RATING REPORT

Indus Lyallpur Limited

REPORT DATE:
June 15, 2021

RATING ANALYST:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	BBB+	A-2	BBB+	A-2
Rating Outlook	Positive		Rating Watch – Developing	
Rating Date	*June 15, 2021*		*April 22, 2020*	

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

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (May 2019) **https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf**

Indus Lyallpur Limited

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.

RATING RATIONALE

Established in 1992, Indus Lyallpur Company Ltd. (ILCL) is a wholly owned subsidiary of Indus Dyeing and Manufacturing Company Limited (IDMC). IDMC belongs to the Indus group which has been operating in the textile sector for over five decades. 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 has invested in a 50MW wind power project. IDMC is the flagship company in the group.

ILCL is engaged in the manufacturing and sale of yarn for exports and the local industry. Head office of ILCL is located in Karachi, while the manufacturing facility is based in Faisalabad, Pakistan.

Capacity Utilization

During FY20, ILCL expanded its installed spinning capacity to 26.5m lbs of yarn from 17.9m lbs (based on conversion to 20s) through addition of 13,860 spindles. Moreover, the management also replaced old machinery with more efficient new machinery.

Capacity Utilization	FY19	FY20
Number of spindles installed	24,960	38,820
Number of spindles worked per annum (average)	24,830	26,595
Number of shifts per day	3	3
Installed capacity of yarn converted into 20 counts (Lbs)	17,936,100	26,203,635.00
Actual production of yarn converted into 20 counts (Lbs)	15,972,420	17,714,930.00
Capacity Utilization	89%	68%

As the capacity expansion was undertaken during the last months of FY20, the company's production remained on the lower side in comparison to the installed capacity. The company's capacity utilization was reported at 68% (FY19: 89%) during FY20. However, all the installed spindles are fully operational and expected to contribute to increase in production going forward. The management has no plans of any significant capex over the rating horizon.

Key Rating Drivers

With diversion of orders from the neighboring countries and ease in lockdown measures post COVID-19 lockdown measures locally, textile companies in Pakistan have witnessed improvement in demand dynamics, which support the business risk profile of the company. However, volatility in raw material prices and exchange rates coupled with the increasing freight costs continue to remain key risk factors

Within the spinning sector, the movement in cotton prices and cotton crop levels drives the performance of the players. Historically, margins and financial performance of players have depicted seasonality. The impact of reduction in cotton crop production and increase in freight rates on account of disruption caused by COVID-19 was experienced by the textile companies. Nevertheless, worsening COVID-19 crisis in neighboring countries led to diversion of orders to local textile industry. Resultantly, textile industry exports have posted a growth of 9% in 9MFY21 vis-à-vis 9MFY20, with value added segment being the major contributor. Majority clients of ILCL are engaged in production of value-added textile products, supporting the business risk profile of the company. Even though impact of Covid-19's third wave remains elevated, we expect the order book for the industry to remain strong in the ongoing year, easing the business risk concerns.

Limited growth was witnessed in the topline during FY20; however, significant improvement has been observed in net sales during 9MFY21 with recovery in demand and expansion in capacity. Sales mix has historically been skewed towards the exports in China. Going forward, attractiveness of prices will determine future sales mix

Sales revenue of the company increased by only 3.1% in FY20 (FY20: Rs. 3.8b; FY19: Rs. 3.6b) on account of disruption caused by COVID-19. Local sales witnessed significant decline during the period; however, growth in export sales primarily during the first nine months not affected by the pandemic more than compensated for the decline in the export sales. Around 67% (FY19: 54%) of the total sales revenue was contributed by exports in FY20 with the remaining emanating from local market (FY20: 33%; FY19: 46%). The client wise concentration risk is present within both export and local sales. Export sales are skewed towards China with more than 90% of export sales directed to the Chinese market. The concentration risk is partly mitigated through long term association with the clients.

During 9MFY21, the company reported sales revenue of Rs. 5.8b (9M'FY20: Rs. 2.8b) with the growth being a function of higher average selling prices and post-expansion increase in sales volumes. Given the attractive prices, exports constituted 80% of the total sales revenue. Going forward, the attractiveness of prices will determine the future sales mix between local and export markets.

Despite marginal increase in sales, lower gross margins, higher expenses and decrease in rebate income resulted in lower profitability in FY20. Profitability metrics have witnessed considerable improvement during 9M'FY21

Gross Margins of the company decreased to 6.1% (FY19: 9.2%) primarily due to last quarter affected by the COVID-19 pandemic. However, shift towards higher margin products, better pricing, and installation of more efficient machinery have contributed to improvement in gross margins to 9.9% (9M'FY20: 7.5%) in 9M'FY21. Decrease in gross profit along with higher expenses (administrative and distribution costs) and lower rebate income culminated to lower net profit of Rs. 0.4m (FY19: Rs. 126.1m) in FY20. However, subsequent improvement in gross profitability in 9M'FY21, has contributed to improvement in net profitability in 9M'FY21 (Rs. 202.1m; 9M'FY20: 73.6m). Improvement trend in profitability is expected to continue provided that recovery in demand persists and COVID-19 situation remains under control.

