RATING REPORT

Thal Limited

REPORT DATE:
December 29, 2020

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 29, 2020*		*December 12, 2019*	
Rating Outlook	Stable		Stable	
Rating Action	*Reaffirmed*		*Reaffirmed*	

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 also serves as the group Chairman of 'House of Habib'. He has served on the Board of Governors of 'Pakistan Institute of Management'. Mr. Habib possesses vast business experience in a variety of industries and serves as Chairman of Habib Insurance Company 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

Incorporated in 1966, Thal Limited (THAL) is a diversified national conglomerate engaged in manufacturing of engineering products, jute products, paper sacks and laminate products. The production facilities of jute products are located in Muzaffargarh, Punjab, engineering operations are based in Karachi, Sindh, papersack operations in Hub, Balochistan and Gadoon, Khyber Pakhtunkhwa and laminate operations in Hub, Balochistan. 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. Furthermore, Thal Limited's subsidiaries include renowned entities like Habib METRO Pakistan (Private) Limited, Makro-Habib Pakistan Limited, Pakistan Industrial Aids (Private) Limited, Noble Computer Services (Private) Limited and Thal Boshoku Pakistan (Private) Limited.

THAL's operations are segregated into two major divisions - Thal Engineering (TE) (contributed ~ 61% of revenues in Q1'FY21) and Building and Allied Materials (BAM) (contributed ~39% of revenues in Q1'FY21). 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. BAM division comprises jute, paper sack and laminate businesses.

TE is further subdivided into Thermal Systems & Engine Components (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 Japan (35%) (subsequently divested 25.4% shareholding to Toyota Boshoku Asia Corporation Limited in FY2019) 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 separate facility for complete manufacturing of seats was also established which commenced operations in February 2020.

Strong sponsor profile and sound corporate governance framework

THAL is part of House of Habib (HoH), an established conglomerate based in Pakistan and engaged in diversified businesses. HoH's operations vary across different sectors comprising automobile, building materials, packaging, and financial services. HOH is known to have equity and technical collaborations with Japanese, European and American companies.

The Board of Directors (BoD) at THAL comprises seven members. Composition of the Board is in line with the best practices as two independent directors (including one female director) are present on the Board. Mr. Imran Ali Habib was appointed as Director of the Company in June 2020 to fill the casual vacancy created by the demise of Mr. Ali S Habib. The board of directors comprises seasoned professionals having experience in the manufacturing, automotive and financial sectors. The majority of directors are either exempted by Securities & Exchange Commission of Pakistan (SECP) from the Directors Training Program due to their requisite qualification and experience of serving on the Boards or are certified by Pakistan Institute of Corporate Governance (PICG). In order to ensure effective oversight, two committees namely Board Audit Committee and Board Human Resource and Remuneration Committee exist at

Board level. In line with best practices, both committees are chaired by an independent director.

Sound internal control framework supported by a well-designed organizational structure and experienced management team

A well-designed organizational structure is in place at the company 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 senior management team comprises experienced professionals well-versed within their respective domains. 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. During the first half FY20, the company modernized its current technology platform from Oracle Database to SAP Hana DB, along with upgradation of its hardware infrastructure. A sound IT infrastructure enabled the organization to quickly adopt tools to enable its employees to work remotely from their homes in 2020, a restriction enforced due to COVID-19 pandemic. 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.

Established market position and track record in the auto parts industry along with technical collaborations with leading international players; market share is also sizeable in other business segments

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, radiators and wire harnesses in the country as depicted by their sizeable market shares; these products are the largest contributors to the company's topline in value terms. 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); these agreements provide competitive advantage to the company through transfer of knowledge and latest technology. Market share of the company within respective businesses classified under the BAM segment is also considered significant. The company is undertaking expansions within the papersack segment, which will enable to further grow its market share within the papersack industry.

