RATING REPORT

Gadoon Textile Mills Limited (GTML)

REPORT DATE:
December 13, 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-1	A+	A-1
Rating Date	*Dec'13,2019*		*Oct' 29, 2018*	
Rating Outlook	Stable		Stable	

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.vis.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.

Profile of Chairman

Mr. Muhammad Yunus Tabba started his over 57 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 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.

RATING RATIONALE

Gadoon Textile Mills Limited (GTML) operates as a yarn (both coarse & fine counts) through two units located at Karachi in Sindh (Unit B) and at Swabi District in Khyber Pakhtunkhwa (Unit A) and a knitwear manufacturer through Unit B.

Industry Dynamics

Overall export performance of the textile sector has been muted during the outgoing year despite significant rupee devaluation and notable measures having been undertaken by the Government of Pakistan (GoP) to uplift the textile sector; the latter included reduction in energy prices and regulatory duty on import of cotton. Non-value added exports contracted by 20.6%/19.9% in terms of volume and value during FY19 while value added exports depicted meager growth of 6.8%/3.0% in volume/value terms. Global demand of Pakistani yarn has experienced downward pressure, owing to the shifting of spinning mills from China to Vietnam coupled with reduced export orders from China in light of the prevailing US-China trade tensions. On the flip side, volume led growth in value added exports has enhanced local consumption for yarn resulting in limited export surplus for the same. Nevertheless signing of FTA phase 2 (free trade agreement) with China presents an opportunity for spinning mills to enhance yarn exports to China.

Table 1: Pakistan's Textile Exports (Source: PBS)

	FY18			FY19		
(Mn Tons, USD Mn)	**Volume**	**Value**	**USD/Unit**	**Volume**	**Value**	**USD/Unit**
Raw Cotton	35	58	1.66	12	20	1.67
Yarn	518	1,371	2.65	427	1,125	2.63
Non-Value Added	**553**	**1,429**	**2.58**	**439**	**1,145**	**2.61**
Knitwear	117	2,733	23.36	133	2,909	21.9
Bedwear	359	2,261	6.30	376	2,262	6.02
Towels	189	788	4.17	194	786	4.05
Readymade Garments	40	2,581	64.53	50	2,657	53.14
Value Added	**705**	**8,362**	**11.86**	**753**	**8,612**	**11.44**

Cost pressures for the industry are reflective of the global and local cotton production data which shows scaled down cultivation area and production at both fronts. Resultantly, local cotton prices have gone up. With respect to the spinning segment, dependence on imported cotton, particularly from India, has been on the higher side given its identical quality with local cotton. However sprained relations with India and significant rupee devaluation would further spike up raw material costs for the spinning segment. Margins and financial performance of players in the industry have depicted volatility due to inherent cyclicality of crop levels and oscillations in cotton prices. VIS expects prices to sustain the high ground based on the ongoing decline in cotton production. Nonetheless materialization of FTA phase 2 with China would provide some ease on the cost front in the form of a relief from duties and tariffs.

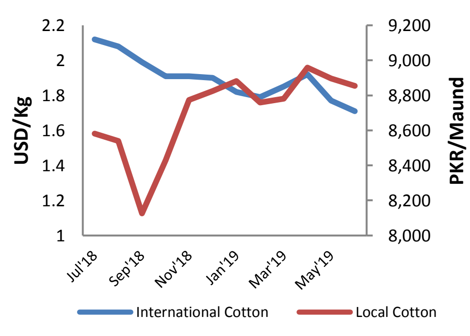

Figure 1

Table 2: (Source: USDA)

Area Under Cultivation (Mn Hectres)	**FY18**	**FY19**	**% Change**
World	33.7	33.5	-0.6%
Pakistan	2.7	2.3	-14.8%
Production (Mn 480lb Bales)			
World	123.8	119.1	-3.8%
Pakistan	8.2	7.6	-7.3%

Operating Performance

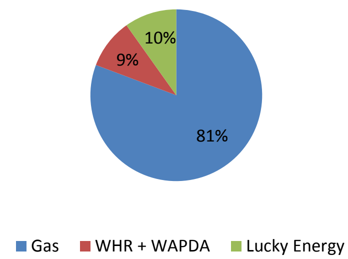

Figure 2: Fuel Mix

The company undertook an addition of 9,696 spindles during the outgoing year, taking the total tally of spindles to 342,420 (FY18: 332,724; FY17: 321,676). To maintain efficient production, the company has installed latest technology based spindles. Expansion of the knitting facility is ongoing and is expected to come online in 1HFY20. Capacity utilization has remained on similar levels (FY19: 93.8%; FY18: 94.8%) on the back of upbeat local demand. More than 4/5th of required power load is being met through cheaper fuel source i.e; gas-based generators, which would now cost 31% higher post gas prices hike by GoP, but still remains cheapest in the mix. Nevertheless, installation of WHR plants, non-reliance on furnace oil and planned machinery upgrades is expected to bring in meaningful cost efficiencies over the medium term.

