RATING REPORT

Al-Ghazi Tractors Limited

REPORT DATE:
March 16, 2021

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	March 16, 2021		December 31, 2019	

COMPANY INFORMATION	
Incorporated in 1983	**External auditors:** A.F. Ferguson & Co. Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Bernd Erich Schwendtke **Chief Executive Officer:** Mr. Raheel Asghar
Major Shareholders:	
Al Futtaim Industries Company LLC – 50.02%	
CNH Global N.V. – 43.17%	

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'2019 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. Raheel Asghar has over 25 years of experience in the automotive industry in UK and Pakistan. An engineer by profession, he started his career with Honda UK manufacturing in England where after performing various roles he managed Honda Engineering Europe Ltd before moving to Pakistan to join Indus Motor Company. At

RATING RATIONALE

Al Ghazi Tractors Limited (AGTL) is engaged in the assembly and sale of agricultural tractors, implements and spare parts. The plant has an installed capacity to produce 30,000 tractors per annum on a single shift basis. 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 the 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 (expiring 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. The company has a wide spread dealer network of 117 dealers and over 3,000 mechanical workshops across the country to work as customer care centers. Upgrading and revamping existing dealership network remains a key area of focus going forward.

Actual Production and Capacity Utilization

Operating Performance	2018	2019
Installed Capacity (Units)	30,000	30,000
Production (Units)	24,823	15,400
Capacity Utilization (%)	83%	51%

With strong demand, the capacity utilization was above 80% in 2018. However, weakening purchasing power of farmers, persistent economic slowdown and depressed demand for tractors were major reasons for decrease in actual production and capacity utilization in 2019. Capacity utilization also remained on the lower side in 9M'2020 due to overall economic slowdown on account of COVID-19.

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) of the industry is reported at around 87,000 tractors.

Measures undertaken by the government to support the agricultural sector and low mechanization rate in Pakistan are expected to support demand for tractors

As per Economic Survey of Pakistan, the production of important crops (cotton, sugarcane, rice, maize, and wheat) registered aggregate growth of 2.90% (FY19: -7.68%) in FY20. According to Pakistan Agriculture Research Council (PARC) wheat sowing is expected to enhance by 2-3% in irrigated areas in FY21. The estimated production in FY21 of wheat is 27 million tons (increase of 8% on annual basis); sugar cane is 7.5 million (increase of 14% on annual basis), rice is 8.2 million ton (increase of 11% on annual basis) and maize is 6.7 million tons (increase of 2% on annual basis). Cotton bales production may decline by 7% to 8 million tons due to reduction in areas under cultivation as well as unprecedented rains. Increase in production of important crops is expected to translate to higher demand for tractors as the disposable income of farmers will increase. Furthermore, reduction in sales tax from 5% to 0% on locally manufactured tractors for one year and subsidized interest rates of 6.25% on all loans for land holdings up 12.5 hectares has already translated to uptick in tractor sales volumes which are 40% higher in 1HFY21 vis-à-vis 1HFY20.

The following factors support low business risk profile of the industry:

Indus Motors he served as Director Marketing & Sales and Senior Director Technical before joining AGTL.

- 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.
- 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.
- Given high localization rate of 92%, the company is relatively less prone to risk of rupee depreciation vis-à-vis other players in the automobile industry.

In line with the slowdown in macroeconomic growth, profitability profile weakened in 2019; challenges posed by COVID-19 contributed to further decrease in profitability in 9M'2020. However, overall macroeconomic recovery is expected to support profitability profile going forward

Topline of the company was reported lower at Rs. 14.0b (2018: Rs. 19.3b) in 2019, thereby depicting decrease of 27.7%. Subdued demand primarily on account of slowdown in agricultural growth, sizeable currency devaluation, high inflation, rising interest rates, and additional sales tax & custom duty were the major reasons that contributed to decrease in topline. Gross and net margins also declined to 18.2% (2018: 24.0%) and 7.0% (2018: 12.7%) due to the aforementioned factors but the same remained in line with the peers. With imposition of lockdown in 2020 due to COVID-19, demand for tractors declined further. Consequently, net sales and profit after tax were reported lower at Rs. 9.2b (9M'20: Rs. 12.5b) and Rs. 889.0m (9M'19: Rs. 1.3b) in 9M'20. Going forward, profitability will remain a function of recovery in overall economic and agricultural growth.

