The Pakistan Credit Rating Agency Limited

Rating Report

The General Tyre & Rubber Company of Pakistan Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-Aug-2020	A	A1	Stable	Maintain	-
10-Oct-2019	A	A1	Stable	Downgrade	-
10-Apr-2019	A+	A1	Stable	Maintain	-
10-Oct-2018	A+	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the realignment of the company’s positioning in the current operating and economic environment of the country. Despite the overall economic slowdown and softening of demand induced by outbreak of COVID-19 with associated lockdown, the company has managed to restrict its top-line loss to 15% in 9MFY20 through focusing on replacement market and rising its market share into this segment. The non-accommodative monetary policy resulted in significant increase of finance cost which suppressed the company’s profitability for the period under review. Currently there is a considerable reduction in policy rate and this will enhance the profitability of General Tyre in near future. Meanwhile the company has undertaken multiple initiatives which will help reduce its operating cost and supplement plant efficiency. The company‘s envisaged fresh business strategy with more focus on replacement market and farm segment has helped the company to maintain its margins. The company has a strong foothold in its respective industry comprising 4 wheeler tyres for cars, LCVs, tractors, buses and trucks. The company is the sole manufacturer of passenger car radial tyres catering the Original Equipment Manufacturers' (OEMs) market. Two wheeler market, in contrast, displays a broader competitive landscape wherein General Tyre holds a relatively small market share. In last 3-4 years company has invested significantly in modernisation and capacity enhancement of its plant through financing. Due to prevailing subdued economic situation, the company could not get much benefit of its expansion therefore overall debt servicing capacity of the company decreased. However, the Company is well poised to take benefit from future revival of demand from both OEM and RM market. Recent drive of Government to curb smuggling may support company in replacement market. The Company is also in close coordination with new auto players and has started supplying tyres to two new auto players. A well-devised governance framework alongside experienced management team is considered positive for the ratings. Association of General Tyre with Bibojee Services (Private) Limited and Pakistan Kuwait Investment Company Limited is also a consideration. The company's core competence lies in its technical collaboration with Continental AG; Germany (one of the world’s leading tyre manufacturer) which assures adherence to international quality standards. Cautious management strategies amidst changing industry environment are critical.

The ratings are dependent on the company to uphold and improve its business risk vis-à-vis financial risk profile. Revival of the demand driver is crucial. Moreover prudent management of financial affairs remains important.

Disclosure

Name of Rated Entity	The General Tyre & Rubber Company of Pakistan Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Tyres(Oct-19)
Rating Analysts	Sohail Ahmed | sohail.ahmed@pacra.com | +92-42-35869504

Profile

Legal Structure The General Tyre and Rubber Company of Pakistan Limited "General Tyres" is a Public Listed Entity with a free float of ~32% shares as on June 30th, 2020. It got listed on Pakistan Stock Exchange in 1982.

Background The company was initially established by General Tire International Corporation (GITC) of USA in 1963, with an initial production capacity of ~120,000 tyes per annum. Currently, Bibojee Services (Private) Limited and Pakistan Kuwait Investment Company (Private) Limited are the two major sponsors of the company.

Operations The primary business of the company is manufacturing and sale of radial tyres for Cars, LCVs, Vans, Jeeps, Pickups, Buses and Bias Tyres for Trucks, Tractors, Rickshaws and Motorcycles. At present, the company has a capacity of 3,933,850 tyre sets.

Ownership

Ownership Structure Bibojee Services (Private) Limited and Pakistan Kuwait Investment Company (Private) Limited are the major shareholders of the company and hold ~27.8% and ~30% shares respectively.

Stability Bibojee Services (Private) Limited is a strong conglomerate diversified into various sectors including textile, automobile, Insurance, tyres & rubber and construction. Pakistan Kuwait Investment Company (Private) Limited is a state-owned Joint venture between Government of Pakistan and Government of Kuwait and is one of the top investment companies of Pakistan.

Business Acumen Apart from General Tyre, both sponsors have strategic stake in other sectors too. Under the ownership of current sponsors, the company has achieved many milestones and has established a formidable position in the tyres sector, which is a representation of strong sponsor acumen.

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. Pakistan Kuwait Investment Company (Private) Limited also holds ~30% shares in Meezan Bank Limited, ~30% in Al-Meezan Investment Management Limited and ~17.6% in National Clearing Company of Pakistan Limited.

Governance

Board Structure Board of Directors consists of 10 members, out of which one is independent, eight non-executive and one is an executive director. Six directors represent Bibojee Services (Private) Limited and three represent Pakistan Kuwait Investment Company (Private) Limited. Management control vests with Bibojee Services.

