RATING REPORT

Indus Lyallpur Limited

REPORT DATE:
August 18, 2022

RATING ANALYST:

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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	BBB+	A-2
Rating Outlook	Stable		Positive	
Rating Date	*August 18, 2022*		*June 15, 2021*	

COMPANY INFORMATION	
Incorporated in 1992	**External auditors:** M/s Yousuf Adil Chartered Accountants
Public Unlisted Company	**Chairman:** Mr. Kashif Riaz
Key Shareholders Dec 31, 2021:	**CEO**: Mr. Imran Ahmed
Indus Dyeing & Manufacturing Company- 89.24%	
Indus Home Limited – 10.75%	

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	RATING RATIONALE

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.

Established in 1992, Indus Lyallpur Company Ltd. (ILCL) 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). The group has presence in the power sector through exposure in wind power project of 50 MW by the name of Indus Wind Energy Limited.

At end-December'21, Indus Dyeing and Manufacturing Company Limited (IDMC) and Indus Home Limited (IHL) holds 89% and 11% shares of the company respectively. In FY21, ILCL issued right shares to finance expansion plans which were subscribed by IHL. During 9MFY22, some shares held by IHL were transferred back to IDMC. By end-FY23, entire shareholding of IHL will be sold to IDMC with its holding in the company increasing to 100%.

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

Capacity Utilization

Over the past 2.5 years the company has been enhancing its spinning capacity from 24,960 spindles in FY19 to 43,370 spindles at end-June'21 thereby adding 18,410 spindles in total. Total cost of the expansion was booked at around Rs. 3b, 83% of which was financed through debt with the remaining financed through issuance of right shares in FY21. Total installed capacity in lbs have witnessed an increase of 69% from FY19-FY21. Moreover, the management regularly incurs BMR related expenditure to enhance the efficiency of available machinery. Capacity utilization level improved noticeably in FY21, as the entity was able to make full use of the expanded capacity.

Capacity Utilization	FY19	FY20	FY21
Number of spindles installed	24,960	38,820	43,370
Number of spindles worked per annum (average)	24,830	26,595	39,539
Number of shifts per day	3	3	3
Installed capacity of yarn converted into 20 counts (Lbs)	17,936,100	26,203,635	30,233,379
Actual production of yarn converted into 20 counts (Lbs)	15,972,420	17,714,930	27,5622,775
Capacity Utilization	89%	68%	91%

Key Rating Drivers

Business risk profile is supported by industry wide growth in exports over the last year

Surge in textile exports has continued in FY22 as COVID-19 related restriction are lifted across the globe. In the period July-April 2022, businesses in Pakistan earned $16.0b from the export of textile and apparel products, an increase of 26% year-on-year. Category wise, knitwear was the commodity that contributed the most, followed by ready-made garments and bed wear. With an investment plan of $3.5b in place for the sector, exports are projected to reach a figure of $21b for FY22, which will be a 40% increase over the last year.

The margins of textile companies have broadly depicted improvement despite the uptick in raw material costs, given that the same was offset by exchange rate movement. Nevertheless, higher raw material pricing has increased the working capital requirements for the companies in the sector, which is likely to weigh on the liquidity of textile players. Spinning players enjoyed inventory gains and benefits of rising yarn prices in the international market. Due to relatively high demand in comparison to the supply, cotton prices in Pakistan depicted a rise of around 80% in the first 11 months of FY22; however, a sharp decline has been observed since then. The order book for the industry is expected to remain adequate in the ongoing year easing our business risk concerns.

Sizeable growth in topline accounted by higher yarn prices along with enhanced volumetric sales due to capacity expansion.

Revenue of ILCL doubled to Rs. 7.9b (FY20: Rs. 3.8b) in FY21 largely on account of capacity expansion. Further growth was visible in 9MFY22 with sales clocking in at 9.3b supported by both volumes and prices. Export sales (direct and indirect) continue to account for a major proportion of revenue (64% in 9MFY22, 82% in FY21), with China being the main destination for direct exports. Direct exports accounted for 26% (FY21: 46%, FY20: 64%) of the total sales mix in 9MFY22. Sales mix is largely contingent on receiving better-priced orders. Hence, there has been a volatility in exports: local sales mix. For indirect exports, there is a diversified customer portfolio, which includes manufacturers of denim, home textile, and knitwear. Going forward, the management expects some reduction in the overall demand in the short-term due to a slowdown in the global market, which might restrict the growth of entity's topline. However, sustainable growth through volumetric uptick is projected going forward.

Increasing margins due to inventory gains, economies of scale and rising yarn prices internationally and locally.

Gross margin of the company was reported higher at 21.8% for 9MFY22 (FY21:10.8%, FY20: 6.1%), due to inventory gains and constant rise in yarn prices over time. With expectancy of price stabilization in the medium term, these high level of margins are not deemed sustainable. Therefore, maintaining the same within manageable levels to commensurate with the assigned ratings is considered important.

