# RATING REPORT

# Gohar Textile Mills (Pvt.) Limited

**REPORT DATE:**
April 18, 2020

**RATING ANALYSTS:**
Maham Qasim
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| RATING DETAILS | | | | |
|---|---|---|---|---|
| **Rating Category** | **Latest Rating** | | **Previous Rating** | |
| | **Long-term** | **Short-term** | **Long-term** | **Short-term** |
| **Entity** | A | A-1 | A | A-1 |
| ***Rating Date*** | *April 18, 2020* | | *March 26, 2019* | |
| **Rating Outlook** | Rating Watch - Negative | | Stable | |

| COMPANY INFORMATION | |
|---|---|
| Incorporated in 1980 | External Auditors: Azhar Zafar & Company |
| Private Limited Company | Chairman of the Board/CEO: Mr. Liaqat Ali |
| **Key Shareholders (More than 5%):** | |
| Mr. Liaqat Ali – 24.92% | |
| Mr. Gohar Mustafa – 44.79% | |
| Mr. Muhammad Aftab Gauhar – 20.87% | |
| Mr. Muhammad Shahzad Gohar – 6.54% | |

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

# Gohar Textile Mills (Pvt.) Limited

## OVERVIEW OF THE INSTITUTION

Gohar Textile Mills Limited (GTML) was established in 1980 in UK and an integrated operation was opened in Pakistan in 1990. The company is involved in the spinning, weaving and finished fabric.

**Profile of the Chairman/CEO**

Mr. Liaqat Ali serves as the Chairman of the Board and Chief Executive Officer. He has over 35 years of experience in the textile industry.

**Financial Snapshot**

**Total Equity**: end-HY20: Rs. 7.6b; end-FY19: Rs. 6.8b; end-FY18: Rs. 5.7b; end-FY17: Rs.5.05b

**Assets:** end-HY20: Rs. 13.2b; end-FY19: Rs. 11.4b; end-FY18: Rs. 9.49b; end-FY17: Rs. 7.82b

**Profit After Tax**: HY20: Rs. 600m; FY19: Rs. 979m; FY18: Rs. 654m; FY17: Rs. 577m

## RATING RATIONALE

**Rating Rationale**

The ratings assigned to Gohar Textile Mills (Pvt.) Limited (GTML) take into account the company's presence in export oriented value-added textile segment, positive momentum in profitability on a timeline basis, sound liquidity and extensive experience of management team in the relevant industry. The ratings derive strength from sound financial risk profile reflected by sustenance of healthy margins, low leverage indicators with limited dependence on long-term borrowings and comfortable debt service coverages. GTML operates as a family owned business with the shareholding vested among individuals of the same family. Economies of scale as a result of volumetric growth have translated to improvement in profitability on timeline basis. Sustainability in business risk profile and improvement in margins and profitability in the given rating horizon are important rating determinants going forward. Further the rating remain cognizant upon low leveraged capital structure, realization of projected targets, incremental cash flow generation from expected capital expenditure coupled with evolution of sector dynamics. However, the ratings remain constrained by overall high business risk related to inherent volatility in the textile sector.

**Competition from regional competitors on a higher side:** The significance of textile sector is exemplified by the fact that this sector contributes more than half of Pakistan's total exports. On average, textile products accounted for 59% of the country's total exports during the last three years. The demand driven price risk is largely curtailed given the demand for textile apparel in the world was recorded around US$920 billion during FY18 and it is projected to increase at a CAGR of 4.4% during the forecasted period to reach approximately US$1.2 trillion by end-FY24. In line with positive demand outlook coupled with recent rupee devaluation, the sector has significant opportunity to earn foreign exchange through textile exports; the same was somewhat capitalized during FY19 with hosiery (Rs. 285b), readymade garments (Rs. 259b) and home textile (Rs. 227m) constituting 13%, 11% and 10% respectively of the total exports of the country. However, potential revenue risk prevails on account of intense competition posed by regional competitors including India and Bangladesh in the international market. In addition, sell side risks involving sizeable energy costs shroud the actual potential of textile industry. Further, in the backdrop of increasing benchmark rates, the borrowing capacity of the local market players has been adversely impacted leading to liquidity stress. In addition, the resistance to change and inflexibility in built in the sector dynamics has hampered the capability of exporters to incorporate ever-changing consumer preferences in the product profile; the same has largely rendered exports uncompetitive in the past. In view of this, relaxation in governed policies, incentivisation of the local textile producers in terms of subsidies, conduction of trade fares and supply of uninterrupted power is likely to play a significant role in unlocking the budding potential of the segment.

