Chairman’s Review

I am pleased to present the 20th Annual Report of the Company for the year ended March 31, 2012.

Economy

The economy has been under pressure in recent years. However, it has shown resilience and is expected to grow by 3.5% to 4.0% in FY12. This is on the back of a reasonable performance of service and agriculture sectors. The inflationary pressures continued to wane and CPI registered at 10.8% on Y-o-Y basis. In line with lower inflation numbers, SBP reduced policy rate by 200 basis points to 12 percent in order to revive private sector investments. Foreign reserves remained relatively stable at USD 16.51 billion despite payments to International Monetary Fund (IMF). Remittances remained a cornerstone with collection of USD 9.7 billion as compared to USD 8.0 billion of last year. On revenue front, FBR was able to collect Rs. 1,266 billion in 9 months of FY12, an increase of 25% on Y-o-Y basis.

On the other hand, external side depicts bleak outlook on the back of rising current account deficit. Trade deficit increased to USD 10.5 billion in the first half of FY12 as imports, primarily driven by high oil price, outpaced exports. These imbalances at the external front and absence of investment inflows pushed the local currency to a record low level. Further, the provisional estimates of fiscal deficit suggest the likely breach of targeted deficit for FY12. As a result, government is relying on domestic banking system to finance fiscal gap, thus, crowding out private sector lending.

Agriculture

The agriculture sector’s performance was less than expected with a repeat of floods which inundated a significant portion of Country’s Southern region. Further, rising costs of energy and fertilizers, together with the lower prices for major crops eroded liquidity of farmers. However, the productivity gains due to increase in area under cultivation of major kharif crops (cotton, rice, sugarcane) allowed agriculture sector to post meagre growth of 1.2% over the last year.

Large Scale Manufacturing

Large Scale Manufacturing (LSM) managed to post growth of 2.3% which is reflective of the lower base of last year. Overall, consumer goods industries performed well and contributed positively to the index. This was due to high worker’s remittances, improved agriculture output and fiscal support. However, worsening energy crisis continued to plague production activities. This perhaps is the time to call for the improved government action to ensure sustained growth in LSM sector for a thriving economy.

Japan and Thailand Disasters

The current year has been very challenging for the automobile industry which witnessed two natural disasters. In March 2011, an unprecedented earthquake and tsunami hit north-eastern part of Japan and as a result many of the Honda Plants were closed immediately. Parts supply was disrupted and company’s production suffered for a couple of weeks in April-May 2011. However soon, the production facilities were restored and Honda, Japan resumed production in May 2011. The company made necessary adjustments to its production plan to achieve targets for the year and production increased by 7.2% in second quarter ending September 2011.

Unfortunately, heavy rains and floods hit Thailand in the beginning of third quarter which severely affected Honda Automobile Thailand and its many vendors causing them to close their production plants. As a result, your company had to stop production again for a couple of months due to non-availability of parts. Production however resumed in March 2012, by resourcing parts from Honda in Turkey and China. Therefore, company’s annual production and sales remained lower than initial targets for the year 2011-12.
Autoplate Industry

The automobile industry grew by 5.6% despite the impact of aforementioned disasters, depreciation of Pak Rupee and inflation. Annual production is gradually moving towards its highest of 164,000 units, achieved five years ago. A recovery despite such adverse factors shows that this industry has enormous potential which can drive the economic engine alone, provided consistent and industry friendly policies are in place. On the other hand issues like tariff rationalization with other countries of the region, under invoicing, limited consultation with OEM on free trade agreements should be resolved in order to maintain investor's confidence.

The total industry production for the financial year ended March 31, 2012 was 143,161 units against 135,904 units for last year, up by 5.3%. Sales also improved to 142,861 units against 135,278 units for last year, up 5.6%. Cars up to 800cc registered growth of 19.8%, cars having engine capacity from 1000cc to 1299cc posted growth of 12.6%, whereas 1300cc & above category showed decline of 7.4%. The quarterly production of auto industry is as follows:
During the year under review, your company produced 11,040 units. Sales were 11,406 units. Decline in production was severe in third and fourth quarters where company produced 2,425 units and 1,140 units respectively because of non availability of parts due to flood in Thailand. The quarterly production figures for last year are given below:

<table>
<thead>
<tr>
<th>Years</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Total</th>
<th>Incr/(Decr)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Honda 2011-12</td>
<td>3,222</td>
<td>4,253</td>
<td>2,425</td>
<td>1,140</td>
<td>11,040</td>
<td></td>
</tr>
<tr>
<td>Honda 2010-11</td>
<td>3,960</td>
<td>3,967</td>
<td>3,801</td>
<td>4,712</td>
<td>16,440</td>
<td></td>
</tr>
<tr>
<td>% increase/ (decrease)</td>
<td>-18.6%</td>
<td>7.2%</td>
<td>-36.2%</td>
<td>-75.8%</td>
<td>-32.8%</td>
<td></td>
</tr>
</tbody>
</table>
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In the federal budget for the year 2011-12, government reduced sales tax from 17% to 16% and Special Excise Duty (SED) of 2.5% was abolished. These changes were welcomed by the industry and had positive impact on the market as industry production increased by 7.1% and 16.5% in next two quarters ending Sep-11 and Dec-11. Company passed on the advantage to the customers by reducing prices on all variants of Honda Civic and Honda City.

