The Pakistan Credit Rating Agency Limited

Rating Report

Ghandhara Industries Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
13-Dec-2019	A	A1	Stable	Downgrade	-
13-Jun-2019	A+	A1	Stable	Maintain	-
12-Dec-2018	A+	A1	Stable	Maintain	-
30-Jun-2018	A+	A1	Stable	Maintain	-
29-Dec-2017	A+	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Ghandhara Industries Limited (GIL) operates in pickups, trucks & buses segment of the automobile sector. The strength of the company is its alliance with ISUZU – a leading Japanese brand in the country's trucks & buses segment. ISUZU has enabled the company to build a strong fortress in the competitive industry of Pakistan. The current economic slowdown and rupee devaluation has hampered the overall demand, impacting the business volumes of the company. Hence, the latest profitability stand diluted. Over the years, the company has improved its ranking and share in the market, however, sustainability of the same is important. It is crucial to sustain the position while managing the rising competition. Foreign players are also taking interest in the local market. Recently launched pickup range of ISUZU D-Max, though slow- has also started its contribution. The group has built synergies between the two companies operating in the same sector. The sponsoring group upholds good corporate governance standards. Their business acumen is further enriched by the group’s stake in the country’s leading tyre manufacturing company. During the period under review, stretch in working capital and increased borrowings along with the rising finance cost have diluted the financial strength of the company. The working capital is supported by short term borrowings.

The ratings are dependent on upholding of the company’s business as well as financial risk profile. Key element is company’s stance on working capital management. Moreover, management’s ability to sustain its market share during the demand crunch is crucial.

Disclosure	
Name of Rated Entity	Ghandhara Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Trucks & Buses(Dec-19)
Rating Analysts	Usama Liaquat | usama.liaquat@pacra.com | +92-42-35869504

Profile

Legal Structure Ghandhara Industries Limited is a public listed entity. The corporate office of the company is in F-3, Hub Chawki Road, S.I.T.E.

Background The company was founded in 1953 by General Motors Overseas Distribution Company and was purchased in 1963 by Late Lt. General (R) Habibullah Khan Khattak. The company was later nationalized in 1972 and renamed as National Motors Limited. In 1992, Late Lt. General (R) Habibullah Khan Khattak reacquired the company from the Government and renamed it to Ghandhara Industries Limited.

Operations Ghandhara is primarily engaged in the assembly (outsourced), body fabrication and sale of Isuzu pickup, truck and buses and is the exclusive distributor and authorised assembler & dealer of ISUZU products in Pakistan. The company has outsourced the assembly of its pickup, truck and buses to Ghandhara Nissan Ltd.

Ownership

Ownership Structure Majority ownership of the company is held by Bibojee Group of Companies, whereas Bibojee Services (Private.) Limited directly owns ~39% shares, Ghandhara Nissan Limited has ~19% and Universal Insurance Company Limited (another associate company) holds ~6% shares. Other shares are held by corporates, financial institutions and individuals.

Stability Bibojee Group of Companies, represents a family with history of entrepreneurship spanning over four decades. The group operates through holding company “Bibojee Services (Private) Limited”. This provides a formal structure to the group and a platform for relatively smooth execution of succession matters amongst family members.

Business Acumen Bibojee is the parent company of Bibojee Group of companies under whose umbrella come automobile companies, textile, insurance, construction and tyre manufacturing concern. Bibojee's group understanding of the business is strong.

Financial Strength Bibojee Services (Private) Limited has strategic stakes in companies from different sectors including Textile, Insurance, Automobile and construction. Financial strength of the group is strong.

Governance

Board Structure The overall control of the company vests in seven members board of directors. The board structure comprises two executive directors, three non-executive director and two independent directors. During the year, one casual vacancy occurred on the Board due to death of Mr. Jamil Ahmed Shah January 10, 2019 which was filled by Mr. Muhammad Kuli Khan Khattak.

Members’ Profile The Board members are professionals with experiences of managing business affairs in different sectors. Mr. Lt. Gen. (Retd.) Ali Kuli Khan Khattak is the Chairman of the Board having diverse experience in the Auto and Allied sector, which brings specialized and comprehensive experience and knowledge on the board.

Board Effectiveness In line with the guidelines of Code of Corporate Governance, the Board has formed two sub-committees – (i) HR and Remuneration Committee and (ii) Audit Committee. Both committees are headed by an Independent director and consist of 5 and 4 members respectively. Attendance in meetings held during FY19 was good.

Financial Transparency An effective Internal Audit department reporting to the Audit Committee is in place. M/s. Shine Wing Hameed Chaudhari & Company, a QCR rated firm, has expressed an unqualified opinion on financial statements of FY19.

