RATING REPORT

Master Changan Motors Limited

REPORT DATE:
December 30, 2022

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlok	Stable		Stable	
Rating Date	December 30, 2022		October 29, 2021	
Rating Action	Reaffiermed		Initial	

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: Corporate Rating Methodology (August 2021) https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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 FY21 are audited by Kreston Hyder Bhimji & Co. Chartered Accountants.

Master Changan Motors Limited ('MCML' or 'the Company') incorporated in 2017 as a public unlisted company. MCML is a joint venture between Master Motor Corporation (Private) Limited (MMCL) and Changan Automobile Investment (Shenzhan) Corporation Limited (Changan) with shareholding of 69.9% and 30%, respectively. MCML is engaged in the assembly and progressive manufacturing and sale of pickups and vans and passenger cars. The business model encapsulates import of Completely Knocked Down Units (CKD's) from Changan International Corporation and local assembly of units prior to sale. Plant of the Company is located at Port Qasim, Karachi. 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's current product portfolio is as follows:

Table 1: Product Portfolio

Product	Category
Oshan (X7)	SUV
Alsvin	Sedan
Karvaan MPV	Van
M9 Sherpa	Pick-up

Sector Update

- Despite surging prices, increasing fuel prices and hikes in interest rates, the sales of Cars and LCV & Pickup posted an all-time high in FY22.
- Passenger cars registered a 55% year on year increase in FY22. One of the reason includes pre booking of cars which has been made few months back before the delivery time.
- Overall total volume of the industry including all categories witnessed an increase of 46% Y/Y in FY22.
- The highest increase of 57% Y/Y was displayed by the Trucks segment during FY22 followed by Cars and LCV & Pickup with 55% and 49%.
- During the current fiscal year, sales of automobiles started to slow down mainly due to weak macro-economic conditions, further increase in fuel prices and interest rates.
- Overall industry offtake (including all segment) down by 47% during 4MFY23 compare to corresponding period last year while individual categories declines ranging from 40-47% Y/Y.
- Going forward, during FY23, GoP restriction on CKD imports continue to impede the automotive industry's access to raw materials. Also, the offtake is forecasted to

remain under stress amid weak macro-economic conditions and recent hike of 100bps in interest rates (Current SBP rate: 16%).

Table 2: Industry Offtake

Offtake (Units)	FY19	FY20	FY21	FY22	4MFY22	4MFY23
Cars	207,630	96,455	151,182	234,180	74,952	39,700
LCV & Pickup	33,016	15,507	30,215	45,087	14,969	8,234
Trucks	5,828	3,088	3,695	5,802	2,011	1,109
Buses	935	559	652	696	2,195	1,319
Tractors	50,405	32,727	50,920	58,947	17,386	9,258

Source: Pakistan Automotive Manufacturers Association (PAMA)
These numbers only include the companies which are PAMA members

Operational Update

Utilization, offtake and market share

Offtake (Units)	FY21	FY22	4MFY23
Capacity	24,872	42,445	14,148
Production	7,839	19,951	4,076
Utilization	*80%*	*47%*	*29%*
Sales	7,168	20,288	3,396

- As planned, MCML has increased its production capacity to around ~45,000 units as at Jun'2022.

Segment	MCML	Launch Date	Competition
SUV/Crossover	Oshan X7	Mar'22	Hyundai Tucson, KIA Sportage, Honda BRV & HRV, DFSK Glory, Proton X70, MG HS, Haval H6 & Jolion, Cherry Tiggo, Peugeot 2008, BAIC BJ40
Sedan	Alsvin	Jan'21	Yaris, Corolla 1.3, City, Proton Saga
Van	Karvaan	May'19	Suzuki Bolan, DFSK K07, FAW XPV
Pickup	Sherpaa	May'19	Suzuki Ravi, FAW Carrier, JAC, Hyundai Porter, Forland, DFSK K01

- The Company has introduced "Oshan X7" in March'22 and entered in the SUV segment of the automobile industry.

- With the launch of Oshan X7, the offtake of the Company clocked in at 2,794 units in 1QFY23. *(42% offtake consist of Oshan X7 in 1QFY23).*

- Going forward, the production and sales number are expected to drop due to lower expected demand on the back of weaker macro-economic conditions and higher interest rates.

