



The Pakistan Credit Rating Agency Limited

Rating Report

Kohat Textile Company Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Jun-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the moderate business profile of Kohat Textile Mills Limited (Kohat Textile). In 9MFY19, growth in the Company's revenues remained in line with the industry. The Company caters to the needs of local industry and deals in specialized products i.e. polyester yarn, acrylic yarn and viscose yarn. Kohat Textile is a net importer that exposes the Company to exchange rate volatility and eventually diluting its profit margins. However, the impact was limited as the Company has adequately invested in technological up gradations and expansion projects, to remain cost competitive which is reflected in continuously improving margins. Nevertheless, the Company's financial profile has remained under pressure due to significant hike in interest rates, reflected by modest coverages. The Company has significantly leveraged capital structure and it is skewed towards short-term borrowings. Going forward, improvement in cash flows is critical for meeting financial needs. The assigned ratings derive comfort from experienced management team, strong financial muscle of the Sponsors and their timely support to the Entity in the form of guarantee and subordinated loans.

The ratings are dependent on managing financial obligations while sustaining business margins, along with prudent management of working capital. Any deterioration in debt coverages leading to higher financial risk or subdued profitability will have a negative impact on the ratings. Saif Group's support to the Entity will remain critical.

Disclosure

Name of Rated Entity	Kohat Textile Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Textile(Oct-18)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Kohat Textile Mills Ltd. (Kohat Textile) commenced operations in 1967 and was listed on PSX in 1970.

Background Kohat Textile is the first textile venture of Saif Group, later on the Group expanded its presence in textile sector through Saif textile and Mediterranean Textile. The Company's production facilities are located in Kohat, KPK.

Operations Kohat Textile operates with a single spinning unit having a capacity of 35,280 spindles. The Company manufactures specialized yarn form polyester, viscose and acrylic. The Company caters its power needs via in-house production (4.22MW) which is sufficient for its energy requirement. Meanwhile, it has PESCO connection as an alternative source.

Ownership

Ownership Structure Kohat Textile's majority stake (~77.98%) is owned by Saif Group, through Saif Holdings. The remaining shareholding rests with financial institutions (10%), general public (10.12%) and directors (0.87%).

Stability The representation of Saif Group's textile ventures in Pakistan's spinning industry remains critical. The Group has a holding company in place, portraying structured line of succession. However, the succession planning is not document yet.

Business Acumen Saif Group is one of the oldest medium-sized business conglomerate in Pakistan with considerable interests in textile. The sponsors have a presence of five decades in local Spinning industry, eventually developing expertise. However, the Group's growth in textile sector was limited but it has sustained through the volatility of textile industry.

Financial Strength Saif Group is one of the leading industrial and services conglomerates in Pakistan. The Group's interests lies in oil and gas exploration, power generation, textiles manufacturing, real estate development and health care services, through 7 subsidiaries and 4 associated companies across different sectors. Saif Group has a strong financial muscle and Sponsors are willing to support Kohat Textile, if needed.

Governance

Board Structure The board comprises seven members with major concentration of Saif Family members on board, including Chairman of BoD, Mr. Osman Saifullah Khan. The board constitutes five non-executive directors, one executive director, while one member is independent director.

Members' Profile Mr. Osman Saifullah – Chairman – holds a post graduate degree in engineering from University of Oxford and post graduate degree in business administration from University of Stanford. Mr. Osman has overall experience of over two decades in textile industry and he is also a senator. The board members have vast knowledge and expertise of textile industry, though diversity in experiences exists as well, ensuring a requisite skill mix for strategic planing.

Board Effectiveness Control of the board vests with Saif Group which ensures smooth operational control. Moreover, Audit and HR Committees are in place to assist the board on relevant matters. Despite presence on board of other Group companies their attendance has remained strong. Board meeting minutes were formally documented. Meanwhile, overall strategy of the Company is discussed in bi-annual meeting of Saif Group, whereas, operational matters are discussed in board meetings.

Financial Transparency M/s Shinewing Hameed Chaudri & Co., Chartered Accountants is the external auditor of the Company. The auditors have expressed unqualified opinion on the financial reports for the periods FY18 and 1HFY19.

Management

Organizational Structure Management control vests with Saif Group. Mr. Assad Saifullah – the CEO – With defined reporting line which ensures smooth flow of operations. Furthermore, the Company has five functional departments and all HoD's reporting directly to CEO.

Management Team Mr. Assad Saifullah - the CEO - has been associated with the Company for a decade. He is supported by a team of seasoned professionals, most of them have been associated with the Company for a reasonably long period of time.

Effectiveness There is no formal management committee, however the Company maintains an adequate IT infrastructure and related controls. Additionally, delegation of power by sponsors to management is considered positive for management effectiveness. The Company's MIS can be classified into two categories on the basis of periodicity – daily and monthly. The daily and weekly reports are generated for top management with main focus on production and liquidity position whereas P&L is discussed on need basis in the meetings.

MIS Kohat Textile has in place Microsoft Dynamics based Enterprise Resource Planning (ERP) system that provides comprehensive MIS reporting.

Control Environment Kohat Textile's plant is connected with head office through VPN, thereby reporting on real time basis. Moreover, international certifications include ISO 9001:2015 and 45001:2018.

