RATING REPORT

Procon Engineering (Pvt.) Limited

REPORT DATE:

October 21, 2021

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		Rating Watch-Negative	
Rating Date	October 21, 2021		May 21, 2020	

COMPANY INFORMATION	
Incorporated in 1988	**External auditors:** Kreston Hyder Bhimji & Co. Chartered Accountants
Private Limited Company	**Chairman:** Mr. Nadeem Malik
Key Shareholders (with stake 5% or more):	**CEO:** 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 (August 2021)* https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

OVERVIEW OF THE INSTITUTION	RATING RATIONALE
Procon Engineering (Pvt.) Limited was incorporated on 13th October, 1988 as a private limited company. The company is engaged in manufacturing of automotive parts and components. **Profile of Chairman and 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 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.	Procon Engineering (Pvt.) Limited (PEPL) is engaged in manufacturing of automotive seats for passenger and commercial vehicles, along with auto parts including cargo deck, chassis frame, and sheet metal/body parts. PEPL is part of Master Group which has diversified presence across various business sectors ranging from mattresses, textile, automobiles and energy sectors. PEPL has three production plants; two are located in Karachi while the other is in Lahore The company has also invested in its subsidiary – Master Auto Engineering (Pvt) Ltd (MAE) and associated company Master Wind Energy Ltd., representing about 9.3% of total assets. **<u>Key Rating Drivers:</u>** **Business risk profile of auto parts manufacturers is supported by sound demand outlook within auto sales on the back of measures highlighted under the Auto Policy (2022-2026).** Pakistan's auto sector has witnessed impressive growth during FY21, with car and tractor sales registering growth of 90% on the back of pick-up in economic activity post ease in COVID-19 induced lockdown and accommodative financing rates. Thereby, PEPL has reaped benefit from the rise in auto sales with upbeat demand for its automotive passenger seats and auto parts. Moreover, Government of Pakistan in its Federal Budget FY22 has announced reduction in FED on vehicles across the board and sales tax reduction for below 1,000 cc cars resulting in a decline in car prices and higher sales volumes in the ongoing year. The government through it Auto Policy (2022-2026) envisions to expand Auto industry of Pakistan and increase the affordability of cars specially in the small category segment through reduction in FED, sales tax and custom duty and offering reduced financing rates for the first time car owners. The Auto Policy has also provided incentives on improving share of energy efficient and environment friendly electric and hybrid cars. The positives outlined in the Auto Policy bodes well with the business risk profile of the company as PEPL is the leading supplier of car seats to some of the major auto players in the market and has notable clients within the tractor segment as well. However, exchange rate risk, cyclicality in auto sales due to slow down in GDP growth and political uncertainty remains key business risk factors. **Sponsor profile along with strong competitive market position provides comfort** Assigned ratings incorporate sponsor support of Master group, a well-diversified conglomerate. Sponsor has from time to time exhibited support through extension of interest free loans repayable at the discretion of the company. Ratings also take into account strong market position of the company build over time; PEPL remains the sole supplier of seats to Honda Atlas Cars and fulfills around two-fourth of the supply of automotive items to two other major market players in auto industry. While this also exposes the company to concentration risk, the longtime association with these customers provides comfort. **Diversification and expansion plans underway** In 2020, in an attempt to diversify the revenue streams, the company established a foaming and synthetic division. Product line includes non-woven fabric, foam seats, foam and spring mattresses, sheets and finished foam. The synthetic division is producing a fabric used in the making of pampers, face masks, and some agricultural activities as well as safety gowns used in health care. Foaming & Synthetic division accounted for ~26% of sales in 2021. Capex in FY20 and FY21 related mostly to establishing foaming and synthetic division

and up gradation of machinery for auto parts. The company's total planned capex amounts to Rs. 2.9b, all debt financed namely through Temporary Economic Refinance Facility (TERF) loan facility. Company has drawn Rs. 1b by the end of FY21. Going forward, the company is in the process of expanding capacity at Port Qasim for the addition of new auto parts to the portfolio. Also, the company, through its subsidiary-MAE, has acquired land in Faisalabad where construction work is in progress for the manufacturing of auto parts in a bid to cater to a major client (Atlas Honda) located in vicinity and thereby save substantial amount of transportation expense. Fresh investment on plant and machinery is also being made to in-house the production of roof headlining fabric which PEPL currently supplies to its clients through imports.

