RATING REPORT

Al Ghazi Tractors Limited

REPORT DATE:
September 18, 2023

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	September 18, 2023		June 02, 2022	

COMPANY INFORMATION	
Incorporated in 1983	**External auditors:** A.F. Ferguson & Co. Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Robert McAllister **Acting CEO:** Mr. Javed Iqbal
Major Shareholders:	
Al Futtaim Industries Company LLC – 50.02%	
CNH Global N.V. – 43.17%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: ***Corporates (May 2023)*** https://docs.vis.com.pk/docs/CorporateMethodology.pdf ***Rating Scale & Definitions*** https://docs.vis.com.pk/docs/VISRatingScales.pdf

Al-Ghazi Tractors Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

RATING RATIONALE

Al Ghazi Tractors Limited ('AGTL' or 'the Company') is a public limited agricultural machinery manufacturer established in June, 1983. The Company is engaged in the assembly and sale of agricultural tractors, implements and spare parts. AGTL has a plant located at Dera Ghazi Khan, having production capacity of 30,000 units per annum on a single-shift basis. Al-Futtaim Group acquired AGTL in 1991 and holds majority stake. AGTL also has an industrial collaboration agreement with CNH Industrial Italia SpA, a leading assembler and manufacturer of the "New Holland" tractors.

Economic Brief

Pakistan achieved annual GDP growth of 6% in FY22. The economic growth was halted by floods and destabilized political environment during FY23. The current account deficit increased to 4.6% of the GDP in FY22. Further, the dollar to rupee incline from FY22 to FY23 was 44.9% resulting in sharp downturn in commodity super-cycle and import constraints.

Similarly, policy rate hike elevated financing cost for buyers and despite provisions made by the Government of Pakistan (GoP) to alleviate pressure on output targets, the agriculture sector growth rate slowed down to 1.6% in FY23 as compared to 4.4% in FY22. The automobile sector in general posted 50% decline in sales in CY23 as compared to CY22. Letter of credit (LC) restrictions, exchange rate fluctuations and higher import prices led to adverse supply and demand dynamics during the outgoing year. The country's per capita income stood at $1,568 in FY23 down from $1,765 in FY22. The same cascading into diminishing purchasing power of customers.

While tractor industry has achieved localization of more than 90%, the players are still dependent on imported parts for manufacturing. Moreover, local vendors/suppliers are also heavily dependent on the imported raw material. The automobile industry has witnessed negative demand/supply dynamics and sales of tractors have also contracted from 1HFY22 to 1HFY23 by 57% which is slightly more than 48% reduction in production quantum.

Sector Brief

Pakistan's tractor sector comprises two major assemblers; Millat Tractors Limited (MTL) and Al-Ghazi Tractors Limited. The production chain has two components – Completely Built Units (CBU) and Semi-Knocked Down (SKD). Aggregate industry production in FY22 reached approximately 58,880 units exhibiting about 16% increase from the previous year (FY21: 50,751). However, industry sales plummeted by 36% in 1QCY23 vis-à-vis same period last year (1QCY23: 9,720, 1QCY22: 15,124). Dealerships and after-sales support play an integral role in the industry. The duopoly of MTL and AGTL have a strong dealer and workshop network. Market share held by AGTL was 23% (CY22: 45%, CY21: 33%) trailing MTL leading the market with a 77% share (CY22: 55%, CY21: 67%) as at end-1QCY23.

Pakistan has 650,000 agricultural tractors functioning in the country with 48 million acres of cultivatable area. Financial barriers to entry in the tractor sector are considered moderate given the assembly line production process. However, franchise value of MTL and AGTL alongside absence of local tractor manufacturing capability favor the market leaders as Massey Ferguson and New Holland Fiat tractors have better on-ground functioning capabilities. The most commonly used tractors have 85 horsepower (hp).

Transformation Drive initiated to enhance sales, supply chain and human capital capabilities

The Company's management started transformation drive that will encompass all layers of technological, technical, supply chain and commercial activities. The management brought forward the transformation plan which has been approved by the BoD. The above initiatives are primarily divided into three areas:

- Technical enhancement of higher hp tractors whereby assembly lines will be upgraded.
- Dealership network will be provided enhanced support to minimize supply chain hurdles.

