The Pakistan Credit Rating Agency Limited

Rating Report

Pak Suzuki Motor Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
05-Aug-2022	AA-	A1	Stable	Maintain	-
11-Aug-2021	AA-	A1	Stable	Maintain	-
31-Dec-2020	AA-	A1	Stable	Maintain	-
31-Dec-2019	AA-	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pak Suzuki Motor Company Limited ("PSMC" or "The Company") is the only player among the established auto OEMs in Pakistan that is predominantly owned by foreign shareholders. Besides, there is a high level of integration with the parent and associates. The rating incorporates PSMC's strong position as a prominent industry player in its respective niche with strong ownership background. Having a presence of more than four decades in the automotive industry, the Company has established a formidable forte in the domestic market. Pak Suzuki offers various product options in the hatchback car segment ranging from 660CC to 1200CC. According to Pakistan Automotive Manufacturers Association (PAMA), the top-selling car is the 660cc Suzuki Alto which is having 47% sales volume against total vehicle sales. Pak Suzuki unveiled its premium Hatchback "Swift" with premium features that are not available in any local cars in this segment. The company holds the highest market share of 54% among the largest three OEMs in the market. PSMC operates in an industry that is cyclical and prone to macroeconomic indicators. 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 slow down the demand for car financing. Despite these challenges, PSMC will remain in the optimal place as rising fuel prices and relatively low maintenance costs will skew demand towards small engine cars for better fuel mileage. The financial risk profile of the company is characterized by comfortable cashflows and a working capital cycle. The capital structure is low leveraged and the company has paid off foreign currency loan from holding company. During the year the Company has available SBP's subsidized borrowing (TERF) for new plant & machinery.

The ratings draw comfort from the diversity in business streams, and its ability to dominate in volumetric sales despite challenges and diverse product streams. Sponsor support remains inevitable along with the integration of the supply chain at the group level and technical support from the sponsor in accordance with the license agreement. The ratings are dependent on the Company's ability to uphold its financial risk profile. However, sustainability in profits and a stable risk profile remain imperative.

Disclosure

Name of Rated Entity	Pak Suzuki Motor Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Passenger Cars(May-22)
Rating Analysts	Sohail Ahmed Qureshi | sohail.ahmed@pacra.com | +92-42-35869504

Profile

Legal Structure Pak Suzuki Motor Company Limited ("the Company") was incorporated in Pakistan as a public limited company in August 1983 under the Companies Act, 1913 (repealed with enactment of the Companies Act, 2017 on 30 May 2017) and started commercial production in January 1984. The company is listed on Pakistan Stock Exchange with a free float of ~26% shares.

Background Pak Suzuki Motors was established Joint Venture between Pakistan Automobile Corporation Limited (PACO) and Suzuki Motor Corporation Japan (SMCJapan) in 1982. The Joint Venture Agreement ended in 1996 and PACO divested its entire shareholding to SMC-Japan.

Operations The principal business activity of the Company is assembling, progressive manufacturing, and marketing Suzuki cars, pickups, vans, 4 x 4s, and motorcycles. Further, Company is also involved in trading activity of Suzuki cars, Heavy bikes, outboard motors, and related spare parts. The company's head office and production facilities are situated in Karachi.

Ownership

Ownership Structure The SMC-Japan is the major shareholder of the Pak Suzuki Motors with the majority stake of ~ 73%. Remaining shareholding lies with individuals and financial institutions.

Stability SMC-Japan is a strong brand known worldwide. It has a history of operations in the automobile sector spanning over ten decades.

Business Acumen SMC-Japan is an AA rating company rated by Rating and Investment Information, Inc (R&I) with a stable outlook as of Jan'22. SMC-Japan is Japanese Multinational Corporation headquartered in Hamamatsu, Japan since 1909, which specializes in manufacturing automobiles, four-wheel drive vehicles, motorcycles, all - terrain vehicles (ATVs), outboard marine engines, wheelchairs, and a variety of other small internal combustion engines.

Financial Strength Suzuki has strong financial strength. The company owns the largest chunk of the market. In addition to that, the vehicles assembled and manufactured by Suzuki have low prices. The vehicles of the company also have resales on a large scale. Besides, the company has the largest distribution channels. Financial strength of the sponsor is strong, as SMC corp. revenue is ~YEN 526bln.

Governance

Board Structure The overall control of the company vests in a seven members board of directors. The board structure comprises one managing director and two independent directors.

Members' Profile The Board members are professionals with diversified experience and have a long association with the Company. Mr. Kinji Saito - Chairman of the board has a long affiliation with Suzuki motors having diverse experience in the Automobile sector, which brings specialized and comprehensive experience and knowledge to the board.

