RATING REPORT

Pak Kuwait Textiles Limited

REPORT DATE:
July 10, 2019

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	BBB+	A-2
Rating Date	*April 30, 2019*	
Rating Outlook	Stable	

COMPANY INFORMATION	
Incorporated in 1981	External Auditors: KPMG Taseer Hadi & Co. Chartered Accountants
Unquoted Public Limited Company	Chairman/CEO: Mr. Tariq Mehmood
Key Shareholders (with stake 10% or more):	
Mr. Raza Nasrullah--15.6%	
Mrs. Rubina Khalid--11.6%	
Mr. Tariq Mehmood – 11.0%	

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

OVERVIEW OF THE INSTITUTION

PKTL was incorporated in 1981 as a public limited company (unquoted) under Companies Act, 1913 (now Companies Act, 2017). The principal activities include production and trading of high quality rising spun polyester/ cotton (P/C) blended and 100% cotton yarn. Due to consistency in quality the company has achieved ISO 9001 Certification in year 2000. PKTL is a member of All Pakistan Textile Mills Association (APTMA).

Profile of the Chairman/ CEO

The company is headed by Mr. Tariq Mehmood who has around 40 years of experience of managing textile mills and is a fellow of the Institute of Chartered Accountant (England & Wales).

Financial Snapshot

***Core Equity**: HYFY19: Rs. 1.28b; FY18: Rs. 1.23b; FY17: Rs. 1.18b*

***Assets:** end-HYFY19: Rs. 3.3b; end- FY18**:** Rs. 2.1b; end-FY17: Rs. 1.8b*

***Sales:** HYFY19: Rs. 2.1b**;** FY18: Rs. 3.9b; FY17: Rs. 3.4b*

***Profit After Tax:** HYFY19: Rs. 95m; FY18: Rs. 98m; FY17: Rs. 16m*

RATING RATIONALE

The ratings assigned to Pak Kuwait Textiles Limited (PKTL) take into account moderate business risk profile of the company supported by growth in revenues, improved margins, higher profitability, and considerable relevant experience of the sponsors. The ratings draw comfort from sound liquidity position, low leverage indicators, minimal reliance on long-term borrowing and adequate coverages. However, vulnerability of spinning sector to raw material prices remains a key challenge faced by the company. The ratings also factor in full capacity utilization of existing units and lack of expansion plan. PKTL operates as a family owned business with the shareholding vested among individuals of the same family.

Profitability underpinned by improvement in margins: Albeit the spinning sector has plummeted for the last few years, the company has managed to grow its revenues and margins on timeline basis. Over the last three business cycles, the company's sales have grown at CAGR of 3.2%. Cotton polyester yarn remains the main revenue driver. During FY18, PKTL evinced notable improvement in operational performance on back of higher retail prices of yarn selling prices, favorable cotton procurement rates, improvement in production process and strict control over operational costs. The increase in sale revenues during FY18 is largely attributed to higher average yarn prices; the price per bag increased during FY18. On the other hand, the volumetric sale also showed a growth of 5.6% during the same period. Subsequently, the sizable increase in output prices contemplated positively on the company's margins. Moreover, the increase in raw material cost, comprising 70% of the total production cost, was largely streamlined; the slight increase was a function of general increase in cotton prices over time. The fuel and power expense was recorded higher in line with increased production and higher per unit cost. The administrative expenses increased slightly owing to inflationary pressure contributing to annual salary adjustments during FY18.

The net sales were recorded higher during 1HFY19; the same increase is aligned with the projected revenue for FY19. Improvement in gross margins has resulted from higher yarn prices and lower increase in input prices. Procurement of raw material to meet its working capital requirements has caused a surge in short term borrowings by the end-HFY19. As a result of growth in quantum sales together with improved margins, PKTL's profit after tax posted growth during 1HFY19. Going forward, net sales of the company are projected to grow at a CAGR of 5% for the next three years as a function of higher volumetric sales coupled with increase in yarn prices. In the backdrop of streamlined procurement cost and increasing trend in yarn prices the management projects to at least sustain gross margins at current levels.

