RATING REPORT

Al-Ghazi Tractors Limited (AGTL)

REPORT DATE:
October 03, 2024

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/Watch	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	
Rating Date	October 03, 2024		September 18, 2023	

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

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates
https://docs.vis.com.pk/docs/CorporateMethodology.pdf
VIS Issue/ Issuer Rating Scale:
https://docs.vis.com.pk/docs/VISRatingScales.pdf

Al-Ghazi Tractors Limited (AGTL)

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 CEO

Mr. Sakib Eltaff possessed more than 27 years' experience. Prior to joining Al-Futtaim Group of Companies, he worked in established companies including Kansai Paint and Hashoo Group. He is a certified Chartered Accountant and holds an MBA from Oxford Brookes University. After serving as Senior General Manager Finance Automation Overseas from 2018 onwards, he was appointed the CEO of AGTL in September 2023.

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. Al-Futtaim Group acquired AGTL in 1991 and holds majority stake. AGTL also has technical collaboration agreement with CNH Industrial Italia SpA, a leading assembler and manufacturer of the "New Holland" tractors. The Company's registered office is located in Karachi while the corporate office is located in Lahore. The assembly plant, located at Dera Ghazi Khan, has production capacity of 30,000 units per annum on a single-shift basis. The marketing offices of the Company are located in Lahore, Multan, Islamabad and Sukkur.

On May 24, 2023 the Company transitioned from its existing BAAN system to SAP S/4HANA as part of its IT infrastructure enhancement initiative. Mr. Javed Iqbal, the CFO of the Company, served as the Acting CEO till September 26, 2023. Subsequently, Mr. Sakib Eltaff was appointed as the CEO of the Company.

Economic Brief

In FY24, Pakistan's GDP expanded by 2.4%, a turnaround from the 0.2% contraction in the previous year, attributed to renewed capital inflows and stabilization of economic conditions in Pakistan. Moving forward, steady growth in agriculture sector would bolster demand of tractors across the country despite the business risks associated with floods and external shocks. Unit sales of key segments in the automobile sector are tabulated as follows:

Automobile Offtake (Units)	FY21	FY22	FY23	FY24
Passenger cars	181,397	234,180	96,812	81,577
Tractors	55,663	43,981	30,942	45,494
Trucks	3,695	5,669	3,182	2,210
Buses	652	661	654	454

Source: PAMA

Automobile sector suffered a dramatic downturn in sales by 57% in FY23, but the rate of decline significantly slowed to 3% in FY24 amid stability in exchange rate, decline in policy rate and ease in supply chain restrictions. However, despite the overall slump in the auto sector, the sales of tractors rose by 47% in FY24 owing to healthy demand dynamics cushioned by farm mechanization and uptick in agricultural activity. This recovery could be dampened in the ongoing period due to the imposition of a 10% sales tax on tractor industry under Finance Act 2024. Additionally, the FBR could further increase the sales tax to 14%, although this proposition is yet to be approved by the GoP. Nevertheless, clinching the IMF deal, coupled with a decline in inflation and interest rate, spurred a surge in auto sales by 82% to 50,915 units (4QFY23: 27,900) in 4QFY24. Furthermore, automobile sales improved by 36% to 17,288 (2MFY24: 12,670) during 2MFY25 primarily driven by sales in the passenger cars segment. Persistently high prices amid political instability yet create a challenging operating environment for the sector, however with the positive response from customers towards tractors and HEVs (hybrid electric vehicles), business risk associated with the automobile sector is considered moderate.

Sector Brief

Pakistan's tractor sector comprises two major assemblers; Millat Tractors Limited (MTL) and AGTL. The production chain has two components – Completely Built Units (CBU) and Semi-Knocked Down (SKD). 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. Provincial government of Punjab has introduced a 'Green Tractor Scheme' for FY25, with an allocation of PKR 30b to subsidize the purchase of 20,000 tractors, ranging from 55 horsepower (hp) to 85 hp, exclusively for Kissan Card holders that could positively impact sales of tractors.

Pakistan has 650,000 agricultural tractors functioning in the country with ~56 million acres (~22.6m hectares) of cultivatable area. While tractor industry has achieved localization of more than 90%, the players are still dependent on imported parts for manufacturing. 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 hp, nevertheless, a recent surge in demand for higher hp models has emerged, driven by farmers' recognition of the inadequacy of lower-powered tractors for crop cultivation further bolstered by government-backed agricultural financing initiatives.

