The Pakistan Credit Rating Agency Limited

Rating Report

Pak Suzuki Motor Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
31-Dec-2020	AA-	A1	Stable	Maintain	-
31-Dec-2019	AA-	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pak Suzuki Motor Company Limited (PSMC) is the only player from among the established auto OEM in Pakistan that is predominantly owned by the foreign shareholder. Besides, there is high level of integration with the parent and associates. The ratings reflects prominent industry positioning of PSMC in its respective niche and strong ownership background. With a presence of up to four decades in the automotive industry, the company has established a formidable forte in the domestic market. The industry that had been reigned by only three OEMs for many years, including PSMC, is now facing competition from the new entrants. PSMC operates in the industry which is cyclical and prone to adverse macro-economic indicators. This is truer for the customer segment of PSMC, which is more price sensitive. Prior CY19, PSMC witnessed sustainable growth in preceding years amid growing middle class with stable margins. Ongoing market conditions and economic slowdown has adversely impacted the Company's revenues and profitability, resulting in a net loss. This was primarily due to slower paced yet multiple times of adjusting the prices upward and later on the pandemic impact, kept the demand restricted. Since the impact has been largely absorbed at the both ends, it has started to reflect positively from the third quarter of the year 2020. It is noticeable that the company has no long term debt on its books, despite challenges. Under the debt metrics, the company has appreciably reduced its debt pressure (short term) to quite an extent, which was built-up to fund its working capital needs. Now the debt requisites are shared with the sponsors, that too at an adequate level, henceforth, recovery is visible in the financial profile. After facing months of muted sales due to COVID-19 on the last couple of quarters, present market conditions appears docile as recent figures represents gradual recovery. The fortune of the industry became hazy if second wave prolongs, therefore the quantum of recovery is dependent on duration and aftermaths of the pandemic. Moreover, reduction in interest rates will help auto-financing pick up pace over the medium-term.

The ratings draw comfort from the diversity in business streams, continuous dominance in volumetric sales despite challenges, integration of supply chain at group level and technical support from the sponsor in accordance with License agreement. The ratings are dependent on the Company’s aptness to manage its financial profile by reducing leveraging and rationalizing its working capital, endurance of which is crucial. Additionally, reversal of losses is important while any significant increase in debt and/or working capital will impact the ratings.

Disclosure

Name of Rated Entity	Pak Suzuki Motor Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20)
Related Research	Sector Study | Passenger Cars(May-20)
Rating Analysts	Raniya Tanawar | raniya.tanawar@pacra.com | +92-42-35869504

Profile

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

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

Operations The principal business activity of the Company is assembling, progressive manufacturing and marketing of Suzuki cars, pickups, vans, 4 x 4s, motorcycles. Further, Company is also involved in trading activity of Suzuki cars, Heavy bikes, outboard motors and related spare parts. The company’s head office and production facilities are situated in Karachi.

Ownership

Ownership Structure The SMC-Japan is the major shareholder of the Pak Suzuki Motors with the majority stake of ~ 73%. Remaining shareholding lies with individuals and financial institutions.

Stability SMC-Japan is a strong brand known worldwide. It has history of operations in automobile sector spanning over ten decades.

Business Acumen SMC-Japan is an A rating company rated by Rating and Investment Information, Inc (R&I) with a stable outlook as of May'20. SMC-Japan is Japanese Multinational Corporation headquartered in Hamamatsu, Japan since 1909, which specializes in manufacturing automobiles, four-wheel drive vehicles, motorcycles, all -terrain vehicles (ATVs), outboard marine engines, wheelchairs and a variety of other small internal combustion engines.

Financial Strength Suzuki Motors Corp, Japan (SMC-Japan) is a multinational concern with about 35 main production facilities in 23 countries and 133 distributors in 192 countries. The worldwide sales volume of automobile is the world's tenth, domestic sales volume is the third largest in the country. Financial strength of the parent company is strong.

Governance

Board Structure The overall control of the company vests in a seven members board of directors. The board structure comprises one managing director and two independent directors.

Members’ Profile The Board members are professionals with diversified experience and have long association with the Company. Mr. Kinji Saito - Chairman of the board has a long affiliation with Suzuki motors having diverse experience in the Automobile sector, which brings specialized and comprehensive experience and knowledge on the board.

Board Effectiveness In line with the guidelines of Code of Corporate Governance, the Board has formed two sub-committees – (i) HR and Remuneration Committee and (ii) Audit Committee. Both committees are being headed by an independent director and consist of 3 members each. Attendance of BoD members remained satisfactory and board meeting minutes are properly documented.

Financial Transparency An effective Internal Audit department reporting to the Audit Committee is in place. M/s. KPMG Taseer Hadi & Co, a QCR rated firm, has expressed unmodified opinion on financial statements for the year ended CY19.

