RATING REPORT

Nadeem Textile Mills Limited (NTML)

REPORT DATE:
March 9, 2020

RATING ANALYST:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	BBB+	A-2	BBB	A-2
Rating Outlook	Stable		Stable	
Rating Date	March 9, 2020		December 18, 2018	

COMPANY INFORMATION	
Incorporated on July 15, 1984	**External auditors:** M/s. Rahman Safaraz Rahim Iqbal Rafiq Chartered Accountants
Public Limited Company	**Chairperson:** Mrs. Naila Zahid
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Zahid Mazhar
Mr. Zahid Mazhar (25.00%)	
Nadeem Power Generation (Pvt.) Ltd. (18.76%)	
Mr. Omer Bin Zahid (16.57%)	
Mr. Hassan Bin Zahid (16.58%)	
Mrs. Rafia Sultana (5.74%)	
Mrs. Naila Zahid (5.08%)	

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

Nadeem Textile Mills Limited

OVERVIEW OF THE INSTITUTION

Nadeem Textile Mills Limited (NTML) was incorporated as a public limited company in Pakistan in 1984. Financial Statements of the company for FY18 were audited by Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants

Profile of Chairman
Mrs. Naila Zahid has been associated with the group since 1993. She is responsible for strategic planning and managing business activities of the company.

Profile of CEO
Mr. Zahid Mazhar has been associated with textile business and the group since 1979. He holds bachelor degree in Commerce. He also serves as a Senior Vice Chairman of All Pakistan Textile Mills Association (APTMA) and the Director of Karachi Cotton Association (KCA).

RATING RATIONALE

Nadeem Textile Mills Limited ('NTML' or 'The Company') is primarily engaged in the manufacturing and sale of yarn to local and international market through 2 units based in Nooriabad and Kotri respectively.

Operating Performance

The company operates with 70,452 spindles through 2 units located in Nooriabad and Kotri respectively. Plant utilization improved slightly to 96.49% for FY19 (FY18: 95.60%). The difference between actual capacity utilization and full capacity can partly be explained by planned maintenance shutdown and partly by demand supply dynamics. NTML's actual production also slightly increased from 22.19mn KGs in FY18 to 22.66mn KGs in FY19.

Business Risk

NTML operates in the cotton yarn spinning business, wherein the performance is sensitive to cyclicality in cotton prices, which further determined by crop yield. Historically, margins and financial performance of players have depicted seasonality. Moreover, competitive intensity is high due to commoditized nature of the product.

Topline revenue has growth, mainly driven by indirect export sales

NTML's topline grew by 12% in FY19, which was slightly slower than prior year (FY18:23%), albeit in line with other industry participants. The growth in top line was driven by indirect export sales, which grew by Rs. 1.2b, while direct export sales reduced by Rs. 461m. Domestic sales also posted some growth, contributing about one-fifth of the uptick in topline.

Table 1: Sales (Figures in PKR' Millions)

	FY18	FY19	FY18	FY19
Local Sales	2,887	3,029	45%	42%
Exports- Direct	2,744	2,283	43%	32%
Exports – Indirect	612	1,774	10%	25%
Duty Drawback	110	-	2%	0%
Wastage Sales	88	99	1%	1%
	6,441	**7,186**		

Double-digit growth has continued in the 1H'FY20, with top line growing by 20% (1HFY20: Rs. 3.8b; 1HFY19: Rs. 3.2b).

Imporvement in profitability has been driven by growth in business volumes, in addition to better margins

NTML's profitability metrics depicted healthy improvement, which is viewed favorably. At present gross margins, the company's size of topline and profitability has become aligned with 'BBB+' rated peers.

Table 2: Profitability Metrics

	FY18	FY19	1H'FY20
Gross Margin	**8.8%**	**10.5%**	**9.6%**
Operating Margin	**5.4%**	**7.9%**	**7.3%**
Net Margin	**2.3%**	**2.8%**	**2.3%**

Given the growth in business volumes and better gross margins, the gross profit grew by 33% (FY19: Rs. 755m; FY18: Rs. 564m). The margins in 1H'FY20 have come under slight pressure, mainly as a result of higher energy costs and higher cost incurred on imported cotton (1H'FY20: 9.6%; 1H'FY19: 11.9%).

Business overheads (administrative & distribution cost) of NTML were lower by 3%, which was mainly precipitated by the drop in distribution costs. In addition, expense charged as other operating overheads was significantly lower, mainly as the company did not record any exchange losses in the period, unlike prior year.

Table 3: Overheads & Other Income

	FY18	FY19
Overheads	**222**	**201**
- Distribution Cost	87	73
-Administrative Expenses	94	102
-Others	40	26
Other Income	**3**	**16**
	218	**185**

Given the drop in overheads the operating profit was higher by 65%. However, the positive impact on topline was partly negated by the rise in finance cost (FY19: Rs. 247m; FY18: Rs. 177m). This was mainly on account of the higher benchmark rates, which on average were 350 bpts higher than the average benchmark rate in FY18

Given the uptick in finance cost and significantly higher effective tax charge, the uptick in net margin was not as sizable as the uptick in operating margin. Nevertheless, profitability margins compare favorably to similar rated peers.

