RATING REPORT

Gadoon Textile Mills Limited

REPORT DATE:
October 31, 2023

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A+	A-1	A+	A-1
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	
Rating Date	*Oct 31, 2023*		*Nov 02, 2022*	

COMPANY INFORMATION	
Incorporated in 1988	**External Auditors:** M/s Yousuf Adil, Chartered Accountants
Public Listed Company	**Chairman of the board:** Mr. Muhammad Ali Tabba
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Muhammad Sohail Tabba
YB Holdings (Private) Limited ~69.57%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Industrial Corporates (May 2023)
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale: https://docs.vis.com.pk/docs/VISRatingScales.pdf

Gadoon Textile Mills Limited

OVERVIEW OF THE INSTITUTION

Gadoon Textile Mills Limited was incorporated in 1988 as part of Yunus Brothers Group (YBG). The principal business activity of the Company is to manufacture and sell yarn, knitted bedding prodcuctss, and production and sale of milk.

Profile of the Chairman:
Mr. Muhammad Ali Tabba is the Chief Executive Officer of Lucky Cement Limited, having taken over from his late father in 2005. He has established him as an exemplar of entrepreneurial excellence not only in Pakistan, but also across the Middle East, Central Africa, Europe, and North America. With variegated interests spanning Building Materials, Chemicals, Pharmaceuticals, Energy, Textiles, Automotive, and Real Estate Development, Mr. Muhammad Ali Tabba has significantly contributed to YBG's growth and diversification, solidifying its position as a global player in multiple industries

Profile of the CEO:
Mr. Muhammad Sohail Tabba is a renowned business leader and philanthropist in Pakistan, heading the YBG

RATING RATIONALE

Corporate Profile
Gadoon Textile Mills Limited ('GTML' or 'the Company') primarily operates within the business-to-business (B2B) segment of the textile industry. Its core activities encompass the manufacturing and sale of yarn and knitted bedding products. Furthermore, the Company has diversified its operations into the dairy sector, where it engages in the production and sale of milk with a current herd size of over 1300 animals. GTML has manufacturing facilities in two regions - North and South of Pakistan. Koyal and Peach are the two leading brands of the Company in the market.

Group Profile
GTML's credit rating draws comfort from its affiliation with the YBG, a reputable conglomerate with a strong financial profile and presence in diversified sectors including textile, building materials, real estate, power generation, chemicals, pharmaceuticals, food, philanthropy, automotive and mobile assembling.

Environment, Social & Governance (ESG) Initiatives
The Company duly complies with environmental laws and is continuously working to improve the environmental management system and to voluntarily comply with new global reporting initiatives. The management of the Company encourages and is keen to explore environment-friendly practices against the goal set for which they are responsible. The Company has invested in a Biological Waste Water Treatment Plant (BWTP) capable of processing millions of gallons of toxic water annually before discharging it from the dye plants. Additionally, a state-of-the-art Waste Heat Recovery Steam Gas (WHRSG) plant, low-voltage LED lights, and a unique manufacturing area infrastructure have collectively saved 15.1 million units of electricity in FY'2023. Similarly, the Company has invested in a Solar plant at the production facility. Furthermore, the Company plans to replace fuel with batteries for its forklifts to reduce its carbon footprint. An Effluent Treatment Plant (ETP) has also been installed to process animal waste, resulting in the production of 90 metric tons of cardboard paper from animal waste. The Company has planned to plant 40,000 trees by the year 2030. The Company's social responsibility is achieved through compliance with relevant legislation and codes of practice, and effective management of social, economic, and environmental impacts.

Investment Portfolio
The Company holds investments of less than 20% in the entities mentioned below. Nevertheless, these investments are categorized as associates due to the Company's substantial influence over their financial and operational strategies, facilitated by its representation on the respective Boards of Directors of these entities.

Table 1: Investment Portfolio (% shareholding)

	Entities	Ownership
Associates	Lucky Core Industries Limited (LCI)	***7.21%***
	Lucky Holdings Limited (LHL)	***1.00%***
	Yunus Energy Limited (YEL)	***19.99%***

conglomerate encompassing textiles, cement, energy, entertainment, real estate, and philanthropy. With over 30 years of leadership, he has earned acclaim for his group and the nation. He's the CEO of Gadoon Textile Mills Limited and Lucky Knits (Private) Limited, as well as a director for various firms. Mr. Muhammad Sohail Tabba is known for chairing Lucky Core Industries Limited and Lucky Cement Limited. He's the visionary behind LuckyOne Mall and Onederland, a world-class children's entertainment facility. His broad social presence includes involvement in educational institutions and the Italian Development Council.

