RATING REPORT

Gatron (Industries) Limited

REPORT DATE:
15 February, 2023

RATING ANALYST:
Ali Yousuf
ali.yousuf@vis.com.pk

RATING DETAILS		
Rating Category	**Initial Ratings**	
	Long-term	**Short-term**
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	*Feb 15, 2023*	

COMPANY INFORMATION	
Incorporated in 1980	**External auditors:** Kreston Hyder Bhimji & Co., Chartered Accountants
Public Listed Company	**Chairman of the Board:** Mr. Abdul Razak Diwan
Key Shareholders (with stake 10% or more):	**Chief Executive Officer:** Mr. Shabbir Diwan
Mr. Rizwan Diwan	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (August 2021) *https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf*

Gatron (Industries) Limited

OVERVIEW OF THE INSTITUTION

Gatron (Industries) Limited was incorporated in Pakistan on November 1980, as a public limited company

Profile of the Chairman:
The Board is chaired by Mr. Abdul Razak Diwan is a founder member of Gatron (Industries) Limited. He is also the Director Finance of the Company since its incorporation.

Profile of the CEO:
Mr Shabbir Diwan, Chief Executive Officer (CEO) at Gatron (Industries) Limited. is an MBA from Institute of Business Administration. Mr. Shabbir Diwan is an Executive Director of Novatex Limited and also a Director in ThalNova Power Thar (Pvt) Limited (Moreoover he is Member and Director, Pakistan Business Council, Pakistan-India Joint Business Council, constituted by Ministry of Commerce Govt. of Pakistan and ex-Hon. Deputy General Secretary, Memon Medical Institute

RATING RATIONALE

Corporate Profile
Incorporated in 1980 Gatron is a public listed company involved in the manufacturing of Polyester Filament Yarn (PFY) and PET Preforms in Pakistan with its plant located at Hub, Baluchistan. The Company forms part of the 'G&T' group, which has been in existence for over seven decades having presence in various sectors including textile, plastic resin and power generation. Leading group companies include Novatex Ltd (PET Resin , Preforms & BOPET Films), Mustaqim Industries (home textiles), Bonanza, Krystalite (PET sheets & Thermoforming products). The Group is an established market player with sound financial standing.

The principal line of business of Gatron (Industries) Ltd is manufacturing of Polyester Filament Yarn through its self-produced Polyester Polymer/Chips which will increase to 231,000 MT. The Company also produces PET Preforms and Knitted Fabrics. Production capacity of Filament Yarn is 75,000 MT/Year, enhancing further to 95,000 MT/year and Preforms is 41,000 MT/Year based on 43.66 gm.

In terms of product mix PFY generates more than 80% of revenue while the rest is contributed by PET Preforms. PFY is procured by the textile sector with a clientele of over 1200 companies. Usage of same provides a smooth and silky finish largely used in denims, knitted fabrics, home clothing and functional items such as car seats. Rupali group is the major competitor in the PFY market however, the Company has strong holding in the southern and northern region of the country.

PET Preforms are procured by international brands such as Pepsi, Coca Cola and Nestle as well as by local renowned brands such as Rooh Afza and Pakola. As a group Gatron and Novatex occupy major market share. Other players in PET Preform market are Eco Pack and Mehran Packages.

The Company introduced production of Knitted Fabrics in FY22. While contribution of knitted garments remain nominal, the Company over time plans to expand the same.

The Company has three wholly owned subsidiaries, off which Gatro Power (Private) Limited remains active. Gatro Power generates and sells electric power, solely to its parent Gatron. The company has a 55 megawatt capacity and generates power on gas and furnace oil as well.

