



The Pakistan Credit Rating Agency Limited

Rating Report

Honda Centre (Pvt.) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Jul-2022	BBB	A2	Stable	Maintain	-
29-Jul-2021	BBB	A2	Stable	Maintain	-
04-Aug-2020	BBB	A2	Stable	Maintain	-
26-Aug-2019	BBB	A2	Stable	Maintain	-
25-Feb-2019	BBB	A2	Stable	Upgrade	-
26-Sep-2018	BBB	A3	Stable	Maintain	-
28-Feb-2018	BBB	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings take comfort from Honda Centre's dealership status with Honda Atlas Cars Pakistan Limited—owned by Atlas Group and Honda Motor Company Limited, Japan. Honda Centre (Pvt) Limited is among the largest authorized 3S dealership for Honda Atlas Cars Pakistan Limited in Pakistan. Honda Centre has been in the auto dealership industry for over a decade now and has captured adequate market share. The sponsors have a good understanding of business and have been managing it well. During the year revenue remained stagnant and depicted 33% revenue from after-sales services as compared to 29% in June-21. The company has long-term contracts with multiple institutional customers for periodic maintenance and after-sales services. According to Pakistan Automotive Manufacturers Association (PAMA), the top-selling Honda Cars are the Civic and City which is having 89% sales volume against total vehicle sales. Honda Atlas unveiled its Honda City 6th generation and Honda Civic 11th generation with a Honda Sensing feature. Demand drivers of the automobile industry are highly correlated with macro-economic indicators such as GDP growth, employment, disposable income, consumer confidence, and accommodative monetary policy. The main industry challenges are global supply chain disruptions, semi-conductor chip shortages, resulting in late deliveries, and associated financial charges. Furthermore, soaring raw material and energy prices coupled with rupee devaluation further deteriorate the margins. On the flip side, a higher policy rate of 15% will peter out the demand for consumer financing. The dealership revenues reciprocate from the company's (Honda Atlas) performance against the demand. In spite of being in the midst of multiple challenges, the Honda City demand will continue to gain upward motion due to its smaller-engine variant (less than 1300cc) which is subject to fewer taxes and better fuel mileage. The company has implemented a strong system of internal controls across the organization, where compliance is being ensured by Honda Atlas as well. Furthermore, the governance structure may be further strengthened by including independent oversight and adopting the practice of preparing quarterly accounts. Financial risk profile of the company appears adequate with comfortable coverages, working capital cycle, and cashflows. Capital structure is leveraged where borrowings are mainly comprised of short-term for working capital management. Going forward, the inclination in vehicle prices will necessitate an increase in associated commission revenue, thus improving margins.

The ratings are dependent on sustainable growth in revenues, margins, and seamlessly managing trade receivables. Good corporate governance practice is considered pivotal for a growing business concern.

Disclosure

Name of Rated Entity	Honda Centre (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating(Jun-22),Methodology Correlation Between Long-term & Short-term Rating Scales(Jun-22),Mehtodology Rating Modifiers(Jun-22)
Related Research	Sector Study Passenger Cars(May-22)
Rating Analysts	Sohail Ahmed Qureshi sohail.ahmed@pacra.com +92-42-35869504

Profile

Legal Structure Honda Centre (Pvt) Limited, (Honda Centre) was established as a private limited company.

Background Honda Centre was established in 2007 and now Honda Centre is the largest authorized 3S dealership for Honda Atlas Cars Pakistan Limited in Pakistan, in terms of both space and capacity. It is a six floor facility housed on 4 kanals in an easily accessible and high end locality of Westridge, Rawalpindi. Besides that, it can accommodate a stock of about 120 new cars that are ready to be driven away.

Operations Honda Centre, Rawalpindi serves the local customers. It has state-of-the-art equipment and lifts with numerous bays and can accommodate between 25 to 30 cars at a time. The technicians are Honda-certified experts and specialists have the most up-to-date tools and technology to repair the vehicles. The range of services includes glass coating, periodic maintenance, general repair, engine overhaul, transmission overhaul, suspension overhaul, battery testing, electrical diagnosis, wheel alignment and balancing, lathe work pressing, car restoration and dressing, disk alignment, and tuning, and air conditioning servicing.

Ownership

Ownership Structure The three shareholders, who are brothers and each own 33.33% stake in the company.

Stability They have no succession planning at the moment regarding transfer of shares in the future.

Business Acumen A family owned business is run by three professionals, have adequate industry experience and carry extensive knowledge of different sectors.

Financial Strength The sponsoring family has two other successful running business in oil and gas sector which, in case of need, would provide financial cushion to continue operating efficiently.

Governance

Board Structure The overall control of the company vests in three-member board of directors (BoD) and all three members have executive roles.

