RATING REPORT

Ahmed Oriental Textile Mills Limited (AOTML)

REPORT DATE:

January 22, 2020

RATING ANALYST:

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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	BBB+	A-2	BBB+	A-2
Rating Outlook	Stable		Stable	
Rating Date	January 17, 2020		October 10, 2018	
Rating Action	*Reaffirmed*		*Initial*	

COMPANY INFORMATION	
Incorporated in June 1989	**External auditors:** Ibrahim Shaikh & Co.
Public Unlisted Company	**Chairman:** Mr. Iftikhar Ahmed Khalid
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Faisal Khalid
Naveena Industries Limited (62%)	
Shazad Khalid (13%)	
Faisal Khalid (12%)	
Iftikhar A. Khalid (6%)	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (April 2019)*
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Ahmed Oriental Textile Mills Limited (AOTML)

OVERVIEW OF THE INSTITUTION

Ahmed Oriental Textile Mills Limited (AOTML) was incorporated in November 1989 as a public limited company and was listed on Karachi Stock Exchange (KSE and Lahore Stock Exchange (LSE). Following the request of the director's, AOTML was de-listed from KSE in November 2002 and LSE in April 2003. The registered office of AOTML is located in Karachi and mills at Rahim Yar Khan (RYK).

RATING RATIONALE

Ahmed Oriental Textile Mills Limited (AOTML) is engaged in manufacturing and sales of yarn. The company is a part of Naveena Group as majority shareholding of the company is vested with Naveena Industries Limited (NIL). Naveena Group has created a holding company, namely Naveena Holdings; existing shareholding of AOTML held by NIL will be transferred to Naveena Holdings during the ongoing year. AOTML primarily deals in coarse count thread yarn.

Production facilities

The company has two spinning mills (Unit 1 and Unit 2), both located in Rahim Yar Khan (RYK). Unit 1 is engaged in production of Blended Yarn (polyester cotton) ranging from 8s to 26s count, while Unit 2 is utilized for production of Cotton Yarn (pure cotton) ranging from 7s to 20s count. The following table presents the cumulative installed capacity and capacity utilization of the company:

Figure 1: Production Details

	FY18	FY19
Number of spindles installed	39,096	39,096
Number of spindles worked	39,096	39,096
Number of shifts per day	3	3
Installed capacity after conversion to 20/s count - kgs	18,212,040	18,212,040
Actual production after conversion to 20/s count - kgs	20,609,033	19,984,575
Capacity utilization	113.2%	109.7%

At present, the company is operating at full capacity. Capacity utilization is greater than 100% due to production of lower count yarn than 20s. Capacity utilization decreased in FY19 vis-à-vis FY18 as proportion of higher count yarn increased in overall production. Currently, the management does not foresee any further expansion in its production facilities.

Rating Drivers

High cyclicality & competitive nature of spinning industry along with volatility in cotton prices translate to high business risk profile for the spinning sector

Inherent cyclicality of cotton price and crop levels drives performance of players operating in the spinning sector. Historically, margins and financial performance of players have depicted seasonality. Moreover, competitive intensity is high due to commoditized nature of the product. Comfort is drawn from AOTML's product diversity (as it produces both cotton and blended yarn).

Revenue witnessed adequate growth in FY19. Client concentration has also increased due to management's preference to work with existing clients with timely repayment history

Net sales of the company have increased at a Compound Annual Growth Rate (CAGR) of 18.2% in the period from end-FY17 to end-FY19. Growth in FY19 was a function of increase in average prices as volumes were reported slightly lower vis-à-vis the preceding year. Majority of AOTML's sales (86%) are geared towards the local market, while the remaining sales constitute direct and indirect exports. AOTML's direct exports comprise sales to China only, thereby indicating geographic concentration risk. Export sales of the company registered sizeable decrease in both value and volumetric terms in FY19 compared to the preceding year; however, considerable growth in local sales translated to growth in overall topline of the company during the same period. Export orders have witnessed improvement during Q1'FY20 in comparison to the same period in the preceding year. Client-wise concentration in revenues depicted an increasing trend as preference was assigned to existing clients which have settled their trade debts in a timely manner. Going forward, the sales of the company are expected to remain at a similar level as the company is in consolidation phase.

Higher input costs and increasing finance costs translated to lower bottom line in FY19

Gross margins remain a function of the input prices. Increase in raw material costs contributed to lower gross margins (FY19: 10.8%; FY18: 11.2%) in FY19. In absolute terms, gross profit of the company increased to Rs. 686.0m (FY18: Rs. 606.3m) on account of growth in topline of the company. However, both net margins and profit tax were reported lower due to growth in operating expenses and higher finance cost (finance cost increased by more than 50% in FY19 on the back of increase in benchmark rates). Going forward, profitability profile will remain dependent on movement in cotton prices and cost of inventory carried by the Company. Reduction in finance costs due to lower utilization of both short term and long term debt is expected to provide support to overall profitability of the company.

Liquidity profile of the company is considered adequate

As a result of decrease in profitability, Funds from Operations (FFO) of the company was reported lower at Rs. 338.0m (FY18: Rs. 375.0m). FFO as a proportion of total debt amounted to 15.3% (FY18: 16.4%). Debt Servicing Coverage Ratio (DSCR) is considered adequate (FY19: 1.2x; FY18: 1.4x). Current ratio has remained marginally over 1.0x (FY19: 1.03x; FY18: 1.02x). Inventory and trade debt provide adequate coverage for short term borrowings. Going forward, improved working capital management through reduction in short-term borrowings is considered important from a ratings perspective.

Leverage indicators have improved on account of increase in equity base due to profit retention. Going forward, improvement in leverage indicators is projected to continue on account of repayment of long term debt

Equity base (excluding revaluation surplus) of the company improved to Rs. 1.9b (FY18: Rs. 1.6b) on account of profit retention. The company has not paid any dividend during the last three years. AOTML's total debt amounted to Rs. 2.2b (FY18: Rs. 2.3b) at end-FY19. Reduction in total debt is attributed repayment of long term debt. In absence of any sizeable capex plans, the management does not envisage any increase in long term borrowing going forward. Short term borrowings comprise two-third of the company's total debt. Going forward, leverage indicators are expected to remain a function of utilization of short term borrowings.

Corporate Governance framework depicts room for improvement

As the company is a family owned entity, Board comprises three family members including the CEO. Overall board composition and oversight has room for improvement through inclusion of independent directors. Furthermore, committees pertaining to audit and HR functions may also be established at Board level in line with best practices.

Financial Summary (amounts in PKR millions)			Appendix I
BALANCE SHEET	**FY17**	**FY18**	**FY19**
Paid up Capital	187.1	187.1	187.1
Total Equity (without revaluation surplus)	1,309.6	1,626.3	1,919.1
INCOME STATEMENT	**FY17**	**FY18**	**FY19**
Net Sales	4,565.2	5,434.6	6,380.6
Profit Before Tax	152.4	323.5	295.9
Profit After Tax	106.2	304.1	282.1
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**
FFO	179.3	375.3	337.7
FFO to Total Debt (%)	8.7%	16.4%	15.3%
Gearing (x)	1.57	1.40	1.15
Current Ratio (x)	0.98	1.02	1.03

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Ahmed Oriental Textile Mills Limited
Sector	Textiles
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
17/1/2020	BBB+	A-2	Stable	Reaffirmed
25/10/2018	BBB+	A-2	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Muhammad Junaid	CFO	November 20, 2019