RATING REPORT

Hantex

REPORT DATE:
February 02, 2021

RATING ANALYSTS:

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RATING DETAILS		
Rating Category	Latest Rating	
	Long-term	Short-term
Entity (Indicative)	BBB+	A-2
Rating Date	*February 02, 2021*	
Rating Outlook	Stable	
Rating Action	*Initial*	

COMPANY INFORMATION	
Incorporated in 2006	**External auditors:** Mohiuddin & Co. Chartered Accountants
Partnership Firm	**Managing Directors:** Mr. Hanif Machiyara Mr. Farhan Hanif Mrs. Shahida Hanif

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (May 2019) *https://www.vis.com.pk/kc-meth.aspx*

Hantex

OVERVIEW OF THE INSTITUTION

Hantex was incorporated as a Partnership firm in 2006. The firm is engaged in the manufacturing and indirect export of yarn and denim fabric.

HANTEX is a family owned business with shareholding vested with Mr. Hanif Machiyara and his family members.

External auditors of the firm are Mohiuddin & Co. Chartered Accountants. The firm is not categorized in the SBP Panel of auditors and do not possess a QCR rating. The firm plans to change its external auditors over the medium term and hire a firm who lie in SBP's panel of auditors.

RATING RATIONALE

Hantex deals in manufacturing and sale of yarn and denim fabric. The firm operates through a unit located at Landhi, Karachi, Pakistan spread over 500,000 square meters. Hantex belongs to the Machiyara Group of Companies which has known presence in the construction, textile, packaging, chemicals and tyre sectors. Group companies include Denim Clothing Company, Han Apparel, Denim Clothing (Pvt) Limited, SH Packages (Pvt) Limited, H2 Ready Mix, HS Create, H&H Agro, Bond Chemicals and Bond Tyres. Sponsors possess sufficient experience in the textile and denim segment.

Power requirement of the manufacturing unit is met through gas based boiler and own captive power plant. For power back-up arrangement, the plant has eleven diesel and petrol based generators installed. Hantex has compliance with major international safety and quality standards. AAPL's units are ISO14001 certified matching international quality standards. Focus on sustainability initiatives through continued investments is planned to continue.

Operations

Hantex's manufacturing unit encompasses spinning, dyeing and weaving processes. Spinning division operates with around 38,400 spindles to produce yarn; around four-fifth of which is utilized in-house to manufacture denim fabric. Annual production capacity of the same is reported at around 18m kg per year. Products range includes ring spun, open end, core spun lycra and multi count and multi twist yarns. Dyeing division involves the processes of rope dyeing, ball warping, re-beaming and sizing of the manufactured yarn. Weaving segment operates with 168 air-jet looms yielding annual production capacity of 26.4m meters. Capacity utilization has been reported at higher levels (above 90%) since the past three years. During FY20, utilization levels dipped on account of temporary plant closure due to COVID-19 lockdown. However, utilization levels regained its previous momentum in the ongoing year. As per management, no expansion plans are on board in the short to medium term.

Key Rating Drivers

Moderate business risk profile supported by stable and growing demand for denim products; US-China Trade disruption has enhanced sales as major buyers continue to diversify procurement. Even though impact of Covid-19's second wave remains elevated, we expect the order book for the industry to remain strong in the ongoing year, easing our business risk concerns.

Business risk profile is supported by stable and growing demand for denim products. VIS expects demand for denim products to remain stable over the medium term. Given the favorable policies & incentives of the government on enhancing exports and trade disruption between US and China, there is significant opportunity for local players to enhance exports. However, local and international expansion by major players is expected to keep pricing power and hence margins in check. Moreover, significant investment required by customers as part of sustainability initiative is expected to add to cost pressures for denim manufacturers. Increased expansion by leading denim and non-denim textile players is also on account of favorable demand and expected increase in orders. Even though impact of Covid-19's second wave remains elevated, we expect the order book for the industry to remain strong in the ongoing year, easing our business risk concerns.

Growth in sales revenue over the past four years has been a function of increase in both average selling prices and volumetric sales. Client concentration risk is considered on the higher side with around four-fifth of the sales revenue being contributed by sister concern; however the same is mitigated with stable order book of the sister concern with major European brands. Adequate order pipeline is expected to translate into continued sales growth, going forward.

Sales revenue of the firm has grown at a CAGR of 7% over the past four years (FY16-FY20). Sales revenue almost entirely comprises exports (direct and indirect) sales. Sales revenue declined during FY20 on account of COVID-19 induced slowdown and temporary plant closure. However, during 1HFY21, sales revenue witnessed an increase owing to sizeable order backlog. Product mix demonstrates that more than 90% of the sales revenue is contributed by denim fabric, with the remaining emanating from yarn sales. In terms of geographical concentration of direct fabric exports, around 73% of sales is generated from Dubai followed by Bangladesh contributing 21% in sales. In terms of client concentration of indirect fabric exports, around four-fifth of the sales is provided by Denim Clothing Company which is a sister concern. Consequently, client concentration is considered to be on the higher side from a ratings perspective; however the same is mitigated with stable order book of the sister concern with major European brands. Adequate order pipeline is expected to translate into continued sales growth, going forward.