Board Effectiveness In line with the guidelines of Code of Corporate Governance, the Board has formed two sub-committees – (i) HR and Remuneration Committee and (ii) Audit Committee. Both committees are headed by an independent director and consist of 3 members each. Attendance of BoD members remained satisfactory and board meeting minutes are properly documented.

Financial Transparency An effective Internal Audit department reporting to the Audit Committee is in place. M/s. KPMG Taseer Hadi & Co, a QCR rated firm, has expressed an unmodified opinion on financial statements for the year ended CY21.

Management

Organizational Structure Pak Suzuki's management team has been divided into over 12 departments. There is a complex organizational structure with all department heads reporting to divisional heads and ultimately to functional heads.

Management Team Management of the company comprises qualified and experienced professionals with a wide range of skills and diversified experience. Mr. Masafumi Harano - CEO has had an association with SMC since 1988 and is an experienced professional in the Auto & Allied industry, and is assisted by a skilled management team.

Effectiveness The management has formed five formal management committees. The board has set up an effective internal audit function that is suitably qualified and experienced in precise implementation of policies and procedures.

MIS The company has installed Infor ERP-LX software and planning to replace it with the latest ERP Solution. The Company further has in house development team which develops dashboards and other systems to support and evaluate business segments.

Control Environment The Company's monthly MIS comprises comprehensive segment and unit wise performance reports reviewed frequently by the senior management. The system, while integrating the business functions of the company, helps the management in timely decision making and strengthens the control environment.

Business Risk

Industry Dynamics The Pakistan automobile segment is facing multiple challenges for the existing players; high-interest rates & CPI index, rupee devaluation, additional customs duties, and entry of new players (KIA & Hyundai). Currently, another issue that impacts the industry is rising freight charges, rollback of government incentives, and price hikes by dealers. Despite all this, offtake observed a brisk upward trend representing the demand revival in 9MCY22. Popularity of the Hyundai Elantra and Sonata models, rolled out in FY21, increased during FY22.

Relative Position Pak Suzuki Motors is among the largest vertically integrated automotive companies in the country with more than ~55% market share. Among its competitors are Toyota Indus Motors and Honda Atlas. Pak Suzuki operates in a price-sensitive market segment whereas the other two players play on the high-end brand variants. In cars of 1000 CC or below category Pak Suzuki Motors continues to dominate the market. The sales may drop going forward as demand for below 1000cc cars will be more affected by the restrictive financing terms and price hikes compared to SUVs as the latter's consumer market is generally more affluent.

Revenues The entire automobile industry of Pakistan had been in deep waters since mid-2018. Car financing became costly, and heightened car prices driven by rupee devaluation reserved the buying power. The pickup in demand is due to lower FED and lower tax incentives for below 1000cc cars (Suzuki Bolan and Suzuki Alto), which reported a massive YoY growth of 76% in 9MFY22. Revenues for CY21 stood at PKR 160bln (CY20: PKR 77bln). The company entered the new year 2021 with betterment as revenues gained momentum with an increase of ~109% in CY21. However, in 3MCY22, the Revenues stood at PKR 48bln.

Margins In CY21 the overall financial matrices of the company remain positive. Gross margins were at ~5.1% during CY21 (CY20; ~4.3%, CY19: ~1.7%). There was a net profit of PKR 2.67bln in CY21 as against a loss of PKR 1.6bln in CY20 attributable to a massive drop in finance costs. However, in 3MCY22, the company faced a loss of PKR 460mln.

Sustainability Maintaining Optimum levels of auto parts and continued operations while ensuring compliance with SOPs is the key focus of the company. The new competition will bring pressure on the existing players, creating the need for innovation and better quality.

Financial Risk

Working Capital ln CY21, PSMC achieved the rationalizing of its inventory levels, denoting the company's adherence to its commitments, working capital relies on a mix of internal generation and advances from customers. Both inventory days and payables days have come down. Hence, moving net working capital days to 37 days in CY21 as compared to 112 days in CY20.

Coverages During CY21 Free cash flow from operations (FCFO) stood at PKR ~2.3bln as compared to PKR 3.4bln in CY20 due to higher taxes paid. However, the interest coverage ratio of the company stood at 17x as compared to 1.3x in CY20. In 3MCY22, FCFO showed a negative value of PKR 794mln.

Capitalization The Company has optimized its capital structure by reducing its debt exposure significantly; from PKR 32bln in CY19 and PKR 12.7bln in CY20 to PKR 1.8bln in CY21, hence the company's gearing ratio has come down to 6.5% from 34% in CY20.