Members' Profile The CEO, Mr Yasir Raza besides the general oversight looks after the technical side of the business. Mr. Taimur Raza heads the Finance department while Mr. Hassan Raza look after the business development and sales function of Honda Centre.

Board Effectiveness The Board members meeting frequency is not defined but the same meet on need basis. Board keeps on oversight over management work. All board members also have management positions in the company which conflicts with the Board's mandate of impartial oversight.

Financial Transparency Absence of an internal audit function further creates room for improvement in the corporate governance framework. M/S Crowe Hussain Chaudhury & Co. Chartered Accountants is the external auditor of the Company. The firm is QCR rates and categorized as "A" in the SBP list of auditors. The auditors have expressed an unqualified audit opinion on the financial statements of Honda Centre for the year ended June 30, 2021.

Management

Organizational Structure Honda Centre has a lean organizational structure divided into various functional departments.

Management Team Honda Centre has organizational structure with an experienced management team and a balanced mix of professionals. The top Management includes four key professionals. Mr Ali Sher Khan, Sr. Manager Sales & Marketing, holds a BS from USA and has been associated with Honda Centre for the past 3 years. Mr Zeeshan Ali, Sr. Manager Sales & Operations, is an MBA, and has been associated with Honda Centre for the past 9 years. Ms Farzana Ahmed, General Manager HR & Operations has been associated with Honda Centre for 6 years.

Effectiveness All members of management team are qualified and experienced individuals and carry extensive experience of the auto industry. They have no formal management committee as the board itself is involved in the day to day operations of the company. However, meetings are conducted by the Head of departments and the frequency of the meetings depends on the business activities. Minutes of the meetings are recorded adequately.

MIS The company's MIS generates Balance Sheet, Profit and Loss, and Cash flow statements on a weekly basis for the Board. The MIS generated Sales reports are reviewed by the top management on a daily basis.

Control Environment The Company has a separate IT department and has integrated all the functions through ERP system which ensures integration across key departments in order to ensure smooth running of operations. Honda Centre is currently using Microsoft's enterprise resource planning software, Dynamics AX 2012. The functionality of this software includes warehouse and transport management, budget planning, demand forecasting, human resources and point of sale. The software provides comprehensive core functionality – financials, human resources, and operations management – to run efficiently, make smart business decisions, and engage with a diverse array of customers.

Business Risk

Industry Dynamics Passenger Cars Market is largely structured with three major players i.e., Pak Suzuki, Honda and Toyota Indus - the OEMs, controlling the market historically. These OEMs sell their cars through their authorized local dealership network across the country. Popularity for the Hyundai Elantra and Sonata models, rolled out in FY21, increased during FY22. There are now a total of 12 local car assembling/importing brands which include Honda, Suzuki, Toyota Indus, and Hyundai. Collective passenger vehicle sales experienced a YoY growth of ~52% in 9MFY22 (SPLY growth rate was ~36%). The strongest growth came from the cars segment which grew by ~54% in 9MFY22. While car buying activity appears to be unfazed by global supply chain shortages and booking suspensions for automobiles in the local markets, sales growth is expected to remain stagnant or may drop going forward due to higher interest rates, devaluation of the PKR, rising freight charges, roll back of government incentives, and price hikes by dealers.

Relative Position For the period July'21 to May'22, Honda Atlas Motors recorded sales of 31,776 units (Civic & City), showing an increase of 41% in sales volume owing to the recovery in the market conditions along with the newly launched Honda Civic 1.5Vtec Turbo has been able to enhance its strength in its peer. Out of the 37 3S dealerships network of Honda Atlas, Honda Centre is one of the well-performing 3S dealerships.

Revenues Over the past couple of years, Honda Centre, witnessed a continuous positive variation in its revenues as the demand had been consistent and upward trending. However, from FY19 onwards, unfavorable conditions prevailed over the auto industry. After regaining the growth of 21% in FY21 the company is in a stagnant growth due to current economic situation. In 1HFY22 the company presented the revenue of PKR 396mln in comparison to same period last year (1HFY21: PKR 593mln).

Margins Overall margins of the entity are considered healthy. Although topline of the Company has been showing a declining trend, owing to the current economic situation. Gross margin in 1HFY22 stood at 30% (FY21: 26.8%; FY20: 31.2%) and net margins in 1HFY22 stood at 13% (FY21: 10%; FY20: 10%; FY19: 11.8%). Moreover, the financial charges in 1HFY22 stood at PKR 19mln (FY21: PKR 38mln, FY20: PKR 67mln), which contributed to an improvement in net margins.

Sustainability A major portion of revenues for a car dealership comes from commissions on car sales. The management at Honda Centre prepares budgets and projections as per the Board requirements in line with their strategic planning and how aggressively they see themselves growing in the future.