Strong recovery observed in the topline of the company along with improvement in the gross margins during FY21. Also, diversification into foaming and synthetic division enhanced the topline of the company.

Topline of the company has witnessed a strong recovery in the outgoing fiscal year post pandemic led decline (FY21: Rs. 13.7b; FY20: Rs. 7.2b; FY19: Rs. 12b). The year on year uptick of 90% in sales was mainly attributable to the volumetric growth along with higher average selling prices. With top six clients constituting 69% of the total revenue, client wise concentration in sales continues to remain high. Nevertheless, the same is partly mitigated by long term association with these customers. The company is projecting strong orders in hands with the addition of new clients and growing auto sales. Based on projected order pipeline, the management is anticipating net revenue to grow further in FY22.

Gross margins of the company inched up at 11.7% (FY20: 10.7%) during FY21 due to increase in prices of the products on the back of favorable demand of vehicles. Growth in topline coupled with higher gross margin and sizable reduction in finance cost due to lower interest rate regime drastically enhanced the profitability of the company to Rs. 779.0m (FY20: Rs. 66.4m) during FY21. PEPL bottom line continues to be supported through recognition of share of profit from associates of Rs. 125m (FY20: Rs. 229.5m) under the equity method, although the same has no cash flow impact. Dividend income from investments however increased in FY21 to Rs. 60.5m (FY20: Rs. 37.5m). Going forward, future profitability is contingent upon the projected growth in volumetric sales.

Capitalization indicators are expected to remain at manageable levels over the rating horizon despite debt drawdown to finance capital expenditure

Equity base of the company has grown to Rs. 4.0b (FY20: Rs. 3.1b; FY19: Rs. 2.9b) on account of profit retention. Long term debt was reported higher at Rs. 1.9b (FY20: Rs. 383m) at end-FY21 due to utilization of Rs. 378m SBP refinance salary support scheme, Rs. 701m of ITERF facility and Rs. 355m of TERF facility. Going forward, management will draw additional long term debt amounting to ~Rs.1.9b to finance capital expenditure. Short term borrowings have been mobilized for working capital requirements and stood at Rs. 3.6b at end-FY21. At end-FY21, gearing and leverage ratios stood at 1.38x (FY20: 1.02x; FY19: 0.96x) and 1.72x (FY20: 1.41x; FY19: 1.31x), respectively. The company has issued corporate guarantee to one of its related party amounting to Rs. 2.2b, accounting for the same results in adjusted leverage of 2.28x. Given higher projected profitability, leverage indicators are expected to remain manageable over the rating horizon.

Liquidity profile is satisfactory

Funds flow from Operations (FFO) has varied in line with the profitability of the company. FFO was reported higher at 655.0m (FY20: 92.3m) in FY21. Resultantly, Debt Service Coverage Ratio (DSCR) stood strong at 5.1x (FY20: 0.91x) during FY21. Inventory levels stood higher at Rs. 3.8b (FY20: Rs. 2.7b) during FY21 in a bid to avoid any shipment delays due to COVID-19 situation and to avert local currency devaluation risk. Current ratio remains well above 1x on a timeline basis. Stock in trade and trade debts stood at 1.48x at end-June'21 are well in excess of short term borrowings

Governance and control framework depicts room for improvement

Overall, Governance and control framework depicts room for improvement. Auditors have expressed qualified opinion on the financial statements on account of recognition of unfunded gratuity scheme Management is working to amend the same in the ongoing year.

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 II
Name of Rated Entity	Procon Engineering (Pvt.) Ltd
Sector	Auto Parts
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		
21-Oct-2021	A	A-2	Stable	Maintained
21-May-2020	A	A-2	Rating Watch-Negative	Maintained
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.

Due Diligence Meetings Conducted

S.No	Names	Designation	Date
1	Mr. Naveed Qamar	Chief Financial Officer	September 14, 2021
2	Mr. Atif Rehman	Finance Manager	September 14, 2021