RATING REPORT

Master Changan Motors Limited

REPORT DATE:
January 23, 2024

RATING ANALYST:
Husnain Ali
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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 Outlook	Stable		Stable	
Rating Date	January 23, 2024		December 30, 2022	
Rating Action	Reaffirmed		Reaffirmed	

COMPANY INFORMATION	
Incorporated in 2017	**External auditors:** M/s Yousuf Adil, Chartered Accountants
Public Unlisted Company	**Chairman of the Board:** Mr. Nadeem Malik
Shareholders (5% or more):	**Chief Executive Officer:** Mr. Nadeem Malik
Master Motor Corporation (Pvt.) Ltd. – 69.9%	
Changan Automobile Investment (Shenzhen) Corporation Limited – 30.0%	

APPLICABLE METHODOLOGY
Applicable Rating Criteria: **Corporates (May 2023)** https://docs.vis.com.pk/docs/CorporateMethodology.pdf **Rating Scale & Definitions** https://docs.vis.com.pk/docs/VISRatingScales.pdf

Master Changan Motors Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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 FY23 are audited by M/s Yousuf Adil, Chartered Accountants.

Profile of Chairman:
Mr. Nadeem Malik holds a graduate degree in Business Management from the U.S.A. He has an extensive experience in the Automotive Industry, and has been successfully running the business since more than two decades. Furthermore, he is the chairman of several other companies under the ambit of Master Group of Companies.

RATING RATIONALE

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 30.0%, 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 (CIC) and local assembly of units prior to sale. The company's plant is located at Steel Mill, Karachi.

The company began commercial production in January 2020, initially concentrating on the pickup/van category before eventually expanding its product line to include passenger cars. Currently, the total number of dealerships is 32. The company's product portfolio is as follows:

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

<u>Sector Update:</u>
In FY23, Pakistan's auto industry faced significant challenges such as increased policy rates, rupee depreciation, and import restrictions, leading to a significant decrease in production and a 57.0% decrease in automobile sales. This decline was due to high vehicle prices and reduced consumer purchasing power. In comparison to other developing countries, Pakistan's automobile consumption is low, contributing just ~ 3% to the GDP.

The global trend shows a shift in demand from sedans to SUVs. In Pakistan, the SUV market reported 25.5% decrease sales in FY23 due to high prices. The growth in this segment is contingent on market pricing and auto imports policies.

Data from the Pakistan Automotive Manufacturers Association (PAMA) indicates that Pak Suzuki Motor Company Limited (PSMC) led the market with a 40.0% share, followed by Indus Motors Company (INDU) and Honda Atlas Cars (Pakistan) (HCAR) with 19.3% and 10.3% market shares, respectively. In the SUV segment, INDU and HCAR held 55.5% and 17.6% of the market in FY23.

Despite these challenges, including interest rate fluctuations and inflationary pressures, the industry may see some recovery by the fourth quarter of FY24 due to relaxed import restrictions, partial price reductions, and more flexible financing options from automakers. Volumetric sales by vehicle type are as follows:

Offtake (Units)	FY21	FY22	FY23	5MFY23	5MFY24
Cars	151,182	234,180	96,811	32,444	13,587
LCV & Pickup	30,215	45,087	30,067	22,688	12,159
Trucks	3,695	5,802	3,182	1,405	736
Buses	652	696	654	256	141
Tractors	50,920	58,947	30,942	1,661	877

**Numbers only include the companies which are PAMA members*

Operational Update

Operational capacity was constrained on account of reduction in demand during FY23. The management opted for retrenchment of some non-technical production line staff, thereby reducing number of production shifts to a single-line shift. MCML's relevant market share in SUV, pickup, van and sedan sub-segments as well as total market share decreased slightly during FY23 mainly due to lower unit sales of sedans and pickups. The company has new automobiles and variants in the pipeline and relevant capital expenditure is being made.

Rating Drivers

Strong sponsor 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 has 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.

Asset based mainly comprises inventory and operating fixed assets: Property, plant and equipment increased to Rs. 7.3b (FY22: Rs. 6.9b) on account of ongoing capital expenditure made during FY23. Given lower sales to dealers and customers, trade debts decreased to Rs. 227.6m (FY22: Rs. 679.2m) by end-FY23. Trade debts from related parties also stood lower at to Rs. 2.7m (FY22: Rs. 256.0m) at end-FY23 on account of considerably lower sales of auto parts to the parent company. On June 16, 2022, MCML experienced a significant inventory depletion following a fire at one of its CKD parts warehouses. The company lodged an insurance claim amounting to Rs. 769.7m, of which Rs. 192.4m remained outstanding as receivable from the insurer at end-FY23; this amount was fully settled in Aug'23. MCML's stock-in-trade decreased to Rs. 7.1b (FY22: Rs. 13.7b) on account of lower raw material inventory coupled with provisioning and write-off primarily regarding the fire incident and also lower goods-in-transit at end-FY23. MCML had higher cash and bank balances at end-1QFY24 mainly on account of recovery of insurance claim and advance bookings.

