



The Pakistan Credit Rating Agency Limited

## Rating Report

### Island Textile Mills Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Sep-2019	BBB+	A2	Stable	Maintain	-
30-Mar-2019	BBB+	A2	Stable	Maintain	-
03-Dec-2018	BBB+	A2	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

Island Textile Mills Limited – a public listed company - primarily engaged in the manufacturing and sale of different varieties of yarn is majorly owned by Tata Group. Group currently owns three textile mills i.e. Island, Salfi and Tata Textile Mills Limited. The Group has also diversified into power and food sectors. Export oriented spinning industry has recently suffered as lower demand for cotton yarn from China, owing to trade war with USA, has led to lower exports volume. Island Textile enjoys strong margins in comparison to its peers due to its automated plant and ensuing operational efficiencies. The ratings of Island capture the working capital cycle of the Company which is stretched due to increased inventory days. The financial risk profile of the Company has seen some deterioration in the coverages due to prevalence of high interest rate and highly leveraged capital structure. Long association of experienced and professional management team adds comfort. Going forward, management is planning to merge all three textile entities in order to benefit from economies of scale.

The ratings are dependent on sustaining business margins while maintaining financial risk at adequate level. Prudent management of short-term liquidity and leveraging moderation would be rating essentials. Going forward, materialization of successful merger of all three textile entities would be significant to rating.

#### Disclosure

<b>Name of Rated Entity</b>	Island Textile Mills Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
<b>Related Research</b>	Sector Study   Spinning(Sep-19)
<b>Rating Analysts</b>	Muhammad Hassan   muhammad.hassan@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Island Textile Mills limited ('The Company' or 'Island Textile') was incorporated in 1970 as a public listed company engaged in the manufacturing and sale of different varieties of yarn. The Company is listed on Pakistan Stock Exchange (PSX).

**Background** Tata Pakistan took over the management of the spinning unit of already established Island Textile Mills Limited, along with Salfi Textile Mills Limited and swiftly developed a recognized name in the spinning of cotton yarns. It later established Tata Textile Mills Limited, in the early 90s, as part of expanding its expanding business base.

**Operations** The primary business of the Company is manufacturing and sale of different varieties of yarn. Functioning with two manufacturing units, the total number of spindles installed is 45,984 spindles.

## Ownership

**Ownership Structure** The CEO – Mr. Shahid Anwar Tata – along with other family members and associated companies collectively own majority (77%) shares of the Company. The remaining shareholding of the Company is majorly held by mutual funds (7%) and general public (7%).

**Stability** Tata group is one of the oldest and renowned groups of Pakistan. Third generation of Tata family has entered into the business. Although the succession plan has not been formalized but roles among Adeel Shahid Tata and Bilal Shahid Tata are clearly defined. Proper definition of roles give Tata group long-term stability.

**Business Acumen** Mr. Anwar Tata - Chairman of the company has more than 50 years of work experience, possessing strong business acumen of the Industry. Tata Family has decades of textile related business which remains key in day to day operations of the group.

**Financial Strength** Apart from Textile companies, Tata group also has interests in power and food sector. Overall financial strength of the sponsors is considered strong.

## Governance

**Board Structure** The control of the Company vests in seven members; including Mr. Anwar Ahmad Tata as the Chairman of the board. There are two executive, four non-executive and one independent director in the board.

**Members' Profile** Board members have diversified experience, and relatively long association with the Company. The Company's Chairman, Mr. Anwar Ahmad Tata has over 5 decades of experience.

**Board Effectiveness** For effective results the board has formed two committees (Audit and HR) to assist the board on relevant matters. During the year four board meetings were held with majority attendance to discuss pertinent matters.

**Financial Transparency** The External Auditors of the Company are M/s. Deloitte Yousuf Adil, Chartered Accountants. They expressed an unqualified opinion on the Company's financial statements for the half year ended June 30, 2018 December 31, 2018. The auditors fall in "Category-A" of SBP's Panel of Auditors. Audit of the Company's financial statements for the year ended June 30, 2019 is currently underway.

## Management

**Organizational Structure** Tata Pakistan has joint management at corporate head office, which wheels all the companies involved in the group. Shahid Anwar Tata – CEO primarily manages the Company's affairs, supported by a team of professionals.

**Management Team** Management team comprises long associated and experienced individuals. Shahid Anwar Tata – CEO – is a graduate with an overall experience of 42 years.

**Effectiveness** All deliberations are held at meetings conducted by department heads on "as and when needed" basis. Though there is no formal process but daily and weekly meetings are done to manage affairs.