Liquidity profile is considered sound in view of adequate cash flows in relation to outstanding liabilities

Liquidity profile of the company is considered sound given adequate cash flows in relation to outstanding obligations, limited trade debts as majority of the sales are on cash and healthy debt servicing ability. With decline in profitability, funds flow from operations (FFO) declined to Rs. 1.1b (9M'19: Rs. 1.2b, 2019: Rs. 710.1m, 2018: Rs. 2.5b) in 9M'20. FFO in relation to total debt is considered adequate (9M'20: 242.7%; 2019: 19.6%; 2018: 63.0%) as the management reduced quantum of short term borrowings at end-September 2020. As per the management, improvement in the working capital cycle and reducing reliance on short term borrowings remained key areas of focus in 2020. Stock-in-trade and trade debts provide sufficient coverage to short term borrowings at end-September 2020 (9M'20: 327.7%; 2019: 77.1%; 2018: 89.7%), while the current ratio was also comfortable at 1.19x (2019: 0.97x; 2018: 1.12x) at end-September 2020.

With reduction in the quantum of debt and higher equity base, capitalization indicators have improved

Equity base of the company was reported higher at Rs. 1.8b (2019: 904m; 2018: Rs. 1.4b) at end-September 2020 due to profit retention. Dividend payout ratio has historically remained on the higher side (2019: 89% 2018: 92%); however, the company did not pay any dividend in 9M'20. Debt of the company comprises only short term borrowings which have been mobilized to fund working capital requirements. Debt outstanding amounted to Rs. 579.5m (2019: Rs. 3.63b; 2018: Rs. 3.97b) at end-9M'20. With increase in orders and build up in refunds due from the government, leverage indicators may increase but are expected to remain at manageable levels going forward.

Sound Corporate Governance and Internal Controls Framework

Overall corporate governance framework is supported by adequate board composition & oversight and professional and experienced management team. 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	**2017**	**2018**	**2019**	**9M'20**
Fixed Assets	715	829	1,068	1,009
Stock-in-Trade	2,321	3,508	2,787	1,898
Trade Debts	12	57	10	0
Refunds due from the GoP	1,222	1,797	773	1,166
Cash & Bank Balances	1,341	294	189	1,322
Total Assets	5,881	6,785	5,475	5,824
Trade and Other Payables	3,670	1,247	736	3,313
Long Term Debt	-	-	-	-
Short Term Debt	-	3,973	3,629	580
Total Debt	-	3,973	3,629	580
Paid Up Capital	290	290	290	290
Total Equity	2,126	1,369	904	1,793
INCOME STATEMENT				
Net Sales	18,871	19,343	13,992	9,183
Gross Profit	5,260	4,636	2,545	1,979
Profit Before Tax	4,585	3,735	1,349	1,268
Profit After Tax	3,123	2,453	978	889
RATIO ANALYSIS				
Gross Margin	27.9%	24.0%	18.2%	21.5%
Net Margin	16.5%	12.7%	7.0%	9.7%
Net Working Capital	1,492	652	(127)	760
Trade debts/Sales	0.1%	0.3%	0.1%	0.0%
FFO	2,970	2,503	710	1,055
FFO to Total Debt (%)	NA	63%	20%	243%
FFO to Long Term Debt (%)	NA	NA	NA	NA
Current Ratio (x)	1.41	1.12	0.97	1.19
Debt Servicing Coverage Ratio (x)	15,312.5	49.0	3.0	5.8
Gearing (x)	-	2.90	4.02	0.32
ROAA (%)	59%	39%	16%	21%
ROAE (%)	114%	140%	86%	88%

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	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	16-Mar-2021	A	A-1	Stable	Reaffirmed
	31-Dec-2019	A	A-1	Stable	Reaffirmed
	24-Dec-2018	A	A-1	Stable	Initial
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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Due Diligence Meetings Conducted	**S. No**	**Name**	**Designation**	**Date**	
	1.	Mr. Malik Ehtisham Ikram	Chief Financial Officer (CFO)	February 2, 2021	