RATING REPORT

Automobile Corporation of Pakistan

REPORT DATE:
July 25, 2019

RATING ANALYST:

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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	BBB	A-2
Rating Outlook	Stable	
Rating Date	*25th July 2019*	

COMPANY INFORMATION	
Incorporated in 1968	**External auditors:** Ibrahim Shaikh and Co. Chartered Accountants
Private Limited Company	**Chairman and CEO:** Mr. Khayam Husain
Key Shareholders (with stake 5% or more):	
Mr. Khayam Husain- 75% *Mrs. Nighat Husain- 7%* *Mrs. Aamana Husain- 9%* *Mr. Omar Khayam- 9%*	

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

Automobile Corporation of Pakistan

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

OVERVIEW OF THE INSTITUTION

Automobile Corporation of Pakistan was incorporated in 1968 as a Private Limited Company under the Companies Ordinance, 1984. Principal activities of the company include fabrication, designing, repairing and servicing of trailers, tankers and other heavy vehicles.

Financial Statements of the company for FY18 were audited by Ibrahim Shaikh and Co. Chartered Accountants. Auditors belong to category 'C' on the approved list of auditors published by the State Bank of Pakistan (SBP).

RATING RATIONALE

Automobile Corporation of Pakistan (AUTOCOM) is a family owned business with around three fourth of the shareholding resting with Mr. Khayam Hussain. Remaining ownership is vested with other family members. Principal activities of the company include fabrication, designing, repairing and servicing of trailers, tankers and other heavy vehicles through two facilities at West Wharf and Port Qasim. The company commenced operations in 1970s with the import of Cometto trailers as CBUs and catered largely to Government and Military segment. After developing necessary expertise, the company then started manufacturing UNADR compliant petroleum tanks for Shell Pakistan in 1998. Currently, the product line of the company comprises petroleum tanks, trailers and other specialized vehicles (refuelers, garbage compactors, and municipal vehicles).

Given growing demand to manufacture tankers as per OGRA standards, AUTOCOM installed an automated assembly line for oil tankers at Port Qasim of 60 units per month in 2017. Post expansion, AUTOCOM has the largest manufacturing facility of 80 units per month in comparison with other formal competitors. Consolidated capacity of four other players is estimated at 40-50 units per month. With higher demand, capacity utilization of the plant was reported on the higher side at 77% (FY17: 59%) during FY18. Competitive advantage stems from long term association with foreign technology partner- Industrie Cometto of Italy, ISO 9001 certification, strength of a multi-disciplinary engineering team, a 24/7 after sales service and strict in-house engineering quality control.

Associated companies of AUTOCOM include Wood and Caves (Pvt) Limited, FAW Pakistan (Pvt) Limited and Automobile Engineering Corporation (Pvt) Limited (AECL). The former two companies are inactive; however AECL is responsible for the management of after sales service for AUTOCOM clients. Moreover, the company holds long term investment in Lucky Cement Limited, market value of which is Rs. 7.2m (FY17: Rs. 12m) at end-FY18. Market risk on the investment exposure is considered to be on the higher side given declining equity index and weak economic indicators of the country.

Key Rating Drivers:

Business Risk Profile

The trucking industry comprises large number of informal and un-organized players yielding high competition. These informal players dominate the overall trailer and tanker market. To formalize the industry, the Government of Pakistan introduced Trucking Policy in 2008 which laid incentives for trailer manufacturers in order to encourage the use of modern prime movers/multi-axle, Euro standard trucks. Under the policy, the GoP rationalized tariff structure on heavy vehicles. For enhanced use of long haulage, duty of prime movers of HP>280 was cut down to 15% on CBUs from 30% and to 0% from 10% on CKDs. Furthermore, given increasing trend in containerized traffic, duty on CBU trailers was brought down to 15% from 60% while on CKD, 5% duty was imposed. Moreover, to encourage the local trailer manufacturing, sales tax exemption was allowed to bring them at par with the Trucks and Prime movers. In light of the aforementioned incentives, demand for trailer and tanker manufacturers has witnessed an increasing trend. In light of weak macroeconomic environment and slowdown in oil sector, VIS expects a slight demand risk to remain; however, given increased Government's focus on shift towards standardized tankers and trailers, replacement demand is anticipated. Business risk profile of the company is considered moderate given strong market presence and competitive edge against other formal and informal players.

Sales and Profitability

Topline of the company has grown at a CAGR of 29% over the last three years (FY15-FY18). Sales revenue reported a double digit increase of 46% during FY18 to Rs. 1.5b (FY17: Rs. 1b) being a function of higher volumetric growth in sales. Product mix demonstrates that more than one half (on the basis of volumes) of the sales is generated through oil tankers. Proportion of oil tanker, trailers and specialized vehicle sales in total sales mix was recorded at 68% (FY17: 71%), 19% (FY17: 8%), and 12% (FY17: 21%), respectively during FY18. Sales of the company are directed in the local market with major customers comprising OMCs (Hascol, Shell, Total Parco, PSO, and Puma) and Logistic companies (J Holding, Rasch Private Limited, and Asif Jadoon). The company follows a Made to Order business model with around three month orders in hand at all times. The management projects greater demand potential to emanate from chemical and jet fuel segments. Diversification in product line is expected in view of planned introduction of refrigerated cargo assembly line, tippers, and aluminum fabrication.

