RATING REPORT

Indigo Textile (Private) Limited

REPORT DATE:

Jun 21, 2021

RATING ANALYSTS:

M. Amin Hamdani
amin.hamdani@vis.com.pk

Arsal Ayub, CFA
arsal.ayub@vis.com.pk

RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A	A-1	A-	A-2
Rating Date	*Jun 21, 2021*		*April 24, 2020*	
Rating Outlook	Stable		Rating Watch - Developing	
Rating Action	Upgrade		Maintained	

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 (April, 2019)
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), Akhtar & Sons.

RATING RATIONALE

Indigo Textile (Private) Limited ('ITPL' or 'the Company') 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 is an export-oriented company, with 60% of the sales comprising indirect exports and the remaining comprising direct exports. In terms of clientele, sales to ITPL's associate company, Akhtar Textile, comprises the largest share of indirect exports, representing 37% of the indirect exports and 22% of the topline during FY20 (FY19: 45% of indirect exports & 28% of topline). Direct exports of the company are mainly focused towards Bangladesh, which constitutes 54% of the direct exports and 22% of the topline (FY19: 54% of direct exports and 20% of topline).

ITPL operates through 166 looms with an annualized denim fabric manufacturing capacity of 30.6m meters. In line with projected increase in demand, the management plans to increase its capacity with installation of 50+ new looms, which should translate in a capacity enhancement of 25%.

Sector Update

- Textile exports comprised 57.1% of Pakistan's total exports as reported in FY20. Following a dip in overall exports of the country, which dropped by 7% in FY20, textile exports also fell by 6% in USD terms.
- The contraction in exports can partly be attributed to significant currency depreciation, with average effective rate for USD being 16% higher in FY20 vis-à-vis FY19.
- Furthermore, some of the contraction emanated from the slowdown in orders in the latter half of FY20, owing to the novel coronavirus outbreak and the ensuing lockdowns across the globe. As a result, textile exports depicted contraction, in quantitative terms, in all categories, except two.
- In the ongoing fiscal year, textile exports have started to post recovery. Even though exports remained sluggish in USD terms, at least in Q1'FY21, the recovery has particularly started to materialize in Q2'FY21, when export proceeds were 4% higher than SPLY.
- During 8MFY21, the overall exports of textile (in terms of USD) remain intact as compared to last year with a marginal drop of 1% Y/Y.
- The top advancers categories during 8MFY21 were Tents canvas & tarpaulin (↑47%), Towels (↑14%), Bed wear (↑9%), Other materials (↑6%).
- On the other hand, mainly cotton related products dented the overall textile contribution as 8MFY21 top decliners include Raw cotton (↓91%), Cotton carded or combed (↓76%), Other yarns (↓44%) and Cotton yarn (↓35%).
- Interviews conducted with senior management of leading textile corporates are indicative of a strong order book in the upcoming period. However, the third wave ensuing lockdown mostly in Europe countries could restrict the textile exports in the on-going period while there is also a prevailing risk of a slower than expected recovery in consumer indices of North America & Europe.

	FY19	FY20	Q1'FY20	Q1'FY21	Q2'FY20	Q2'FY21	8M'FY20	8M'FY21
PAKISTAN EXPORTS (IN USD' MILLIONS)	24,257	22,505	5,832	5,255	6,102	6,160	16,439	16,066
TEXTILE (IN USD' MILLIONS)	13,659	12,851	3,411	3,070	3,408	3,550	9,100	9,007
PKR/USD RATE (AVERAGE)	136.3	158.2	124.4	166.9	134.3	160.8	156.2	161.9
SOURCE: SBP								

Operations & Business Update

- In FY20, ITPL's capacity utilization level increased from 76% to 80%, despite a 3% decline in quantitative sales. As a result, the finished goods inventory as of Jun'20, was up by 5% YoY.

P&L (Extract)	FY18	FY19	FY20	H1'FY21
Sales	6,189	7,482	8,280	5,618
Gross Margin	*17.0%*	*16.6%*	*15.7%*	*12.6%*
EBIT Margin	*8.3%*	*8.9%*	*7.8%*	*6.9%*
Net Margin	*5.2%*	*4.4%*	*3.5%*	*4.6%*

- ITPL's topline grew by 11% in FY20, mainly being driven by 14% increase in pricing. Sales offtake in H1'FY21 has posted strong improvement, as reflected in the table above, which was mainly driven by quantitative increase in sales. As per management, topline in 10M'FY21 has already exceeded the preceding year topline by 11% and the management expects the topline to post ~30% growth in FY21.

- We have noted pressure on gross margins, which have been undergoing a consistent squeeze since FY19. This is mainly attributable to an increase in cotton yarn pricing, which has been partly offset by PKR depreciation. As per management, gross margin for FY21 is expected to be ~15%, albeit, we expect the same to be a challenging task, given a stronger PKR and higher inflation in H2'FY21.

- In H1'FY21, we have noted that the net margin has posted improvement, despite the contraction of gross margin during the period. This is mainly attributable to lower debt utilization and lower prevailing interest rate during this period. The lower debt utilization was mainly a result of a contraction of working capital cycle, which decline from 166 days in FY20 to 107 days for H1'FY21.

