

RATING REPORT

Sazgar Engineering Works Limited

REPORT DATE:

January 25, 2024

RATING ANALYST:

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RATING DETAILS

Rating Category	Initial Rating	
	Long-term	Short-term
Entity	A	A-2
Rating Outlook	Stable	
Rating Action	Initial	
Rating Date	January 25, 2024	

COMPANY INFORMATION

Incorporated in 1991	External Auditors: Saeed Kamran and Co.
Public Limited Company	Chairperson: Saira Asad Hameed
Key Shareholders (with stake 5% or more):	CEO: Mian Asad Hameed
Mian Asad Hameed – 41.85%	
Saira Asad Hameed – 6.41%	
Muhammad Ali Hameed – 11.61%	

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria: Industrial Corporates (May 2023)

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

VIS Rating Scale (2023)

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

Sazgar Engineering Works Limited

OVERVIEW OF THE INSTITUTION

RATING RATIONALE

Sazgar Engineering Works Limited was established on September 21, 1991 as a private limited company and converted into a public limited company on November 21, 1994. The company is engaged in the manufacturing and selling of automobiles, auto parts and household appliances. The company's manufacturing plant is located in Rainwind, Lahore and the registered office is located in Thokar Niaz Baig, Lahore.

Profile of CEO:

Mr. Mian Asad Hameed graduated from the United States and has been on the company's board of directors since inception. In 1980, he began his career as an Assistant Area Manager for Burma Shell. He joined M/S Ciba Enterprises (Private) Limited in 1984 as a director and was later named as the company's Chief Executive in 1986, a position he held until 2008. He has been involved in the creation of wheel rim dies, production machinery, and the development and design of the Mini cab three-wheel rickshaw. He is a pivotal figure contributing significantly to the success of four-wheeler project.

Sazgar Engineering Works Limited ('SAZEW' or 'the company') was established on September 21, 1991 as a private limited company and converted into a public limited company on November 21, 1994. The company is engaged in the manufacturing and selling of automobiles, auto parts and household appliances. The company's registered office and manufacturing facilities are located at Lahore.

Sector update: The rally of auto industry in FY22 was halted in FY23 on account of hike in policy rate, rupee depreciation and import restrictions which led to industry-wide curtailment in production. During FY23, car sales decreased by 57% owing to sharp increase in prices and declining purchasing power of customers. Automobile consumption in Pakistan remains modest when compared to other developing countries, as does the automobile sector's contribution to Pakistan's GDP, which is ~3%. Moreover, global transition of demand from sedans to SUVs has emerged though aggregate demand of SUVs in Pakistan has remained stagnant on account of increase in prices during FY23. Volumetric sales of SUVs decreased by 25.5% (1QFY24: 4,787, 1QFY23: 6,431). Given that Auto Policy 2021-26 aims to protect localization and improve exports of local assemblers, growth in off-take of jeeps & pickups segment remains dependent on price acceptance in the market and competitive dynamics. According to market data from PAMA (Pakistan Automotive Manufacturers Association), Pak Suzuki Motor Company Limited (PSMC) remained the market leader with 40.0% market share (FY22: 39.6%) followed by Indus Motors Company (INDU) with 19.3% (FY22: 19.9%) market share and Honda Atlas Cars (Pakistan) (HCAR) with 10.3% market share (FY22: 10.4%) during in FY23. In the relevant segment (SUVs), INDU and HCAR captured 55.5% and 17.6% market share during FY23, respectively. Industry risk associated with automobile sector has remained elevated on account of interest rate fluctuation, inflationary pressure and import restrictions. However, recent relaxation regarding import restrictions, partial reduction in vehicle prices along with relaxed financing options by some automobile assemblers may help in off-loading of inventories to certain extent. Industry sales figures are as followed:

Jeeps, SUVs and Pickups Off-Take (units)	FY21	FY22	FY23
INDU	10,586	18,005	12,266
HCAR	4,015	4,255	4,056
PSMC	9,631	14,230	3,808
SAZEW	0	997	1,828

Three-Wheeler Off-Take (units)	FY21	FY22	FY23
SAZEW	15,665	15,683	9,381
Qingqi	18,813	14,007	6,639
United Auto	6,653	3,156	1,708
Road Prince	10,116	8,361	1,677

