RATING REPORT

Master Changan Motors Limited

REPORT DATE:

October 29, 2021

RATING ANALYSTS:

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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	*October 29. 2021*	

COMPANY INFORMATION

Incorporated in 2017	**External auditors:** Kreston Hyder Bhimji & Co.
Public Unlisted Company	**Chairman of the Board:** Mr. Naveed Malik
Shareholders (5% or more):	**Chief Executive Officer:** Mr. Danial Malik
Master Motor Corporation (Pvt.) Ltd. – 69.9%	
Changan Automobile Investment (Shenzhen) Corporation Limited – 30.0%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Master Changan Motors Limited

OVERVIEW OF THE INSTITUTION

Master Changan Motors Limited (MCML) was incorporated as a Public Unlisted Company Limited in 2017. Registered office of the company is based in Karachi. Financial Statements of the company for FY20 were audited by Kreston Hyder Bhimji & Co. Chartered Accountants.

Profile of Chairman:

Mr. Naveed Malik holds a bachelor's degree in Business Management from the U.S.A. He has an extensive experience in the foam products industry, and has been successfully running the business since more than three decades. Furthermore, he is the chairman of several other companies under the ambit of Master Group of Companies.

RATING RATIONALE

Corporate Profile: Incorporated in 2017 as a public unlisted company; Master Changan Motors Limited (previously known as Master Motors Limited) is principally engaged in the assembly and progressive manufacturing and sale of pickups and vans, passenger cars, and trucks. The company is a joint venture between Master Motor Corporation (Private) Limited (MMCL) and Changan Automobile Investment (Shenzhan) Corporation Limited (Changan) with shareholding of 70% and 30%, respectively. The business model encapsulates import of Completely Knocked Down Units (CKD's) from Changan International Corporation and local assembly of units prior to sale. The company commenced commercial production in January 2020 with an initial focus on pickup/vans segment and gradually increasing the portfolio in passenger cars. The company continues to increase its product offering with a SUV addition planned by the end of 2021.

Segment wise Sales Contribution	FY19	FY20	FY21
Vans	81.4%	85.3%	64.3%
Pickups	16.2%	13.6%	5.8%
Passenger Cars	1.1%	0.0%	29.7%
Truck	1.2%	1.2%	0.2%
Total	**100.0%**	**100.0%**	**100.0%**

The company operates through twenty-two dealers spread across the country, and plans to expand going forward. Existing capacity stands at 25,000 units annually on double shift basis which is in the process of being enhanced to 45,000 units by FY22, given the strong demand.

Rating Drivers

Business risk profile is supported by positive momentum in the auto sector post pandemic; however the industry remains exposed to changes in the economic environment.

Assigned ratings take into account positive momentum experienced in the automobile sector in the post pandemic recovery period. Demand prospects for vans and pickups segment are optimistic given expected growth in tourism, inauguration of new motorways coupled with new and under-way motorway projects, and higher liquidity available to consumers due to decrease in international travel since beginning-2020. Moreover, tax and duty incentives provided in FY22 budget have further improved the industry outlook; incentivizing assemblers to lower prices going forward. The same would allow players to capitalize on the un-captured industry volumes.

The nature of the industry is categorized as oligopolistic with few large players dominating the market. In the pickups/vans segment, major players include Suzuki Ravi, Toyota Hilux, JAC, D-Max, and Hyundai Porter. In the passenger car segment, MCML product line competes with Honda Civic and City, Suzuki Swift, Toyota Corolla, Toyota Yaris, and Hyundai Elantra. Among new entrants KIA has also emerged in the passenger car segment. During FY21, pickups and vans segment posted growth of 79% (FY20: -47%), and passenger car segment

(1300CC and above) grew by 94% (FY20: -61%).

Despite strong demand outlook of the automobile industry; downward pressure is expected, particularly on the passenger car segment, on account of recent increase in interest rates by 25bps by the SBP and more stringent automobile financing regulations.

Furthermore, GDP growth stood above expectations at 3.9% during FY21 and is forecasted to be to 4.1% during FY22. The same is expected to boost industry's prospects going forward. However, the industry remains exposed to key risks manifesting the short-run economic developments in Pakistan including the following:

- Continued persistence of COVID-19 with spread of delta variant,
- Consistent rupee devaluation which has depreciated by 4.9% since beginning-FY22
- Geo-political developments in Afghanistan,
- Implementation of IMF program, recommended actions, and structural benchmarks.

Strong sponsor profile provide support

Equity in the company is held by MMCL (70%) and Changan (30%). Both the sponsors have strong financial profile. Changan is a Chinese state owned enterprise with a strong competitive position in the auto sector, being one of the leading brands in China with a market share of 63%. The group operates in more than 60 countries and more than 150,000 professional team members globally. It operates joint ventures with Ford (Changan Ford), Groupe PSA (Changan PSA), Mazda (Changan Mazda) and Suzuki (Changan Suzuki). The association with Changan as JV partners provides MCML access to technical knowledge as well as broad product line.

