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Research Update:

UzAuto Motors Outlook Revised To Positive On Strong Performance And Expected Further Growth; 'B+/B' Ratings Affirmed

January 23, 2023

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Rating Action Overview

- We expect UzAuto Motors' (UAM's) results will show it outperformed our forecast for 2022, generating about US$270 million-US$290 million of EBITDA on the back of record production and the launch of new models on the GEM platform, compared with about US$200 million in our previous base case.
- We expect UAM to show further EBITDA growth in 2023-2024, supported by strong demand for cars in the region and planned capacity expansion to 500,000 units annually, while we project the company's funds from operations (FFO) to debt at well above 45%.
- At the same time, our current rating assessment is limited by the historically volatile free operating cash flow (FOCF), in particular resulting from large swings in capital spending (capex) and working capital, and limited although improving transparency at the holding company level.
- We therefore revised our outlook on UAM to positive from stable and affirmed our 'B+/B' long- and short-term ratings.
- The positive outlook indicates that we could raise the long-term rating if UAM successfully expands production capacity while maintaining EBITDA margins at 8.5%-9.5%, FFO to debt above 45%, and reducing intrayear working capital volatility.

Rating Action Rationale

Capacity expansion plans and growing domestic demand should support EBITDA growth above US$300 million in 2023-2025. By the end of 2022, UAM reported a record high level of production of about 328,000 units, on the back of the successful launch of new models on the GEM platform, which is currently ramping up. However, we expect the company to further increase volumes given its announced plans to expand its capacity to 500,000 units by 2025. We currently expect that the company will be able to sell those volumes, thanks to the strong growth prospects of the domestic market, driven by a young and growing population and still low automobilization levels compared with neighboring countries in the region. This should translate into top-line growth of 30%-45% in 2023 and 10%-20% in 2024. We note 2022 profitability was hit by inflation and additional costs related to the GEM platform launch, depressing EBITDA margin to about 8.5% from 10.8% in 2021. However, we expect a change in the portfolio mix with the introduction of two new higher margin models, Onix and Tracker, as well as economies of scale, will offset persistent inflation pressure. We think this will keep the EBITDA margin at 8.5%-9.5% and that it could result in sustainable EBITDA generation above US$300 million in the next two years. We note that gradual domestic market liberalization, including the reduction of custom duties in Uzbekistan in February 2022, along with additional capacity investments by other players, could intensify competition in Uzbekistan in the next few years. However, we still expect UAM to sustain its leading market position, supported by a fresh new model line-up and its cost-efficient local production, which allow it to offer its vehicles at lower price points relative to competitors.

UAM's ability to generate FOCF, in particular by controlling working capital fluctuations, is a key rating factor. UAM's cash flow generation has been highly volatile historically, constraining the rating at the current level. The company generated US$220 million-US$240 million in operating cash flow, before working capital changes, annually during 2020-2022. However, the company faced a working capital outflow of US$365 million in 2020 on the back of shrinking customer prepayments because of the pandemic. This was followed by a working capital inflow of US$290 million in 2021, as the decline in prepayments reversed and UAM extended the number of days payable. We further note sizable half-year working capital fluctuations during 2022, with a US$167 million outflow during the first half of 2022 followed by an expected material working capital inflow in the second half of the year, leading to a sizable cash buildup. We estimate the year-end 2022 cash balance and short-term deposits at more than US$500 million, which should provide some cushion for potential liquidity outflows in 2023. Also, we understand the inventory buildup to launch the GEM platform and negotiations with suppliers are now final, and that management expects no further material working capital fluctuations. Nevertheless, we expect the company's operating cash flow generation to remain prone to large swings, for example, because capacity expansion plans can materially affect inventories or lead to additional advances to suppliers, or due to typically volatile customer prepayments, which fluctuate with legislative changes or macroeconomic conditions. We also note that the company's capex remains uneven, because it is mainly driven by decisions on major capacity investments, and this may compound the volatility of its FOCF.

We expect the group's credit quality to develop in line with UAM's, with the introduction of International Financial Reporting Standards (IFRS) improving transparency. We expect UAM to remain the core asset of its parent company, UzAutoSanoat, generating about 80% of the group's EBITDA. Therefore, the parent company's credit quality is closely linked to UAM's, in our view. Specifically, our view of the group's business is mainly driven by UAM, given that the holding company's diversification into other areas of light vehicle production, such as in engine production, is limited. Despite plans for several joint ventures being announced last year between the holding company and its foreign partners in Uzbekistan and export markets, we don't expect any material debt incurred in connection with these partnerships or at other subsidiaries. As a result, we believe the group's FFO to debt will be above 50% in the next two years, close to that of UAM.