International partnerships cemented diversification of the company's product portfolio: SAZEW has international partnerships with two Chinese automobile groups - Beijing Automotive Group Company Ltd. (BAIC) and Great Wall Motor Company Ltd. (GWM). BAIC is a state-owned automobiles manufacturer established in 1958 and headquartered in Beijing, China, carrying a 'BBB+' credit rating from an international credit

rating agency. GWM is the largest SUVs manufacturer in China with a registered headquarters in Baoding, Hebei, China. With the debut of GWM's Haval brand in 2021, SAZEW moved into the passenger automotive industry. BAIC's commercial vehicle production commenced in 2021. Initially, the company imported CBU (completely built-up units) from GWM and BAIC and has recently transitioned into local assembly of the same for the purpose of automation of production assembly and fostering localization to limit supply chain constraints. Haval Jolion is the latest addition to the four-wheeler portfolio of SAZEW, launched in Aug'23, a year after the launch of Haval H6 HEV. Major international suppliers are Chinese including GWM, BAIC for Four Wheelers Kits and Parts, Chongqing D Pok Import and Export Co. Ltd. and Chongqing Zonsen Engine Manufacture Co. Ltd. for three-wheeler parts. SAZEW's major local suppliers of three-wheeler auto parts are Services Industries Limited, Panther Tyres Limited, Automotive Engineering Pvt Ltd., Projection Engineering Pvt Ltd. and Z.N.M Engineering Works. The company's product mix as follows:

Product segment	Variants
Four-Wheeler	Haval H6, Haval Jolion, BAIC Jeep
Three-Wheeler	Deluxe Mini Cab, 6-Seater, Cargo Loader, EV Rickshaw and Multi-Purpose Rickshaw
Automotive Parts	Fiat Rims, Massey Ferguson Rims

Customer name	Location	Product	Payment terms
Millat Tractors Limited	Sheikhupura	Tractor wheel rims	30 days credit
Al Ghazi Tractors Limited	D.I. Khan	Tractor wheel rims	30 days credit
General customers	All over Pakistan	Three wheelers	Advance
General customers	All over Pakistan	Four wheelers	Advance

Key Rating Drivers

Operational update: SAZEW's yearly installed capacity is 24,000 units for the four-wheelers and 20,000 units for the three-wheelers. During FY23, capacity utilization of three-wheelers decreased to 46% (FY22: 80%, FY21: 79%), while capacity utilization of four-wheelers improved to 8% (FY22: 2%, FY21: nil). Localization levels of three-wheelers and four-wheelers is ~80% and ~30%, respectively. Currently, the company has 18 dealerships for four wheelers and 50 dealerships for three wheelers. The management plans to open 5 more four-wheeler dealerships in FY24.

Asset base mainly comprises operating fixed assets, inventory and cash: Property, plant and equipment has been expanding on a timeline basis and stood at Rs. 3.1b (FY23: Rs. 2.9b; FY22: Rs. 2.6b; FY21: Rs. 1.8b) at end-1QFY24 given continuous capex over the years. Inventory levels increased to Rs. 3.7b (FY23: 1.7b; FY22: Rs. 1.7b) mainly on account of higher sales and prices. Cash and bank balances increased sizably to Rs. 2.7b (FY23: 1.0b; FY22: Rs. 173.0m) by end-FY23.

Sales have been on an increasing trend; sound margins and profitability: Sales have been primarily increasing on the back of higher demand of four wheelers especially HEV automobiles on account of escalation in fuel prices. During FY23, SAZEW raised the average price of its four-wheeler product portfolio by 46.1% while the average price of the entire product portfolio increased by 35.3%. Given high demand for Haval's newly launched automobiles, the company sold 1,828 (FY22: 997) four-wheelers during FY23.

The four-wheeler segment's net sales increased to Rs. 14.7b (FY22: Rs. 5.7b), accounting for majority of total net sales during FY23. Given decreasing disposal income and thus buying power of customers on account of economic downturn, three-wheeler segment's net sales decreased by 25.1% to Rs. 2.9b (FY22: Rs. 3.9b) during FY23. Automotive parts are only sold to tractors manufacturers; net sales of auto parts decreased by 29.7% to Rs. 530.4m (FY22: Rs. 755.0m) during FY23 given the adverse impact of floods on the demand of tractors, reducing off-take of their auto parts.