Members' Profile Lt. Gen. (Retd.) Ali Kuli Khan Khattak is the Chairman of the Board having diverse experience in Auto and Allied sector. Other members are also highly qualified professionals and have sufficient experience in managing the company's affairs.

Board Effectiveness Two sub committees on the Board exist; (i) Audit Committee & (ii) HR & Remuneration Committee. Attendance recorded during the board and its sub-committees' meetings was good and minutes of the meetings have been extensively documented.

Financial Transparency An effective Internal Audit department reporting to the Audit Committee is in place. The External Auditor of the company are M/s A.F. Ferguson & Co, Chartered Accountants, one of the big four firms. They expressed an unqualified opinion on the half yearly financial statements of the company for 1HFY20.

Management

Organizational Structure Well-defined organizational structure exists. Operations are segregated into various departments wherein clear lines of responsibility are defined for each cadre.

Management Team Mr. Hussain Kuli Khan - the CEO of the company, has an overall experience of ~24 years. He did his Business Administration from Gettysburg College, USA. He also underwent training for 6 months in tyre manufacturing plants of Continental AG in Europe. He is supported by a team of experienced professionals working under various sub-divisions to ensure smooth reporting.

Effectiveness The management committee is headed by Chief Executive Officer, Mr. Hussain Kuli Khan. The committee also includes Chief Financial Officer, Executive Director Works, Executive Director Corporate Service & HR and Executive Director Marketing. Further, different departments' heads are responsible to ensure smooth running of their relevant departments.

MIS The company has implemented all in one SAP consisting of 9 modules. Detailed business continuity plan to address risk assessment and disaster recovery policy is in place.

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 Tyre industry is composed of three segments, (i) 2 & 3 wheeler tyres (ii) Tyres for Cars and LCVs, and (iii) Tyres for Trucks, Buses and Tractors. Tyres demand is driven by sales of new vehicles and demand from replacement market. Overall economic slowdown recently exacerbated by Covid19 had impacted the sales of new vehicles and hence the revenue from OEMs.

Relative Position The company optimizes on its strong competitive position in the upper niche segment of the tyres sector, i.e., 4 wheeler tyres. In addition to being the only local producer of passenger car tyres in the country, it also has developed a strong grasp in the production of tractor tyres. In 2 & 3 wheeler domain, the company is currently in the process of penetrating its presence and has a small share. The company continues to struggle in replacement market as they face stiff competition from cheap imported tyres through both green and grey channels. However, in current year, increased focus on replacement market has resulted in sales value growth.

Revenues During 9MFY20, revenue clocked in at PKR~6,388mln (9MFY19: PKR~7,493mln) depicting a decrease of ~15% YOY basis. Sales remained lower during the period under review especially reduced sales of OEM's resulted in reduced revenue, owed due to slowdown of demand for the following reasons (i) overall economic slowdown (ii) Lower demand from OEM's in Nov & Dec 2019 (iii) lockdown imposed starting from end-Mar20 due to Covid19.

Margins Despite the decrease in sales, the company managed to increase gross profit margin to ~16.3% during 9MFY20 (9MFY19: ~14.2%) due to increased sales in Replacement Market, better product mix and price increase to offset inflation. Increased gross profit margins translated into better operating profits. Finance cost of the company increased by 72% during 9MFY20 to PKR~671mln (9MFY19: ~390mln) which led to overall loss of the company. Consequently, net loss of the company recorded at PKR~105mln during 9MFY20 down from net profit of PKR~96mln for 9MFY19, reflecting a significant decline.

Sustainability Currently, the company has made investment in Capital expenditure, Due to slowdown in economy and Covid19 induced lockdown, the company could not take benefits of investment. However, as the businesses are open again and the company is poised to reap the benefits. The company is working on strategies to reduce the cost and go for leaner production. Further, company is in close coordination with all OEM's including both new auto players. Both new players have started purchasing tyres from the company which is going to bode well for future sales.

Financial Risk

Working Capital Due to less than expected sales during the period under review, the company's inventory piled up to high levels and inventory days increased to ~172 days in 9MFY20 (9MFY19:~128 days). Hence, net working capital days increased to ~186 days (9MFY19:~150 days). To finance the increased working capital needs, short term borrowings also took an upsurge in 9MFY20 to PKR 5.932mln (FY19: PKR 4,876mln, FY18: PKR 2,689).

Coverages Free Cash Flow from operations (FCFO) increased to PKR~739mln during 9MFY20 (9MFY19: PKR ~398mln) on account of higher finance cost and reduced tax payment. Coverages of the company during the period under review remained same as compared to corresponding period of last year. Interest coverage ratio of the company was stagnant at ~1.1 during 9MFY20 (9MFY19: ~1.1).

