The Pakistan Credit Rating Agency Limited

Rating Report

Honda Centre (Pvt.) Limited

Report Contents

Rating History

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

Rating Rationale and Key Rating Drivers

The ratings take comfort from Honda Centre's dealership status with Honda Atlas Cars Pakistan Limited– owned by Atlas Group and Honda Motor Company Limited, Japan. Honda Centre (Pvt) Limited is among the largest authorized 3S dealership for Honda Atlas Cars Pakistan Limited in Pakistan. Honda Centre has been in the auto dealership industry for over a decade now and has captured adequate market share. The sponsors have a good understanding of business and injected a sizable amount as a subordinated debt in the company. Demand drivers of the automobile industry are highly correlated with macro-economic indicators such as GDP growth, employment, disposable income, consumer confidence and accommodative monetary policy. Outbreak of COVID-19 coupled with subdued economic activity, massive rupee depreciation, higher interest rates and inflationary pressures reduced the demand of automobiles and also surpressed the profitability of Honda Centre. However, the company 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 and after sale services. 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	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Passenger Cars(May-20)
Rating Analysts	Muhammad Noor ul Haq | noorulhaq@pacra.com | +92-42-35869504

Profile

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

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

Operations Honda Centre, Rawalpindi serves the local customers. It has state of the art equipment and lifts with numerous bays and can accommodate between 25 to 30 cars at a time.. The technicians are Honda certified experts and specialists 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 33.33% stake in the company

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

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

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

Governance

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

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

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

Financial Transparency Absence of an internal audit function further creates room for improvement in the corporate governance framework. M/S Horwath Hussain Chaudhury & Co. Chartered Accountants, is the external auditor of the Company. The auditors have expressed an unqualified audit opinion on the financial statements of Honda Centre for the year ended June 30, 2019.

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. CFO has resigned from the position and the Company is actively pursuing to fill in the gap. years.

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

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

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

Business Risk

Industry Dynamics FY 2019-20 proved to be a challenging year for businesses, GDP growth turned negative 0.4% and the economy has contracted for the first time since 1952 and also has missed almost all key targets. Outbreak of COVID-19 coupled with currency devaluation and inflationary pressures remained the key factors of negative growth. In prevailing subdued economic condition automobile industry observed a significant decrease in demand, additionally imposition of FED ranging 2.5 to 7.5% on different models and 5% of custom duty led to increase in prices of vehicles. Simultaneously, consumer purchasing power remained constricted and auto-financing reduced significantly due to higher interest rates. Pakistan's auto industry is largely dominated by the big 3 Japanese automakers; Honda (~16%), Toyota (~23%) and Suzuki (61%). During FY20 around 110,580 cars were sold by these automakers (FY19: 239,635) which showed 54% decline.

Relative Position For the current financial year, Honda Atlas Motors recorded its sales at 22,418 units, showing a decline of 54% in sales volume owing to the unfavorable economic conditions. However, Honda Atlas launched new Honda Civic 1.5L and introduced a model update BR-V to enhance its strength in its peer. Out of 33 3S dealerships network of Honda Atlas, Honda Centre is one of the best performing 3S dealership.

Revenues Over the past couple of years, Honda Centre, witnessed a continuous positive variation in its revenues as the demand had been consistent and upward trending. During FY19, despite the some unfavorable economic conditions the entity's revenue witnessed a decrease of ~14% to PKR 1,257mln in comparison to prior year growth of ~42% (FY18: PKR 1,363mln; FY17: 968) and during 1HFY20 the company's revenue stood at PKR 483mln.

Margins Overall gross margins are considered healthy. Although topline of the Company has been showing a declining trend since FY19, owing to less demand. Despite sizeable gross margins (1HFY20: 26.7%; FY19: 25.8%; FY18: 27.6%), net margins (1HFY20: 7.6%; FY19: 11.8%; FY18: 13.7%) are on the lower side due to considerable general and administrative expenses. Moreover, increasing use of short term financing also contributed to higher financial charges (IHFY20: PKR 42mln; FY19: PKR 45mln, FY18: PKR 33mln), which contributed to further erosion in net margins

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

Financial Risk

Working Capital For working capital needs, which is a function of inventory and receivables, Honda Centre relies on both internal cash flows as well as short term borrowing (STB). Although net working capital days have increased significantly 132days at the end of the 1HFY20; considered high. As at end-Dec19, STB of the Company were remained stagnant at PKR 375mln (FY19: 375mln, FY18: 374mln); which are being used as advances to principal against the inventory of cars and spare parts inventory.