**Integrated manufacturing facility:** GTML is a vertically integrated textile unit consisting of an in-house yarn manufacturing, weaving, fabric processing (dyeing, printing & finishing), CMT (Cutting, Stitching & Packing), Quilting (Wadding and Quilt making) manufacturing facility.

Yarn manufacturing unit of the company has an installed capacity of 31,680 spindles with a production capacity of 685 tons of yarn/month. Out of the total yarn requirement, around one half is internally manufactured while the remaining is procured from other local and international yarn manufacturers. The capacity utilization of spinning unit stood at 98%

(FY18: 97%) in FY19.

The company aggregate annual weaving capacity of 62m square meters increased to 68m square meters owing to installation of additional 24 airjet looms during FY19 taking the total tally of looms to 440 (FY18: 416) with 100 auto looms, 100 suzler looms and 240 airjet looms. The CAPEX on procurement of new looms was recorded at Rs. 178.0m during FY19; the entire financing was done through company's own sources. The capacity utilization of the weaving unit was recorded at 94% (FY18: 95%) during FY19. Processing function at GTML comprises fabric bleaching, dyeing, printing and finishing. Monthly fabrics processing capacity in linear meters is around 4,200,000 linear meters. The capacity utilization of the processing unit remained at 94% during FY19 as compared to 96% in preceding year. During FY19, the company made CAPEX of Rs. 106.0m for capacity enhancement of bleaching plant.

The Printing Range includes rotaries, panel and digital printing with a combined printing capacity of 100,000 meters/day. The company has 2 Reggiani machines with 15 color printing options and a working width of 3.2 meters, 1 Reggiani flat bed and 1 MS digital printing machines. The rotary, flat bed and digital machines are capable of doing standard design repeats of 640mm, 820mm and 914mm. Moreover, quality assurance department involves strict quality control procedures with routine checkup for composition, thread count, piling, absorbency, whiteness, wet & dry washing and rubbing analysis to assure that fabric is properly inspected for relevant factors before being forwarded to the next stage of production.

In order to maintain the quality of processed fabrics, the company has a testing laboratory including abrasion tester, crease recovery tester, spray tester and multi-light meter to ensures all dyed fabric is properly checked for factors including shrinkage, color and thread quality. The company has a Stitching, Wadding and Quilting unit with over 600 machines including lock stitch, over lock, multi needle, kaj button, ruffling, blind stitch, embroidery, threading and cutters etc. In atomization, the company also has multi needle quilting machines, direct filling, auto cutting, auto pillows making and embroidery machines .In the stitching unit, an aggregate CAEX of Rs. 60m was made on account of addition of over lock machine, single needle machine, metal detector machine, SMART MRT system, duvet cover and ultra-sonic quilting machine.  Therefore, the capacity of the stitching unit was enhanced to 86.8m square meters in FY19 as compared to 74.8m square meters in the preceding year. Further the capacity utilization of the stitching unit was recorded slightly higher at 85.2% (FY18: 83.1%) during FY19.

