RATING REPORT

Premium Textile Mills Limited (PRET)

REPORT DATE:
September 25, 2019

RATING ANALYST:
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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	BBB+	A-2
Rating Outlook	Stable		Stable	
Rating Date	September 24th 2019		July 19th, 2018	

COMPANY INFORMATION	
Incorporated in 1987	**External auditors:** Rehman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants
Public Listed Company	**Chairman:** Mr. Mohammad Aslam
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Abdul Kadir Haji Adam
Trustees of Abdul Kadir Adam Beneficiary – 45.5%	
CDC – Trustee National Investment (UNIT) – 11.9%	
Local – Individual – 11.6%	
Rahmat Investment Company (Pvt.) Ltd – 6.5%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Industrial Corporates (May 2019) https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Premium Textile Mills Limited (PRET)

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Premium Textile Mills Limited (PRET) was incorporated as a Public Limited Company in 1989. The shares of the Company are quoted on Pakistan Stock Exchange Limited. Financial Statements of the company for FY18 were audited by Rehman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants.

Premium Textile Mills Limited (PRET) is part of the Premium Group of Companies which is involved in trading (Premium Resources), auto parts (Techno Fabrik) and textile (PRET and Premium Knits) sectors. PRET is engaged in the manufacturing and sale of yarn to both local and export market. The manufacturing facility of the company is located in Nooriabad. The power requirement of the production unit is met through internal generation while sanctioned load from K-Electric (KE) is available as a backup.

Group Snapshot
Premium Textile Mills Limited (Spinning – Melange Yarn)
Premium Knits (Home Textile – Bedding)
Premium Resources (Trading)
Techno Fabrik (Auto parts)

PRET has a number of value-added products in its portfolio, including injected slub (patterned yarn) as well as a customized polyester mix tailored to consumer specification. During FY19, blended cotton and cotton mélange comprised the major portion of Company's production. PRET's yarn production count ranges from 8s to 36s. Based on assets installed, average count produced is around 22s.

Product Portfolio
Carded / Cotton / Slub & Siro / Weaving
Blended / CVC / PC / CP
Carded / Cotton Mélange (Dyed)
Heather Grey

Capacity Utilization

	FY17	FY18	FY19
No. of spindles installed	77,628	73,308	75,540
No. of spindles worked	68,215	69,291	68,614
Installed capacity of yarn (Kgs in millions)	26.5	25.7	26.6
Actual production of yarn (Kgs in millions)	20.4	24.8	24.1
Capacity Utilization (%)	**76.9%**	**96.5%**	**90.7%**

As part of the company's Balancing, Modernization and Rebalancing (BMR) initiative, the management has completed installation of new gas generators while installation of spindles is in process. As of July 2019, the number of operational spindles stood at 83,000. During the first half of FY20, the management expects that the existing capacity to further increase by 10% due to installation of new spindles. Moreover, in-house dyeing (previously outsourced), reduction in wastages and combing will enhance production efficiencies and diversify product portfolio. Capacity utilization has remained on the higher side over the last 2 years and is expected to remain at similar levels, going forward.

Rating Drivers

High cyclicality & competitive intensity for spinning industry and volatility in cotton prices translate into high business risk profile for the spinning sector.

Inherent cyclicality of cotton price and crop levels drives performance of players operating in the spinning sector. Historically, margins and financial performance of players have depicted seasonality. Moreover, competitive intensity is high due to commoditized nature of the product. Comfort is drawn from PRET's product diversity (produces both cotton and blended yarn), presence across a wide count range and focus on efficiency enhancements which has led to higher gross margins vis-à-vis peers. PRETs high reliance on exports to the United States translates into geographical concentration risk. However, the company has the ability to diversify to traditional markets in case of an adverse scenario.

Strong growth in revenues in FY19. Client concentration has increased on a timeline basis as part of a deliberate strategy to focus on higher value added clients.

Net Sales of PRET witnessed a growth of 32.8% during the outgoing year. The increase in net sales was on account of higher average selling price and growth in quantity sold (17% increase). Around four fifth of the sales are geared towards export market (direct export and indirect export sales). In contrast to other large players operating in the spinning sector where exports are concentrated to China, PRET's exports have primarily been generated from USA and Turkey. Client concentration has depicted an increase as part of a deliberate strategy to focus on higher value added clients.

Gross margins increased during FY19 and compare favorably to peers. However, net margins witnessed a slight decline on the back of higher overheads and finance cost. In absolute terms, profit before tax recorded a strong growth of 47% despite 25% increase in depreciation expense.

During FY19, margins of the company witnessed an upward trend (FY19: 13.9%; FY18: 11.2%). Improvement in gross margins is attributable to BMR undertaken by the company which has resulted in enhanced efficiencies. Growth in gross margin has not translated into higher net profit margins on account of increase in operating expenses, taxes and finance cost (finance cost has nearly doubled in FY19 due to higher borrowings and increase in benchmark rates). Going forward, profitability profile will be supported by volumetric growth in sales and elevated gross margins which are expected to sustain at current levels. Management expects gross margins to sustain at current levels on account of benefit of BMR undertaken (installation of new spindles, full year impact of installation of in-house power generators and completion of in-house dyeing facility). However, overall gross margins will remain dependent on movement in cotton prices and cost of inventory carried by the Company. Higher tax charges given the withdrawal of tax credit under section 65-B is also going to impact profitability in future.