Table: Subsidiaries

Name	Nature
Gatro Power (Private) Limited	Generate and sell electric power to captive parent
G-Pac Energy (Private) Limited	Generate and sell electric power to captive parent
Global Synthetics Limited	Dormant

Sector Dynamics & Competitive landscape

The demand for PFY is majorly driven by the textile sector as polyester fabric is amongst the most dominant man-made fabric for local use. Pakistan's polyester demand is estimated around 361,000 Metric Tons which is met through local production (35%) while the remaining portion 65% is catered through imports. This share of local manufacturers is expected to increase to 43% in year 2022-23 based on their capacity after their current expansion underway. Domestic market is dominated by two major players, namely Gatron and Rupali Group.

Competitive pressures in the industry remain heightened due to dumping from China, and Malaysia into Pakistan, consequently curtaining margins of the local players. Anti-dumping duties on PFY were imposed in 2017 to restore these margins (ranging from 3.25 % to 11.35%) further in December 2021 NTC has reduced the notified anti-dumping duties in the range of 2.78% to 6.82% , however, the duties were not effectively implemented and over Rs.16bn remains uncollected from importers during past five years. More recently, Government has imposed a 5% regulatory duty in Dec 2022 which is expected to provide some cushion to the local players who are already in the expansion phase.

Major raw materials Purified Terephthalic Acid (PTA) and Monoethylene Glycol (MEG) are both crude oil derivatives and therefore remain vulnerable to changes in international commodity prices. However historically PFY prices move with the change in PTA/MEG prices. PTA is primarily procured locally from Lotte Chemicals Pakistan Limited while MEG is fully imported. Amidst economic challenges, currency volatility and gas shortages, competitive pressures are expected to remain high in the industry.

Key Rating Drivers

Group synergies provide leverage

Being part of the G&T group, the Company benefits from the synergies that are derived on group basis in terms of better pricing, access to capital, preferential access to raw materials, pricing discounts on volumes and pooling of shared resources.

Revenue growth supported by capacity expansion and devaluation.

While crossing the Rs. 23b mark in FY22 (FY21: Rs. 16b), sales revenue noted year-on-year increase of ~45%, fueled largely by devaluation gains. The growth was also supported by volume increase in yarn sales. PFY sales stood at Rs. 19.7b in FY22 (FY21: Rs. 12.6 b), accounting for more than 80% of revenues. In Q1FY23, the total revenue recorded by the Company was around Rs. 5b.

In comparison to previous year the Company more than doubled its exports however exports as a ratio of total sales stood low at around 3% (FY21: 2%). While the Company has a strong local market, it plans to increase its exports by tapping other potential countries besides the current markets. Client concentration is fairly low in the yarn segment with about a wide array (~1200 companies) of textile Companies procuring. In the Preforms segment, client concentration is mitigated through long-term contracts with the customers.

While currency devaluation impacts the raw material costs for the Company, it is absorbed in the final pricing as product pricing is regularly aligned on landed cost basis. Rather currency fluctuations deters commercial importers to dump imported PFY in the country, thereby aiding local players. In addition, with the Company aiming to increase their export base, currency gains will continue to contribute to topline growth.

Margins constrained over the rating horizon
Gross margin increased to 13% in FY22 (FY21: 11.3%) to some extent attributed to PKR devaluation and increased freight on competitive imports which was favorable for the Company in FY22. However, this benefit was offset in 1QFY23 due to decrease in sales quantity of both PFY and PET Preforms on account of sudden surge of imported PFY with lower import freight cost and flooding condition prevailing in the country. Consequently, Company recorded a lower gross margin of 3.8% (1QFY22: 14%). Rising manufacturing overheads mainly power costs and availability constraints of gas in winters are projected to dampen projected margins over the rating horizon. However the company has alternative power sources being gensets on HFO (furnace oil), KE supply and solar.

Moreover, financial charges arising out of higher debt and higher interest rates has impacted net margins of the Company. However, a major part of the long term debt company is fixed at lower rates under subsidized schemes. Debt servicing will continue to be a drag on future profitability. Dividend income from Gatro Power will support bottom line profitability, which is projected to increase on higher rates but at the same time remains vulnerable to availability of gas resource. Nominal net margins have been projected over the rating horizon.

