# RATING REPORT

# Thal Limited

**REPORT DATE:**
November 22, 2018

**RATING ANALYSTS:**
Talha Iqbal
*talha.iqbal@jcrvis.com.pk*

Mohammed Ibad Desmukh
*ibad.deshmukh@jcrvis.com.pk*

| RATING DETAILS | | |
|---|---|---|
| | Initial Rating | |
| **Rating Category** | **Long-term** | **Short-term** |
| **Entity** | AA | A-1+ |
| **Rating Outlook** | Stable | |
| ***Rating Date*** | *November 20, 2018* | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 1966** | **External auditors:** EY Ford Rhodes Chartered Accountants |
| **Listed Public Limited Company** | **Chairman of the Board:** Mr. Rafiq M. Habib |
| | **Chief Executive Officer:** Mr. Mazhar Valjee |

| APPLICABLE METHODOLOGY(IES) |
|---|
| ***Applicable Rating Criteria: Industrial Corporates (May, 2016)*** <br> ***http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf*** |

# Thal Limited

## OVERVIEW OF THE INSTITUTION

In 1966, Thal Limited (THAL) was incorporated as a public limited company and listed on Pakistan Stock Exchange (PSX). THAL is part of House of Habib (HoH), an established conglomerate headquartered in Pakistan. HoH's operations vary across different sectors.

**Profile of Chairman**
Mr. Rafiq M. Habib is one of THAL's founding members. He also serves as Group Chairman of HoH and was previously part of the Board of Governors for Pakistan Institute of Management. Mr. Habib possesses vast business experience in a variety of industries and serves as Chairman of Habib Insurance Company Limited and Shabbir Tiles & Ceramics Limited.

**Profile of CEO**
Mr. Valjee has served on the boards of (the former) Thal Jute Mills Limited and THAL. He has also served as CEO of Indus Motor Company Limited, Pakistan Jute & Synthetics Limited, Habib Metro Pakistan (Private) Limited, Makro Habib Pakistan Limited and has headed several other businesses of HoH.

## RATING RATIONALE

Commencing operations in 1966 as a jute mill, Thal Limited (THAL) is a diversified national conglomerate engaged in manufacture of engineering products (Karachi), jute products (Muzaffargarh), paper sacks (Hub & Gadoon) and laminated products (Hub). The company has further diversified into the energy chain by undertaking 11.9% stake in Sindh Engro Coal Mining Company Limited (SECMC) and plans to hold 26% (currently 49.99%) stake in a 330MW coal-fired power project, ThalNova Power Thar (Private) Limited, through its wholly owned subsidiary Thal Power (Private) Limited.

THAL's operations are divided into two divisions – Thal Engineering (~67% of revenues) (TE) and Building & Allied Materials (~33% of revenues) (BAM). TE is a supplier of auto parts for Original Equipment Manufacturers (OEM) including Indus Motor Company Limited (IMC), Pak Suzuki Motor Company Limited (PSMC) and Honda Atlas Cars Limited (HCAR). TE has a long-term association of over two decades with IMC and PSMC while association with HCAR is around 15 years. TE has presence in all segments of the automotive industry. BAM is the non-engineering division of THAL which comprises jute, paper sack and laminate businesses.

TE is further subdivided into Thermal Systems (automotive air conditioner, HVAC, aluminum radiator, cooling sub module, lever assembly heater control, reserve tank and starter & alternator) and Electric Systems (wire harness for automobiles). In 2014, Thal Boshoku Pakistan (Private) Limited (ThalBoshoku) was established as a separate entity under a joint venture agreement between THAL (55%), Toyota Boshoku Corporation (35%) and Toyota Tsusho Corporation (10%) under which one phase of manufacturing process for automobile seat frames and air cleaners was transferred to a facility in Pakistan. Currently, ThalBoshoku is in process of establishing a new plant in Karachi which will undertake complete manufacture of seats; this facility is expected to come on line in 2019. Capacity utilization levels have ranged between 70-95% for air conditioner, 50-65% for starter and alternator, 67% for jute and 75% for paper sack business.