Improvement in the macroeconomic indicators and rise in demand for automobiles post COVID-19 lockdown supports business risk profile of the company; business risk continues to remains underpinned by diversified revenue profile across product segments

Performance of the largest segment of the company, TE, is closely linked to the performance of the overall automobile industry. Automobile industry sales in Pakistan declined by 26% in FY20 (compared to FY19) on account of rising interest rates, economic slowdown, governments' documentation drive and escalating prices due to rupee depreciation along with inflation; however, recovery has been noted during FY21 with industry sales registering a growth of 18% in 5M'FY21 (compared to 5M'FY20). This growth has been achieved on account of improvement in macroeconomic indicators, decrease in interest rates and backlog of orders accumulated during COVID-19 lockdowns. All the OEMs continue to have strong order books, which indicate favorable demand prospects for automobile industry as well as automotive part manufactures. Moreover, business risk profile of THAL is further supported by presence of cost pass through mechanism in place through which any change in input cost and/or exchange rate is passed on to the OEMs. Nevertheless, supply chain disruptions on account of COVID-19, increase in competition from existing and new auto part manufacturers (APMs) and any adverse change in the operating environment and duty structure continue to remain key risk factors which may impact business risk profile of the company. In response to changing market dynamics with respect to TE, management has inked new agreements with Hyundai Nishat and Atlas Honda, as well as expanded its product portfolio for existing OEM clients.

Over the years, THAL has diversified its revenue base by venturing into different businesses. Having started as a jute mill, the company, through mergers with other companies, diversified into paper sack and laminates business followed by its venture into the auto parts sector. Furthermore, in 2016, the company further broadened its operations by investing in the energy sector through investments in SECMC and ThalNova. Expansion within business segments has also remained a focus of the management in order to increase its product offerings. In December 2020, the company has announced investment of Rs. 1.7b in Woven Polypropylene (WPP) Bags manufacturing facility. This investment will enable the company to cater to additional demand within the packaging business. Moreover, plans to enhance capacity of food grade bags to cater to increasing demand are also underway. Varied nature of the businesses and diversified product offerings within business segments are likely to provide support to the topline of the company over the medium to long term. However, risk of volatility in input cost and exchange rate in the jute, paper sack and laminates segments is considered to be high vis-à-vis TE. Moreover, sectoral concentration is also observed in the paper sack (cement) and jute business (government commodity operations). Nevertheless, management is making concerted efforts to increase client base and enhance value addition across all business divisions.

Growth in automobile, cement and construction industry and improving margins in existing businesses bode well from the profitability perspective

Net sales of the company decreased by 26% in FY20 primarily on account of slowdown in automobile sales. Revenue from the laminates business was also lower vis-à-vis the preceding year due to impact of COVID-19. Export sales growth and increase in gunny sack demand enabled the jute business to sustain sales momentum during FY20, thereby providing support to the overall revenue base of the company. Paper sack revenue was also higher in FY20 vis-à-vis FY19 due to increase in average selling prices despite lower volumes due to stagnation in cement industry sales. In Q1'FY21, net sales registered a growth 26% over the same period in the preceding year. Growth in sales was noted across all the business segments in Q1'FY21 on account of economic recovery post COVID-19 lockdown. Specifically, growth in automobile and cement industry sales, as well as recognition of construction industry by the government of Pakistan and announcement of construction package contributed to growth in sales of the company. In FY21, revenues are projected to increase by more than 18% (compared to FY20) on account of continuation of existing improvement trends in demand generating industries.

Barring the jute business, net profitability and margins of all the other segments were reported lower in FY20 (compared to FY19) on account of various challenges such as suppression of demand in key industries (cement, automobiles) on account of COVID-19, rupee devaluation and inability to pass on the increase in input prices to end consumers (laminates business). However, net profitability and margins depicted considerable improvement across all the business segments in Q1'FY21 in comparison to the corresponding period in the previous year. Management expects margins to improve further going forward due to favorable demand prospects and cost efficiency initiatives undertaken by the management.