Business Risk

Industry Dynamics Pakistan's textile exports stagnated in 9MFY19 (~0.1% growth YoY). Even though major segments including cotton cloth, knitwear, garments and bed-wear displayed strong volumetric growth, a unit price dip resulting from sharing currency devaluation benefits with export clientele, curbed overall growth. Cotton yarn also displayed double-digit volumetric decline on account of the US-China trade war. Going forward, the withdrawal of zero-rated sales tax status from textile sector coupled with the increase in interest rate may impact liquidity and profitability of Pakistan's textile industry.

Relative Position Kohat Textile is one of the pioneer of Pakistan's spinning industry; though it has sustained through the market volatility and industry driven crises over the period of five decades but the growth in textile segment was limited. However, on standalone basis, Kohat Textile's share in local spinning industry is minimal.

Revenues In 9MFY19, the Company's top-line clocked in at PKR 2,001mln, posting a growth of 28%. The growth is attributable to continuous BMR activities which has yielded better product profile, in turn, better pricing. The Company's revenues wholly comprises local yarn sales with adequate customer concentration.

Margins The Company's gross margin has shown improvement (9MFY19: 9.6%, 9MFY18: 8.7%), owing to better pricing and cost efficiency through BMR. Additionally, the subsidized gas and electricity cost has further lowered the conversion cost. Collectively, these factors have translated into better gross margins. This was followed by improved operating margin (9MFY19: 6.3%, 9MFY18: 4.8%), owing to lower then proportionate increase in operating expense. This led to better net margin of the Company (9MFY19: 1.9%, 9MFY18: -1.0%), despite significant increase in finance cost. Resultantly, the Company booked a profit of PKR 38mln (9MFY18: loss of PKR 16mln).

Sustainability Kohat Textile has incurred BMR of PKR 300mln (operational since June 18) to increase operational efficiencies, a key factor in order to improve margins in stretched textile industry. The BMR majorly includes partial replacement of old spindles with energy efficient spindles; portraying local market capitalization with improved margins. In addition, The Company is in process of upgrading its blow room line for higher production of surgical cotton.

Financial Risk

Working Capital In 9MFY19, the Company's raw material inventory days increased (9MFY19: 70days, 9MFY18: 51days), on the back of hiked raw material cost, a factor of significant rupee devaluation. This led to higher inventory days (9MFY19: 81days, 9MFY18: 65days). Eventually, resulting in higher gross working capital days (9MFY19: 125days, 9MFY18: 107days).

Coverages The Company's operating cash flows (FCFO) posted a growth of ~47% in 9MFY19 (9MFY19: PKR 171mln, 9MFY18: PKR 116mln), which is attributable to higher profitability. Meanwhile increase in finance cost by ~70% led to deteriorated interest coverage (9MFY19: 2.2x, 9MFY18: 2.5x). This was followed by slightly better debt coverage (9MFY19: 1.1x, 9MFY18: 1.0x), on the back of declined uncovered short term borrowing at trade assets level. While on account of hiked interest rates, the Company's coverages are expected to remain stretched in near future.

Capitalization Kohat Textile has a significantly leveraged capital structure ~59.2% (9MFY19). Total debt stood at PKR 1,234mln, mainly comprising of the current debt ~ 75%.



Kohat Textile Mills Limited				
Listed Public Limited				
BALANCE SHEET				
	Mar-19	Jun-18	Jun-17	Jun-16
	9M	12M	12M	12M
a Non-Current Assets	1,494	1,478	1,276	1,339
b Investments (Incl. Associates)	-	-	-	-
Equity Instruments	-	-	-	-
Debt Instruments	-	-	-	-
c Current Assets	1,184	975	860	635
Inventory	696	483	414	305
Trade Receivables	311	336	254	151
Others	176	157	192	179
d Total Assets	2,678	2,453	2,136	1,974
e Debt/Borrowings	1,234	1,054	721	856
Short-Term	829	688	472	391
Long-Term (Incl. Current Maturity of Long-Term Debt)	405	366	249	465
Other Short-Term Liabilities	330	320	364	113
Other Long-Term Liabilities	264	250	211	198
f Shareholder's Equity	850	829	841	807
g Total Liabilities & Equity	2,678	2,453	2,136	1,974

INCOME STATEMENT				
a Turnover	2,001	2,244	2,230	2,228
b Gross Profit	192	215	180	132
c Net Other Income	(6)	(9)	4	(3)
d Financial Charges	(78)	(60)	(51)	(69)
e Net Income	38	11	36	(19)

CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	171	183	177	112
b Total Cashflows (TCF)	171	183	177	112
c Net Cash changes in Working Capital	(207)	(168)	28	(151)
d Net Cash from Operating Activities	(96)	(42)	151	(102)
e Net Cash from Investing Activities	(68)	(264)	(25)	(51)
f Net Cash from Financing Activities	163	311	(134)	156
g Net Cash generated during the period	(1)	4	(8)	3

RATIO ANALYSIS				
a Performance				
Turnover Growth	28%	1%	0%	3%
Gross Margin	10%	10%	8%	6%
Net Margin	2%	0%	2%	-1%
ROE	6%	1%	4%	-2%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+U	1.1	1.2	1.4	0.6
Interest Coverage (X) (FCFO/Gross Interest)	2.2	3.2	3.6	1.7
Debt Payback (Years) (Total Debt (excluding Covered Short T	3.3	3.2	2.0	10.4
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable L	92	76	65	52
d Capital Structure (Total Debt/Total Debt+Equity)	59%	56%	46%	51%

Kohat Textile Mills Limited

Jun-19

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.

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(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

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- (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

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- (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.
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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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- (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)
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- (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)
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- (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)

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- (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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