Autos Dec’21 earnings preview

NEXT CAPITAL

Automobile Assembler — Marketweight

January 21, 2022

Pakistan Equities
Automobile Assembler

Key Points

- For Dec’21 quarter, we estimate the Japanese trio to post combined net profit of PKR7.5bn, compared to PKR4.7bn in the same period last year, showing a whopping growth of 59%YoY.
- The YoY growth is mainly attributable to overall higher sales, which surged by 57%YoY mainly led by HCAR followed by PSMC and INDU. Whereas, on sequential basis, profitability of the coverage universe is expected to grow marginally by 2%QoQ.
- HCAR is expected to report the highest YoY/QoQ growth in earnings of 83%/46% while INDU is estimated to follow and PSMC is expected to report negative earnings growth on both YoY and QoQ basis. On QoQ basis, INDU is also expected to report negative growth in earnings.
- Gross margins of our coverage companies are estimated to remain relatively flat at 8% compared to the previous quarter and an increase of 0.28ppt on YoY basis. Despite sharp rise in volumes and higher prices, cost pressures are likely to keep margins expansion in check.
- We maintain our Marketweight stance on the sector with INDU our top pick.

The sector to witness a massive increase in earnings on YoY basis

Next Capital auto sector coverage universe (INDU, PSMC, HCAR) is likely to witness healthy increase in earnings during the quarter ending Dec’21 compared to the same period last year. The combined profit after tax is projected to post an increase of 59%YoY. The increase in earnings is mainly attributable to higher sales volume and multiple price hikes. However, we estimate marginal increase of 2%QoQ in profitability that is mainly affected by PKR depreciation and elevated commodity prices despite increase in prices and sharp rise in volumes in the month of Dec’21.

Volumes back to historic levels, expecting some consolidation during the coming quarters

Automobile sales continued their upward trajectory during the quarter as sales increased 57%YoY, which we attribute to pent-up demand and incentives announced in FY22 budget. Combined sales of our universe for Dec’21 quarter improved to 73,523 units as compared to 47,097 units. Individually PSMC, INDU and HCAR witnessed a strong recovery in sales where they posted an increase of 65%YoY, 35%YoY, and 67%YoY, respectively. Thus, we foresee, industry revenue to clock in at PKR132bn, as compared to PKR89.7bn in the corresponding period last year and PKR141bn in Sep’21 quarter. Having said that, gross margins are expected to remain rather flat at 8.1% on QoQ basis despite sharp recovery in unit sales albeit higher car prices following PKR depreciation and higher freight charges in addition to restrictive policies for auto financings, we opine. Going forward, further macro-economic tightening, revision in prudential regulation and supply issues of semiconductor chips globally will limit demand during the coming quarters.

Volatile exchange rate and elevated commodity prices to keep margins in check

We expect gross profit during the quarter ending Dec’21 in absolute terms to increase to PKR10.78bn compared to PKR7.0bn of Dec’20. However, decline by 6.4%QoQ. In addition, gross margins of our coverage companies are estimated to remain flat at 8% against the previous quarter and increase by 0.28ppt on YoY basis despite the sharp rise in volumes and price. We opine, flattish gross margin is mainly attributable to PKR devaluation and sky rocketed commodity prices with compromised pricing power of the local auto assemblers. Going forward, with an increasing competition from new entrants, decline in purchasing power, expected slowdown in volumes, and limited pricing power, gross margins of our coverage companies are unlikely to shoulder their era 2015-2019. Furthermore, exchange rate weakness will further increase pressures exacerbating overall cost structure for auto assemblers in the short to medium term.

Outlook

We maintain our MarketWeight stance on the sector preferring only INDU with a strong customer preference particularly from rural buyers on cash and healthy dividend Yield. To recall, during CY21 auto sector performance has been on the trim, as companies’ margins came under pressure rightly so on the back of rising commodity prices and PKR devaluation. In addition, much of the headwinds are behind us however, revision in prudential regulation related to auto financing and recent amendments made in finance bill (mini budget) will further lead to increase in car prices, in the times of higher inflation and lower purchasing power. It is pertinent to note, most of the on-going launches are in SUV category with prices that are almost at par with the existing players offerings in the sedan segment. We think, pricing power of incumbent players will get tested especially the ones having limited product offerings in the market, and they may have to be more cautious in their approach. Hence, further shift in consumer preferences towards SUVs cannot be ruled out.

Key Data	
Mkt. Cap. (USDmn)	1,742
Mkt. Cap. (PKRbn)	307
Index Weightage (KSE-100)	3.4%
Number of Listed Companies	12

Source: PSX, Next Research

Dec'21 Sector Estimates

EPS	Dec'21	YoY	QoQ	DPS
INDU	66.20	76%	-4%	31
HCAR	9.62	83%	46%	-
PSMC	11.37	-8%	-6%	3.5

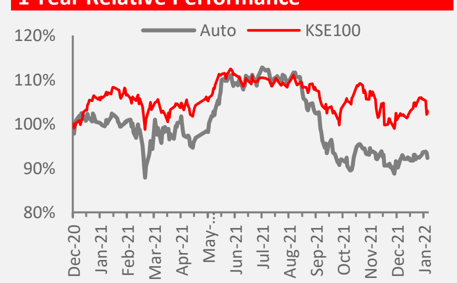
Source: Company Accounts, Next Research

Cumulative Sector Estimates

	EPS	DPS
INDU (1HFY22)	135.22	65.5
HCAR (9MMY22)	22.71	-
PSMC (CY21)	37.98	3.5

Source: Company Accounts, Next Research

1 Year Relative Performance



ource: PSX, Next Research

M Shumail Rauf
+92-21-35222204
shumail.rauf@nextcapital.com.pk

Analyst Certification, Disclosures & Contacts

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Next Capital Limited employs a three tier rating system depending upon sector's proposed weight in the portfolio as compared to sectors weight in KSE-100 index, as follows:

Rating	Sector's proposed weight in the portfolio
Over Weight	> Weight in KSE 100 index
Market Weight	= Weight in KSE 100 Index
Under Weight	< Weight in KSE 100 Index

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Rating	Expected Total Return
Buy	R ≥ 15%
Neutral	0% ≥ R < 15%
Sell	R < 0%

Where;

R = Expected Dividend Yield + Expected Capital Gain

R' is before tax

Investment horizon is between six months to twelve months

Ratings are updated regularly based on the latest developments in the economy/sector/company, changes in stock prices, and changes in analyst's assumptions.

Karachi Head Office

2nd Floor Imperial Court Building,
Dr. Ziauddin Ahmed Road,
Karachi75530 , Pakistan

☏: +92-21-111-639-825
🖶: +92-21-35632321

Lahore Office

63-A, Agora Eden City
DHA Phase VIII,
Lahore, Pakistan

☏: +92-42-37135843-8
🖶: +92-42-37135840

Research

☏: 92-21-111-639-825 (Ext:109, 129)
✉: research@nextcapital.com.pk

Sales and Trading

☏: 92-21-111-639-825 (Ext: 106)
✉: equitysales@nextcapital.com.pk

Corporate Finance & Advisory

☏: 92-21-111-639-825 (Ext: 131)
✉: cf@nextcapital.com.pk

www.nextcapital.com.pk