Key Rating Drivers

Business risk remain elevated amid weak macroeconomic environment, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand. All these factors pose a challenge to the sector in terms of margins sustainability and future growth.

Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports broke the threshold, clocking in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and provides employment to about 40% of the industrial labor force[1]. Contributing around 8.5% to the country's gross domestic product (GDP), with an estimated market size of around Rs. 4.0tr, textile sector has maintained an average share of about 60% in national exports over the years.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22	FY23
Pakistan Total Exports	22,536	25,639	32,450	27,911
Textile Exports	12,851	14,492	18,525	16,710
PKR/USD Average rate	158.0	160.0	177.5	248.0

Source: SBP

The lingering effects of Covid-19 pandemic continue to shape the Pakistan's textile industry. Initially, as lockdowns lifted, the industry capitalized on opportunities, securing production contracts with Western countries. This redirection of substantial volumes to Pakistan, was complemented by government import tax reductions and subsidized covid-related financing programs such Temporary Economic Refinance Facility (TERF), spurred robust export growth during FY20-22. However, a subsequent phase presented new challenges. Global interest rate hikes aimed at curbing post-pandemic inflation, coupled with geopolitical unrest such as the Ukraine conflict, led to supply chain disruptions and energy crisis. These factors led to a global demand slowdown in major textile economies, reflected in a ~15% year-on-year decline in Pakistan's textile exports in FY23, totaling USD 16.5b (FY22: USD 19.3b). Knitwear, Readymade, and Bed wear segments remain key contributors, making up over 60% of the textile exports.

Table: Textile Export Details (in USD millions)

	FY20	FY21	FY22	FY23	YoY FY23
High Value-Added Segment	**9,669**	**12,427**	**15,611**	**13,576**	**-13%**
- Knitwear	2,794	3,815	5,121	4,437	-13%
- Readymade Garments	2,552	3,033	3,905	3,492	-11%
- Bed wear	2,151	2,772	3,293	2,692	-18%
- Towels	711	938	1,111	1,000	-10%
- Made-up Artides	591	756	849	693	-18%
- Art, Silk & Synthetic Textile	315	370	460	412	-10%
- Others	555	743	872	851	-2%
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,719**	**2,926**	**-21%**
- Cotton Cloth	1,830	1,921	2,438	2,022	-17%
- Cotton Yarn	984	1,017	1,207	844	-30%
- Others	43	34	74	60	-20%
Total	**12,527**	**15,399**	**19,330**	**16,502**	**-15%**

Source: PBS

[1] https://www.brecorder.com/news/40179021

Flash floods in Sindh and Southern Punjab from last year's monsoon wreaked havoc on the cotton crop. This catastrophe led to a historic low yield of 4 million bales in 2022, compared to a 12 million bales annual demand. Local cotton prices subsequently reached a 12-year high of over Rs. 22,000 per 40kg during the year, and imports rose by ~20% in USD terms for FY22, vis-à-vis preceding year. This situation heightened working capital needs, adversely affecting profit margins and liquidity profile for textile entities, particularly spinners, weavers, and dyeing companies. On a positive note, the production target for the current season is set at 12.7 million bales, supported by favorable weather and timely government intervention. During Q1FY24, 4.0 million bales have already been produced, marking an impressive 80.0% increase compared to the same period last year.

The industry is facing business risk due to weak macroeconomic environment both globally and locally, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand, primarily from North America and Europe.

Previously, the sector also enjoyed incentives provided by the government through a five-year textile policy (2020-25), including preferential energy rates, low-interest financing schemes, and timely payments of various refunds, easing liquidity constraints for local players. However, the prevailing economic instability led to the reduction or withdrawal of many of these supports. This along with contractionary monetary policy and political uncertainties in the country are the key present business risk factors. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future prospects of textile exports.

Despite falling volumes, revenue growth continues, supported by consistent rupee depreciation and higher per unit prices.

