

Chairman's Review

It gives me great pleasure to present to you the review on your company's performance for the year ended March 31, 2004 alongwith audited accounts.

The Economy

The economic recovery gained further momentum in the first three quarters of the current financial year. Accordingly, the GDP growth is likely to exceed the budgeted target of 5.3% against 5.1% of the last year. This growth is augmented by agriculture growth at 4.3% - due to increased supply of water and agriculture credit, which has resulted in increase in production of wheat at 20.1 mln tones, sugarcane 52.6 mln tones, rice at 4.9 mln tones and cotton at 10.1 mln bales.

The large scale manufacturing has registered a growth of 14.2% during the current period against 8.0% of the last period, led by automobile sector. The export maintained growth with 13.4% increase for the first nine months of the year under review at US\$ 8.90 billion against US\$ 7.85 billion in the same period, last year. The imports stood at US\$ 10.50 billion as compared to US\$ 9.03 billion, up 16.3%. The current account balance remained in surplus at US\$ 1.9 billion. The growth in revenue collection for first three quarters was at Rs. 351.7 billion against Rs. 310.3 billion in the same period last year, up 13.3%.

The overseas remittances though lower than last year's were handsome at US\$ 2.87 billion against US\$ 3.10 billion in the last corresponding period. The foreign exchange reserves were US\$ 12.6 billion end March 2004, up 17.3%, from June 2003. The rupee dollar exchange rate parity stayed under control at Rs. 57.55 whereas rupee remained under pressure against Yen at 0.5526. The foreign direct investment is expected to increase one billion dollar mark by the end of this fiscal year.

The Automobile Industry

The Consumer Finance Policy, easy availability of consumer credit and low rates of interest has surged the demand of all automotive vehicles, especially cars. The industry responded to rising demand by sharp increase in production which is expected to cross 100,000 units by end June 2004. The growth during the year was cars: 62.9%, tractors 28.1%, LCV, buses and trucks, 13.2% and motorcycles, 72.8%. Overall the automotive industry grew 62.2% at 402,853 units for the year ended March 31, 2004 as compared to 248,388 units in the same corresponding period, last year. The quarterly production growth of each sector is shown as under:

Category	Q1	Q2	Q3	Q4	Total 2004	2003	Growth
Cars	20,253	20,408	23,298	24,922	88,881	54,573	62.9%
Tractors	8,641	6,858	9,451	8,903	33,853	26,425	28.1%
LCV, Buses, Trucks etc	4,642	3,349	4,741	4,707	17,439	15,402	13.2%
Motorcycles	47,971	64,776	72,727	77,206	262,680	151,988	72.8%
Total 2003-04	81,507	95,391	110,217	115,738	402,853	248,388	62.2%

The car production for the year under review starting from April 2003 to March 2004 was 88,881 units as compared to 54,573 units, up 62.9% in the same corresponding period last year. The sales also increased 61.3% to 88,386 units against 54,805 units, last year. The comparison of quarterly production growth is as below:

Production

Year	Q1	Q2	Q3	Q4	Total
2003-04	20,253	20,408	23,298	24,922	88,881
2002-03	12,753	12,673	12,858	16,289	54,573
Growth	58.8%	61.0%	81.2%	53.0%	62.9%

The production in the category of 1300cc and above, where your company belongs, increased to 34,916 units as compared with 21,411 units, last year. Your company produced 11,586

units during the year ended March 31, 2004 against 8,401 units in the same period, last year. The company planned increase in its production capacity in early half of the year and gradually enhanced production during later half of the year with 78.3% and 96.4% growth in the third and fourth quarters respectively. The sale was 11,750 units against 8,401 units in the same corresponding period, last year. The production of 1300 cc and above cars vis-à-vis your company production in each quarter is given below:

1300cc Category	Q1	Q2	Q3	Q4	Total
Industry 2003-04	8,005	8,598	8,698	9,615	34,916
Industry 2002-03	5,116	5,670	4,858	5,767	21,411
Growth	56.5%	51.6%	79.0%	66.7%	63.1%
Honda 2003-04	2,283	2,362	3,333	3,608	11,586
Honda 2002-03	2,288	2,407	1,869	1,837	8,401
Growth	-0.2%	-1.9%	78.3%	96.4%	37.9%

New Models

Pursuing policy of reinforcing the landscapes of Pakistan automotive industry, through style, technology and comfort to the customers, your company launched two new models of Honda City and Honda Civic during the year.

