RATING REPORT

Gatron (Industries) Limited

REPORT DATE:
May 17, 2024

RATING ANALYST:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	*Stable*		*Stable*	
Rating Date	*May 17, 2024*		*Feb 15 ,2023*	
Rating Action	*Reaffirmed*		*Initial*	

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 **Mr. Saqib Haroon Bilwani**	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates: *https://docs.vis.com.pk/docs/CorporateMethodology.pdf*

APPLICABLE RATING SCALE(S)
VIS Issue/Issuer Rating Scale: *https://docs.vis.com.pk/docs/VISRatingScales.pdf*

Gatron (Industries) Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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

Profile of the Chairman:
The Board is chaired by Mr. Abdul Razak Diwan is a founding 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 Chairman 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

Gatron (Industries) Limited ('GIL' or 'the Company') was incorporated in 1980 as 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).

<u>Product Portfolio:</u>

The principal line of business of Gatron (Industries) Ltd is manufacturing of Polyester Filament Yarn through its self-produced Polyester Polymer/Chips. The Company also produces PET Preforms and Knitted Fabrics. Production capacity of Filament Yarn is 77,000 MT/Year, enhancing further to 98,000 MT/year and PET Preforms is 31,500 MT/Year based on 27 gm.

Polyster Filament Yarn (PFY): 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.

PET Preforms: The Company also manufactures PET preforms, which 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.

<u>Intermediate products:</u>

GIL produces different types of Polymer Chips viz. Textile Grade Chips (TGC) and Film Grade Chips (FGC). TCG is used in the manufacturing of PFY while FGC is sold to a group company. GIL is also expected to start manufacturing silica chips, which are vital components in the production of PET films.

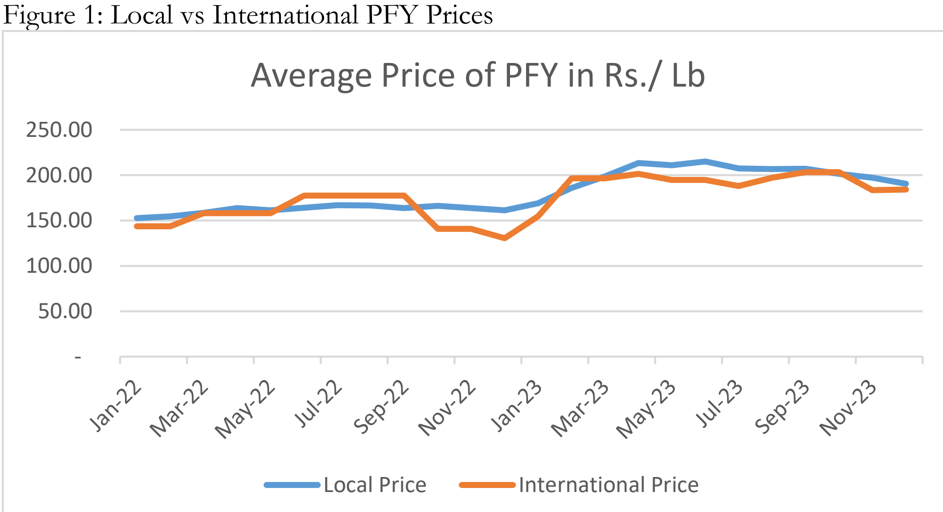
<u>Sector Update</u>

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. It is estimated that Pakistan's requirement for PFY is approximately 350,000 Metric Tons per annum. Local manufacturers (operating at 100%) have available capacities to meet 50% of the PFY local demand. However, with current operating rate of 60%, local manufacturers have a market share of approximately 30% of this demand, with imports accounting for roughly 70%. The domestic market features prominent dominance by two key entities: GIL and Rupali Group.

Intense competitive pressures persist within the industry, largely due to the influx of low-priced imports from China into Pakistan, which compresses the profit margins of local manufacturers. This surge in dumping primarily stemmed from substantial capacity expansions in China. Chinese producers have reportedly ramped up operations to utilize over 90% of their new capacities, aiming to present robust operational metrics to banks and local authorities to secure full loan disbursements for completing these expansions. In response, Pakistan introduced anti-dumping duties on PFY in 2017, setting rates between 3.25% and 11.35% to bolster local margins. In December 2021, the National Tariff Commission (NTC) adjusted these duties to a range of 2.78% to 6.82%. Despite measures taken up by the authorities over the years, implementation gaps have left over Rs.16 billion in duties uncollected from importers over the past five years. More recently, in December 2022, the government levied a 5% regulatory duty expected to support local manufacturers, particularly those undergoing expansions. Internationally, countries like Turkey, India, the US, Vietnam, Brazil South Korea and Mexico have imposed anti-dumping duties (ADD) on Chinese PFY, with rates between 16% and 32%.