Management

Organizational Structure Pak Suzuki’s management team has been divided into over 12 departments. There is a complex organizational structure with all department heads reporting to divisional heads and ultimately to functional heads. CEO is heading few functions.

Management Team Management of the company comprises qualified and experienced professionals with a wide range of skills and diversified experience. Mr. Masafumi Harano - CEO has association with SMC since 1988 and is an experienced professional in the Auto & Allied industry, and is assisted by able management team.

Effectiveness The management has formed five formal management committees. The board has set up an effective internal audit function who is suitably qualified and experienced for precise implementation of policies and procedures.

MIS The company has installed Infor ERP-LX software and planning to replace it with the latest ERP Solution. The Company further has in house development team which develops dashboards and other systems to support and evaluate business segments.

Control Environment The Company’s monthly MIS comprises comprehensive segment and unit wise performance reports review frequently by the senior management. The system, while integrating the business functions of the company, helps the management in timely decision making and strengthens the control environment.

Business Risk

Industry Dynamics The Pakistan automobile segment has been witnessing a difficult time from the past 2 years beginning in late 2018 year. Where 2019 was the year with multiple challenges for the existing players; high interest rates & CPI index, rupee devaluation, additional custom duties and entry of new players (KIA & Hyundai), Year 2020 brought yet another blow, drastically affecting the entire world economies. Outbreak of COVID-19 has turned the tables for many industrial segments in Pakistan including passenger cars. Offtake between Jul'20 - Oct'20 observed brisk upward trend representing the demand revival; 43,865 units as against 40.583 units in the SPLY.

Relative Position Pak Suzuki Motors is among the largest vertically integrated automotive company in the country with more than 50% market share. Among its competitors are Toyota Indus Motors and Honda Atlas. Pak Suzuki operates in a price sensitive market segment whereas other two players play on the high end brand variants. In cars of 1000 CC or below category Pak Suzuki Motors continues to dominate the market. The Company has fallen prey to the pandemic situation in the country and around the globe. In line with industry. operations halted during the state of corona affairs, however gradually returning to life after closure period of 3months.

Revenues The year 2019 has not been fortunate for the entire automobile sector including Pak Suzuki. Since CY19, revenues have shown downward trajectory. Car financing became costly, heightened car prices driven by rupee devaluation reserved the buying power. Year 2020 brought additional challenge: COVID19 which further damaged the demand however, some respite is seen recently. Some hit came from discontinuation of Mehran, which later on will be replaced by the new variant; Suzuki Alto. Revenues for 9MCY20 stood at PKR 50bln (9MCY19: PKR 91bln)

Margins instilling impact of falling revenues along with high cost of raw material, hike in interest rates and volatile currency devaluation have restricted the profit levels of the company, reflecting in the overall margins as well. Gross margins were at ~2.2% during 9MCY20 CY19; ~1.7%, CY18: ~5.8%). The company booked a loss at operating level eventually leading a net loss of PKR 2.6bln in CY19 as against a profit of PKR 1.3bln in CY18 attributable to significant finance cost hike. During the 9MCY29 PSML continued to post a loss; PKR 2.6bln.

Sustainability The COVID-19 outbreak has created various challenges, adding more pressure to the already struggling sector of the country. Maintaining Optimum levels of auto parts and continued operations while ensuring compliance with SOPs is the key focus of the company.

Financial Risk

Working Capital The company is up to rationalising its inventory levels working capital relies on a mix of internal generation and advances from customer. Both inventory days and payables days are on a rise due to volatile market conditions attributed to COVID-19 (Jun'20: ~162days, CY19: ~105 days; CY18: ~81 days). Hence, moving net working capital days to 132 days in Jun'20 as compared to ~83 days in CY19.

Coverages During 9MCY20 Free cash flow from operations (FCFO) witnessed a recovery, stood at PKR ~1.6bln as compared to negative PKR -730mln in CY19. Cash flows got off pressure due to tax relief on incurring losses. As a result interest coverage and core coverage ratio of the company turned positive. Going forward, resumption of positive cashflow streams are critical to keep the coverages intact.

Capitalization The Company has optimized its capital structure by reducing its debt exposure significantly; from PKR 32bln in CY19 to PKR 87mln in 9MCY20, hence company's gearing ratio has come down to 35% from 56% in CY19. The debt exposure has been shifted to parent company SMC-Japan (PKR ~12bln).