MMCL is a part of Master Group of Companies. Master Group is a diversified business group with presence in mattresses & upholstery, home fashion, textile, chemical, power, automobile and auto part sectors. During the outgoing year, MCML was recognized as the number one distributor of Changan and as per management, Changan aims to leverage this JV to export to other regional markets.

Product coverage strengthens competitive position

The product portfolio of the company offers broad coverage ranging from van, pickup, sedan, and to-be launched SUV segments. The offerings have been well perceived by the market, evident through forward bookings in the pickup and van segments as opposed to cash sales offered by competition despite pricing being above immediate competition. The company positions itself against Suzuki Ravi and Suzuki Bolan in the pickup and van segment respectively, and is managing to gradually grow its market share in both segments. In 2021, market share in the pickup/van segment increased to 23% (FY: 12%). Growth in the commercial segment is expected to remain upbeat on the back of increased economic activity.

In the passenger car segment under Alsvin brand, MCML has positioned itself in the 1300 cc above category against Honda City and Toyota Yaris at a lower price point which protects them from any possible downside to some extent. In the car segment, MCML recorded a market share of 2-3% in FY21 which is expected to increase to 9% in FY22.

As per management, the company is planning to launch a competitively priced SUV by end-2021 to enhance market reach. Management does not foresee any new competition in the medium term given the sizable investment and expects to capture sizeable share in the SUV segment.

Capacity additions to accommodate expected volumetric growth

The company is currently undergoing an expansion project in its production facility at Port Qasim, Karachi, to increase the existing capacity by 20,000 vehicles per year to 45,000 units. The initiative is expected to be completed by end-March 2022, and expected cost of the remaining project amounts to Rs. 3b which will be financed through debt. In addition, the company is planning to pursue multiple projects going forward including localization and installation of solar power projects. Expected capex for the next three years ranges between Rs. 10b to Rs. 12b, expected to be financed through debt and equity injection by sponsors.

Growth in market share, particularly in the passenger car segment, is being constrained by existing production capacity, and is therefore being addressed by undergoing capacity addition plans.

Strong revenue and profitability growth

During FY21, net revenues witnessed significant growth (FY21*: Rs. 10.0b; FY20: Rs. 1.2b) driven by higher volumes of pickup and vans along with uptick in passenger cars sales. The sales mix is dominated by the pickup and van segment with its flagship product (Changan Van – Kaarvan); however the share declined to 70% during FY21* (FY20: 99%) as the company entered into the passenger car segment with the launch of three models of Alsvin during the outgoing year.

Gross margins registered improvement in FY21 (FY21*:16%, FY20: 11%) on account of change in sales mix. Vans, a relatively higher margin product, constituted a larger share of the sales mix in FY21* compared to previous year. Operating margins at 4% (FY20: (11%)) during FY21* were constrained due to higher marketing and sales commission expenses associated with the new offering and significant increase in international freight charges. On account of lower interest rates, finance costs reduced by 35% during the outgoing year resulting in net margin of 1.3% (FY20: (15%)) during FY21*. Going forward, while gross margins will remain exposed to exchange rate volatility to some extent, operating and net margins are expected to depict improvement on the back of volumetric sales growth.

Cash flow coverage indicators provides comfort

Funds from Operations (FFO) turned positive during FY21* to Rs. 229m (FY20: Rs. (177m)) on the back of increase in profitability. As a result, cash flow coverage indicators including FFO/Total Debt and FFO/Long-Term debt increased to 12% (FY20: (15%)) and 12% (FY20: (21%)) respectively thus providing comfort to the ratings. Consequently, debt servicing also increased to 1.2x during FY21* (FY20: 0.0x).

Liquidity profile remains constrained as the current ratio stood at 1.0x (FY20: 1.2x) at end FY21* due to higher inventory levels to cater to rising demand and additional buffer for any shipping delays. However, ratings draw comfort from healthy growth in cash balances during FY21* on the back of sharp increase in advances from customers.

**As per management accounts-FY21*

Sponsor support provides support to capitalization indicators

Borrowings primarily relate to long term borrowings which recorded an uptick in FY21* on account of financing capacity expansion. Gearing levels, however, remained within manageable levels at 0.8x (FY20: 0.4x) during FY21*, while leverage increased to 4.7x (FY20: 0.9x) on the back of increase in customer advances. In FY20, directors and the holding company injected equity support amounting to Rs. 590m on account of losses in the initial years. During FY21*, with uptick in profitability, the company repaid part of the loan which resulted in reduction of the equity base to Rs. 2.4b (FY20: Rs. 2.6b). Going forward, sponsors plan to inject Rs 3b in the company to support future growth. VIS anticipates uptick in gearing to fund planned expansions, however continued sponsor support is expected to keep gearing levels within acceptable limits.

**As per management accounts-FY21*

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 DISCLOSURES — Appendix III

Name of Rated Entity	Master Changan Motors Limited
Sector	Automobile
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				
29 October, 2021	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 Meeting Conducted	

S.No	Name	Designation	Date
1	Omair Asghar	Acting Chief Financial Officer	21st Sep 2021
2	Muhammad Asif	Senior Manager – Finance	21st Sep 2021