UAM's plan for an IPO of a minority stake is unlikely to change our view of its link with the government. UAM announced a domestic IPO launch in December 2022 with a target of disposing 5% of its share capital, with a further capital disposal planned in a subsequent international IPO, which for now is delayed on the back of increased market volatility. Even if the second IPO were to go ahead, we expect that the government would keep a large controlling stake in UAM (more than 75%, in our view). As a result, we think that the likelihood of UAM receiving extraordinary government support in times of difficulty is unlikely to change. Conversely, the potential entry of international investors could further enhance transparency and the implementation of best corporate practices, for example, quarterly reporting and public announcement of a financial policy. We still believe our assessment of a high likelihood of extraordinary government support captures the group's importance to the local economy as a national auto producer and large employer, as well as the government's influence on UAM's strategic and business plans through its board of directors, and its track record of previous support through favorable loan rates and market regulation.

Outlook

The positive outlook reflects our expectation that pricing and new model launches could support EBITDA margins at 8.5%-9.5% and absolute EBITDA above US$300 million, as well as cumulative FOCF above US$100 million in 2022-2023. In addition, with limited new debt for UAM's capacity expansion, FFO to debt should remain comfortably above 45%, and we expect no significant additional incurrence of leverage at the holding level.

Upside scenario

We could raise our rating in the next 15-18 months if:

- UAM successfully expands its capacity, while sustaining production above 400,000 units in 2023.
- UAM generates annual EBITDA above US$300 million, supported by strong demand and pricing.
- FFO to debt remains consistently above 45%, with limited additional leverage buildup to finance its capacity expansion program.
- Cumulative FOCF is above US$100 million in 2022-2023, supported by good management of capex and a more predictable working capital trajectory.

The credit quality of parent UzAutoSanoat would also need to develop in line with that of UAM to support a potential upgrade. Notably, we expect the parent's credit metrics to be similar to those of UAM, implying limited additional debt (other than assumed in our base case) and no material negative cash burn at other subsidiaries. We expect transparency will increase at the parent company with the introduction of IFRS reporting.

We could also raise the rating on UAM if we raise the sovereign rating on Uzbekistan (BB-/Stable/B).

Downside scenario

We could revise the outlook to stable if the company is unable to sustain EBITDA above US$300 million, due to weakening demand, the failure to expand capacity, or inability to offset foreign exchange pressure or cost inflation through price adjustments. We could also revise the outlook if we observe negative FOCF as a result of a significant capital investment program with uncertain future returns or higher working capital requirements than we envisage in our base case.

The probability of a downgrade is limited in the next two years. This would require material EBITDA reduction or leverage build up at UAM or the holding level, leading to FFO to debt below 30% and adjusted debt to EBITDA above 3.0x for the consolidated group, or unexpected pressure on the company's or the group's liquidity.

Company Description

Based in Uzbekistan, UAM is the largest passenger vehicle manufacturer in Central Asia. By the end of 2022, we think the company produced 328,000 vehicles, reporting about US$270 million-US$290 million of EBITDA. The company currently produces 12 passenger car models, mostly in the lower price segment, under the Chevrolet brand in technical partnership with GM.

UAM benefits from high import tariffs imposed on imported cars without the level of localization required by the Uzbekistani government, with its domestic market share in passenger vehicles at 96% as of year-end 2021. Its products are also exported to other countries in the Commonwealth of Independent States, with export sales contributing about 18% to total revenue in our base case for 2022.

The GEM project, launched by the end of 2022 after total investments at about US$350 million during 2020-2022, is an initiative under which UAM is introducing the new Onix and Tracker models, designed by General Motors (GM) specifically for emerging markets. Once fully operational, the project should support UAM's profitability through economies of scale and phase-out of legacy models. It should also bolster the company's position in export markets, supporting further increases in exports to 20% of total revenue.

The company was founded in 1993 as a joint venture between Uzbekistan's government and Daewoo Motors, with GM replacing Daewoo in 2008. In 2018, UzAutoSanoat acquired GM's 25% stake and UAM is now 100% owned by the government of Uzbekistan.

Our Base-Case Scenario

Assumptions

- Consumer price index growth in Uzbekistan of 10%-11% annually and an exchange rate of Uzbekistani sum (UZS) 11,200-UZS12,000 to US$1 in 2022-2024.
- UAM's auto production increasing to 328,000 units in 2022, after 228,000 units in 2021, thanks to new capacity after the launch of the GEM platform, along with easing chip shortages. We further expect UAM will gradually increase its production capacity to 500,000 units by 2025.
- Strong demand in the domestic and export markets absorbing all of UAM's production, such that sales volume grows broadly in line with production. Share of export sales further expanding up to 20% in 2022-2025 from 16% in 2021.
- Revenue growth of 30%-45% in 2023 and 10%-20% in 2024 on the back of pricing and strong demand.
- S&P Global Ratings-adjusted EBITDA margin drops to about 8.5% in 2022 from 10.8% in 2021 caused by inflated component costs and higher selling, general, and administrative expenses. With the introduction of new models following the launch of the GEM platform, UAM should realize cost efficiencies. Combined with matching pricing to offset inflationary pressure, we expect EBITDA margin to remain within the 8.5%-9.5% range in the next two years.

