Research Update:

UzAuto Motors 'B+/B' Ratings Affirmed On Expected Growth; Outlook Remains Positive

January 25, 2024

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Rating Action Overview

- The general repayment capacity of Uzbek government-related enterprises might weaken because of the potential risk of lapses in internal controls or government supervision. We therefore revised the likelihood of extraordinary government support for UzAuto Motors to moderately high from high since we now consider that the entity's link to the government is strong, versus very strong previously.
- That said, UzAuto Motors has retained a dominant position in Uzbekistan, on the back of the government's high import tariffs and production localization requirements, among other protection measures.
- We therefore affirmed the 'B+/B' issuer credit ratings UzAuto Motors, reflecting our 'b+' assessment of the company's stand-alone credit profile, and our 'B+' rating on the company's debt.
- The positive outlook indicates that we could raise the ratings if UzAuto Motors successfully expands production capacity while maintaining EBITDA margins at 8.5%-9.5% and funds from operations to debt above 45%, and reducing intrayear working capital volatility, alongside having generated free operating cash flow above US$100 million in 2022-2023.

Rating Action Rationale

Risk of potential lapses in administrative capacity led us to revise UzAuto Motor's likelihood of government support to moderately high. We now see that UzAuto Motor has a strong link with the government, versus very strong previously, since we think the government oversight is not as scrupulous as we thought. For example, there was a failure to recognize covenant breaches at Uzbekneftegaz (see "Uzbekneftegaz Outlook Revised To Negative On Covenant Breach And Revised Likelihood Of Government Support," published Nov. 29, 2023, on RatingsDirect), increased dividends extracted from Almalyk (see "Uzbekistani Copper And Gold Miner Almalyk 'B+' Rating Affirmed On Progressing Expansion; Outlook Stable," published Dec. 1, 2023), and delayed payments by an unrated entity in the agriculture sector. In an adverse scenario, inadequate internal controls and government supervision could delay timely and sufficient support to UzAuto

Motors. Although we continue to regard ongoing government support to UzAuto Motors in terms of market regulation as favorable, we acknowledge that the company's management does not differ materially from other GREs, given similarities in the boards of directors composition and the instruments available to the government to provide timely liquidity support. Furthermore, we note the increased dividend payout to 50% of net income from 30% expected previously, still coupled with continued investments into capacity expansion, driven by the government. Moreover, although we do not foresee such a scenario in our base case, the presence of an additional layer, parent company Uzavtosanoat, might slow communication to the government of extraordinary help needed for UzAuto Motors.

On a stand-alone basis, we expect UzAuto Motors will increase its production and sustain EBITDA above $300 million in 2023-2025, supported by strong domestic demand. This is despite ongoing domestic market liberalization and growing competition in the region. We expect the company's 2023 EBITDA to have just surpassed $300 million, capturing higher sales on the back of strong domestic demand from a young and growing population and still-low light vehicle ownership levels, compared with neighboring countries. That said, the company faces heightening domestic and regional competition from original equipment manufacturers (OEMs) in Asia OEMS like Geely Automobile Holdings Ltd. (BBB-/Negative/--), Kia Corp. (BBB+/Positive/--), Cherry, Exceed, and BYD. However, we expect competition will mostly affect the premium segment, and UzAuto Motors generates up to 70% of EBITDA from its lower-price segment. Moreover, although we recognize the government's steps toward domestic market liberalization, including a recent custom duties reduction for engines below 1,200 cubic centimeters, we do not anticipate a near-term disruption to UzAuto Motors' competitive position. We think the company's market position is secured by pricing flexibility thanks to efficiency gains from its large scale and high degree of localization alongside Chevrolet's strong brand recognition in the country.

We assigned a new management and governance (M&G) modifier assessment of moderately negative to UzAuto Motors. The action follows the revision to our criteria for evaluating the credit risks presented by an entity's M&G framework. The terms management and governance encompass the broad range of oversight and direction conducted by an entity's owners, board representatives, and executive managers. These activities and practices can impact an entity's creditworthiness and, as such, the M&G modifier is an important component of our analysis. Our M&G assessment of moderately negative points to certain M&G weaknesses that weigh down creditworthiness for UzAuto Motors. The company is a core subsidiary of parent company Uzavtosanoat and is significantly influenced by the decision-making at the parent level, which might not be fully transparent.

Outlook

The positive outlook reflects our expectation that pricing and model launches could support EBITDA margins at 8.5%-9.5% and absolute EBITDA above US$300 million, as well as having generated free operating cash flow (FOCF) of above US$100 million in 2022-2023. In addition, with limited new debt for UzAuto Motors' capacity expansion, funds from operations (FFO) to debt should remain comfortably above 45%, and we do not expect the holding company to materially increase leverage.

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, a failure to expand capacity, or an inability to offset foreign exchange pressure or cost inflation through price adjustments. We could also revise the outlook to stable if we observe negative FOCF because of a sizable capital investment program with uncertain future returns or higher-than-anticipated working capital requirements.

A downgrade would occur if a material EBITDA reduction or leverage build-up at UzAuto Motors, or the holding level, led to FFO to debt close to 30% and S&P Global Ratings-adjusted debt to EBITDA close to 3.0x for the consolidated group. Rating pressure would also stem from unexpected strain on the company's or the group's liquidity.

Upside scenario

We could raise our rating in the next 12 months if:

- UzAuto Motors expands its capacity while sustaining production above 400,000 units in 2024.
- The company generates annual EBITDA above US$300 million, supported by strong demand and pricing.
- FFO to debt remains above 45%, with limited additional leverage buildup to finance its capacity expansion program.
- Cumulative FOCF exceeds US$100 million, underpinned by good expenditure management and a more predictable working capital trajectory.

