The Pakistan Credit Rating Agency Limited

Rating Report

Kohat Textile Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
26-Jun-2020	A-	A2	Stable	Maintain	YES
27-Dec-2019	A-	A2	Stable	Maintain	-
28-Jun-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect a moderate business profile of Kohat Textile Mills Limited (Kohat Textile). 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 of raw material. This exposes the Company to exchange rate volatility and eventually dilutes its profit margins. However, the impact remains limited as the Company has adequately invested in technological upgradations and expansion projects to remain cost-competitive as reflected in improved margins in recent years. The Company has managed to improve its operating profit in 9MFY20 despite the withdrawal of zero-rating and an increase in energy prices by 31% while the overall profitability was negatively impacted by the exorbitant increase in KIBOR. The outbreak of Covid-19 has impacted the revenues of the Company as demand contracted. The Company's financial profile is considered adequate on the back of manageable working capital cycle, moderate coverages and leveraging. Recent SBP measures and interest rate cut will provide relief to the Company. The assigned ratings derive comfort from an experienced management team, strong financial muscle of the Sponsors and their timely support to the Entity in the form of subordinated loans.

The Rating Watch signifies the prevailing uncertainty due to the outbreak of COVID-19 pandemic and tough economic conditions. This has impacted the entire textile chain as demand contracts due to shutdown in domestic and global markets. Recent SBP measures will provide some respite in this regard. The Company’s production facilities were shut down for 3 days as per the provincial government orders due to outbreak of Covid-19, subsequently, operations were resumed with partial capacity due to lockdown in the country. Currently, the mill is running at full capacity. Demand has improved recently but will take time to reach pre corona level. PACRA is closely monitoring the situation and will take rating action accordingly.

The ratings are dependent on the Company’s ability to sustain its operations in prevailing conditions. Significant deterioration in revenues and/or debt coverages due to the prolonged downturn leading to higher financial risk or subdued profitability will have a negative impact on the ratings. Saif Group's support to the Company will remain critical.

Disclosure	
Name of Rated Entity	Kohat 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	Adil Kaleem | adil.kaleem@pacra.com | +92-42-35869504

Profile

Legal Structure Kohat Textile Mills Limited. (Kohat Textile) commenced operations in 1967 and was listed on Pakistan Stock Exchange 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 an unqualified opinion on the financial reports for the periods ending June 2019 and December 2019.

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, the 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 includes ISO 9001:2015 and 45001:2018.

Business Risk

Industry Dynamics Textile exports of the country dropped by ~8% for 11MFY20 to stand at ~USD 11.6bln as compared to ~USD 12.6bln in 11MFY19 due to slowdown in demand for textile products internationally, instigated by Covid-19 led lockdowns in major export destinations. Going forward, prevailing uncertainty in the dynamics of textile sector due to Covid-19 outbreak globally, lifting of lockdowns in most countries, contraction in local and international demand is expected to affect the entire textile value chain. Locally, textile sector will find comfort in relief measures introduced by State Bank of Pakistan such as deferment of loan payments for one year, low interest rates and salary refinance scheme.

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 During 9MFY20, the Company's revenue declined by 11.5% and stood at PKR 1,943mln (PKR 6,247mln) on the back of withdrawal of the zero-rating status of textile status and Covid-19 outbreak and subsequent lockdown in the country.

Margins Despite lower revenue, the Company was able to improve its gross margins in 9MFY20 to ~12% (9MFY19: 9.6%) on the back of better yarn prices. Similarly operating margins also improved and stood at 7.7% (9MFY20: 6.3%). However due to higher finance cost (9MFY20: PKR 140mln: 9MFY19: PKR 78mln) the Company's Net margin further dropped (9MFY20: 1% : 9MFY19: 1.9%) and the Company posted lower Net Profit (9MFY20: PKR 20mln, 9MFY19: PKR 38mln). Profitability is expected to further decrease as margins have deteriorated since COVID-19 outbreak.

Sustainability Due to COVID-19 outbreak and subsequent lockdown, Kohat Textile has to shut down all of its operations as per government directive. However, after getting approval the Company resumed its operations though production remained low. Since the government has eased the lockdown from 11th May demand and production level have improved. However, full resumption of operations and recovery in sales of the Company remains unclear. The Company's performance is expected to deteriorate further by end FY20.

Financial Risk

Working Capital Working Capital requirement of Kohat Textile emanates from financing receivables and inventor. The Company meet its requirements through short term borrowings. In 9MFY20, the Company's Net working capital days increased (9MFY20: 110days, 9MFY19: 91days) on the back of higher inventory days (9MFY20: 94days, 9MFY19: 81days) and lower revenue. Due to higher inventory levels, the Company's reliance on short term borrowing increased and room to borrow at trade level remains thin at 4%.

Coverages In 9MFY20, the Company's FCFO improved slightly (9MFY20: PKR 225mln; 9MFY19: PKR 171mln) on the back of better margins. however, due to higher short term borrowing and higher interest rates, finance cost increased which led to a deterioration of the interest coverage (9MFY20:1.6x; 9MFY19: 2.3x). Debt Coverages improved on the back of lower CMLTD. The Company has opted to defer principal repayment of debt for one year under SBP COVID-19 relief initiative which will provide a much-needed breather to the coverages.