Gross profitability of the company has depicted improvement over the last two years on account of higher average selling prices and efficient raw material procurement. Overall profitability profile of the firm has declined on account of higher finance cost incurred on elevated borrowings. Net margins remain on the lower side vis-à-vis peers; however witnessed an increase during 1HFY21.

Gross margins (GMs) of the firm have increased over the last 2 years due to increasing average selling prices and efficient cotton procurement. Overall net profitability of the company was negatively impacted by higher finance costs incurred on elevated borrowings. Management expects to maintain profitability levels at current levels going forward.

Adequate liquidity profile as evident by sufficient cash flow coverages against outstanding obligations.

Liquidity profile of the company is considered adequate in view of sufficient cash flows coverage of outstanding obligations; however the same compare lower as compared to FY17 and FY18 when the firm had limited finance charges. On account of elevated debt levels to finance working capital requirements, cash flow coverage of total debt decreased to 15% during FY20 as compared to 39% in FY18. Working capital cycle of the firm necessitates utilization of short term borrowing which has witnessed an increase on a timeline basis. Single client concentration in trade debts of the firm is considered high given around 92% of the same emanating from the sister concern-Denim Clothing Company. Improvement in the same is considered important. Trade debts and stock provide sufficient coverage to short term borrowings. Going forward, management envisages maintaining liquidity indicators at current levels, given no expansion plans in the medium term.

Leverage indicators have increased on a timeline basis owing to elevated debt levels. Given no projected increase in debt levels, management foresees leverage indicators to remain at similar levels, going forward.

Equity base of the firm has grown at a CAGR of 8% over the last 4 years. Total debt of the firm has been increasing on a timeline basis to finance routine capital expenditure and working capital requirements. Consequently, leverage and gearing indicators have increased to 2.77x (FY19: 2.76x, FY18: 2.11x) and 1.35x (FY19: 1.46x, FY18: 0.82x), at end-FY20, respectively. Given no projected increase in debt levels, management foresees leverage indicators to remain at similar levels, going forward.

Corporate Governance framework has room for improvement.

Given the firm's shareholding structure and involvement of owners in management roles, oversight is currently constrained. No formal board committees are in place. Ratings of Hantex are constrained by the current corporate infrastructure given firm's status of a partnership firm. Corporate governance framework can also be strengthened through improvement in board composition and oversight and documentation of a succession plan. Senior management team comprises professionals who have had a lengthy association with the firm. Functioning of the IT department is considered adequate with an Oracle based in-house developed ERP system installed since 2018. The ERP encompasses all modules for operational and financial management. Moreover, the firm also has two to three data back-up sites available. Improvement in corporate governance framework over the rating horizon shall be tracked by VIS.

Hantex **Appendix I**

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**FY20**	**HY21**
Fixed Assets	2,314	2,137	2,256	2,076	
Stock-in-Trade	692	660	1,417	1,154	1,344
Trade Debts	2,702	3,369	5,010	6,187	6,809
Cash & Bank Balances	56	123	21	87	
Total Assets	6,180	6,731	8,997	9,712	
Trade and Other Payables	1,178	1,531	1,738	1,949	
Long Term Debt	714	481	382	373	446
Short Term Debt	794	1,294	3,108	3,120	3,513
Total Debt	1,508	1,775	3,490	3,493	3,960
Paid Up Capital	NA	NA	NA	NA	
Partners' Capital	2,239	2,162	2,395	2,578	2,766
INCOME STATEMENT	**FY17**	**FY18**	**FY19**	**FY20**	**HY21**
Net Sales	6,365	7,856	8,220	7,673	4,724
Gross Profit	629	735	692	793	495
Operating Profit	482	585	562	673	
Profit Before Tax	389	420	268	253	224
Profit After Tax	328	348	205	166	172
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**	**FY20**	**HY21**
Gross Margin (%)	9.9%	9.4%	8.4%	10.3%	10.5%
Net Margin (%)	5.2%	4.4%	2.5%	2.2%	3.6%
Net Working Capital	639	506	522	876	
Trade debts/Sales	42%	43%	61%	81%	72%
FFO	704	694	454	535	313
FFO to Total Debt (%)	47%	39%	13%	15%	16%
FFO to Long Term Debt (%)	99%	144%	119%	143%	140%
Debt Servicing Coverage Ratio (x)	9.0	5.3	2.6	2.3	2.6
Current Ratio (x)	1.2	1.1	1.1	1.1	
Stock+ Trade Debts/STD	427%	311%	207%	235%	232%
Gearing (x)	0.67	0.82	1.46	1.35	1.43
Leverage (x)	1.76	2.11	2.76	2.77	
ROAA (%)	6%	5%	3%	2%	
ROAE (%)	16%	16%	9%	7%	

ISSUE/ISSUER RATING SCALE & DEFINITION 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	Hantex
Sector	Textile Industry
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.
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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				
02-02-21	BBB+	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Muhammad Imran	Financial Controller	07-Jan-2020
Mr. Zeeshan Bantva	Assistant Manager Finance	07-Jan-2020