**Strong sponsor profile**

THAL is part of House of Habib (HoH), an established conglomerate headquartered in Pakistan. HoH's operations vary across different sectors comprising automobile, building materials, packaging, and financial services. HoH is known to have an established network of international technical collaborations.

**Established market position and track record in the auto parts industry along with technical collaborations with leading international players**

THAL possesses more than two decades of experience and an established track record in the auto parts industry. It is one of the largest manufacturers of air conditioners and wire harnesses in the country; these products are the largest contributors to the company's topline in value terms with a dominant market share. Business risk profile is further supported by long-term technological collaborations with international players like Denso Corporation (Japan), Yazaki Corporation (Japan) and Furukawa Electric Company Limited (Japan), which results in the availability of latest technology, providing an edge over competitors. Market share of the company is also sizeable within BAM segment.

**Business risk underpinned by diversified revenue profile across product segments**

Performance of TE, which contributes around two-thirds to the company's topline, is a proxy of the Pakistani automobile industry. Market dynamics signified by presence of excess demand also make the industry economically attractive for potential new players. However, the automobile sector could face some headwinds over the rating horizon mainly due to expected economic slowdown resulting from mounting external vulnerabilities. Moreover, rising interest rates may adversely impact automobile sales volumes. Business risk profile is supported by mechanism in place through which any change in input cost and/or exchange rate is passed on to the OEM. Nevertheless, increase in competition from existing and new auto part manufacturers (APMs) and any adverse change in the operating environment and duty structure (currently APMs enjoy a 45% duty advantage on localized parts), including but not limited to inclusion of auto sector in Pakistan-Thailand Free Trade Agreement, may impact business risk profile of the company.

THAL has, over the years, significantly diversified its revenue profile. Having started as a jute mill, the company first ventured into the auto parts sector, and subsequently, into the paper sack and laminates businesses. Moreover, in 2016, the company further broadened its operations by investing in the energy sector through investments in SECMC and ThalNova. However, given risk of volatility in input cost and exchange rate, business risk of jute, paper sack and laminates segments is considered to be high vis-à-vis TE. Moreover, sectoral concentration in paper sack (cement) and jute business (government commodity operations) is on the higher side. Management is making concerted efforts to increase client base and enhance value addition across all business divisions. Nevertheless, a diversified revenue profile across product segments is likely to support steady topline growth over the medium term.

**Low leveraged capital structure and conservative financial policy**

In the recent past, THAL has not undertaken any debt. Moreover, the company has a conservative financial policy as reflected by prudent dividend payout history and low reliance on external debt. This is further supported by very low projected levels of debt, if any, on balance sheet over the rating horizon despite significant investments being undertaken by the company. Capitalization levels have increased on a timeline basis on account of profit retention. Liquidity profile is considered strong on account of healthy cash flows, low working capital intensity, strong current ratio and sizeable liquid assets carried on the balance sheet. Moreover, significant unrealized gain on strategic investments adds to the balance strength.

**Profitability to witness increase due to topline growth, stable margins in existing businesses and dividend income from energy projects and investment portfolio**

Net sales of the company have increased at a Compound Annual Growth Rate (CAGR) of 13% over the last 5 years (FY14-18) on account of healthy growth in vehicle sales of major customers and higher jute off take by government. Slowdown in automobile sales notwithstanding, steady demand for auto parts from OEMs and volumetric growth in jute, paper sack and laminates segments is projected to result in growth in revenues over the next three years. Gross margins of TE have remained largely stable over the past five years given the nature of products; however, margins of remaining businesses have depicted relatively higher volatility. In FY17, other income spiked to Rs. 3.1b (FY16: Rs. 1,167.5m; FY15: Rs. 898.1m) primarily due to gain on disposal of investment Metro Habib Cash and Carry Pakistan (Pvt) Ltd. Profitability profile is supported by sizeable dividend income from investment portfolio. Going forward, volumetric growth and stable margins are expected to support earnings over the ratings horizon while income from investments is also projected to contribute significantly to the bottom line once dividend income from energy segment materializes.