Management

Organizational Structure The organizational structure of the company is divided broadly into various functional departments and all the department heads report to Deputy Chief Executive Officer. Major departments include (i) Finance, (ii) Human Resources and Admin (iii) Quality control (iv) Sales and Marketing (v) Material Management.

Management Team Team Management of the company comprises qualified and experienced professionals with a wide range of skills and diversified experience. Mr. Ahmad Kuli Khan Khattak is the CEO of the company Mr. Muhammad Kuli Khan Khattak is the Deputy Chief Executive Officer. He has an overall experience of over 12 years and he is assisted by able management team.

Effectiveness Every department head is responsible to manage the affairs of their departments. Clearly defined rules and responsibilities in organization add to the effectiveness of the organization structure.

MIS The company has implemented ERP-business software package designed to integrate all areas of a business. Strong MIS system is expected to add value to the company's operations going forward.

Control Environment The corporate structure of the company is diverged into various departments each having an effective Internal Control System. Robust MIS to assist reporting needs of management strengthens the control environment.

Business Risk

Industry Dynamics Pakistan’s trucks and buses industry is dominated by domestic players such as Ghandhara Industries, Ghandhara Nissan, HinoPak and Master. Lately, Ghandhara Industries has outperformed HinoPak in terms of market share and now occupies the highest share in the industry followed by HinoPak, Ghandhara Nissan and Master. During FY19, only 6,763 units of trucks and buses were sold as compared to 10,093 units in FY18 with a decline of ~33%. Current economic slowdown and muted CPEC related activities, which coupled with high interest rates and rupee devaluation has further affected the overall LSM segment of the country, Hence, demand for trucks and buses has slowed down significantly.

Relative Position Ghandhara Industries - a strong player in the industry, possessing ~45% market share as at End June-19. Much of the trucks demand of the company is generated through commercial customers, such as oil marketing companies. The company sold 3,018 units of ISUZU trucks and buses and 391 units of pick up truck during FY19 as compared to 4,000 units of buses and trucks in FY18. The company performed well as compared to the overall industry as it could restrict the decline in sales to 25% as compared to 33% of overall market in FY19. Due to strong relationship with its customers, the company is well poised to retain its market share.

Revenues Revenue decreased by ~17% and ~31% during FY19 and 1QFY20 respectively as compared to the corresponding periods. The company posted a revenue of PKR 13,910mln in FY19 (FY18: PKR 16,772mln) owing to stringent market conditions and decreasing trend in overall truck and bus market. The newly launched Isuzu DMAX pick up truck contribution towards the revenue has also started, with 391 units sold in FY19.

Margins Instilling impact of decreased revenues along with high cost of raw material and significant currency devaluation drive the decrease in gross profit margin of the company, which reduced by ~49% in FY19, standing at PKR 1,602mln. For 1QF20 gross profit decline was 35% as compared to corresponding period. Decrease in gross profit margin led to decrease in operating margin in FY19. Net profits for FY19 was reduced to PKR 60mln as compared to PKR 1,362mln in FY18 on account of significant hike in finance cost due to rising interest rates and company’s increased borrowings.

Sustainability Keeping in view the economic trends, the Company is making all necessary efforts to improve its position on the back of enhanced product line and improved competitiveness which will create sufficient potential demand in local market. Recent Launch of D-Max pick-ups will also add to the revenues.

Financial Risk

Working Capital Inventory days of the company increased, on annualized figures, to ~296 days at the end of 1QFY20 (~153 days 1QFY19) in anticipation of future sales, launch of new product and less than expected demand. Net working capital days of the company also increased, on annualised figures, to ~288 days in 1QFY20 as compared to ~145 days in 1QFY19.

Coverages Free cash flow from operations (FCFO) decreased by ~71% on YOY basis in FY19 clocking in at PKR~360mln (FY18: PKR~1,236mln). 1QFY19 also witnessed a decline of 39% in FCFO on the backdrop of decreased profits. Decrease in FCFO led to decrease in interest coverage of the company, interest coverage ratio decreased to 0.5x and 0.4x in FY19 and 1QFY20 respectively (FY18: 6.9x, 1QFY19: 1.8x).

Capitalization The company has a leveraged capital structure. Total debt of the company in 1QFY20 clocked in at PKR~6,681mln as compared to PKR~5,313mln in 1QFY19. Out of the total debt of, PKR~6,613mln was short term and PKR~68mln was long term debt. Gearing ratio is continuing its upward trend as it stand at ~59% in 1QFY20 (1QFY19: ~51%).