**Performance lifted by exports:** Product portfolio primarily includes plain dyed bedding, embroidered bed-sets, cushions, curtains, quilts, mattress protectors, blankets and pillows. Duvet cover sets and sheet sets are the main revenue drivers for the company constituting around 70% of the total sales mix. The breakdown of revenue mix in terms of product portfolio is presented in the table below:

| **Products** | **FY17** | **FY18** | **FY19** |
|---|---|---|---|
| Sheet Sets | 33.3% | 31.2% | 34.1% |
| Pillows, Pillow Covers, Pillow Ticks & Bolster | 10.1% | 10.2% | 10.9% |
| Cushions & Cushion Covers | 1.8% | 0.4% | 0.3% |
| Bed Sets | 3.7% | 7.0% | 1.7% |
| Curtains | 1.2% | 0.9% | 1.1% |
| Duvet Set & Duvet Cover Set | 39.9% | 38.2% | 35.6% |
| Comforters | 8.4% | 7.4% | 7.6% |

| | | | |
|---|---|---|---|
| Mattress Protector | 0.9% | 1.3% | 3.1% |
| Gowns | 0.4% | 0.6% | 1.4% |
| Blankets | 0.0% | 2.6% | 2.6% |
| Mixed Made Ups | 0.3% | 0.2% | 1.4% |
| Total | 100% | 100% | 100% |

The customers of the company include renowned international brands including K-Mart, ALDI, LIDL, Home choice, Next, Primark, Debenhams, Walmart/ASDA, Legend, Sainsbury's, Target, SIMBA, Woolworth, Turner Bianca, Gerber and MEXOM. As a result of dealing with prominent wholesale clients the client concentration was sizeable, albeit the same has a declining trend, with top-10 customers representing 56% (FY18: 67% FY17: 77%) of the total revenues during FY19. Europe is the main export market for GTML constituting for more than half of the total revenues.

Almost 80% export sales are made on credit. The company has different payments terms with different buyers with credit period ranging between 15-90 days. Exports are made on four different bases of payments including Letter Of Credit (LC), Cash against Documents (CAD), Documents against Acceptance (DAA) and Telegraphic Transfer (TT) basis. On the other hand, yarn procurement from local market is done on cash while payment period for imported raw materials ranges between 10-90 days. GTML's total power requirement is around 10MW; the same has been arranged through various sources including 9.6MW from Water and Power Development Authority (WAPDA) and 10.7MW from the company's captive power. The power supply from WAPDA is currently relatively cheap; out of the total indigenous power production, 4MW is gas based while the remaining generation is based on furnace and diesel engine.

**Profitability indicators supported by improvement in margins:** Over the last three years, sales of the company have grown at a CAGR of around 23%; moreover, the sales for FY19 were recorded 57% higher than the preceding year. The export sales remain the major revenue driver contributing around 97% to the sales mix. Net sales of the company increased during the outgoing year; the increase was a combined outcome of higher selling prices and quantity of made ups. The revenues of the company maintained a positive trajectory during the ongoing year as well with sales recorded at Rs. 7.5b during HY20; which is largely in tandem with projected revenue target of Rs. 15.3b for FY20. However, the impact of higher prices did not reflect fully on the company's margins, exhibiting a slight increase to 15.4% (FY19: 15.2%; FY18: 12.9%) during HY20 on account of increased input cost primarily pertaining to procurement of yarn & cotton coupled with higher fuel expense. As per the management, the cost of cotton increased to Rs. 9,062/40 Kg in HY20 from Rs. 8,680/40 Kg during FY18. Further, the increase in cotton prices was largely an outcome of increased proportion of imported cotton (Egyptian and Afghani) in the raw material mix owing to adherence to customer demand specifications. In addition, the hike in energy cost from Rs. 14/unit to Rs. 22/unit during the review period led to loss in margin improvement.