Elevated Capitalization indicators
Total equity base stood at Rs. 7.4b (FY22: Rs. 7.7b) at end 1QFY23. The Company secured long term funding for expansion of yarn and resin capacities along with higher working capital borrowing to support enhanced capacities. Consequently, gearing was recorded higher at 2.16x. We expect gearing levels to remain elevated over the next 2 years due to additional drawdown in pipeline and lower profit generation.

Satisfactory liquidity profile
Amidst macro-economic challenges and slowdown in the textile sector, we expect some extension in working capital cycle, which is also reflective in Q1'23 results. However, given adequate lines and cushion available in short term borrowing coverage, liquidity indicators are expected to remain satisfactory. Liquidity profile remains underpinned on projected dividend income from 100% subsidiary i.e. Gatro Power.

Sound Corporate Governance and IT framework
Corporate governance framework is reflective of a listed entity with 7 member Board inclusive of 3 non-executive directors and 3 independent directors. For effective oversight, two board level committees, namely Audit Committee, Human Resources & Remuneration Committee are in place. As per best practices, independent member chairs both committees and the board has female representation as well.

The Company has a well-designed organizational structure. Recent implementation of new ERP system SAP S/4 HANA provides additional leverage to the Company in terms of operational efficiencies. .

Gatron (Industries) Limited Appendix I

Financial Statement				(Amount in Million)
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**1QFY23**
Property, Plant & Equipment	3,578	5,949	9,769	11,507
Stock in Trade	2,395	3,840	6,318	11,855
Trade Debts	2,230	2,897	4,323	4,577
Cash & Bank Balances	64	103	133	209
Other Assets	2,018	22,071	3,128	4,759
Total Assets	**10,285**	**14,860**	**23,671**	**32,907**
Trade and Other Payables	1,578	1,806	3,668	7,556
Short Term Borrowings	1,672	3,521	4,892	7,872
Long-Term Borrowings *(Inc. current matur)*	1,178	2,931	5,974	8,114
Deferred Liabilities	415	502	796	1,291
Other Liabilities	110	145	570	673
Total Liabilities	**4,953**	**8,905**	**15,900**	**25,506**
Issued, Subs, and Paid Up Capital	384	384	384	384
Equity	**5,333**	**5,955**	**7,771**	**7,401**
INCOME STATEMENT				
Net Sales	12,938	16,558	23,960	4,896
Gross Profit	945	1,867	3,176	184
Operating Profit	451	1,316	2,646	-41
Investment Income - Dividend	1,213	113	226	
Profit Before Tax	1,458	1,302	2,559	-277
Profit After Tax	1,061	1,066	1,827	-370
FFO	1,679	1,662	2,979	24
RATIO ANALYSIS				
Gross Margin (%)	7.3%	11.3%	13.3%	3.8%
Net Margin (%)	8.2%	6.4%	7.6%	-7.6%
FFO to Long-Term Debt	1.43	0.57	0.50	0.01
FFO to Total Debt	0.59	0.26	0.27	0.01
Debt Servicing Coverage Ratio (x)	11.44	12.43	11.27	0.65
ROAA (%)	11.1%	8.5%	9.5%	-1.3%
ROAE (%)	19.9%	18.9%	26.6%	-4.9%
Gearing (x)	0.53	1.08	1.40	2.16
Debt Leverage (x)	0.93	1.50	2.05	3.45
Current Ratio	1.70	1.49	1.42	1.27
Inventory + Receivables/Short-term Borrowings	2.77	1.91	2.18	2.09

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES					Appendix III
Name of Rated Entity	Gatron (Industries) Limited				
Sector	Polyester Filament Yarn				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: Entity				
	15/2/2023	A-	A-2	Stable	Initial
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information.				
Due Diligence Meeting Conducted	**Name**	**Designation**	**Date**		
	Mr. Shabbir Diwan	CEO	Jan 18, 2023		
	Mr. Mustufa Bilwani	CFO			
	Mr. Naeem	Senior Finance Manager			