RATING REPORT

Indus Home Limited

REPORT DATE:
July 24, 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-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Maintained	
Rating Date	*July 24, 2023*		*August 01, 2022*	

COMPANY INFORMATION

Incorporated in 2006	**External Auditors:** EY Ford Rhodes Chartered Accountants
Public unlisted company	**Chairman/ Director:** Mr. Kashif Riaz
Key Shareholders:	**CEO/Director:** Mr. Irfan Ahmed
Indus Dyeing and Manufacturing Company Limited ~99.99%	

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

Indus Home Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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. In the present, IHL is involved in production of griege, terry towel and other home textile products.

During the review period, the company underwent a transition in its leadership as they appointed a new Chairman.

Profile of Chairman

Mr. Kashif Riaz, with an MBA in Marketing from Faisalabad University, has over 20 years of experience in the Textile Industry. He currently serves as the CEO of Sunrays Textile Mills Limited and holds a director position at IDMC.

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 Textile Mills Limited.

Corporate Profile

Indus Home Limited (IHL), a wholly owned subsidiary of Indus Dyeing and Manufacturing Company Limited and part of the Indus Group, specializes in production and export of terry cloth, terry garments, and other towel/terry products. Recently, it has ventured into local yarn sales market as well. With a 17-year history, the company handles various operations such as spinning, weaving, dyeing, fabrication, and processing. Production infrastructure is based in Raiwand near Lahore, powered by over 4,500 employees (including management staff and workers).

IHL holds ISO and various other globally recognized certifications, demonstrating its commitment to high-quality standards. Average energy demand of 5MW is met via the national grid and gas-powered plants, while a mix of coal, biomass, and gas boilers is used for steam needs.

Investment Portfolio

Long-term investment currently includes its wholly owned subsidiary, Indus Home USA. During the review period, the company sold its entire investment (~24% stake) in the associate entity, Indus Lyallpur Limited, to the holding company. Management also divested Rs. 100m investment in HBL TFC and short-term investments of Rs. 1.1b in T-Bills to address financing needs.

Group Profile

Indus Group of Companies is a prominent textile group in the country, boasting an annual turnover exceeding US$300m. With over six decades of experience, the group operates five distinct entities. These include four cotton-ginning factories, five yarn-spinning mills in Karachi, Hyderabad, Muzaffargarh, and Faisalabad, and the largest terry towel factory in Lahore. The group also has a stake in a 50MW wind power project in Thatta, Jhampir, Sindh.

Environmental, Social, & Governance (ESG) Initiatives

IHL is committed to environmental sustainability, reflected through initiatives such as utilization of wastewater treatment plant, implementation of waste management systems for both hazardous and non-hazardous waste (reused & recycled), installation of solar power plant in spinning facility, and on-site plantation drives. The company is working on a decarbonization plan and aims to cut emissions by 25% by 2025 based on the Science Based Targets initiative. Additionally, management prioritizes employee education, professional skill development, and training opportunities for unskilled workers. Health and safety policies are in place and the company maintains a dedicated team to ensure a safe work environment.

In FY23, the newly established spinning unit operated at full capacity, while efficiency enhancement initiatives were implemented in both towel and spinning facility.

IHL undertook a capital expansion initiative in FY22 to achieve backward integration by establishing a spinning unit. The facility, comprising 2,880 rotors, commenced operations in May'22 and initially had a daily yarn production capacity of 510 bags, which has recently been raised to 600 bags. Total project cost stood at ~Rs. 3b, financed through long-term debt. Management reports that this strategic move has resulted in reduced production costs and improved gross margins. Nearly half of the yarn output is used in-house, while the rest is sold locally.

In addition, the company has recently upgraded its looms to newer and more efficient air-jet models, totaling 132 looms. This upgrade was accompanied by capacity expansions in dyeing, processing, and stitching operations, all funded internally. Thus, a slight increase in installed capacity of the towel facility is noted.

Operating Performance

While the spinning unit operated at full capacity, production levels for the towel facility remained consistent in FY22 and saw a drop this fiscal year due to global demand slowdown. Moreover, improvements in spinning unit efficiency are projected to lead to a ~17% increase in annual production capacity.