Major raw materials used in the manufacturing of PFY are Purified Terephthalic Acid (PTA) and Monoethylene Glycol (MEG), which are both crude oil derivatives and therefore remain vulnerable to changes in international commodity prices. However, historically PFY prices have moved with the change in PTA/MEG prices. PTA is procured both locally and internationally while MEG is fully imported. Amidst economic challenges, currency volatility and gas shortages, competitive pressures are expected to remain high in the industry. Due to excessive dumping of low priced PFY by Chinese manufacturers, local PFY price are significantly influenced. This practice undermines local production as it forces down domestic prices, making it difficult for local manufacturers to raise prices to cover escalating costs except for specialized products. Despite anti-dumping duties imposed to protect local industries, evasion tactics by importers, such as obtaining court stay orders, have resulted in significant uncollected duties, further straining local producers. A comparison of local vs international prices of PFY is given below:

Figure 1: Local vs International PFY Prices



Operational Update:

Property, plant and equipment was recorded higher at Rs. 20.2b (FY23: Rs. 16.9b; FY22: Rs. 9.8b) at end-9M'FY24. The increase is attributed to significant capital investments made during the review period (FY23 and 9M'FY24), especially with the commissioning of new Polycondensation plant, which is completed at an estimated cost of more than Rs. 7billion. The production capacity of Polyester Filament Yarn (PFY) has notably increased to 98,000 tons per annum. Total capacity of intermediate products (viz. TGC, FGC, Amorphous and Silica Chips) increased to 700 tons/day from 100 tons/day. Production capacities and actual production are mentioned below:

Year (FY July – June)	FY22	FY23	1H'FY24
Polyester Filament Yarn			
Annual capacity (including 75 denier)	43,424	43,424	21,712
Annual capacity (including 150 denier)	86,280	86,280	43,140
Actual Production	56,887	54,594	25,706
Capacity Utilization (%) Based on 150 Denier	65.9%	63.3%	59.6%
Polyester P.E.T. Preforms			
Annual capacity (including 43.7gms)	41,017	41,017	20,509
Annual capacity (including 27 gms)	31,512	31,512	15,756
Actual Production	14,080	12,298	4,040
Capacity Utilization (%)	19.4%	17.0%	25.6%
Knitted Fabrics			
Annual capacity	1,090	1,090	545
Actual Production	200	681	314
Capacity Utilization (%)	18.3%	62.5%	57.6%

Issuance of Rights: During Q3'FY24, GIL issued 32 million ordinary shares at Rs. 175/share fully paid in cash, totaling Rs. 5.6 billion. The proceeds will be utilized to finance the Company's working capital requirements to ensure smooth operations. As per the senior management, as a result of this issuance, short-term borrowings are expected to decline to negligible/very low level, thereby reducing pressure on the bottom-line.

Key Rating Drivers

Sponsor support remained a key strength.

Assigned ratings draw comfort from strong sponsor profile. 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.

Challenging business risk environment amid Chinese PFY dumping.

Operating predominantly in the local market, competitive pressures from PFY dumping from China as mentioned above in detail, challenge GIL's pricing power, since it is cheaper for downstream textile industries to import PFY than to procure locally. This results in diminished margins and profitability.

Despite growth in topline, profitability drops, attributed to rising input costs, higher depreciation, and financial charges. Equity injection will support the bottomline, going forward.

During FY23, topline increased by ~14%, amounting to Rs. 27.4b, largely driven by higher unit selling prices of both PFY and PET preforms, despite 9.6% lower volumetric sales vis-à-vis FY22. The Company mainly has a local clientele base, with local sales contributing ~96% of the total net sales. During the same period more than 80% of the sales were attributed to sales of PFY. Client concentration risk has remained low on a timeline basis since sales emanate from a diverse clientele base. GIL's raw material costs also increased substantially due to higher unit procurement prices of PTA and MEG. PTA is procured both locally and internationally from Lotte Chemicals Pakistan Ltd, and Yi Sheng DA Co, a Chinese supplier, while MEG is completely imported.

