RATING REPORT

Al-Ghazi Tractors Limited

REPORT DATE:
December 28, 2018

RATING ANALYSTS:

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RATING DETAILS

	Latest Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A	A-1
Rating Date	*December 24, 2018*	
Rating Outlook	Stable	
Outlook Date	*December 24, 2018*	

COMPANY INFORMATION

Incorporated in 1983	**External auditors:** A.F. Ferguson & Co. Chartered Accountants
Public Limited Company	**Chairman of the Board:** Charles Leonard Hunt **Chief Executive Officer:** Mohammad Shahid Hussain

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) http://www.jcrvis.com.pk/kc-meth.aspx

Al-Ghazi Tractors Limited

OVERVIEW OF THE INSTITUTION

Al-Ghazi Tractors Limited (AGTL) was incorporated in June 1983 as a public limited company. Manufacturing facility is situated at Dera Ghazi Khan, Punjab, Pakistan. In December 1991, the company was acquired by Al-Futtaim Group.

Shareholding pattern at end-December'2017 demonstrates that Al-Futtaim Group is the parent company of AGTL with ownership of 50.02%. Moreover, 43.17% of the shares of the company are owned by CNH Industrial. Consequently, around 93% of the company's ownership is vested with foreign companies. Remaining shares are held by general public and financial institutions.

Profile of Chairman

Mr. Charles Leonard Hunt brings forward extensive experience and expertise of the automotive industry of UK and USA.

Profile of CEO

Mr. Mohammad Shahid Hussain possesses more than 30 years of experience and has worked for MNCs including Berger Paints, Philips, Tetra Pak and Makro Cash & Carry. Prior to AGTL, Mr.

RATING RATIONALE

Al-Ghazi Tractors Limited (AGTL) is involved in the assembling and sale of agricultural tractors, implements and spare parts. With an installed capacity of 30,000 tractors on a single shift basis, AGTL holds around two-fifth of the tractor industry market share. The Company has also diversified in the sale of implements, and lubricants. Moreover, AGTL also exports tractors to Afghanistan while other potential markets also being explored as allowed by brand owners i.e. CNHI. Sale of trading goods and exports currently comprises a limited portion of the overall revenues.

Product portfolio of AGTL ranges from 55hp to 85/95hp tractors with bulk of the sales emanating from low horsepower (hp) tractors. Increasing sales in the higher hp segment remains a key focus area of the management. AGTL has an industrial collaboration agreement (renewed in 2017 for a period of 10 years) with CNHI Industrial Italia S.p.A, one of the leading tractor manufacturers in the world, to assemble and sell 'NEW HOLLAND' CNHI tractors in Pakistan. Sales are diversified across the country with the management planning to enhance sales in the Central Punjab region. The company has a wide spread dealer network of 85 dealers and over 3,000 mechanical workshops across the country to work as customer care centers. Significant focus remains on upgrading and revamping existing dealership network.

Over the last few years, capacity utilization has depicted variation but has increased on a timeline basis in 2017 and 9M18 (9M18: 89%; 2017: 80%; 2016: 53%; 2015: 45%). Capacity utilization has increased due to favorable industry dynamics supported by improvement in farmer's income and agricultural productivity.

Structure of the Tractor Industry

Pakistan's tractor industry comprises three assemblers with the top two players named Millat Tractors Limited (MTL) and AGTL which cater up to 96% of industry's demand. Smaller brands, such as Belarus Tractors, John Deere and others, import tractors as completely built-up units (CBU) and semi knocked-down (SKD) units and cater to the remaining 4% of the demand. Total annual installed capacity (based on single shift operations) is reported at around 70,000 tractors. Apart from 2017 and in the ongoing year, industry capacity utilization has remained on the lower side due to lack of implements for various agricultural activities, including tertiary (harvesting), secondary (agronomic practices) and primary (soil preparation) activities and the lack of awareness among farmers about implements.

Business and Industry Risk

- Low penetration (Pakistan 1 tractor for 100 acres against an international norm of 1 tractor for 25 acres and even lesser in the first world countries) and mechanization rate (Pakistan: 0.9hp/hectare against an international norm of 1.7hp/hectare) depict significant potential for growth in sale of tractors.
- Government support bodes well for the business risk profile of the tractor industry. This is evident from historical support to the sector in the form of tractor schemes (subsidies on tractor purchases) and sizeable reduction in GST on tractors over the years from 17% to 5%.
- While capital requirements are low, strong brand name and franchise enjoyed by two leading players (AGTL and MTL) along with nationwide dealer network acts as a barrier to entry for new players.
- Demand for tractors has depicted variation over the last few years and is largely dependent on farmer's economic health, crop production which is further dependent on weather conditions, availability of water (water scarcity in the country is a key risk), and assistance from GoP in the form of subsidies.
- Given the duty advantage enjoyed by local players and low prices of tractors produced in the country, local players are well-positioned to deal with the threat of imports.
- Imported components for AGTL comprise around 8% of the total number of parts used. In value terms, imported parts comprise around one fourth of the total cost of raw materials consumed. Given high localization rate, the company is relatively less prone to risk of rupee depreciation vis-à-vis other players in the automobile industry.