The automobile industry exhibits inherent cyclicality, with consumer spending typically increasing during periods of economic growth due to improved employment rates and incomes, leading to higher consumer confidence and vehicle purchases. During 1HCY24, tractor production and sales saw significant increases, rising by 24.3% to 21,919 units and by 15.8% to 22,500 units compared to the previous period. AGTL's market share decreased to 31% (CY23: 36%, CY22: 45%), while MTL's share increased to 69% (CY23: 64%, CY22: 55%) in 1HYC24. The downward trend in market share of AGTL is attributed to increasing demand of higher hp tractors. AGTL has acquired the services of consultants for the purpose of marketing insights and research and development of tractors with 75 or more horsepower to challenge MTL in the future and seize the market share lost in CY23. The Company projects that it will sell ~16,000 tractors during CY24. The table below shows historic sales numbers in the tractor sector:

Sales (Units)	CY20	CY21	CY22	CY23	1HCY24
Al-Ghazi (Fiat)	12,142	18,156	19,929	15,420	6,979
Millat Tractors (Massey Fergusen)	27,016	37,243	24,052	24,818	15,521
Total Tractors	**39,235**	**55,663**	**43,981**	**40,752**	**22,500**

Source: PAMA

Transformation Drive

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 was approved by the BoD in CY22. The plan is 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.
- IT infrastructure initiative was commenced in which ERP system was migrated to SAP S/4 HANA to enhance operational transformation and unlock capabilities for growth. Transition to the new system was completed on May 24, 2024.

Business & Operational Review

The Company has segmented its portfolio in two categories; tractors of 85 hp and above (A) and tractors below 85 hp (B). In CY23, there was significant shift in sales mix as sale of NH Ghazi model (65 hp) increased on account of shift in market demand towards higher hp tractors. The table below shows the breakdown on tractor sales in terms of models:

Model	HP	2022	%	2023	%	1H2024	%
NH 480 S (55 HP)	55	8,099	40.6%	3,179	20.6%	1,116	16.0%
NH 480 PP (55 HP)	55	7,464	37.5%	1,944	12.6%	1,813	26.0%
NH GHAZI (65 HP)	65	3,880	19.5%	6,458	41.9%	2,484	35.6%
NH 640 (75 HP)	75	464	2.3%	3,311	21.5%	1,508	21.6%
NH 70-56 (85 HP)	85	22	0.1%	37	0.2%	0	-
NH DABANG (85 HP)	85	0	-	491	3.2%	58	0.8%
Total		**19,929**		**15,420**		**6,979**	

The management is actively engaged in improving technical functions of the A category variants of the tractors as part of the transformation of AGTL's product portfolio. AGTL has a robust dealership network of more than 100 dealers nationwide with the majority of dealers located in Punjab. AGTL incentivizes and commemorates dealership conferences on a yearly basis. While AGTL's export sales are limited, Afghanistan has emerged as primary region. Capacity utilization decreased to 48% (CY22: 71%) in CY23 due to reduced demand on account of increase in prices.

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 a technical agreement with CNHI Italia SpA, a leading assembler and manufacturer of the "New Holland" tractors.

Asset base mostly consists of operating fixed assets, inventories, refunds from the GoP and trade debts

Operating fixed assets increased to PKR 1.8b (CY23: PKR 1.6b, CY22: PKR 1.3b) mainly due to capital expenditure made on transformation drive. Stock-in-trade increased by 15.1% to PKR 6.1b (CY22: PKR 5.3b) at end-CY23 on account of lower units sold resulting in higher inventory cost. Inventories further increased to PKR 7.8b at end-1HCY24. Trade deposits, mostly consisting of deposit with Government authority and LC margins, continued to show downward trend (1HCY24: PKR 38.9m, CY23: PKR 324.9m) during the review period.

Trade debts normally remain low (CY23: nil, CY22: PKR 161.8m) due to sales of tractors done through pay orders and agricultural loans; suggests minimal credit risk. Trade debts however increased to PKR 2.6b at end-1HCY24 on account of credit terms extended to dealers. The management believes that trade debts will continue to increase given new marketing strategy, however, nearly all of the trade debts are settled within a week. Cash & bank balances provide support to liquidity profile, standing at PKR 0.9b (CY23: PKR 1.7b, CY22: PKR 0.7b) by end-1HCY24. Total asset base stood to PKR 17.9b (Jun'23: 14.2b, Jun'22: PKR 12.3b) as of Jun'24.

Revenue growth with increased prices despite lower volumetric off-take while margins remained stable

Nearly the all of revenue comprises local tractor sales with minimal contribution from exports. The average sales price of the total portfolio increased by 53.2% to PKR 2.2m per tractor (CY22: PKR 1.4m) during CY23 and further rose to PKR 2.5m per tractor during 1HCY24. Volumetric off-take decreased by 22.6% (CY23: 15,420, CY22: 19,929) due to price factor amid weak economic conditions. Unit sales decreased slightly to 6,979 (1HCY23: 7,108) in 1HCY24. Given increase in prices, net sales increased to PKR 34.5b (CY22: PKR 28.2b) and continued to grow, reaching PKR 17.5b (1HYC23: PKR 14.8b) in 1HCY24. Net sales are projected to further increase to PKR 38b in CY24.

