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Automobile Sector: Valuations not compelling

Synopsis…

Pakistan's auto industry sector is one of the booming industrial sectors as compared with other sectors as far as a constant demand for all types of vehicles (including motorcars, LCVs, 2/3 wheelers, trucks, tractors, buses and prime-movers).

Pakistan is yet dependent upon a number of regular imports of various auto spare parts and components, which ultimately increases the cost for the entire local auto industry. Due to continuous devaluation of Pak-Rupee, the auto industry is facing much problem while importing the spare parts which increases the cost per unit and ultimately effect sales price. Here price elasticity of demand plays a key role and hence we see less off-take of cars by local public.

As per statistics, sale prices have increased by 100% in the last 4 years alone, at the pretext of rupee devaluation. Imported cars and energy crisis had also aggravated problems of the auto industry.

As for the listed company's earnings, HCAR is coming out of the woods with visible
2Q & 3Q profitability; wherein it seems that the company could post sanguine numbers in final quarter.

Productions at glance

A glance at the production capability shows that Pak Suzuki (PSMC) is utilizing 62% production capacity. PSMC may increase its production if demand increased while Indus Motors (INDU) is performing on 100% capacity utilization; this means they can invest more to increase production capacity and which is positive sign for the company's growth in future. Whereas Honda Atlas (HCAR) is utilizing 22% production capacity because, company is catering assembly line of high end segment.

Company	Production Capacity	Annual production	Capacity Utilization
Pak Suzuki	150,000	92,529	62%
Indus Motors	54,800	54,900	100%
Honda Atlas	50,000	11,040	22%

Source: Company Reports & SCSTrade Research Dept.

Assembler	Exp P/E	PBV	ROE	Hist. P/E
Pak Suzuki	5.2	0.5	5.19	10.17
Indus Motor	8.6	1.4	25.29	5.52
Honda Atlas	25.2	3.5	2.32	N/m
Avg benchmark	6.9	0.9		7.8

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Problems with automobile sector…

Automobile companies are also facing plethora of issues and a negative trend in growth due to ongoing power crisis, vulnerable economic conditions and excessive taxes and levies imposed upon auto sector by the government on regular basis.

Pakistan's auto sector has been producing vehicles of international standards, and review in government's policies is needed to lower down the prices of cars by protecting local industry. The auto sector is ready to compete with India after opening of trade from January 1, 2013 but continuity in policies is required for the competition with India.

Car production in 2006-07 was 220,000 but it declined to 170,000 units due to import of used cars. We can expect that auto industry would face problems till June 2013 due to political uncertainty and general elections in Pakistan. According to our research no country assembled car 100 per cent while increase in car sales volume was crucial to improve the auto industry position. In Pakistan two wheelers had achieved targets of *Auto Industry Development* while four-wheelers failed to deliver.

Demand driven by cheaper rates....

Toyota and Honda cars which are manufactured in-Pakistan were cheaper and better than Indian cars but Tata Nano car was cheaper, but due to high taxes and duty charges in Pakistan it made Pakistani cars costly, we can expect that Pakistan industry can come with cheap cars if Govt. promote auto mobile industry.

We believe that automobile industry is on good track as per demand created in Pakistan's market, in the recent years' data the manufactured products are totally sold in the particular products that means there is possible growth trend in automobile sector given positive economic trend and also Pak currency does not slides down against USD.

Sector valuations: Not so compelling

We see HCAR coming out of the red and regained its profitability but still we do not see compelling valuations in the sector except PSMC which still offers lowest PE of 5.2x and we recommend Hold.

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