Hussain served as the CEO and Managing Director of General Tyre Pakistan for more than 6 years. He is currently also serving as Country Head- Al Futtaim Automobile Pakistan.

Sales and Profitability

Sales revenue of the company has grown at a CAGR of 29% over the past three years (2014-2017) on account of improvement in commodity prices and farmer economics. Sales growth during 2017 was also supported by GOP's assistance in the form of GST reduction and subsidy schemes. Growth momentum in sales continued in the ongoing year with net sales increasing by 11.5% during 9MCY18. Given improving sales volumes and average selling prices coupled with effective cost management, gross margins of the company have increased on a timeline basis from 25.9% in 2015 to 27.9% in 2017. Resultantly, profit after tax increased to Rs. 3.1b (2016: Rs. 1.93b; 2015: Rs. 1.59b). Despite pressure on margins (primarily due to rupee depreciation), profitability was largely maintained during 9MCY18 on account of growth in turnover. Going forward, dip in sales volume due to economic slowdown, lower projected gross margins and higher finance cost shall translate into reduced profitability levels in 2019.

Liquidity

Liquidity profile of the company is considered strong given healthy cash flows in relation to outstanding obligations, limited trade debts as majority of the sales are on cash and healthy debt servicing ability. With increasing profitability, funds flow from operations (FFO) rose to Rs. 2.9b (2016: Rs. 2b) during 2017 with FFO to Total Debt reported at 73% at end-September'2018. However, stock-in-trade and trade debts were lower vis-à-vis short-term borrowing at end-September'2018. Current ratio stood at 1.07(x) (2017: 1.41(x); 2016: 3.32(x)) at end-September'2018.

Capitalization

Despite healthy profitability levels, equity base of the company has declined significantly from Rs. 8.5b in 2014 to Rs. 1b at end-September'2018 due to dividend payout. AGTL has historically remained debt free. However, debt to the tune of Rs. 3.9b at end-September'2018 was mobilized to fund working capital requirement. Consequently, capitalization profile of the company is constrained due to elevated gearing and leverage indicators reported at 3.74x (2017: 0) and 5.4x (2017: 1.8x) at end-September'2018. Going forward, capitalization indicators of the company are expected to remain constrained, going forward.

Corporate Governance Framework

Overall corporate governance framework is supported by adequate board composition & oversight and professional and experienced management team. In line with regulatory requirement, a performance self-evaluation criteria for monitoring board performance is in place. Moreover, the company has a dedicated internal audit function which uses risk based audit methodology to form its quarterly reports which are reviewed and approved by the Board Audit Committee. AGTL has implemented BaaN ERP along with relevant modules for its IT related needs.

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**2015**	**2016**	**2017**	**9M2018***
Fixed Assets	612	650	715	750
Stock-in-Trade	2,115	1,409	2,284	3,442
Trade Debts	28	280	12	89
Refunds due from the GoP	1,018	819	1,222	1,574
Cash & Bank Balances	2,330	1,317	1,341	589
Total Assets	6,405	4,644	5,881	6,756
Trade and Other Payables	549	1,157	3,670	1,652
Long Term Debt	-	-	-	-
Short Term Debt	-	-	-	3,916
Total Debt	-	-	-	3,916
Total Equity	5,789	3,359	2,126	1,047
INCOME STATEMENT				
Net Sales	9,636	12,099	18,871	15,521
Gross Profit	2,499	3,349	5,260	3,886
Profit Before Tax	2,392	2,878	4,585	3,203
Profit After Tax	1,592	1,927	3,123	2,110
RATIO ANALYSIS				
Gross Margin (%)	25.9%	27.7%	27.9%	25.0%
Net Margin	16.5%	15.9%	16.5%	13.6%
Net Working Capital	5,240	2,786	1,492	388
Trade debts/Sales	0.3%	2.3%	0.1%	0.4%
FFO	1,138	2,004	2,970	2,154
FFO to Total Debt (%)	NA	NA	NA	73%
FFO to Long Term Debt (%)	NA	NA	NA	NA
Current Ratio (x)	10.5	3.3	1.4	1.1
Debt Servicing Coverage Ratio (x)	1.3	2.4	1.9	2.0
Gearing (x)	-	-	-	3.74
ROAA (%)	19%	35%	59%	44.4%
ROAE (%)	22%	42%	114%	176.8%

** Ratios Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITION — Appendix II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Al-Ghazi Tractors Limited				
Sector	Automobile Industry				
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				
	24-Dec-2018	A	A-1	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	JCR-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.				
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