Table: Capacity & Production Data (Units in million)

	FY21	FY22	9M'FY23
	Spinning		
Installed Capacity (lbs)	-	3.3	14.2
Actual Production (lbs)	-	2.7	14.2
Capacity Utilization (%)	-	***82%***	***100%***
	Towel		
Installed Capacity (lbs)	28.3	29.1	21.8
Actual Production (lbs)	24.9	24.5	14.7
Capacity Utilization (%)	***88%***	***84%***	***67%***

**Spinning unit started operations in May'22*

Key Rating Drivers

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, demand slowdown, high interest rate situation, inflationary pressures and recent floods adversely affecting cotton crop while ongoing energy crisis in the country pose a challenge to 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 finally broke the threshold, coming in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr. Barring seasonal and cyclical fluctuations, textiles sector has maintained an average share of about 60% in national exports.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22		10M'FY22	10M'FY23
Pakistan Total Exports	22,536	25,639	32,450		26,858	23,211
Textile Exports	12,851	14,492	18,525		15,174	14,178
PKR/USD Average Rate	158.0	160.0	177.5		174.4	245.4

Source: SBP

Export revenues from textile sector have noted sizeable growth over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports in FY22. However, current fiscal year has been significantly impacted and 10M export proceeds (in value terms) reflect a year-on-year (YoY) decline of ~14%.

Table : Textile Export Details (in USD millions)

	FY20	FY21	FY22		10M'FY22	10M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**		**12,908**	**11,337**
- Knitwear	2,794	3,815	5,121		4,218	3,712
- Readymade Garments	2,552	3,033	3,905		3,214	2,905
- Bed wear	2,151	2,772	3,293		2,727	2,250
- Towels	711	938	1,111		928	825
- Made-up Articles	591	756	849		710	585
- Art, Silk & Synthetic Textile	315	370	460		385	343
- Others	555	743	866		725	718
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**		**3,074**	**2,372**
- Cotton Cloth	1,830	1,921	2,438		2,006	1,685
- Cotton Yarn	984	1,017	1,207		1,006	637
- Others	43	34	72		62	51
Total	**12,527**	**15,399**	**19,332**		**15,982**	**13,709**

Source: PBS

Towel exports in FY22 amounted to $1.1 billion, with an 18% annual growth, and export quantity increased by ~4% from 213,150 MT to 221,489 MT. However, towel exports were also affected by the global demand slowdown this fiscal year.

Cotton prices rose to a new 12-year high of ~Rs. 21,600/maund as of March'22, as a result of the shortage and higher input costs of fertilizer and energy. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Table: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	10M'FY23
Per Maund	8,770	8,860	13,000	17,380	20,235
YoY % Change	26%	1%	32%	34%	*n/a*

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than $2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dying companies.

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

High cyclicality and competitiveness in the spinning sector add to business risk profile.
Movement in cotton prices and cotton crop levels drives performance of spinning players in Pakistan. Given sizeable deficit in local cotton production compared to demand in recent years, cotton prices remained high. However, availability of imported yarn kept yarn prices competitive in the current fiscal year and thus resulting in weakening of profitability profile for spinning players.

Despite robust growth in sales revenue in FY22, the recent demand slowdown affected sales volume this fiscal year. The same was offset by currency devaluation and addition of local yarn sales. High concentration of clients presents a risk.
Net sales achieved strong double-digit annual growth for two consecutive years, surpassing the Rs. 13b mark in FY22. The sizeable YoY uptick of ~46% can be explained by a ~8% uptick in volumes, ~14% higher prices in dollar terms, and ~24% rupee devaluation impact. The addition of a spinning unit caused a shift in sales mix, with local sales contribution increasing from 4% in FY21 to 17% this fiscal year. This trend is further supported by a ~37% growth in exports, while local sales nearly tripled in value in FY22. The surge in local sales was driven by a sizeable growth in yarn sales attributed to regional yarn shortages.

Product wise, bathrobes, bath towels, and body sheets consistently generate over two-thirds of export revenues, with the remaining coming from other terry towel products. Meanwhile, local sales mainly include yarn sales and low-grade towels. Roughly, 15% of sales revenue is attributed to institutional clients such as hospitals and hotels, while the rest serves retails customers. Exports are diversified among 22 countries, with only UK, Singapore, and USA contributing over 10% of sales, minimizing geographic concentration risk. However, client concentration remains high, with top ten clients generating more than half of entire revenues. The predominant clients are retailers and distributors, namely Cleland Mciver Limited (UK), Westpoint Home LLC (USA), Desipro Pte Ltd (Singapore), and JYSK (Denmark).