Despite increase in sales, AGTL's market share dropped to 39% (CY22: 45%, CY21: 33%) in CY23. The decline in AGTL's market share in the outgoing year is on account of growing demand for higher hp tractors. AGTL is in the process of aligning its product portfolio in line with the changing demand. Raw materials as a percentage of cost of goods sold (COGS) remained rangebound at 93% (CY22: 94%, CY21: 91%) in CY23. The 75 hp NH 640 series tractors, the most profitable variant, witnessed an increase in sales by 614% during CY23.

Gross profit increased to PKR 3.9b (1HCY24: PKR 2.3b; CY23: 6.4b, CY22: PKR 5.1b) with improvement in material procurement process and partial cost-pass to customers. As a result, gross margin improved to 18.6% (CY22: 17.6%) during CY23 and reached 22.5% (1HCY24: 15.8%) during 1QCY24. Distribution and administration expenses, mainly driven by salaries, and wages and transformation costs, increased to PKR 932.3m (1HCY23: PKR 597.8m; CY23: PKR 597.8m, CY22: PKR 1.5b). The Company generated sizable income on its deposits and savings accounts of PKR 224.4m (1HCY23: PKR 326.9m; CY23: PKR 560.1m, CY22: PKR 107.2m) in 1HCY24. Financial charges decreased to PKR 158.4m (1HYC23: PKR 245.0m) amid lower draw down on short term debt and prompt repayment of long-term debt. As a result of healthy revenue generation and stable gross margin, net profit increased to PKR 2.6b (CY22: PKR 2.2b) in CY23. Net profit showed more than double-digit growth, reaching PKR 1.7b (1HCY23: PKR 802.3m) in 1HCY24. As per management, net profit is estimated around PKR 3b during CY24.

During the period under review, higher prices and cost-optimization boosted profitability; while the margins largely remain stable. Sustained growth in topline and improvement in margins remain important for ratings, moving forward.

Sufficient cash flow coverage supporting liquidity profile

In CY23, FFO (funds from operations) decreased slightly to PKR 2.4b (CY22: PKR 2.5b, CY21: PKR 3.0b) due to incidence of higher income tax. FFO however increased significantly to PKR 1.7b (1HCY23: PKR 663.0m) in 1HCY24 driven by sizable growth in profit. DSCR (debt servicing coverage ratio) was reported higher at 11.86x (1HCY23: 3.86x; CY23: 7.50x, CY22: 11.02x) due to increase in FFO in 1HCY24. FFO to total debt coverage improved to 2.05x (end-CY23: 1.39x, end-CY22: 0.65x) owing to higher FFO at end-1HCY24. Short-term debt coverage improved to 6.11x (end-CY23: 3.69x, end-CY22: 1.46x) on account of increase in trade debts and stock-in-trade at end-1HCY24. Current ratio improved to 1.50x (CY22: 1.20x, CY21: 1.51x) in CY23 with build-up of stock-in-trade. The current ratio remained unchanged at end-1HCY24.

Cash conversion cycle deteriorated significantly to 64 days (CY23: 29 days, CY22: 43 days) owing to higher inventory days in 1HCY24. Inventory build-up was in tandem with increase in imported component required for the launch of the new 85 hp tractor, expected to be launched during

4QCY24. Overall, cashflows remain strong, while debt coverages and relevant liquidity metrics remain mostly favorable compared to industry peer.

Low financial risk profile underpins the rating assigned to AGTL

Equity base increased to PKR 7.5b by end-1HCY24 (CY23: PKR 5.8b, CY22: PKR 3.1b) on the back of profit retention and absence of dividend payout. Dividend payout has remained nil since 2022 due to restrictions on remittances imposed by the State Bank of Pakistan.

According to the management, additional debt financing will be mobilized for the transformation requirement of the Company. The Company allocated approximately PKR 3.4b for its transformation drive, mainly financed from internal cashflows and short-term debt. The Company had spent PKR 2.2b on this initiative by end-1HCY24.

The Company financial risk is low as gearing ratio (1HCY24: 0.23x; CY23: 0.29x, CY22: 1.20x) and debt leverage (1HCY24: 1.38x; CY23: 1.46x, CY22: 2.92x) have improved on timeline basis owing to limited debt mobilization and healthy growth in equity base. The ratings incorporate low financial risk profile which compares favorably with the peer.