In FY23, the Company experienced an upswing in sales revenue, registering a growth of 5.8% Y/Y. The total sales revenue reached a historic high of Rs. 58.0b, compared to Rs. 54.8b in FY22. This growth was primarily attributed to an increase in effective per-unit prices. The current sales composition reveals that the majority, 89%, is attributed to spinning, 10% is from knitting, and the remaining portion is derived from milk sales. The decline in export (direct and indirect) sales, is evident in the export-to-local sales ratio, which transitioned from 66:34 in the previous year to 51:49 in FY23.

Going forward, the management anticipates growth in exports and projects total revenue to increase in the range of 20% - 30% in FY24. However, net margins are expected to stay under pressure mainly due to higher forecasted finance costs.

After peaking in FY22, profitability margins have returned to historic levels; profit from associate continue to support the bottom-line.

The Company's profitability margins reached their peak in FY22, driven by higher yarn prices, a growing customer base for knitted bedding products value-added segment in export markets, and inventory gains. However, the current year saw a regression to historical norms, primarily influenced by elevated raw material prices due to the depreciating rupee value, escalated power expenses attributable to increases in gas tariffs & electricity rates, and higher conversion costs in comparison to the preceding period. All of which resulted in a decrease in gross margin. Management anticipates these margin levels to persist in FY24.

In FY23, there was an increase of approximately 11.2% in raw material expenses compared to FY22. Imported raw materials now constitute a substantial portion, accounting for 62.8% of the overall raw material procurement costs incurred during FY23. The rise in administrative expenses appears to be concomitant with the prevailing inflationary trends. Conversely, the distribution costs have exhibited a decline, primarily owing to the contraction in overall export sales and the concurrent reduction in shipping freight expenses compared to the same period last year (SPLY). Notably, the uptick in financial charges is a result of elevated benchmark interest rates and the growing requirements of working capital, offsetting any increase in profitability buoyed by the share of profits from associates.

Debt service coverage dipped while remaining in line with industry peers and high inventory holding days have led to elevated cash conversion cycle.

In FY22, the Company witnessed a significant increase in adjusted Funds from Operations (FFO) (adjusted for dividend income received), primarily because of heightened profit generation. However, FY23 presented a contrasting scenario characterized by a decline in profit before tax and a surge in financial charges, resulting in a notable contraction in cash-flow coverages. Resultantly, the Debt Service Coverage Ratio (DSCR) experienced a reduction to approximately 2.01x (FY22: 5.66x) in FY23, albeit remaining within a range consistent with industry peers. While the current ratio of over 1.19x lags behind peers, an extended cash conversion cycle, due to higher inventory holding days, amplifies reliance on short-term finance. The aging profile of trade debts remains sound. During the rating horizon, the liquidity profile is expected to maintain at the same level, supported by a sustained level of projected profitability.

Strong bottom-line performance fueled equity growth. Nevertheless leverage ratios was higher than industry peers.

In FY23, the Company witnessed growth in its equity base, registering an approximate 15% Y/Y increase, primarily driven by a positive bottom line. A dividend of Rs. 560.6m was disbursed in FY23, marking a payout ratio of 9.8% in line with historical levels. The Board of Directors (BoD) of the Company in its meeting held on June 22, 2023, decided to set aside PKR 16.5b for long-term investments, capacity expansions, and BMR, and cannot be distributed as dividends. This amount is now designated as a capital reserve in the financial statements and is not available for distribution by way of dividends. Throughout FY23, the Company undertook a significant capital expenditure of PKR 11.5b, primarily allocated to the establishment of value-added units totaling PKR 4.8b, expected to commence operations at the beginning of the upcoming year, as well as the procurement of efficient generators totaling PKR 1.5b and replacement of obsolete machinery with technologically advanced machines totaling PKR 5.5b. Going forward, the Company plans to in-house the dyeing process as well.

Debt profile is a blend of short-term and long-term debt, with total interest-bearing liabilities increasing drastically to Rs. 25.6b (FY22: Rs. 10.9b; FY21: Rs. 9.7b) at end-FY23. This substantial increase can be attributed to long-term debt and short-term borrowings, experiencing a remarkable surge of 112% and 153%, respectively compared to SPLY. This aligns with the strategic utilization of long-term debt to facilitate the financing of expansion initiatives discussed above and short-term debt to cater to heightened working capital needs. Consequently, Gearing and leverage ratios were also reported higher at 1.24x (FY22: 0.60x) and 1.86x (FY22: 1.27x) making it higher than industry peers. In the coming period, due to no significant utilization of long-term debt for financing expansion initiatives, combined with the projected expansion of the equity base through retained profits, capitalization indicators are forecasted to decline gradually during the rating horizon.

