# RATING REPORT

# Al-Ghazi Tractors Limited

**REPORT DATE:**
June 02, 2022

**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 Action** | Upgrade | | Reaffirmed | |
| **Rating Date** | June 02, 2022 | | March 16, 2021 | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 1983** | **External auditors:** A.F. Ferguson & Co. Chartered Accountants |
| **Public Limited Company** | **Chairman of the Board:** Mr. Robert McAllister<br>**Acting CEO & CFO:** Mr. Malik Ehtisham Ikram |
| **Major Shareholders:** | |
| Al Futtaim Industries Company LLC – 50.02% | |
| CNH Global N.V. – 43.17% | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| ***Applicable Rating Criteria: Corporates (August 2021)***<br>**https://docs.vis.com.pk/docs/CorporateMethodology202108.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'2021 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.

## RATING RATIONALE

Al Ghazi Tractors Limited ('AGTL' or 'the Company') is engaged in the assembly and sale of agricultural tractors, implements and spare parts. AGTL plant is located in Dera Ghazi Khan, having an installed capacity to produce 30,000 tractors per annum on a single shift basis. The Company's head office is located in Karachi. 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.

**Sector Brief**

- Pakistan's tractor assembly industry comprises 3 assembler, with the top 2 assemblers being Millat Tractors Limited (MTL) and AGTL, which constitute significant portion of industry capacity (See Table 1 below). 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 generally cater to niche segments. Total annual installed capacity (based on single shift operations) of the industry is reported at around 87,000 tractors.

***Table 1: Industry Statistics***

| | CY17 | CY18 | CY19 | CY20 | CY21 | 4MCY21 | 4MCY22 |
|---|---|---|---|---|---|---|---|
| **Production (units)** | | | | | | | |
| **AGTL** | 24,091 | 24,823 | 15,400 | 12,654 | 17,120 | 4,981 | 9,373 |
| **MTL** | 40,757 | 39,970 | 24,958 | 26,447 | 37,074 | 13,109 | 11,046 |
| **ORIENT** | 385 | 456 | 246 | 64 | 115* | 112 | NA |
| **TOTAL** | **65,233** | **65,249** | **40,604** | **39,165** | **54,309** | **18,202** | **20,419** |
| **Sales (units)** | | | | | | | |
| **AGTL** | 24,423 | 23,933 | 15,719 | 12,142 | 18,156 | 6,088 | 9,115 |
| **MTL** | 41,604 | 38,663 | 25,136 | 27,016 | 37,243 | 13,603 | 10,857 |
| **ORIENT** | 321 | 464 | 301 | 77 | 147* | 123 | NA |
| **TOTAL** | **66,348** | **63,060** | **41,156** | **39,235** | **55,546** | **19,814** | **19,972** |
| **Market Share (%)** | | | | | | | |
| **AGTL** | ***36.8%*** | ***38.0%*** | ***38.2%*** | ***30.9%*** | ***32.7%*** | ***30.7%*** | ***45.6%*** |
| **MTL** | ***62.7%*** | ***61.3%*** | ***61.1%*** | ***68.9%*** | ***67.0%*** | ***68.7%*** | ***54.4%*** |
| **ORIENT** | ***0.5%*** | ***0.7%*** | ***0.7%*** | ***0.2%*** | ***0.3%*** | ***0.6%*** | ***NA*** |

*Source: PAMA, VIS Database*
** Based on Jan-Jun 2021 numbers*

- Overall demand of the industry remained depressed in 2020 wherein overall offtake in units displayed a further drop to 39,235 units (down by 5% Y/Y). Major factors contributing to lower volumes were persistent economic slowdown, exacerbated by the pandemic, and deteriorating farm economics.

- With the rebound in overall macro-economic, conditions including GDP growth and lifting of pandemic era lockdowns, demand of tractors depicted strong uptick in 2021, with industry offtake rising to 55,546 units (up by 42% Y/Y). However, the overall demand remained lower than CY17-18 period, as illustrated in the table above. As per industry experts, the demand in CY17-18 period was a high offtake period for the industry, being supported by accommodative farmer financing initiatives by the Government of Pakistan.

