FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades JSC UzAuto Motors to 'BB-'; Outlook Stable

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Fitch Ratings - Barcelona - 13 Dec 2022: Fitch Ratings has upgraded JSC UzAuto Motors' (UAM) Long-Term Issuer Default Rating (IDR) and senior unsecured rating to 'BB-' from 'B+'. The Outlook on the Long-Term IDR is Stable. The Recovery Rating remains at 'RR4'.

The upgrade follows the revision of socio-political and financial implications of a UAM default to 'Strong' from 'Moderate'. We have therefore equalised its rating with that of sovereign in line with Fitch's 'Government-Related Entities Rating Criteria'(GRE). Fitch continues to assess UAM's Standalone Credit Profile (SCP) at 'b'.

KEY RATING DRIVERS

Strong Socio-Political Impact: Our revision of socio-political implications of a UAM default to 'Strong' reflects our view of a material negative socio-political impact given UAM's large revenue and contribution to Uzbekistan's economy. In addition, UAM, together with related parties, has a rather large workforce in the country of about 28,000 staff, which in case of default will increase the unemployment rate in the country.

Strong Financial Implication: Our revision of financial implication of default to 'Strong' reflects the proven record of the company's access to international capital markets. We expect that a UAM default would adversely affect the reputation of Uzbekistan, as it is a state-owned company and one of the largest corporate companies in the country. In terms of revenue size it is similar to such companies like JSC Almalyk Mining and Metallurgical Complex (BB-/Stable) and JSC Uzbekneftegas (BB-/Stable). UAM is one of few entities in Uzbekistan that placed a Eurobond, leading us to believe that this company could be treated as proxy for government bonds.

Strong Links with State: Fitch views the status, ownership and control linkage of UAM with the state as 'Strong' due to full state ownership and operational control by the parent over the company's capex and operational strategy. We assess the support track record as 'Strong' due to historical state support in different forms, including shareholder loans on favorable terms; the absence of large dividends paid to the parent, which we expect to continue at least until the end of the large capex programme; and a favourable regulatory environment supported previously by high import duties for cars, protecting UAM's dominant position in its domestic market.

Car Sales Disruption: UAM has a long-term license agreement with General Motors Company (GM; BBB-/Positive), and while there may be alternative offers from foreign competitors, a default of UAM would cause temporary disruption to the delivery of new cars. While the regulatory environment has softened over the last two years with falling import duties, demand for UAM's cars is still strong and it remains the dominant seller in Uzbekistan. UAM supplies the most affordable cars in the local market and we believe that it would be hard to substitute UAM's cars with other foreign brands in the medium term.

Constrained SCP: UAM's 'b' SCP reflects a weaker business profile than that of other Fitch-rated carmakers, with limited scale, a narrow product range and sales concentration in Uzbekistan. This could be mitigated by its entry into new markets in the CIS region. Its business profile is also constrained by the absence of a strong brand, limiting the company's competitive position in relation to global auto manufacturers'. UAM's operating activity is fully dependent on its existing long-term license agreement with GM, which provides access to the latter's technological knowledge.

Inherent Cash Flow Volatility: UAM's cash flow generation has been highly volatile since 2016 and is one of the key rating constraints. Its funds from operations (FFO) and free cash flow (FCF) margins were deeply negative in 2020 before returning to strongly positive territory in 2021, mainly driven by extreme year-on-year working capital development and expansionary capex. Although its main capex project is set to complete by 2023, Fitch expects such volatility to remain in the near term on the back of raw-material price inflation and lingering supply-chain issues in the auto industry.

Temporary Profitability Erosion: EBITDA profit margin in 2022 has been affected by inflation and industry-wide chip shortage, which led to inefficiencies of fixed-cost absorption in 1H22. This is partially offset by price increases on average of about 10% and some production catch-up in 2H22. We expect EBITDA and EBIT margins to slightly decline to 8.9% and 7.4%, respectively, in 2022, before trending toward 11% and 8% by 2025. This is due to a change in the portfolio mix, with UAM's legacy models being phased out by 2023 and sales of the new and relaunched models growing.

Dominant Position: UAM is the main producer of passenger cars in Uzbekistan and has a dominant position in Uzbekistan. This, combined with high capex in production facilities and favourable regulation, acts as significant barriers to entry and supports the company's local market share. Nevertheless, ongoing liberalisation of Uzbekistan's economy could increase competition from foreign competitors and erode UAM's sales and profitability.

