RATING REPORT

Indus Motor Company Limited

REPORT DATE:
June 12, 2020

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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AA+	A-1+	AA+	A-1+
Rating Outlook	Stable		Stable	
Rating Date	*12 June, 2020*		*17 June, 2019*	

COMPANY INFORMATION	
Incorporated in 1989	**External auditors:** A.F Ferguson & Co.
Public Limited Company	**Chief Executive Officer:** Ali Asghar Jamali
Key Shareholders (with stake 5% or more):	
Foreign Investor ~ 80.66%	
Associated Companies ~ 6.28%	
Individuals (General Public) ~ 6.22%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (April 2019) https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Indus Motor Company Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Indus Motor Company was incorporated in Pakistan as a public limited company in December 1989 and started commercial production in May 1993. The company is listed on the Pakistan Stock Exchange

Profile of CEO

Ali Asghar Jamali was appointed as Chief Executive Officer in January 2017. He has been with the Company since October 2000 and has served in key roles in various departments, owing to which he has acquired rich experience in end to end management of company operations. He is a fellow of the Institute of Chartered Accountants of Pakistan and has attended the Advance Management Program at Harvard University and the Accelerated Management Program at Wharton School of Business in the USA.

Indus Motor Company Limited (IMC), a Joint Venture between Toyota Motor Corporation (TMC), Toyota Tsusho Corporation (TTC) and House of Habib (HoH), is a sole manufacturer, assembler, distributor and importer of Toyota and Daihatsu vehicles in Pakistan. The company has a strong (3S - sales, service and spare parts) distribution network of 47 independent dealers spread nationwide. Registered head office and production facility is located in Port Qasim, Karachi.

Since its inception, IMC has effectively adopted Kaizen (continuous improvement) concepts within the organization and follows just-in-time manufacturing method to avoid excess inventory. In FY19, the company enhanced its annual production capacity to 66,000 units (FY18: 54,800) on a double shift basis. Capacity utilization remained elevated till FY19 but has declined sharply to around 57% during 9MFY20. Due to continuous slowdown in demand, IMC along with all other auto manufacturers observed higher non-production days (NPDs) during the ongoing fiscal year in order to rationalize operational costs and maintain optimum inventory levels. Management expects improvement in utilization levels in FY21; quantum of improvement is contingent on duration and breadth of the pandemic.

	FY19	FY18	FY17
Capacity based on double shift basis	66,000	54,800	54,800
Production	65,346	62,886	59,945
Utilization	99.0%	114.8%	109.4%

Product Portfolio

IMC's sales operations are broadly segregated into two divisions namely; manufacturing division and trading division. The former entails assembling of completely knocked down (CKD) units while the trading division involves sale of completely built up (CBU) units of imported Toyota vehicles, and the sale of spare parts and motor oil. The company in an effort to diversify product portfolio, launched its mid-segment sedan 'Toyota Yaris' (with upgraded product & safety features and fuel efficiency) *(two variants replacing one variant of corolla)* in the ongoing year (March'20) targeted towards the budget car segment. Going forward, the management is focused towards capturing additional market share through offering enhanced product features/specifications and aggressive marketing strategies given that auto industry market size is expected to pick pace at a gradual pace.

Segments	CKD (Manufacturing division)	CBU (Trading division)
Passenger Car	Corolla/Yaris	Camry/Prius/Avanza
Light Commercial Vehicle (LCV)	Hilux/Revo	-
Sports Utility Vehicle (SUV)	Fortuner	Land Cruiser/Rush
Commercial	-	Hiace/Coaster

Key Rating Drivers

Strong sponsor profile

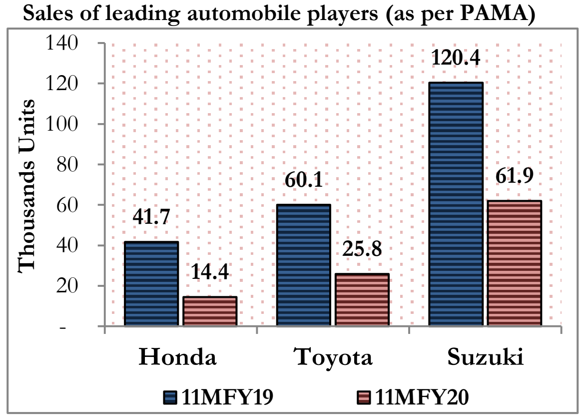
Assigned ratings incorporate strong financial profile of the sponsors. Toyota Motor Corporation (TMC), established in 1937 and headquartered in Japan, is the world's second largest auto manufacturer present in 25 countries with global retail sales volumes of 10.4 million during April-March, 2020. Standard & Poor's (S&P) has assigned long-term credit ratings of A+ to 'Toyota Motor Corporation'.