- 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 the 2 leading players (AGTL and MTL) along with nationwide dealer network and surplus supply, acts as a barrier to entry for new players.

**Profile of Acting CEO & CFO**

Mr. Ikram is a seasoned Senior Finance Executive with a career spanning 18 years of experience. He joined Al-Futtaim in 2012 and has been working at various Senior Finance & Leadership positions. Previously, he has also worked with leading consultancy firms including PWC and KPMG. Mr. Ikram is a member of the Institute of Chartered Accountants of Pakistan and holds a post graduate degree in Managerial economics.

**Business & Operational Review - AGTL**

- Product portfolio of AGTL ranges from 55hp to 85hp 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.

- With the improvement in demand, capacity utilization has increased to 57% in CY21, compared to 42% in CY20.

- Production and sales units of the Company have increased in CY21 (see table 2 below) as the economy started making recovery post lifting of the pandemic era lockdowns. Management expects tractors demand growth to continue going forward despite the prevailing depreciation of PKR. In addition, given high local cost component of 68%, the Company is relatively less prone to risk of rupee depreciation vis-à-vis other players in the automobile industry. In terms of components, localization is higher at 92%.

- AGTL's market share had depicted a decline in CY20 to 30.9% from 38.2% in CY19. However, recovery in market share has been noted in CY21, as it improved to 32.7%. As shown in Table 1 above, market share of AGTL has improved to 45.6% in 4MFY22. As per management, the improvement in market share is attributable to management's focus on enhancing the distributor network. Management expects full year FY22 market share of more than 40%.

- The Company has also diversified in the sale of implements, and lubricants. Moreover, AGTL also exports tractors to Afghanistan while other potential markets are 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.

*Table 2: Operations*

| MTL | CY18 | CY19 | CY20 | CY21 |
|---|---|---|---|---|
| **Capacity** | 30,000 | 30,000 | 30,000 | 30,000 |
| **Production** | 24,823 | 15,400 | 12,654 | 17,120 |
| ***Utilization*** | ***83%*** | ***51%*** | ***42%*** | ***57%*** |
| **Sales (Units)** | 23,933 | 15,179 | 12,142 | 18,156 |
| ***Sales as % of production*** | ***96%*** | ***102%*** | ***96%*** | ***106%*** |

**Rating Drivers**

**Strong sponsors profile supports the assigned ratings of AGTL**

- Al Futtaim Industries Company LLC is the holding company of AGTL with 50.02% shares. Al Futtaim was established as a trading business 9 decades ago and now has more than 200 companies in diverse sectors including automotive, electronics, engineering & technologies, retail, financial services, general services and real estate. It employs 42,000+ people at different geographical locations.
- The other major sponsor of AGTL is CNH Industrial, which holds 43.17% shares of AGTL. CNH Industrial is present in 180 countries having 12 brands, 67 manufacturing plants, 56 research centers and employs more than 63,000+ people. CNH Industrial designs, produces and sells agricultural and construction equipment (tractors, combines, excavators), wheel loaders, trucks, commercial vehicles, buses and specialty vehicles. CNH Industrial has net sales of USD 31.6b in FY21.

**Profitability profile posted improvement in CY21 with the recovery in economic activities**

- With the decline in volumetric offtake, AGTL's revenue further dropped in CY20 to 11.9b (CY19: 13.9b, CY18: 19.3b). However, the rebound in economic activities and decline in interest rates resulted in recovery in tractor demand, as a result of which the Company's net sales depicted strong growth in CY21 (up by 72% Y/Y from Rs. 11.9b).

- Despite the decrease in topline in CY20, AGTL's gross margins depicted recovery, mainly being driven by pricing increase and cost efficiencies. During CY21, gross margin of the Company remained intact while the net margin depicted notable improvement on the back of better operational efficiency, increased other income and minimal finance cost.

- Going forward, profitability will remain a function of overall economic and agricultural growth while ratings foresee the margins to stay intact during the rating horizon.