- A working capital inflow in 2022 contributing to cash build up above US$500 million. We assume only a modest change of working capital in the next two years, with the company's sizable cash position to cover any fluctuations, if needed.
- Capex of US$80 million in 2022 required for final installation of the GEM platform and about US$100 million yearly in 2023-2024 reflecting the capacity expansion investments.
- No mergers or acquisitions in the next two to three years.
- Dividend payment up to 30% of the net income.

Key metrics

UzAuto Motors JSC--Key Metrics*

	--Fiscal year ended Dec. 31--				
Mil. $	**2020a**	**2021a**	**2022e**	**2023f**	**2024f**
Revenue	2,623.0	2,162.0	~3,200	4,300-4,600	4,800-5,100
Revenue growth (%)	(0.1)	(0.2)	~50	35-45	10-20
Sales ('000 units)	295.0	228.0	~328	400-430	430-460
EBITDA	235.0	233.0	270-290	370-440	400-490
EBITDA margin (%)	8.9	10.8	~8.5	8.5-9.5	8.5-9.5
Working capital changes	(365.0)	290.0	25-105	(300)-(150)	(300)-(150)
Free operating cash flow (FOCF)	(214.0)	267.0	180-250	(100)-50	(50)-150
Debt	277.0	328.0	~390	~450	~440
FFO to debt (%)	67.0	56.0	~55	>55	>55
UzAutoSanoat EBITDA	303.0	292.0	330-350	450-520	490-580
UzAutoSanoat FFO to debt (%)	75.0	50.0	~50	>55	>55
UzAutoSanoat debt	316.0	458.0	~520	~570	~550

*All figures adjusted by S&P Global Ratings. Our debt adjustments at UAM level include US$105 mil. guarantees, provided to UzAuto Motors Powertrain and consolidated at UzAutoSanoat level. We do not net available cash in our adjusted debt calculation, in line with business risk profile weak peers. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess UAM's liquidity as adequate.

The ratio of liquidity sources to uses will exceed 1.2x in the 12 months from Jan. 1, 2023, supported by improving cash flows and limited debt maturities. This is further supported by the sizable cash position the company holds to offset any unforeseen fluctuations in working capital.

Principal liquidity sources:

- Unrestricted cash and cash equivalents and short-term deposits above US$500 million.
- Cash FFO of US$300 million-US$340 million.

Principal liquidity uses:

- Maintenance spending and capacity expansion project of about US$100 million.
- Up to US$300 million of intra-year working capital volatility covered by the company's cash balance.
- Dividend payment up to 30% of net income.

Covenants

UAM bears a covenant on the outstanding Eurobond, which limits new debt issuance in case net debt to EBITDA exceeds 3.75x. Under our base-case assumptions, we believe UAM will remain compliant with these covenants in the next 12 months with at least 20% headroom.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-4

Governance factors are a negative consideration in our credit rating analysis of UAM, similar to corporate peers in Uzbekistan and Kazakhstan. UAM and its parent company, UzAutoSanoat, are on the path to greater disclosure and transparency. UzAutoSanoat has recently initiated IFRS disclosure, but with only 2020 full-year results available so far. We think the group's governance still lags international best practices, especially when compared with those of public companies in developed markets. Moreover, our assessment reflects the elevated country-related governance risks in Uzbekistan, where the company's operations are concentrated. Environmental factors have an overall neutral influence on our rating analysis of UAM. Although UAM lags global auto producers in terms of the transition to electric vehicle production, this is offset by significantly lower regulatory pressure from the Uzbekistani government and the lack of carbon dioxide emission regulation, limiting the effect on the company's financials in the next few years, in our view.

Issue Ratings - Subordination Risk Analysis

Capital structure

UAM's current capital structure comprises a US$300 million senior unsecured bond due 2026 and export credit agency unsecured financing of US$50 million attracted at the end of 2022. The company further guarantees US$105 million of amortizing export credit agency loan issued to sister company, UzAuto Motors Powertrain, to fund its capex program, ranked pari passu with outstanding bond.

Analytical conclusions

The bond and export credit agency financing were issued to fund the GEM platform construction, and we align the rating on the notes with the long-term issuer credit rating because the notes are not structurally or contractually subordinated to any other debt instrument.

Ratings Score Snapshot

Issuer Credit Rating	B+/Positive/B
Business risk:	Weak
Country risk	High
Industry risk	Moderately High
Competitive position	Weak
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bb-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	b+
Group credit profile	b+
Entity status within group	Core (no impact)
Related government rating	BB-
Likelihood of government support	High (no impact)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate

Entities, Nov. 13, 2012

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; Outlook Action

	To	From
UzAuto Motors JSC		
Issuer Credit Rating	B+/Positive/B	B+/Stable/B
Senior Unsecured	B+	B+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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