Total net sales increased by 76.7% (FY23: Rs. 18.2b, FY22: Rs. 10.3b), mainly on the back of sizable increase in the sales of four-wheeler segment. Total net sales improved further to Rs. 8.0b (1QFY23: Rs. 1.5b) during 1QFY24. As a result of higher volumetric off-take of high margin four-wheelers, gross margins improved (1QFY24: 18.8%; FY23: 14.0%, FY22: 6.6%) during FY23 and 1QFY24. As per management, growth in demand of four-wheelers is mainly due to customer preference to purchase Haval's SUVs and HEVs that are available for relatively lower prices and provide better fuel consumption compared to the competitors' automobiles.

Despite higher operating expenses and financial charges, the company recorded net profit of Rs. 995.1m (FY22: Rs. 117.8m, FY21: Rs. 75.8m) during FY23 on the back of higher sales and margins. The profitability improved further during 1QFY24 to Rs. 658.5m (1QFY23: Rs. 11.0m). The company projects net sales and bottom line of Rs. 36.0b and Rs. 2.2b respectively during FY24 on the basis of growing brand presence and advance bookings by customers.

Liquidity profile improved on a timeline basis: FFO increased significantly mainly on account of improved profitability from core operations. FFO to total debt increased to 2.5x (FY22: 0.2x; FY21: 0.1x) and improved further to 6.6x (*annualized*) during 1QFY24. Given higher FFO, debt servicing coverage ratio (DSCR) also stood comfortable at 3.1x (FY22: 1.0x, FY21: 1.2x) in FY23 and improved further in 1QFY24. Credit risk is considered somewhat mitigated due to increase in net sales on the cash basis (FY23: 97%, FY22: 93%, FY21: 82%). Current ratio improved to 1.2x (FY22: 1.0x). Cash conversion cycle remained in negative whereas trade debts as a percentage of net sales remained low. Given that liquidity indicators remained adequate during the reporting period, liquidity risk incorporated in the ratings is considered low.

Improving equity base and low gearing: The equity base enhanced on a timeline basis to Rs. 3.8b (FY23: Rs. 2.9b, FY22: Rs. 1.9b) by end-1QFY24 on account of profit retention. The company possesses only long-term debt on its balance sheet. Gearing, already low, improved further to 0.1x (FY23: 0.2x, FY22: 0.4x) owing to lower borrowings (1QFY24: 497.8m; FY23: Rs. 535.7m, FY22: Rs. 868.4m) and higher equity base. Trade payables increased to Rs. 6.3b (FY23: 3.8b; Rs. 2.5b) mainly due to higher advances from trade customers. Debt leverage, therefore increased to 2.0x (FY23: 1.6x; FY22: 1.9x) by end-1QFY24. The ratings incorporate low gearing level during the rating horizon as the company projects to meet working capital requirements through internal cash generation along with no major capex in the foreseeable future.

Corporate profile: SAZEW began as a manufacturer of household items and tractor rims in 1991. The company entered the three-wheel industry in 2004 and became a leading assembler in Pakistan and also started exporting its products in more than 25 countries. The company's major ownership has rested with Hameed family since inception. SAZEW established its name in the three-wheeler products segment before entering the SUV and HEV segment as the company, along with 20 other companies, was awarded Greenfield Status in the Automotive Development Policy (2016-21). SAZEW's management team features professionals with

extensive experience. The management team is spearheaded by Mian Asad Hameed. Mr. Saeed Iqbal Khan serves as the COO of Three-Wheeler and Automotive Parts Division while Mian Muhammad Ali Hameed has been appointed as the COO of Car Division for a period of three years with effect from March 28, 2023. The total number of permanent employees were 1,197 (Jun'22: 1,117) as of end-Jun'23.

The status and names of directors is shared below:

Status	Names of Director(s)
Independent Directors	Mr. Umair Ejaz, Mr. Taha Mahmood, Mr. Muhammad Omer Saeed
Non-Executive Directors	Mrs. Saira Asad Hameed, Mrs. Sana Suleyman, Mr. Humza Amjad Wazir
Executive Directors	Mr. Mian Asad Hameed (CEO), Mr. Saeed Iqbal Khan, Mr. Mian Muhammad Ali Hameed
Female Directors	Mrs. Saira Asad Hameed, Mrs. Sana Suleyman

Out of nine directors, seven have acquired the Directors' Training Program from SECP approved Institutions up to June 30, 2023 whereas two directors fall under the exemption criteria of Listed Companies (Code of Corporate Governance) Regulations 2019 and also obtained exemption from SECP. The Board has formed Audit Committee, HR and Remuneration Committee, Nomination Committee, and Risk Management Committee to oversee the company's operations.