*Table 3: Profitability*

| Rs. m | CY18 | CY19 | CY20 | CY21 |
|---|---|---|---|---|
| **Net Sales** | 19,343 | 13,992 | 11,935 | 20,579 |
| **Gross Profit** | 4,636 | 2,545 | 2,771 | 4,721 |
| **Profit before tax** | 3,735 | 1,349 | 1,928 | 4,170 |
| **Profit after tax** | 2,435 | 978 | 1,350 | 2,958 |
| **Gross margin (%)** | ***24.0%*** | ***18.2%*** | ***23.2%*** | ***22.9%*** |
| **Net margin (%)** | ***12.7%*** | ***7.0%*** | ***11.3%*** | ***14.4%*** |
| **ROAA (%)** | ***38.7%*** | ***15.9%*** | ***25.3%*** | ***40.3%*** |
| **ROAE (%)** | ***140.3%*** | ***86.0%*** | ***84.6%*** | ***94.5%*** |

**Sound liquidity profile with adequate cash flow coverage**

- Liquidity profile of the Company is considered sound, given adequate cash flows and negligible trade debts (as majority of the sales are on advance payments).

- With the improvement in profitability, Funds from Operations (FFO) improved in 2020 to Rs. 1.4b compared to CY19 of Rs. 710m. FFO further posted improvement in CY21 to come at Rs. 3.0b.

- Current ratio of the Company also remained comfortable at 1.51x as at Dec'21, supporting the short term rating assessment of AGTL. (Dec'20: 1.39x, Dec'19: 0.97x).

*Table 4: Liquidity & Cashflow*

| | CY18 | CY19 | CY20 | CY21 |
|---|---|---|---|---|
| **Current ratio (x)** | 1.12 | 0.97 | 1.39 | 1.51 |
| **Inventory + Trade debts/Short term (x)** | 0.90 | 0.77 | 1.26 | NA |
| **FFO (Rs. m)** | 2,503 | 710 | 1,379 | 2,973 |
| **FFO/Debt** | 0.63 | 0.20 | 0.87 | NA |
| **DSCR** | 20.94 | 2.78 | 10.46 | 340.64 |

**Rating is supported by low financial risk profile**

- Equity base of the Company was reported higher at Rs. 4.0b as at Dec'21 mainly due to internal cash generation (net profit). (Dec'20: 2.9b, Dec'19: 0.9b). Nevertheless, it will revert back to Rs. 2.9b level as of Q1CY22, as the Company announced 100% dividend, which will reflect in Q1CY22 accounts.

- AGTL's balance sheet, which only comprised short term borrowings to fund working capital requirements, was debt free as of Dec'21, mainly as the Company is using customer advances as working capital finance.

- With a debt free balance sheet gearing has receded to zero, while leverage was also considered moderate as of Dec'21. Going forward, capitalization indicators are projected to stay on the lower side. The management expects to incur capital expenditure of Rs. 2-3b over the short term horizon, which will be funded through a mix of debt and equity financing, albeit the exact funding mix is yet to be decided.

*Table 5: Capitalization*

| | Dec'18 | Dec'19 | Dec'20 | Dec'21 |
|---|---|---|---|---|
| **Long Term Debt** | - | - | - | - |
| **Short Term Debt** | 3,973 | 3,629 | 1,589 | - |
| **Total Liabilities** | 5,416 | 4,572 | 2,895 | 5,517 |
| **Equity** | 1,369 | 904 | 2,288 | 3,973 |
| **Gearing (x)** | ***2.90*** | ***4.02*** | ***0.69*** | **-** |
| **Leverage (x)** | ***3.96*** | ***5.06*** | ***1.27*** | ***1.39*** |
| **DPS/EPS (%)** | ***92%*** | ***89%*** | ***92%*** | ***100%*** |

**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 BaaN ERP along with relevant modules for its IT related needs. The Company is planning to adopt SAP ERP system in future.