DERIVATION SUMMARY

UAM's business profile is weaker than that of global automotive manufacturers including GM (BBB-/Positive), Ford Motor Company (BB+/Positive), and Renault SA (BB/Stable). The company is not fully comparable to Fitch-rated peers as it does not own the brand of the models it manufactures and the associated technological knowledge. Moreover, despite its dominant position in its domestic market UAM's scale is much smaller than peers'. The company's product and geographical diversification is also significantly lower than global automotive manufacturers'.

Though UAM's EBITDA and EBIT margins are commensurate with Fitch's expectation for the investment- grade category, its cash flow generation has been erratic. We forecast that UAM's FFO margin will be in the range of 6%-9% in 2022-2025, in line with GM's and Ford's, but lower than Stellantis N.V.'s (BBB/Stable). The historical FCF margin volatility stems from large annual working-capital swings and growth capex.

UAM's gross leverage profile is comparable with Ford's and GM's. We expect UAM to reach net cash position by 2025.

KEY ASSUMPTIONS

- Revenue peak in 2023 driven by new model launches and pricing, and to remain at USD4 billion 2024-2025

- EBITDA margin of 8.9% in 2022 before gradually trending toward 11% by 2025

- Negative to neutral working-capital changes, in line with revenue growth to 2025

- Average capex at 3.4% of sales to 2025, including spending to increase production capacity to around 500,000 units

- Dividend pay-out ratio between 15% and 30%

- No M&A for the next four years

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

-Upgrade of Uzbekistan's sovereign rating

-EBITDA leverage sustainably below 1.3x accompanied by sustainably positive FCF margin could be positive for SCP, but not necessarily for the IDR

Factors that could, individually or collectively, lead to negative rating action/downgrade:

-Downgrade of Uzbekistan's sovereign rating

-EBITDA leverage sustainably above 2.3x or sustainably negative FCF could be negative for the SCP but not necessarily for the IDR

-Evidence of weaker ties between Uzbekistan and UAM (including, but not limited to, a change of UAM's legal status; a decline of government ownership to less than 50%; weakening of financial and regulatory support)

The following rating sensitivities are for Uzbekistan (9 September 2022):

-External Finances: Weakening of external finances, for example through a sustained widening of the current account deficit derived from a permanent decline in remittances or worsening trade deficit, resulting in a significant decline in foreign-exchange (FX) reserves or rapid increase in external liabilities

- Public Finances: A marked rise in the government debt-to-GDP ratio or the erosion of the sovereign fiscal buffers, for example due to an extended period of low growth or crystallisation of contingent liabilities, that could result in the removal of the +1 notch for this factor

- Macro: Significant narrowing of Uzbekistan's GDP per capita gap vs. peers, for example underpinned by the implementation of structural reforms, while improving macroeconomic stability

-Structural: Significant improvement of governance standards including rule of law, voice and accountability, regulatory quality and control of corruption

-External and Public Finances: Significant strengthening of the sovereign's fiscal and external balance sheets, for example, through sustained high commodity export revenues

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Improved Liquidity: Fitch expects UAM to conclude 2022 with more than USD100 million readily available cash, after restricted cash adjustment of about USD90 million. We deem such liquidity satisfactory to sustain intra-year working-capital swings. During the course of 2022, UAM obtained a trade finance facility in the amount of USD100 million from two financial institutions for its payables to suppliers, which provides additional headroom to liquidity.

Its IPO in December 2022 should bring in some cash proceeds of about USD20 million-USD50 million. We forecast the cash position to further improve on the back of positive cash flow generation beyond 2022.

Bullet Debt Maturity Profile: The Eurobond is the main borrowing facility in the UAM's debt quantum, with a maturity in May 2026. The company also guarantees UzAuto Motors Powertrain's amortising loan with ECA to fund its capex programme. Although UAM has no imminent debt maturities, refinancing risk is on the rise and its own production capacity expansion could mean additional funding needs.

ISSUER PROFILE

UAM is the dominant car producer in Uzbekistan which is 100% indirectly owned by JSC Uzavtosanoat, the state-owned company, which is the dominant controlling body of the automotive industry within the Republic of Uzbekistan (BB-/Stable). UAM produces and sells vehicles and spare parts under the brand of Chevrolet mainly in Uzbekistan and Kazakhstan.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING			RECOVERY	PRIOR
JSC UzAuto Motors	LT IDR	BB- Rating Outlook Stable	Upgrade		B+ Rating Outlook Stable
senior unsecured	LT	BB-	Upgrade	RR4	B+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 29 Oct 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

JSC UzAuto Motors	EU Issued, UK Endorsed

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