Low leveraged capital structure and conservative financial policy; strong liquidity profile on account of healthy cash flows

Total debt of the company was reported at Rs. 566.5m (FY20: 352.6m; FY19: nil) at end-Q1'FY21. Debt primarily comprised short term financing; the company availed Export Refinance Facility which resulted in increase in short term borrowings. Although borrowings have increased on a timeline basis, overall financial profile is conservative as depicted by very low gearing and leverage indicators. The company also has prudent dividend payout history, which has enabled the company to improve its capitalization levels on account of profit retention. Going forward, management plans to finance the import of machinery required for manufacturing WPP bags through SBP's Temporary Economic Refinance Facility ("TERF") of approximately Rs. 1.1 billion. This facility will be obtained for 10 years at a rate of 1.95% per annum. Hence, overall quantum of debt is expected to increase in the medium term but leverage indicators are expected to remain low given the sizeable equity base of the company. 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 sheet strength.

FINANCIAL SUMMARY	(amounts in PKR millions)			
BALANCE SHEET	**FY19**	**FY20**	**1QFY20**	**1QFY21**
Property Plant and Equipment	2,188	3,118	2,175	3,049
Long term loans	861	1,927	860	1,939
Long term investments	5,432	5,796	5,461	5,873
Stock-in-Trade	5,635	5,554	5,596	5,447
Trade Debts	2,348	2,508	1,657	2,628
Cash & Bank Balances	612	849	585	853
Total Assets	21,223	24,116	21,292	25,834
Trade and Other Payables	2,484	2,684	2,353	3,237
Short Term Debt	-	145	0.05	361
Long Term Debt	-	208	13	205
Total Debt	-	353	13	566
Share Capital	405	405	405	405
Total Equity	18,631	20,901	18,819	21,696
INCOME STATEMENT	**FY19**	**FY20**	**1QFY20**	**1QFY21**
Net Sales	22,374	16,448	3,998	5,057
Gross Profit	4,157	2,278	348	786
Admin Expense	754	773	179	194
Distribution cost	253	197	50	57
Finance Cost	10	17	3	6
Other Income(Inc. Dividends Received)	1,528	1,408	229	418
Profit (Loss) Before Tax	4,335	2,372	285	928
Profit (Loss) After Tax	3,155	1,867	194	717
RATIO ANALYSIS	**FY19**	**FY20**	**1QFY20**	**1QFY21**
Gross Margin (%)	18.6%	13.8%	8.7%	15.5%
Net Margin (%)	14.1%	11.4%	4.9%	14.2%
Net Working Capital	9,881	9,816	10,025	10,591
(Stock-in-Trade + Trade Debts)/Short Term Borrowings	N/A	5560%	15432615%	2237%
FFO	3,330	2,348	242	702
FFO to Total Debt (x)	N/A	666%	7230%	496%
Current Ratio (x)	4.8	4.2	5.1	3.7
Gearing (x)	0	0.017	0.001	0.03
Leverage (x)	0.14	0.15	0.13	0.19
ROAA (%)	15.7%	8.2%	3.7%	11.5%
ROAE (%)	18.0%	9.4%	4.2%	13.5%

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix I

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 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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, 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. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.
Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
29/12/2020	AA	A-1+	Stable	Re-affirmed
12/12/2019	AA	A-1+	Stable	Re-affirmed
20/11/2018	AA	A-1+	Stable	Initial

Due Diligence Meetings Conducted

S.No	Name	Designation	Date
1	Mr. Muhammad Tayyab Ahmad Tareen	Chief Executive Officer (CEO)	Dec 16, 2020
2	Syed Umair Ahmed	Head of Papersack Business	Dec 16, 2020
3	Syed Akkas-ul-Husaini	Head of Engineering	Dec 16, 2020
4	Mr. Saqlain Akhtar	Head of Jute Business	Dec 16, 2020
5	Mr. Mustafa Jafar	Head of Laminate Business	Dec 16, 2020