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
11-Aug-2021	AA-	A1	Stable	Maintain	-
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 among the established auto OEMs in Pakistan that is predominantly owned by the foreign shareholder. Besides, there is high level of integration with the parent and associates. The rating incorporates PSMC's strong position as a prominent industry player in its respective niche with strong ownership background. Having a presence of more than four decades in the automotive industry, the Company has established a formidable forte in the domestic market. PSMC operates in an industry which is cyclical and prone to macro-economic indicators. This is more applicable for the customer segment of PSMC, which is more price sensitive. This is going to be in favour of the Company in near future as upcoming new auto policy (2021-2026) tends to provide much awaited relief to local operators, particularly to the segment where PSMC is a market leader, making it a beneficiary. The industry that had been reigned by only three OEMs for many years, is now facing competition from new entrants. It is noticeable that there has been few addition in the past under below 1000cc car segment, but it did not effect PSMC market position. The last 2-3 years have been a rough journey for auto manufacturers in Pakistan where the industry suffered various challenges, though PSMC remained resilient. After facing months of muted sales due to COVID-19, present market conditions appear positive. Recent figures represent strong uptick in sales during 1HCY21, on the back of lower interest rates (7%) - thus boosting consumer auto-financing, eventually enabling the companies to enhance their revenue base. Moreover, future of the industry is getting better and clearer as COVID-19 driven risk factors are settling. The year 2021 started with good fortune, as adversities that pushed the Company into losses (for a while), turns to evade and profitability returned at net level on the books of the Company. The risk profile seems credible as it is pertinent to note that the company carries a low leverage book and strong coverages. Under the debt metrics, the Company has eliminated its debt pressure (short term) from the external exposure. Now the debt requisites are shared with the sponsors, that too at an adequate level, henceforth, recovery is visible in the financial profile.

The ratings draw comfort from the Company's revival of profits within its targeted timeline, ability to dominate in volumetric sales despite challenges and diverse product streams. Sponsor support remains inevitable along with 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 ability to uphold its financial risk profile. However, sustainability in profits and stable risk profile remains imperative.

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-21)
Rating Analysts	Raniya Tanawar | raniya.tanawar@pacra.com | +92-42-35869504

Profile

Legal Structure Pak Suzuki Motor 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 PSMC was established as Joint Venture between Pakistan Automobile Corporation Limited (PACO) and Suzuki Motor Corporation Japan (SMC Japan) 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 CY20

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. He 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 2-3years 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 1HCY21. 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 Pak Suzuki Motor's 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. In line with the industry the Company has fallen prey to the challenge of pandemic situation in the country and around the globe.

Revenues Revenues for CY20 stood at PKR 77bln (CY19: PKR 117bln). Beginning 2021 witnessed betterment as revenues gained momentum with an increase of ~88% during 1QCY21. Highest selling car variant under PSMC’s product portfolio was Suzuki Alto. Previously it was Mehran, which discontinued.

Margins 1QCY21 brought positivity to the financial matrices, after bearing losses for some time, as a result of strategic measures taken to control cost and mitigate the risk profile, gross margins were ~6.1% (CY20; ~4.3%, CY18: ~1.7%). The Company earned profits as against a loss in CY20; net profit stood at PKR 777mln in 1QCY21 as against a loss of PKR 1.6bln in CY20, mainly attributable to massive drop in finance cost.

Sustainability The upcoming new Auto Policy (21-26) will facilitate the local manufacturers operating in ‘below 1000c’ cars eventually benefiting the Company. However, new competition will bring pressure on the existing players, creating the need for innovation and better quality. Moreover, susceptibility regarding COVID-19 continues to hover.

Financial Risk

Working Capital In 1QCY21, PSMC achieved the rationalising of its inventory levels, denoting companys adherence towards its commitments, working capital relies on a mix of internal generation and advances from customer. Both inventory days and payables days have come down. Hence, moving net working capital days to 38days in Mar'21 as compared to ~112 days in CY20.

Coverages Company’s FCFO returned to green zone in the period CY20 (PKR 3.4bln) while being negative during CY19 (PKR -730mln) therefore resulting in better coverages: (!QFCY21: 5x, CY20: 1.3x, CY19: -0.4x). PSMC has gone cash surplus as the business have started supporting the operations. Going forward, sustainable positive cashflows are important to keep the coverages intact.

Capitalization Recently PSMC acquired a TERF facility amounting PKR 581mln as at Mar’21, for the import of new plant & machinery. This is for a new variant/product line. Apart from this there is no Short term borrowings left on the company’s book. During CY20, The Company shifted its external debt burden to a parent loan of PKR 12bln. This loan has been paid off completely in May’21(post balance sheet item). This will eventually improve the capital structure of the company significantly in future. The company has almost gone debt free, just like it was in Dec’17. The Company has optimized its capital structure by reducing its debt exposure significantly; from PKR 32bln in CY19 to PKR 722mln in 1QCY21. Hence, Company's gearing ratio has come down to 34% from 56% in CY19.