OVERVIEW OF THE INSTITUTION

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

Profile of Acting CEO & CFO

Mr. Javed Iqbal joined AGTL as CFO in July 2022 and has been the acting CEO since December 2022. He is Chartered Accountant by profession with a career spanning 30 years across Chemical Manufacturing, FMCG and Service sectors. Prior to joining AGTL, he has worked at Management Positions for companies like Pakistan Services Limited (Hashoo Group), Ittehad Chemicals Ltd, Unilever, Daewoo and American Express Bank Ltd.

- SAP S/4 HANA implementation (Currently ERP BAAN) to enable operational transformation and unlock capabilities for growth.

According to the management, AGTL had a controlled employee turnover despite operational difficulties as against considerable layoffs and plant shutdowns by the other player. The management plans to implement improved HR policies by end-2023 to enhance employee engagement and performance.

Business & Operational Review – AGTL

The Company's main product line includes 55 to 85 hp tractors out of which 480 series (55 hp) tractor variant contributed 41% to total sales (CY21: 36%). The Company has segmented its portfolio in two categories; tractors including and above 85hp (A) and tractors below 85hp (B). AGTL controls just 3% of the market share in the former and 65% market share in the lower hp band of tractors. The management is actively engaged in improving technical functions of the A category variants as part of the transformation of AGTL's product portfolio.

AGTL has a robust dealership network of 77 dealers nationwide. The majority of dealers (47) are located in Punjab whereas 18 dealers are selling AGTL's tractors in Sindh and the rest are spread across other areas of Pakistan. AGTL incentivizes and commemorates dealership conferences on a yearly basis. In CY22, untapped regions were targeted. While AGTL's export sales are limited, Afghanistan has emerged as primary region.

Capacity utilization improved to 71% in CY22 from 57% in CY21. As a result, production slowed down in 1QCY23, with capacity utilization falling to 4% and is largely in line with peers. Kissan Package was launched by the GoP in Oct 2022 through which the CBU tractors were allowed to be imported. According to the management, import of CBU is more costly than local assembled tractors, therefore import of tractor has remained muted under this package as well.

Rating Drivers

Strong sponsors' profile supports the assigned ratings of AGTL

AGTL majority shareholders are two multinational conglomerates. Al Futtaim Industries Company LLC holds 50.02% shares in AGTL. Al Futtaim started as a trading business in 1930 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 across the globe. CNH Industrial (CNHI) was founded in 2012 and holds 43.17% shares in AGTL. CNHI is present in 180 countries having 12 brands, 67 manufacturing plants, and 56 research centers and employs more than 63,000 people. CNHI designs, produces and sells agricultural and construction equipment (tractors, combines, excavators), wheel loaders, trucks, commercial vehicles, buses and specialty vehicles. AGTL has an industrial agreement with CNHI Italia SpA, a leading assembler and manufacturer of the "New Holland" tractors.

Decreasing trend in profit margins on a timeline basis

Despite inflationary pressure and import restrictions, the company's unit sales increased by 10% (CY22: 19,929, CY21: 18,156), resulting in net sales reaching Rs. 28.2b (CY21: Rs. 20.6b). AGTL's market share improved to 45% in CY22 from 33% in CY21. AGTL credited the increase in market share to farmer support programs, enhanced dealer alliances and penetration in new regions. However, a downturn in sales volume was witnessed in 1QCY23 as the company sold 2,246 tractors against a production of 1,317 units.

Rs. in m	Mar'21	Mar'22	Mar'23
Sales	5,043	8,653	4,174
Gross Profit	1,171	1,913	632
Net Profit	693	1,159	230

The average sales price of the total portfolio increased by 25% (CY22: Rs. 1.4m, CY21: Rs. 1.1m). Average sales price of the total portfolio witnessed a further increase to Rs. 1.9m in 1QCY23.

