

Chairman's Review

It's my privilege to present you the financial statements for the nine months period ended December 31, 2006.

The Economy

The Pakistan economy continued to perform well in the first half of the year 2006-07 with better than expected crops of wheat, cotton and sugarcane. During a recent analysis of Pakistan's economy, an IFI expressed satisfaction over the strong fundamentals and projected an overall GDP growth of over 6 percent. The manufacturing sector, which has remained a major driver of the resurgence of the economy slowed down. The deceleration in the growth rate of manufacturing sector has been attributed to the slow down in the textile industry. The revenue collection for the first half of the year improved 26%, to Rs. 409 billion as compared to the same period last year.

The trade deficit remained a cause of concern as the exports registered a moderate gain of 4.8% during the period under review - recorded US \$8.4 billion. The imports increased to US \$14.9 billion, up 9.1%. The major escalation came in import of petroleum products. The deteriorating trade and current account deficits are posing a challenge for the managers of the economy. The Foreign Direct Investment (FDI) is expected to touch US \$2.0 billion in the first half of the year. The remittances from overseas Pakistanis were up 24.4%, in the first five months of the year, to US \$2.09 billion. As a result foreign exchange reserves are now at US \$12.9 billion. Inflation is still high at 8.39% over the same period last year. This high rate of inflation is affecting the production costs and is hurting the weaker segments of the population.

The Automobile Industry

The industry benefited from the lower financing rates that prevailed for the last two years. The growth in demand due to this factor has somewhat leveled off as the cost of leasing has increased rapidly. This coupled with the liberal import policy, resulting in import of 32,047 used and 5,244 new units during April 06-December 06 period, have restricted the growth of the local OEMs and the vending industry. During the period from April-06 to December-06 the growth has been restricted to 11.6% when compared to the same period of last year. A total of 125,616 units were produced against 112,537 units in the same period of last year. The sales increased 9.0% to 120,129 units against 110,234 units in the corresponding period last year. After recording double digit growth for many quarters in last couple of years, the production of Oct 06 - Dec 06 quarter recorded a decline of 0.5% over the same quarter last year.

Company Performance

In recent past we have introduced two new models and have also undertaken a major expansion with a financial outlay of well over Rs.3.5 billion. The company has also undertaken major commitment of resources towards localization. In house manufacturing and assembling of parts



is being done progressively. These activities have contributed towards increasing costs for the company which will benefit the company in the future: all of it could not be passed on presently.

The best business practices of Honda bind it to quality and environment friendly products. The company as a policy provides its customers global models at regular intervals that encompass the Honda strength in R&D. Your company has privilege of changing the landscapes of Pakistan automobile industry & introducing several first in the market, like Programmed Fuel Injection (PGMF-i), Variable Valve Timing & Lift Electronic Control (VTECH), prosmatec transmission, Anti-Lock Braking System (ABS), sun roof (Oriel), Alloy Wheel, 16 valve engine in 1.3L cars, Steermatic, to name a few. Honda does not develop low specs models that are region specific. In compliance to its global policy Honda City is Euro-III-compliant and Honda Civic is Euro IV compliant. The introduction of state of the art technology has remained a hallmark of Honda in Pakistan. We led the way by introducing many of the features that are now standard in locally assembled cars. With the new Civic, Honda has created a shining chapter in the history of auto industry in the country with introduction of state of the art safety standards and environment friendly Euro-IV-compliant technology. This car has been declared "The Car of the Year" the world over. The NEW CIVIC is a totally new product under the familiar name tag, not merely another CIVIC. Since we started in 1994, Civic introduced four full model changes, in addition to three minor model changes.

During the period under review, thus your company produced 13,800 units against 23,484 units. The company had to observe shut down days for our capacity expansion activities in June-06 and August-06. The sales were contained at 13,555 units against 22,047 units in the same period of last year. The reduced sales reflect saturation of the market due to easy availability of imported used and new cars at far reduced rate of custom duties etc. During April 05 to March 06 the imported cars at 16,005 units had a 26% market share of 1000cc and above market. During the 9 month period of April 06 to December 06, the market share of these used and new cars at 24,157 units has increased to 43%. The rate of increase is indeed alarming. The tough market conditions are thus reflected in these financial results.

The sales during first nine months of the year were Rs.12,005.0 million against Rs.18,585.0 million. The cost of goods sold was Rs.11,855.4 million against Rs. 17,974.3 million. As compared to the same period last year the gross profit thus reduced to Rs.149. 5 million against Rs.610.7 million. The administrative & selling expenses were Rs. 269.2 million against Rs. 205.1 million in the comparable period last year. Thus the company suffered an operating loss of Rs. 119.7 million against operating profit of Rs. 405.6 million to be made up in future. Other income was Rs. 100.9 million against Rs. 270.6 million due to decrease in interest income. Financial and other expenses were high at Rs. 200.7 million against Rs. 63.6 million mainly due to increase in bank borrowings due to out flow of cash for expansion, model change and localization. Thus



the company suffered loss before tax of Rs. 219.4 million against profit before tax of Rs. 612.5 million in the same corresponding period of last year. After tax adjustment, the net loss for the period was Rs. 126.4 million against net profit of Rs. 376.1 million in the same period, last year - to be duly made up in the future. The after tax loss was Rs. 1.77 per share against Rs. 5.27 profit in the same period last year. The return on equity was negative against positive return on equity of 16.8%.

The company has completed capacity expansion in the last quarter and now the plant has installed capacity of 50,000 units per annum, in double shifts against 5,000 units, a few years ago – last Japanese maker to enter this market. The increase in fixed assets and bank borrowings to support the long term and short term requirements would increase depreciation and interest expenses over the next couple of years.

Future Outlook

The industry is again experiencing under-capacity utilization situation after expansions of production facility & stagnation in the automobile industry, owing to continued import of new and old cars. In all 37,291 units have been imported since April 2006. The protection of automobile industry is vital through long term policy and monitoring of imports through transfer of residence and gift scheme etc., which is being manipulated by importers for no gain to the country, much less to the consumer in the long run.

As a result of the capacity expansion in plant and improved service network through induction of new dealerships, your company is now well poised to service all orders without long waiting period. We can now look forward to be first choice of the customers as usual because of the improved quality, delivery and service capabilities.

پرواز ہے دونوں کی اسی ایک فضا میں
کرگس کا جہاں اور ہے شامین کا جہاں اور
(Let us continue to fly our flag high)

Thanks

I must thank our customers, vendors, dealers and financial institutions for their continued support and trust in our product. I am also thankful to M/s Honda Motor Company, Atlas Group, Mr. Tatsuhiro Oyama and Mr. Masahiro Takedagawa for their help and support and the President, Mr. Mamoru Suwama, and his team for their commitment and hard work.

Yusuf H. Shirazi
Chairman

Lahore
January 27, 2007