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Financial Summary
PKR mln

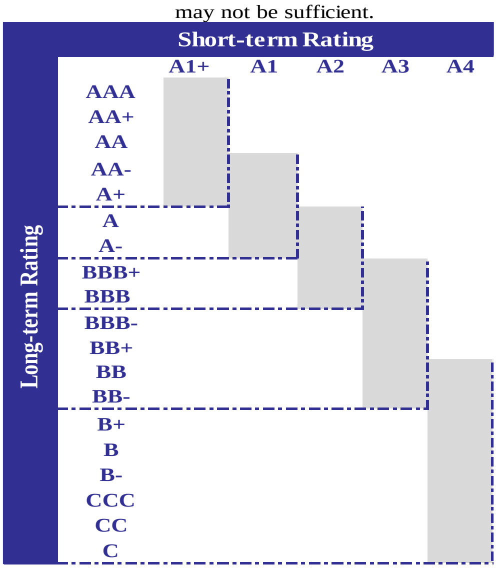
Pak Suzuki Motor Company Limited Passenger Cars	Mar-21 3M	Dec-20 12M	Dec-19 12M	Dec-18 12M
A BALANCE SHEET				
1 Non-Current Assets	22,543	20,708	19,189	17,499
2 Investments	-	-	-	-
3 Related Party Exposure	501	513	522	435
4 Current Assets	51,381	45,484	57,949	43,577
a Inventories	*18,434*	*18,055*	*37,517*	*29,397*
b Trade Receivables	*1,865*	*1,749*	*1,490*	*787*
5 Total Assets	74,425	66,704	77,660	61,510
6 Current Liabilities	36,246	26,215	18,914	20,966
a Trade Payables	*6,035*	*4,380*	*7,252*	*8,846*
7 Borrowings	722	150	32,559	11,310
8 Related Party Exposure	12,086	15,731	-	-
9 Non-Current Liabilities	249	259	236	-
10 Net Assets	25,122	24,349	25,951	29,233
11 Shareholders' Equity	25,123	24,349	25,951	29,233
B INCOME STATEMENT				
1 Sales	36,098	76,720	116,548	119,854
a Cost of Good Sold	*(33,889)*	*(73,419)*	*(114,563)*	*(112,809)*
2 Gross Profit	2,209	3,302	1,985	7,045
a Operating Expenses	(1,376)	(3,431)	(5,090)	(5,008)
3 Operating Profit	832	(129)	(3,105)	2,037
a Non Operating Income or (Expense)	*514*	*565*	*188*	*306*
4 Profit or (Loss) before Interest and Tax	1,346	436	(2,917)	2,343
a Total Finance Cost	*(250)*	*(2,622)*	*(2,035)*	*(260)*
b Taxation	*(318)*	*596*	*2,031*	*(785)*
6 Net Income Or (Loss)	778	(1,589)	(2,920)	1,298
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,242*	*3,410*	*(730)*	*995*
b Net Cash from Operating Activities before Working Capital Changes	*850*	*1,056*	*(2,120)*	*1,161*
c Changes in Working Capital	*6,973*	*34,131*	*(13,998)*	*(10,097)*
1 Net Cash provided by Operating Activities	7,824	35,186	(16,118)	(8,937)
2 Net Cash (Used in) or Available From Investing Activities	(2,103)	(799)	(2,903)	(8,525)
3 Net Cash (Used in) or Available From Financing Activities	574	12,575	32,083	9,788
4 Net Cash generated or (Used) during the period	6,295	46,962	13,062	(7,673)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	88.2%	-34.2%	-2.8%	17.7%
b Gross Profit Margin	6.1%	4.3%	1.7%	5.9%
c Net Profit Margin	2.2%	-2.1%	-2.5%	1.1%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	22.8%	48.9%	-12.6%	-7.6%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	13.1%	-6.0%	-12.6%	4.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	51	140	108	83
b Net Working Capital (Average Days)	38	112	83	60
c Current Ratio (Current Assets / Current Liabilities)	1.4	1.7	3.1	2.1
3 Coverages				
a EBITDA / Finance Cost	8.1	1.2	-0.1	19.4
b FCFO / Finance Cost+CMLTB+Excess STB	4.8	1.3	-0.4	5.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.2	15.5	-0.1	0.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	33.8%	34.4%	55.6%	27.9%
b Interest or Markup Payable (Days)	0.0	0.5	114.7	0.0
c Entity Average Borrowing Rate	5.7%	11.5%	12.0%	2.4%

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