Improved profitability has reinforced capitalization buffers, albeit they remain on the lower side vis-à-vis peers

Owing to prudent dividend payouts – averaging 20% in FY18-19, the tier I equity of the company has increased by 30% since Jun'18. For the purposes of gearing and leverage calculation, we have included the loan from associate and director, including the amount classified in current liabilities. All the loans from associate, including the one from director, are repayable, but their consideration as tier II equity is warranted by their stickiness, with these loans having only increased on a timeline.

Table 4: Capitalization (Figures in PKR' Millions)

	Jun'18	Jun'19	Dec'19
Tier I Equity	**727**	**908**	**960**
-Paid-up Capital	192	192	192
-Reserves	535	716	768
Tier 2 Equity	**407**	**423**	**598**
-Long from Associate (Long term)	317	333	364
- Loan from Director (Long term)	-	-	131
-Loan from Director (Current Liabilities)	10	10	30
-Loan from Associate (Current Portion)	80	80	73
Adjusted Equity	**1,134**	**1,331**	**1,558**
Gearing	**1.6x**	**1.3x**	**1.5x**
Leverage	**2.0x**	**1.6x**	**2.2x**

Table 5: Tier 2 Equity (Long-term Trend) (In PKR' Millions)

	Jun'14	Jun'15	Jun'16	Jun'17	Jun'18	Jun'19	Dec'19
Tier 2 Equity	326.1	436.7	375.3	423.5	406.8	423.0	597.8

The gearing and leverage of the company lags the peers, albeit in view of the company's internal capital generation ability, indicators are expected to improve going forward. As per management, dividend policy is expected to remain aligned with long-term trend, while capital expenditure will also remain limited.

Liquidity has certainly imrpoved, which bodes well for the company's debt repayment ability

The company operates with a cash conversion cycle close ~60 days, which is commensurate with the sector. The company operates with a capital structure of 60:40 (debt: equity). The short term borrowings remain adequately covered with inventory and trade debts, covering 1.6x of the short term borrowings as of Dec'19.

Table 6: Liquidity (Figures in PKR' Millions)

	Jun'18	Jun'19	Dec'19
Cash Conversion Cycle (Days)	**59.7**	**61.9**	**75.1**
Inventory Days (Days)	63.9	60.1	74.5
Receivable Days (Days)	32.6	40.4	53.2
Payable Days (Days)	36.8	38.6	52.6
Debt	**1,861**	**1,756**	**2,083**
-Long Term	148	85	53
-Short Term	1,713	1,671	2,030
FFO	**280.0**	**418.3**	**196.3**
FFO to Debt	**15.0%**	**23.8%**	**18.8%**
-FFO to Long Term Debt	**114.2%**	**265.3%**	**332.7%**
DSCR	**1.68**	**1.88**	**1.89***

With the uptick in business volume, the debt has not risen as much, and despite significant uptick in finance costs (owing to higher interest rate), the debt service coverage has improved on a timeline.

We have noted an uptick in trade debts on a timeline basis. Albeit comfort is derived from the sound aging profile of the trade debts and historical trend of trade debt collection.

Table 7: Trade Debts (In PKR' Millions)

	Jun'18	Jun'19	Dec'19
Trade Debts	641	950	1,260

Financial Summary (amounts in PKR millions) Appendix I

	FY18	FY19	1H'FY20
BALANCE SHEET			
Fixed Assets	1,700	1,640	1,638
Stock-in-Trade	1,232	886	1,910
Trade Debts	641	950	1,260
Cash & Bank Balances	99	144	156
Total Assets	4,109	4,216	5,429
Trade and Other Payables	686	673	1,302
Long Term Debt	245	158	118
Short Term Debt	1,616	1,599	1,965
Total Debt	1,861	1,757	2,083
Total Liabilities (excl. sponsor loan)	2,244	2,150	3,099
Paid-up Capital	192	192	192
Total Equity (incl. sponsor loan)	1,134	1,331	1,426

INCOME STATEMENT	FY18	FY19	1H'FY19	1H'FY20
Net Sales	6,441	7,186	3,159	3,791
Gross Profit	564	755	376	363
Operating Profit	346	569	290	279
Profit Before Tax	168	323	190	123
Profit After Tax	150	200	155	86

RATIO ANALYSIS	FY18	FY19	1H'FY20
Gross Margin (%)	8.8%	10.5%	9.6%
Net Profit Margin	2.3%	2.8%	2.3%
Net Working Capital	(30)	180	501
Current Ratio	0.99	1.08	1.15
FFO to Total Debt (%)	15.0%	23.8%	18.8%*
FFO to Long Term Debt (%)	114.2%	265.3%	332.7%*
Debt Servicing Coverage Ratio (x)	1.68	1.88	1.89*
ROAA (%)	4.0%	4.8%	3.6%*
ROAE (%)	24.8%	24.5%	18.4%*
Gearing (x)	1.64	1.32	1.46
Leverage (x)	1.98	1.62	2.17
*Annualized			

ISSUE/ISSUER RATING SCALE &DEFINITIONS — Appendix II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Nadeem Textile Mills 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		
	09/03/20	BBB+	A-2	Stable	Upgrade
	18/12/18	BBB	A-2	Stable	Upgrade
	12/03/18	BBB-	A-3	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.				
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Due Diligence Meetings Conducted	**Name**	**Designation**	**Date**		
	Mr. Abdul Amin Siddiqui	CFO	March 5, 2020		