



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
29-Jul-2021	BBB	A2	Stable	Maintain	-
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 managing it well. 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. An unprecedented yet challenging phase that occurred due to COVID-19 outbreak have gradually reverted. Year 2021 started with a good fortune for the entire industry as demand slate witnessed a significant uptick. Reduced interest rates helped in improving the ratio of car financing, leading to higher car sales particularly in the period 1H CY21. Similar trend is likely to continue. This time the industry witnessed a large range of different versions of cars available to the buyer as new players entered the market (KIA, MG, Hyundai), making it more competitive. Honda has sustained its position within its respective niche, along with its peers, also reflecting in its revenues and profitability. Revenues are on a growth trajectory. To keep up with the rising competition Honda Atlas is also bringing in new car variants, including Honda City's 6th generation. The dealership revenues reciprocates from company's (Honda Atlas) performance against the demand. In view of the demand side, the future prospects appears promising. At the same time sustainability of 'After sale' segment based inflows remains imperative. 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. Good corporate governance practice is considered pivotal for a growing business concern.

#### Disclosure

<b>Name of Rated Entity</b>	Honda Centre (Pvt.) Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Rating(Jun-21),Criteria   Correlation Between Long-term & Short-term Rating Scales(Jun-21)
<b>Related Research</b>	Sector Study   Passenger Cars(May-21)
<b>Rating Analysts</b>	Raniya Tanawar   raniya.tanawar@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Honda Centre (Pvt) Limited, (Herein referred as '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** There are three shareholders, who are brothers and each own 33.33% stake in the company.

**Stability** There exist no succession planning at the moment with respect to transfer of shares in the future.

**Business Acumen** A family owned business is run by three professionals, having 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 looks 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, 2020.

## 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. Mr. Muhammad Hassan is the Finance Manager, associated with the entity for the past 7 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** The Pakistan automobile segment has been witnessing a difficult time from the past 2-3years beginning in late 2018 year. The existing players had to bear multiple challenges; high interest rates & CPI index, rupee devaluation, additional custom duties and entry of new players. Outbreak of COVID-19 was yet another blow to the already struggling industry. The year 2021 has been fortunate for the industry when challenges started to evade. . Offtake observed brisk upward trend representing the demand revival during 1H21. Industry dynamics have changed with the entrance of new car makers (KIA, MG & Hyundai). The evolution of new competition is yet to be seen.

**Relative Position** For the period July to Jun'21, Honda Atlas Motors recorded sales of 25,276 units (Civic & City), showing a massive increase of 73% in sales volume owing to the recovery in the market conditions. Out of 33 3S dealerships network of Honda Atlas, Honda Centre is one of the well 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. From FY19 onwards, unfavourable conditions prevailed over the auto industry. Entity's revenue witnessed a decrease of ~40% during FY20 to PKR 748mln in comparison to prior year PKR 1,257mln (FY18: PKR 1,363mln; FY17: 968). 1HFY21 presented better with revenue growth of ~58% as the industry has picked up itspace

**Margins** Overall margins of the entity are considered healthy. Although topline of the Company has been showing a declining trend, owing to demand fluctuations. gross margins (FY20: 31%; FY19: 25.8%; FY18: 27.6%), net margins (FY20: 10%; FY19: 11.8%; FY18: 13.7%). Moreover, increasing use of short term financing also contributed to higher financial charges (FY20: PKR 67mln; FY19: PKR 47mln, FY18: PKR 35mln), which contributed to dilution in net margins. 1HFY21 gross margins witness a dip as the demand during this period is slow hence slower revenues ultimately translate into lower margins. however in times to come margins will improve.

**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 for their internal purposes and as per the Board requirements in line with their strategic planning and how aggressively they see themselves growing in the future. The new launch of Honda City: 1.2 and 1.5 Variant will enable Honda Atlas to remain resilient to the brewing competition.

## 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 197days at the end Jun20; considered high. As the inventory levels swore due to COVID-19 reciprocating in pending orders. This increase has relatively diluted during 1HFY21 as orders pickd up pace. At end-Jun20, STB also increased to PKR 415mln (FY19: 375mln, FY18: 374mln); while dropping to PKR 375mln in 1HFY21, which are being used as advances to principal against the inventory of cars and spare parts inventory

**Coverages** During FY20, Honda Centre's operating cashflows (FCFO) decreased to PKR 161mln (FY19: PKR 201mln; FY18: 261mln) on account of lower revenues & profits. Interest coverage ratio stood at 2.5x (FY19: 4.5x; FY18: 7.8x). Debt payback on the other hand increased to 2.8x (FY19: 1.8x; FY18: 1.2x). The coverages improved significantly during 1HFY21 ( 6.2x) as finance cost dropped.

