RATING REPORT

Indus Motor Company Limited

REPORT DATE:
June 19, 2019

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	AA+	A-1+
Rating Outlook	Stable	
Rating Date		

COMPANY INFORMATION	
Incorporated in 1989	**External auditors:** A.F Ferguson & Co.
	Chairman of the Board: Ali S. Habib
	Chief Executive Officer: Ali Asghar Jamali

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (May, 2016) http://www.vis.com.pk/kc-meth.aspx

Indus Motor Company Limited

OVERVIEW OF THE INSTITUTION

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 Chairman

Ali S. Habib is the Chairman of Indus Motor Company Limited and is also the Founding Director of the Company. He also serves as a Member on the Board of Directors of Thal Limited, Shabbir Tiles & Ceramics Limited and Habib Metropolitan Bank Limited. He is a graduate in Mechanical Engineering from the University of Minnesota, USA. He has attended the PMD Program at Harvard University

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

RATING RATIONALE

Corporate Profile

Indus Motor Company Limited (IMC) was formed in 1989 as a public limited company in accordance with a Joint Venture agreement between Toyota Motor Corporation, Toyota Tsusho Corporation and House of Habib (Hoh). IMC acts as a sole manufacturer, assembler and distributor of Toyota and Daihatsu vehicles in Pakistan.

Product Portfolio

The company has 2 operating divisions known as manufacturing and trading. The former includes assembling completely knocked down (CKD) units. Trading segment includes sale of completely built up (CBU) units of imported Toyota vehicles. Main product offerings of IMC in the manufacturing segment include "Corolla", "Hilux" and "Fortuner" while key product portfolio in the trading segment includes "Camry", "Prius" and "Land Cruiser". Within the product classification, IMC has around 15 different variants based on engine capacity and transmission type (Corolla: 6; Hilux: 7; Fortuner: 2). Further diversification in product portfolio and strengthening presence in existing segments is planned over the rating horizon.

Segments	CKD	CBU
Passenger Car	Corolla	Camry/Prius
Light Commercial Vehicle (LCV)	Hilux	-
Sports Utility Vehicle (SUV)	Fortuner	Land cruiser/Rush

Production

The company has increased its production of vehicles per day since it commenced operations on a timeline basis on account of efficient production methodologies adopted. Over the years, IMC has achieved continuous process improvements by adopting a lean production process and "Kaizen" concepts (continuous improvement). The company follows "Just In Time" production process to avoid excess inventory.

The company had an installed capacity of 54,800 units/annum based on a double shift basis at end-FY18. However successful completion of debottlenecking of the paint shop has further increased the company's capacity. IMC has been operating at over full capacity for the last 4 years (FY18: 114.7%; FY17: 109.39%; FY16: 116.96%; FY15: 103.81%).

Industry Structure

Passenger car segment of the industry includes hatchbacks, sedans, 4x4s (SUVs) and LCVs. More than four-fifth of the segment is represented by hatchback and sedan vehicles in terms of units. The industry is currently concentrated with only 3 players having local assembling operations. Passenger car sales have grown at a 5 year Compounded Annual Growth Rate (CAGR) of 14% from FY13 to FY18. The average capacity utilization for the industry has jumped from 52% in FY13 to 101% in FY18 on account of strong growth in demand for vehicles. The total installed capacity of existing local assemblers stood at 254,800 units at end-FY18 which is expected to further increase on the back of planned capacity enhancement by existing players.

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.

Annual Sales (Units)						
Company	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**
HCAR	18,915	23,310	23,311	25,800	39,163	50,100
PSMC	77,050	78,005	133,952	110,000	132,548	140,313
INDU	38,517	34,470	57,387	64,584	59,911	64,000
Total	**134,482**	**135,785**	**214,650**	**200,384**	**231,622**	**254,413**

With the finalization of Auto Development Policy (2016-21), a number of new players (KIA/Hyundai/Renault/Master) are extending their footprint in Pakistan based on the incentives being offered. Resultantly, overall production capacity of cars (vans/jeeps/pickups/LCVs) is expected to increase by over 150,000 units.

