RATING REPORT

Gadoon Textile Mills Limited (GTML)

REPORT DATE:
October 31, 2018

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RATING DETAILS

	Initial	
Rating Category	**Long-term**	**Short-term**
Entity	A+	A-1
Rating Outlook	Stable	
Rating Date	*Oct' 29, 2018*	

COMPANY INFORMATION

Incorporated in 1988	**External auditors:** Deloitte Yousuf Adil & Co. Chartered Accountants
Listed Public Limited Company	**Chairman of the Board**: Mr. Muhammad Yunus Tabba
Key Shareholders (with stake 5% or more):	**Chief Executive Officer**: Mr. Muhammad Sohail Tabba
- Yunus Brothers Group	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) http://www.jcrvis.com.pk/kc-meth.aspx

Gadoon Textile Mills Limited

OVERVIEW OF THE INSTITUTION

Gadoon Textile Mills Limited (GTML) was incorporated in 1988 as part of Yunus Brothers Group (YBG). The sponsor has diversified interests in textiles, building materials, real estate, power generation, chemicals, pharmaceuticals, food and automotive sectors.

Awards and Recognition

Top 25 Companies for The Year Award
Top Exporter (Foreign Exchange Earner) of the Province
Top Importer of The Province
Top Income Tax Payer of The Province
Best Consumer Award
Businessman of the Year
Gold Medal Award
Business Excellence Award
Awarded With Best Corporate Report Award 2015, 2016 and 2017

Profile of Chairman

Mr. Muhammad Yunus Tabba started his over 56 years long career with YBG as one of its founding members. He was awarded "Businessman of the Year" award by the Chambers of Commerce several times during his entrepreneurial career.

Profile of CEO

Mr. Muhammad Sohail Tabba is a seasoned businessman with extensive experience in

RATING RATIONALE

Gadoon Textile Mills Limited **(**GTML) has around three decades of experience in the textile sector and produces yarn (both coarse & fine counts) and knitted fabric through two units located at Karachi in Sindh (Unit B) and at Swabi District in Khyber Pakhtunkhwa (KPK) (Unit A). Unit A was established in the inaugural year. The company has captive power generation plants with a total capacity of 56 megawatt (MW). GTML's yarn is primarily sold to large scale local textile industry, the key markets being Karachi, Faisalabad and Lahore. GTML also sells products to international market, primarily comprising China. "Koyal" (local) and "Peach" (export) are two of GTML's key brands. Majority of GTML's sales are generated through agents while direct sales largely include related party revenues.

At end-FY18, GTML operated with 332,724 spindles (FY17: 321,676) and capacity utilization was reported at 94.8% (FY17: 97.6%). Going forward, GTML plans capex for renovation and replacement of machinery. Planned capex for FY19 pertains to installation of two additional gas gensets, replacement of obsolescent machinery and capacity enhancement in knitting operations to cater to additional demand. Capex planned will diversify revenues, enhance operational efficiency and reduce cost of production. The project is to be primarily funded through debt financing.

Besides core textile operations, GTML has investments in power (Yunus Energy Limited: 19.98% stake) and Chemicals sectors (ICI Pakistan Limited: 6.48% stake). These investments represent over one-tenth of the company's asset base and contribute to the Company's profitability and cash flows through dividend income. Moreover, GTML has three planned investments in power projects which will only be undertaken if feasible tariff is approved by National Electric Power Regulatory Authority. These include the following:

a) Investment of Rs. 720m for a 20% stake in Yunus Wind Power Limited for establishing a 50MW wind power project.
b) Investment of Rs. 720m for a 20% stake in Tricom Wind Power (Private) Limited for setting up a 50MW wind power project.
c) Wholly-owned hydro power projects with collective capacity of ~150MW to be set up in KPK.

<u>Rating Drivers</u>

Strong sponsor profile and market position

GTML is part of the Yunus Brothers Group (YBG), a reputable conglomerate with strong financial profile and presence in diversified sectors including textiles, building materials, real estate, power generation, chemicals, pharmaceuticals, food and automotive sectors. In terms of spindles installed, GTML is the largest spinning enterprise in the country and enjoys a sizeable market share in the country's yarn exports at ~6%.

Consistent operating performance with continuous focus on efficiency enhancements

Over the last five years, capacity utilization has consistently remained on the higher side at over 90%. Adequate power arrangements are in place with GTML primarily relying on gas based power generation for its power related needs. Moreover, the management has focused on improving efficiencies through BMR, optimizing fuel mix and reducing power cost through installation of waste heat recovery plant.

manufacturing, energy, real estate and cement sectors. Mr. Sohail is a chairman of ICI Pakistan Limited and NutriCo Morinaga (Private) Limited. Furthermore, he serves as a CEO of Lucky Energy (Private) Limited, Yunus Energy Limited and LuckyOne (Private) Limited.

High cyclicality & competitive intensity for spinning industry, volatility in cotton prices and geographic concentration in export sales translate into high business risk profile. Diversification through existing and planned investments supports assessment of business risk profile

Inherent cyclicality of cotton price and crop levels drives performance of players operating in the spinning sector. Historically, margins and financial performance of players have depicted seasonality. Moreover, competitive intensity is high due to commoditized nature of the product. Comfort is drawn from GTML's product diversity (produces both cotton and blended yarn) and presence across a wide count range. However, as with other local producers in the spinning sector, reliance on China as the major export market translates into country concentration risk. Imposition of duties ranging from 10-25% on Chinese textile exports to USA is expected to impact yarn exports from Pakistan to China. USA imported US$45b worth of textile and apparel goods from China in 2017.