**Capitalization** Equity base of the Company has grown from PKR 807mln to PKR 862mln due to profit retention. There is no specific dividend payment policy in place. At end-Jun20, the Company has a slightly low leveraged capital structure: ~46% (FY19: 47%; FY18: 59.7%). 1HFY21 debt to equity stood at 42%



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Financial Summary

PKR mln

Honda Centre (Private) Limited Passenger Cars	Dec-20 6M	Jun-20 12M	Jun-19 12M	Jun-18 12M
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#### A BALANCE SHEET

1 Non-Current Assets	783	729	645	613
2 Investments	-	-	-	-
3 Related Party Exposure	210	210	210	-
4 Current Assets	558	610	605	707
a Inventories	207	213	162	105
b Trade Receivables	207	236	210	193
5 Total Assets	1,551	1,549	1,460	1,320
6 Current Liabilities	60	59	75	90
a Trade Payables	34	12	3	3
7 Borrowings	398	452	421	639
8 Related Party Exposure	230	230	230	230
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	862	807	733	361
11 Shareholders' Equity	862	807	733	592

#### B INCOME STATEMENT

1 Sales	593	748	1,257	1,363
a Cost of Good Sold	(460)	(515)	(933)	(986)
2 Gross Profit	133	233	324	376
a Operating Expenses	(34)	(55)	(72)	(76)
3 Operating Profit	100	179	252	301
a Non Operating Income or (Expense)	2	3	3	2
4 Profit or (Loss) before Interest and Tax	101	181	255	302
a Total Finance Cost	(19)	(67)	(47)	(35)
b Taxation	(24)	(33)	(60)	(80)
6 Net Income Or (Loss)	59	81	148	187

#### C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	110	161	201	261
b Net Cash from Operating Activities before Working Capital Cha	91	97	168	233
c Changes in Working Capital	32	(4)	(113)	(151)
1 Net Cash provided by Operating Activities	123	93	55	82
2 Net Cash (Used in) or Available From Investing Activities	(74)	(123)	(63)	(11)
3 Net Cash (Used in) or Available From Financing Activities	(54)	31	9	(63)
4 Net Cash generated or (Used) during the period	(5)	(0)	1	8

#### D RATIO ANALYSIS

1 Performance				
a Sales Growth (for the period)	58.6%	-40.5%	-7.8%	40.8%
b Gross Profit Margin	22.5%	31.2%	25.8%	27.6%
c Net Profit Margin	9.9%	10.9%	11.8%	13.7%
d Cash Conversion Efficiency (FCFO adjusted for Working Capit	23.9%	21.0%	7.0%	8.1%
e Return on Equity [ Net Profit Margin * Asset Turnover * (Total	13.6%	10.4%	21.2%	34.5%
2 Working Capital Management				
a Gross Working Capital (Average Days)	133	200	97	70
b Net Working Capital (Average Days)	126	197	97	69
c Current Ratio (Current Assets / Current Liabilities)	9.3	10.3	8.1	7.9
3 Coverages				
a EBITDA / Finance Cost	6.5	3.3	6.2	9.7
b FCFO / Finance Cost+CMLTB+Excess STB	5.5	1.9	2.9	4.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Financ	1.4	2.8	1.8	2.2
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	42.2%	45.8%	47.1%	59.5%
b Interest or Markup Payable (Days)	0.0	76.0	89.7	72.7
c Entity Average Borrowing Rate	5.6%	10.0%	5.6%	4.0%

**Credit Rating**

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

Scale	Long-term Rating Definition
AAA	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	<b>Very high credit quality.</b> 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.
AA-	
A+	
A	<b>High credit quality.</b> 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.
A-	
BBB+	
BBB	<b>Good credit quality.</b> 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.
BBB-	
BB+	<b>Moderate risk.</b> 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.
BB	
BB-	
B+	
B	<b>High credit risk.</b> 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.
B-	
CCC	
CC	<b>Very high credit risk.</b> 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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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):

<p><b>Entities</b></p> <ul style="list-style-type: none"> <li>a) Broker Entity Rating</li> <li>b) Corporate Rating</li> <li>c) Financial Institution Rating</li> <li>d) Holding Company Rating</li> <li>e) Independent Power Producer Rating</li> <li>f) Microfinance Institution Rating</li> <li>g) Non-Banking Finance Companies (NBFCs) Rating</li> </ul>	<p><b>Instruments</b></p> <ul style="list-style-type: none"> <li>a) Basel III Compliant Debt Instrument Rating</li> <li>b) Debt Instrument Rating</li> <li>c) Sukuk Rating</li> </ul>
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(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

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- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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- (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)
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- (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)

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- (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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