RATING REPORT

Indigo Textile (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	*November 27, 2019*		*November 05, 2018*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirm		Initial	

COMPANY INFORMATION	
Incorporated in 2002	**External auditors:** Munaf Yusuf & Co. Chartered Accountants
Private Limited Company	**Chief Executive Officer:** Amir Maqbool **Board of Directors:** - Rizwan Iqbal Umer - Harris Siddique - Shiraz Masood - Farooq Javed - Khurshid Akhtar - Zeeshan Mansoor

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

Indigo Textile (Private) Limited

OVERVIEW OF THE INSTITUTION

Indigo Textile (Private) Limited (ITPL) was established in 2006 as a JV between Akhtar Group and Haji Khuda Bux Amir Umar.

Haji Khuda Bux Amir Umar group is engaged in the ginning, export, import, indenting of raw cotton and merchandising of cotton, blended yarns and other textile made ups and has been involved in the cotton trade since 1932. Akhtar group specializes in the textile sector particularly denim fabric and garments but also has diversified in the dairy and power sectors.

ITPL belongs to the Akhtar Group of Companies which is a family owned group. Akhtar Group of companies includes Dairyland Private Limited, ACT Wind Private Limited, Akhtar Textile Industries Private Limited (ATIL), and Akhtar & Sons.

RATING RATIONALE

Indigo Textile (Private) Limited (ITPL) was established in 2006 as a JV between Akhtar Group and Haji Khuda Bux Amir Umar. The company is engaged in manufacturing and sale of denim fabric. ITPL operates through 161 looms with an annualized denim fabric manufacturing capacity of 30.6m meters. Capacity utilization has remained around 88% during the last three years. In line with projected increase in demand, the management plans to increase its capacity with installation of 30 new looms.

Total Asset base of the company was reported at Rs. 10.4b (FY18: Rs. 9.5b; FY17: Rs. 8.4b) at end-Mar'2019. Due to capital intensive nature of the business, property, plant and equipment constitutes the largest component of the total assets base. Trade debts as a percentage of total assets have increased on a timeline basis and largely comprise receivables from a related party - Akhtar Textile Industries (Private) Limited (ATIL).

Demand outlook for denim remains favorable; 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 fabric. However, expansion by local and international players is expected to keep pricing power and hence margins under pressure. Many denim garment manufacturers are pursuing backward integration to manufacture denim fabric themselves. Other key business risk factors include volatility in yarn prices and limited ability to pass on the same to the end consumer. Due to shortfall in cotton crop production in Pakistan in FY20, the prices of cotton crop and hence cotton yarns are expected to depict an upward trend in the short term. Efficient procurement may partly mitigate this risk. Moreover, demand by customers for adherence to environment friendly practices may require additional investment by the companies, further exacerbating cost pressures on denim producers.

Sales have depicted an increasing trend but client-wise concentration risk is also sizeable

Net sales of the company registered sizeable growth of 26% to increase to Rs. 6.2b (FY17: Rs. Rs. 4.7b) in FY18. Growth in topline was a function of rupee devaluation and volumetric increase in sales. Sales mix remained similar vis-à-vis the preceding year with approximately three fourth of the total sales revenue generated from indirect exports to local players. Around one-half of the indirect sales are directed to ATIL (associate company). Top ten clients accounted for 65.6% (FY17: 81.4%) of total revenues. Business risk is considered to be on the higher side in view of the sizeable concentration (client and geographic) in sales.

Net sales were reported at Rs. 5.7b (9M'FY18: Rs. 4.6b) in 9M'FY19. Rupee devaluation was primary factor for growth in sales during this period. 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.

Growing topline and stable margins have translated to improvement in profitability

After witnessing improvement to 17.0% (FY17: 15.2%) in FY18, gross margins of the company decreased to 15.1% (9M'FY18: 14.2%) in 9M'FY19. Rupee devaluation and efficient procurement of cotton yarn contributed to improvement in gross margins in FY18; however, subsequent increase in input prices resulted in decrease in gross margins in 9M'FY19. Net profit of the company was reported at Rs. 236.9m (FY18: Rs. 319.3m; FY17: Rs. 207.6m) in 9M'FY19. Going forward, gross margins and profitability may come under pressure over the short to medium term on account of cost pressures pertaining to input prices and competitive pressure on account of significant capacities coming online.

Liquidity profile is considered adequate in view of sufficient cash flows in relation to outstanding long-term obligations

Liquidity profile of the company is considered adequate in view of sufficient cash flows in relation to outstanding obligations and manageable aging of trade debts. With improvement in profitability, Funds from Operations (FFO) has also increased. Debt servicing coverage ratio has declined on year on year basis but remains in line with ratings benchmark. The Company's working capital cycle is extended and necessitates utilization of short-term borrowings, which have increased on timeline basis on account of increase in trade debts. With current assets being greater than current liabilities, current ratio of ITPL was reported at 1.30(x) (FY18: 1.24x; FY17: 1.24x) at end-Mar'2019.

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

Equity base of the company increased to Rs. 3.2b (FY18: Rs. 2.8b; FY17: Rs. 2.5b) on account of internal capital generation. Dividend payout ratio of the company was reported at 23.5% during FY18 and the management expects the same to remain at similar levels going forward provided that profitability depicts a growing trend. Debt carried on the balance sheet largely comprises short-term debt to fund working capital requirements. With greater increase in borrowings vis-à-vis the growth in equity, leverage indicators of the company have trended upwards. Gearing ratio of the company was reported at 1.23x (FY18: 1.22x; FY17: 1.12x) at end-9M'FY19. Given the expansion plans of the company, leverage indicators may increase over the short to medium term but are expected to remain at manageable level. 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.

Indigo Textile (Private) Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**9M'FY19**
Fixed Assets	3,687	4,055	3,947	4,009
Stock-in-Trade	1,079	1,475	2,209	2,312
Trade Debts	1,372	2,122	2,471	3,092
Cash & Bank Balances	7	4	21	26
Total Assets	6,768	8,360	5,599	6,390
Trade and Other Payables	884	1,163	1,407	1,581
Long Term Debt	791	750	592	615
Short Term Debt	1,338	2,042	2,874	3,259
Total Debt	2,129	2,792	3,466	3,874
Paid up capital	300	300	300	300
Total Equity	2,305	2,486	2,831	3,150
INCOME STATEMENT				
Net Sales	4,754	4,914	6,189	5,666
Gross Profit	951	746	1,054	856
Operating Profit	561	354	517	458
Profit Before Tax	437	221	363	272
Profit After Tax	437	208	319	237
RATIO ANALYSIS				
Gross Margin (%)	20%	15%	17%	15%
Net Margin	9.19%	4.22%	5%	4%
FFO	574	442	637	N/A
FFO to Total Debt (%)*	27%	16%	24%	N/A
FFO to Long Term Debt (%)*	73%	59%	143%	N/A
Current Ratio (x)	1.31	1.24	1.24	1.30
Debt Servicing Coverage Ratio (x)*	3.45	2.39	2.06	N/A
Gearing (x)	0.92	1.12	1.22	1.23
Leverage (x)	1.35	1.65	1.79	1.80
ROAA (%)*	7%	3%	4%	3%
ROAE (%)*	21%	9%	12%	11%
(Stock in Trade + Trade Debts) / Short Term Borrowings	1.77	1.59	1.83	1.76

ISSUE/ISSUER RATING SCALE & DEFINITION Annexure 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 — Annexure III

Name of Rated Entity	Indigo Textile (Private) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see 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
Nov 5, 2018	A-	A-2	Stable	Initial