Despite increase in net sales, gross margins declined to 5.3% (FY22: 13.3%) on account of higher production costs due to increased raw material prices and higher energy prices, which were not completely passed forward to the end consumer, mainly due to PFY dumping from China. Furthermore, growth in topline was offset by higher operating expenses, resulting in lower profitability. Finance costs increased multifold, surging to Rs. 1.1b (FY22: Rs. 312.7m) due to greater reliance on working capital financing, which negatively impacted the bottom line. Although investment income increased substantially to Rs. 1.1b (FY22: Rs. 225.8m), net profit plummeted to Rs. 205.3m (FY22: Rs. 1.8b), mainly due to higher input costs coupled with higher financial charges, with net margins shrinking to 0.7% compared to 7.6% in FY22.

In 9M'FY24, the Company recorded net sales of Rs. 26.9b, depicting a 32.7% increase vis-à-vis SPLY. PFY sales contributed more than 3/4th to the total net sales. FGC is a polyester chip that the company has recently started to produce and mainly reflects the increase in topline during 9M'FY24 vis-à-vis SPLY. Gross profit amounted to Rs. 1.3b, while gross margins remained subdued following the same trend as in FY23. Furthermore, operating expenses remained on the higher side, while the Company did not receive any investment (dividend) income from its power subsidiary. In addition to this, higher financial charges coupled with tax costs led to a net loss of Rs. 1.03b (9M'FY23: Rs. -124.1m). Despite the reduction in profitability, company has sufficient liquidity to pay off the long-term loans 50% of which are obtained on concessionary terms. Going forward, production and sale of intermediate products (chips) and sale of FGC is expected to bolster topline. Management expects profitability to improve amid higher topline and improved demand with better pricing.

Liquidity profile has fallen below the rating thresholds; however, recent equity injection in 3QFY24 has retained the same to adequate levels. Cashflow coverages remained stressed with room for improvement. Given ratings draw comfort from cash and bank balances on balance sheet as at 9MFY24.

Liquidity profile of the Company deteriorated during FY23 as current ratio fell to 0.82x. The core reason for that was higher trade and other payables. Moreover, funds from operations (FFO) decreased by more than 36% to Rs. 1.9b (FY22: Rs. 2.98b) by end-FY23, with the same trend continuing in 9M'FY24, where FFO turned negative due to payment of higher financial charges. During the review period, the Company faced challenges in meeting debt obligations due to declining cash flow coverages, driven by heightened long-term borrowings and diminished profitability. This is evidenced by a lower DSCR, which deteriorated to 0.63x (FY23: 1.60x; FY22: 7.04x) in 9M'FY24, primarily due to lower FFO coupled with higher scheduled loan repayments. Nevertheless, comfort is provided by Rs. 3.05 billion in cash and bank balances, which serve as a buffer to meet scheduled loan repayments.

Net operating cycle improved to 31 days (FY23: 89 days; FY22: 96 days) in 9M'FY24, with elevated buildup of payables as customer advances. Looking ahead, improvement of liquidity indicators with cash flow coverages (specifically DSCR improvement to more than 1x) is considered imperative from rating's perspective.

Capitalization profile registered improvement amidst equity injection of Rs. 5.6b in Q3'FY24

Despite net losses in 9M'FY24, equity increased to Rs. 12.4b (FY23: Rs. 7.86b; FY22: Rs. 7.8b) in 9M'FY24, on the back of rights issuance. In FY23, the Company announced dividend at Rs. 3.0/share amounting to Rs. 115.1m. Long term financing (including current portion) increased to Rs. 9.5b (FY23: Rs. 8.9b; FY22: Rs. 6.0b) by end-9M'FY24. The Company has obtained Diminishing Musharka from different Islamic Banks for the purchase of plant and machinery and solar panels. GIL mobilized an additional of Rs. 5.2b in long term financing during the review period to fund expansions. The Company increased its short-term borrowings during FY23 to Rs. 8.5b, however, the same has declined to Rs. 1.8b by end-9M'FY24 (FY22: Rs. 4.9b). Consequently, total net debt of the Company has witnessed an increase of Rs. 428.0m during the review period (FY23 & 9M'FY24) to stand at Rs. 11.3b at end-9M'FY24 (FY22: Rs. 10.9b).

