

PAKISTAN TEXTILES

MARKET VISTA

REP-019

Interloop – Stands Strong on Value Added Credentials

- Interloop Limited (INLO) – one of the world's largest hosiery manufacturers – is in process of listing on Pakistan Stock Exchange through Initial Public Offering (IPO), with the book building process scheduled to commence on 13th Mar'19.
- The company intends to raise fresh capital of Pkr4.9bn or US\$35.4mn (at a floor price of Pkr45 per share) for 12.5% stake in the company, which it plans to utilize in funding its expansion projects.
- Despite challenging domestic backdrop over the last 5yrs, INLO has managed to perform remarkably well, registering stable revenue (4yr CAGR: 8.3%) and profitability growth (4yr CAGR: 15.7%).
- The management expects earnings to grow at a 5-year CAGR of 17.5% to reach PKR8.7bn by FY23, as incremental production from new capacity additions would push earnings higher.
- At a floor price of Pkr45 per share, Interloop appears slightly expensive (IL – trailing P/E: 10.09(x) vs. peer avg. of 8.92(x), 13% premium) when pitted against select group of listed peers on all most every valuation metric.
- However, distinguished margin profile (IL - GM: 29.4% vs. 10.7% for AKD Textile Universe), superior asset yields (IL- ROE/ROA: 43%/12% vs. 14%/6% for listed peers) and strong earnings growth (forward 5yr CAGR: 17.5%, management estimates) rightly justify the premium valuations. Hence, we advise investors to subscribe at a floor price of Pkr45 per share.

Interloop Limited – Best in class: Interloop limited (INLO) is one of the world's largest hosiery manufacturers, with manufacturing units operating in Pakistan and Bangladesh. Vertically integrated, the company owns state of the art production facilities including spinning, dyeing, knitting, and finishing, with the respective segment annual capacities of 25mn (kgs), 4.5mn (kgs) and 624mn (pairs). With a superior product quality, timely delivery and following strict business ethos, INLO has gained customer confidence globally, with a customer base of top global brands including the likes of Nike, Adidas, Puma, and Reebok to name a few.

A largest private sector IPO – Overview: Interloop is in the process of listing on the Pakistan Stock Exchange through an Initial Public Offering (IPO), with the book building process scheduled to commence on 13th Mar'19. The company intends to raise fresh capital of Pkr4.90bn or US\$35.4mn (at a floor price of Pkr45) for 12.5% stake (Issue size: 109mn shares, 81.75/27.25mn Book Building/General Public) in the company. The proceeds from the issue will be used to expand its existing hosiery manufacturing capacity (from existing 624mn pairs to 750mn pairs) and to set up a new denim manufacturing facility (capacity: 40k denim pieces per day).

Expansion plan: Capitalizing its well-established brand equity, INLO has embarked on a multi-dimensional expansion, with a total expected investment outlay of Pkr11.2bn. The expansion plan comprises i) capacity addition of ~126mn pairs of socks in INLO's existing hosiery business (~22.6% additional) and ii) a new denim manufacturing facility (40k denim pieces per day). Out of the total investment outlay of Pkr11.2bn, the company plans to inject Pkr4.9bn (44% of the total) as fresh equity via IPO, while the remaining Pkr6.3bn (56% of the total) will be financed through debt. Project wise, Pkr4.45bn (40% of the total) will be spent on the new hosiery production line (commercial operations expected to commence by Feb'20) while the denim manufacturing facility would cost around Pkr6.75bn (60% of the total), with the production facility expected to be operational from Oct'19 - onwards. The land amounting Pkr269mn has already been acquired for the denim facility.

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Valuation

Scrip	P/E	P/EBIT	EV/EBIT	P/B
NML	11.84	8.15	11.47	0.64
GATM	9.63	6.03	12.93	1.58
NCL	5.30	3.02	8.60	0.91
GADT	5.60	3.24	8.25	0.81
FML	14.15	13.88	15.05	2.41
KTML	6.99	4.69	7.15	0.75
Peer Avg.	8.92	6.50	10.58	1.18
Interloop*	10.09	8.73	12.79	4.32

Source: Company reports, PSX & AKD Research

*At a floor price of Pkr45 per share

Post IPO Shareholding Pattern

Description	No of Shares (mn)	% holding
Held by Sponsor Directors	581	67%
Held by Other Directors	110	13%
Held by Other Family Members	69	8%
Held by General Public	109	13%
Total Ordinary Shares	869	100%
Non Voting Shares under ESOS	2	-
Total Outstanding Shares	871	-