Profitability improved mainly on the back of higher margins and lower taxation despite decrease in sales: The company's net sales are divided into manufacturing and trading segments. Manufacturing segment is related to assembly, manufacturing and sale of locally assembled vehicles and scrap sales. Trading segment mainly pertains to sale of motor oil and spare parts.

The average sales price of the company's entire product portfolio increased by 18.5% during FY23. The effect of price hike led to decrease in volumetric sales by 26.5% during FY23. Apart from Oshan, all other product categories experienced a decreased in unit sales.

With the 57% Y/Y volumetric decrease in industry sales and constraint of operational capacity on account of reduction in demand, the overall volumetric sales of MCML have declined by 63.1% in FY23.

Net sales decreased by 28.1% mainly due to lower volumetric off-take during 1QFY24. Gross margin increased to 16.1% (FY23: 15.8%, FY22: 9.4%) during FY23 and 1QFY24, primarily due to higher volumetric sales of Oshan, a high margin product, according to the management.

Operating expenses increased by 11.7% owing to increase in depreciation charges and exchange loss during FY23. The company's other income, mainly from bank deposits, continues to support profitability during FY23. The company's financial charges increased on account of hike in policy rate and higher average borrowings in FY23. Taxation decreased to Rs. 405.4m (FY22: Rs. 585.9m) on account of adjustment of carried forward minimum tax balance. Resultantly, net margin increased to 4.7% (FY22: 3.0%; FY21: 0.9%) during FY23. Net margin increased to 6.6% (1QFY23: 4.1%) during 1QFY24.

The management anticipates higher sales and enhanced net income, projecting resurging in Karvaan and Alsvin sales, aligning closer with the volumetric figures recorded in FY22. In pursuit of the same, the management has strategically concentrated on implementing discount frameworks. Additionally, the management draws optimism from favorable policy rate and stability in exchange rate during 4QFY24.

Cash flow coverages remained sound: FFO increased to Rs. 1.9b (FY22: Rs. 1.2b) on account of higher profit generation from core operations during FY23. FFO to long-term debt and FFO to total debt also improved by during FY23. DSCR, though adequate, decreased to 2.1x (FY22: 3.3x) due to higher financial charges paid during FY23.

Performance obligation underlying the opening contract liability of Rs. 11.4b, were satisfied in full during FY23. Accordingly, said liability was recorded in net sales during the outgoing year. Resultantly, trade payables decreased to Rs. 6.2b (FY22: Rs. 16.4b) by end-FY23. Current ratio improved to 1.2x (FY22: 1.0x) owing to impact of lower trade payables on current liabilities at end-FY23. Current ratio improved slightly to 1.3x by end-1QFY24.

Leverage indicators improved on the back of sound internal capital generation: The company's equity base increased on the back of profit retention

(1QFY24: Rs. 5.3b; FY23: Rs. 4.9b, FY22: Rs. 3.5b, FY21: Rs. 2.4b). Long-term borrowings increased to Rs. 4.5b (FY22: Rs. 3.9b), mobilized from a consortium of local commercial banks for capital expenditure. Interest free loan rendered by the company's directors remained outstanding at Rs. 260.0m (FY23: Rs. 260.0m, FY22: Rs. 260.0m) at end-1QFY24. Short-term borrowings stood at Rs. 1.5b (FY23: Rs. 1.4b, FY22: Rs. 1.6b) at end-1QFY24.

Gearing level (1QFY24: 1.1x; FY23: 1.2x, FY22: 1.6x) and debt leverage (1QFY24: 2.4x; FY23: 2.7x, FY22: 6.4x) decreased on account of higher total equity. Gearing is projected to remain in similar range and debt leverage is projected to increase slightly on account of higher trade payables by end-FY24. According to the management, any capex planned will be met mainly through internal cash flows.

REGULATORY DISCLOSURES	**Appendix I**
Name of Rated Entity	Master Changan Motors Limited
Sector	Automobile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
January 23, 2024	A-	A-2	Stable	Reaffirmed
December 30, 2022	A-	A-2	Stable	Reaffirmed
October 29, 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.
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Due Diligence Meeting Conducted	

S.No	Name	Designation	Date
1	**Mr. Muhammad Imran**	CFO	19-Dec-23
2	**Mr. Muhammad Asif**	Senior Manager Finance	
3	**Mr. Taha Ahmed Khan**	Manager Financial Reporting	