RATING REPORT

Hantex

REPORT DATE:
April 21, 2022

RATING ANALYSTS:

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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	Stable		Stable	
Rating Date	*April 13, 2022*		*February 02, 2021*	

COMPANY INFORMATION

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

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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.

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.

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. Weaving segment operates with 168 air-jet looms yielding annual production capacity of 26.4m meters. Capacity utilization has been reported at higher levels (around 80%) since the past three years, although during HFY22, utilization levels inched down to average at 73.5%. However, as per management, utilization levels are expected to operate at almost full capacity given adequate order pipeline.

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.

Key Rating Drivers

Denim sector demand depicts gradual recovery post slowdown during COVID induced slowdown.

Demand for denim and denim garments suffered a setback during the pandemic-induced lockdowns, as consumer patterns shifted towards comfort wear, suited more for in-door living, instead of denim wear, which is considered more of an attire for outdoors. In FY21, we have noted some recovery in demand for denim products as key markets, EU & North America, have posted improvement in retail spending. With gradual demand recovery in key markets, offtake and margins of denim manufacturers have started to normalize towards its long term trend.

Volume growth to lead revenue growth however margins to remain under pressure.

Sales revenue of the Company increased to Rs. 9.1b (FY20: 7.6b) in FY21, registering an increase of 19.6% on account of growth in both volumes and selling prices. Product mix demonstrates that more than 90% of the sales revenue is contributed by denim fabric, with the remaining emanating from yarn sales. Sales remain concentrated to associated concern, Denim Clothing Company, accounting for four fifth of the sales. However, the risk is somewhat mitigated with stable order book of the sister concern with major European brands. Some of notable clients include H&M, Zara, Mango and etc. The Company has added few new clients in the ongoing year and is exploring opportunities in United States markets. During HY22, sales depict a decline to Rs. 4.1b compared to same period last year, however management remains confident of recovery in the second half to maintain the sales revenue in FY22.

Gross Margins of the Company remain under pressure and stand reduced at 9.4% (FY21: 11.2%; FY20: 12.1%) in 1H'FY22 owing to increase in cotton prices, and other raw material prices (including specialty chemicals) on account of rupee devaluation and inflationary pressures. While selling and administrative expenses remained contained in FY21 operating margins declined to 7.8% (FY21: 9.9%; FY20: 10.6%) as a trickledown effect of lower gross margins. Finance costs witnessed significant reduction in 1H'FY22 primarily due to repayment of long term loan which was supported by equity injection of Rs. 186.1m by sponsors. In absolute terms, net profit of the Company grew to Rs. 413m (FY20: Rs. 306m) in FY21 while for 1H'FY22 it stood at Rs. 168m (HFY21: Rs. 172m). Management expect margins to remain under pressure. Margin improvement over the rating horizon, however, will remain important in line with the assigned level of ratings.

Higher outstanding receivables against related party is a constraint on liquidity.

Liquidity profile of the Company is adequate with current ratio standing at 1.3x (FY21: 1.30x) and short term borrowings coverage against stock and trade debt at 238% as at end Dec'21. However, increasing working capital cycle is likely to exert pressure on liquidity profile of the Company. The Company faces working capital strain on account of extended credit terms offered by Denim Clothing given to buyers mainly on account of denim sales slowdown in European retail outlets.

	FY19	FY20	FY21	HFY22
Cash Conversion Cycle	**153**	**237**	**244**	**305**
- Days Inventory Outstanding	46	61	**42**	65
- Days Sales Outstanding	186	266	290	377
- Days Payable Outstanding	79	90	88	137

Funds from Operations (FFO) increased to Rs. 765.4m (FY20: Rs. 571.4m) in FY21 on account of higher profitability, however due to increase in working capital debt, cash flow coverage indicators stand constrained with FFO to Total Debt standing at 18% (FY20: 16%) in FY21. Debt servicing remains sound at 2.87xx (FY20: 2.38x).

Elevated gearing and leverage indicators.

Equity base of the Company has grown on a timeline on account of profit retention and equity injection by partners (HFY22: Rs. 3.7b; FY21: Rs. 3.3b; FY20: Rs. 2.7b). Total debt of the Company comprise around four-fifth of short-term borrowings to finance working capital requirements. Incorporating for indirect bill discounting as debt, leverage and gearing indicators stand elevated at 2.4x (FY21: 2.5x; FY20:2.5x) and 1.45x (FY21: 1.66x; FY20:1.89x), at end Dec'21, respectively. VIS expects gearing and leverage indicators to remain elevated till pressure on receivable eases.

Corporate Governance framework has room for improvement.

Corporate governance infrastructure in place is reflective of Company's operational status as a family owned partnership concern. Ratings remain constrained due to the organizational status of the Company.

Hantex Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**HFY22-UA**
Fixed Assets	2,256	2,076	1,908	1,718
Stock-in-Trade	1,417	1,154	962	1,988
Trade Debts	5,010	6,187	8,398	8,714
Cash & Bank Balances	21	65	147	56
Total Assets	8,997	9,690	11,580	12,647
Trade and Other Payables	1,738	1,590	2,348	3,269
Long Term Debt	382	373	226	137
Short Term Debt	4,481	4,811	5,347	5,222
Total Debt	3,490	3,493	4,212	4,634
Partners' Capital	2,395	2,749	3,348	3,708
INCOME STATEMENT				
Net Sales	8,220	7,673	9,177	4,087
Gross Profit	692	931	1,028	385
Operating Profit	562	812	905	317
Profit Before Tax	268	392	490	188
Profit After Tax	205	306	413	168
RATIO ANALYSIS				
Gross Margin (%)	8.4%	12.1%	11.2%	9.4%
Net Margin (%)	2.5%	4.0%	4.5%	4.1%
FFO	580	571	765	-
FFO to Total Debt (%)	17%	16%	18%	-
FFO to LT Debt (%)	152%	153%	338%	-
Debt Servicing Coverage Ratio (x)	3.0	2.4	2.9	-
Current Ratio (x)	1.1	1.2	1.3	1.3
ST Debt Coverage (%)	207%	235%	235%	238%
Gearing (x)*	2.03	1.89	1.66	1.45
Leverage (x)	2.76	2.53	2.46	2.41

**incorporating indirect bill discounting*

ISSUE/ISSUER RATING SCALE & DEFINITION — Annexure I

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				
21-04-22	BBB+	A-2	Stable	Reaffirm
02-02-21	BBB+	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Muhammad Imran	Financial Controller	07-Feb-2022
Mr. Zeeshan Bantva	Assistant Manager Finance	07-Feb-2022