RATING REPORT

Indus Lyallpur Limited

REPORT DATE:
September 27, 2019

RATING ANALYST:

Talha Iqbal
talha.iqbal@vis.com.pk

Asfia Aziz
asfia.aziz@vis.com.pk

RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	BBB+	A-2
Rating Outlook	Stable	
Rating Date	*20th September 2019*	

COMPANY INFORMATION	
Incorporated in 1992	**External auditors:** M/s Deloitte Yousuf Adil, Chartered Accountants
Public Unlisted Company	**CEO:** Mr. Naveed Ahmed
Key Shareholders:	
Indus Dyeing & Manufacturing Company- 99.9%	

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

Indus Lyallpur Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

OVERVIEW OF THE INSTITUTION

Indus Lyallpur Company Limited (ILCL) was incorporated in Pakistan on April 25, 1992 as a public limited company (unlisted). The principal activity of the Company is manufacturing and sale of yarn. The manufacturing facilities of the Company are located in Faisalabad.

RATING RATIONALE

Indus Lyallpur Company Limited (ILCL), incorporated in 1992, is a wholly owned subsidiary of Indus Dyeing and Manufacturing Company Limited (IDMC). Head office of the company is located in Karachi with the manufacturing facility located in Faisalabad, Pakistan. IDMC purchased ILCL's manufacturing facility from MIMA Group in 2012.

ILCL is a part of Indus Group of Companies which is a sizeable player in the country's 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

ILCL's core business relates to manufacturing of yarn from a mix of imported and local cotton. ILCL has an installed spinning capacity of 17.9m lbs of yarn with 24,960 spindles. Over the last 2 years, the company has been operating at high capacity utilization levels. Capacity utilization was reported at 93% in FY18 (FY17: 95%). Capacity utilization is planned to be increased significantly through addition of 14,500 European ring frames which is planned to be funded through a long-term finance facility at concessional rates. Completion of the expansion will enhance installed capacity of yarn by around 50%. Cost of the project is estimated at Rs. 2b; around 65% of which will be funded through concessionary rate LTFF borrowings. Remaining funding requirement is expected to be met through internal cash generation. Expansion project is expected to commence operations from February 2020.

Around one half of the yarn is produced on courser counts for Chinese denim manufacturers. The remaining half is produced on finer counts for local hosiery and knitwear manufacturers. All units of the company are operating continuously on gas and diesel based power generators. Grid based power is an alternate stand-by energy source in case of gas shortage and load shedding.

Key Rating Drivers

High cyclicality and competitiveness in spinning sector and country concentration in exports translates into high business risk profile. However, business risk profile is supported by favorable government policies and demand dynamics in the backdrop of ongoing expansion in the value added segment.

Movement in cotton prices and cotton crop levels drives performance of spinning sector players. Historically, margins and financial performance of players have depicted seasonality. Moreover, competitive intensity is high due to commoditized nature of the product. As with other local producers in the spinning sector, reliance on China as the major export market translates into some country concentration risk. However, business risk profile is supported by favorable government policies for the textile sector and given expected elevated local demand (with a number of players in the value added segment undergoing expansion). Supportive government policies for the textile sector are evident from availability of funding lines at concessionary rates and commitment for timely release of outstanding refunds. However, imposition of 17% GST on textile exports is expected to result in some increase in working capital borrowings. Actual quantum will depend on timing of release of refunds.

Sales revenue has depicted an increase in FY18 and FY19 on the back of higher average selling prices and volumetric growth. Sales mix has historically been skewed towards exports with China being the core export market with clients largely comprising stockists. However, in FY19, sales mix depicted a shift towards the domestic market owing to weak market dynamics in China. Management expects sales mix to revert to historical levels with exports being the major

contributor to topline.

Sales revenue of the company increased by 18% in FY18 and was reported at Rs. 3.2b (FY17: Rs. 2.7b). Growth in topline was a function of both higher average selling prices due to currency devaluation and higher volumetric sales in the export market. Around 66% of the total sales revenue was contributed by exports in FY18 with the remaining emanating from local market. Geographic concentration risk in exports sales is considered on the higher side with more than 90% of exports sales directed to Chinese stockists. However during FY19, sales were impacted due to US China Trade War and higher reliance on self-manufactured yarn. Consequently, contribution of export sales declined to 46% in 9MFY19. Management expects sales mix to revert to historical levels with exports being the major contributor to topline. During 9MFY19, the company recorded sales revenue of Rs. 2.7b primarily being a function of higher average selling prices supported by sizeable currency devaluation during the period.

