



The Pakistan Credit Rating Agency Limited

Rating Report

Honda Centre (Pvt.) Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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

Car dealership (authorized) rides on the strength of the Principal (auto manufacturer/assembler). The stronger the Principal in the respective market, higher is the standing of the car dealer. There is a pre-defined set of criteria – qualitative & quantitative – that the Principal demands of the dealer network. The rating takes comfort from Honda Centres' alliance to Honda Atlas Cars Pakistan Limited– owned by Atlas Group and Honda Motor Company Limited, Japan. Honda Centre is one of the largest authorized 3S dealership for Honda Atlas Cars Pakistan Limited in Pakistan. Honda Centre (Pvt) Limited (HC) has been in the auto dealership industry for over a decade now. The sponsors have a good understanding of the business. The company's profitability and leveraging are good. The sponsors have injected a sizeable amount as a subordinated debt. The overall auto sector business is dependent on economic indicators and demand led by businesses and investors. Honda Centre has built a sustainable position in the competitive auto industry of Pakistan. The volumes have seen substantial jump; with consequent rise in topline and profitability. This is an outcome of the dealership's well-articulated plan to link-up with some financial institutions to cater to the leasing market. Honda Centre has captured adequate market share over a decade of operations. It is important to sustain the growth while managing the rising competition, which is more of a Principal's domain. Foreign players are also taking interest in the local market. Control environment may be strengthened by including independent directorship and adopting quarterly accounts.

The ratings are dependent on sustaining a steady revenue stream and financial risk profile. Any prolonged downturn in subdued business volume can have a detrimental effect on the rating. 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 Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Passenger Cars(Feb-19)
Rating Analysts	Muhammad Noor ul Haq muhammad.noorulhaq@pacra.com +92-42-35869504

Profile

Legal Structure Honda Centre (Pvt) Limited (HC) is registered as a private limited company.

Background HC was established in 2007 and in the past four years has already seen turnover in excess of PKR 1 billion. HC 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. The dealership has state of the art equipment and lifts with numerous bays and can accommodate between 25 to 30 cars at a time. 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 with the state-of-the-art service center. The technicians are Honda certified experts and specialists having most up-to-date tools and technology to repair the vehicles. The range of services include 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, each own 33% stake in the company.

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

Business Acumen The eldest brother, Mr. Yasir Raza is the Chief Executive Officer, who holds a Bachelor's degree from UET and an MBA from London Metropolitan University, carries years of experience in the technology and oil & gas sectors. Dr. Taimur Raza, CEO's younger brother, holds an MBBS from Hamdard University and an MRCP degree from the UK. He has previously worked as a medical professional and is now part of the HC team. Mr. Hassan Raza, executive director, and youngest amongst the three directors holds a BA and MBA degrees from Indiana University. He has worked extensively in the consultancy sector internationally, with prestigious firms like KPMG in the UK, and Deloitte and EY in USA.

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).

Members' Profile Mr. Yasir Raza, CEO, 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 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 To ensure effective, transparent and independent oversight of the company internal audit function plays a pivotal role which could report directly to the Board.

Management

Organizational Structure HC has a lean organizational structure.

Management Team HC 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 HC for the past 3 years. Mr. Zeeshan Ali, Sr. Manager Sales & Operations, is an MBA, and has been associated with HC for the past 9 years. Ms. Farzana Ahmed, General Manager HR & Operations has been associated with HC for 6 years and Mr. Muhammad Bin Qasim, CFO, is a chartered accountant and has been with HC for 4 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.

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 HC 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 The automotive industry in Pakistan is one of the fastest growing industries of the country, accounting for 4% of Pakistan's GDP and employing a workforce of over 1,800,000 people. Pakistan's auto industry is largely dominated by Honda, Toyota and Suzuki.

Relative Position For the Financial year ended June 2018, Honda Atlas Motors witnessed the highest growth amongst its peers clocking in at 31 per cent YoY to a total of 51,494 units. The growth is mostly attributable to 302 per cent increase in BR?Vs sold due to the low base of BR?V units in 2016-17 as sales of the said SUV were initiated in 4QFY17. Disregarding BR?V, the company still posted 16 per cent growth originating from City and Civic models

Revenues During FY18, the HC's revenues witnessed a sharp increase of 42% in comparison to prior year growth of 10% (FY18: PKR 407m; FY17: PKR 286m).

Margins During FY18, a significant increase in the operating margin (FY18: 74%, FY17: 65%) is also witnessed. With a significant increasing operating margin, but a considerably lower non-recurring non-core income from revaluation of fixed assets (FY18: 2m; FY17: 18m), however, resulted in slight growth of net profit margin for the period (FY18: 46%, FY17: 43%).

