RATING REPORT

Indus Home Limited

REPORT DATE:
May 8, 2019

RATING ANALYST:

Talha Iqbal
talha.iqbal@vis.com.pk

Muhammad Tabish
muhammad.tabish@vis.com.pk

RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	*May 8, 2019*	

COMPANY INFORMATION	
Incorporated in 2006	**External auditors:** M/s EY Ford Rhodes Chartered Accountants
Public Unlisted Company	**Chairman:** Mr. Mian Mohammad Ahmed
Key Shareholder (s):	**CEO:** Mr. Irfan Ahmed
Indus Dyeing and Manufacturing Company Limited – 99.99%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (May 2016)*
http://www.vis.com.pk/docs/Corporate-Methodology-201605.pdf

Indus Home Limited

OVERVIEW OF THE INSTITUTION

Indus Home Limited (IHL), a wholly owned subsidiary of Indus Dyeing and Manufacturing Company Limited (IDMC), was incorporated in Pakistan as a Public Unlisted Company on may, 2006. IHL is involved in the business of griege, terry towel and other home textile products.

Profile of Chairman

Mr. Mian Mohammad Ahmed laid the foundation of the Indus group of companies by setting up cotton ginning factories and later on establishing textile spinning. He is responsible for strategic and corporate planning.

Profile of CEO

Mr. Irfan Ahmed is the CEO of the company; possess BSC Textile Engineering Degree from USA and a vast knowledge of Terry Towel Industry with ten years' experience. He is a director in IDMC and Sunrays

RATING RATIONALE

Group Profile

Indus Home Limited (IHL), incorporated in 2006, is a wholly owned subsidiary of Indus Dyeing and Manufacturing Company Limited (IDMC). The company is a part of Indus Group of Companies, which enjoys a reputable market position in textile business with an annual turnover of over US$300m.

Within textile sector, Indus Group has over five decades of experience and operates through five entities. The group is primarily engaged in the business of cotton ginning, yarn spinning, greige fabric manufacturing and home textiles (primarily towel business). Furthermore, the group is also investing in a 50MW wind power project. IDMC is the flagship company in the group.

Operations

IHL's core business operations include production and export of griege and finished terry cloth and other textile products. Head office of the company is based in Karachi and the towel manufacturing and finishing facility is located in Raiwind near Lahore. At present, the company's operations encompass weaving, dyeing and fabrication. IHL has an installed capacity of 120 air jet looms; 96 remained operative during 2018. Capacity utilization has remained low at 57% (FY18: 59%; FY17: 58%) during HFY19 due to limited business orders. Power requirement is met through a gas based captive power plant and national grid.

Efficiency Enhancement & Expansion Plans

Going forward, management has rolled out a three year capex plan to enhance operational efficiency and expand business operations. Planned capex for 2019 and 2020 pertains to replacement of existing looms (replacement of 24 old Dornier looms with Picanol looms) and dyeing machinery. Moreover, the company also plans backward integration of operations through setting up of spinning facility. The project is expected to come online in 2021. Entire cost of project will be arranged through concessionary rate long-term financing facility (LTFF). Moreover, the expansion is projected to result in reduced cost of production and improved margins.

Key Rating Drivers

Business risk profile supported by favourable industry dynamics and increased opportunities for growth.

Total textile exports depicted strong growth of 14% during FY18 with increase being driven by the value added segment. While pace of growth in textile exports has slowed down in the ongoing year, VIS expects double digit growth in textile exports over the medium term as impact of planned and ongoing capacity expansion along with supportive government policies kicks in. Supportive government policies for the textile sector are evident from availability of electricity at competitive rates, sizeable rupee depreciation over the last 18 months, availability of funding lines at concessionary rates and commitment for timely release of outstanding refunds. Moreover, improving perception (opening of visa regimes) and law and order situation is facilitating buyers to visit the Country and place orders. Major buyers are also looking to diversify their procurement from China (ongoing trade war between USA and China and increasing cost of doing business in China) and Bangladesh (protest against low wages in Bangladesh) which is expected to result in a gradual shift in orders to Pakistan. Nonetheless, key business risk factors include slow-down in major markets, inability to pass on increase in input cost, increase in competition from other regional countries and exit of a major customer.

Sales have depicted growth in FY18 and in the ongoing year on the back of higher average selling prices. USA and Europe remain core markets with clients comprising a mix of institutional brokers and direct clients. Deepening in relationship with existing clients and diversification into non-traditional markets is planned to achieve volumetric growth in sales.

IHL is primarily an export-oriented company with around 98% of total sales comprising exports. Sales have depicted a growth of 9% during FY18. Given the sizeable increase in average selling prices due to rupee depreciation, net sales were higher by 26% during 9MFY19 and stood at Rs. 5.3b (9MFY18: Rs. 4.2b). Major export markets include US, UK and other European countries. Management has been working on further developing and strengthening sales channels in these traditional markets while also looking to diversify into non-traditional markets including MENA, China and Russia. Further penetration and orders from existing customers is also being focused to enhance sales. Client base includes a mix of institutional brokers and direct clients. Client concentration risk is considered on higher side with top 10 clients contributing around four-fifth of total sales. However, comfort is drawn from lengthy association with major clients. In terms of product-wise sales mix, around 80% of the sales revenue emanates from bath towel followed by bathrobe. Other products include hand towel and body sheets.