Key Rating Drivers

Assigned rating incorporates business risk profile of the denim sector, and ITPL's market positioning within the sector

- Business risk profile of the company is supported by stable and growing demand for denim products globally. Although the industry has undergone a slowdown in FY20-21, as global consumer spending on garments took a hit as a result of the pandemic-induced slowdown.
- There certainly pressure on gross margin, given historical drop in cotton production in Pakistan and projections of subdued growth over the next two years. The price volatility in cotton yarn pricing affects the risk profile of denim sector players. Recent price volatility is provided in the table below.
- Overall textile industry off take has benefited in H1'FY21 from lower impact of Covid-19 on textile operations, vis-à-vis regional counterparts. However, positive momentum is likely to fade off once capacity of regional counterparts comes back online.

Local Cotton Prices	FY18	FY19	FY20	8MFY21
Per Maund (Rs.)	6,953	8,770	8,860	9,643
% Change	6%	26%	1%	9%

**Prices based on daily average*

- The Company's business risk, as reflected by the topline strength and gross margins is viewed positively. The envisaged capacity enhancement is likely to translate in superior growth vis-à-vis peers. Ceteris paribus, the changes in other metrics, the envisaged growth is viewed positively and has been incorporated into the rating assessment.

- Topline concentration has reduced on a timeline, albeit is still considered to be moderately high. During FY20, sales to top-10 clients represented 47% of the topline, vis-à-vis 60% in the preceding year.

Declining cash conversion cycle has had positive impact on liquidity & cash flow coverage indicators

Liquidity Analysis	FY18	FY19	FY20	H1'FY21
FFO (Mn.)	637	758	634	NA
FFO/Total Debt (%)	18.4%	20.3%	19.2%	NA
FFO/LTD (%)	107.5%	119.0%	79.4%	NA
DSCR (x)	2.06	2.27	1.83	NA
Current Ratio (x)	1.24	1.26	1.44	1.59
Cash Conversion Cycle (days)	173	177	166	107

- Liquidity profile of the Company is considered adequate, in view of the cash flow coverage of debt, which is superior to peer median.

- The cash conversion cycle has posted consistent improvement, which is also reflected by the improved current ratio.

Improvement in capitalization indicators continued in FY20, leveraging are expected to stay at same levels going forward

Balance Sheet (Extract)	Jun'18	Jun'19	Jun'20	Dec'21
Total Assets (Mn.)	5,599	6,516	6,281	6,363
Total Liabilities (Mn.)	5,506	5,805	5,269	5,050
Equity (Exc. Surplus on reval.) (Mn.)	2,831	3,193	3,581	3,843
ST Debt (Mn.)	2,874	3,095	2,500	1,836
LT Debt (Mn.)	592	636	799	891
Total Debt (Mn.)	3,466	3,731	3,299	2,727
Gearing (x)	1.22	1.17	0.92	0.71
Leverage (x)	1.79	1.82	1.47	1.31

- Given strong internal cash generation and full retention during FY20, the Company's equity base has posted strong growth. In absolute terms, the equity base is aligned with the peer median.

- As of Dec'20, given the reduction in debt, the gearing and leverage stood on the lower side and compared favorably to peers.

- Going forward, the management has envisaged the long term debt to increase by Rs. 1b, given financing requirement for the envisaged growth. Resultantly, the gearing is projected to rise to 1.0x during the medium term horizon, which would still remain within acceptable threshold. The entire facility is planned to be taken under SBP's concessionary financing scheme, which will cost ~5%.

Indigo Textile (Private) Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**H1'FY21**
Fixed Assets	3,947	4,031	5,647	5,497
Stock-in-Trade	2,209	2,565	2,608	2,089
Trade Debts	2,471	3,027	2,627	2,983
Cash & Bank Balances	21	22	38	62
Total Assets	9,546	10,547	11,928	11,861
Trade and Other Payables	1,407	1,826	1,689	2,062
Long Term Debt	592	636	777	868
Short Term Debt	2,874	3,095	2,500	1,836
Total Debt	3,466	3,731	3,277	2,704
Paid up capital	300	300	300	300
Total Equity	2,831	3,193	3,581	3,843
INCOME STATEMENT				
Net Sales	6,189	7,482	8,280	5,618
Gross Profit	1,054	1,241	1,302	706
Operating Profit	517	666	644	386
Profit Before Tax	363	393	376	308
Profit After Tax	319	329	290	257
RATIO ANALYSIS				
Gross Margin (%)	17.0%	16.6%	15.7%	12.6%
Net Margin	5.2%	4.4%	3.5%	4.6%
FFO	637	758	634	NA
FFO to Total Debt (%)	18.4%	20.3%	19.2%	NA
FFO to Long Term Debt (%)	107.5%	119.0%	79.4%	NA
Current Ratio (x)	1.24	1.26	1.44	1.59
Debt Servicing Coverage Ratio (x)	2.06	2.27	1.83	NA
Gearing (x)	1.22	1.17	0.92	0.71
Leverage (x)	1.79	1.82	1.47	1.31
ROAA (%)*	3.6%	3.3%	2.6%	4.3%*
ROAE (%)*	12.0%	10.9%	8.6%	13.8%*
(Stock in Trade + Trade Debts) / Short Term Borrowings	1.63	1.81	2.09	2.76
* Annualized				

*Annualized

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	
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
Jun 21, 2021	A	A-1	Stable	Upgrade
April 24, 2020	A-	A-2	Rating Watch - Developing	Maintained
Nov 27, 2019	A-	A-2	Stable	Reaffirmed

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Nadeem Naz	Group CFO	May 25, 2021