RATING REPORT

Treet Corporation Limited

REPORT DATE:
November 12, 2019

RATING ANALYSTS:

Maham Qasim
maham.qasim@vis.com.pk

RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity	A	A-2	AA-	A-1
Rating Outlook	*Negative*		Stable	
Rating Date	*24 Sep'19*		*21 May'19*	
Sukuk (preliminary)	*A*		*AA-*	
Rating Outlook	*Negative*		*Stable*	
Rating Date	*24 Sep'19*		*21 May'19*	
PTC	AA		AA	
Rating outlook	Stable		Stable	
Rating Date	*21 May'19*		*21 May'19*	

COMPANY INFORMATION-based on FY 2016-17

Incorporated in 1977	**External auditors:** M/s KPMG Taseer Hadi & Co. Chartered Accountants
Public Limited Company	**Chairman:** Dr. Mrs. Niloufer Qasim Mahdi
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Syed Shahid Ali
Syed Shahid Ali & Family – 39.4%	
NIT – 8.9%	
Loads Limited (Associated Company) – 5.5%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria:
Industrial Corporates (May 2019) https://www.vis.com.pk/kc-meth.aspx
Notching the Issues (June 2016) https://www.vis.com.pk/kc-meth.aspx

OVERVIEW OF THE INSTITUTION

Treet Corporation Limited (TCL) was incorporated in 1977 as a public limited company and is listed on the Pakistan Stock Exchange. The group is principally engaged in the manufacturing and sale of razors and razor blades, soaps, corrugation packaging, motorbikes, lead acid batteries and pharmaceutical products. Group's activity also includes establishing and managing educational projects as well as trading chemicals. The head office is located in Lahore, Pakistan while the manufacturing units are located in Lahore, Gujranwala**,** Hyderabad and Faisalabad.

Profile of Chairman

Dr. Mrs. Niloufer Qasim Mahdi continues to Chair the Board. She holds BA (Hons), MA, M.Litt, and D.Phil degrees from Oxford University.

Profile of CEO

Syed Shahid Ali has been serving as CEO of TCL for more than two decades. Mr. Ali holds a Master's degree in economics, a graduate diploma in development economics from Oxford University and a graduate diploma in management sciences from University of Manchester.

Financial Snapshot

Net Profit/ (Loss): 9MFY19: Rs. 1.5b; FY18: Rs. (630.5m); FY17: Rs. 215.9m

Total Equity: 9MFY19: Rs. 7.8b; FY18: Rs. 9.1b; FY17: Rs. 9.4b

RATING RATIONALE

The ratings incorporate TCL's strong sponsorship profile coupled with implicit support demonstrated by primary sponsor in terms of continuing equity injection. The ratings take into account diversified revenue stream of the company owing to presence in different product segments. Revision in ratings incorporate significant deterioration in financial risk profile on the back of sizeable loss incurred by the company during the last two consecutive fiscal periods resulting in weakening of liquidity profile and risk absorption capacity. Ratings also reflect weakening in industry dynamics resulting in slackened demand in the blade segment as an outcome of price escalation leading to increased market risk impacting the business risk profile of the company. Ratings remain dependent upon recovery of margins and strengthening of capitalization indicators.

Profitability:

The overall sales of the company exhibited around 12% increase to Rs. 9.4b (FY7: Rs. 8.4b) primarily on account of volumetric increase in sales of razor blades. On the other hand, sales of other product segments including corrugated boxes, bikes, soaps and batteries were recorded lower during FY18 as compared to preceding year. TCL reported an after tax loss of Rs. 630.5m during FY18 as compared to profit of Rs. 215.9m during FY17 as a result of drop in the margins in the blade segment to 26.9% (FY17: 35.7%) given the same contributes over two-thirds to the total revenue mix. The decline in margins was a function of increase in cost of imported raw material used in manufacturing of razors. The increase in selling and administrative expense was mainly a function of higher employee related expense as a result of annual salary adjustments and higher headcount in line with increase in scale of operations. Moreover, financial cost increased due to higher utilization of funding lines in the current period to meet higher working capital requirements along with increase in benchmark interest rates. TCL reported other income amounting to Rs. 129.5m (FY17: Rs. 121.4m); the income largely pertained to export rebate, scrap sale and profit on disposal of assets.