Capitalization Total Debt of the company clocked in at PKR~7,264mln (FY19: PKR~6,505mln). The increase stemmed from short-term borrowings which increased to PKR~5,932mln (FY19: PKR~4,876mln). Long term borrowing of the company stood at PKR~1,332mln (FY19: PKR~1,629mln). Equity of the company stood at PKR~3,159mln (FY19: PKR~3,241mln). Increase in debt alongside a slight erosion in equity elevated the gearing ratio to ~69.7% in 9MFY20 (FY19: ~66%).

PKR mln

General Tyre and Rubber Company Limited	Mar-20	Jun-19	Jun-18	Jun-17
Tyres	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	5,226	5,181	4,321	3,768
2 Investments	-	-	-	-
3 Related Party Exposure	15	16	15	10
4 Current Assets	7,528	7,278	6,350	4,825
a Inventories	*4,291*	*3,722*	*3,325*	*2,075*
b Trade Receivables	*1,025*	*1,237*	*1,027*	*879*
5 Total Assets	12,769	12,475	10,686	8,603
6 Current Liabilities	1,766	1,984	2,055	1,460
a Trade Payables	*647*	*963*	*866*	*314*
7 Borrowings	7,264	6,505	4,407	2,698
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	580	645	653	649
10 Net Assets	3,159	3,341	3,571	3,796
11 Shareholders' Equity	3,159	3,341	3,571	3,796
B INCOME STATEMENT				
1 Sales	6,388	10,486	11,785	9,645
a Cost of Good Sold	*(5,345)*	*(8,897)*	*(9,700)*	*(7,589)*
2 Gross Profit	1,043	1,589	2,086	2,056
a Operating Expenses	(517)	(692)	(820)	(700)
3 Operating Profit	527	897	1,265	1,356
a Non Operating Income or (Expense)	*28*	*(59)*	*(69)*	*(56)*
4 Profit or (Loss) before Interest and Tax	555	839	1,197	1,300
a Total Finance Cost	*(671)*	*(585)*	*(257)*	*(124)*
b Taxation	*11*	*(131)*	*(224)*	*(303)*
6 Net Income Or (Loss)	(105)	123	716	874
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*739*	*752*	*1,224*	*803*
b Net Cash from Operating Activities before Working Capital Changes	*184*	*239*	*969*	*658*
c Changes in Working Capital	*(566)*	*(649)*	*(879)*	*(694)*
1 Net Cash provided by Operating Activities	(382)	(410)	90	(36)
2 Net Cash (Used in) or Available From Investing Activities	(334)	(1,264)	(917)	(770)
3 Net Cash (Used in) or Available From Financing Activities	607	1,738	819	788
4 Net Cash generated or (Used) during the period	(109)	65	(8)	(17)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-18.8%	-11.0%	22.2%	1.8%
b Gross Profit Margin	16.3%	15.2%	17.7%	21.3%
c Net Profit Margin	-1.6%	1.2%	6.1%	9.1%
d Cash Conversion Efficiency (EBITDA/Sales)	15.0%	12.6%	13.2%	16.7%
e Return on Equity (ROE)	-4.3%	3.6%	19.4%	25.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	220	162	113	105
b Net Working Capital (Average Days)	186	130	95	99
c Current Ratio (Total Current Assets/Total Current Liabilities)	4.3	3.7	3.1	3.3
3 Coverages				
a EBITDA / Finance Cost	1.4	2.3	6.3	13.7
b FCFO / Finance Cost+CMLTB+Excess STB	0.7	0.6	1.7	1.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	15.1	9.4	1.8	2.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	69.7%	66.1%	55.2%	41.5%
b Interest or Markup Payable (Days)	99.2	82.5	86.6	177.7
c Average Borrowing Rate	12.9%	10.6%	7.0%	5.1%

Credit Rating

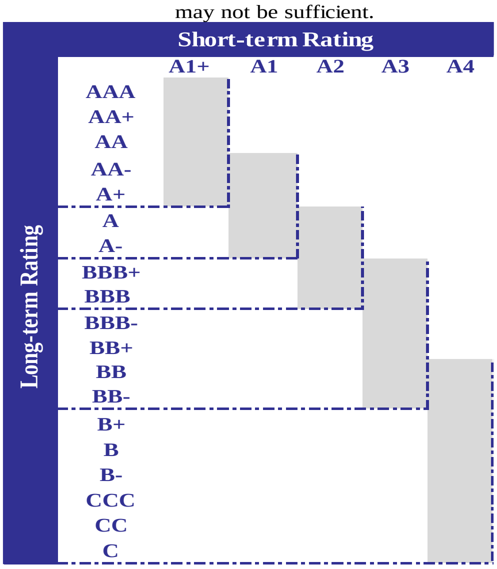
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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

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(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)
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