Sazgar Engineering Works Limited
Annexure I

FINANCIAL SUMMARY					
<i>(PKR in millions)</i>					
BALANCE SHEET	FY21	FY22	FY23	1QFY24	FY24 (P)
Property, Plant and Equipment	1,844.8	2,640.6	2,861.5	3,057.5	3,535.4
Deferred Taxation	54.9	178.8	39.2	-	-
Stock-In-Trade	817.9	1,741.8	1,680.0	3,671.7	2,570.3
Trade Debts	116.9	179.8	270.3	380.2	304.6
Trade Deposits and ST Prepayments	1,626.0	451.0	1,359.2	510.2	421.4
Other Receivables	115.4	202.0	348.8	467.8	468.0
Cash and Bank Balances	15.0	173.0	1,028.8	2,673.7	1,417.6
Other Assets	67.3	89.0	97.4	127.5	103.9
Total Assets	4,658.2	5,656.1	7,685.1	10,888.6	8,821.4
Long-Term Borrowing (inc. current portion)	429.5	705.5	535.7	497.8	344.9
Short-Term Borrowing	119.7	162.9	-	-	-
Total Borrowing	549.2	868.4	535.7	497.8	344.9
Deferred Liabilities	250.7	299.2	399.7	427.9	730.9
Trade Payables	2,008.2	2,498.3	3,809.9	6,361.9	2,917.3
Other Liabilities	10.4	36.2	24.8	27.4	-
Total Liabilities	2,818.5	3,702.1	4,770.1	7,315.1	3,993.1
Paid Up Capital	465.0	604.5	604.5	604.5	604.5
Total Equity	1,839.8	1,954.0	2,915.1	3,573.6	4,828.3
INCOME STATEMENT					
	FY21	FY22	FY23	1QFY24	FY24 (P)
Net Sales	4,033.6	10,048.1	18,174.3	8,044.3	35,965.3
Gross Profit	366.7	666.8	2,549.5	1,510.6	5,235.8
Operating Expenses	258.7	367.9	930.6	445.3	1,665.3
Other Income	17.6	18.4	30.4	79.6	164.0
Finance Cost	21.2	53.9	167.8	35.6	104.4
Profit Before Tax	104.5	263.5	1,481.5	1,109.4	3,630.1
Profit After Tax	75.8	117.9	995.1	658.5	2,155.1
RATIO ANALYSIS					
	FY21	FY22	FY23	1QFY24	FY24 (P)
Gross Margin	9.1%	6.6%	14.0%	18.8%	14.6%
Net Margin	1.9%	1.2%	5.5%	8.2%	6.0%
ROAA	2.0%	2.3%	14.9%	28.4%*	26.2%
ROAE	4.2%	6.2%	40.9%	81.2%*	55.7%
Current Ratio (x)	1.2	1.0	1.2	1.2	1.7
FFO	73.0	188.0	1,297.4	829.2	1,695.5
FFO to Total Debt (x)	0.1	0.2	2.5	6.6*	4.9
FFO to Long Term Debt (x)	0.2	0.3	2.5	6.6*	4.9
Debt Servicing Coverage Ratio (x)	0.1	1.1	3.1	4.1*	5.7
Net Working Capital	453.1	(83.4)	739.2	1,218.4	2,131.1
Cash Conversion Cycle (days)	(108)	(23)	(44)	(33)	(21)
Trade debts/Sales	2.9%	1.8%	1.5%	1.2%*	0.8%
Gearing (x)	0.3	0.4	0.2	0.1	0.1
Leverage (x)	1.5	1.9	1.6	2.0	0.8

*Annualized

REGULATORY DISCLOSURES		Appendix II			
Name of Rated Entity	Sazgar Engineering Works Limited				
Sector	Automotive Assemblers				
Type of Relationship	Solicited				
Purpose of Rating	Entity Ratings				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	RATING TYPE: ENTITY				
	25-01-2024	A	A-2	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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Due Diligence Meetings Conducted	Name	Designation	Date		
	Mr. Muhammad Atif Rao	Chief Financial Officer	November 24, 2023		
	Mr. Muhammad Usman	Senior Manager Finance			