The profitability indicators of the company took a further downward turn with the company reporting an after tax loss of Rs. 1.5b during 9MFY19. The net loss was a combined outcome of decline in margins to 13.4% (FY18: 18.7%; FY17: 24.8%) coupled with higher finance cost incurred during 9MFY19. The company experienced a sharp dip in margins owing to higher contribution of the battery segment entailing negative margins to the revenue mix. The battery segment reported sizeable negative contribution given high utility to sales ratio owing to underutilization of plant capacity together with high fuel expense given the plant was run on diesel engine. Going forward, the management plans to address the issue by fully utilizing the production capacity of 125,000/month since the company has secured export orders of 50,000/month. Moreover, the company has shifted the main power source of battery segment to WAPDA from diesel based engine to minimize fuel cost. In addition, going forward the company to divest the battery segment into a separate company. The demand of the company's flagship product, razors took a sharp hit during

2QFY19 as a result of TCL transferring the price hike emanating from currency devaluation to end consumers to rescue the impact of drop in margins in the blade segment. Moreover, the overall margins were also impacted due to delay in transferring the incremental cost into the final retail price in the soap, packaging and pharmaceutical segments. Given the company restored the sales volumes in the packaging segment during the outgoing year, the management has planned to increase to the prices by around 25% during FY20 to restore the margins at around 8% for the aforementioned segment. Moreover, to further ease the pressure on margins the company has increased the prices in soap segment by 10% during the ongoing year.

There was a noticeable increase in the operating expenses amounting to 2.2b (FY18: Rs. 1.9b; FY17: Rs. 1.5b) during 9MFY19 owing to inflationary pressure coupled with higher quantum of exports made during the period. Further, TCL also incurred higher finance cost amounting to Rs. 792.0m during the 9MFY19 as compared to Rs. 244.4m in the corresponding period last year as a result of piled up inventory levels given depressed demand together with higher credit period allowed to customers to cater to strong competition leading to high receivable days. Moreover, the increase in the benchmark interest rates also contributed to higher finance cost for the ongoing year. Going forward, VIS expects rescue of operating margins despite increasing competition and rupee depreciation on account of impact of various costs saving initiatives, planned increase in prices and higher penetration in export markets for pharmaceutical segment. The management has projected to close FY20 around Rs. 16.0b. Given the volumetric growth in sales, profitability is projected to depict stable growth over the rating horizon.

Liquidity

Liquidity profile of the company exhibited weakening on account decline in profitability metrics owing to slump in demand patterns and depressed margins. Given the company reported loss during the outgoing year, funds flow from operations (FFO) turned negative. However, liquidity profile is supported by presence of liquid assets held on balance sheet amounting to Rs. 495.5m (FY18: Rs. 462.5m; FY17: Rs. 571.7m) at end-9MFY19 owing to investment made in listed equities. However, owing to lackluster performance of stock market the company does not plan of liquidating the securities to ease cash inflows. Further, the company has made strategic investment into related party, Loads Limited, amounting to Rs. 1.4b (FY18: Rs. 456.1m; FY17: Rs. 425.1m) at end-9MFY19. The share of profit received from aforementioned investment amounted to Rs. 20.2m (FY17: Rs. 38.3m) during FY18. In addition, working capital cycle increased on account of higher inventory accumulated for finished goods. As per management, the additional stock accumulated during the outgoing year on account of slackened demand. Trade debts in relation to sales increased on a timeline basis on account of higher contribution of soap segment in the sales mix; given the company has to offer longer tenor credit to retailers in the segment to increase market penetration due to stiff competition. In line with negative FFO, debt servicing coverage ratio (DSCR) is currently negative; however the same is projected is projected to remain adequate once the margins return to normal levels.