On August 23, 2003, the company introduced new model (FMC - Full Model Change) of Honda City which received tremendous response from the market. The new model is distinct advanced shape with aesthetically designed interior. The new model's unique "IDS" (Intelligence Dual & Sequential Ignition) engine employs two spark plugs per cylinder for maximum fuel efficiency and Vario (Continuously Variable Transmission) allows smooth step-less power transfer from the engine to the wheel to match the moods. One of the reasons for low production during second quarter of the year was phase out period of Honda City. This shortfall was compensated in the later half of the year with increase in production as compared to the first half.

The second change in the product line during the year was, in fact, the 9th change since start of your Company's commercial production in 1994. The new model of Honda Civic 2004 was launched on April 15, 2004 with MMC (Minor Model Change). The new model features changes in head lights, front bumper, tuner and four wheel disk brakes in Exi models also, which previously was available only in Vti models. The sale of Honda Civic was thus down in the last quarter due to phasing out of the old model, but the overall, shortfall was compensated by increase in sales of Honda City. The model mix of Civic & City was 44:56 in the year under review against 55:45 in the same corresponding period last year.

The company celebrated 50,000th car rolling out ceremony during September 2003.

As a good corporate citizen, we follow the public policy in letter and spirit. As such, following the government decision your company primarily was the only one that reduced retail prices by Rs. 12,500 on all Honda Civic Exi models and Rs. 17,500 on all Honda Civic Vti models w.e.f June 01, 2003 which caused the company loss of profit of Rs. 66.1 million which the company would have earned, otherwise.

Company Performance

The sale during the year under review was Rs. 9,358.4 million against Rs. 4,901.1 million in the nine months period ended March 31, 2003. The cost of goods sold also increased to Rs. 8,602.4 million against Rs. 4,333.7 million, last year. The gross profit was Rs. 756.0 million as compared to Rs. 567.4 million. However, the gross profit ratio reduced from 11.6% for nine months period ended last year to 8.1% during the year under review due to adverse rupee yen parity, provision of Rs. 41.6 million for custom duty against expected demand recognized by the company, effect of retail price reduction of Rs. 66.1 million as stated above and change of sales mix.

The administration and selling expenses were Rs. 160.9 million against Rs. 107.3 million for nine months period, last year. The expenses were down in terms of sales from 2.2% to 1.7% mainly due to better cost control measures and increase in sales revenue. The operating profit was Rs. 595.0 million against Rs. 460.0 million. The other income also grew from Rs. 51.3 million to Rs. 72.9 million. The income from bank deposits did not increase in proportion to cash reserves mainly due to continuously decreasing interest rates. The financial and other charges were Rs. 47.7 million against Rs. 35.5 million last period.

Thus the profit before tax during the year was Rs. 620.2 million against Rs. 475.8 million and after tax profit Rs. 408.7 million against Rs. 346.1 million, last year. The net profit margin was down from 7.1% last year to 4.4% in the year under review for reasons explained above. The earning per share before tax was, however, at Rs.14.8 against Rs.11.3, last year. The return on equity during the year was 34.1% against 29.7%, last year.

The cash flow position improved significantly during the year to Rs. 3,514.9 million at the year end as compared to Rs. 1,263.9 million last year. The main reason for this increase was change in policy of booking of cars at 100% down payment instead of Rs. 100,000. The major cash out flow consists of fixed capital expenditure of Rs. 243.9 million which represents addition of plant and machinery owing to change in new models of City and Civic.