In terms of market share, Pak Suzuki Motor Company (PSMC) has been the predominant player in passenger car segment due to higher penetration in small car division (hatchbacks and sedans). IMC ranks next to PSMC followed by Honda Atlas Cars Pakistan (HCAR) in terms of volumetric market share.

Overall Market Shares						
Company	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**
HCAR	15.70%	17.50%	13.16%	11.83%	18.38%	19.91%
PSMC	56.18%	57.37%	55.10%	58.75%	53.51%	55.71%
INDU	28.05%	25.13%	31.73%	29.42%	28.11%	24.38%

Rating Drivers

Strong Sponsor Profile

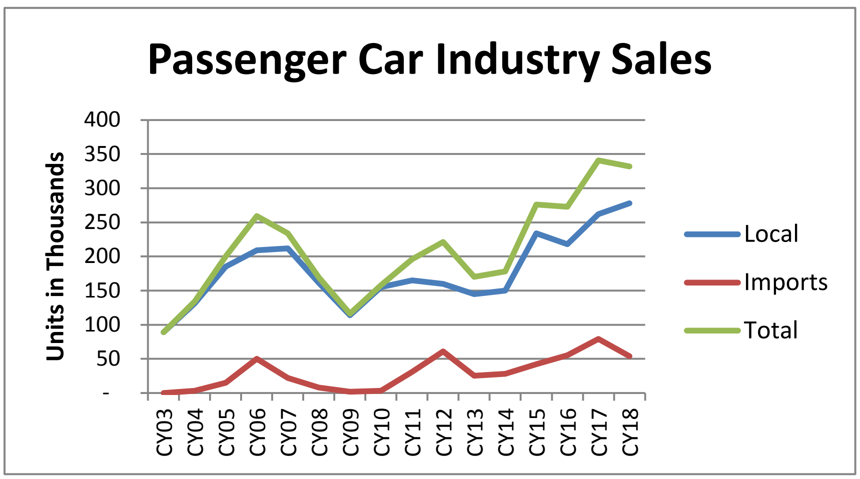
The assigned ratings incorporate strong financial profile of Sponsors. Toyota Motor Corporation is the leading automobile manufacturer in the World with presence in 25 countries. The company was ranked number 6 in Fortune Global 500 list in 2018 and had sold 8.9m units globally. Standard & Poor's (S&P) has assigned a rating of AA- to the company while Moody's reaffirmed the rating at Aa3 in March'2019. Toyota Motor Corporation's credit rating is the highest amongst global carmakers reflecting its strong financial and business risk profile.

Business risk profile is considered sound given solid franchise and strong competitive position in the product segment that the company operates. Strong dealer network and declining trend in imported car sales support business risk profile. Efforts to reduce exposure to currency fluctuation through increasing localization have limited margin attrition vis-à-vis historical levels. Some cyclicality in sales due to slow down in GDP growth and frequent policy changes are key business risk factors.

Market Position & franchise: IMC's solid franchise and strong market position in the product segment that the Company operates is a key rating driver. The Company continues to maintain over 50% market share in the 1.3L, 1.6L & 1.8L segment. Solid franchise is reflected by high brand strength that the Company enjoys and strong resale value of the Company's cars.

Segment-Wise Market Share	FY16	FY17	FY18	1HFY19
Corolla 1.3L	68%	70%	59%	58%
Corolla 1.6L &1.8L	72%	41%	48%	54%
Fortuner	15%	28%	53%	29%
Hilux	85%	89%	78%	72%

Demand dynamics and auto industry cyclicality: Historically, auto sales have depicted some cyclicality with volumes varying with economic growth, policy changes and availability of auto financing. However, long-term demand outlook for automobile sales is considered favorable given low motorization rate and projected rise in per capita income. Demand for passenger cars (including imports) after witnessing significant growth during CY15-CY17, declined slightly on a timeline basis in CY18. While slow-down in GDP and auto financing growth will be a constraint, passenger car sales volumes (excluding imports) in CY19 are expected to get some support from removal of ban on non-filers and launch of new models. Over the long-term, local passenger car sales are projected to grow at a CAGR of 10.29% over the next 7 years with entry of new players and enhanced product offering by existing players being key drivers.



