



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
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 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 (Pvt) Limited is one of 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 the business. The company's profitability and leveraging are good. The sponsors have injected a sizable amount as a subordinated debt. The overall auto sector business is dependent on economic indicators and demand led by businesses and investors. Of late - massive rupee depreciation, rising interest rate environment and increasing inflationary pressures - overall demand for auto has plummeted with the automakers seeing a considerable reduction in their capacity utilization and profitability. However, Honda Centre has built a sustainable position in this competitive auto industry by securing contracts with a few key institutions which drive bulk of their demand for vehicles. It is important to sustain the growth while managing the rising competition, which is more of a Principal's domain. It is crucial for the overall demand to pick-up for the alleviation of related concerns. In the meantime, the profitability is being supplemented by the 'After Sale' segment-reporting net profitability for the dealership and covering its operational cost. Hence limiting and/or cushioning the unforeseen drag on the risk absorption capacity. 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, credit quality of the receivables, the transaction structure and the servicer's experience. 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	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
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, (hereinafter referred to as “company” or “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 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 and 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 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).

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 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. M/s Horwath Hussain Chaudhury & Co. Chartered Accountants, is the external auditor of the company.

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 and Mr Muhammad Bin Qasim, CFO, is a Chartered Accountant and has been with Honda Centre 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 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 This has been a challenging year for the automobile industry for many reasons. Inconsistent policies have created a lot of uncertainty in the market. The unprecedented devaluation of more than 30% of PKR had a cost-push effect on pricing and the increase in markup rates has negatively impacted purchases through banks. The total industry production increased by 4.03% whereas nominal increase of 2.57% was witnessed in industry sales and this was mainly due to back orders carried forward from last year. Pakistan's auto industry is largely dominated by Honda, Toyota and Suzuki.

Relative Position Despite, challenging economic conditions and with the dip of 2.9% from last year the Company was able to achieve its 'second best' results in terms of production & sales. Company has generated highest sales revenue of PKR 95bln as compared to PKR 92bln last year, mainly due to the price revisions. The Company achieved cumulative production of its 400,000th unit in Oct-18. All models contributed in achieving this goal, with major contribution of 53% coming from 'City' and 44% from 'Civic'.

Revenues Despite some slight downward trends in figures the Company's results of operations, financial position and net assets are indicative of a solid financial condition. During FY19, the Honda Centre's revenues witnessed a decrease of ~14% in comparison to prior year growth of ~42% (FY19: PKR 324mln; FY18: PKR 376mln).

Margins During FY19, 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: 2mln, FY17: 18mln), however, resulted in slight growth of net profit margin for the period (FY18: 46%, FY17: 43%).

Sustainability The Company has laid the foundation for long term sustainable leadership and is committed to achieve profitable growth, financial flexibility and operational excellence. The core area of focus is strategy formulation for sustainable operations. Therefore, budgets and forecasts are prepared as per the requirements.

Financial Risk

Working Capital The company has a short working capital cycle. Although net working capital days have increased (FY19: 97 days, FY18: 70 days), they are still slightly on the higher side. The number of days increased as the trade receivable days increased to 59 (CY18: 43 days) and inventory held days increased to 39 (CY18: 27days).

Coverages As at end FY19, short term borrowing of the company was slightly increased by ~1.5% stagnant (FY19: 399mln, FY18: 393mln) which is being used for working capital management while the Company's operating cash flows (FCFO) decreased to PKR 208mln (FY18: 261mln) due to squeezing of revenue compared from last year. Interest coverage ratio showed a dip (FY19: 4x, FY18: 7x) due to decreasing FCFO. As a result, debt coverage ratio also increased to 4x (FY18: 3x).

Capitalization At end-FY19, the Company had a slightly levered capital structure, with a debt to debt plus equity ratio of 47% (FY18: 52%). Although long term debt has also increased to PKR 253mln (FY18: 245mln), 94% (230mln) of this long term debt is a loan obtained from directors without markup and security. It will be discharged after payment of all outstanding liabilities of financial institutions.



Honda Centre (Private) Limited				
Private Limited				
BALANCE SHEET				
	Jun-19	Jun-18	Jun-17	Jun-16
	12M	12M	12M	12M
a Non-Current Assets	645	613	627	463
b Investments (Incl. Associates)	-	-	-	-
Equity	-	-	-	-
Fixed Income	-	-	-	-
c Current Assets	815	707	472	476
Inventory	162	105	93	90
Trade Receivables	210	193	130	139
Others	442	409	249	246
d Total Assets	1,460	1,320	1,099	939
e Debt/Borrowings	652	639	581	559
Short-Term	375	374	324	325
Long-Term (Incl. Current Maturity of Long-Term Debt)	277	265	258	235
Other Short-Term Liabilities	75	90	63	60
Other Long-Term Liabilities	-	-	-	-
f Shareholder's Equity	733	592	454	320
g Total Liabilities & Equity	1,460	1,320	1,099	939

INCOME STATEMENT				
a Turnover	1,257	1,363	968	867
b Gross Profit	324	376	286	260
c Net Other Income	3	2	18	10
d Financial Charges	(47)	(35)	(28)	(25)
e Net Income	148	187	122	107

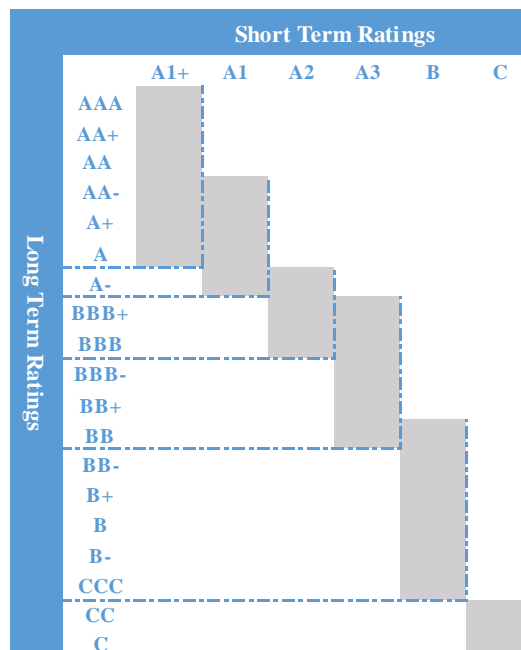
CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	202	261	166	146
b Total Cashflows (TCF)	202	261	166	146
c Net Cash changes in Working Capital	(113)	(151)	6	52
d Net Cash from Operating Activities	55	82	146	173
e Net Cash from Investing Activities	(63)	(11)	(11)	(8)
f Net Cash from Financing Activities	9	(63)	(135)	(156)
g Net Cash generated during the period	1	8	(0)	9

RATIO ANALYSIS				
a Performance				
Turnover Growth (vs SPLY)	-8%	41%	12%	240%
Gross Margin	26%	28%	30%	30%
Net Margin	12%	14%	13%	12%
ROE	22%	36%	31%	29%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+U	2.8	4.8	4.3	5.8
Interest Coverage (X) (FCFO/Gross Interest)	4.3	7.4	5.9	5.9
Debt Payback (Years) (Total Debt (excluding Covered Short T	4.2	2.8	4.2	4.6
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable L	97	69	85	97
d Capital Structure (Total Debt/Total Debt+Equity)	47%	52%	56%	64%

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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