A potential upgrade would also hinge on the credit quality of parent Uzavtosanoat developing in line with that of UzAuto Motors. Specifically, similar credit metrics at both the parent and UzAuto Motors would imply limited additional debt (other than our base-case assumption) and no material negative cash burn at other subsidiaries. We expect transparency will increase at the parent company with the introduction of IFRS reporting.

An upgrade of Uzbekistan (BB-/Stable/B) will not immediately prompt a similar action on UzAuto Motors, all else remain the same.

Company Description

Based in Uzbekistan, UzAuto Motors is the largest passenger vehicle manufacturer in Central Asia. The company sold about 160,000 vehicles in the first half of 2023, reporting US$141 million of EBITDA. The company currently sells 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 that do not have the level of localization required by the Uzbekistani government, with its domestic market share in passenger vehicles at 93% as of year-end 2022. Its products are also exported to other countries in the Commonwealth of Independent States, with export sales contributing about 14% to total revenue in 2022.

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, Uzavtosanoat 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 9%-11% annually and an exchange rate of Uzbekistani sum (UZS) 11,700-UZS12,000 to US$1 in 2023-2024.
- UzAuto Motors to gradually increase its production capacity to 440,000 units by 2025, following an estimated 370,000-380,000 units in 2023 thanks to expanded capacity after the launch of the GEM platform, compared with 328,000 in 2022.
- Strong demand in the domestic and export markets absorbing all of UzAuto Motors' production, such that sales volumes rise broadly in line with production. Share of export sales further expanding no higher than 20% in 2023-2025 from 13% in 2022.
- Revenue growth of 20%-25% in 2023 and 10%-20% in 2024 on the back of pricing and strong demand.
- S&P Global Ratings-adjusted EBITDA margin to remain at 8.0%-9.0% in the next two years.
- About US$100 million-US$300 million outflow of working capital in the next two years, with intra-year fluctuations covered by cash balances.
- Total capital expenditure (capex) of US$200 million--US$230 million in 2023-2024, reflecting the capacity expansion investments.
- No mergers or acquisitions in the next two to three years.
- Dividend payment of 50% of the net income.
- Export credit agency financing of up to $50 million and an additional loan to fund capacity expansion in 2023-2024 of up to $100 million.

Key metrics

UzAuto Motors--Forecast summary

	--Fiscal year ends Dec. 31--			
(Mil. US$)	2021	2022	2023e	2024f
Revenue	2,162	3,265	3,900-4,100	4,320-5,000
Revenue growth, (%)	(17.6)	51.0	20.0-25.0	10.0-25.0
Sales ('000 units)	228	328	370-380	400-450
EBITDA	237	288	330-350	360-425
EBITDA margin, (%)	10.9	8.8	8.0-9.0	8.0-9.0
Working capital changes, full year	291	410	(200)-(300)	(100)-(200)
Capital expenditure (capex)	236	111	60-80	160-170
Free operating cash flow (FOCF)	274	598	(50)-40	(20)-100
Debt	329	426	530	550

UzAuto Motors--Forecast summary (cont.)

	--Fiscal year ends Dec. 31--			
(Mil. US$)	2021	2022	2023e	2024f
FFO/debt (%)	57	53	50-55	50-60
Uzavtosanoat EBITDA	292	346	380-420	460-530
Uzavtosanoat debt	458	541	660-680	680-690
Uzavtosanoat FFO/debt (%)	61	54	45-50	45-65

*All figures adjusted by S&P Global Ratings. a--Actual, e--Estimate, f--Forecast.

Liquidity

We assess UzAuto Motors' liquidity as adequate.

The ratio of liquidity sources to uses will exceed 1.2x in2024, supported by improving cash flows and limited debt maturities. This is further supported by the cash position the company holds to offset any unforeseen fluctuations in working capital.

As of Dec. 31 2023, we estimate UzAuto Motors' principal liquidity sources for 2024 will be:

- Unrestricted cash and cash equivalents and short-term deposits of $307 million; and
- Cash FFO of $300 million-$330 million.

We estimate the following principal liquidity uses for the same period:

- Maintenance spending and capacity expansion project of about $150 million;
- Up to $200 million of intra-year working capital volatility; and
- Dividend payment of 50% of net income.

Environmental, Social, And Governance

Governance factors are a negative consideration in our credit rating analysis of UzAuto Motors, similar to corporate peers in Uzbekistan and Kazakhstan. UAM and its parent company, Uzavtosanoat, are on the path to greater disclosure and transparency. Uzavtosanoat has recently initiated IFRS disclosure, but with only 2020 full-year results available so far. We think the group's overall 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 UzAuto Motors. Although the company 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

UzAuto Motors' current capital structure comprises a US$300 million senior unsecured bond due 2026, export credit agency unsecured financing of US$48 million and $150 million unsecured syndicated term loan, both of which are only partially withdrawn. The company further guarantees US$133 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 debt instruments were issued to fund the GEM platform construction and current capacity expansion, 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	Moderately Negative (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	Moderately high (no impact)

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- 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
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- 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: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Uzbekistani Copper And Gold Miner Almalyk 'B+' Rating Affirmed On Progressing Expansion; Outlook Stable, Dec. 1, 2023
- Uzbekneftegaz Outlook Revised to Negative On Covenant Breach and Revised Likelihood of Government Support, Nov. 29, 2023

Ratings List

Ratings Affirmed	
UzAuto Motors JSC	
Issuer Credit Rating	B+/Positive/B
Senior Unsecured	B+

information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.