Your Board of Directors in their meeting held on May 15, 2004 has announced 42.5% cash dividend (Rupees 4.25 per share for Rs.10 each) against 35% cash dividend last year. After distribution of Rs.178.5 million dividend, the balance of Rs. 230 million will be transferred to general reserves. Thus the company has maintained record of fair payout to the

shareholders. Since 1994, when your company commenced operations, the company has so far distributed Rs. 868 million as dividend and bonus shares to the shareholders. The shareholders' equity has increased to Rs.1,932 million from Rs. 1,702 million, last year.

During the year, the company has contributed a sum of Rs. 3,843.8 million towards government revenue in the shape of custom duty, sales tax, income tax and other government levies. The accumulated revenue contribution over last ten years is now Rs. 14.7 billion.

The company has further strengthened its 3S (Sale, Service, Spare Parts) dealership network by inaugurating two new dealerships at Mirpur, Azad Kashmir and Gujranwala to cater the expanding business requirements. In addition, 11 PITSTOP at Karachi, Sukkur, Faisalabad, Lahore, Burewala and Islamabad have been set up during the year to ensure better and quick after sales service to the customer in remote areas as well. The company continues to aim at a strong network, presently with sixteen 3S dealerships and thirty PITSTOP.

Expansion Plan

The company has planned to invest over Rs. 460 million in its paint shop and other manufacturing facilities, to enhance the production capacity more than double. The expansion will be completed by end of second quarter this year, when the production capacity on double shift, will increase to 2,400 units per month and 30,000 units per annum. It will create additional employment opportunities crying need of the day.

Safety and Environment

Safety and Environment issues are an integral part of the company. A healthy, safe & environment friendly and responsible workplace is critical to our company. As a corporate citizen, the company recognizes its social responsibility to actively

pursue solutions to environmental and safety issues. Therefore, the company is always working on the impact on environment at all stages of operations.

In September last year, the company achieved ISO 14001 certification successfully after an audit conducted by M/s AIB-VINCOTTE International Ltd., Brussels, Belgium. To achieve this target, the company formed an ISO Secretariat to prepare the action plans and procedures to provide direction to the environment activities and establish responsibilities for safety and environment. To implement solid waste management and to control water contamination, the company has planned to install 'Waste Water Treatment Plant' during the year, whereas, incinerator has already been installed and its commissioning is under process, at the cost of Rs. 5 million and Rs. 4.5 million respectively. Further, a number of in-house and out-source training courses were held to create awareness among associates on critical environment issues at each department level. Where possible, the company will require to main contractors and suppliers to have a documented EMS in place.

Human Resources

Mr. Takashi Otsuki, who joined this company on December 27, 1999 left in December last year, after serving this company for four years as Director and Sr. General Manager Finance. Mr. Toshitsugu Kaneko replaced him as a director. Mr. Akira Yoshizawa & Mr. Yukihiro Aoshima were replaced by Mr. Keizaburo Otaki & Mr. Koji Nakazono respectively. Mr. Y. Urakobo, General Manager Quality Control went back to Japan in May 2003 after completing its tenure of service with the company. He was replaced by Mr. Yuji Shoyama. I wish to record appreciation on behalf of the Board of Directors for the valuable contributions made by the out going members during their tenure with the company and wish good luck to their successors.

The company started with 197 associates in 1994 at the start of production. They are now 625 by the end of March 31, 2004, which includes 62 post graduates and engineers, 38 graduates and 532 technicians and skilled labour.

Future Outlook

The automobile industry has seen brisk growth in the last couple of years. The car demand is expected to cross 100,000 units for the financial year 2003-2004. The industry has the potential to grow further. This is due to better economic conditions as a result of consistent government policies, which is expected to continue, and also due to liquidity in the market. It is estimated that by the end of June 2004, the total investment in the automobile industry would rise to US\$ 1.7 billion. Foreign exchange saving in terms of local manufacturing would be US\$ 1.2 billion. The car manufacturing units would be paying taxes to the tune of Rs. 51.5 billion. The contribution to GDP will be Rs. 153.9 billion. Total employment, direct and indirect would be over 200,000.