Automobile sales, which were already on a downward trajectory since the beginning of current fiscal year, have slumped further post March'20 as government imposed nation-wide lockdown to curb Covid-19 pandemic. Sales are expected to depict gradual recovery; quantum of recovery is dependent on duration and breadth of the pandemic. Moreover, reduction in interest rates may help auto-financing pick up pace over the medium-term.

During 11MFY20, sale of passenger cars witnessed a notable decline due to macroeconomic stabilization and import compression policies being pursued by government. Currency devaluation in addition to imposition of taxes and duties on import of CKD kits and raw materials led to significant jump in vehicle prices. This along with sizeable increase in interest rate led to a sharp slowdown in auto financing growth (Auto financing had grown at a CAGR of 31.2% during (2014-2018) but the same increased by only 4% during 2019) which negatively affected auto sales in both commercial (commercial vehicles) as well as the consumer segments (passenger vehicles).

Exhibit 1

Sales of leading automobile players (as per PAMA)



Automobile sales, which were already on a downward trajectory since the beginning of current fiscal year, have slowed down further amidst unprecedented large-scale lockdown of non-essential services in the country due to Covid-19 whereas recovery in sales is dependent on duration and breadth of the pandemic. Moreover, given recent decline in interest rate by around 525bps (from a high 13.25% to 8%) during a 3-month period (from March to May of 2020), auto-financing may pick up pace in the medium-term which would provide some support to auto sales in next fiscal year.

Sound business risk profile

Business risk profile is considered sound given solid franchise, high brand value and strong competitive position in the product segment in which IMC operates. Strong dealer network and declining trend in imported car sales further support the business risk profile whereas significant rupee devaluation is a drag on profitability (although prices have been increased regularly to offset pressure on margins). Cyclicality in sales due to slow down in GDP growth and frequent policy changes are key business risk factors. IMC's sales mix also benefits from healthy mix of urban and rural segment (where the agricultural economy has been relatively less impacted vis-à-vis large scale manufacturing). While the recent announcement of agriculture package along with higher sugar cane prices (during MY20 season) and aggressive wheat procurement program bodes well for farmer income levels, losses due to locust attacks to crop poses a risk. Long-term demand outlook for automobile sales is considered favorable given low motorization rate (18 vehicles per 1000 people) and projected rise in per capita income.

Going forward, competitive pressures are expected to intensify as new players roll out product offerings. Higher penetration of new entrants will largely be in hatchback, light engine capacity sedans and SUVs/Crossovers segment. VIS expects limited similar vehicles expected to be introduced (in terms of engine capacity) to compete against IMC's flagship products in 2020.

After registering a growth of ~13% in FY19, sales are expected to stay sluggish in the ongoing fiscal year. Going forward, recent launch of Toyota Yaris will provide support to future sales growth in FY20.

Topline of the company has registered a double digit Compound Annual Growth Rate (CAGR) of ~13% over past five fiscal years (FY15-19) while crossing the Rs. 150b mark during outgoing year FY19. Growth in sales has been a function of volumetric growth and higher pricing in view of escalated raw material costs. Customer base comprises a mix of rural and urban customers while a sizeable chunk of high-end Light Commercial Vehicle (LCVs) sales comprises armed forces and other law enforcement agencies.

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During 9MFY20, net sales were reported significantly lower at Rs. 75.8b (9MFY19: Rs. 117.9b) owing to weak market demand. Sales are expected to stay sluggish for the remaining fiscal year given further slowdown in demand due to advent of Covid-19 and its consequent lockdowns. Going forward, latest addition in product portfolio will provide support to future sales growth (as healthy sales orders are anticipated by the management from 'Toyota Yaris') once the lockdown is lifted and the demand for auto industry recovers.

Declining trend in profitability margins across industry; however, IMC is better positioned as compared to its peers. Going forward, improvement in sales volume and reduction in per unit cost through focus on cost efficiencies will support profitability profile in FY21.