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Financial Summary
PKR mln

Pak Suzuki Motor Company Limited	Mar-22	Dec-21	Dec-20	Dec-19
Passenger Cars	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	25,692	24,736	20,708	19,189
2 Investments	-	-	-	-
3 Related Party Exposure	749	744	513	522
4 Current Assets	81,940	66,510	45,484	57,949
a Inventories	*37,294*	*26,225*	*18,055*	*37,517*
b Trade Receivables	*2,225*	*2,225*	*1,749*	*1,490*
5 Total Assets	108,381	91,990	66,704	77,660
6 Current Liabilities	78,587	61,752	32,434	18,914
a Trade Payables	*12,760*	*11,450*	*7,490*	*7,252*
7 Borrowings	1,875	1,866	150	32,559
8 Related Party Exposure	-	-	12,621	-
9 Non-Current Liabilities	1,693	1,546	259	236
10 Net Assets	26,226	26,826	21,240	25,951
11 Shareholders' Equity	26,364	26,826	24,349	25,951
B INCOME STATEMENT				
1 Sales	47,736	160,082	76,720	116,548
a Cost of Good Sold	*(46,387)*	*(151,912)*	*(73,419)*	*(114,563)*
2 Gross Profit	1,349	8,171	3,302	1,985
a Operating Expenses	(1,472)	(5,424)	(3,431)	(5,090)
3 Operating Profit	(123)	2,747	(129)	(3,105)
a Non Operating Income or (Expense)	*506*	*1,521*	*565*	*188*
4 Profit or (Loss) before Interest and Tax	383	4,268	436	(2,917)
a Total Finance Cost	*(1,031)*	*(472)*	*(2,622)*	*(2,035)*
b Taxation	*188*	*(1,116)*	*596*	*2,031*
6 Net Income Or (Loss)	(460)	2,679	(1,589)	(2,920)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*(794)*	*2,317*	*3,410*	*(730)*
b Net Cash from Operating Activities before Working Capital Changes	*(416)*	*3,874*	*1,056*	*(2,120)*
c Changes in Working Capital	*(1,337)*	*17,700*	*34,131*	*(13,998)*
1 Net Cash provided by Operating Activities	(1,753)	21,574	35,186	(16,118)
2 Net Cash (Used in) or Available From Investing Activities	(985)	(6,051)	(799)	(2,903)
3 Net Cash (Used in) or Available From Financing Activities	15	(10,071)	12,575	32,083
4 Net Cash generated or (Used) during the period	(2,724)	5,452	46,962	13,062
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	19.3%	108.7%	-34.2%	-2.8%
b Gross Profit Margin	2.8%	5.1%	4.3%	1.7%
c Net Profit Margin	-1.0%	1.7%	-2.1%	-2.5%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-4.5%	12.5%	48.9%	-12.6%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	-7.6%	11.6%	-6.0%	-12.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	65	55	140	108
b Net Working Capital (Average Days)	42	33	105	83
c Current Ratio (Current Assets / Current Liabilities)	1.0	1.1	1.4	3.1
3 Coverages				
a EBITDA / Finance Cost	68.4	44.7	1.2	-0.1
b FCFO / Finance Cost+CMLTB+Excess STB	-22.7	10.2	1.3	-0.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-0.6	0.9	15.5	-0.1
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	6.6%	6.5%	34.4%	55.6%
b Interest or Markup Payable (Days)	1972.1	698.1	0.5	114.7
c Entity Average Borrowing Rate	1.4%	2.2%	11.5%	12.0%

Credit Rating

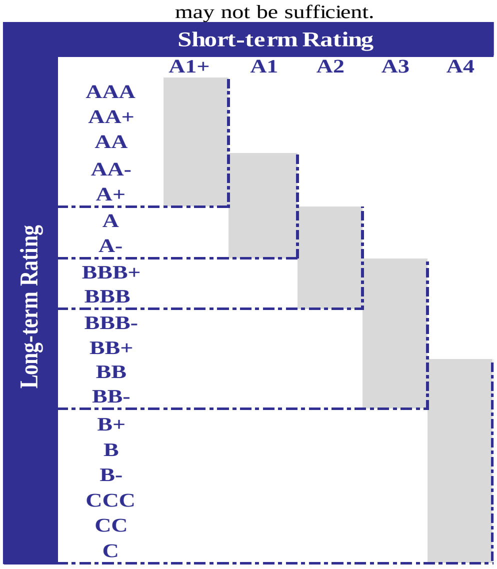
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ 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.
A+ 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.
BBB+ 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.
BB+ BB 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.
B+ 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.
CCC CC C	**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.
D	Obligations are currently in default.

Short-term Rating

Scale	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
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 surveill 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):

Entities
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

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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(Credit Rating Companies Regulations,2016)

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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).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
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(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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Independence & Conflict of interest
(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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