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 debt obligations. Cash flows of the company have varied in line with profitability, with FFO amounting to Rs. 433.4m (FY20: Rs. -16.9m, FY19: Rs. 182.9m) in 9M'FY21. The Debt Service Coverage Ratio (DSCR) stood at 4.3x (FY20: 0.7x; FY19: 2.8x) at end-9M'FY21. Inventory and Trade Debts provide healthy coverage for short-term debt obligations while current ratio has remained above 1x on a timeline basis. Trade debt ageing remains manageable. Going forward, with improving profitability and limited additional debt drawdown, liquidity profile is expected to strengthen further.

Leverage indicators are projected to improve over the rating horizon

Equity base (excluding surplus revaluation) has increased on a timeline basis. At end-9M'FY21, the equity base augmented to Rs. 2.2b (FY20: Rs. 1.5; FY19: Rs. 1.5b) on account of retained earnings and equity injection of Rs. 450m. Total debt of the company was reported at Rs. 3.9b (FY20: Rs. 3.5b; FY19: Rs. 1.5b) at end-9M'FY21. Increase in total debt was primarily a function of higher long term borrowings acquired to fund expansion in capacity and replace old machinery. Long term debt amounted to Rs. 2.4b (FY20: Rs. 2.0b; FY19: Rs. 84.1m) at end-9M'FY21. Short term borrowings are used for working capital requirements and stood at Rs. 1.54b (FY20: Rs. 1.49b; FY19: Rs. 1.46b). Given the increase in borrowings, gearing and leverage ratios stood higher at 1.75x (FY20: 2.23x; FY19: 0.98x) and 2.0x (FY20: 2.64x; FY19: 1.17x), respectively at end-9M'FY21. Given projected increase in profitability and no significant debt drawdown plans, capitalization indicators are expected to improve going forward.

Adequate Corporate Governance Framework

Board of Directors (BoD) includes seven members with extensive experience in the textile sector. Management may consider inclusion of independent directors on the Board in line with best practices. External auditors of the company are M/s 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	**FY18**	**FY19**	**FY20**	**9MFY21**
Fixed Assets	1,062.3	1,152.5	3,568.2	3,789.5
Stock-in-Trade	800.7	1,112.0	1,405.7	1,741.2
Trade Debts	807.3	973.0	534.8	1,005.2
Cash & Bank Balances	15.0	33.8	16.0	16.7
Total Assets	2,874.9	3,517.2	5,989.7	6,934.5
Trade and Other Payables	201.6	222.1	579.3	498.3
Long Term Debt	92.5	84.1	2,042.4	2,369.4
Short Term Debt	979.9	1,461.0	1,488.0	1,540.6
Total Debt	1,063.6	1,534.6	3,514.6	3,824.7
Paid up Capital	1410.4	1410.4	1410.4	1860.4
Total Equity (Without surplus revaluation)	1,456.6	1,582.6	1,585.2	2,237.4
INCOME STATEMENT				
Net Sales	3,195.9	3,697.4	3,815.2	5,899.7
Gross Profit	242.0	339.6	233.0	584.1
Profit Before Tax	93.9	172.6	31.1	271.0
Profit After Tax	81.2	126.1	0.4	202.1
RATIO ANALYSIS				
Gross Margin (%)	7.6%	9.2%	6.1%	9.9%
Net Margin	2.5%	3.4%	0.0%	3.4%
FFO	207.8	182.9	(16.9)	433.4*
FFO to Total Debt (%)	19.5%	11.9%	-0.5%	14.8%*
FFO to Long Term Debt (%)	248.2%	248.2%	-0.8%	24.4%*
Current Ratio (x)	1.5	1.4	1.1	1.5
(Stock+ Trade Debts)/ Short-term Debt	164.1%	142.7%	130.4%	178.3%
Debt Servicing Coverage Ratio (x)	6.6	2.8	0.7	4.3*
Gearing (x)	0.74	0.98	2.23	1.75
Leverage (x)	0.90	1.17	2.64	2.00
ROAA (%)	3.1%	3.9%	0.01%	4.2%*
ROAE (%)	5.7%	8.3%	0.03%	14.1%*

**Annualized numbers*

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

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
15-June-2021	BBB+	A-2	Positive	Maintained
22-Apr-2020	BBB+	A-2	Rating Watch – Developing	Maintained
20-Sep-2019	BBB+	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.
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. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Zahid Mahmood	Chief Financial Officer (CFO)	20-May-2021
Mr. Akbar Adnan	Manager Accounts & Finance	20-May-2021