Capitalization Despite an increase in short term borrowings (9MFY20: PKR 918mln, 9MFY19: PKR 829mln), Kohat Textile has slightly reduced its leverage to 44% in 9MFY20 (9MFY19: 59.2%), owing to the revaluation of fixed assets as at end FY19. Short term borrowing comprises 68% of total borrowing. The Company has recently availed SBP loan for salaries introduced by SBP under COVID-19 relief initiative.

Financial Summary
PKR mln

The Pakistan Credit Rating Agency Limited

Kohat Textile Mills Limited	Mar-20	Jun-19	Jun-18	Jun-17
##	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	2,357	2,353	1,480	1,276
2 Investments	3	3	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	1,306	1,159	976	860
a Inventories	*659*	*668*	*483*	*414*
b Trade Receivables	*495*	*308*	*336*	*254*
5 Total Assets	3,666	3,514	2,456	2,136
6 Current Liabilities	342	432	323	360
a Trade Payables	*236*	*330*	*252*	*295*
7 Borrowings	1,249	985	954	621
8 Related Party Exposure	100	103	102	104
9 Non-Current Liabilities	267	286	250	211
10 Net Assets	1,707	1,708	828	841
11 Shareholders' Equity	1,707	1,708	828	841
B INCOME STATEMENT				
1 Sales	1,943	2,966	2,244	2,230
a Cost of Good Sold	*(1,712)*	*(2,656)*	*(2,029)*	*(2,050)*
2 Gross Profit	231	310	215	180
a Operating Expenses	(81)	(96)	(81)	(72)
3 Operating Profit	150	214	134	108
a Non Operating Income	*(2)*	*(12)*	*(7)*	*3*
4 Profit or (Loss) before Interest and Tax	148	202	127	111
a Total Finance Cost	*(140)*	*(116)*	*(63)*	*(52)*
b Taxation	*11*	*(19)*	*(54)*	*(24)*
6 Net Income Or (Loss)	20	67	10	35
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*225*	*273*	*183*	*177*
b Net Cash from Operating Activities before Working Capital Changes	*106*	*176*	*125*	*123*
c Changes in Working Capital	*(283)*	*(80)*	*(168)*	*28*
1 Net Cash provided by Operating Activities	(178)	96	(42)	151
2 Net Cash (Used in) or Available From Investing Activities	(67)	(101)	(264)	(25)
3 Net Cash (Used in) or Available From Financing Activities	244	4	311	(134)
4 Net Cash generated or (Used) during the period	(1)	(2)	4	(8)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-12.7%	32.2%	0.6%	--
b Gross Profit Margin	11.9%	10.5%	9.6%	8.1%
c Net Profit Margin	1.0%	2.3%	0.5%	1.6%
d Cash Conversion Efficiency (EBITDA/Sales)	12.0%	9.9%	8.7%	8.7%
e Return on Equity (ROE)	1.5%	5.3%	1.3%	4.2%
2 Working Capital Management				
a Gross Working Capital (Average Days)	150	112	121	109
b Net Working Capital (Average Days)	110	77	76	61
c Current Ratio (Total Current Assets/Total Current Liabilities)	3.8	2.7	3.0	2.4
3 Coverages				
a EBITDA / Finance Cost	1.7	2.6	3.2	3.9
b FCFO / Finance Cost+CMLTB+Excess STB	1.2	1.3	1.2	1.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.8	2.4	3.2	2.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	44.2%	38.8%	56.0%	46.2%
b Short-Term Borrowings / Total Borrowings	0.7	0.6	0.7	0.7
c Average Borrowing Rate	15.1%	10.7%	6.8%	6.9%

Credit Rating Scale & Definitions

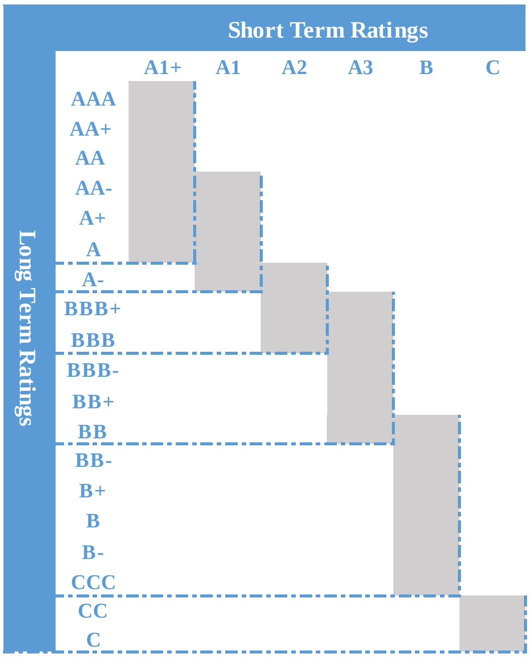
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
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.
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.
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+ 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.
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.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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 surveill the opinion due to lack of requisite information.

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

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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)

Independence & Conflict of interest

(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)

Proprietary Information