Recent demand slowdown due to economic downturn in major world economies led to a sizeable dip in export volumes in current fiscal year. However, consistent rupee depreciation and local yarn sales helped offset the impact, resulting in revenues of Rs. 11.8b in 9M'FY23. Sales projections for FY24 stand at Rs. 18.9b.

Strategic move towards backward integration and addition of local yarn sales positively impacted gross margins; however, rising operating overheads and high financial charges have led to thinner net margins. Improving the same is crucial from a ratings perspective.
Gross margins have significantly improved during the review period, primarily driven by consistent rupee devaluation, reduced reliance on outsourced yarn, and the addition of local yarn sales. Moreover, the pilot introduction of sportswear production using synthetic polyester filament yarn from Jan'23 onwards also contributed to margin improvement. Management intends to fully launch commercial sales in FY24, recognizing the higher margins it offers.

Presently, ~45% of the manufactured yarn is utilized internally, fulfilling ~30% of the overall raw material demand. The rest is sourced locally (includes direct yarn purchases and yarn conversion), with a small portion obtained from the parent company, Indus Dyeing and Manufacturing Company Limited (IDMC). In contrast, bulk of cotton procurement, about three-fourths, comes from imports; nevertheless, there has been a recent uptick noted in utilization of local cotton during this fiscal year. Adequate stock levels are maintained to meet confirmed sales orders, with overall raw materials sourced at an average ratio of 30:70

between imports and local procurement. In the past 21 months, cotton procurement costs rose up by ~50% with increased volumes, while yarn rates surged by ~74%, but procured volumes declined this year due to lower production in towel segment.

Operating overheads, including distribution and administration costs, significantly increased during the review period due to factors like high inflation, elevated freight charges, and increased salaries. Financial charges more than doubled compared to FY21 levels, due to higher benchmarks rates, increased running finance utilization and fresh borrowings availed to finance capex, thus affecting net margins. Additionally, decline in other income resulting from the redemption of short-term investments, reduced exchange gains, losses on forward booking contracts and super taxation further weakened the bottom-line.

Cash flow generation has improved, but debt coverage metrics lag behind peers. Nonetheless, liquidity profile received significant support from the redemption of short-term investments and sale of exposure in an associate entity. Cash conversion cycle is elevated.
Despite declining net profitability, funds flow from operations (FFO) improved by 1.6x in FY22 and remained healthy in the current fiscal year, aided by sizeable export rebate received and higher depreciation expense. As a result, cash flow coverages improved yet lag behind peers. Debt servicing coverage ratio (DSCR) declined due to an increase in the current portion of long-term debt.

Current ratio despite a dip caused by the absence of short-term investments, remains above 1.2x, reflecting satisfactory liquidity position. Proceeds from liquidation of short-term investments and sale of exposure of an associate entity provided additional comfort. The coverage of short-term borrowings with trade debts and inventory remains sufficient. However, cash conversion cycle has stretched to 179 days in 9M'FY23 from 104 days in FY21, mainly due to increased inventory holding and debtor days, while credit payable days have declined. Trade debts have a satisfactory ageing profile, with majority settled within 90 days and only a few extending to 180 days.

Leverage ratios have increased over the years as additional funding was required to support backward integration efforts and growing working capital requirements.
Equity base grew by ~13% in the last 21 months, reaching Rs. 6.2b at end-9M'FY23, driven by strong profit retention. In FY21, a dividend of Rs. 50m was paid with a payout ratio of 11%. Debt profile is a mix of long-term and short-term debt, with total interest-bearing liabilities increasing to Rs. 11.1b (FY22: Rs. 10.0b, FY21: Rs. 7.1b) at end-9M'FY23; ~60% constituted short-term debt. Aggregated running finance lines amount to Rs. 10.2b, with majority being ERF facility. In the review period, the company secured a Rs. 1.9b long-term loan for setting up a spinning unit and acquiring machinery. Consequently, gearing and leverage ratios have depicted weakening on a timeline basis. As per management, the same is projected to decrease gradually in the next four years, with no dividend payout.

REGULATORY DISCLOSURES — Appendix I

Name of Rated Entity	Indus Home Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see table below
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
24/07/2023	A-	A-2	Stable	Reaffirmed
08/01/2022	A-	A-2	Stable	Maintained
05/25/2021	A-	A-2	Positive	Maintained
04/29/2020	A-	A-2	Rating Watch – Developing	Maintained
05/08/2019	A-	A-2	Stable	Initial

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Ahmed Fraz	CFO	July 05, 2023