Liquidity profile improved on the back of healthy cash flows in relation to outstanding obligations: Overall liquidity profile of the company has remained sound on account of augmentation of profits and higher funds from operations (FFO). FFO has been depicted a positive trend for the last three years driven by higher revenues coupled with improved margins. As a result, FFO to total debt improved by end-FY18. However, the improvement in FFO was offset by upsurge in short term borrowing at end-1H19. On the other hand, long-term financing, constituting less than 4% of the total borrowing mix, continued to decline in line with timely repayment of contractual obligations. With overall minimal reliance of long-term funding and improvement in internal cash generation, debt service coverage has remained strong. Going forward, given short term borrowing is projected to remain at existing level with no new procurement of long-term debt planned, the debt levels are expected to largely remain at current level in the next three years. As per management, cash flows are expected to remain robust on account of increase in sales and operational efficiencies emanating from continuous improvement in plant and machinery coupled with prospective economic changes having a positive impact on textile sector.

Leveraged capital structure with debt matrix constituting larger proportion of short term borrowings: The equity base of the company has steadily strengthened on the back of profit retention. The short term borrowings have increased in line with increase in working-capital requirements to fund higher inventory levels. The increase in short term borrowing is in line with sizeable quantum of raw material purchased for meeting the production orders received. The long-term finances include LTFF loans from commercial banks with markup ranging between 3M KIBOR+0.9% to 6M KIBOR+1.5%. All of the long term financing will be retired by 30th September, 2019. The company has started paying dividend in FY17; dividend payout was recorded at 48% by the end-FY18. As per management, the equity base is projected to strengthen further on account of positive momentum in revenues and improvement in margins.

Financial Summary *(in PKR millions)*				
BALANCE SHEET	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**	**December 31,2018**
Non-Current Assets	1,033	987	939	915
Stock-in-Trade	619	384	699	1,876
Trade Debts	114	176	192	251
Cash & Bank Balances	83	69	94	82
Stores and Spares	26	27	26	36
Advances, Deposits, and Prepayments	138	141	167	167
Other Assets	15	1	0.5	1
Total Assets	2,028	1,785	2,118	3,328
Trade and Other Payables	151	145	232	331
Short-Term Borrowings	394	203	448	1,514
Long-Term Borrowings *(Inc. current matur)*	168	131	82	58
Deferred Liabilities	110	117	111	109
Accrued mark-up	10	7	11	33
Tier-1 Equity	1,195	1,182	1,234	1,283
INCOME STATEMENT	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**	**1HY19**
Net Sales	3,039	3,343	3,872	2,143
Gross Profit	136	211	316	234
Operating Profit	44	112	223	188
Profit After Tax	(52)	16	98	95
FFO	45	107	189	155
RATIO ANALYSIS	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**	**1HY19**
Gross Margin (%)	4.5	6.3	8.2	10.9
Net Margin (%)	-1.7	0.5	2.5	4.4
Net Working Capital	383	392	448	510
Current Ratio (x)	1.6	2.0	1.6	1.3
FFO to Long-Term Debt (x)	0.27	0.82	2.29	5.36*
FFO to Total Debt (x)	0.08	0.32	0.36	0.20*
Debt Servicing Coverage Ratio (x)	1.04	1.48	2.16	3.00
ROAA (%)	-	0.82	5.04	3.49*
ROAE (%)	-	1.31	8.15	7.56*
Gearing (x)	0.47	0.28	0.43	1.23
Debt Leverage (x)	0.70	0.51	0.72	1.59
Dividend Payout Ratio (%)	0	180	48	49
(Stock in Trade+ Trade Debt) to ST Borrowings (%)	186	276	199	140

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS — 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	Pak Kuwait Textiles Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	
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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Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
April 30, 2019	BBB+	A-2	Stable	Initial