of improved sales mix. Volumes fell by 6.4% YoY due to Corolla sales going down by 8.3% as the company's plant faced operational issues at start of the year, a 8-10 day strike at the end of the year and anticipation of new face-lift. During the last quarter, the company's margins suffered (16.5% from 19.2% in 3QFY17) due to stronger yen (2% average) and 18% QoQ decline in volumes. However going forward, Corolla sales are expected to pick up pace with the unveiling of new face-lift corolla in Jul'17. We expect 8% YoY growth in Corolla sales and 10% YoY growth in Hilux and Fortuner sales for FY18E. With the debottlenecking project to be completed in 2018, the double shift capacity is expected to increase capacity by additional ~10k units next year.

Investment thesis: At TP of PKR2,297, we have an Overweight stance on INDU, offering return of 33% at last closing, exclusive of dividend yield of 7.2% for FY18E. Risks to our investment case include (1) unprecedented sharp FX movement (2) delay in completion of debottlenecking (currently scheduled for 3Q18) or any sudden plant production issue and (3) any risk to rising demand dynamics from slowdown in economic growth.

Disclaimer

This research report is for information purposes only and does not constitute nor is it intended as an offer or solicitation for the purchase or sale of securities or other financial instruments. Neither the information contained in this research report nor any future information made available with the subject matter contained herein will form the basis of any contract. Information and opinions contained herein have been compiled or arrived at by BMA Capital Management Limited from publicly available information and sources that BMA Capital Management Limited believed to be reliable. Whilst every care has been taken in preparing this research report, no research analyst, director, officer, employee, agent or adviser of any member of BMA Capital Management Limited gives or makes any representation, warranty or undertaking, whether express or implied, and accepts no responsibility or liability as to the reliability, accuracy or completeness of the information set out in this research report. Any responsibility or liability for any information contained herein is expressly disclaimed. All information contained herein is subject to change at any time without notice. No member of BMA Capital Management Limited has an obligation to update, modify or amend this research report or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate, or if research on the subject company is withdrawn. Furthermore, past performance is not indicative of future results.

The investments and strategies discussed herein may not be suitable for all investors or any particular class of investor. Investors should make their own investment decisions using their own independent advisors as they believe necessary and based upon their specific financial situations and investment objectives when investing. Investors should consult their independent advisors if they have any doubts as to the applicability to their business or investment objectives of the information and the strategies discussed herein. This research report is being furnished to certain persons as permitted by applicable law, and accordingly may not be reproduced or circulated to any other person without the prior written consent of a member of BMA Capital Management Limited. This research report may not be relied upon by any retail customers or person to whom this research report may not be provided by law. Unauthorized use or disclosure of this research report is strictly prohibited. Members of BMA Capital Management and/or their respective principals, directors, officers and employees may own, have positions or effect transactions in the securities or financial instruments referred herein or in the investments of any issuers discussed herein, may engage in securities transactions in a manner inconsistent with the research contained in this research report and with respect to securities or financial instruments covered by this research report, may sell to or buy from customers on a principal basis and may serve or act as director, placement agent, advisor or lender, or make a market in, or may have been a manager or a co-manager of the most recent public offering in respect of any investments or issuers of such securities or financial instruments referenced in this research report or may perform any other investment banking or other services for, or solicit investment banking or other business from any company mentioned in this research report. Investing in Pakistan involves a high degree of risk and many persons, physical and legal, may be restricted from dealing in the securities market of Pakistan. Investors should perform their own due diligence before investing. No part of the compensation of the authors of this research report was, is or will be directly or indirectly related to the specific recommendations or views contained in the research report. By accepting this research report, you agree to be bound by the foregoing limitations.

BMA Capital Management Limited and / or any of its affiliates, which operate outside Pakistan, do and seek to do business with the company(s) covered in this research document. Investors should consider this research report as only a single factor in making their investment decision. BMA Research Policy prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer/company prior to the publication of a research report containing such rating, recommendation or investment thesis.

Rating

Investors should carefully read the definitions of all rating used within every research reports. In addition, research reports carry an analyst's independent view and investors should ensure careful reading of the entire research reports and not infer its contents from the rating ascribed by the analyst. Ratings should not be used or relied upon as investment advice. An investor's decision to buy, hold or sell a stock should depend on said individual's circumstances and other considerations. BMA Capital Limited uses a three tier rating system: i) Overweight, ii) Market-weight and iii) Underweight (new rating system effective Feb 29'16) with our rating being based on total stock returns versus BMA's index target return for the year. A table presenting BMA's rating definitions is given below:

Rating definitions	
Overweight	Total stock return > expected market return + 2%
Market-weight	Expected market return ± 2%
Underweight	Total stock return < expected market return - 2%

*Total stock return = capital gain + dividend yield

Old rating system (discarded effective Feb 29'16)

Buy	>20% upside potential
Accumulate	>=5% to <=20% upside potential
Hold	<5% to >5% potential
Reduce	<=-5% to >=-20% downside potential
Sell	<-20% downside potential

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)