The distribution cost increased primarily as a result of higher freight expense owing to increase in cost of clearing and forwarding contracts and higher courier expenses in line with increase in scale of operations. Further, administrative expenses increased on a timeline basis owing to inflationary pressure, leading to annual salary adjustments together with higher headcount reported during FY19. In the backdrop of increasing average benchmark interest rates coupled with higher average short-term borrowings finance cost of the company increased during FY19 and the ongoing year. However, the increase in operating expenses and finance cost was offset by stable margins and positive momentum in revenues, therefore, GTML's bottom line was recorded higher during FY19 as compared to preceding year. The same trend in profitability was also witnessed with sizable net profit of Rs. 600.0m recorded during HY20.

Going forward, the management projects sales to grow at a CAGR of 16.8% over the next two years with gross margins expected to be maintained around 16.0%. The profitability is projected to exhibit positive momentum on account of initiation of operations of the new weaving unit in FY21 along with improvement in increase in size of business operations of the existing composite unit.

**Strong liquidity profile as evident from healthy cash flows in relation to outstanding obligations and adequate debt service ability:** Liquidity profile of the company is considered sound in view of sizable cash flows in relation to long-term outstanding obligations and sound debt service capacity. As an outcome of improved scale of operations and improvement in margins, Funds from Operations (FFO) exhibited an increasing trend and were recorded higher at Rs. 824.8m (FY19: Rs. 1.4b; FY18: Rs. 914.5m) during HY20. However, owing to increase in short-term funding, the increase in FFO to total debt was marginalized; on the other hand, FFO to long-term debt and debt service coverage remained sizeable during the period under review. According to the management, cash flows are expected to improve on account of increase in sales supported by incremental revenue from installation of air jet looms unit which are expected to come online in July'21 coupled with cost saving from improving operational efficiencies from investment in wadding, processing and stitching unit. Out of the 136 looms to be installed, the shipment of 48 looms has already been received; the same are in the installation phase. Trade receivables stood higher on account of sales growth along with PKR depreciation against USD & addition of new clients in FY19. The aging of receivables is considered satisfactory since around 3% of the total export receivables were due for more than three months. Further, there was considerable increase in stock in trade on a timeline basis in line with sizeable quantum of raw material inventory for meeting production orders received. The imported raw materials include yarn, fabric, dyes and packaging material. The current ratio is maintained at 1.5x over the review period. The sizable increase in other receivables to Rs. 1.0b (FY19: Rs.679.6m; FY18: Rs. 580.9m) was an outcome of higher sales tax and duty drawback receivable from the government.

**Conservative capital structure:** The equity base of the company has steadily strengthened on the back of profit retention and equity injection by the sponsors to the tune of Rs. 162.5m during FY19. GTML procured long-term debt during the review period to finance capex in plant and machinery of around Rs. 327m with purchase of 48 weaving machines. The entire long-term funding pertains to export based long-term financing offered by apex bank at concessional rates. However, despite procurement of additional long-term borrowing during the outgoing year, the long-term debt levels largely remained almost at prior year's level owing to regular timely payment of contractual obligations. The markup on LTFF loans ranges between 3.0% and 4.0%. However, total debt levels of the company have increased on account of higher utilization of short-term credit facilities to meet increased working capital requirements during FY19 and HY20. According to the management, the increase in short-term credit is temporary in nature, mainly pertaining to financing of work in process inventory to process orders of clients booked. Given higher short-term borrowings carried on the balance sheet, gearing and leverage indicators have witnessed an increasing trend on a timeline basis; however both remain on a lower side than industry averages. Moreover, for the procurement of the remaining 88 weaving looms entailing a total capex Rs. 700m, the company plans to obtain a long-term facility of Rs. 550m from SBP during the ongoing year. Further the management also projects an additional equity injection of Rs.237.5m and Rs. 200.0m in FY20 and FY21 respectively; hence despite procurement of long-term financing the leverage indicators are likely to decline further and remain within comfortable levels.