Source: Interloop Prospectus & AKD Research

Financing for Expansion Projects

Pkr bn	Fund Raised	Cont.
IPO Proceed	4.9	44%
Debt Financing	6.3	56%
Total	11.2	100%

Source: Interloop Prospectus & AKD Research



AKD Securities Limited

Funds Allocations

Hosiery Project

Description	Funds (PkrMn)	Allocation (%)
Plant & Machinery	2,698	61%
Land & Building	822	18%
Power & Utilities	903	20%
Misc. Expenses	31	1%
Total	4,454	100%

Denim Project

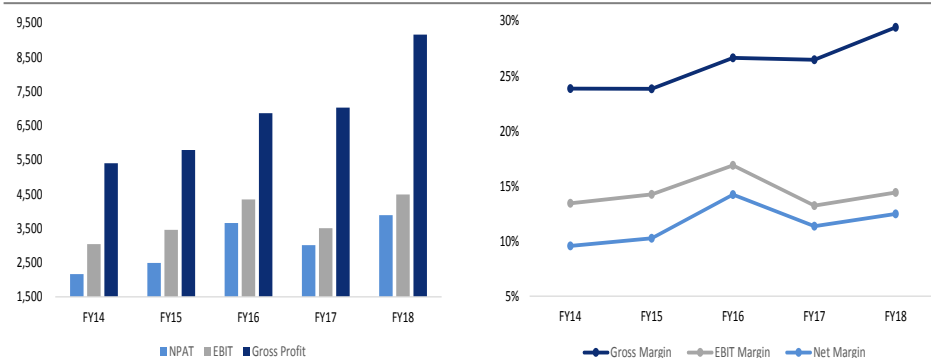
Description	Funds (PkrMn)	Allocation (%)
Plant & Machinery	3,893	58%
Land & Building	2,193	32%
Power & Utilities	529	8%
Misc. Expenses	135	2%
Total	6,750	100%

Source: Interloop Prospectus & AKD Research

With existing capacity utilization reaching ~86%, the company's decision to add another hosiery production line is timely and should continue to support bottom-line growth (last 4yr CAGR: 15.7%), in our view. At the same time, the benefits of entering into denim business are threefold. Firstly, the denim segment offers a higher margin, which would further strengthen INLO's margin profile. Secondly, it is one of the fastest growing segments in the textile industry world-wide (with segment expected to grow by 6.4% annually vs. 3.6% expected in hosiery segment). Thirdly, diverse product slate post commissioning of denim plant would render further stability to the company's bottom-line.

Performance review – An outperformer during challenging times: Even in the last 5yrs, when the textile industry witnessed a tough working environment (i.e. rising input costs and overvalued currency) and exports remained stagnant, INLO has managed to perform remarkably well, by registering stable revenue (4yr CAGR: 8.3%) and profitability growth (4yr CAGR: 15.7%). Despite rising cost pressures, the company margins both at gross and net level have improved by 6%/2% to 29% and 12%, respectively, where margin accretion was primarily driven by i) in-house cost-efficiencies and ii) the company's ability to pass-on incremental costs through its premium product quality. Going forward, the management expects earnings to grow at a 5-year CAGR of 17.5% to reach PKR8.7bn by FY23.

Distinguished Margin Profile



Source: Interloop Prospectus & AKD Research

Valuation – Premium brands command premium price: At a floor price of PKR45 per share, Interloop appears slightly expensive (IL – trailing P/E: 10.09(x) vs. peer avg. of 8.92(x), 13% premium) when pitted against select group of listed peers on almost every valuation metric (see table on RHS), a potential premium of 13-34%. However, distinguished margin profile (IL - GM: 29.4% vs. 10.7% for AKD Textile Universe), superior asset yields (IL- ROE/ROA: 43%/12% vs. 14%/6% for listed peers) and strong earnings growth (forward 5yr CAGR: 17.5%, management estimates) rightly justify the premium valuations. Hence, we advise investors to subscribe at a floor price of PKR45 per share.