## Al-Ghazi Tractors Limited — Appendix I

### FINANCIAL SUMMARY
*(amounts in PKR millions)*

| BALANCE SHEET | Dec'16 | Dec'17 | Dec'18 | Dec'19 | Dec'20 | Dec'21 |
|---|---|---|---|---|---|---|
| Fixed Assets | 650 | 715 | 829 | 1,068 | 1,067 | 1,109 |
| Stock-in-Trade | 1,428 | 2,321 | 3,508 | 2,787 | 2,005 | 2,875 |
| Trade Debts | 280 | 12 | 57 | 10 | - | 5 |
| Refunds due from the GoP | 819 | 1,222 | 1,797 | 773 | 1,451 | 2,983 |
| Cash & Bank Balances | 1,317 | 1,341 | 294 | 189 | 231 | 1,998 |
| Total Assets | 4,644 | 5,881 | 6,785 | 5,475 | 5,183 | 9,490 |
| Trade and Other Payables | 1,157 | 3,670 | 1,247 | 736 | 1,065 | 1,907 |
| Long Term Debt | - | - | - | - | - | - |
| Short Term Debt | - | - | 3,973 | 3,629 | 1,589 | - |
| Total Debt | - | - | 3,973 | 3,629 | 1,589 | - |
| Paid Up Capital | 290 | 290 | 290 | 290 | 290 | 290 |
| Total Equity | 3,359 | 2,126 | 1,369 | 904 | 2,288 | 3,973 |
| | | | | | | |
| **INCOME STATEMENT** | **CY16** | **CY17** | **CY18** | **CY19** | **CY20** | **CY21** |
| Net Sales | 12,099 | 18,871 | 19,343 | 13,992 | 11,935 | 20,579 |
| Gross Profit | 3,349 | 5,260 | 4,636 | 2,545 | 2,771 | 4,721 |
| Profit Before Tax | 2,878 | 4,585 | 3,735 | 1,349 | 1,928 | 4,170 |
| Profit After Tax | 1,927 | 3,123 | 2,453 | 978 | 1,350 | 2,958 |
| | | | | | | |
| **RATIO ANALYSIS** | **Dec'16** | **Dec'17** | **Dec'18** | **Dec'19** | **Dec'20** | **Dec'21** |
| Gross Margin | 27.7% | 27.9% | 24.0% | 18.2% | 23.2% | 22.9% |
| Net Margin | 15.9% | 16.5% | 12.7% | 7.0% | 11.3% | 14.4% |
| Net Working Capital | 2,786 | 1,492 | 652 | (127) | 1,114 | 2,808 |
| Trade debts/Sales | 0.02 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| FFO | 2,005 | 2,970 | 2,503 | 710 | 1,379 | 2,973 |
| FFO to Total Debt (%) | NA | NA | NA | NA | 86.8% | NA |
| FFO to Long Term Debt (%) | NA | NA | NA | NA | NA | NA |
| Current Ratio (x) | 3.32 | 1.41 | 1.12 | 0.97 | 1.39 | 1.51 |
| Debt Servicing Coverage Ratio (x) | 1,970.79 | 3,198.44 | 20.94 | 2.78 | 10.46 | 340.64 |
| Leverage (x) | 0.38 | 1.77 | 3.96 | 5.06 | 1.27 | 1.39 |
| Gearing (x) | - | - | 2.90 | 4.02 | 0.69 | - |
| ROAA (%) | 34.9% | 59.3% | 38.7% | 15.9% | 25.3% | 40.3% |
| ROAE (%) | 42.1% | 113.9% | 140.3% | 86.0% | 84.6% | 94.5% |

# 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** | see table below |
| **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** | see table below |

**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| **02-June-2022** | A+ | A-1 | Stable | Upgrade |
| **16-Mar-2021** | A | A-1 | Stable | Reaffirmed |
| **31-Dec-2019** | A | A-1 | Stable | Reaffirmed |
| **24-Dec-2018** | A | A-1 | Stable | Initial |

**Due Diligence Meetings Conducted**

| S. No | Name | Designation | Date |
|---|---|---|---|
| 1. | Mr. Saad Khan Gul | DGM Finance | May 12, 2022 |