Capitalization and Funding

Equity base of the company has declined during the ongoing year on account of net loses reported during FY18 and 9MFY19. Dividend paid during FY18 was recorded at Rs. 5.5m as compared to Rs. 132.1m paid during the preceding year. Debt matrix of the company is heavily tilted towards short-term obligations with long-term debt only accounting for less than 1% of total borrowings. The entire long-term debt is expected to be redeemed in shares by end-FY20. Going forward, the management does not plan on acquiring any new long-term funding for the next three years. During FY20, the management plans to divest the battery segment into a separate company by injecting Rs. 4.0b, already raised through right issue in FY16, by Jan'FY20. Given, the increase in working capital requirement owing to higher piled up inventory levels gearing and leverage indicators increased on a timeline basis despite periodic redemption of the company's Participation Term Certificates. Once the company is able to offload the piled up inventory in the ongoing year by exercising the export option available, the leverage indicators are expected to come down going forward.

Expansion projects:

Various expansion plans are underway with educational project, Institute for Art and Culture, initiated during FY19 with enrolment of 500 students. The management projects that the number of students will increase to 1000 by end-FY20. In the backdrop of further business diversification, TCL has acquired majority stake in a pharmaceutical company and mandate has been given to financial consultants offering its shares to the public through listing process and to raise funding to meet its expansion plan. Application for listing is already filed with PSX and 50.0m shares will be offered to the public through IPO / book building process at the floor price of Rs. 12.5/share. In addition, the management is in the process of issuing Sukuk and Preference Shares both amounting to Rs. 1.0b each to meet the expansion requirements; the approval for both have been received by shareholders. The preference shares will be non-convertible cumulative issued to existing shareholders with redemption offer available with shareholders after four years of issuance. Meanwhile, Sukuk will be based on Shirkat-ul-Aqd where the Issuer and the Investor have agreed to contribute their investment in cash, stock and trade debts for participating in operating activities of the business including but not limited to manufacturing and selling blades, educational project, soaps, corrugation, lead acid batteries, pharmaceuticals products, corrugation, motorcycles and to participate in the musharakah profits so generated at pre-agreed ratio between them. The Sukuk will be perpetual unless otherwise converted into ordinary shares or put option for redemption in cash exercised by Sukukholders. The company's ability to maintain its risk profile in the current economic scenario while venturing into various new businesses would be tested over time.

Corporate Governance

Overall corporate governance framework is supported by adequate board composition and oversight. Senior management team has largely remained stable; the same is considered crucial for materialization of the future growth plans. Governance framework is supported by strong financial planning process, documented policy & procedural framework along with focus on transparency as evident from detailed governance related disclosures in the annual report that provide important information for stakeholders.

Treet Corporation Limited Appendix I

BALANCE SHEET	FY17	FY18	3QFY19
Fixed Assets	11,555.3	13,471.7	13,905.8
Stock-in-Trade	1,350.4	1950.7	2,691.8
Trade Debts	888.3	1,035.9	1,745.4
Cash & Bank Balances	1,002.2	1,118.2	72.2
Total Assets	17,733.4	21,001.9	22,277.3
Trade and Other Payables	1,348.2	1,023.5	2,124.5
Long Term Debt- redeemable in Shares	518.0	345.0	171.9
Long Term Debt- redeemable in cash	18.8	12.6	6.3
Short Term Debt	5,659.0	9,700.4	11,710.6
Paid-up Capital	1,421.4	1,600.8	1,654.5
Tier I Equity	7,876.6	7,405.9	6,216.3
Total Equity	9,380.4	9,065.4	7,871.1
INCOME STATEMENT	FY17	FY18	3QFY19
Net Sales	8,418.2	9,410.3	8,668.3
Gross Profit	2,083.8	1,757.4	1,165.6
Operating Profit	512.0	(93.4)	(1,018.0)
Finance Cost	390.8	486.6	792.0
Profit Before Tax	304.6	(478.8)	(1,401.5)
Profit After Tax	215.9	(630.5)	(1,483.5)
FFO	358.6	(361.5)	(885.8)
RATIO ANALYSIS	FY17	FY18	3QFY19
Gross Margin (%)	24.8	18.7	13.4
Net Working Capital	(2,056.8)	(4,437.7)	(7,216.9)
FFO to Total Debt (x)	0.06	-	-
FFO to Long Term Debt (x)	19.1	-	-
Debt Servicing Coverage Ratio (x)	2.0	0.33	-
Current Ratio (x)	0.73	0.61	0.49
ROAA (%)	1.4	-	-
ROAE (%)	2.6	-	-
Gearing (x)	0.69	1.20	1.71
Leverage (x)	0.98	1.48	1.75