Liquidity profile remains satisfactory due to healthy cash flow generation and strong debt servicing ability. Improved working capital management through reduction in short-term borrowings is considered important from a ratings perspective.

Despite higher taxes paid, Fund From Operations (FFO) depicted healthy growth vis-à-vis preceding year on the back of improved profitability. FFO for the outgoing year was reported at Rs. 693.3m (FY18: Rs. 526.0m). Healthy cash flow generation has resulted in strong debt servicing ability as reflected by a debt servicing coverage ratio 2.8x (FY18: 3.2x) for FY19. Strong debt servicing ability is also a function of extended maturity of long term debt (entirely comprising concessionary LTFF borrowings) mobilized by the Company. However, cash flow coverage of total debt declined (FY19: 14.7%; FY18: 17.0%) due to sizeable increase in total borrowings to fund higher working capital requirements. As per management, imposition of 17% GST on textile exports is expected to result in limited increase in working capital borrowings. Going forward, improved working capital management through reduction in short-term borrowings is considered important from a ratings perspective. Current ratio has remained marginally over 1.0x (FY19: 1.1x; FY18: 1.2x). Inventory and trade debt provide adequate coverage for short term borrowings.

Leverage indicators have increased on a timeline basis and are on the higher side due to sizeable capital expenditure undertaken and elevated working capital borrowings. Lower projected capex from FY21 and improved working capital management is expected to result in gradual reduction in leverage indicators over the rating horizon.

Equity base (excluding surplus revaluation) has grown to Rs. 2.1b (FY18: Rs. 1.8b) at end-FY19. The growth in equity base is on account of higher retained earnings. Dividend paid for FY18 amounted to Rs. 138.7m (FY17: Rs. 77.0m). Going forward, the dividend payout is expected to remain around historical levels.

PRET's total debt amounted to Rs. 4.7b (FY18: Rs. 3.8b) at end-FY19. Increase in total debt is a function of sizeable long-term borrowing mobilized for BMR and higher working capital borrowings. Around one third of the company's total debt is long-term while the remaining comprises short term debt to meet working capital needs. Short term borrowing was reported at Rs. 3.1b (FY18: Rs. 1.6b) at end-FY19. Gearing and leverage ratio stood at 2.3x (FY18: 1.7) and 2.7x (FY18: 2.1x), respectively at end-FY19. Leverage indicators are expected to remain elevated during FY20 on account of higher working capital requirements post imposition of 17% GST on textile exports and sizeable capex planned for the ongoing year. Lower projected capex from FY21 and improved working capital management is expected to result in gradual reduction in leverage indicators over the rating horizon.

Adequate Governance Framework

Board of Directors (BoD) at PRET comprises seven members including two independent directors. Existing governance framework of the company is considered satisfactory as indicated by presence of two independent directors. Board Audit Committee (BAC) is also chaired by an independent director. In line with best practices, PRET should have presence of at least one female director on Board. On the IT front, the company is also in the process of installing an oracle based ERP system which is expected to be completed in the ongoing fiscal year. The system will comprise the production, planning, accounting, inventory and payroll modules.

Financial Summary (amounts in PKR millions)				Appendix I
	FY16	**FY17**	**FY18**	**FY19(UA)**
BALANCE SHEET				
Fixed Assets	2,142.8	2,113.7	2,791.2	3,311.5
Long term Investment and Deposits	1.5	1.5	2.0	2.0
Stock-in-Trade	888.1	1,372.1	1,453.0	2,441.6
Trade Debts	674.3	1,154.8	1,139.7	1,660.5
Cash & Bank Balances	14.5	9.0	36.0	12.6
Total Assets	3,910.6	4,865.0	5,669.7	7,796.1
Trade and Other Payables	349.8	506.3	706.4	867.1
Long Term Debt (including current maturity)	927.62	856.77	1,447.34	1,660.70
Short Term Debt	1,121.7	1,877.9	1,637.6	3,055.9
Total Debt	2,049.4	2,734.7	3,084.9	4,716.6
Total Liabilities	2,455.0	3,309.4	3,847.9	5,707.1
Total Equity (without surplus revaluation)	1,445.7	1,546.7	1,817.7	2,085.3
INCOME STATEMENT				
Net Sales	4,814.0	5,413.2	6,431.4	8,540.0
Gross Profit	419.5	548.3	717.2	1189.3
Operating Profit	258.3	373.2	528.8	877.4
Profit After Tax	138.3	175.6	345.4	419.8
RATIO ANALYSIS				
Gross Margin (%)	8.7%	10.1%	11.2%	13.9%
Net Profit Margin	2.9%	3.2%	5.4%	4.9%
Net Working Capital	202.7	277.1	440.5	340.2
FFO	316.6	434.5	526.0	693.3
FFO to Total Debt (%)	15.4%	15.9%	17.0%	14.7%
FFO to Long Term Debt (%)	34.1%	50.7%	36.3%	41.7%
Debt Servicing Coverage Ratio (x)	3.1	2.6	3.0	2.8
ROAA (%)	3.7%	4.0%	6.6%	6.2%
ROAE (%)	9.9%	11.7%	20.5%	21.5%
Gearing (x)	1.4	1.8	1.7	2.3
Leverage (x)	1.7	2.1	2.1	2.7

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix II

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	Premium Textile Mills Limited				
Sector	Textiles				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	24-Sep-19	A-	A-2	Stable	Upgrade
	19-Jul-18	BBB+	A-2	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.				
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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