



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-Mar-2020	BBB+	A2	Negative	Maintain	YES
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 – is primarily engaged in the manufacturing and sale of different varieties of yarn. The Company is part of Tata group that currently owns three textile mills, Tata Textile, Salfi Textile and Island Textile Mills Limited. The group has also diversified into power and food sectors. Spinning industry was suffering from lower demand for cotton yarn from China owing to trade war with USA that led to lower exports. The recent outbreak of COVID-19 pandemic has impacted the entire textile chain, as demand has gone down globally. The impact on yarn sales has been visible in both local and export markets. Island Textile's margins and, in turn, profitability suffered due to disproportionate increase in raw material prices and higher finance costs. The ratings reflect the Company's modest financial risk profile characterized by high leveraging, weak coverages and stressed cashflows. Long association of experienced and professional management team and proven track record of sponsors add comfort. Going forward, management is planning to merge all three textile entities in order to benefit from economies of scale.

The Rating Watch signifies prevailing uncertain business dynamics due to COVID-19 outbreak and still evolving situation. The Company's production facilities, like other industrial units, have been shut down in line with the provincial Government's directive of lockdown. PACRA is closely monitoring the situation and will take rating action accordingly.

The ratings are dependent on improving business margins and outcome of current scenario. A prolonged downturn or halt in production leading to significantly lower revenues will impact the ratings. Prudent management of short-term liquidity and sustaining adequate coverages is critical. Elimination of trade level mismatch in assets and liabilities remains crucial.

Disclosure

Name of Rated Entity	Island Textile Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Spinning(Sep-19)
Rating Analysts	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 nonexecutive 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 interim audit ended December 31st, 2019. The auditors fall in "Category-A" of SBP's Panel of Auditors.

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 – has 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.

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 Pakistan's textile exports displayed small growth in dollar terms in 1HFY20. While some leading textile categories displayed strong volumetric growth, the hit to unit prices on account of exporters having to share the benefit of the currency depreciation with buyers in the extremely competitive international market, curbed overall growth. Recent economic policies including the reimposition of duty on ginned cotton, removal of zero-rated status of the textile sector, as well as, disruption of global supply chains instigated by Covid-19 pandemic are expected to affect players across textile industry adversely.

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 During FY19, the Company's revenue increased by ~20% to PKR 7,557mln (FY18: PKR 6,303mln) on account of better yarn prices in the local market and impact of currency devaluation on exports. Exports made up ~58% of total sales. Trend of revenue increase continued through 1HFY20, with revenue increasing to PKR 4,009mln (1HFY19: PKR 3,027mln).

Margins During FY19, the Company's cost of sales increased by ~21% (FY19: PKR 6,546mln, FY18: PKR 5,386mln) on the back of ~19% increase in raw material cost. Increase in cost of sales nullified the impact of higher revenue and resultant, gross margin slightly decreased to 13.4% (FY18: 14.6%) and operating margin to 10.2% (FY18: 10.4%). Net profit decreased to PKR 183mln (FY18: PKR 455mln) as a result of higher finance cost (FY19: PKR 473mln, FY18: PKR 319mln) and cost of sales which led to net profit margin declining to 2.4%. Gross margin further decline to 9.1% and operating margin to 5.8% in 1HFY20. The Company made a net loss of PKR 94mln (1HFY19: PKR 194mln) due to higher finance and raw material costs.

Sustainability Island Textile maintained full capacity utilization during 1HFY20 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 FY19, the Company's net working capital cycle increased to 130days (FY18: 123days) due to some increase in average inventory and receivable days. The Company's trade leverage increased to a healthy 33% (FY18: 29%) during the period, depicting a significant room to borrow. Net working capital cycle improved in 1HFY20 and came down to 106days (1HFY19: 165days) as the Company's inventory days decreased to 77days (1HFY19: 138days). Trade leverage also increased to 36%, depicting an improving room to borrow.

Coverages During FY19, the Company's cash flows (FCFO) slightly decreased to PKR 945mln YoY (FY18: PKR 958mln) owing to decline in net profit. As a result, interest coverage ratio dropped to 1.9x (FY18: 2.8x) and debt coverage ratio to 0.8x (FY18: 1.3x). Interest coverage ratio further decreased in 1HFY20 to 0.6x (1HFY19: 2.5x) and debt coverage ratio 0.6x (1HFY19: 1.0x) as the Company's FCFO declined to PKR 337mln (1HFY19: PKR 493mln) on the back of the Company recording a net loss in the period.