Operating expenses increased in line with the growth in sales revenue. Although finance cost of the company increased due to elevated debt levels, net margins were reported higher at 15.1% (FY21: 5.1%, FY20: 0.01%). Net profit after tax was reported at Rs. 1.4b (FY21: Rs. 400m, FY20: Rs. 0.4m) in 9MFY22. Impact of rise in policy rate over the rating horizon is expected to be off-set by projected revenue growth.

Strengthening of liquidity profile

Even though the quantum of debt has increased over the last couple of years to finance expansion, cash flow coverages improved to higher profitability. At end-9MFY22, FFO to Total Debt and FFO to Long Term Debt were reported at 39.4% (FY21: 22.8%) and 88.8% (FY21: 34.4%) respectively. Debt servicing coverage was also adequate at 4.4x (FY21: 6.9x, FY20: 0.7x), while stock in trade and trade debts provided sufficient coverage against shot-term borrowings. Going forward, a sustained level of profitability should help to maintain liquidity coverages. Working capital cycle of the company being above 100 days necessitates the utilization of short –term borrowings. Aging profile of trade debts is considered manageable with around 64% of trade receivables are not over-due with 33% being due within 90 days.

Profit retention aided in improvement of capitalization profile

Equity base of the company has depicted a substantial increase over the period Jul’20-Mar’22 and was reported at Rs. 3.8b (FY21: Rs. 2.4b, FY20: Rs. 1.6b) at the end-Mar’22. In addition to profit retention, right shares worth Rs. 450m were issued to Indus Home Limited (a related company) during FY21. Long-term debt largely comprises TERF whereas short-term borrowings comprise a mix of running finance lines, FE loans and money market funding. Risk of currency devaluation on FE loans is offset by higher export revenue.

Despite the drawdown of additional long-term debt to finance the capacity expansion project and the higher utilization of short-term financing to fulfill working capital requirements, leverage and gearing indicators have reduced and were reported at 1.71x (FY21: 1.80x, FY20: 2.64x) and 1.54x (FY21: 1.58x, FY20: 2.23x), respectively at end-Mar’22. Going forward, with limited additional drawdown of debt expected, further improvement in these indicators is considered important.

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**9MFY22**
Fixed Assets	1,062.3	1,152.5	3,568.2	3,870.8	3,982.6
Stock-in-Trade	800.7	1,112.0	1,405.7	1,336.0	3,728.9
Trade Debts	807.3	973.0	534.8	1,399.0	2,555.1
Cash & Bank Balances	15.0	33.8	16.0	28.5	27.0
Total Assets	2,874.9	3,517.2	5,989.7	7,036.6	10,629.6
Trade and Other Payables	201.6	222.1	579.3	416.5	501.6
Long Term Debt	92.5	84.1	2,042.4	2,551.4	2,615.9
Short Term Debt	979.9	1,461.0	1,488.0	1,296.6	3,284.4
Total Debt	1,072.4	1,545.0	3,530.5	3,847.9	5,900.4
Paid up Cpaital	1,410.0	1,410.4	1,410.4	1,860.4	1,860.4
Total Equity (Without surplus reval)	1,456.6	1,582.6	1,585.2	2,433.7	3,833.4
INCOME STATEMENT					
Net Sales	3,195.9	3,697.4	3,815.2	7,870.1	9,285.2
Gross Profit	242.0	339.6	233.0	851.7	2,025.8
Profit Before Tax	93.9	172.6	31.1	496.0	1,497.1
Profit After Tax	81.2	126.1	0.4	399.1	1,399.6
RATIO ANALYSIS					
Gross Margin (%)	7.6%	9.2%	6.1%	10.8%	21.8%
Net Margin	2.5%	3.4%	0.0%	5.1%	15.1%
FFO	207.8	182.9	(16.9)	877.4	1,747.1
FFO to Total Debt (%)	19.4%	11.8%	-0.5%	22.8%	39.4%
FFO to Long Term Debt (%)	224.6%	217.6%	-0.8%	34.4%	88.8%
Current Ratio (x)	1.5	1.4	1.1	1.6	1.6
(Stock+Trade Debts)/ Short-term Debt	164.1%	142.7%	130.4%	210.9%	191.3%
Debt Servicing Coverage Ratio (x)	6.6	2.8	0.7	6.9	4.4
Gearing (x)	0.74	0.98	2.23	1.58	1.54
Leverage (x)	0.90	1.17	2.64	1.80	1.71
ROAA (%)	3.1%	3.9%	0.0%	6.1%	21.1%
ROAE (%)	5.7%	8.3%	0.0%	19.9%	59.4%

**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	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. 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	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
18-August-2022	A-	A-2	Stable	Upgrade
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

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Zahid Mahmood	Chief Financial Officer (CFO)	18-July-2022
Mr. Akbar Adnan	Manager Accounts & Finance	18-July-2022
Mr. Nawaz Malik	Export Manager	18-July-2022