RATING REPORT

Indus Lyallpur Limited

REPORT DATE:
September 28, 2023

RATING ANALYST:

Asfia Amanullah
asfia.aziz@vis.com.pk

Shaheryar Khan
shaheryar.khan@vis.com.pk

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 Date	*September 28, 2023*		*August 18, 2022*	
Rating Action	Reaffirmed		Reaffirmed	

COMPANY INFORMATION	
Incorporated in 1992	**External auditors:** M/s Yousuf Adil Chartered Accountants
Public Unlisted Company	**Chairman:** Mr. Kashif Riaz
Key Shareholders:	**CEO**: Mr. Imran Ahmed
Indus Dyeing & Manufacturing Company- 100%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: 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 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-June'23, Indus Dyeing and Manufacturing Company Limited (IDMC) holds 100% (Dec'21: 89%) shares of the Company as entire shareholding of Indus Home Limited (IHL) was sold to IDMC.

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

During FY22, the Company enhanced yarn capacity through addition of spindles. Subsequently, capacity utilization levels have improved over the review period as the entity was able to make full use of the expanded capacity. Moreover, the management regularly incurs BMR related expenditure to enhance the efficiency of available machinery. During FY22 and 9MFY23, the Company incurred BMR related capex to the tune of Rs. 900m, which was largely financed through internal capital generation and only a meager Rs. 141m, was financed through long-term debt.

Going forward, in the wake of the high interest rate environment, management has decided not to pursue any expansion plans.

Capacity Utilization	FY21	FY22	9MFY23
Number of spindles installed	43,370	44,016	44,016
Number of spindles worked	39,539	43,379	43,124
Number of working days	365	365	274
Number of shifts per day	3	3	3
Installed capacity of yarn- KGs	13,713,770	13,917,993	10,452,177
Actual production of yarn - KGs	12,502,392	13,067,746	10,240,361
Capacity Utilization	91%	94%	98%

Key Rating Drivers

Business risk profile is constrained by current weak macroeconomic environment both globally and locally as evident by demand slowdown, high interest rate situation, inflationary pressures and ongoing energy crisis. These factors pose a challenge to margins sustainability and future growth.

The local spinning sector is highly organized, comprising of 477 small and large-scale spinning mills, making the industry competitive. During FY23, the overall textile industry faced significant challenges arising from flash flooding which inundated about a third of the country under water, destroying vast amounts of crops particularly in the Sindh, Southern Punjab and Baluchistan regions. About 45% of the total cotton crop was damaged, resulting in a significant drop in output to 4.76m bales during 9MFY23, against an annual target of 9m bales. Combined with higher input costs of fertilizers and energy, prices increased sharply to a 12-year high of Rs. 21,600/maund during March'23. Timeline price changes can be seen below:

Table: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	FY23	2M'FY24
Per Maund	8,770	8,860	13,000	17,380	18,500	19,200
YoY % Change	26%	1%	32%	34%	*6.4%*	*3.8%*

Moreover, quantum of raw cotton imports has decreased during FY23 due to import restrictions and severe currency devaluation, declining by about 13.2% YoY to 683,911 MT (FY22: 788,107 MT). Consequently, besides affecting profit margins, higher raw material prices increasing the working capital requirements have negatively affected the liquidity profile of the overall textile sector. Additionally, with supply and demand constraints, cotton yarn output has declined notably during FY23 by about 22.1% to 2.7m MT (FY22: 3.5m MT). Going forward, industry players expect cotton output to breach the 10m bales mark for FY24 due to favorable weather conditions, increase in minimum support price and governmental financial assistance to farmers for purchase of raw materials, particularly in Punjab. However, as per estimates, production is still projected to fall short of the annual target of 12.7m MT.

In terms of exports, textile 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 due to challenging global and local macroeconomic environment 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

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.

