RATING REPORT

Akhtar Textile Industries (Private) Limited

REPORT DATE:

November 27, 2019

RATING ANALYSTS:

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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Date	*Nov 27, 2019*		*June 28, 2018*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirm		Initial	

COMPANY INFORMATION	
Incorporated in 1985	**External auditors:** Munaf Yusuf & Co. Chartered Accountants
Private Limited Company	**Chief Executive Officer:** Abdullah Akhtar **Board of Directors:** - Perwaiz Akhtar - Javed Akhtar - Mansoor Akhtar - Jahangir Akhtar

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (May, 2016) **https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf**

Akhtar Textile Industries (Private) Limited

OVERVIEW OF THE INSTITUTION

Akhtar Textile Industries (Private) Limited (ATIL) incorporated in 1985 is engaged in the business of manufacturing and exports of denim garments.

Akhtar Group of companies includes Dairyland Private Limited, ACT Wind Private Limited, Indigo Textile Private Limited, and Akhtar & Sons.

ATIL is fully compliant with International Social and Environmental & Quality standards as required by its client.

RATING RATIONALE

Akhtar Textile Industries (Private) Limited (ATIL) is a part of Akhtar Group of Companies which is a family owned group. The group specializes in the textile sector particularly denim fabric and garments but also has diversified interests in the dairy and power sectors. ATIL's production facilities are based in four units comprising step wise manufacturing of cut to pack denim garments with denim fabric primarily procured from an associated company - Indigo Textile Private Limited.

Management has continued to enhance the production capacity of the company in order to cater the growth in demand. At end-9M'FY19, ATIL reported garments manufacturing capacity at 30,500 pieces/day (FY18: 28,500 pieces/day; FY17: 28,000 pieces/day). During 9MFY19, total production amounted to 6.87m pieces (FY18: 8.55m pieces; FY17: 8.16m pieces), translating into capacity utilization of 100% (FY18: 99%; FY17: 91%). Going forward, the management plans to further increase its capacity to 55,000 pieces/day in FY19 incurring a capex of Rs. 1.4b which will be financed by a combination of SBP's Long Term Finance Facility and internal capital generation.

Stable demand prospects persist; however, competitive pressures may arise from induction of additional capacities both locally and internationally

Business risk profile of the company is supported by stable and growing demand for denim garments. The global denim market is valued at 1.3b US$ in 2018 and is expected to reach 1.6b US$ by the end of 2025, depicting a CAGR of 3.1% during 2019-2025[1]. However, expansion by local and international major players is expected to keep pricing power and hence margins under pressure. Key business risk factors include volatility in fabric prices and limited ability to pass on the same to the customers as prices are decided on an annual basis. Moreover, demand by customers for adherence to environment friendly practices may require additional investment, further exacerbating cost pressures.

Topline has continued to depict upward trajectory but client-wise concentration risk is also sizeable

Net Sales of the company increased to Rs. 7.4b (FY17: Rs. 5.9b) in FY18, depicting a growth of 12.1%. Growth in the topline was a function of rupee devaluation and higher volumes. Majority of the revenue is derived from export sales, with local sales constituting only 2.6% (FY17: Rs. 2.2%) of the total net sales. As per management, growth in export sales was achieved on account of increase in production capacity and improvement in quality due to installation of modernized plant and machinery. Sales in 9M'FY19 were reported at Rs. 6.47b. Going forward, growth momentum in sales is expected to continue. As per management, higher demand due to existing trade war between China and United States of America will be a key factor contributing to growth in topline of the company.

Around 82% (FY18: 84%; FY17: 83%) of the total export sales emanate from clients in USA. The company has also significant client concentration with sales catered to a single client. Business risk is on the higher side given the sizeable concentration (client and geographic) in

[1] https://www.reuters.com/brandfeatures/venture-capital/article?id=88973

sales. However, long-term association of ATIL with the largest client and sound global reputation of the client partly mitigate the sales concentration risk. Moreover, guarantee by a global financial institution in case of any potential non-payment by the largest client provides comfort to the ratings.

Profitability improved due to growth in topline of the company and recovery in margins

Gross Margins increased to 12.4% (FY17: 10.1%) in FY18, with further improvement witnessed in 9M'FY19 as the same were reported at 17.6% (9M'FY18: 12.2%). Improvement in gross margins was a function of rupee devaluation. Going forward, gross margins are expected to remain under pressure over the short to medium term on account of increase in denim fabric prices due to shortfall in domestic cotton crop production along with increase in competition due to significant capacities coming online. A sizeable one time gain on sale of land was also recorded in other income (9M'FY19: Rs. 208.7m; 9M'FY18: Rs. 1.2m). Net profit after tax of the company was reported at Rs. 715.0m (9M'FY18: Rs. 236m; FY18: Rs. 359.8, FY17: Rs. 259.4) during 9M'FY19.