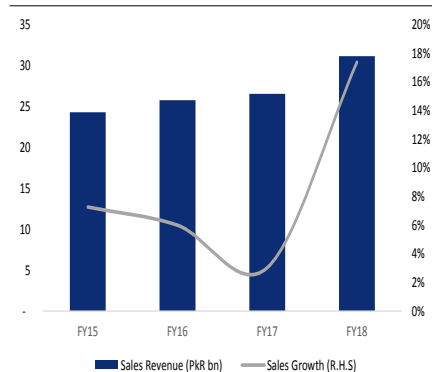
Investment perspective: Interloop offers best in class business with stable revenue (4yr CAGR: 8.3%) and profitability growth (4yr CAGR: 15.7%). Strong organic earnings growth (forward 5yr CAGR: 17.5%, management estimates), distinguished margin profile (IL - GM: 29.4% vs. AKD Textile Universe - GM: 10.7%) combined with well-established brand equity make a compelling long term investment case for Interloop. With exports comprising ~90% of the top line and operations skewed towards value-added chain, INLO is best positioned to benefit from the current domestic backdrop (i.e. rupee depreciation and export incentives).

Existing & Post expansion capacities

Segment	FY18	FY19	Post Expansion
Socks (mn dz-annual)	52	59	75
Denim (000 pieces/day)	-	-	40

Source: Interloop Prospectus & AKD Research

Stable Revenue Stream with ~90% exports



Source: Interloop Prospectus & AKD Research

Valuation

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Annual Financial Databank

Key Ratios	FY14	FY15	FY16	FY17	FY18
EPS (PkR)	2.5	2.9	4.2	3.5	4.5
EPS growth	n.a	15%	47%	-18%	29%
PER (x)	18.1	15.7	10.7	13	10.1
ROE	27.80%	26.40%	29.40%	20.80%	42.80%
ROA	10.10%	10.80%	15.50%	10.60%	11.90%
BVS (PkR)	8.9	4.6	3.6	4.1	5.9
P/BVS (x)	5	9.8	12.3	11	7.7
Sales Growth	n.a	7.30%	6.00%	3.00%	17.40%
Gross Margin	23.90%	23.80%	26.70%	26.50%	29.40%
Operating Margin	13.40%	14.20%	16.90%	13.20%	14.40%
Net Margin	9.60%	10.30%	14.20%	11.30%	12.50%
Debt-to-Equity (x)	1.4	1.1	0.6	0.7	2
Effective tax rate	2.00%	3.00%	5.50%	3.30%	3.00%

Income Statement

(PkRmn)	FY14	FY15	FY16	FY17	FY18
Sales	22,650	24,295	25,751	26,530	31,139
Cost of sales	-17,246	-18,504	-18,888	-19,504	-21,977
Gross Profit	5,404	5,791	6,863	7,026	9,162
Distri. & Admin. Expense	-2,133	-2,036	-2,054	-3,412	-4,256
Other operating income/(expense)	-228	-294	-462	-108	-416
Profit from operations	3,043	3,458	4,346	3,506	4,480
Finance cost	-833	-891	-473	-392	-484
PBT	2,212	2,569	3,875	3,114	4,006
Taxation	-45	-78	-214	-103	-120
Profit for the year	2,166	2,491	3,660	3,011	3,886

Balance Sheet

(PkRmn)	FY14	FY15	FY16	FY17	FY18
Operating fixed assets	10,228	11,472	11,746	13,687	15,494
Non-Current Assets	11,149	12,777	13,257	15,167	15,961
Stores and spares	557	560	583	697	779
Stock in trade	4,422	4,006	3,177	3,566	5,122
Trade debts	3,501	4,277	4,778	4,814	7,293
Current Assets	10,225	10,203	10,391	13,330	16,789
Total Assets	21,375	22,980	23,649	28,496	32,750
Total Equity	7,785	9,418	12,456	14,443	9,083
Long-term financing and leases	4,615	4,598	3,134	1,918	2,249
Non-Current Liabilities	5,362	5,582	4,396	3,490	4,174
Trade and other payables	1,804	1,642	2,160	1,832	3,206
ST borrowing	5,360	5,055	3,255	7,637	15,181
Current portion of non-current liabilities	848	1,116	1,292	1,011	969
Current Liabilities	8,227	7,980	6,796	10,563	19,493
Total Equity and Liabilities	21,375	22,980	23,649	28,496	32,750

Source: Interloop Prospectus & AKD Research

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New Rating Definitions

Buy	> 19% expected total return (Rf: 13% + Rp: 6%)
Neutral	> 13% to < 19% expected total return
Sell	< 13% expected total return (Rf: 13%)

Old Rating Definitions (Discontinued)

Buy	> 20% upside potential
Accumulate	> 5% to < 20% upside potential
Neutral	< 5% to > -5% potential
Reduce	< -5% to > -20% downside potential
Sell	< -20% downside potential
Not Rated	No investment opinion or recommendation

Valuation Methodology

To arrive at our period end target prices, AKDS uses different valuation techniques including:

- Discounted Cash Flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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