Table 3: Capacity Details

	FY17	FY18	FY19
Spindles	321,676	332,724	342,420
Capacity Utilization	97.6%	94.8%	93.8%
Knitting Machines	12	12	12
Installed capacity (kgs)	1,485,000	1,485,000	1,485,000

Investment Mix and plans

Long term investments represent more than 1/5th of the non-current asset base at end-FY19. Significant holdings include 6.48% ownership interest in ICI Pakistan Limited and 19.98% stake in Yunus Energy Limited. The company also holds a minimal portion of ownership (1%) in Lucky Holdings Limited. Given its new venture into the dairy segment, GTML is holding Rs.130m worth of biological assets, mainly constituting a mix of mature and immature livestock; going forward, there are plans to further invest in dairy segment, which has started commercial production post FY19. Revenues from this segment will start to flow in from FY20, while management expects the dairy operations to significantly support profitability and cashflows over the next 3-4 years. Moreover, GTML has gained the approval for investment in 150 MW Hydel Power Project and investment in Yunus Wind Power Limited and Tricom Solar Power (Private) Limited is still in the pipeline. Additional revenue and income lines would further diversify company's revenue stream, which bodes well from a rating perspective.

Table 4: Investment Book

PKR Bn	FY17	FY18	FY19
Associates (Book value as per equity method)			
ICI Pakistan Limited	1.57	1.66	1.76
Yunus Energy Limited	0.74	0.84	0.94
Lucky Holdings Limited	0.16	0.18	0.04
Subsidiary			
Gadoon Holdings (Private) Limited	-	-	0.16
Total	2.47	2.68	2.90

Rating Drivers

Better pricing has driven growth momentum in topline with increased contribution from local sales. However, orders from international markets are expected to grow.

In FY19, GTML reported topline revenue of Rs. 31.2b, 13% higher than FY18 (Rs. 27.5b). Growth in sales is mainly attributable to higher pricing charged in view of escalated raw material costs. Overall volumetric sales for the company declined by 5% whereby quantum sales of yarn, company's principal business segment, declined by 7% alone. The volumetric decline is partially due to a switch in orders of yarn count from different countries. Given lower export orders of yarn from China, proportion of export sales of the company have fallen significantly in FY19 as compared to prior years (FY19: 26.7%; FY18: 37.5%). Nevertheless, based on the improved export opportunity for local garment players for direct exports to USA, local yarn sales for the company witnessed impressive growth of 36%. On the other hand, sales concentration risk tends to be on the lower side for local sales, as major clientele consists of a diversified dealer base and related parties. Even though the company has a spread out international reach with more than 20 countries in its export clientele, concentration of sales remains on the higher side with bulk ~ roughly 70% of the export sales to China. Management remains proactive on exploring potentially viable export opportunities in the international market and expects to diversify export revenues in light of the US-China trade war.

Table 5: Segment Wise Sales & Profitability

(Rs. Mn)	FY18	FY19
Yarn	26,163	29,806
Export	9,426	7,072
Local	16,737	22,734
Profit Before Tax	684	778
Knitting	1,392	1,412
Export	904	1,274
Local	488	138
Profit Before Tax	312	327
Total Sales	27,555	31,218
Export	10,330	8,346
Local	17,225	22,872

Gross margins have depicted consistent improvement on the back of improving inventory & fuel efficiencies and better pricing. Nevertheless, despite the notable improvement, margins continue to trail peers in the industry.

Higher reliance on imported cotton, rupee devaluation and rising local cotton prices have resulted in escalated cost of production. Nonetheless, higher raw material costs were offset by reduced power costs, attributable to a more optimal fuel mix i.e. high dependency on gas based generators. This, along with better pricing, uplifted gross margins (FY19: 9.3%; FY18: 7.1%). However, inherent cyclicality and oscillations in crop prices remains a challenge for GTML. Therefore diversification in business segments and use of efficient fuel mix would make the company more competitive in terms of margins vis-à-vis peers.

Table 6: Raw Material Costs

	FY18		FY19	
	Volume	Average Price (Rs/Kg)	Volume	Average Price (Rs./Kg)
Imported Raw Material	56.1%	216.3	56.7%	268.7
Local Raw Material	43.9%	158.4	43.3%	213.1

Absence of export rebate and increased interest cost burden has had slightly impact on the company's earnings profile.