Sound Corporate Governance and Internal Controls Framework

Overall corporate governance framework is supported by balanced Board composition, board oversight and a professional and experienced management team. During 2023, Mr. Dmitrii Bogatyrev was co-opted as a non-executive and nominee director of Al-Futtaim Industries Co. LLC, succeeding Mr. Ramesh Narasimhan. Additionally, Mr. Malik Mirza was elected as an Independent Director for the first time on the Board. The Board re-elected Mr. Robert McAllister as the Chairman. Ms. Farah Qureshi, an Independent Director, passed away in 2024; the causal vacancy was filled on September 05, 2024 with the appointment of Ms. Samiha Zahid.

The Company has a dedicated internal audit function that uses risk-based audit methodology for quarterly reports, which are reviewed and approved by the Board Audit Committee. Migration to SAP S/4 HANA is likely to enhance operational transformation and unlock capabilities for growth.

Al-Ghazi Tractors Limited Appendix I

FINANCIAL SUMMARY						*(amounts in PKR millions)*
BALANCE SHEET	**CY20**	**CY21**	**CY22**	**CY23**	**1HCY23**	**1HCY24**
Fixed Assets	1,067	1,109	1,331	1,608	1,539	1,726
Inventories	2,005	2,875	5,264	6,084	3,997	7,776
Trade Debts	0	5	162	0	1	2,569
Trade Deposits	25	115	373	325	496	39
Refunds from the GoP	1,451	2,983	4,203	4,210	4,208	4,219
Cash and Bank Balances	231	1,998	728	1723	5,399	846
Total Assets	**5,183**	**9,490**	**12,281**	**14,230**	**12,184**	**17,881**
Trade and Other Payables	1,065	1,907	2,652	3,813	4,577	6,153
Customer Advances	123	3,489	111	131	765	139
Long-Term Debt (incl. current maturity)	0	0	65	57	54	53
Short-Term Debt	1,589	0	3,709	1,649	0	1,692
Total Debt	**1,589**	**0**	**3,775**	**1,706**	**54**	**1,745**
Dividend Payable	0	0	2,417	2,417	2,417	2,417
Total Liabilities	**2,895**	**5,517**	**9,148**	**8,449**	**8,250**	**9,937**
Paid-Up Capital	290	290	290	290	290	290
Total Equity	**2,288**	**3,973**	**3,132**	**5,780**	**3,934**	**6,634**
INCOME STATEMENT	**CY20**	**CY21**	**CY22**	**CY23**	**1HCY23**	**1HCY24**
Net Sales	11,935	20,579	28,202	34,544	14,751	17,541
Gross Profit	2,771	4,721	4,962	6,423	2,332	3,940
Profit Before Tax	1,928	4,170	3,796	4,687	1,664	2,837
Profit After Tax	**1,350**	**2,958**	**2,156**	**2,612**	**802**	**1,733**
RATIO ANALYSIS	**CY20**	**CY21**	**CY22**	**CY23**	**1HCY23**	**1HCY24**
Gross Margin	23.2%	22.9%	17.6%	18.6%	15.8%	22.5%
Net Margin	11.3%	14.4%	7.6%	7.6%	5.4%	9.0%
Net Working Capital	1,114	2,808	1,837	4,143	2,399	5,414
FFO*	1,379	2,973	2,456	2,372	1,326	3,583
FFO to Long-Term Debt (x)	-	-	37.68	41.32	24.63	68.16
FFO to Total Debt (x)	0.87	-	0.65	1.39	24.63	2.05
DSCR (x)	-	340.64	11.02	7.50	3.86	11.86
Current Ratio (x)	1.4	1.5	1.2	1.5	1.3	1.5
Short-Term Debt Coverage (x)	1.3	-	1.5	3.7	-	6.1
Cash Conversion Cycle* (days)	82	36	43	43	(9)	64
Gearing (x)	0.7	-	1.2	0.3	0.0	0.2
Leverage (x)	1.3	1.4	2.9	1.5	2.1	1.4
ROAA*	25.3%	40.3%	24.0%	17.3%	10.9%	23.1%
ROAE*	84.6%	94.5%	68.9%	63.8%	27.9%	60.6%

*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

Rating Date	Medium to Long Term	Short Term	Rating Watch/ Outlook	Rating Action
RATING TYPE: ENTITY				
03-Oct-2024	**A+**	**A-1**	**Stable**	**Reaffirmed**
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

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.
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Due Diligence Meetings Conducted

S. No	Name	Designation	Date
1	Qaiser Javed	DGM Finance	12-Sep-2024
2	Irfan Khan	Manager Finance	