Localization & pricing power: Exposure to rupee devaluation is a drag on profitability of local automobile manufacturers. However, IMC over the years has significantly increased the localization level in the vehicles manufactured thereby reducing exposure to rupee depreciation risk. The Company has exposure against a basket of currencies. In the backdrop of rise in input prices, IMC has demonstrated satisfactory pricing power where prices have increased by over 20% since Novemeber'2017 without impacting volumes. Business risk profile draws support from clientele of IMC which tends to be relatively less sensitive to price changes vis-à-vis smaller segment.

Competition from new entrants: Entry of new players is expected to intensify competitive pressures in the auto industry. Higher penetration of the new players is expected to be largely in the hatchback, light engine capacity sedans and SUVs/Crossovers segment. VIS expects low impact of entry of new auto assemblers on IMC's business risk profile given limited similar vehicles expected to be introduced (in terms of engine capacity) over the rating horizon to compete against IMC's flagship product i.e.; Corolla. While incentives offered to new entrants are significant, IMC's high localization levels, existing dealer network and strong balance sheet are expected to be a source of competitive advantage.

Competition from imports: Volume of imported cars had increased at a CAGR of 41.6% during the 3 year period (CY14-CY17). However, with increase in duties the same declined in CY18. With the introduction of SRO No. 52(I)/2019, quantum of imports has witnessed a noticeable dip in recent months. Given the strong long-term demand, local assemblers are expected to be key beneficiaries of dip in imports.

Dealer Network: IMC has a wide-spread dealer network across the country which has made vehicle purchase, after sales service and spare part availability convenient for its customers. The company plans to continue to aggressively expand its dealership network across the country.

Policy uncertainty: Significant changes in policies (policy on imported cars, non-filer ban, FED of 10% on 1700cc and above cars) over the years have been a source of uncertainty for passenger car sales. Policy changes in future will also be a key determinant of overall industry volumes.

Assessment of financial profile incorporates IMC's strong leverage free balance sheet, robust profitability and abundant liquidity, elements that provide the company with financial flexibility and support its rating.

Revenues: Net sales of IMC have grown at a 5 year (FY13-FY18) CAGR of 17% while net sales increased by 21% during 1HFY19. Since FY15 the company has been operating at full capacity on a double shift basis which has restricted potential volumetric growth. However, the increasing share of higher priced models and intermittent price hikes have been key growth drivers from FY15 onwards. Customer base of the Company comprises a mix of rural and urban customers while a sizeable chunk of high end light commercial vehicle sales is to the armed forces and other law enforcement agencies.

With an increase in capacity post debottlenecking of paint shop and focus on general customer orders, IMC has managed to grow volumes during 9MFY18 in contrast to industry peers who have witnessed a decline in passenger car sales. Diversification in product portfolio, as has been the case in the past, will continue to support sales, going forward.

Units Sold	9MFY18	9MFY19	% Change
PSMC	107,294	99,569	-7%
IMC	46,427	49,566	7%
HCAR	39,013	35,888	-8%

Margins and Profitability: Gross margins of IMC have historically compared favorably to other passenger car manufacturers. While margins have witnessed some pressure in the ongoing year (1HFY19: 13%; FY18: 17%; FY17: 18%; FY16: 16%) due to significant rupee depreciation and rise in input prices (particularly steel prices), impact on margins is relatively lower vis-à-vis other peers. Despite decline in margins, dip in overall profitability (Profit after tax declined by around 6% during 1HFY19) was limited due to IMC's ability to manage and control costs (which remains a key focus area) and sizeable treasury income (emanating from company's holding of sizeable marketable securities portfolio). Despite the dip in customer advances, overall treasury income will continue to remain sizeable due to higher benchmark rates.