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Financial Summary
PKR mln

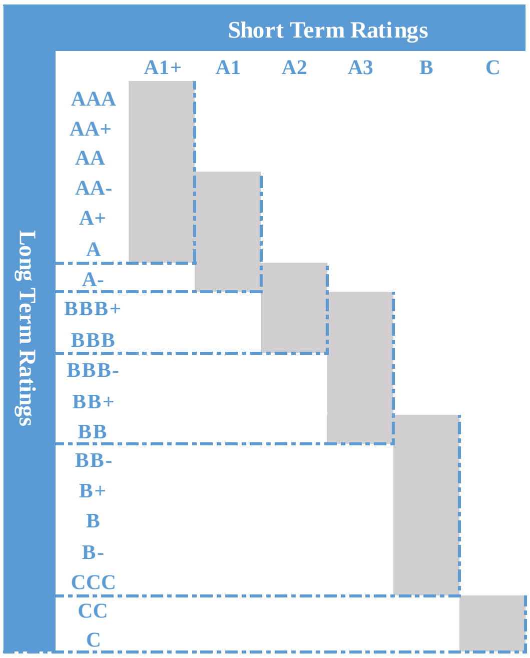
Ghandhara Industries Limited Auto & Allied Trucks & Buses	Sep-19 3M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	2,927	2,884	2,481	2,058
2 Investments	88	88	89	89
3 Related Party Exposure	1	1	1	1
4 Current Assets	11,994	12,950	9,463	6,447
a Inventories	*9,284*	*10,359*	*6,888*	*3,779*
b Trade Receivables	*288*	*88*	*95*	*485*
5 Total Assets	15,010	15,923	12,034	8,595
6 Current Liabilities	3,544	4,762	3,439	3,958
a Trade Payables	*375*	*517*	*502*	*416*
7 Borrowings	6,681	6,362	3,675	830
8 Related Party Exposure	85	118	105	65
9 Non-Current Liabilities	38	33	91	52
10 Net Assets	4,662	4,648	4,724	3,690
11 Shareholders' Equity	4,662	4,648	4,724	3,690
B INCOME STATEMENT				
1 Sales	3,029	13,910	16,772	10,741
a Cost of Good Sold	*(2,622)*	*(12,308)*	*(13,661)*	*(8,538)*
2 Gross Profit	407	1,602	3,111	2,203
a Operating Expenses	*(213)*	*(803)*	*(931)*	*(510)*
3 Operating Profit	194	799	2,180	1,693
a Non Operating Income or (Expense)	*8*	*91*	*6*	*(222)*
4 Profit or (Loss) before Interest and Tax	202	890	2,186	1,471
a Total Finance Cost	*(222)*	*(751)*	*(222)*	*(225)*
b Taxation	*33*	*(79)*	*(602)*	*(451)*
6 Net Income Or (Loss)	14	60	1,362	796
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*86*	*360*	*1,236*	*1,090*
b Net Cash from Operating Activities before Working Capital Changes	*(121)*	*(240)*	*1,040*	*867*
c Changes in Working Capital	*(636)*	*(1,899)*	*(3,413)*	*(932)*
1 Net Cash provided by Operating Activities	(758)	(2,138)	(2,372)	(66)
2 Net Cash (Used in) or Available From Investing Activities	(3)	(212)	(472)	(110)
3 Net Cash (Used in) or Available From Financing Activities	317	2,353	2,536	395
4 Net Cash generated or (Used) during the period	(444)	3	(308)	219
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-12.9%	-17.1%	56.2%	84.4%
b Gross Profit Margin	13.4%	11.5%	18.5%	20.5%
c Net Profit Margin	0.5%	0.4%	8.1%	7.4%
d Cash Conversion Efficiency (EBITDA/Sales)	8.3%	7.7%	13.4%	14.4%
e Return on Equity (ROE)	1.2%	1.3%	32.4%	23.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	302	229	122	139
b Net Working Capital (Average Days)	288	215	112	125
c Current Ratio (Total Current Assets/Total Current Liabilities)	3.4	2.7	2.8	1.6
3 Coverages				
a EBITDA / Finance Cost	1.2	1.5	12.5	9.6
b FCFO / Finance Cost+CMLTB+Excess STB	0.4	0.5	6.6	6.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-0.1	-0.2	0.0	0.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	58.9%	57.8%	43.8%	18.4%
b Interest or Markup Payable (Days)	89.4	99.5	98.2	54.8
c Average Borrowing Rate	13.0%	14.4%	8.0%	30.5%

Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings	
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings	
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security’s market price or suitability for a particular investor.

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

Proprietary Information