Sound corporate governance framework anchored by a well-structured organizational layout and experienced management team.
GTML maintains a well-structured organizational framework, characterized by discrete departments responsible for core functions, each overseen by its own dedicated management team. The Company benefits from sponsors possessing substantial expertise within the textile sector, bolstering the overall strength of its governance framework.

The composition of the 8-member board includes two independent directors and a non-executive director who is female, indicative of a commitment to diversity and independence within the board's composition.

Furthermore, to ensure the highest standards of transparency and governance, GTML has established specialized committees for Audit and HR and remuneration, which extend their purview across the organization, encompassing both operational and departmental aspects. This diligent approach to committee oversight underscores the company's commitment to robust governance practices.

Gadoon Textile Mills Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**FY23**
Fixed Asset	10,165.0	10,253.6	11,016.8	21,242.8
Long term investments	3,150.6	3,570.6	4,233.6	5,497.7
Stock-in-Trade	12,914.4	10,877.3	18,381.4	23,408.1
Trade Debts	2,333.0	4,038.4	3,751.4	2,972.1
Cash and Bank Balance	86.1	143.2	159.8	265.2
Total Assets	**30,833.4**	**31,226.2**	**40,823.1**	**59,239.2**
Trade and Other Payables	4,181.7	7,101.9	9,798.2	9,278.2
Long-Term Borrowings *(Incl. current maturity)*	3,594.8	4,641.4	4,771.6	10,098.6
Short-Term Borrowings	12,362.1	5,038.8	6,118.0	15,462.4
Total Debt	15,956.9	9,680.2	10,889.6	25,561.0
Total Liabilities	**21,748.8**	**18,616.1**	**22,820.0**	**38,548.0**
Paid-up Capital	280.3	280.3	280.3	280.3
Total Equity	**9,084.4**	**12,610.1**	**18,003.1**	**20,691.2**
INCOME STATEMENT				
Net Sales	28,986.8	41,009.8	54,828.1	57,997.2
Gross Profit	2,241.3	4,975.6	8,341.2	6,167.8
Operating Profit	830.2	4,703.6	8,021.7	6,472.0
Profit Before Tax	**337.7**	**4,026.1**	**6,918.1**	**4,782.3**
Profit After Tax	**45.5**	**3,534.1**	**5,713.6**	**3,291.9**
RATIO ANALYSIS				
Gross Margin (%)	7.7%	12.1%	15.2%	10.6%
Net Margin (%)	0.2%	8.6%	10.4%	5.7%
Net Working Capital	475.3	4,060.1	8,078.7	5,156.5
Current Ratio (x)	1.03	1.31	1.47	1.19
Adjusted FFO	703.0	4,122.9	6,954.1	4,237.2
FFO to Long-Term Debt (%)	19.6%	88.8%	145.7%	42.0%
FFO to Total Debt (%)	4.4%	42.6%	63.9%	16.6%
DSCR (x)	1.57	6.57	5.79	1.95
Gearing (x)	1.76	0.77	0.60	1.24
Debt Leverage (x)	2.39	1.48	1.27	1.86
Inventory + Receivable/Short-term Borrowings (x)	1.23	2.96	3.62	1.71
ROAA (%)	0.2%	11.4%	15.9%	6.6%
ROAE (%)	0.5%	32.6%	37.3%	17.0%

REGULATORY DISCLOSURES — Appendix II

Name of Rated Entity	Gadoon Textile Mills Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		Rating Type: Entity		
31/10/2023	A+	A-1	Stable	Reaffirmed
02/11/2022	A+	A-1	Stable	Reaffirmed
30/11/2021	A+	A-1	Stable	Reaffirmed
13/11/2020	A+	A-1	Stable	Maintained
24/4/2020	A+	A-1	Rating Watch - Developing	Maintained
13/12/2019	A+	A-1	Stable	Reaffirmed
29/10/2018	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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Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Muhammad Imran Moten	CFO	27th September, 2023
Mr. Muhammad Umair	Company Secretary and Financial Controller	
Mr. Abdul Jabbar Raja	GM Finance	
Mr. Muhammad Usman Rauf	Deputy Manager Accounts and Finance	