Around two fifth of the raw material procurement comprises imported components such as axles, suspensions, pumps and cranes with the remaining comprising local components. Given growing sales revenue and higher localization rate, average gross margins (GMs) of the company over the past four years (FY15-FY18) was reported at 19.2%. Given stable margins and an upward trend in topline, net profit of the company grew at a CAGR of 32% over the last three years (FY15-FY18). Going forward, future profitability is contingent upon the projected growth in volumetric sales. However, risk of currency devaluation impacting profitability remains given strong competitive environment.

Liquidity

With improving earning profile and strong debt servicing ability, liquidity position of the company has improved. In absolute terms, funds flow from operations (FFO) increased to Rs. 62m (FY17: Rs. 21m) in FY18. Resultantly, Debt Service Coverage Ratio (DSCR) and FFO/Long-Term Debt remain healthy at 3.8(x) (FY17: 3.1(x)) and 84% (FY17: 25%), during FY18 respectively. Current ratio remains well above 1x on a timeline basis. Short term borrowings have been mobilized for working capital requirements and stood at Rs. 115m at end-June'18. Stock in trade and trade debts at 6.19(x) at end-June'19 are well in excess of short term borrowings. Trade debts aging profile remains with in manageable levels. Moreover, working capital cycle of the company is relaxed with advance receipt on sales and raw material payment terms of 60-90 days.

Capitalization

Equity base of the company has grown at a CAGR of 19% over the last three years (FY15-FY18) on account of profit retention. Long term debt to the tune of Rs. 74m at end-June'18 has been withdrawn to fund expansion at Port Qasim plant. The management does not expect an increase in the same going forward. Short term borrowings have been mobilized for working capital requirements and stood at Rs. 115m at end-June'18. At end-FY18, gearing and leverage ratio stood at 0.47(x) (FY17: 0.51(x)) and 2.02(x) (FY17: 1.59(x)), respectively. Given limited growth in debt and projected profitability, leverage indicators are expected to improve going forward.

Corporate Governance

Board composition is considered adequate comprising five members including four independent directors. Board of Directors includes Mr. Khayam Husain, Mr. Mohammad Rajpar, Mr. General Ovais Mustafa, Mr. Riaz Siddiqui, and Mr. Sohail P. Ahmed. AUTOCOM has installed SAP Business Intelligence as its ERP software, modules of which include finance, marketing, HR, Procurement, Inventory Management, Production and CRM for after sales service. The main data server is at the Head Office at West Wharf which is synced with the backup server at Port Qasim through fiber optics. The IT department maintains daily backup of data. Internal Audit department performs pre-audit regularly along with functional audits with the help of an Audit Manual. Consequently, Internal Audit, Information Technology functions and overall corporate governance of the company are considered adequate given status of a private limited company.

Automobile Corporation of Pakistan **Appendix I**

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY15**	**FY16**	**FY17**	**FY18**
Fixed Assets	63	70	235	300
Long term Investments	8	10	12	8
Stock-in-Trade	186	229	410	650
Trade Debts	49	30	46	64
Cash & Bank Balances	5	20	2	12
Total Assets	416	498	896	1,267
Trade and Other Payables	116	153	313	569
Long Term Debt	1	3	84	74
Short Term Debt	23	21	83	115
Total Debt	25	24	167	190
Total Equity	239	280	328	404
INCOME STATEMENT				
Net Sales	701	837	1,018	1,491
Gross Profit	129	169	196	282
Profit After Tax	38	43	47	88
RATIO ANALYSIS				
Gross Margin (%)	18.4%	20.2%	19.2%	18.9%
Net Margin	5.4%	5.1%	4.6%	5.9%
Trade debts/Sales	7%	4%	5%	4%
FFO	33	23	21	62
FFO to Total Debt (%)	134%	95%	13%	33%
FFO to Long Term Debt (%)	2512%	815%	25%	84%
Current Ratio (x)	2.1	2.1	1.5	1.3
(Stock+ Trade Debts)/ Short term borrowing	1004%	1232%	552%	619%
Debt Servicing Coverage Ratio (x)	NA	4.1	3.1	3.8
Gearing (x)	0.10	0.09	0.51	0.47
Leverage (x)	0.72	0.76	1.59	2.02
Dividend Payout Ratio (%)	0%	0%	0%	0%
ROAA (%)	9%	9%	7%	8%
ROAE (%)	16%	16%	15%	24%

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	Automobile Corporation of Pakistan
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				
7/25/2019	BBB	A-2	Stable	Initial