The Pakistan Credit Rating Agency Limited

Rating Report

Diamond Tyres Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
22-Apr-2021	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Diamond Tyres Limited ("Diamond Tyres" or the "Company") has a reputable presence in 2 & 3 wheelers industry since long. Being a volume driven plus price sensitive industry, the competition is tough. Diamond Tyres has demonstrated resilience in the competitive environment and achieved a strong footprint as a prominent player in its respective niche. Over the years the company has progressed both in terms of financial aspects and operational level, by enhancing its product range of offering within the tyre & tubes domains. Given the industry dynamics, innovation and advancement has become inevitable. Aiming for growth, the company is eyeing to increase its market share in replacement market as well as in Agriculture and Ultra-Light Trucks by adding more flares to its existing product palette through expansion. This will reap benefits in the future and shall boost up the already growing revenues of the company, deriving strength to the financial matrices. Revenue stream is segmented into OEMs and Replacement Markets (RM), wherein (RM) has a higher inclination. In line with the industry, Company's profitability has been restricted on account of continuous increase in input costs on the back of frequent rounds of rupee depreciation as the Company imports majority of its raw materials. At present the company's debt book is adequately leveraged, however it is expected to elevate - yet remain comfortable - in coming years as the expansion is under way. Despite COVID-19 outbreak and subsequent impacts of lockdown, the company has performed at par. The measures introduced by SBP in the wake of the COVID-19 pandemic; principal deferment and rate cut of 625bps, will benefit the financial profile amidst projected future cashflows. The company operates under the umbrella of Diamond Group of Industries, which comprises five other companies and constitutes renowned names; Diamond Supreme Foam, Dolce' Vita and Diamond Jumbolon, reflecting good financial backing. Both businesses (foam & tyre) are cyclical in nature hence, corroborating continuous inflows at group level. The subsequent generations of sponsoring family are the joint owners of the business. The group entails a central treasury & financial management system where decision making is held mutually. In light of this the assigned ratings reflect Diamond Tyres profound acumen of the sponsor and relatively stable position in the tyre industry. However, the governance framework needs strengthening. The management is mindful of the essence of corporate structure and is keen towards change for the better. This lends support to ratings.

The ratings are dependent on management's ability to sustain its business profile and profitability in line with business expansion. Prudent management of the working capital, maintaining sufficient cash flows and coverages is imperative. Improvement in governance structure remains important for the ratings.

Disclosure

Name of Rated Entity	Diamond Tyres 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 | Tyres(Oct-20)
Rating Analysts	Raniya Tanawar | raniya.tanawar@pacra.com | +92-42-35869504

Profile

Legal Structure Diamond Tyres Limited (hereinafter referred to as ‘‘the Company’’ or ‘‘Diamond Tyres’’) is a public unlisted company incorporated in 2004 under the Companies Ordinance, 1984 (now “Companies Act, 2017”).

Background In 1968 Diamond Rubber Mills, DRM, was established by Mr. S.M Shaffi (Late) in Karachi, engaged in bicycle tyres & tubes production only. Initially Mr. Shaffi with his 3 sons: Mr Ejaz (Late), Mr Iftikhar and Mr. Waqar were in the business. In 2004, Hashir Textile Mills factory was taken over and converted into a manufacturing unit of tyres. In 2008, the plant was shifted to Lahore from Karachi with a colossal expansion bearing the name Diamond Tyres Limited. The Company is operating under the umbrella of Diamond Group of Industries, which comprises five (5) companies, including Diamond Tyres, and owns renowned brand names like Diamond Supreme Foam, Dolce’ Vita and Diamond Jumbolon. Now, the company is governed by the descendants of Mr. Iftikhar and Mr Ejaz (Late).

Operations The company has classified its business operation into one main division i.e. "Tyre & Tubes Division". The Company is engaged in manufacturing of tyres and tubes of 2 & 3 wheelers, auto richkshaws and wheel-barrow. It also produce tyres of LCVs and front tyres & tubes of tractors. The Company extends its plans for entering into commercial and agricultural tyres & tubes. The company has its head office in Lahore. and factory is situated in Manga Mandi on an area of 16 acres of land.

Ownership

Ownership Structure Diamond Tyres is a family owned business. The entire ownership vests in sponsoring members. Mr. Mudassir Iftikhar, Mr Shariq Iftikhar, Mr. Muzammil Ejaz & Mr. Bilal Ejaz.

Stability There has been no change in the shareholding structure of the company over the years. The subsequent generations of the sponsoring family is running the business affairs since long. Major shareholding is expected to remain with the sponsoring family.

Business Acumen The founding members of the company possess strong profiles relating to the tyre& tube, foam and mattress industry. They are professionals with good professional experiences.

Financial Strength Financial strength of the sponsors is considered good, as the sponsoring company is owned by individuals possessing good financial profiles. Having investments in diversified businesses such as home textile, foam & mattresses, bodes well for the Company.

Governance

Board Structure The board of directors (BoD) consists of 4 directors, all with executive roles in the Company. No independent directors on the board exist.

