# RATING REPORT

# Towellers Limited

**REPORT DATE:**
January 07, 2022

**RATING ANALYST:**
Sara Ahmed
*sara.ahmed@vis.com.pk*

Syeda Aaminah Asim
*aaminah.asim@vis.com.pk*

| RATING DETAILS | | |
|---|---|---|
| | Initial Rating | |
| Rating Category | Long-term | Short-term |
| **Entity** | A | A-1 |
| ***Rating Date*** | *January 07, 2022* | |
| **Rating Action** | Initial | |
| ***Rating Outlook*** | Stable | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 1973 as a Private Limited Company with subsequent conversion to Public Limited Company in 1994** | **External auditors:** Mushtaq & Company, Chartered Accountants |
| **Public Listed Company** | **Chief Executive Officer (CEO):** Ms. Mehreen Obaid Agha |
| **Key Shareholders (with stake 5% or more):** | **Chairperson:** Ms. Mahjabeen Obaid |
| *Ms. Mahjabeen Obaid – 14.51%* | |
| *Ms. Mehreen Obaid Agha – 14.47%* | |
| *Ms. Sana Bilal – 14.47%* | |
| *Ms. Hadeel Obaid – 14.47%* | |
| *Mr. Sheikh Obaid Humza – 23.43%* | |
| *Public – 15.86%* | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| **VIS Entity Rating Criteria** *Industrial Corporates (August 2021)* |
| https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf |

# Towellers Limited

## OVERVIEW OF THE INSTITUTION

Towellers Limited was incorporated in 1973 as a Private Limited Company, and subsequently converted into Public Limited Company in 1994, under the Companies Act, 1913 (Companies Act, 2017), and is quoted on Pakistan Stock Exchange (PSX). The head office and manufacturing facilities of all business units are located in Karachi, Pakistan.

**Profile of Chairperson:** Ms. Mahjabeen Obaid graduated from Chatham College USA, and has pursued further studies in textile designing from Fashion Institute of Technology. She holds a Director position in Towellers Limited since 2008, and is a certified director from PICG since 2016.

**Profile of C.E.O.:** Ms. Mehreen Obaid Agha graduated from Mount Holyoke College, and has experience in manufacturing and industrial management. She is renowned humanitarian, and served as a Director of Towellers Limited since 2004 until she was appointed as the Chief Executive Officer of the company in 2011 after the demise of her father, Sheikh Muhammad Obaid.

## RATING RATIONALE

**Corporate Profile:** Incorporated in 1973 as a private limited company with subsequent conversion into a Public Limited Company in 1994; Towellers Limited is principally engaged in exports of knitted garments and home textiles. Main export markets include the United States, Spain, Italy, and Germany. The company operates weaving, dyeing, bleaching, knitting, and stitching divisions. Head office is situated in F.B. Area, Karachi, while manufacturing facilities are located in North Karachi Industrial Area and Federal B. Area, Karachi.

Shareholding pattern reflects 81.35% of the shares vested among five siblings while the remaining majorly being held by public. Towellers Limited is actively managed by four sisters namely Mahjabeen Obaid, Mehreen Obaid Agha, Sana Bilal, and Hadeel Obaid. Two remaining directors, Zeeshan K. Sattar and Abdul Jalil Shariff, are not part of the sponsoring family and have 2.76% and 0.03% of the shareholding respectively.

Board of Directors consist of eight members with two independent representation. The company has two board committees comprising of three members each, Board Audit Committee and Human Resource And Remuneration Committee, both chaired by Mr. Valy Tariq Rangoon Wala.

In FY21, external auditors, Mushtaq & Co, have issued a qualified opinion on the financial statements on account of non-provision of Gas Infrastructure Development Cess (GIDC) to the tune of Rs. 37m. The company sought stay order against recovery of the same from Sindh High Court, and in line with their legal advice they have not accounted for the same.