Topline of the company grew by 65% during FY22 largely driven by higher average selling prices; it remained stable for 9MFY23

- Net sales of the Company witnessed a sizeable jump of 65% in FY22 driven largely by higher average selling prices of yarn.
- Export sales (direct and indirect) continue to account for a major proportion of revenue (FY22: 82%; FY21: 80%), with China being the main destination for direct exports. Direct exports accounted for 36% (FY22: 20%; FY21: 42%) of the total sales mix in 9MFY23. The Company mainly caters to Asia and Europe in geographical terms.
- Customer concentration of sales mix is on a medium to high scale with top 10 customers accounting for 66% of total net sales during 9MFY23 (FY22: 36%; FY21: 43%). However, client concentration risk is partially eliminated due to long-term association with the existing clientele.
- During 9MFY23, revenue of the Company recorded a decline of 2% as compared to similar period last year.
- While management expects revenues to report a stable growth in the ongoing year in view of gradual recovery of the overall economy on national and international fronts; materialization of the same will be critical.

Margins under pressure due to elevated input costs and higher benchmark rates

- Gross margins of the Company increased during FY22 and were reported at 18.2% (FY21: 10.8%; FY20: 6.1%). Higher yarn prices coupled with favorable cotton prices resulted in inventory gains.
- However, the same deteriorated to 8.9% during 9M23 on account of increase in prices of imported raw material led by currency devaluation, higher local cotton prices, and elevated fuel expense.

- In value terms, 74% of raw materials including raw & processed cotton are imported while the remaining proportion is imported. Management expects the imported proportion of raw material to remain on the higher side exposing the Company to exchange rate volatility risk.
- Financial costs sharply increased by 118% in 9MFY23. Higher benchmark rates and greater total borrowing levels contributed towards the sharp incline.
- Due to the aforementioned, net margins of the Company also significantly weakened to 1.8% (FY22: 11.3%, FY21: 5.0%) in 9MFY23.
- Given uncertain macroeconomic environment, improving margins will be important from a ratings perspective.

Although liquidity profile weakened, the same remain within benchmarks fotr the assigned ratings

- With lower profits in 9MFY23, Funds from Operation (FFO) of the Company decreased by 65% on an annual basis. In line with the elevated quantum of debt, cash flow coverages against outstanding obligations have also witnessed weakening in the review period.
- FFO to Total Debt and FFO to Long-Term Debt declined to 11% (FY22: 43%; FY21: 23%) and 27% (FY22: 79%; FY21 34%) respectively during 9MFY23; however remain at adequate levels.
- While Debt Servicing ratio (DSCR) remain at adequate levels for the assigned ratings, the same reduced on a timeline basis to 1.62x (FY22: 4.70x; FY21: 6.80x) during 9MFY23.
- Current ratio as of end-Mar'23 stood at 1.48x, which is fairly above the minimum threshold level. Short-term borrowing coverage is deemed adequate at 177% at end-Mar'23.
- Aging profile of trade debts is considered manageable with 93% of outstanding trade receivables due within two months.
- Ratings may come under pressure with further weakening in the cash flow coverages.

Increasing leverage levels in 9MFY23, however remains within manageable levels

- Tier-I Equity base of the company depicted a slight increase of 4% by end-Mar'23 through profit retention.
- The debt profile comprises a mix of long-term (41%) and short-term borrowings (59%) at end-Mar'23.
- Growth in long-term debt over the years was to finance expansion and BMR initiatives. 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.
- Short-term borrowings increased by a staggering 81% at end-9MFY23 compared to FY22, due to higher working capital requirements in lieu of rising raw materials costs.
- With increase in quantum of debt being greater than profit retention in the review period due to increased cash conversion cycle, gearing and debt leverage ratios have depicted an uptick in 9MFY23.
- While capitalization levels have increased, gearing and leverage indicators remain at comfortable levels and were reported at 1.60x (FY22: 1.20x; FY21: 1.55x) and 1.82x (FY22: 1.41x; FY21: 1.77x) respectively, at end-9MFY23.

- Maintaining capitalization indicators at levels that commensurate with the benchmarks for the assigned ratings will be important.

REGULATORY DISCLOSURES Appendix I

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.
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Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
28-Sept-2023	A-	A-2	Stable	Reaffirmed
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
Shafqat Masood	Senior Vice President	25th August, 2023
Yasir Anwar	Chief Financial Officer	