Gross Margins	1HFY18	1HFY19
IMC	17.6%	13.0%
Honda	11.2%	7.0%
PSMC	8.8%	4.7%

Profit After Tax (Rs. In millions)	1HFY18	1HFY19	% Change
IMC	7,364	6,914	-6%
Honda	3,034	1,632	-46%
PSMC	1,833	1	-100%

Liquidity: Liquidity profile is strong given the Company's robust cash flows, favorable working capital cycle and sizeable holding of cash and liquid investment portfolio. Short-term investment carried on balance sheet represented over half of total asset base at end-1HFY19. Given the increase in production and slow-down in demand, customer advances have witnessed a noticeable decline. Even after adjusting for customer advances, liquidity buffer remains sizeable and will allow the Company to undertake planned capital expenditure from internal sources as has been the case in the past. Given that sales are primarily undertaken on cash, trade debts carried on balance sheet are minimal.

Capitalization: Equity base of IMC has consistently grown over the years on account of healthy internal capital generation. The Company has maintained a consistent dividend payout history over the last few years (FY18: 70%; FY17: 69.52%; FY16: 68.62%). Assessment of capitalization draws support from no plans to undertake debt over the rating horizon.

Overall corporate governance framework is supported by strong financial planning process and sound internal control systems in place. Detailed disclosures in annual report and regular analyst briefings reflect focus on transparency and disclosures.

Overall board oversight is considered strong with discussion during board minutes revolving around future, review of financial performance and internal controls. Board composition is planned to be aligned with regulatory requirement and best practice within regulatory timeframe. Board of directors and senior management team comprises individuals with extensive experience. Moreover, strong focus on training of work force has been noted. IMC has the latest version of SAP (SAP HANA) installed for its IT related needs with all relevant modules being integrated. Regular review of all internal controls is also being undertaken by Toyota Motor Corporation.

Indus Motor Company Limited **Appendix I**

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	30-Jun-16	30-Jun-17	30-Jun-18	31-Dec-18
Non-Current Assets	10,156	6,438	7,382	10,003
Stock-in-Trade	7,785	9,318	11,150	12,391
Trade Debts	1,132	759	1,453	2,121
Short Term Loans & Advances	1,125	1,653	3,714	3,381
Cash & Short Term Investments	36,434	44,709	57,231	35,252
Other Assets	904	1,003	1,062	2,483
Total Assets	57,536	63,880	81,992	65,631
Trade and Other Payables	10,035	9,683	15,731	13,921
Short Term Borrowings	-	-	-	-
Long Term Finances - Secured	-	-	-	-
Total Interest Bearing Debt	-	-	-	-
Advances From Customers	19,127	22,189	27,491	13,828
Other Liabilities	745	807	1,937	283
Total Liabilities	29,907	32,679	45,159	28,032
Total Equity	27,630	31,197	36,744	37,564
INCOME STATEMENT	30-Jun-16	30-Jun-17	30-Jun-18	31-Dec-18
Net Sales	108,759	112,272	140,207	76,466
Cost of Sales	91,027	92,450	115,830	66,389
Gross Profit	17,731	19,822	24,377	10,057
Distribution Expenses	1,061	1,228	1,283	596
Administrative Expenses	931	1,053	1,523	662
Other Income	3,164	3,593	3,900	2,098
Finance Cost	77	398	572	28
Profit before Tax	17,397	19,141	23,002	10,040
Taxation	5,943	6,140	7,227	3,126
Profit After Tax	11,455	13,001	15,775	6,914
RATIO ANALYSIS	30-Jun-16	30-Jun-17	30-Jun-18	31-Dec-18
Gross Margin (%)	16%	18%	17%	13%
PBT Margin (%)	16%	16%	17%	16%

Net Margin (%)	11%	12%	11%	9%
Current Ratio (x)	1.58	1.76	1.65	1.98
Net Working Capital	17,473	24,763	29,381	27,597
Working Capital Cycle	(7.94)	(2.09)	(4.91)	(8.27)
Gearing (x)	-	-	-	-
Debt Leverage (x)	1.08	1.05	1.23	0.75
FFO	9,865	11,994	15,682	8,340
FFO to Total Debt (%)	-	-	-	-
FFO/Long Term Debt	-	-	-	-
Debt Servicing Coverage Ratio (x)	-	-	-	-
ROAA (%)*	21%	21%	22%	19%
ROAE (%)*	44%	44%	46%	37%

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	
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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Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
17-06-2019	AA+	A-1+	Stable	Initial