Members’ Profile Members of the board have sound professional background, which brings ample experience and knowledge to the board. Mr. Shariq Iftikhar is the Chief Executive-CEO. He is a graduate by education and has been associated with the family business for 15 years which consists of several industries comprising manufacture of foam mattresses, spring mattresses, and expanded poly-ethylene for insulation.

Board Effectiveness The board, having sponsoring members, supports the management in terms of strategic guidance. Albeit, no formal board committees exist.

Financial Transparency The auditors of the company are Sarwar Chartered accountants, categorised under ‘C’ category on the list of SBP list of auditors, issued an unqualified audit opinion pertaining to annual financial statements for FY20.

Management

Organizational Structure The organization structure is lean and divided into departments with defined roles. All department heads, report to the Chief Executive Officer (CEO).

Management Team Members of the Board are directly involved in the business activities. Mr. Muzammil Ejaz - Sponsor Director, a thorough professional - associated with the Company since its inception, aptly oversees the overall operations. Mr Syed Adeel Ahmed, who recently joined as the CFO of the Company, holds experience in multiple business segments. He is being accompanied by a good team of professionals at Diamond Tyres.

Effectiveness Currently, the Company has a management committee which comprises. (i) CFO (ii) Director Sales (iii) GM Production & (iv) GM Procurement. The Committee meets on monthly basis. There is a sound Supply Chain Management process for procurement and sales, requiring approval from the GM factory.

MIS In house real time integrated information/dashboard system exists, driven by Diamond Group. Modules of the developed systems consists Oracle financial & Order management, Oracle Manufacturing, HRMS and dashboard reporting system. The implementation of these modules were done by A. F. Ferguson & Co.

Control Environment The corporate structure of the Company is diverged into various departments each having an effective Internal Control System to ensure achievement of overall strategic goals and reliable reporting. Back-up policies and disaster recovery plans are in place to ensure smooth functioning.

Business Risk

Industry Dynamics Pakistan's Tyre industry is composed of three segments, (i) 2 & 3 wheeler tyres (ii) Tyres for Cars and LCVs, and (iii) Tyres for Trucks, Buses and Tractors. Tyres demand is driven by sales of new vehicles and demand from replacement market. Overall economic slowdown recently exacerbated by Covid19 had impacted the sales of new vehicles and hence the revenue from OEMs. However, tyre manufacturers operating in two wheels segment has shown higher resilience towards change in macro economic indicators, compared to four wheels tyre segment.

Relative Position Diamond Tyres has evolved to become prominent player and suppliers/manufacturers of 2 & 3 wheeler tyres and tubes in Pakistan and Internationally. The company is well poised among the leading market players (Service & Panther) under 2&3 wheelers tyre segment. It has the second highest capacity of tubes production with 26mln units. Diamond Tyres has a presence in international market and exports tyres in several SAARC countries including, Afghanistan, Sri Lanka and Nepal.

Revenues The sales are contributed largely by replacement segment (~65%), followed by OEM (~35%) and exports (~6%). Despite the Covid19 impact in last quarter of FY20 revenue reflected as growth of ~15% during FY20 as compared to FY19 (~18%) much in line with the industry. The Company’s topline clocked in at PKR 7,037mln as at end-Jun20 (FY19: PKR 6,128mln).

Margins The segment in which the company operates is comparatively low margin based. The cost of goods sold to sales percentage stands above ~90%. Regardless of this, gross margin increased by ~2.6% on back of cost push impact and controlled cost of production (1QFY21: 13%, FY20: 10.3%, FY19: 7.7%). Accordingly, operating margin inclined by ~3.2% in 1QFY21 (FY20: 6.7%, FY19: 4.4%). High finance cost kept the net profit restricted during FY20 (PKR 76mln), while regaining momentum in 1QFY21 (PKR 191mln).

Sustainability The company anticipates to penetrate in the tyre market by increasing its market share and is focused towards revenue diversification. Replacement market has relatively higher proportion as compared to OEMs and shall remain steady in future. At the strategic level, in order to cater the local demand, the company plans to extend its business avenues by entering into the Agri/farm tyres. The company has entered in the initial phase of its expansion.

Financial Risk

Working Capital The Company relies on short term borrowings and internally generated cash to fund its working capital needs. Short term borrowings have been maintained at a monotony level; 1QFY21 - PKR 1.86bln, FY20 - PKR 1.97bln, FY19 - PKR 1.94bln. As the business is in its expansion phase and sales are gradually increasing, company's gross working capital days have risen to 130 days in FY20 from 120 days in FY19, this also incorporates the effects of COVID-19 outbreak. Net working capital days have also increased to 112 days in FY20 as compared to 98 days in FY19 however, some respite is observed during 1QFYFY21 (87days).

Coverages The Company generates free cashflow FCFO at a fair pace: PKR~666mln during FY20 (FY19: PKR~310mln, FY18: PKR 314mln). Over the years interest coverage against FCFO have been fluctuating - on account of higher interest cost, however still remained comfortable (1QFY21:5.7x, FY20: 2.8x, FY19: 2.1x, FY’18: 3.3x). Going forward, sustainable cash flows from operations is necessary to keep the coverages intact.