On the back of augmentation in core equity, gearing (debt/equity), leverage and capital structure significantly improved to 0.91x (FY23: 2.21x; FY22: 1.40x), 2.06x (FY23: 3.78x; FY22: 2.05x) and 48:52 (FY23: 69:31) respectively, in 9M'FY24. In the medium to long term, the management does not expect to mobilize any further long-term loans; however, regular BMR and investment in energy efficient projects will continue.

Corporate Governance Profile
Corporate governance profile is reflective of a listed entity with 10-member Board inclusive of 5 non-executive directors and 3 independent directors. For effective oversight, two board level committees, namely Audit Committee and Human Resources & Remuneration Committee are in place. As per best practices, independent member chairs both committees and the board has one female representation as well. During FY23, Mr. Saqib Haroon Bilwani was appointed as a non-executive director. The auditor's M/s Kreston Hyder Bhimji & Co., Chartered Accountants retired in the outgoing year and have been recommended for reappointment by the Audit Committee for FY24.

Gatron (Industries) Limited **Appendix I**

Financial Summary	(PKR *in Million)*			
BALANCE SHEET	**FY21**	**FY22**	**FY23**	**9M'FY24**
Property, Plant & Equipment	5,949	9,769	16,938	20,242
Long term investments	417	403	390	522
Stores and spares	885	1315	1579	992
Stock in Trade	3,840	6,318	11,387	6,793
Trade Debts	2,897	4,323	3,976	4,484
Other receivables	319	552	1,846	949
Cash & Bank Balances	103	133	337	3046
Other Assets	449	860	1,124	1,013
Total Assets	**14,860**	**23,671**	**37,577**	**38,042**
Trade and Other Payables	1,343	2,936	4,022	4,479
Advances From Customers-secured	176	451	548	5,800
Bills Payable	287	281	4,674	919
Short Term Borrowings	3,521	4,892	8,474	1,819
Long-Term Borrowings *(Inc. current maturity)*	2,931	5,974	8,912	9,474
Deferred Liabilities	502	796	1,673	1,826
Other Liabilities	145	571	1414	1302
Total Liabilities	**8,905**	**15,900**	**29,717**	**25,620**
Paid Up Capital	384	384	767	1,087
Equity	5,955	7,771	7,860	12,423
INCOME STATEMENT	**FY21**	**FY22**	**FY23**	**9M'FY24**
Net Sales	16,558	23,960	27,384	26,883
Gross Profit	1,867	3,176	1,454	1,325
Operating Profit	1,316	2,646	553	786
Profit Before Tax	1,302	2,559	551	-490
Profit After Tax	1,066	1,827	205	-1,031
FFO	1,662	2,979	1,881	-133
RATIO ANALYSIS	**FY21**	**FY22**	**FY23**	**9M'FY24**
Gross Margin (%)	11.3%	13.3%	5.3%	4.9%
Net Margin (%)	6.4%	7.6%	0.7%	N/A
FFO to Long-Term Debt	0.57	0.50	0.21	N/A
FFO to Total Debt	0.26	0.27	0.11	N/A
Debt Servicing Coverage Ratio (x)	13.83	7.04	1.60	0.63
ROAA (%)	8.5%	9.5%	0.7%	N/A
ROAE (%)	18.9%	26.6%	2.6%	N/A
Gearing (x)	1.08	1.40	2.21	0.91
Debt Leverage (x)	1.50	2.05	3.78	2.06
Current Ratio	1.49	1.42	1.01	1.09
Net Operating Cycle	92	96	89	31
Inventory + Receivables/Short-term Borrowings	1.91	2.18	1.81	6.20

**Annualized*

REGULATORY DISCLOSURES					Appendix II
Name of Rated Entity	Gatron (Industries) Limited				
Sector	Textile				
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				
	17/05/2024	A-	A-2	Stable	Reaffirmed
	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.				
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Due Diligence Meeting Conducted	**Name**	**Designation**	**Date**		
	Mr. Shabbir Diwan	CEO	25th Mar, 2024		
	Mr. Mustafa Bilwani	CFO			
	Mr. Naeem	GM Finance			