Liquidity profile is considered adequate in view of sufficient cash flows in relation to outstanding long-term obligations but mismatch is observed on the balance sheet with short-term borrowings being utilized to fund long-term investments

Liquidity profile of the company is considered adequate in view of sufficient cash flows in relation to outstanding obligations and manageable levels of aging of trade debts. With improvement in cash flows on account of higher profitability, Debt Service Coverage Ratio was reported higher at 2.27x (FY18: 2.22x; FY17: 1.95x) in 9M'FY19. Current ratio of the company stood at 1.18x (FY18: 1.06x; FY17: 1.05x) at end-9M'FY19. Stock-in-trade and trade debts do not provide sufficient coverage to short term borrowings indicating mismatch on balance sheet.

Leverage indicators of the company may increase slightly but are expected to remain within manageable levels

Equity base (excluding revaluation surplus) of the company has grown on account of internal capital generation (9M'FY19: Rs. 3.2x; FY18: Rs. 2.5b; FY17: Rs.2.2b). Total quantum of dividend paid in FY18 amounted to Rs. 90m (FY17: Rs. 90m), resulting in dividend payout ratio of 25.0% (FY17: 34.7%). Going forward, management expects dividend payout to remain at similar levels provided that profitability continues to depict improvement. Debt carried on the balance sheet largely comprises short-term debt to fund long term loans and advances and working capital requirements. With increase in debt being higher than increase in equity base, both gearing and leverage increased to 1.50x (FY17: 1.42x) and 2.45x (FY17: 2.19x), respectively in FY18. Gearing and Leverage reduced to 1.32x and 2.18x in 9M'FY19 due to greater increase in equity. Going forward, leverage indicators are expected to increase slightly in view of additional borrowings to fund capex but are expected to remain at manageable levels. Maintaining leverage indicators within benchmarks for the assigned ratings is considered important.

Room for improvement in Corporate Governance Framework exists

Corporate Governance framework implemented at the company exhibits room for improvement as Board discussions minutes are not documented, while a formal independent Internal Audit department is also not present in the company. Board composition and oversight may be enhanced through inclusion of independent directors and greater discussion on future strategy and improvisation of internal control framework of the organization. While a formal internal audit function is absent, the company has separate Compliance and Quality Assurance departments at its manufacturing facilities. Moreover, the internal audit remains the focus of the management going forward.

Akhtar Textile Industries (Private) Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**9M'FY19**
Fixed Assets	3,891	4,731	4,811	4,851
Stock-in-Trade	1,150	1,565	1,817	2,338
Trade Debts	415	375	456	1,326
Cash & Bank Balances	123	16	75	201
Total Assets	7,258	9,157	10,740	12,311
Trade and Other Payables	1,354	1,338	1,952	2,282
Long Term Debt	548	479	391	318
Short Term Debt	1,728	2,669	3,403	3,948
Total Debt	2,276	3,148	3,794	4,266
Paid up capital	300	300	300	300
Total Equity (excluding revaluation surplus)	2,041	2,212	2,524	3,239
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**9M'FY19**
Net Sales	6,109	5,906	7,415	6,470
Gross Profit	837	594	919	1,141
Operating Profit	613	361	533	783
Profit Before Tax	469	275	421	783
Profit After Tax	451	259	360	715
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**9M'FY19**
Gross Margin (%)	14%	10%	12%	18%
Net Margin (%)	7%	4%	5%	11%
Gearing (x)	1.1	1.4	1.5	1.3
Leverage (x)	1.9	2.2	2.5	2.2
FFO	640	419	580	699
FFO to Long Term Debt (%)	117%	87%	148%	293%
FFO to Total Debt (%)	28%	13%	15%	22%
Debt Servicing Coverage Ratio (x)	3.0	2.0	2.2	2.3
ROAE (%)	21%	11%	12%	22%
ROAA (%)	5%	3%	3%	6%
Current Ratio (x)	1.0	1.0	1.1	1.2
(Stock in Trade + Trade Debts) / Short Term Borrowings	0.91	0.73	0.67	0.93

ISSUE/ISSUER RATING SCALE & DEFINITION Annexure 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 — Annexure III

Name of Rated Entity	Akhtar Textile Industries (Pvt.) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
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
Nov 27, 2019	A-	A-2	Stable	Reaffirmed
June 28, 2018	A-	A-2	Stable	Initial