Sustainability Budgets and forecasts are prepared as per the Board requirements.

Financial Risk

Working Capital Although net working capital days have decreased, (FY18: 224 days, FY17: 291 days), they are still slightly on the higher side.

Coverages As at end FY18, short term borrowing of the company is stagnant (FY18: 324m; FY17: 324m) which is being used for working capital management while HC's operating cashflows (FCFO) increased to PKR 263m (FY17: 166m) due to higher revenue compared from last year. Interest coverage ratio increased (FY18: 8x, FY17: 5.9x) due to increasing FCFO. Debt coverage ratio increased (FY18: 5.9x, FY17: 4.3x) also due to higher FCFO.

Capitalization At end-FY18, the company had a slightly levered capital structure, with a debt to debt plus equity ratio of 49% (FY17: 56%). Although long term debt has decreased to PKR 248m (FY17: 258m), 95% (248m) of this long term debt is a loan obtained from directors without markup and security.



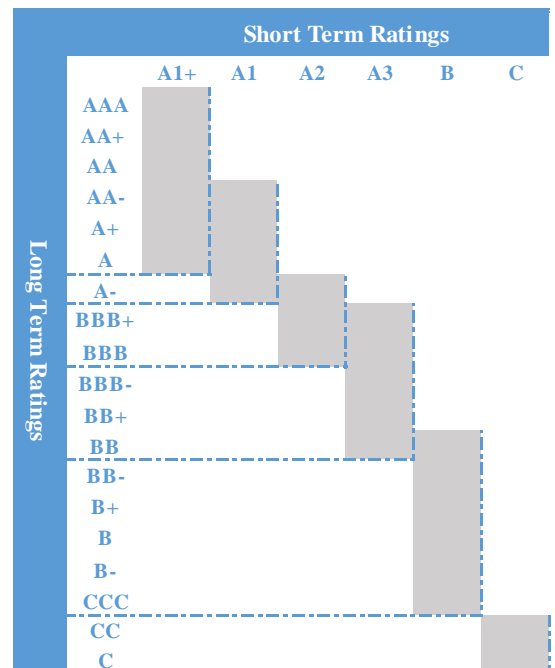
Honda Centre (Private) Ltd

BALANCE SHEET	30-Jun-18	30-Jun-17	30-Jun-16
	CY18	CY17	CY16
Non-Current Assets	613	627	463
Investments (Incl. Associates)	-	-	-
Equity	-	-	-
Debt	-	-	-
Current Assets	707	472	476
Inventory	191	125	90
Trade Receivables	193	130	139
Others	322	217	246
Total Assets	1,320	1,099	939
Debt	393	334	325
Short-term	374	324	325
Long-term	20	10	1
Other Short-term Liabilities	90	63	60
Other Long-term Liabilities	245	248	234
Shareholder's Equity	592	454	320
Total Liabilities & Equity	1,320	1,099	939
INCOME STATEMENT	30-Jun-18	30-Jun-17	30-Jun-16
Turnover	1,363	968	867
Gross Profit	407	286	260
Other Income	2	18	10
Financial Charges	(35)	(28)	(25)
Net Income	187	122	107
CASHFLOW STATEMENT	30-Jun-18	30-Jun-17	30-Jun-16
Free Cashflow from Operations (FCFO)	261	166	146
Net Cash changes in Working Capital	(151)	6	52
Net Cash from Operating Activities	82	146	173
Net Cash from Investing Activities	(11)	(11)	(8)
Net Cash from Financing Activities	(63)	(135)	(156)
Net Cash generated during the period	8	(0)	9
RATIO ANALYSIS	30-Jun-18	30-Jun-17	30-Jun-16
<u>Performance:</u>			
Turnover Growth	40.8%	11.7%	-12.5%
Gross Margin	29.9%	29.5%	30.0%
Net Margin	13.7%	12.6%	12.4%
ROE	22.3%	18.8%	22.0%
<u>Coverages:</u>			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	4.8	4.3	5.8
Interest Coverage (x) (FCFO/Gross Interest)	7.4	5.9	5.9
Debt Payback (Years) (Total Lt. Debt (excluding Covered Short Term Borrowings) / FCFO)	1.2	1.9	1.9
<u>Liquidity:</u>			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	85.6	91.4	97.1
Capital Structure (Total Debt/Total Debt+Equity)	51.9%	56.1%	63.6%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

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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

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- (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)

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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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