The sponsors have continuous interaction with the management especially regarding transformation plan. AGTL plans to improve the performance of present tractor portfolio. Raw materials as a percentage of cost of goods sold (COGS) stood higher at 94% (CY21: 91%). The 75 hp 640 series tractors, the most profitable variant, witnessed an increase in production and sales by 35% and 21% respectively. With sales tax being non-refundable in Finance Act after June, 2022, AGTL recorded 17% input sales tax that added further to COGS during the reporting year (CY22: Rs. 2,389m, CY21: Rs. 871m). Furthermore, Tractors are now part of the exempt category with respect to sales tax, therefore, input sales tax on tractor components and parts has become non-refundable eventually becoming part of the cost to the company.

Similarly, supply chain hurdles and the increase in fuel prices enhanced manufacturing and operating costs thereby decreasing operating profit to Rs. 4.1b (CY21: Rs. 4.3b). The operating profit decreased further to Rs. 412m in 1QCY23 (1QCY22: Rs. 1,633m). The management's strategy to control manufacturing costs, is by having preferred vendors to procure raw material to improve quality and take discounts on bulk purchasing n. In CY22, the Company recorded a higher effective tax rate at 43% (CY21: 19%) due to adjustment of super tax in the reporting year (4%) and corresponding period (10.5%) and also recorded tax charges of the previous year. The unregistered persons sales tax was increased to 20+4% (FY23: 20+3%) in the recent government budget. The company resolved a case in litigation with Collector of Customs in Sindh High Court in CY22 regarding recovery of sales tax and duty amounting to Rs. 115m during the past years.

The Company's profit after tax stood at Rs. 2.2b compared to Rs. 3.0b from the prior year. Net profit remained strained reported at Rs. 0.2b (1QCY22: Rs. 1.2b) in 1QCY23. Gross margin and net margin are on a declining trend as the automobile sector is generally facing shrinking margins due to conflation of demurrage costs and commodity super-cycle. The tractor sector follows the same course. Profitability margins, being dependent on the macroeconomic conditions in the country, are expected to remain under stress.

Sufficient cash flow coverage supporting liquidity profile

Largely stable profitability for the last many years has channeled sound liquidity. Trade debts are marginal as the purchase of tractors is done using draft orders or agricultural loans through specific financial institutions. Therefore, credit risk against the sale of tractors is considered nominal.

The company's total assets grew because of significant spending in the early stages of transformation with additions to operating fixed assets by 31%, primarily driven by acquisition of Rs. 101.7m plant and machinery and Rs. 77.1m computer hardware. The transformation process will include expenditure on assembly lines, IT infrastructure, human capital and sales management for which the company spent a total of Rs. 103.2m at end-1QCY23. Funding from operations (FFO) improved constantly from CY19 to CY21. However, in CY22, FFO decreased by 17% impacted by lower profitability. Nevertheless, coverage has remained strong. The unsold finished tractors and implements increased to Rs. 2,400.5m from Rs. 322.2m at end-CY21 that led to overall higher inventory levels of Rs. 5,264m at end-CY22 (CY21: Rs. 2,875m). Higher inventory levels were reported across the industry as well. Given lower unit sold in 1QCY23, inventories increased further by end-1QCY23. Customers and dealers' advances increased to Rs. 7.8b (CY22: Rs. 0.1b, CY21: Rs. 3.5b) as the company only recognized revenue when performance obligations are met. The company had significant amount (1QCY23: Rs. 5.4b; CY22: Rs. 728m; CY21: Rs. 2b) of cash available at end-1QCY23. With the recent relaxation in import restrictions, the management expects to deliver units against customer advances during CY23.

The increase in payables to CNHI and security deposits received from customers impacted the current ratio on a timeline basis that was reported at 1.13x (CY22: 1.20x CY21: 1.51x). The management has stated that recovery is made without noticeable delays. Net working capital health is an important financial performance indicator for entities under the umbrella of multinational parent groups.

Low financial risk profile underpins the rating assigned to AGTL

While dividend payout ratio had been historically high, AGTL BoD decided not to pay cash dividend in CY22. AGTL's equity base increased to Rs. 3.4b by end-1QCY23 (CY22: Rs. 3.1b, CY21: Rs. 4.0b) on the back of profit retention.

