RATING REPORT

Thal Limited

REPORT DATE:
December 13, 2019

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	AA	A-1+	AA	A-1+
Rating Date	*December 12, 2019*		*November 20, 2018*	
Rating Outlook	Stable		Stable	
Rating Action	*Reaffirmed*		*Initial*	

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. Muhammad Tayyab Ahmad Tareen

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

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 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. Muhammad Tayyab Ahmad Tareen joined as CEO of Thal Limited on 1st July 2019. He has more than 25 years of experience mainly with multinationals and private equity. Before joining House of Habib, he was associated with K-Electric, the largest vertically integrated power utility in Pakistan, serving as its CEO and Chairman of the Board, CFO and Chief Strategy Officer. He led the operational turnaround of this ailing utility company, turning it into profitable enterprise after 17 years of losses. He is a Member of Institute of Chartered Accountants in England and Wales.

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 holds 26% stake in a 330MW coal-fired power project, ThalNova Power Thar (Private) Limited, through its wholly owned subsidiary Thal Power (Private) Limited (TPPL).

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 while a facility for complete manufacture of seats is expected to commence volume production in December 2019.

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. In 2019, Mr. Tayyab Tareen joined as CEO to replace Mr. Mazhar Valjee. Only change in Board of Directors was the appointment of Muhammad Tayyab Ahmad Tareen as Executive Director in place of Sohail P. Ahmad who served as Vice Chairman. Board continues to comprise two independent directors in line with best practices.

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.

Automobile sector faced headwinds mainly due to economic slowdown resulting from mounting external vulnerabilities, and rising interest rates; business risk profile remains 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. Automobile sales in Pakistan declined by 7% in FY19 (compared to FY18) and further by 41% in 1QFY20 (compared to 1QFY19). Rising interest rates, economic slowdown, governments' documentation drive and escalating prices due to rupee depreciation along with inflation were the main factors for this slowdown. Nevertheless, business risk profile of THAL 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), may impact business risk profile of the company. In response to changing market dynamics with respect to TE, management has established agreement with Hyundai Nishat, as well as expanded its product portfolio for existing OEM clients.

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 over the medium term.

Profitability is dependent on recovery in automobile sales, stable margins in existing businesses and dividend income from energy projects and investment portfolio

In FY19, net sales of the company increased by 16% on account of growth in vehicle sales of major customers and higher sales contributed by papersack segment. However, in 1QFY20, net sales decreased by 18% compared to same period last year. Decline in revenues is attributed to the slowdown in automobile sales; however, this was partially offset by higher revenues contributed by BAM division. In FY20, revenues are projected to decline by 15-20% on account of weak auto sector dynamics, although steady volumetric growth in jute, paper sack and laminates segments is projected to lend some support to revenue base.

In FY19, gross margins of all business divisions (including TE) remained largely stable. However, in 1QFY20, gross margins decreased significantly to 8.7% (1QFY19: 17.3%) on account of lower margins in TE segment. The management cites that this is attributed to significant provision against inventory which had piled up due to slow off-stake by auto customers. However, the management is of the view that gross margins would recover by end-FY20 as provisioning would be reversed while off take of inventory by OEMs gathers pace in 3QFY20.

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.

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 liquid assets carried on the balance sheet. Moreover, significant unrealized gain on strategic investments adds to the balance strength.

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY18**	**FY19**	**1QFY19**	**1QFY20**
Property Plant and Equipment	1,410	2,188	1,623	2,175
Long term deposits	13	15	14	15
Long term investments	4,938	5,431	5,169	5,460
Stock-in-Trade	3,954	5,635	4,968	5,596
Trade Debts	1,520	2,348	1,699	1,657
Cash & Bank Balances	701	612	710	585
Total Assets	18,917	21,223	19,505	21,292
Trade and Other Payables	2,379	2,483	2,443	2,353
Short Term Debt	0.6	-	35	0
Total Debt	0.6	-	35	13
Paid up capital	405	405	405	405
Total Equity	16,438	18,631	16,929	18,819
INCOME STATEMENT	**FY18**	**FY19**	**1QFY19**	**1QFY20**
Net Sales	19,293	22,374	4,881	3,998
Gross Profit	3,661	4,157	847	348
Admin Expense	814	754	179	179
Finance Cost	9	10	3	3
Other Income(Inc. Dividends Received)	1,446	1,521	182	229
Profit (Loss) Before Tax	3,804	4,335	714	285
Profit (Loss) After Tax	2,686	3,155	511	194
RATIO ANALYSIS	**FY18**	**FY19**	**1QFY19**	**1QFY20**
Gross Margin (%)	19.0%	18.6%	17.3%	8.7%
Net Margin (%)	13.9%	14.1%	10.5%	4.9%
Net Working Capital	9,082	9,881	9,121.7	10,025
Trade debts/Sales (%)	7.9%	10.5%	8.7%	10.4%
FFO	2,601	3,330	442	242
FFO to Total Debt (x)	4,335.3	n/a	12.6	74.4
Current Ratio (x)	4.67	4.82	4.54	5.07
Gearing (x)	0.00	-	0.00	0.00
Debt Leverage (x)	0.15	0.14	0.15	0.13
ROAA (%)	14.8%	15.7%	10.6%	3.65%
ROAE (%)	16.9%	18.0%	12.3%	4.14%

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: 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 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	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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
12/12/2019	AA	A-1+	Stable	Re-affirmed
20/11/2018	AA	A-1+	Stable	Initial