**MIS** Island Textile deploys Oracle based Enterprise Resource Planning (ERP) system. The Company's MIS can be classified into two categories on the basis of periodicity – daily and monthly. The daily and weekly reports generated for top management mainly scrutinize production and liquidity position whereas the Company's P&L is discussed on need basis in the meetings.

**Control Environment** Island Textile's plant is connected with head office through VPN, thereby reporting on real time basis. Moreover. All the associated companies of Tata Pakistan group are ISO-9001 compliant, whereas Island Textile Mills Limited is COM4 Compact Certified, COM4 Ring Certified and has OEKO Tex Standard 100 Certification.

## Business Risk

**Industry Dynamics** During FY19, exports stagnated despite major segments including cotton cloth, knitwear, garments and bedwear displayed strong quantitative growth, industry players needed to share the benefit of the currency depreciation with their buyers which resulted in a unit price dip across all major categories, curbing overall growth. This, coupled with cotton yarn displaying double-digit quantitative decline on account of the US-China trade war as well as strong domestic demand for yarn, resulted in overall increase in exports of only -0.1% YoY. Going forward, withdrawal of textile's zero rated status will impact industry's overall liquidity and margins.

**Relative Position** With 45,984 spindles Island Textile's position in Pakistan spindle capacity is considered small. However, on group level Tata group has a better position among industry players with 127,092 spindles.

**Revenues** Island Textile's revenues come from local and export sales. During 9MFY19, the Company's revenues clocked in at PKR 4,932mln (9MFY18: PKR 4,343mln), posting a growth of 6% on account of local yarn's price During 9MFY19, Island Textile's revenue remained in favor of exports, with exports constituting 61% of total sales.

**Margins** During 9MFY19, the Company's cost of sales only increased by 3% (9MFY19: PKR 4,169mln, 9MFY18: 4,047mln). Relatively stagnant cost of goods coupled with increase in revenue resulted in gross profit margin of the Company increasing to 15.5% (9MFY18: 12.9%) and operating profit margin to 11.9% (9MFY18: 9.6%). Profitability of the Company also increased to 3.6% during 9MFY19 (9MFY18: 3.1%) on the back of higher yarn prices in the local market and currency devaluation.

**Sustainability** Island Textile maintained full capacity utilization during FY19 and no further expansion is envisaged in near future. Going forward, the management is working to increase the turnover and productivity of the Company, while reducing the cost of production.

## Financial Risk

**Working Capital** During 9MFY19, the Company's net working capital cycle increased to 165days (9MFY18: 103days) due to average inventory days increasing to 139days (9MFY18: 79days) and average receivable days to 36 days (9MFY18: 29days). The Company's trade leverage stood at a healthy 29% during the period, depicting a significant room to borrow.

**Coverages** During 9MFY19, the Company's cash flows (FCFO) increased on a YoY basis (9MFY19: 667mln, 9MFY18: 593mln) owing to improved profitability, resulting in better interest coverage ratio (9MFY19: 2.2x, 9MFY18: 0.9x). However, after the commencement of repayment of long term debt, deterioration can be seen in debt coverage ratio (9MFY19: 0.9x, 9MFY18: 1.9x). Hike in interest rate may further push coverages down.

**Capitalization** Island Textile has a highly leveraged capital structure, clocking in at 66.3% at the end of 9MFY19 (9MFY18: 68.7%). Out of the total debt 34% of the debt comprises of long-term borrowings. Going forward, in absence of any major capacity expansion, and with the gradual payments of long-term loans, the leveraging is expected to reduce over time.