Total debt, mainly short-term, was Rs. 3.8b (CY21: nil) at end-CY22 and gearing ratio was reported at 1.2x (CY21: nil). At end-1QCY23, the company utilized customer advances (1QCY23: Rs. 7.8b; CY22: Rs. 111m) and trade creditors to finance working capital needs. Debt leverage increased to 4.61x (CY22: 2.92x, CY21: 1.39x) at end-1QCY23. According to the management, additional debt financing will be mobilized for the transformation requirement of the Company. Approximately Rs. 3.4b (AED 45m) is required for future CAPEX requirements at debt-to-equity ratio of 30:70, according to the management. As the transformation will take place in phases, AGTL will mobilize financing when required. The gearing is therefore expected to remain manageable. Capitalization for the outgoing period is shown below:

	CY21	CY22	1QCY23
Long Term Debt (Rs. in m)	-	58	60
Short Term Debt (Rs. in m)	-	3,709	-
Total Liabilities (Rs. in m)	5,517	9,149	15,511
Equity (Rs. in m)	3,973	3,132	3,362
Gearing (x)	-	1.20	0.02
Leverage (x)	1.39	2.92	4.61

Sound Corporate Governance and Internal Controls Framework

Overall corporate governance framework is supported by adequate Board composition & oversight and a professional and experienced management team. The Company has a dedicated internal audit function that uses risk-based audit methodology to form its quarterly reports which are reviewed and approved by the Board Audit Committee. AGTL is moving from ERP BAAN to SAP S/4 HANA as part of its transformational strategy to improve operational efficiency. The management expects implementation of SAP S/4 HANA to be completed by March 31st, 2024.

Al-Ghazi Tractors Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**CY20**	**CY21**	**CY22**	**1QCY23**
Fixed Assets	1,067	1,109	1,331	1,393
Inventories	2,005	2,875	5,264	6,253
Trade Deposits	25	115	373	1,049
Refunds from the GoP	1,451	2,983	4,203	4,240
Cash and Bank Balances	231	1,998	728	5,399
Other Assets	404	410	382	539
Total Assets	**5,183**	**9,490**	**12,281**	**18,873**
Trade and Other Payables	1,065	1,907	2,652	5,055
Customer Advances	123	3,489	111	7,792
Long-term Debt	0	0	58	60
Short-term Debt	1,589	0	3,709	0
Total Debt	**1,589**	**0**	**3,767**	**60**
Unpaid Dividend	0	0	2,417	2,417
Total Liabilities	**2,895**	**5,517**	**9,148**	**15,511**
Paid-Up Capital	290	290	290	290
Total Equity	**2,288**	**3,973**	**3,132**	**3,362**
INCOME STATEMENT	**CY20**	**CY21**	**CY22**	**1QCY23**
Net Sales	11,935	20,579	28,202	4,174
Gross Profit	2,771	4,721	4,962	632
Profit Before Tax	1,928	4,170	3,796	345
Profit After Tax	**1,350**	**2,958**	**2,156**	**230**
RATIO ANALYSIS	**CY20**	**CY21**	**CY22**	**1QCY23**
Gross Margin	23.2%	22.9%	17.6%	15.1%
Net Margin	11.3%	14.4%	7.6%	5.5%
Net Working Capital	1,114	2,808	1,837	2,013
Trade debts/Sales	-	-	0.01	-
FFO	1,379	2,973	2,456	685
FFO to Total Debt (%)	87.2%	-	65.2%	NM
FFO to Long Term Debt (%)	-	-	NM	NM
Current Ratio (x)	1.39	1.51	1.20	1.13
Debt Servicing Coverage Ratio (x)	10.46	340.64	17.84	11.10
Leverage (x)	1.27	1.39	2.92	4.61
Gearing (x)	0.69	N/A	1.20	0.02
ROAA*	25.3%	40.3%	24.0%	6.8%
ROAE*	84.6%	94.5%	68.9%	26.3%

*Annualized**

REGULATORY DISCLOSURES — Appendix II

Name of Rated Entity	Al-Ghazi Tractors Limited
Sector	Automobile Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
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				
18-Sep-2023	**A+**	**A-1**	**Stable**	Reaffirmed
02-Jun-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. Javed Iqbal	Acting CEO	July 04, 2023