Proportion of local sales in sales mix to increase while significant depreciation in FY18 and in the ongoing fiscal year will improve export opportunities in non-traditional markets

Net sales of the company have increased at a Compound Annual Growth Rate (CAGR) of 8.3% over the past five fiscal years (FY14-18). On overall basis, local sales have represented around two-thirds of the topline over the past three fiscal years. Going forward, export sales may witness pressure on account of lower exports to China; management expects to mitigate this through enhanced focus on domestic sales of yarn given the improved export opportunity for local garment players for direct exports to USA. Impact of BMR in the ongoing year on the production and sales of the company may also be witnessed. Management remains proactive on exploring potentially viable export opportunities in the international market to diversify export revenues. Significant rupee depreciation in FY18 and in the ongoing year should facilitate in this regard.

Diversification in revenue streams supports assessment of profitability profile. Margins compare less favorably to peers and remain dependent on cotton prices. Efficiency initiatives and increasing trend in cotton prices should shield margins against higher cost of doing business (due to increase in projected inflation) and increase in cost of production due to existing proportion of imported cotton in production mix

Over the last two fiscal years, gross margins have witnessed improvement to 7.1% (FY17: 5.7%; FY16: 3.4%) at end-FY18 on the back of shift in fuel mix towards cheaper natural gas from furnace oil, strategic procurement of local and imported cotton and BMR. JCR-VIS expects increasing trend in cotton prices and efficiency gains to shield margins against higher cost of doing business (due to increase in projected inflation) and increase in cost of production due to existing proportion of imported cotton in production mix. While absence of rebate is going to impact other income, overall profitability will continue to be supported by sizeable contribution of profit from associates which has represented around one-third to GTML's profit after tax over the last two fiscal years.

Sound liquidity profile

In absolute terms, Funds from Operations (FFO) (adjusted for dividend income) amounted to Rs. 1.5b (FY17: Rs. 1.1b) depicting a 35.4% increase on account of higher dividend income and overall profitability. Debt Service Coverage Ratio (DSCR) and FFO/Long-Term Debt remain strong at 3.8x (FY17: 4.7x) and 2.53x during FY18, respectively. While DSCR is expected to decline as a results of funds mobilized for expansion and diversification projects, the same is expected to remain at comfortable levels given adequate cash flow from operations and extended and staggered long-term debt repayments which will allow GTML financial flexibility in undertaking diversification projects. Ageing profile of trade debts remains strong.

Adequate capitalization indicators

Equity base of the Company has consistently grown over time on account of healthy internal capital generation while dividend payout has remained conservative at 36.6% (FY17: 17.9%; FY16: 37.2%). GTML's short-term borrowings are seasonal in nature and in line with inventory levels. As sizeable procurement is undertaken during the season, gearing and leverage increase in line with short term borrowings. Debt profile is primarily short-term in nature (~95% of the outstanding debt). While remaining short-term in nature, proportion of long-term advances in financing mix is expected to increase. At end-FY18, gearing and leverage ratios increased to 1.27x (FY17: 1.17x) and 1.82x (FY17: 1.71x), respectively. Leverage indicators would need to be sustained and remain commensurate with the assigned ratings, particularly when investing in new power sector projects.

Corporate Governance

Overall corporate governance framework is supported by sound board composition and oversight, stable and professional management team and strong internal controls. Governance framework is supported by focus on transparency as evident from governance related disclosures in the annual report which provide important information for stakeholders

Gadoon Textile Mills Limited **Appendix I**

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**FY18**	**FY17**	**FY16**
Fixed Assets	7,791.9	7,447.7	7,727.0
Long Term Investments	2,686.9	2,472.7	2,194.3
Stock-in-Trade	7,469.6	5,700.6	5,148.4
Trade Debts	2,464.2	1,750.8	1,547.6
Cash & Bank Balances	188.9	163.9	387.5
Total Assets	23,142.5	19,999.8	19,094.9
Trade and Other Payables	3,088.5	2,779.4	1,856.8
Long Term Debt	594.3	-	-
Short Term Debt	9,864.9	8,636.0	9,553.8
Total Equity	8,213.5	7,366.7	6,533.6
INCOME STATEMENT	**FY18**	**FY17**	**FY16**
Net Sales	27,554.7	23,248.6	21,269.5
Gross Profit	1,944.9	1,328.8	726.2
Profit After Tax	1,185.3	807.0	(273.8)
RATIO ANALYSIS	**FY18**	**FY17**	**FY16**
Gross Margin (%)	7.06%	5.72%	3.41%
Current Ratio (x)	0.96	0.87	0.80
FFO to Total Debt (x)	0.14	0.13	0.04
FFO to Long Term Debt (x)	2.53	-	-
Gearing	1.27	1.17	1.46
Leverage	1.82	1.71	1.96
Debt Servicing Coverage Ratio (x)	3.83	4.70	1.67
ROAA (%)	5.49%	4.11%	-1.42%
ROAE (%)	15.22%	11.61%	-4.19%

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Gadoon Textile Mills Limited (GTML)
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	
Instrument Structure	N/A
Statement by the Rating Team	JCR-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	JCR-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
RATING TYPE: ENTITY				
Oct-29-18	A+	A-1	Stable	Initial