**Sound corporate governance framework supported by a well-designed organizational structure and experienced management team**

THAL has instituted a well-designed organizational structure comprising separate departments for finance, information technology, internal audit, human resources, corporate affairs and legal. The business divisions have independent management teams and organizational structure. The board of directors includes individuals having experience in the manufacturing, automotive and financial sectors. An experienced management team is in place. Information technology infrastructure comprising enterprise resource planning system and hardware & storage infrastructure, is considered to be adequate for current and future operations of the company. Internal Audit Department is outsourced to Noble Computer Services (Private) Limited, which is a subsidiary of THAL, and reports directly to the Board Audit Committee. Overall scope of internal audit function is comprehensive while a formalized follow up mechanism is in place and company is currently in process of migrating from transaction-based audit to process-based audit.

## FINANCIAL SUMMARY *(amounts in PKR millions)*

| BALANCE SHEET | FY16 | FY17 | 9MFY18 |
|---|---|---|---|
| Fixed Assets | 651.3 | 1019.2 | 1206.2 |
| Long term deposits | 8.1 | 14.0 | 13.3 |
| Stock-in-Trade | 2,764.3 | 2,914.0 | 4,016.5 |
| Trade Debts | 1,003.9 | 1,041.4 | 2,186.2 |
| Cash & Bank Balances | 402.2 | 522.3 | 831.0 |
| Total Assets | 13,685.6 | 17,427.2 | 18,568.1 |
| Trade and Other Payables (excluding unclaimed and unpaid dividends) | 1,369 | 1,910.8 | 2,302.9 |
| Short Term Debt | 22.8 | 9.1 | - |
| Total Debt | 24.4 | 10.8 | 1.6 |
| Total Equity | 12,227.6 | 15,433.1 | 16,052.4 |
| **INCOME STATEMENT** | **FY16** | **FY17** | **9MFY18** |
| Net Sales | 15,266.4 | 17,124.4 | 13,622.8 |
| Gross Profit | 3,369.3 | 3,633.0 | 2,521.0 |
| Admin Expense | 572.8 | 741.8 | 560.6 |
| Finance Cost | 3.8 | 8.5 | 6.4 |
| Profit (Loss) Before Tax | 2,979.0 | 5,447.0 | 2,709.6 |
| Profit (Loss) After Tax | 2,178.8 | 3,966.2 | 2,054.0 |
| **RATIO ANALYSIS** | **FY16** | **FY17** | **9MFY18** |
| Gross Margin (%) | 22.1% | 21.2% | 18.5% |
| Net Margin (%) | 14.3% | 23.2% | 15.1% |
| Net Working Capital | 6,859.6 | 9,648.7 | 9,396.9 |
| Trade debts/Sales (%) | 6.6% | 6.1% | 16.0% |
| FFO | 1,751.3 | 1,365.1 | 1,210.5 |
| FFO to Total Debt (x) | 71.70 | 126.90 | 745.40 |
| Current Ratio (x) | 5.71 | 5.84 | 4.73 |
| Gearing (x) | - | - | - |
| Debt Leverage (x) | 0.12 | 0.13 | 0.16 |
| ROAA (%) | 16.9% | 25.5% | 11.4% |
| ROAE (%) | 18.9% | 28.7% | 13.0% |

## RATING SCALE & DEFINITION

## Appendix I

**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:** JCR-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.jcrvis.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.jcrvis.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.

**'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.jcrvis.com.pk/images/policy_ratings.pdf

**'SD' Rating:** An 'SD' rating is assigned when JCR-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 II |
|---|---|
| **Name of Rated Entity** | Thal Limited |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity Ratings |
| **Rating History** | see table below |
| **Instrument Structure** | n/a |
| **Statement by the Rating Team** | JCR-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** | JCR-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. |
| **Disclaimer** | Information herein was obtained from sources believed to be accurate and reliable; however, JCR-VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. JCR-VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2018 JCR-VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to JCR-VIS. |

Rating History:

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| 20/11/2018 | AA | A-1+ | Stable | Initial |