### Rating Drivers

**Positive momentum in exports of value-added segment of the textile industry**

Outlook of the textile industry remains positive on account of recovery in international markets and export-oriented policies of the government. 4M'FY22 posted 27% upsurge in textile exports vis-à-vis SPLY primarily on account of strong growth in home textiles, towels, knitwear, and ready-made textile products. On the other hand, cotton and cotton cloth represented a lower portion in the overall textile exports thus indicating growth in the value added segment. Going forward, prospects remain strong on account of gradual establishment of international customer base alongside favorable incentives offered by the government. However, federal government's consideration to revise gas tariff for textile export units to $9 per mmbtu from $6.5 from November 15 2021 to March 31, 2022 remains a key risk which would detrimentally impact cost of sales. Nonetheless, undergoing rupee devaluation is likely to offset possible increase in gas tariff.

**Undergoing BMR projects and Solar Power Project to contribute towards operational efficiencies**

The company is currently undergoing BMR projects to boost operational efficiencies. During FY21, replacement projects involving dyeing and stitching units were undertaken with project cost amounting to Rs. 250m funded through internal cash generation. Expected capex for BMR projects in FY22 amounts to Rs. 300m which will be financed through LTFF, whereby the company plans to replace looms and upgrade other machines.

Furthermore, the company invested in a 342 kW solar power project in FY21 subsequently lowering energy costs by Rs. 8.4m. Expected payback period is less than 3 years, and the initiative leads towards operational efficiencies.

**Profitability indicators depict positive momentum**

In FY21, sales revenue of the company increased to Rs. 5.2b (FY20: Rs. 3.8b) registering 38% growth on YOY basis driven by 22% increase in average prices, while volumetric sales growth was recorded at 10%. Revenues were adversely impacted in FY20 amid pandemic with decline in hospitality industry globally and closures of international markets. However, sales picked momentum in FY21 with gradual recovery of international markets registering sizeable growth. Sales in Q1'FY22 are reported at Rs. 2.4b, with further surge in the current quarter as per management. Sales mix constitutes knitted garments and home textiles with ~ 60:40 proportion in FY21 respectively. United States and Spain were the main export markets in FY21 contributing 53% (FY20: 49%) and 20% (FY20: 14%) towards total sales mix, respectively. Rest of the export markets were majorly focused in Germany and Italy in the outgoing year. Furthermore, client concentration exists on the higher side and depicts an increasing trend in FY21, with top ten clients constituting 87% (FY20: 71%) of the total sales.

Gross margins reached to pre-COVID levels in FY21 at 21.3% (FY20: 18.6%; FY19: 22.4%), recording improvement in the outgoing year despite increase in yarn prices. Improvement in gross margins in FY21 is attributable to the low fixed costs leading to realization of economies of scale with volumetric growth. Gross margins in Q1'FY22, however, reduced to 18.9% due to impact of increased raw material prices. Operating margins and net margins also recouped to pre-COVID levels in FY21 standing at 11.4% (FY20: 7.6%; FY19: 11.7%) and 10.7% (FY20: 7.3%; FY19: 10.5%) in FY21, respectively. During FY21, distribution costs witnessed 26% increase on account of surge in export freight charges globally, while administrative expenses also increased by 20%. Freight charges continue to impact operating margins in the ongoing year with Q1'FY22 recording operating margins at 10.9%. Going forward, company is projecting strong growth in revenues while uncertainty around gross and net margins will continue to prevail due to rising working capital requirements partly mitigated by currency devaluation.

**Strong cash flow and liquidity profile**

Funds from Operations (FFO) increased to Rs. 677m (FY20: Rs. 215m) in FY21 on account of higher profitability. Zero debt capital structure provides ample room for any future debt servicing capacity. It is noted that financial charges reflected in the financial statements relate primarily to bank charges.

Liquidity profile is also strong with current ratio standing at 2.9x (FY20: 2.8x) in FY21. Cash conversion cycle increased to approximately 40 days (FY20: 32 days) in FY21 primarily on account of reduction in payable days outstanding, while decrease in receivable days outstanding was off-set by increase in inventory days outstanding. Ageing of trade debts remain manageable with 80% of trade debts being secured against letter of credit. Therefore, working capital management remains satisfactory in FY21 without undertaking short-term borrowings. However, the company has recently sought export refinance facility amounting to Rs. 500m for working capital management.