Financial Risk

Working Capital For working capital needs, which is a function of inventory and receivables, Honda Centre relies on both internal cash flows as well as short-term borrowing (STB). Net working capital days have increased to 190days in 1HFY22 (FY21: 169days; FY20: 197days) are considered high. As the inventory levels swore due to disrupted supply chain reciprocating in pending orders. In Dec21, STB stood at PKR 375mln (FY21: 375mln, FY20: 415mln, FY19: 375mln); which are being used as advances to principal against the inventory of cars and spare parts inventory.

Coverages During 1HFY22, Honda Centre's operating cashflows (FCFO) decreased to PKR 79mln (FY21: PKR 176mln, FY20: PKR 110mln) on account of lower revenues & profits. Interest coverage ratio stood at 4.2x (FY21: 4.7x; FY20: 2.5x). Debt payback on the other hand increased to 2.1x (FY21: 1.8x; FY20: 2.8x). The coverages improved significantly during 1HFY22 as finance costs dropped.

Capitalization Equity base of the Company has grown from PKR 900mln to PKR 947mln due to profit retention. There is no specific dividend payment policy in place. In 1HFY22, the Company has a slightly low leveraged capital structure: ~40% (FY20:46%; FY21:41%).



Honda Centre (Private) Limited Passenger Cars	Dec-21 6M	Jun-21 12M	Jun-20 12M	Jun-19 12M
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A BALANCE SHEET

1 Non-Current Assets	793	772	729	645
2 Investments	-	-	-	-
3 Related Party Exposure	210	210	210	210
4 Current Assets	607	608	610	605
<i>a Inventories</i>	213	216	213	162
<i>b Trade Receivables</i>	215	200	236	210
5 Total Assets	1,610	1,590	1,549	1,460
6 Current Liabilities	37	62	59	75
<i>a Trade Payables</i>	6	11	12	3
7 Borrowings	395	398	452	421
8 Related Party Exposure	230	230	230	230
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	947	900	807	733
11 Shareholders' Equity	947	900	807	733

B INCOME STATEMENT

1 Sales	396	907	748	1,257
<i>a Cost of Good Sold</i>	(278)	(664)	(515)	(933)
2 Gross Profit	118	243	233	324
<i>a Operating Expenses</i>	(30)	(65)	(55)	(72)
3 Operating Profit	88	178	179	252
<i>a Non Operating Income or (Expense)</i>	2	4	3	3
4 Profit or (Loss) before Interest and Tax	89	181	181	255
<i>a Total Finance Cost</i>	(19)	(40)	(67)	(47)
<i>b Taxation</i>	(20)	(41)	(33)	(60)
6 Net Income Or (Loss)	50	100	81	148

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	79	176	161	201
<i>b Net Cash from Operating Activities before Working Capital Cha</i>	61	130	97	168
<i>c Changes in Working Capital</i>	(17)	8	(4)	(113)
1 Net Cash provided by Operating Activities	45	139	93	55
2 Net Cash (Used in) or Available From Investing Activities	(41)	(84)	(123)	(63)
3 Net Cash (Used in) or Available From Financing Activities	(2)	(55)	31	9
4 Net Cash generated or (Used) during the period	1	(0)	(0)	1

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	-12.6%	21.3%	-40.5%	-7.8%
<i>b Gross Profit Margin</i>	29.7%	26.8%	31.2%	25.8%
<i>c Net Profit Margin</i>	12.6%	11.0%	10.9%	11.8%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capit</i>	15.7%	20.3%	21.0%	7.0%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total</i>	10.6%	11.3%	10.4%	21.2%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	195	174	200	97
<i>b Net Working Capital (Average Days)</i>	190	169	197	97
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	16.3	9.9	10.3	8.1
3 Coverages				
<i>a EBITDA / Finance Cost</i>	5.7	5.7	3.3	6.2
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	3.8	4.0	1.9	2.9
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Financ</i>	2.1	1.8	2.8	1.8
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	39.8%	41.1%	45.8%	47.1%
<i>b Interest or Markup Payable (Days)</i>	89.0	79.4	76.0	89.7
<i>c Entity Average Borrowing Rate</i>	5.9%	5.8%	10.0%	5.6%

Credit Rating

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	Very high credit quality. Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
AA-	
A+	
A	High credit quality. Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
A-	
BBB+	
BBB	Good credit quality. Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BBB-	
BB+	Moderate risk. Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
BB	
BB-	
B+	
B	High credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
B-	
CCC	
CC	Very high credit risk. Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

<p>Entities</p> <ul style="list-style-type: none"> a) Broker Entity Rating b) Corporate Rating c) Financial Institution Rating d) Holding Company Rating e) Independent Power Producer Rating f) Microfinance Institution Rating g) Non-Banking Finance Companies (NBFCs) Rating 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) Conflict of Interest

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
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- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(F-VII)

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