Capitalization During FY19, Island Textile had a moderately leveraged capital structure (FY19: 50.5%, FY18: 65.4%). Out of total debt, ~52% comprised long-term borrowings. Leveraging experienced a small decline in 1HFY20 to 46.3% (1HFY19: 64.8%) mainly due to significant decrease in short term borrowings, which made up ~39% of total borrowings in the period. Going forward, in absence of any major capacity expansion, and with the gradual payments of long-term loans, the leveraging is expected to further reduce over time.



Island Textile Mills Limited Textile	Dec-19 6M	Jun-19 12M	Jun-18 12M	Jun-17 12M
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A BALANCE SHEET

1 Non-Current Assets	5,547	5,648	3,988	4,199
2 Investments	-	4	26	26
3 Related Party Exposure	-	585	451	310
4 Current Assets	2,423	3,652	2,989	2,343
<i>a Inventories</i>	1,133	2,229	1,832	1,407
<i>b Trade Receivables</i>	665	868	666	514
5 Total Assets	7,970	9,890	7,454	6,877
6 Current Liabilities	736	786	401	356
<i>a Trade Payables</i>	117	117	100	76
7 Borrowings	3,249	4,446	4,562	4,571
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	222	306	80	182
10 Net Assets	3,763	4,353	2,411	1,768
11 Shareholders' Equity	3,763	4,353	2,411	1,768

B INCOME STATEMENT

1 Sales	4,009	7,557	6,303	5,708
<i>a Cost of Good Sold</i>	(3,646)	(6,546)	(5,386)	(5,257)
2 Gross Profit	363	1,012	917	451
<i>a Operating Expenses</i>	(133)	(241)	(263)	(178)
3 Operating Profit	231	771	654	273
<i>a Non Operating Income</i>	(21)	(73)	69	82
4 Profit or (Loss) before Interest and Tax	209	698	724	356
<i>a Total Finance Cost</i>	(270)	(473)	(319)	(305)
<i>b Taxation</i>	(34)	(42)	50	(38)
6 Net Income Or (Loss)	(94)	183	455	13

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	337	828	854	533
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	55	422	539	224
<i>c Changes in Working Capital</i>	1,246	(276)	(541)	(458)
1 Net Cash provided by Operating Activities	1,300	146	(1)	(233)
2 Net Cash (Used in) or Available From Investing Activities	(39)	(27)	(13)	(51)
3 Net Cash (Used in) or Available From Financing Activities	(1,199)	(116)	(4)	288
4 Net Cash generated or (Used) during the period	62	3	(19)	3

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	6.1%	19.9%	10.4%	--
<i>b Gross Profit Margin</i>	9.1%	13.4%	14.6%	7.9%
<i>c Net Profit Margin</i>	-2.3%	2.4%	7.2%	0.2%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	9.5%	12.5%	15.2%	10.6%
<i>e Return on Equity (ROE)</i>	-4.6%	5.4%	21.8%	0.7%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	111	135	128	115
<i>b Net Working Capital (Average Days)</i>	106	130	123	110
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	3.3	4.6	7.5	6.6
3 Coverages				
<i>a EBITDA / Finance Cost</i>	1.5	2.2	3.2	2.1
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	0.6	0.8	1.3	0.6
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	11.5	5.9	4.8	12.5
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	46.3%	50.5%	65.4%	72.1%
<i>b Short-Term Borrowings / Total Borrowings</i>	0.4	0.5	0.4	0.3
<i>c Average Borrowing Rate</i>	13.0%	9.7%	6.6%	6.4%

#	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	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
AA+ AA AA-	Very high credit quality. 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.	A1	A strong capacity for timely repayment.
A+ A A-	High credit quality. 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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
BBB+ BBB BBB-	Good credit quality. 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
BB+ BB BB-	Moderate risk. 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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
B+ B B-	High credit risk. 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.	C	An inadequate capacity to ensure timely repayment.
CCC CC C	Very high credit risk. 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.		
D	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.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) Conflict of Interest

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- 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

Restrictions

- (3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
- (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)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (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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