Coverages During 1HFY20, Honda Centre's operating cashflows (FCFO) decreased to PKR 94mln (FY19: PKR 201mln; FY18: 261mln). Interest coverage ratio stood at 2.6x (FY19: 6.2x; FY18: 9.7x). Debt coverage ratio on the other hand increased to 2.5x (FY19: 1.8x; FY18: 1.2x).

Capitalization Equity base of the Company has grown from PKR 733mln to PKR 763mln due to profit retention. There is no specific dividend payment policy in place. At end-Dec19, the Company has a slightly less levered capital structure, with a leverage ratio of 50.5% (FY19: 52.7%; FY18: 59.7%). The company has a Long Term Debt of PKR 250mln (FY19: 253mln; FY18: 245mln), 90% (230mln) of this LTD is a loan obtained from directors without markup and security and will be discharged after the payment of all outstanding liabilities.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Honda Centre (Private) Limited	Dec-19	Jun-19	Jun-18	Jun-17
Passenger Cars	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	644	645	613	627
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	788	815	707	472
a Inventories	*151*	*162*	*105*	*93*
b Trade Receivables	*182*	*210*	*193*	*130*
5 Total Assets	1,432	1,460	1,320	1,099
6 Current Liabilities	35	75	90	63
a Trade Payables	*3*	*3*	*3*	*3*
7 Borrowings	404	421	639	581
8 Related Party Exposure	230	230	230	230
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	763	733	361	224
11 Shareholders' Equity	763	733	592	454
B INCOME STATEMENT				
1 Sales	483	1,257	1,363	968
a Cost of Good Sold	*(354)*	*(933)*	*(986)*	*(682)*
2 Gross Profit	129	324	376	286
a Operating Expenses	(34)	(72)	(76)	(99)
3 Operating Profit	94	252	301	186
a Non Operating Income or (Expense)	*0*	*3*	*2*	*18*
4 Profit or (Loss) before Interest and Tax	95	255	302	204
a Total Finance Cost	*(43)*	*(47)*	*(35)*	*(28)*
b Taxation	*(15)*	*(60)*	*(80)*	*(55)*
6 Net Income Or (Loss)	37	148	187	122
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*94*	*201*	*261*	*166*
b Net Cash from Operating Activities before Working Capital Changes	*54*	*168*	*233*	*140*
c Changes in Working Capital	-	*(113)*	*(151)*	*6*
1 Net Cash provided by Operating Activities	54	55	82	146
2 Net Cash (Used in) or Available From Investing Activities	-	(63)	(11)	(11)
3 Net Cash (Used in) or Available From Financing Activities	-	9	(63)	(135)
4 Net Cash generated or (Used) during the period	54	1	8	(0)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-23.2%	-7.8%	40.8%	11.7%
b Gross Profit Margin	26.7%	25.8%	27.6%	29.5%
c Net Profit Margin	7.6%	11.8%	13.7%	12.6%
d Cash Conversion Efficiency (EBITDA/Sales)	22.5%	21.8%	23.7%	22.8%
e Return on Equity (ROE)	9.9%	22.3%	35.8%	31.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	133	97	70	85
b Net Working Capital (Average Days)	132	97	69	84
c Current Ratio (Total Current Assets/Total Current Liabilities)	22.6	10.9	7.9	7.5
3 Coverages				
a EBITDA / Finance Cost	2.6	6.2	9.7	8.3
b FCFO / Finance Cost+CMLTB+Excess STB	2.0	2.9	4.9	4.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.5	1.8	2.2	3.5
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	45.4%	47.1%	59.5%	64.1%
b Interest or Markup Payable (Days)	73.7	89.7	72.7	84.0
c Average Borrowing Rate	13.0%	5.9%	4.0%	3.3%

Credit Rating

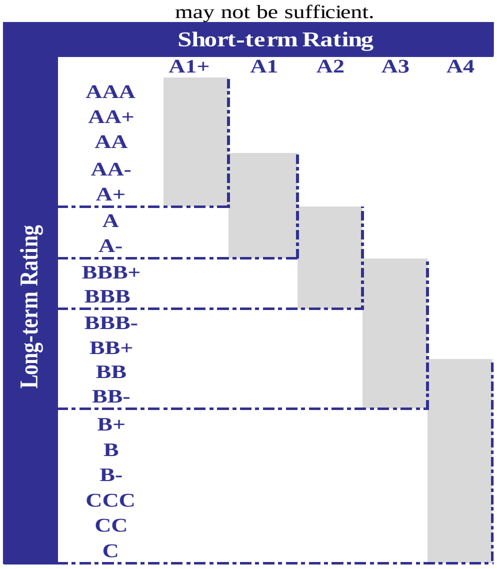
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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