PACRA

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

		Sep-20	Dec-19	Dec-18	Dec-17
Pak Suzuki Motor Company Limited					
Passenger Cars		9M	12M	12M	12M
A BALANCE SHEET					
1	Non-Current Assets	18,389	19,189	17,499	9,696
2	Investments	-	-	-	-
3	Related Party Exposure	574	522	435	250
4	Current Assets	38,431	57,949	43,577	40,964
a	*Inventories*	*21,670*	*37,517*	*29,397*	*23,946*
b	*Trade Receivables*	*1,269*	*1,490*	*787*	*532*
5	**Total Assets**	57,394	77,660	61,510	50,910
6	Current Liabilities	20,812	18,914	20,966	21,361
a	*Trade Payables*	*6,277*	*7,252*	*8,846*	*6,655*
7	Borrowings	87	32,559	11,310	-
8	Related Party Exposure	12,925	-	-	-
9	Non-Current Liabilities	229	236	-	-
10	**Net Assets**	23,341	25,951	29,233	29,550
11	**Shareholders' Equity**	23,341	25,951	29,233	29,550
B INCOME STATEMENT					
1	**Sales**	50,082	116,548	119,854	101,812
a	*Cost of Good Sold*	*(48,956)*	*(114,563)*	*(112,809)*	*(92,159)*
2	**Gross Profit**	1,126	1,985	7,045	9,653
a	*Operating Expenses*	(2,588)	(5,090)	(5,008)	(4,404)
3	**Operating Profit**	(1,461)	(3,105)	2,037	5,249
a	*Non Operating Income or (Expense)*	*272*	*188*	*306*	*400*
4	**Profit or (Loss) before Interest and Tax**	(1,189)	(2,917)	2,343	5,649
a	*Total Finance Cost*	*(2,399)*	*(2,035)*	*(260)*	*(29)*
b	*Taxation*	*990*	*2,031*	*(785)*	*(1,793)*
6	**Net Income Or (Loss)**	(2,599)	(2,920)	1,298	3,826
C CASH FLOW STATEMENT					
a	*Free Cash Flows from Operations (FCFO)*	*1,557*	*(730)*	*995*	*1,515*
b	*Net Cash from Operating Activities before Working Capital Chc*	*(876)*	*(2,120)*	*1,161*	*2,234*
c	*Changes in Working Capital*	*21,402*	*(13,998)*	*(10,097)*	*2,753*
1	**Net Cash provided by Operating Activities**	20,526	(16,118)	(8,937)	4,987
2	**Net Cash (Used in) or Available From Investing Activities**	(860)	(2,903)	(8,525)	(3,892)
3	**Net Cash (Used in) or Available From Financing Activities**	12,920	32,083	9,788	(453)
4	**Net Cash generated or (Used) during the period**	32,586	13,062	(7,673)	641
D RATIO ANALYSIS					
1	**Performance**				
a	*Sales Growth (for the period)*	-42.7%	-2.8%	17.7%	33.1%
b	*Gross Profit Margin*	2.2%	1.7%	5.9%	9.5%
c	*Net Profit Margin*	-5.2%	-2.5%	1.1%	3.8%
d	*Cash Conversion Efficiency (FCFO adjusted for Working Capit*	45.8%	-12.6%	-7.6%	4.2%
e	*Return on Equity [Net Profit Margin * Asset Turnover * (Total*	-12.6%	-12.6%	4.9%	14.9%
2	**Working Capital Management**				
a	*Gross Working Capital (Average Days)*	169	108	83	112
b	*Net Working Capital (Average Days)*	132	83	60	94
c	*Current Ratio (Current Assets / Current Liabilities)*	1.8	3.1	2.1	1.9
3	**Coverages**				
a	*EBITDA / Finance Cost*	0.3	-0.1	19.4	N/A
b	*FCFO / Finance Cost+CMLTB+Excess STB*	0.7	-0.4	5.4	N/A
c	*Debt Payback (Total Borrowings+Excess STB) / (FCFO-Financ*	-12.7	-0.1	0.0	0.0
4	**Capital Structure**				
a	*Total Borrowings / (Total Borrowings+Shareholders' Equity)*	35.8%	55.6%	27.9%	0.0%
b	*Interest or Markup Payable (Days)*	49.1	114.0	0.0	N/A
c	*Entity Average Borrowing Rate*	12.6%	12.0%	2.4%	N/A

Credit Rating

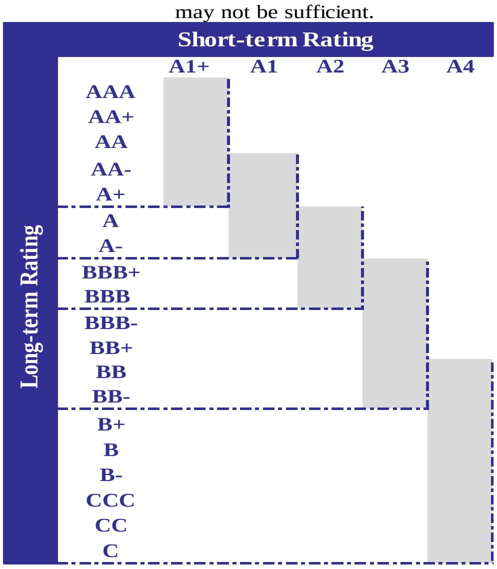
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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