Capitalization The Company’s capital structure is moderately leveraged capital. Total debt of the company in FY20 increased to PKR~2,728mln as compared to PKR~2,393mln in FY19. Out of the total debt more than ~70% pertains to short term. Equity of the company stood at PKR~2,239mln in FY20 (FY19: PKR~2,164mln). Gearing ratio of the company stood at ~54.9% in FY20 from ~52.5% in FY19. Going forward, the planned expansion has an estimated cost of PKR ~4.6bln, will be majorly funded through debt henceforth, debt book of the company will witness an uptick in near future.

The Pakistan Credit Rating Agency Limited

Diamond Tyres Limited Tyres	Sep-20 3M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET				
1 Non-Current Assets	2,965	2,909	2,899	1,700
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	3,415	3,476	2,956	2,534
a Inventories	*1,199*	*1,750*	*1,512*	*1,050*
b Trade Receivables	*1,623*	*1,029*	*705*	*745*
5 Total Assets	6,380	6,385	5,854	4,234
6 Current Liabilities	643	714	685	507
a Trade Payables	*326*	*297*	*396*	*312*
7 Borrowings	2,633	2,728	2,393	2,064
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	673	704	612	283
10 Net Assets	2,430	2,239	2,164	1,380
11 Shareholders' Equity	2,430	2,239	2,164	1,380
B INCOME STATEMENT				
1 Sales	2,607	7,037	6,128	5,202
a Cost of Good Sold	*(2,267)*	*(6,311)*	*(5,655)*	*(4,784)*
2 Gross Profit	340	726	474	418
a Operating Expenses	(82)	(252)	(202)	(179)
3 Operating Profit	258	474	271	239
a Non Operating Income or (Expense)	*(12)*	*(9)*	*(17)*	*(12)*
4 Profit or (Loss) before Interest and Tax	246	466	255	228
a Total Finance Cost	*(63)*	*(244)*	*(155)*	*(101)*
b Taxation	*8*	*(146)*	*(65)*	*(9)*
6 Net Income Or (Loss)	191	76	35	118
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*350*	*666*	*310*	*314*
b Net Cash from Operating Activities before Working Capital Chai	*286*	*422*	*155*	*213*
c Changes in Working Capital	*12*	*(518)*	*(232)*	*(979)*
1 Net Cash provided by Operating Activities	299	(96)	(78)	(766)
2 Net Cash (Used in) or Available From Investing Activities	(128)	(171)	(68)	(162)
3 Net Cash (Used in) or Available From Financing Activities	-	237	130	979
4 Net Cash generated or (Used) during the period	170	(30)	(16)	51
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	48.2%	14.8%	17.8%	68.5%
b Gross Profit Margin	13.1%	10.3%	7.7%	8.0%
c Net Profit Margin	7.3%	1.1%	0.6%	2.3%
d Cash Conversion Efficiency (FCFO adjusted for Working Capita	13.9%	2.1%	1.3%	-12.8%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total A*	31.5%	3.5%	1.9%	10.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	98	130	120	99
b Net Working Capital (Average Days)	87	112	98	78
c Current Ratio (Current Assets / Current Liabilities)	5.3	4.9	4.3	5.0
3 Coverages				
a EBITDA / Finance Cost	5.6	3.3	2.8	4.6
b FCFO / Finance Cost+CMLTB+Excess STB	2.5	1.2	1.0	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance	0.7	1.8	2.8	1.7
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	52.0%	54.9%	52.5%	59.9%
b Interest or Markup Payable (Days)	69.5	152.1	186.0	152.1
c Entity Average Borrowing Rate	9.2%	9.3%	6.6%	6.2%

#	Notes
	* Quarterly figures are annualised where required to make it comparable
A7	Borrowings is inclusive of: Long Term borrowings (incl. lease)+Short term borrowings +Current maturity

Credit Rating

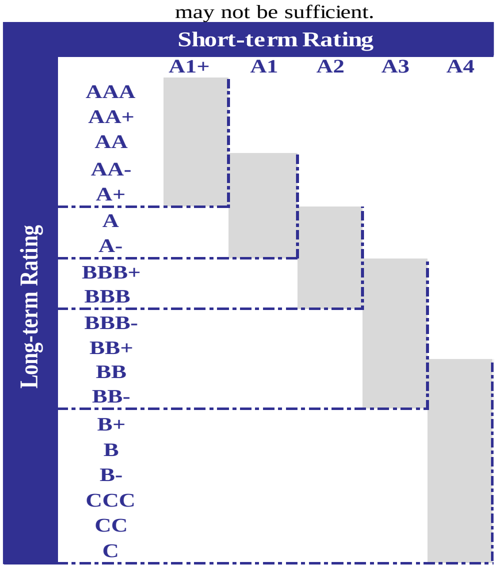
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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