The Pakistan Credit Rating Agency Limited

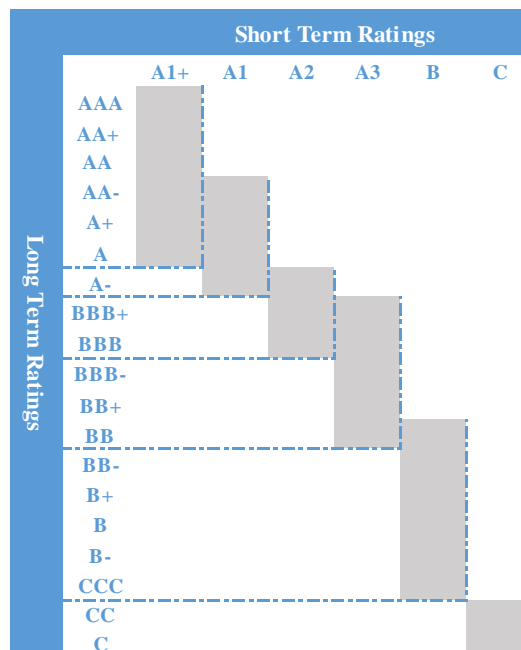
Island Textiel Mills Ltd Textile	Mar-19 9M	Jun-18 12M	Mar-18 9M	Jun-17 12M	Jun-16 12M
<b>A BALANCE SHEET</b>					
1 Non-Current Assets	3,844	3,988	4,038	4,199	4,038
2 Investments	-	26	-	26	23
3 Related Party Exposure	443	451	322	310	306
4 Current Assets	4,395	2,989	2,255	2,343	2,046
a Inventories	3,162	1,832	1,268	1,407	1,021
b Trade Receivables	645	666	487	514	340
5 Total Assets	8,681	7,454	6,615	6,877	6,414
6 Current Liabilities	919	401	387	356	565
a Trade Payables	260	100	112	76	125
7 Borrowings	5,083	4,562	4,206	4,571	4,283
8 Related Party Exposure	-	-	-	-	-
9 Non-Current Liabilities	95	80	287	182	50
10 Net Assets	2,585	2,411	1,734	1,768	1,516
11 Shareholders' Equity	2,585	2,411	1,914	1,768	1,516
<b>B INCOME STATEMENT</b>					
1 Sales	4,932	6,303	4,646	5,708	4,248
a Cost of Good Sold	(4,169)	(5,386)	(4,047)	(5,257)	(4,083)
2 Gross Profit	762	917	599	451	164
a Operating Expenses	(173)	(263)	(153)	(178)	(199)
3 Operating Profit	589	654	446	273	(35)
a Non Operating Income	(50)	75	20	82	(45)
4 Profit or (Loss) before Interest and Tax	539	729	466	356	(80)
a Total Finance Cost	(324)	(319)	(232)	(305)	(306)
b Taxation	(39)	50	(88)	(38)	167
6 Net Income Or (Loss)	176	460	146	13	(219)
<b>C CASH FLOW STATEMENT</b>					
a Free Cash Flows from Operations (FCFO)	667	860	593	533	122
b Net Cash from Operating Activities before Working Capital Changes	337	545	315	224	(177)
c Changes in Working Capital	(830)	(541)	30	(458)	(158)
1 Net Cash provided by Operating Activities	(493)	4	345	(233)	(335)
2 Net Cash (Used in) or Available From Investing Activities	(10)	(13)	(8)	(51)	(455)
3 Net Cash (Used in) or Available From Financing Activities	428	(9)	(643)	288	672
4 Net Cash generated or (Used) during the period	(75)	(19)	(306)	3	(118)
<b>D RATIO ANALYSIS</b>					
1 Performance					
a Sales Growth (for the period)	4.3%	10.4%	8.5%	34.4%	--
b Gross Profit Margin	15.5%	14.6%	12.9%	7.9%	3.9%
c Net Profit Margin	3.6%	7.3%	3.1%	0.2%	-5.2%
d Cash Conversion Efficiency (EBITDA/Sales)	14.9%	15.3%	14.0%	10.6%	4.5%
e Return on Equity (ROE)	9.4%	22.0%	10.5%	0.8%	-14.4%
2 Working Capital Management					
a Gross Working Capital (Average Days)	175	128	108	105	91
b Net Working Capital (Average Days)	165	123	103	98	81
c Current Ratio (Total Current Assets/Total Current Liabilities)	4.8	7.5	5.8	6.6	3.6
3 Coverages					
a EBITDA / Finance Cost	2.4	3.2	2.9	2.1	0.6
b FCFO / Finance Cost+CMLTB+Excess STB	0.9	1.3	1.9	0.6	0.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	4.9	4.8	5.5	12.5	-17.1
4 Capital Structure (Total Debt/Total Debt+Equity)					
a Total Borrowings / Total Borrowings+Equity	66.3%	65.4%	68.7%	72.1%	73.9%
b Short-Term Borrowings / Total Borrowings	0.5	0.4	0.4	0.3	0.3
c Average Borrowing Rate	8.5%	6.6%	6.7%	6.6%	6.9%

#	Notes
D5	The line includes Advances from Customers, amounting to PKR 2.5bln [FY17: PKR 2.2bln]
-	-
-	-
-	-
-	-

## Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings		Short Term Ratings	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <b>AA</b> <b>AA-</b>	<b>Very high credit quality.</b> Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	<b>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</b> <b>A-</b>	<b>High credit quality.</b> Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.	<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<b>Good credit quality.</b> Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</b> <b>BB-</b>	<b>Moderate risk.</b> Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.	<b>B</b>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</b> <b>B-</b>	<b>High credit risk.</b> A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.	<b>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.		
<b>D</b>	Obligations are currently in default.		



**Outlook (Stable, Positive, Negative, Developing)** Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

**Rating Watch** Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

**Suspension** It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

**Withdrawn** A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

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- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

### **Probability of Default**

(22) PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(F-VII)

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