RATING REPORT

Procon Engineering (Pvt.) Limited

REPORT DATE:
August 30, 2019

RATING ANALYST:
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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-2	A	A-2
Rating Outlook	Stable		Stable	
Rating Date	*August 27, 2019*		*April 6, 2018*	

COMPANY INFORMATION	
Incorporated in 1988	**External auditors:** Kreston Hyder Bhimji & Co. Chartered Accountants
Private Limited Company	**Chairman of the Board:** Mr. Nadeem Malik
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Nadeem Malik
Mr. Nadeem Malik – 33.3%	
M/s N.M Holding (Pvt.) Ltd. – 33.3%	
M/s Najeeb Holding (Pvt.) Ltd. - 33.3%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (May 2016)*
http://www.vis.com.pk/docs/Corporate-Methodology-201605.pdf

Procon Engineering (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Procon Engineering Private Limited (PEPL) was incorporated on 13th October, 1988 as a private limited company. The company is engaged in manufacturing of automotive parts and components. PEPL has three production plants; two are located in Karachi while the other is in Lahore. External audit of the company for FY18 was conducted by Kreston Hyder Bhimji & Co. Chartered Accountants.

Profile of Chairman & CEO:

Mr. Nadeem Malik is a seasoned businessman with extensive experience in the automobile and foam products industry. Mr. Nadeem has been associated with Master group for the past three decades and is currently serving as Chairman of various associate companies. He holds a Bachelor's degree in Business Administration from the University of Southern California.

RATING RATIONALE

Procon Engineering Private Limited (PEPL) is primarily engaged in manufacturing of automobile seats for passenger and commercial vehicles along with auto parts including cargo deck, chassis frame, and sheet metal/body parts. During the outgoing year, PEPL incorporated a subsidiary company – Master Auto Engineering (SMC-Pvt.) (MAE) Limited by subscribing its shares.

Key Rating Drivers:

Sound sponsor profile

PEPL is a part of 'Master Group of Industries', which has diversified presence across various business sectors including vertically integrated textile unit, foam and spring mattresses, engineering and automobile sectors. The sponsor depicted financial support for PEPL through injection of interest free loan long term loan in FY18. Going forward, VIS expects technical and financial support from the sponsor to continue in case a need arises.

Competitive market position

The assigned ratings incorporate prominent position of the company in car seats manufacturing as it contributes more than 60% of the total industry car seat sales. The company is the sole supplier of seats to Honda Atlas Cars (HAC) and has a sizeable market share in seat supplies to other two major market players namely Indus Motors Company (IMC) and Pak Suzuki (PS). Moreover, the company also generates significant revenue from sheet metal products. Due to oligopolistic nature of the industry, concentration is witnessed in the company's sales. However, the concentration risk is partly mitigated on account of long term relationships with clients. Furthermore, the management has also established relationship with some new market players and is in negotiations with others, which is expected to reduce client wise concentration as well as support business volumes over long term. Moreover, management expects additional orders from an associate company which has started production of automobiles. Impact, if any, due to competition from existing and new competitors will be an important rating consideration.

Strong Strategic Alliances & Inventory Management practices

PEPL has technical collaborations with Japanese and Thai brands, namely TS Tech and TCH Suminoe for assistance in operations and maintenance of quality; assistance is in the form of process streamlining along with strategic recommendations. The company implements the philosophy of 'Just-In-Time' delivery and maintains minimum level of finished goods inventory, resulting in increased operational efficiency.

Challenging business risk profile in view of the weak macroeconomic indicators may affect the demand for automobiles; however, the management's focus on diversification is expected to reduce the impact of weak demand

Sizeable PKR devaluation, weak GDP growth outlook, rising interest rates, and the decision by the automobile manufacturers to increase prices may have unfavorable impact on the demand for automobiles going forward. With slowdown in sales of automobile companies, demand for seats manufactured by PELP may also be affected. However, with recent expansion in the capacity of sheet metal products, and MoUs signed with foreign partners to determine feasibility of manufacturing other automobile parts, the management is aiming product wise diversification in order to support the financial profile of the company.

Growth in topline has translated into improvement in profitability on timeline basis; profitability is expected to remain in line with projections going forward

Topline of the company registered healthy growth in FY18 on account of volumetric increase in sales due to higher demand and higher prices due to pass through of increase in raw material prices. Gross margins remained at approximately similar level in FY18 in comparison to the preceding year. Finance cost witnessed considerable increase on account of higher utilization of debt, especially short term borrowings, and exchange loss on translation of foreign currency loan. Higher finance costs coupled with higher administrative and distribution costs on account of higher business resulted in lower net profit margins. Overall quantum of net profit was reported higher vis-à-vis the preceding year as share of profit from associate companies more than doubled during the outgoing year.

Gross and Net margins witnessed improvement in HY19 on account of improved product mix and efficient procurement of raw material. As per management, overall profitability of the company is expected to remain in line with projections as product wise diversification is expected to compensate for any decrease in demand of seats.

Capitalization indicators have depicted improvement on account of profit retention and capital injection in the form of long term loan

Equity base of the company has increased on timeline basis primarily on account of profit retention, while contribution of additional interest free loan from directors repayable at the discretion of the company also aided growth in the equity base. Total debt was also reported higher on timeline basis primarily due to increase in short term borrowings. Utilization of short term borrowings increased on account of increasing working capital requirements due to currency devaluation. Resultantly, gearing and leverage ratios increased to 1.5x (FY18: 1.2x; FY17: 0.8x) and 2.1x (FY18: 1.8x; FY17: 1.5x) respectively at end-HY19. Going forward, no significant increase in borrowings is planned in view of the Capex requirements. Sustaining leverage indicators in line with projections is considered to be a key determinant of ratings.

Liquidity profile of the company remains adequate

In line with increase in profitability, Funds from Operations (FFO) have grown on timeline basis. However, FFO in relation to total debt declined to 15.6% (FY17: 24.2%) at end-FY18 on account of growth in quantum of total debt. Current ratio has depicted improvement on the back of increase in stock in trade, trade debts and short-term advances. Stock in trade and trade debts provide adequate coverage for short term borrowings. Going forward, maintenance of liquidity indicators is considered important from rating perspective.

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: 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 DISCLOSURE	Appendix III
Name of Rated Entity	Procon Engineering (Pvt) Limited
Sector	Automobiles
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				
27-Aug-19	A	A-2	Stable	Reaffirmed
09-Apr-18	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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