Market Share	FY19	FY20	FY21	FY22	1QFY23
SUV/Crossover	-	-	-	3.6%	18.07%
Sedan	-	-	3.4%	16.6%	8.0%
Van	1.6%	18.1%	37.4%	41.1%	41.7%
Pickup	0.4%	3.2%	4.6%	4.3%	6.1%
Relevant Market Share	**1.0%**	**10.2%**	**10.4%**	**16.1%**	**15.3%**
Industry Market Share	**0.13%**	**1.2%**	**2.9%**	**5.5%**	**6.0%**

- With the Alsvin sales in full swing during FY22, the market share of MCML in Sedan segment has increased.
- Launch of Oshan X7 during FY22 has further added in the relevant market share of MCML in FY22 which has increased to 16.1% from 10.4% in FY21.
- During 1QFY23, market share of Sedan segment has dropped to 8.0% whereas SUV segment has depicted improvement to 18.07%.
- Overall relevant market share of MCML is forecasted to stay in the same range with the new entrants mainly in SUV segment making stiff competition.

Rating Drivers

Strong Sponsor Profile

- Equity in the company is held by MMCL (69.9%) 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. 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. Diversified businesses of the sponsor also provide financial strength to MCML.

Strong growth in topline with increased sale of sedan and launch of SUV during FY22, however projected volumes depict a decline

- With the 44% Y/Y volumetric increase in industry sales and the enhancement in the production capacity of the Company, the overall volumetric sales of MCML has increased by 1.8x in FY22.

- Sedan came out as the largest contributor with 53% share in the overall sales (47% in volumetric terms).

- Net sales of the Company clocked in at Rs. 37.9b in FY22 (FY21: 9.3b) mainly on the back of notable increase in volumes while the prices also went up during the period.

- In FY23, volumes are expected to decline amid weak macro-economic conditions and high interest rates coupled with restrictions on import of raw materials as per the direction of SBP. However, product prices are expected to remain on the higher side. In addition, notable reduction in freight costs that were substantially higher last year provides room for margin improvement. Company expects higher product prices and improved margins to contribute towards preservation of profitability despite volume sales recording a notable decline. Achievement of projected plans will remain a key rating factor.

While cash flow coverages remain comfortable, liquidity profile remains under pressure

- FFO of MCML has notably improved in FY22 to came in at Rs. 1.2b on the back of increase in internal cash generation, while the same clocked in at Rs. 540m in 1QFY23.

- Resultantly, cash flow coverage indicators including FFO/Total Debt and FFO/LT debt improved to 21.8% and 30.8% as at Jun'22 (13.4% & 13.4% as at Jun'21), providing comfort to the ratings.

- Consequently, debt servicing also increased to 3.3x as at Jun'22 (Jun'21: 1.2x).

- Liquidity profile remains constrained as the current ratio stood at 1.09x as at Sep'22 (Jun'22: 1.06x, Jun'21: 0.96x). Whereas, Cash+ST investment also declined to Rs. 1.1b as at Sep'22 from Rs. 2.6b as at Jun'21.

Ratings draw comfort from management's decision of conservative capitalization structure

- Equity base of the Company posted strong growth to stand at Rs. 4.2b as at Sep'22 (Jun'21: 2.4b). This also include interest free sponsor loan of Rs. 260m.

- MCML has mobilized LT debt on its balance sheet for setting up a plant at Port Qasim, capacity expansion at Pakistan Steel plant and other projects. LT debt is now standing at Rs. 3.9b as at Sep'22. (Jun'21: Rs. 1.6b). As at Jun'22, 39% of the LT debt is against on subsidized rates under different schemes.

- Management is not planning to mobilize any further LT debt during the rating horizon.

- Short term borrowings of the Company increased to Rs. 3.2b as at Sep'22 (Jun'22: 1.6b). The core reason of the same is to finance the inventory as the Company has transferred to sight LC from DA LC previously. This may add further burden on working capital requirements of the Company.

- Consequently, total debt stood at Rs. 7.1b as at Sep'22 (Jun'22: 5.5b, Jun'21: 1.4b). Gearing and Leverage elevated to 1.71x and 4.95x as at Sep'22 (Jun'22: 1.46x & 6.02x, Jun'21: 0.69x & 5.27x).

- Leverage indicator of MCML remained elevated due to high advances from customers on balance sheet.

- Going forward, capitalization indicators are expected to remain in the same range as the Management decided not to increase the capitalization structure above 70:30 (Debt: Equity) which is standing at 63:37 as at Sep'22.

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

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	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				
30 December, 2022	A-	A-2	Stable	Maintained
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	Muhammad Imran	Chief Financial Officer	04 Nov 2022
2	Muhammad Asif	Senior Manager – Finance	04 Nov 2022