Financial Results

The company started 2011-12 with progressive financial results for first and second quarters, whereby it managed to absorb the impact of Japan tsunami and posted gross and operating profits. However, operations were discontinued for a couple of months after Thailand floods, which eroded gross and operating profit margins in last quarter and the company ended up with loss before tax of Rs 498.8 million.

Sales revenue for the year decreased by 24.6% at Rs 16,599.6 million against Rs 22,026.1 million in the corresponding period last year. Cost of sales were Rs 16,643.6 million, resulting in gross loss of Rs 44.0 million against gross profit of Rs 199.3 million, last year. This was because production and sales volume saw a decrease of 32.8% & 30.7% respectively, due to factors mentioned above, and current volumes were not sufficient to absorb fixed expenses. Further, Pak Rupee depreciated against US$ and Japanese ¥, production cost remained under pressure and the complete impact could not be passed on to the customers.

In second half of the year, the company focused on cost down efforts and curtailed unproductive expenses to ease pressure on cash flow. Resultantly, running administrative and selling expenses were reduced by
6.9% to Rs 289.5 million against Rs 310.9 million in the last year. Other income increased to Rs 204.4 million against Rs 84.0 million last year, mainly from return on bank deposits due to better cash flow in the first half of the year. Other charges increased to Rs 217.8 million mainly due to exchange rate impact on payable balance of Suppliers Credit Facility, availed from Honda subsidiary company on parts purchases. The loss from operations increased to Rs. 346.9 million. Financial charges remained at Rs. 151.9 million.

Thus, loss before tax for the year was Rs 498.8 million against Rs 244.8 million in last year. The loss after tax was Rs 532.2 million against Rs 298.4 million last year.

During the year, the company contributed Rs 6.28 billion towards the government revenue in the shape of custom duty, sales tax and other government levies. Now, since incorporation, the company has paid accumulated amount of Rs 67.93 billion to the government exchequer.
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Changes on the Board

With annual Human Resource changes in Honda Motor Company, three directors representing HMC were changed. Mr. Yukimitsu Miyagi, who served as Vice President Production for more than four and half years returned to Japan and Mr. Akio Takemoto succeeded him as Vice President Production. Mr. Shigeru Yamazaki and Mr. Takashi Nagai were replaced by Mr. Yuishi Fukuda and Mr. Shigeki Takane respectively. Further, Mr. Jawaid Iqbal Ahmed who had been associated as director since the inception of the company also retired & Mr. M. Naeem Khan has joined as his successor. The Board appreciate the contributions made by the out-going directors and welcomes the new directors on the Board.

Future Outlook

Under the prevailing circumstances, outlook for 2012 remains challenging. The risk to macroeconomic stability stems from external sector and the continued weakness on the fiscal side. In terms of real sector, there has been improvement for last couple of months. The government
must work together with all stakeholders to take decisive action of broadening revenue mobilization, restructuring of public sector enterprises and providing solution to the worsening energy crises. On the other hand, government should target early realization of planned foreign financial inflows to mitigate uncertainty at external account. Agriculture, a core contributor of revival with 25% share in the economy, will remain the nucleus of economic growth. Reasonable support price, improved acreage in major crops and timely financial support by government to farmers will assist in moving the economic cycle at a higher pace. However, depreciating rupee and political instability will keep a check on the progress.

The automobile industry is steadily moving up for last three years, combating all internal and external challenges. The increase in automobile loan disbursement by 46.4% in the first half of the year will further push demand in the industry in the coming quarters.

The company has been focusing on the revamping the financial position and have positive prospects for improved financial results next year. We will keep focus on improving all-round efficiency, controlling running expenses, innovation in product line-up and excellent after sales back up for customer satisfaction.

I heartily applaud the Japanese and Thai nations for their marvellous efforts in recovering from the natural disasters. I take pride in Atlas Group & Honda partnership and would like to acknowledge their continued help and support to the company. I would also like to thank our valued customers, dealers, vendors, financial institutions and shareholders for their continued support to the company. I also thank Mr. Takeharu Aoki, President & CEO, who is working hard to overcome the difficult situation with his able leadership and support from his dedicated team.

(Let us do better and better)

Yusuf H. Shirazi
Chairman
Lahore, May 14, 2012