Even though reduced export sales have scaled down distribution expenses by 8%, uptick in admin expenses was witnessed at 23% largely on account of higher employee costs ~ to make salaries market compatible. Moreover absence of export rebate largely led to a hefty contraction in other income by 64% during the outgoing year. However sizeable contribution of profit from associates (FY19: Rs. 463.9m; FY18: Rs.477.2m) continued to partially support profitability. In line with a significant increase in benchmark rates, finance costs have jumped by 91% on an annual basis. Resultantly net margins slightly compressed to 3.7% in FY19 vis-à-vis 4.3% in FY18.

Adequate cashflows relative to outstanding debt alongside more than sufficient coverage of short term borrowings via inventory and receivables supports the assessment of liquidity profile

Liquidity profile is considered sound in view of healthy cash flow generation, full coverage of short term borrowings by way of inventory and receivables and adequate debt servicing ability. Even though FFO to to LT Debt has reduced significantly, primarily due to higher mobilization of LT Debt to fund growth based CAPEX ~ Rs. 2.8b of expansion in knitting facilities, addition of technologically advance machinery and replacement of efficient generators, it still remains adequate (FY19: 78.9%; FY18: 253.5%). DSCR has slightly declined but stood at comfortable level as repayments for the LTFF undertaken are yet to kick in. We believe that debt servicing ability will remain strong given adequate cash generation and soft annual repayments (roughly Rs.267mn/annum) going forward. On the flip side, GTML witnessed a slight elongation in its cash cycle which went upto almost 101 days in FY19 from 87 days in SPLY; this can largely be attributed to increased sales to local clientele, wherein higher payment delays were incurred, and holding of high inventory volumes in order to hedge against rising cotton prices.

Capital structure and growth in equity base has remained along similar lines

Stable profitability, along with conservative dividend payout (FY19: 20.4%; FY18: 36.7%), continue to reinforce the capital buffers (Net Equity: FY19: Rs. 9.2b; FY18: Rs. 8.2b). Despite additional LT debt undertaken, capital structure of the company has remained similar, with gearing and debt leverage reported at 1.37x and 1.96x (FY18: 1.27x; 1.82x). Debt profile, still, largely constitutes short term financing (78.8%). Going forward the company projects improved capital structure with gearing and leverage to remain lower than current level.

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.

Gadoon Textile Mills Limited Appendix I

FINANCIAL SUMMARY		*(amounts in PKR millions, unless stated otherwise)*	
BALANCE SHEET	**FY17**	**FY18**	**FY19**
Fixed Assets	7,447.7	7,791.9	9,870.3
Long Term Investments	2,472.7	2,686.9	2,869.8
Stock-in-Trade	5,700.6	7,469.6	8,397.9
Trade Debts	1,750.8	2,464.2	3,517.7
Cash & Bank Balances	163.9	188.9	106.3
Total Assets	19,999.8	23,142.5	27,279.4
Trade and Other Payables	2,779.4	3,088.5	3,695.7
Long Term Debt	-	594.3	2,675.1
Short Term Debt	8,636.0	9,864.9	9,926.7
Paid Up Capital			
Total Equity	7,366.7	8,213.5	9,189.5
INCOME STATEMENT	**FY17**	**FY18**	**FY19**
Net Sales	23,248.6	27,554.7	31,217.5
Gross Profit	1,328.8	1,944.9	2,892.7
Total Expenses	563.0	823.0	776.3
Other Income	277.7	449.2	163.9
Finance Cost	342.6	574.7	1,097.9
Share from associates	384.1	477.2	463.9
Profit Before Tax			
Profit After Tax	807.0	1,185.3	1,166.3
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**
Gross Margin (%)	5.72	7.06	9.27
Net Margin (%)	3.47	4.30	3.74
Current Ratio (x)	0.87	0.96	1.02
(Inventory+Recievables)/ST Borrowings (x)	0.86	1.00	1.20
FFO to Total Debt (x)	0.13	0.14	0.17
FFO to Long Term Debt (x)	-	2.53	0.79
Gearing (x)	1.17	1.27	1.37
Leverage (x)	1.71	1.82	1.96
Debt Servicing Coverage Ratio (x)	4.70	3.83	3.32
ROAA (%)	4.11	5.49	4.63
ROAE (%)	11.61	15.22	13.39

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

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	Gadoon Textile Mills Limited (GTML)				
Sector	Textile				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	Dec-13-19	A+	A-1	Stable	Reaffirmed
	Oct-29-18	A+	A-1	Stable	Initial
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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