

Chairman's Review

I feel privilege in presenting you the financial statements of the company for the period ended September 30, 2006.

The Economy

The economy is expected to maintain its growth momentum for the current year, particularly, strong agriculture growth which, in turn, would support performance in key industries, such as textile and sugar. Inflation is declining, though at slow pace and is expected to remain under control due to oil prices. On external sector, exports for the first quarter were US\$ 4.3 billion, up by 2.4%, and imports were high at US\$ 7.4 billion, up 13.4% over the same quarter, last year. The trade deficit widened to 31.7% mainly due to slow down in exports and higher import of petroleum products & Completely Built Units (CBU) vehicles. The remittances from overseas Pakistani in the first quarter grew 23.6%, to US\$ 1.2 billion. The revenue collection was Rs 187.3 billion, an improvement of 23.2% over the same quarter last year. Due to tightening of monetary policy, the lease financing rates were increased sharply during the period under review.

The Industry

The automobile industry, with sales growth of 11.9% in the six months period ending September 30, 2006 over the same period of last year, seem to have reached the optimum level of its growth momentum under the current circumstances. During the period of last six months ending September 30, 2006, the total automobile production was 88,979 units against 75,721 units in the same period of last year. The consolidated sales were 84,404 units as compared to 75,449 units over the same corresponding period of last year. However, the declining trend was witnessed in production and sales for July 06 ~ September 06 quarter by 15.3% and 9.7% respectively as compare to the preceding quarter of April 06 ~ June 06.

As expected, the liberal auto policy, with short term objectives to fill-up the demand-supply gap, has already shown its adverse impact on the auto industry. The share of local auto industry was eaten by the substandard imported vehicles, evident from 69.1% increase in CBU import and 27.3% decrease in CKD import during July 06 ~ September 06 period. This was coupled with the rise in the lease financing rates which led the unviable leasing options for the customers. Following the capacity expansion and shift in demand from locally assembled vehicles to import based vehicles, the industry now has huge production capacity surplus.



The production and sales of your company for the first half of the year were 11,150 units and 9,954 units, down 31.9% and 39.6% respectively, over the same period of last year. The decline in production and sales was due to the factors mentioned above coupled with pre-planned shut down of three weeks in August 2006 for the capacity expansion activities.

On July 29, 2006, the company launched a new model of Honda Civic 're-born' in 1800cc category, replacing the previous Civic models of 1500cc and 1600cc engine capacity. The new model carries Honda's next-generation 1.8-liter SOHC i-VTEC engine - the first entirely new Civic power plant in 17 years, through Honda's advanced i-VTEC (Intelligent Variable Valve Timing and Lift Electronic Control) system and DBW (Drive By Wire) technology. Sensitivity towards safety and environment is fully reflected in the new model with Supplemental Restraint System (SRS) and being Euro 4 compliant vehicle. The new model, being the only Euro 4 compliant car in Pakistan, is expected to add value in the existing product line up of the company.

Company's Performance

The sales revenue for the first half of the year was down to Rs. 8,696.6 million against Rs. 13,704.5 million in the same period of last year mainly due to late entry of the new model. The cost of goods sold was Rs. 8,394.0 million against Rs. 13,276.2 million. The gross profit was Rs. 302.5 million against Rs. 428.3 million, reduced by 29.4%; however GP margin was slightly improved from 3.1% of last year to 3.5%. The administration and selling expenses were Rs. 180.4 million. The low sales volumes could not fully absorb the direct production costs and fixed operating expenses due to expansion underway, which led to decrease in gross profit and operating profit for the period under review. Other income also decreased to Rs 84.9 million mainly due to reduction in bank deposits, resulting from low customer advances. The financial and other charges also increased sharply from Rs. 44.2 million to Rs. 134.1 million, mainly due to mark up on bank borrowings availed by the company to support its capacity expansion and working capital requirements. Thus the profit before tax was Rs. 72.9 million, down by 83.8% over the same period of last year. After adjustment of income tax provisions, net profit for the year was reduced to Rs 46.9 million against Rs. 280.1 million in the same six months period of last year.

The after tax return on equity for the period was reduced to 1.72% and earnings per share to Rs. 0.66 against 12.3% and Rs. 3.92 per share respectively, in the same period of last year due to circumstances as explained above.

Future Outlook

The economic growth for the existing fiscal year is expected to slow down, with exports to remain under pressure to sustain the growth rate. However, the current trend of higher imports and widening trade deficit would be a testing time for the economy. Inflationary pressures in the economy would be exacerbated with the falling value of the rupee.

Following the upsurge demand in automobile sector a couple of years before, massive capacity expansions were undertaken by all OEMs. However, the enthusiasm of automotive industry's to increase production capacity has been dampened by the influx of used cars of assorted makes. The condition of import of vehicles up to 5 years would not be sufficient to curb the influx of used cars, which thus is likely to continue unabated and will reduce further the capacity utilization of the industry. The industry is facing tough times ahead with declining sales volumes and increasing fixed costs. A suitable protection must be ensured to encourage local investment, production – employment – in the national interest –as elsewhere. However, the management of your company will continue to focus on quality and cost control measures to improve its competitiveness to meet the future challenges that are to come.

محبت مجھے اُن جوانوں سے ہے
ستاروں پہ جو ڈالتے ہیں کمند۔

(Let us continue to fly our flags high)

Acknowledgement

On behalf of the Board, I would like to thank the customers, dealers, vendors, financial institutions, shareholders for their continued support and trust in the company product. I would also thank Honda Motor Company for their continued support in implementing the expansion project for growth of the company. I also thank Mr. Mamoru Suwama and his team for their commitment and hard work.



Yusuf H. Shirazi
Chairman

Lahore, November 22, 2006.