Gross margins improved on the back of shift towards higher margin product and inventory gains. Additionally, exchange gains on foreign currency debtors have supported bottom line. Margins are expected to face pressure in the absence of inventory gains and sizeable rupee depreciation.

Gross margins (GMs) of the company have been increasing on a timeline basis with the same being reported at 9.1% during 9MFY19 (FY18: 7.6%, FY17: 5.8%). The improvement in margins is attributable to sales shift towards higher margin products, inventory gains, and currency devaluation. Overall profitability of the company is supported by other income generated through duty drawback on exports and gain on revaluation of foreign currency debtors. Given the absence of duty drawback incentive on yarn exports, other income witnessed a decline during 9MFY19. Going forward, management expects higher sales revenue to offset the impact of increase in finance cost and facilitate in maintaining profitability profile.

Liquidity profile is supported by adequate cash flows and sound debt servicing ability.
Liquidity profile of the company is considered adequate with sufficient cash flows in relation to outstanding obligations. Cash flows of the company have increased in line with improving profitability with FFO amounting Rs. 168m (FY18: Rs. 208m, FY17: Rs. 98m) during 9MFY19. However, higher utilization of short term borrowings during FY19 has resulted in slight reduction cash flow coverage of outstanding debt. Debt Service Coverage Ratio (DSCR) remains strong at 6.6x (FY17: 5.6x) in FY18. Trade debts after increasing in FY18 have declined at end-9MFY19. However, aging profile of trade debt remains within manageable levels. Stock in trade and trade debts are well in excess of short term borrowings (163% at end-9MFY19) while current ratio has historically remained consistently at over 1(x). Going forward, maintaining adequate cash flow coverage is considered important given expected increase in long term debt for expansion project.

While leverage indicators are projected to increase on account of additional debt to fund expansion, leverage indicators are projected to remain sound over the rating horizon.
Equity base of the company has grown at a CAGR of 4% over the past three years (FY16-FY19) on account of profit retention. Total debt of the company was reported at Rs. 1.2b (FY18: Rs. 1.1b) at end-Mar'2019. More than 90% of the total debt comprises short term borrowings to finance working capital requirements. Gearing and leverage indicators were recorded at 0.81x (FY18: 0.74x) and 1.01x (FY18: 0.90x), respectively at end-Mar'2019. Given projected increase in debt levels to fund expansion project, leverage and gearing indicators are expected to increase going forward. Future trend with respect to leverage indicators will be an important rating consideration.

Adequate 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 'Oracle Financials' as its ERP. External auditors of the company are M/s Deloitte Yousuf Adil, Chartered Accountants. Auditors belong to category 'A' on the approved list of auditors published by the State Bank of Pakistan. The company has also a separate Internal Audit department in place.

Indus Lyallpur Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY17**	**FY18**	**9MFY19**
Fixed Assets	1,032	1,062	1,037
Long term Investments	-	-	-
Stock-in-Trade	844	801	1,144
Trade Debts	293	807	727
Cash & Bank Balances	8	15	26
Total Assets	2,349	2,875	3,160
Trade and Other Payables	180	202	227
Long Term Debt	23	93	87
Short Term Debt	663	980	1,149
Total Debt	687	1,072	1,235
Total Equity (Without Surplus on revaluation)	1,378	1,457	1,519
INCOME STATEMENT			
Net Sales	2,719	3,196	2,776
Gross Profit	159	242	254
Profit After Tax	15	81	62
RATIO ANALYSIS			
Gross Margin (%)	5.8%	7.6%	9.1%
Net Margin	0.6%	2.5%	2.2%
Trade debts/Sales	11%	25%	20%
FFO	98	208	168
FFO to Total Debt (%)	14%	19%	18%
FFO to Long Term Debt (%)	419%	225%	258%
Current Ratio (x)	1.5	1.5	1.5
(Stock+ Trade Debts)/ Short term borrowing	171%	164%	163%
Debt Servicing Coverage Ratio (x)	5.6	6.6	3.4
Gearing (x)	0.50	0.74	0.81
Leverage (x)	0.65	0.90	1.01
ROAA (%)	1%	3%	3%
ROAE (%)	1%	6%	6%

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 Lyallpur Limited
Sector	Textiles
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings.

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
20/09/2019	BBB+	A-2	Stable	Initial