The Pakistan Credit Rating Agency Limited

Rating Report

Pak Suzuki Motor Company Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
31-Dec-2019	AA-	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pak Suzuki Motor Company Limited (PSMC) is the only player from among the established auto OEM in Pakistan, that is predominantly owned by the foreign shareholder. Besides, there is high level of integration with the parent and associates. The ratings reflect strong industry positioning of PSMC in its respective niche. With a presence of up to four decades in the automotive industry, the company has established a formidable forte in the domestic market. PSMC witnessed sustainable growth in preceding years amid growing middle class with stable margins. The industry is cyclical and prone to adverse macro-economic indicators. This is more true for the customer segment of PSMC. However, the automobile industry has witnessed a significant dip in volumes from January 2019. Ongoing economic slowdown has impacted the Company's revenues and profitability in 9MCY19, resulting in net loss. This was primarily due to slower pace of adjusting the prices upward, hence the impact on volumes is relatively lower. The delta has been reduced now and will reflect positively in 2020. The Company has significant leveraging to fund its working capital needs, currently extended beyond normalcy. Relatively higher finance cost and low cashflows have resulted in weak coverages. Debt metrics need to be upheld and benefits from the new initiatives to develop new models should lead to healthy topline and in turn healthy bottom-line. The ratings draw comfort from the diversity in business streams, integration of supply chain at group level and technical support from the sponsor in accordance with License agreement. A sizeable portion of debt is covered through assurance / credibility of Suzuki group, providing support to the assigned ratings. The overall leveraging is expected to get rationalised in the near future, providing relief to the financial profile.

The ratings are dependent on the Company’s ability to improve its financial profile by reducing leveraging and rationalizing its working capital. The management is working on this front and timely materialization of these initiatives is critical. Additionally, maintaining margins and improving profitability from core operations is important. Any significant increase in debt and/or working capital will impact the ratings without any support.

Disclosure	
Name of Rated Entity	Pak Suzuki Motor Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Passenger Cars(Feb-19)
Rating Analysts	Usama Liaquat | usama.liaquat@pacra.com | +92-42-35869504

Profile

Legal Structure Pak Suzuki Motors Limited (PSML) is a public listed entity with a free float of ~26% shares, as to date sep-19. It got listed on Karachi Stock Exchange (now ''Pakistan Stock Exchange'') in 1983.

Background Pak Suzuki Motors was established Joint Venture between Pakistan Automobile Corporation Limited (PACO) and Suzuki Motor Corporation Japan (SMC-Japan) in 1982. The Joint Venture Agreement ended in 1996 and PACO divested its entire shareholding to SMC-Japan. The company commenced its commercial production in 1983.

Operations The principal business activity of the Company is assembling, progressive manufacturing and marketing of Suzuki cars, pickups, vans, 4 x 4s, 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 history of operations in automobile sector spanning over ten decades.

Business Acumen SMC-Japan is an A rating company rated by Rating and Investment Information, Inc (R&I) with a stable outlook. 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 Motors Corp, Japan (SMC-Japan) is a multinational concern with about 35 main production facilities in 23 countries and 133 distributors in 192 countries. The worldwide sales volume of automobile is the world's tenth, domestic sales volume is the third largest in the country. Financial strength of the parent company is strong.

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 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 on 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 being 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 unmodified opinion on financial statements for the period ended June 30, 2019 and CY18.

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. CEO is heading few functions.

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 association with SMC since 1988 and is an experienced professional in the Auto & Allied industry, and is assisted by able management team.

Effectiveness The management has formed five formal management committees. The board has set up an effective internal audit function who is suitably qualified and experienced for 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 review 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 automotive market is slowly shifting towards a service oriented model with new players focusing extensively on customer experience and consumer data. Transitions in automotive markets are providing opportunities for some parts while other components face stiff decline over the forecasts. Increase in additional customs duty directly results in increase in cost of production. Prevailing situation of higher inflation, rising interest rates, devaluation of pak rupee pose major challenges for auto industry. The total industry sales of locally manufactured Passenger Cars and LCV vehicles were 240,646 units in the country during FY19 compared to 258,682 units sold last year indicating a 7% drop in the market. However the recent restriction on the import of used vehicles is a positive news for local industry during the period.

Relative Position Pak Suzuki Motors is among the largest vertically integrated automotive company in the country with more than 50% market share. Among its competitors are Toyota Indus Motors and Honda Atlas. In cars of 1000 CC or below category Pak Suzuki Motors has a dominant position.

Revenues The company along with assembling and manufacturing also provides after sales services and warranties with only a negligible portion of export sales. Pak Suzuki had experienced consistent growth in revenues over the years. During CY18, revenues witnessed ~17.7%, growth driven mainly by increase in car sales division (16% increases). During 9MCY19 revenues showed a very slow growth due to substantial increase in selling prices of vehicles because of imposition of new duties & taxes and devaluation of Pak Rupee.

Margins Instilling impact of almost stagnant revenues along with high cost of raw material and significant currency devaluation drive the decrease in gross profit margin of the company, which reduced to ~5.9% in CY18 (CY17: ~9.5%). For 9MCY19 gross profit further deteriorated to ~1.3%. Decrease in gross profit margin led to decrease in operating margin in CY18 and operating loss in 9MCY19. The Company has made net profit of PKR 1.3bln in CY18 as against PKR 3.8bln in CY17 and after tax loss of PKR 2.69bln in 9MCY19 on account of significant finance cost hike (9MCY19: PKR 1,027mln; CY18: PKR 260mln; CY17: PKR 29mln).

Sustainability The company undertakes localization of auto parts to facilitate availability at economical cost. In this regard technical assistance agreements have been entered into with international suppliers and equity of PKR 344.4mln has been injected.