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	**Treet Corporation Limited**
Sector	**Consumer Goods**
Type of Relationship	**Solicited**
Purpose of Rating	**Entity & Instrument Rating**

Rating History	**Rating Date**	**Medium to Long**	**Short Term**	**Rating Outlook**	**Rating Action**
			RATING: ENTITY		
	24/09/2019	A	A-2	Negative	Downgrade
	21/05/2019	AA-	A-1	Stable	Reaffirmed
	02/08/2018	AA-	A-1	Stable	Reaffirmed
	12/20/2016	AA-	A-1	Stable	Reaffirmed
	12/08/2015	AA-	A-1	Stable	Reaffirmed
	2/23/2015	AA-	A-1	Stable	Reaffirmed
	12/10/2013	AA-	A-1	Stable	Reaffirmed
	3/06/2012	AA-	A-1	Stable	Reaffirmed
			RATING: PTC		
	21/05/2019	AA		Stable	Reaffirmed
	02/08/2018	AA		Stable	Reaffirmed
	12/20/2016	AA		Stable	Reaffirmed
	12/08/2015	AA		Stable	Reaffirmed
	2/23/2015	AA		Stable	Reaffirmed
	12/10/2013	AA		Stable	Reaffirmed
	10/23/2012	AA		Stable	Final
			RATING: SUKUK		
	24/09/2019	A		Negative	Downgrade
	21/05/2019	AA-		Stable	Reaffirmed
	12/20/2016	AA-		Stable	Reaffirmed
	12/08/2015	AA-		Stable	Reaffirmed
	4/10/2015	AA-		Stable	Preliminary

PTC Issue

TCL issued PTCs amounting to Rs. 1.25b in 2013. The company issued 41,822,250 certificates of Rs.30 each to existing shareholders in the ratio of 1 PTC for every 1 ordinary share. These certificates are listed Pakistan Stock Exchange (PSX). The principal amount of PTCs shall be redeemed through cash and mandatory conversion into ordinary shares through share conversion @ 0.07shares per PTC per annum at a pre-agreed conversion price of Rs.59.14 for 2013 to 2018 and 0.08 shares per PTC at the price of Rs. 51.38 for 2019. The PTCs shall be redeemed through cash @ Rs. 4.14 per annum from year 2013-2018 and Rs. 4.4 for the year 2019. The PTC holder is entitled to a minimum profit of (Category A profit) at Rs. 4.14 per annum for each PTC and contingent profit (Category B profit) based on consolidated profits before tax, WWF, WPPF and finance cost based on pay off matrix. The issue has been secured by way of fixed and floating charge over designated fixed assets. An additional lien has been marked on investment in shares of existing companies amounting to Rs. 250m as a trust security/property.

Proposed Sukuk Structure	TCL plans to issue Sukuk upto Rs.1.0b at face value of Rs.40 per Sukuk. Objective of the issue is to meet working capital requirements of the company. The Sukuk is proposed to be issued in perpetuity to existing shareholders in the by way of Renounceable Offer Letter (ROL); ROL will be trade-able at Pakistan Stock Exchange (PSX). The Sukuk will be listed on Pakistan Stock Exchange (PSX). Sukuk will be converted into ordinary shares maximum ratio of one sukuk to one ordinary share at the option of sukuk holders. The company will give a time bound put option to redeem the sukuk in full or partial payments in cash after expiry of three years (and therafter after every third anniversary of such date). Sukuk will carry voting right equal to one-tenth of ordinary share of the Company. Profit payment will be made to Sukuk holders in cash on annual basis. The profit for each Sukuk will be higher of either the cash dividend (interim plus final) paid by the Company per Ordinary share during the relevant financial year or 6% of Musharkah profit of relevant financial year (divided by number of Sukuks outstanding). The Company will have no option to redeem the Sukuk in cash or to convert them into Ordinary shares.
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. Copyright 2019 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.