Comparative Position

On the other hand, there is a controversy going on to import cars in CBU or import reconditioned cars to fill in the temporary gaps in demand and supply and reduction in the competitive advantage to the industry in this connection. The comparison of Pakistan with Thailand and India, the two near comparative countries is given below:

Duties:

On CKD

Country	Import Duty	Excise Duty*	Commodity Tax	Govt. Tax	VAT / S. Tax*	Total**	With holding Income Tax
Pakistan	35%	-	-	-	15%	155	6%
India	20%	8%	-	-	16%	150	-
Thailand	20%	-	33%	-	-	160	-

* Adjustable

** Common Value of 100 is taken and the duty/taxes are applied in sequence

On CBU

Country	Import Duty	Excise Duty*	Commodity Tax	Govt. Tax	VAT / S. Tax*	Total**	With holding Income Tax
Pakistan	100%	-	-	-	15%	230	6%
India	60%	8%	-	-	16%	200	-
Thailand	80%	-	57%	10%	7%	313	-

* Based on 1300-1500cc

** Common Value of 100 is taken and the duty/taxes are applied in sequence

General Tariff Rates

PAKISTAN						INDIA		THAILAND	
DUTY						DUTY ON ALL CARS		DUTY	
	Import	S. Tax	Inc. Tax	CVT	Total	Basic Duty	Additional Duty	Misc. Duties	Total
Upto 1000cc	75%	15%	6%	5.00%	124%	105.00%	24.00%	27.50%	156.50%
1001cc-1300cc	100%	15%	6%	5.00%	156%				
1301cc-1500cc	100%	15%	6%	6.25%	159%				
1501cc-1800cc	125%	15%	6%	7.50%	195%				
1801cc-3000cc	150%	15%	6%	7.50%	228%				
Minimum - 124%						DUTY		DUTY	
						Basic Duty		Duty - 80%	
						Additional Duty		Excise Duty	
						Misc. Duties		Less than 2400cc - 56.9%	
						Total		Less than 3000cc - 74.7%	
								Less than 3000cc - 107%	
								Over 3000cc - 101.7%	
								Minimum - 213%	

Import of Reconditioned Cars

PAKISTAN	INDIA	THAILAND
VOLUME OF IMPORTS (INSIGNIFICANT)	VOLUME OF IMPORTS (INSIGNIFICANT)	VOLUME OF IMPORTS (INSIGNIFICANT)
1. Allowed under Transfer of Residence, Gift Scheme & Personal Baggage	1. Allowed under Transfer of Residence after 2 years 2. Gift Scheme - NIL	1. Allowed under Transfer of Residence after 2 years. 2. Gift scheme - NIL

Continuity in Policies

The above comparative evaluation will show that no stretch of imagination, would justify import of CBU or reconditioned cars in the country which according to government's own study will have more disadvantage than advantage to the economy as a whole: nor any reduction in the competitive advantage is called for, which is causing alarm not only to the foreign investor but also the local – more so – the vending industry, the lifeline of the industry.

All this, therefore, calls for a review of the thinking in the overall interest of the industry – nay the economy and the stakeholders, including investors, employees and the consumers. The foreign investment in the country continues to be a high risk investment. Automotive industry is also threatened by WTO and SAFTA

which must be avoided. The Government's thinking further belies its assurance of continuation of the policies at the highest level. This, therefore, calls for continuity of the current policy in the interest of the nation as a whole:

ستاروں سے آگے جہاں اور بھی ہیں

(There is a world beyond the world!)

Acknowledgement

I would like to thank the customers, the dealers, vendors, financial institutions and the shareholders for their trust and confidence in the company. I also thank the Government and Honda Motor Company for their assistance in the growth of the company. May I also thank Mr. Mamoru Suwama, President of the company for his leading the company well enough and the staff members for their dedication and commitment to the growth of the company.

Yusuf H. Shirazi
Chairman