Internal cash generation has remained sufficient to meet annual capital expenditure requirements till date.

**Low capitalization indicators**

Post adjustment of surplus on revaluation; equity base of the company stood at Rs. 2.1b (FY20: Rs. 1.5b) in FY21 on account of higher profitability. Tier-1 equity at end-Q1'FY22 further increased to Rs. 2.4b. With no interest bearing obligations coupled with higher profit generation and retention; capitalization indicators of the company are strong reflective from zero gearing and low leverage at 0.49x (FY20: 0.56x) in FY21. Capitalization indicators are expected to depict increase going forward as the company plans to undertake long term financing to fund capex; however remaining within manageable levels. Maintenance of capitalization indicators along with achievement of projected profitability will remain important for ratings.

# Towellers Limited Appendix I

| FINANCIAL SUMMARY | | | | *(amounts in PKR millions)* |
|---|---|---|---|---|
| **BALANCE SHEET** | **FY19** | **FY20** | **FY21** | **Q1'FY22** |
| Property, Plant, & Equipment | 1,231 | 1,664 | 1,811 | 2,876 |
| Stock-in-Trade | 487 | 568 | 1,102 | 1,229 |
| Trade Debts | 403 | 510 | 453 | 1,360 |
| Cash & Bank Balances | 287 | 350 | 300 | 218 |
| Total Assets | 2,740 | 3,550 | 4,297 | 6,306 |
| Trade and Other Payables | 588 | 672 | 845 | 1,536 |
| Long Term Debt | - | - | - | - |
| Short Term Debt | - | - | - | - |
| Total Debt | - | - | - | - |
| Total Liabilities | 686 | 835 | 1,019 | 1,715 |
| Paid Up Capital | 170 | 170 | 170 | 170 |
| Tier 1 Equity | 1,204 | 1,487 | 2,099 | 2,357 |
| Total Equity | 2,054 | 2,714 | 3,278 | 4,591 |
| | | | | |
| **INCOME STATEMENT** | **FY19** | **FY20** | **FY21** | **Q1'FY22** |
| Net Sales | 3,848 | 3,772 | 5,221 | 2,370 |
| Gross Profit | 863 | 701 | 1,112 | 447 |
| Operating Profit | 449 | 287 | 594 | 259 |
| Profit Before Tax | 451 | 315 | 614 | 263 |
| Profit After Tax | 403 | 276 | 556 | 247 |
| | | | | |
| **RATIO ANALYSIS** | **FY19** | **FY20** | **FY21** | **Q1'FY22** |
| Gross Margin (%) | 22.4% | 18.6% | 21.3% | 18.9% |
| Operating Margin (%) | 11.7% | 7.6% | 11.4% | 10.9% |
| Net Margin (%) | 10.5% | 7.3% | 10.7% | 10.4% |
| Net Working Capital | 888 | 1,180 | 1,593 | 1,842 |
| Trade debts/Sales | 10% | 14% | 9% | 14.3% |
| FFO | 484 | 215 | 677 | 231 |
| FFO to Total Debt (%) | - | - | - | - |
| FFO to Long Term Debt (%) | - | - | - | - |
| Debt Servicing Coverage Ratio (x) | 76 | 35 | 125 | 119 |
| Current Ratio (x) | 2.5 | 2.8 | 2.9 | 2.2 |
| Stock+Trade Debts/STD | - | - | - | - |
| Gearing (x) | - | - | - | - |
| Leverage (x) | 0.57 | 0.56 | 0.49 | 0.73 |
| ROAA (%) | 22% | 9% | 14% | 18.6% |
| ROAE (%) | 39% | 21% | 31% | 44.3% |

## ISSUE/ISSUER RATING SCALE &DEFINITIONS
## Appendix II

VIS Credit Rating Company Limited

### RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

**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** | Towellers 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** | | | | |
| | **01/07/2022** | 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. | | | | |
| **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** | | **Name** | **Designation** | **Date** | |
| | **1** | Mr. Adnan Moosaji | CFO | 1st -Dec-2021 | |