Financial Risk

Working Capital The company's working capital relies on a mix of internal generation and advances from customer. Average inventory days has increasing trend due to slower than anticipated growth in sales (9MCY19: ~98 days; CY18: ~100 days: CY17: ~72 days). This coupled with increase in payable days has caused net working capital days to increase to ~65 days in 9MCY19 as compared to ~60 days in CY18.

Coverages Free cash flow from operations (FCFO) significantly dropped to PKR 30mln in 9MCY19 from PKR 995mln in CY18 and PKR 1,515 in CY17. Cash flows decreased due to loss during the period under review. Decreased cash flows led to deteriorated interest coverage and core coverage ratio of the company. Going forward, strengthened cashflow streams are essential to keep the coverages intact.

Capitalization The company has zero borrowings until June 2018, however, during 9MCY19 the company's gearing ratio has picked up its pace which is 45.1% as compared to 27.9% in CY18 mainly dominated by short term borrowings. Going forward, gearing ratio is expected to decrease in near future as the company plans to rationalise the inventory.

PKR mln

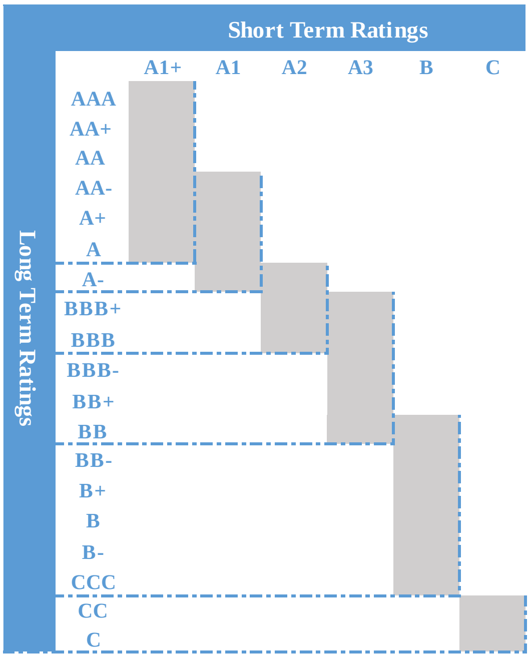
Pak Suzuki Motor Limited Passenger Cars	Sep-19 9M	Dec-18 12M	Dec-17 12M	Dec-16 12M
A BALANCE SHEET				
1 Non-Current Assets	21,364	17,499	9,696	7,334
2 Investments	-	-	-	-
3 Related Party Exposure	433	435	250	85
4 Current Assets	50,440	43,577	40,964	30,434
a Inventories	*35,713*	*29,397*	*23,946*	*16,289*
b Trade Receivables	*343*	*787*	*532*	*1,497*
5 Total Assets	72,237	61,510	50,910	37,852
6 Current Liabilities	24,132	20,966	21,361	11,635
a Trade Payables	*14,242*	*8,846*	*6,655*	*3,708*
7 Borrowings	21,525	11,310	-	-
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	330	-	-	-
10 Net Assets	26,251	29,233	29,550	26,217
11 Shareholders' Equity	26,251	29,233	29,550	26,217
B INCOME STATEMENT				
1 Sales	91,065	119,854	101,812	76,516
a Cost of Good Sold	*(89,925)*	*(112,809)*	*(92,159)*	*(69,167)*
2 Gross Profit	1,140	7,045	9,653	7,349
a Operating Expenses	(3,959)	(5,008)	(4,404)	(3,544)
3 Operating Profit	(2,819)	2,037	5,249	3,805
a Non Operating Income or (Expense)	*82*	*306*	*400*	*630*
4 Profit or (Loss) before Interest and Tax	(2,737)	2,343	5,649	4,435
a Total Finance Cost	*(1,027)*	*(260)*	*(29)*	*(19)*
b Taxation	*1,077*	*(785)*	*(1,793)*	*(1,643)*
6 Net Income Or (Loss)	(2,687)	1,298	3,826	2,773
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*30*	*995*	*1,515*	*2,426*
b Net Cash from Operating Activities before Working Capital Changes	*(670)*	*1,161*	*2,234*	*3,257*
c Changes in Working Capital	*(5,395)*	*(10,097)*	*2,753*	*(5,372)*
1 Net Cash provided by Operating Activities	(6,065)	(8,937)	4,987	(2,115)
2 Net Cash (Used in) or Available From Investing Activities	(2,902)	(8,525)	(3,892)	(3,113)
3 Net Cash (Used in) or Available From Financing Activities	9,715	9,788	(453)	(1,230)
4 Net Cash generated or (Used) during the period	748	(7,673)	641	(6,458)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	1.3%	17.7%	33.1%	-9.5%
b Gross Profit Margin	1.3%	5.9%	9.5%	9.6%
c Net Profit Margin	-3.0%	1.1%	3.8%	3.6%
d Cash Conversion Efficiency (EBITDA/Sales)	-1.0%	3.0%	6.2%	5.8%
e Return on Equity (ROE)	-12.9%	4.4%	13.7%	10.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	100	83	76	46
b Net Working Capital (Average Days)	65	60	57	29
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.1	2.1	1.9	2.6
3 Coverages				
a EBITDA / Finance Cost	-0.9	19.4	N/A	7441.0
b FCFO / Finance Cost+CMLTB+Excess STB	0.0	5.4	N/A	4091.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-0.2	0.0	0.0	0.0
4 Capital Structure (Total Debt/Total Debt+Equity)				

Credit Rating Scale & Definitions

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 Ratings	
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 Ratings	
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.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) 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.

Rating Team Statements
(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

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(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.
(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)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(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)

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)
Proprietary Information