Improvement witnessed in profitability margins in the ongoing year. Margins expected to revert to historical levels in the absence of sizeable rupee depreciation.

Gross margins of the company have depicted volatility over last three years ranging between 11% and 15%; reported at a low of 11.7% (FY17: 14.5%) during FY18. Decline in gross profit was attributed to increase in proportion of commission based sales on a timeline basis along with rise in cost of inputs (raw materials by 14%, fuel 23% and salaries by 18%). However, given the significant rupee depreciation gross margins were reported higher at 15.3% (9MFY18: 11.2%) during 9MFY19. Exchange gain due to rupee devaluation supported the overall profitability. The company posted profit after tax (PAT) of Rs. 341.6m in 9MFY19 vis-à-vis Rs. 146.7m in the corresponding period last year. Going forward, gross margins are expected to normalize to historic levels in the absence of sizeable rupee depreciation. Management is focusing on enhancing efficiencies in order to support margins.

Liquidity profile is supported by adequate cash flows and sound debt servicing ability.

Liquidity profile of the company is considered sound with adequate cash flows to cover outstanding debt repayments. However, higher utilization of short term borrowings during the ongoing year has resulted in reduction in cash flow coverage multiples. Furthermore, trade debts have witnessed a significant increase on a timeline basis due to increase in credit terms of existing clients, shift of few major customers from advance to deferred payment terms and increase in higher undiscounted foreign currency receivables at end-9MFY19 to avail devaluation benefit. However, aging profile of the same remains within manageable levels. Stock in trade and trade debts are well in excess of short term borrowings (149.1% at end-9MFY19) while current ratio has historically remained consistently at over 1(x).

Sound capitalization indicators.

Equity base of the company has grown to Rs. 4,335.2m (FY18: Rs. 3,992.7m; FY16: Rs. 3,667.8m) at end-9MFY19. On a timeline basis, equity base has observed an increasing trend on account of profit retention and no dividend payout policy. More than three-fifth of total debt comprises short term borrowings to fund working capital requirements. Total debt amounted to Rs. 3.2b (FY18: Rs. 1.4b) at end-9MFY19, increase in which is attributable to higher short term debt (ERF). Gearing and leverage indicators have increased on a timeline basis and were reported at 0.74x (FY18: 0.35x, FY17: 0.34x) and 0.95x (FY18: 0.55x, FY17: 0.50x), respectively at end-3QFY19. While leverage indicators are expected to increase given the planned debt draw down for expansion and BMR, leverage indicators are expected to remain manageable over the rating horizon.

Corporate governance framework

Board of Directors (BoD) includes seven members with extensive experience in textile sector. However, inclusion of independent directors and formation of board level committees is required to enhance board level governance. Presently, the company has implemented 'Microsoft Dynamics AX' as its ERP. The system features fully integrated modules including sales, production, inventory management, and general ledger. External auditors of the company are EY Ford Rhodes Chartered Accountants. Auditors belong to category 'A' on the approved list of auditors published by the State Bank of Pakistan.

Indus Home Limited **Appendix I**

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**Mar'19**
Fixed Assets	2,673.7	2,553.3	2,752.2	3,262.4
Stock-in-Trade	1,224.8	1,502.0	1,867.8	2,102.0
Trade Debts	340.3	455.5	891.4	1,334.8
Cash & Bank Balances	21.9	25.4	141.2	412.7
Total Assets	2,528.6	2,935.9	3,452.1	5,171.0
Trade and Other Payables	376.9	441.3	630.7	710.0
Long Term Debt	180.5	141.4	438.1	911.0
Short Term Debt	1,285.4	1,117.1	967.0	2,305.0
Total Debt	1,466.0	1,258.4	1,405.1	3,216.0
Total Equity	3,264.1	3,667.8	3,992.7	4,335.2
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**Mar'19**
Net Sales	5,206.6	5,529.1	6,025.5	5,336.9
Gross Profit	796.0	799.5	702.6	818.7
Profit After Tax	379.9	410.2	330.7	341.6
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**Mar'19**
Gross Margin (%)	15.3%	14.5%	11.7%	15.3%
Net Margin	7.3%	7.4%	5.5%	6.4%
Trade debts/Sales	6.5%	8.2%	14.8%	18.8%
FFO	670.6	734.6	657.3	592.1
FFO to Total Debt (%)	45.7%	58.4%	46.8%	24.6%
FFO to Long Term Debt (%)	371.5%	519.5%	150.0%	86.7%
Current Ratio (x)	1.48	1.85	2.11	1.68
(Stock+ Trade Debts)/ Short term borrowing	121.7%	175.2%	285.3%	149.1%
Debt Servicing Coverage Ratio (x)	7.93	7.95	8.90	8.27
Gearing (x)	0.45	0.34	0.35	0.74
Leverage (x)	0.60	0.50	0.55	0.95
ROA (%)	7.7%	7.7%	5.7%	6.2%
ROE (%)	12.4%	11.8%	8.6%	10.9%

ISSUE/ISSUER RATING SCALE &DEFINITIONS — Appendix 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					Appendix III
Name of Rated Entity	Indus Home Limited				
Sector	Textiles				
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		
	5/8/2019	A-	A-2	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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