RATING REPORT

Al-Ghazi Tractors Limited

REPORT DATE:
December 31, 2019

RATING ANALYSTS:

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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	A	A-1	A	A-1
Rating Outlook	Stable		Stable	
Rating Date	December 31, 2019		December 24, 2018	

COMPANY INFORMATION

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

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (April 2019)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

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'2018 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 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. 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

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 in the long term. AGTL has an industrial collaboration agreement (expire in 2027) 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 and Balochistan 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.

Capacity utilization of the company remained buoyant in 2017 and 2018 with utilization levels reported above 80%. However, due to weakening in macroeconomic environment and farmer's economic health (low agricultural output), utilization was recorded on the lower side at 59% in 9M2019.

Structure of the Tractor Industry

Pakistan's tractor industry comprises three assemblers with the top two players named Millat Tractors Limited (MTL) and AGTL catering to 98% 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 demand. Total annual installed capacity (based on single shift operations) is reported at around 70,000 tractors.

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.
- While capital requirements are low, strong brand name and franchise enjoyed by two leading players (AGTL and MTL) along with nationwide dealer network and surplus supply 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.
- Value of imported components for AGTL comprise around one-fifth of the raw material used. Given high localization rate, the company is relatively less prone to risk of rupee depreciation vis-à-vis other players in the automobile industry.

In line with macroeconomic slowdown, profitability profile depicted weakening in the ongoing year.

Topline of the company witnessed growth of 3% in 2018 amounting Rs. 19.4b (2017: Rs. 18.9b) led by improvement in commodity prices. However, sales growth was disrupted in the ongoing year on the back of subdued demand, sizeable currency devaluation, high inflation & rising interest rates, additional sales tax & custom duty and increased regulatory requirements. Consequently sales revenue and overall profitability of

Automobile Pakistan. the company witnessed deterioration in the ongoing year. Gross margins of the company declined to 21.3% (9M2018: 25%, 2018: 24.1%, 2017: 27.9%) in 9M2019 due to aforementioned reasons but continue to compare favorably to peers on account of effective cost management and efficient operations. Profit after tax for 9M2019 was reported at Rs. 1.3b (9M2018: Rs. 2.1b, 2018: Rs. 2.4b). Going forward, profitability profile will be a function of volumetric growth in sales and sustaining margins.

Liquidity profile continues to remain strong. Focus has remained on efficient inventory management and optimizing working capital cycle.
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 weakening in profitability profile, funds flow from operations (FFO) declined to Rs. 1.2b (9M2018: Rs. 2.2b, 2018: Rs. 2.5b, 2017: Rs. 3b) in 9M2019; however FFO to Total Debt was reported higher at 92% (2018: 63%) at end-September 2019 due to lower short term borrowings at period end. Liquidity profile also improved on account of Rs. 2b received from GoP against sales tax refundable balance. Stock-in-trade and trade debts provide sufficient coverage to short term borrowings at end-September 2019. Current ratio stood at 1.11(x) (2018: 1.12(x); 2017: 1.41(x)) at end-September 2019.

Leverage indicators have improved on a timeline basis. Equity base remains low.
Equity base of the company was reported at Rs. 1.3b at end-September 2019. Dividend payout ratio has historically remained on the higher side. Debt outstanding amounted to Rs. 1.7b (2018: Rs. 3.97b) at end-September 2019 and has been mobilized to fund working capital requirement. Given the decline in borrowings, gearing and leverage indicators were reported lower at 1.37x (2018: 2.90) and 3.41x (2018: 3.95x) at end-September 2019 but are expected to increase again as fresh build up in refunds takes place.

Strong 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.

Al-Ghazi Tractors Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**2015**	**2016**	**2017**	**2018**	**9M2019***
Fixed Assets	612	650	715	829	900
Stock-in-Trade	2,149	1,428	2,321	3,508	2,701
Trade Debts	28	280	12	57	43
Refunds due from the GoP	1,018	819	1,222	1,797	575
Cash & Bank Balances	2,330	1,317	1,341	294	921
Total Assets	6,405	4,644	5,881	6,785	5,589
Trade and Other Payables	549	1,157	3,670	1,247	1,692
Long Term Debt	-	-	-	-	-
Short Term Debt	-	-	-	3,973	1,736
Total Debt	-	-	-	3,973	1,736
Paid Up Capital	290	290	290	290	290
Total Equity	5,789	3,359	2,126	1,369	1,267
INCOME STATEMENT					
Net Sales	9,636	12,099	18,871	19,373	12,542
Gross Profit	2,499	3,349	5,260	4,665	2,675
Profit Before Tax	2,392	2,878	4,585	3,735	1,818
Profit After Tax	1,592	1,927	3,123	2,453	1,289
RATIO ANALYSIS					
Gross Margin	25.9%	27.7%	27.9%	24.1%	21.3%
Net Margin	16.5%	15.9%	16.5%	12.7%	10.3%
Net Working Capital	5,240	2,786	1,492	652	456
Trade debts/Sales	0.3%	2.3%	0.1%	0.3%	0.3%
FFO	1,139	2,005	2,970	2,503	1,201
FFO to Total Debt (%)	NA	NA	NA	63%	92%
FFO to Long Term Debt (%)	NA	NA	NA	NA	NA
Current Ratio (x)	10.5	3.3	1.4	1.1	1.1
Debt Servicing Coverage Ratio (x)	NA	NA	15,312.5	49.0	5.6
Gearing (x)	-	-	-	2.90	1.37
ROAA (%)	19%	35%	59%	39%	27.7%
ROAE (%)	22%	42%	114%	140%	130.0%

** Ratios Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITION 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	Al-Ghazi Tractors Limited
Sector	Automobile Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	
Instrument Structure	N/A
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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Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
31-Dec-2019	A	A-1	Stable	Reaffirmed
24-Dec-2018	A	A-1	Stable	Initial