**Information Technology and Internal Audit function:** GTML is shifted from Oracle-based ERP software to SAP comprising modules including Financial Management, Sales and Invoicing (both export and local), Purchase Management, Production Management (Spinning, Weaving, Processing, and Folding), Human Resources Management, Inventories Management, Taxation, Gate In/Out, Employees Provident Fund and Design Studio. Majority of the computerized machines are integrated with the software solution which provides real time data on production. The internal audit team is comprises six members who conduct post and pre-audit of all the transactions.

**Gohar Textile Mills (Pvt.) Limited** **Annexure I**

## FINANCIAL SUMMARY *(amounts in PKR millions)*

| BALANCE SHEET | June 30, 2017 | June 30, 2018 | June 30, 2019 | Dec 31, 2019 |
|---|---|---|---|---|
| Non-Current Assets | 4,635 | 4,874 | 4,958 | 5,214 |
| Stock-in-Trade | 1,871 | 2,641 | 3,427 | 3,952 |
| Trade Debts | 581 | 956 | 1,765 | 2,249 |
| Other Receivables | 514 | 581 | 680 | 1,005 |
| Cash & Bank Balances | 38 | 43 | 37 | 40 |
| Other Assets | 183 | 390 | | |
| **Total Assets** | **7,822** | **9,485** | **11,396** | **13,174** |
| Trade and Other Payables | 556 | 664 | 1,034 | 1,174 |
| Short Term Borrowings | 1,606 | 2,464 | 2,829 | 3,732 |
| Long-Term Borrowings *(Inc. current maturity)* | 590 | 622 | 630 | 632 |
| Paid Up Capital | 69 | 69 | 231 | 231 |
| **Tier-1 Equity** | **3,966** | **4,705** | **5,923** | **6,675** |
| Total Equity | 5,047 | 5,701 | 6,843 | 7,560 |

| INCOME STATEMENT | June 30, 2017 | June 30, 2018 | June 30, 2019 | Dec 31, 2019 |
|---|---|---|---|---|
| Net Sales | 7,790 | 7,842 | 12,297 | 7,513 |
| Gross Profit | 1,196 | 1,178 | 1,872 | 6,359 |
| Operating Profit | 744 | 698 | 1,315 | 1,155 |
| Profit Before Tax | | 580 | 1,063 | 669 |
| Profit After Tax | 577 | 654 | 979 | 600 |
| FFO | 903 | 914 | 1,375 | 825 |

| RATIO ANALYSIS | June 30, 2017 | June 30, 2018 | June 30, 2019 | Dec 31, 2019 |
|---|---|---|---|---|
| Gross Margin (%) | 15.3 | 15.0 | 15.2 | 15.4 |
| Net Working Capital | 872 | 1,282 | 2,311 | 2,760 |
| FFO to Long-Term Debt | 1.53 | 1.47 | 2.18 | 2.61 |
| FFO to Total Debt | 0.41 | 0.30 | 0.40 | 0.38 |
| Debt Servicing Coverage Ratio (x) | 6.9 | 3.9 | 4.3 | 4.9 |
| Current Ratio (x) | 1.38 | 1.38 | 1.56 | 1.53 |
| ROAA (%) | 8.1 | 7.6 | 9.4 | 9.8 |
| ROAE (%) | 12.1 | 12.2 | 15.6 | 16.7 |
| Gearing (x) | 0.55 | 0.66 | 0.58 | 0.65 |
| Debt Leverage (x) | 0.70 | 0.78 | 0.77 | 0.84 |
| (Stock in Trade + Trade Debts)/Short Term Borrowing (x) | 1.53 | 1.46 | 1.84 | 1.66 |

## ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure 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** | Gohar Textile Mills (Pvt.) Limited | | | | | |
| **Sector** | Textile | | | | | |
| **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** | | | | | |
| | 04-18-2020 | A | A-1 | Rating Watch Negative | Maintained | |
| | 03-26-2019 | A | A-1 | 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. | | | | | |
| **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** | | **Name** | **Designation** | **Date** | | |
| | 1 | Mr. Asif Sheikh | CFO | 4-March-2020 | | |