While comparing favorably vis-à-vis peers, gross margins have trended downwards to 10.3% (FY19: 12.1%; FY18: 17.1%) in 9MFY20 owing to PKR depreciation against various currencies, lower production and increase in duties charged at import stage. Overall expenses have been maintained at manageable levels through focus on operating efficiencies and cost controls. Bottom-line profitability of the company also draws its support from sizeable treasury income (owing to investments in TDRs & T-Bills). However, decline in sales and margins resulted in profit after tax being lower at Rs. 4.98b (9MFY19: Rs. 10.25b) during 9MFY20. Going forward, increase in sales will be key profitability driver while continued focus on cost controls and further enhancing efficiencies are expected to keep operating expenses within manageable levels.

The ratings incorporate IMC's strong balance sheet and abundant liquidity, elements that provide the company with financial flexibility and support its rating.

Assessment of liquidity profile incorporates healthy cash flows, efficient working capital cycle and sizeable holding of cash and liquid investment portfolio. However, given sharp contraction in demand and sluggishness in automobile sales, advances from customers and dealers have declined. Resultantly, investment portfolio reduced at end-June 2019 but has increased again as at end-March 2020. Investment portfolio represented around 46% of the asset base at end-March 2020. Strong buffer on balance sheet is also evident from IMC providing financial support packages to its dealers and vendors to minimize the impact of Covid-19 outbreak. Quantum of capital expenditure undertaken is expected to remain highest amongst all peers for FY20 primarily due to launch of Toyota Yaris.

Sizeable internal capital generation continue to reinforce capital buffers (Net Equity: 9MFY20: Rs. 41.8b; FY19: Rs. 40.0b; FY18: Rs. 36.7b). Dividend payout ratio was reported at 66% (FY18: 70%) in FY19. At present, debt profile is very limited and only long term loan mobilized include concessionary rate financing under SBP borrowing scheme for renewable energy projects.

Experienced and diverse board composition and senior management team. Overall governance level is considered strong.

Board of Directors (BoD) comprises ten members including Chairman, CEO, three representatives from JV partners (Toyota), two executive directors and three independent directors. Board meetings are convened regularly while scopes of these meetings largely pertain to financial performance and internal controls. IMC has in place a qualified senior management team with extensive experience in automobile sector. Additionally, the company also benefits from the support and guidance from its JV partner. The company has deployed latest version of fully integrated SAP (SAP HANA) to meet its IT related needs.

Indus Motor Company Limited **Appendix I**

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**9MFY20**	**FY19**	**FY18**	**FY17**
Non-Current Assets	16,592	13,805	7,382	6,438
Stock-in-Trade	11,015	13,560	11,150	9,318
Trade Debts	942	2,548	1,453	759
Short Term Loans & Advances	3,245	3,728	3,714	1,653
Cash & Short Term Investments	35,227	26,684	57,231	44,709
Total Assets	69,196	64,783	81,992	63,880
Trade and Other Payables	16,405	15,950	15,731	9,683
Short Term Borrowings	-	-	-	-
Long Term Finances – Secured *(including current portion)*	228	54	-	-
Total Interest Bearing Debt	228	54	-	-
Advances From Customers	10,365	7,930	27,491	22,189
Total Liabilities	27,350	24,738	45,180	32,682
Paid-up Capital	786	786	786	786
Total Equity	41,846	40,045	36,744	31,197
INCOME STATEMENT				
Net Sales	75,830	157,996	139,715	112,272
Gross Profit	7,775	19,192	23,885	19,822
Other Income	2,337	4,307	3,901	3,593
Finance Cost	54	67	80	398
Profit before Tax	7,101	18,976	22,999	19,141
Profit After Tax	4,984	13,715	15,772	13,001
RATIO ANALYSIS				
Gross Margin (%)	10%	12%	17%	18%
PBT Margin (%)	9%	12%	16%	17%
Net Margin (%)	7%	9%	11%	12%
Current Ratio (x)	1.9	2.1	1.6	1.8
Net Working Capital	25,262	26,679	29,381	24,763
Working Capital Cycle	(9.3)	(4.5)	(4.9)	(2.1)
Gearing (x)	0.01	0.00	-	-
Debt Leverage (x)	0.65	0.62	1.23	1.05
FFO	5,165	10,156	15,682	11,994
FFO to Total Debt* (x)	30.1	189.2	-	-
FFO/Long Term Debt* (x)	30.1	189.2	-	-
Debt Servicing Coverage Ratio (x)	-	-	-	-
ROAA (%)*	10%*	19%	22%	21%
ROAE (%)*	16%*	36%	46%	44%

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III				
Name of Rated Entity	Indus Motor Company Limited				
Sector	Automobile				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	RATING TYPE: ENTITY				
	12/6/2020	AA+	A-1+	Stable	Reaffirmed
	17/6/2019	AA+	A-1+	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
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