RATING REPORT

Ahmed Oriental Textile Mills Limited (AOTML)

REPORT DATE:

December 31, 2021

RATING ANALYST:

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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	BBB+	A-2
Rating Outlook	Stable		Stable	
Rating Date	December 31, 2021		November 20, 2021	
Rating Action	*Upgrade*		*Maintained*	

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 Holdings Limited (62%)	
Shazad Khalid (13%)	
Faisal Khalid (12%)	
Iftikhar A. Khalid (6%)	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Industrial Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Ahmed Oriental Textile Mills Limited (AOTML)

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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 directors, 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).

Ahmed Oriental Textile Mills Limited (AOTML) is engaged in manufacturing and sales of yarn. The company is a part of Naveena Group, which also owns Naveena Industries Limited.

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 total manufacturing unit:

Figure 1: Production Details

	FY20	FY21
Number of spindles installed	39,096	60,700
Number of spindles worked	39,096	60,700
Number of shifts per day	3	3
Installed capacity after conversion to 20/s count – kgs	22,350,993	25,108,863
Actual production after conversion to 20/s count – kgs	18,708,750	24,766,373
Capacity utilization	83.7%	98.6%

At present, the company is operating at full capacity. During the outgoing year, in May'2021, the company installed 21,600 spindles which led to a 12% increase in installed capacity at end-FY21 given 2 months of operations of the new spindles. The management further plans to install 8,100 additional spindles by Jan'22 cost of which has been incurred in the latest financials with the major financing availed through concessionary funding including LTFF and TERF. This will result in an increase in installed capacity by approximately 48% at end-FY22. The full year impact of the expansion is expected to be seen in FY23 with installed capacity projected at 39.5m kgs of yarn per annum (FY21: 25.1m kgs per annum).

Rating Drivers

Recovery in industry wide exports post ease in COVID-19 lockdown measures support business risk profile of the company.

- Subsequent to posting export contraction in FY20 - owing to the pandemic-induced slowdown experienced in H2'FY20 – Pakistan's export base grew by 14% in FY21, which is partly attributable to a low base effect. Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21). So the uptick is largely aligned with historical numbers and is not considered material.

- Share of textile exports in total exports has oscillated in the range of 54-59%, coming in at 57% during the past 2-years (FY20-21). In FY21, owing to the similar low-base effect, as discussed above, textile exports were up 13%.
- In USD' terms textile exports have grown at a CAGR of 4.4% during the past 3-year period (FY19-FY21), despite depreciation in average USD/PKR parity of 24%, 16%, and 1% in FY19, FY20 and FY21 respectively.
- As illustrated in the table above, textile exports in Q1'FY22 were 37% higher than SPLY. Inclusive of textile exports for Oct'2021, the number for 4M'FY22 textile exports came in at USD 6b. With additional capacities coming online in January 2022, textile exports for FY22 are likely to exceed the annualized figure of USD 18b.
- As illustrated in the table below, the composition of textile exports has depicted improvement in the last 4-yar period, with contribution from higher value added segment increasing from 72.9% in FY18 to 80.7% in FY21 of aggregate textile exports.
- Cotton production in Pakistan, on the other hand, was at its lowest level in decades for FY21. Cotton prices rose to a new 11-year high of ~Rs. 13,000/maund as a result of the production shortage, and cotton imports have climbed by 59.8% in quantity and 68.1% in USD terms, for FY21 vis-à-vis preceding year.
- Given favorable weather conditions, cotton production in Pakistan posted strong growth in FY22, with cotton crop for Jul-Nov'22 (Rabi) season being 81% higher than SPLY. Nevertheless, the upward momentum in cotton pricing continued in FY22, with prices as of November 2022 hovering at ~Rs. 16,000 per mound.
- The margins of textile operators have broadly depicted improvement despite the uptick in raw material costs, given that the same was offset by exchange rate movement. Nevertheless, higher raw material pricing has increased the working capital requirements for textile operators, which is likely to weigh on the liquidity of textile players. VIS expects the order book for the industry to remain adequate in the ongoing year along with transfer orders of neighboring countries, easing our business risk concerns

Topline of the company has witnessed a double-digit growth in FY21 due to an uptick in both sales volume and higher average selling prices led by currency devaluation. Going forward, sales are expected to escalate on account of adequate orders in pipeline along with further planned expansion in the spinning segment.

Net sales of the company increased by 49% to Rs. 9.5b (FY20: Rs. 6.4b) during FY21 due to volumetric increase and higher average selling prices led by currency devaluation. Proportion of indirect exports increased in FY21 with the same contributing around 54% (FY20: 33%) share in gross revenue. Total exports comprised around 62% (FY20: 47%) in FY21 with the remaining encompassing local sales. Local sales and were reported higher at Rs. 3.6b (FY20: Rs. 3.4b) in FY21. Going forward, to avail tax incentive of being classified as an indirect exporter, sales mix is expected to be dominated by indirect exports to local customers who utilize the yarn to manufacture export products. Client concentration has remained on the higher side, however, long term association with clients provides comfort to the assigned ratings. During 1QFY22, the company reported sales revenue to the tune of Rs. 4.3b led by an uptick in volumetric sales and average selling prices. Going forward, in the medium term, sales escalation is expected to be on account of adequate orders in pipeline along with planned expansion in the spinning segment.

Overall profitability profile of the company in FY21 improved on account of higher gross margins led largely by inventory gains. However, increasing interest rate levels on short-term running finances are expected to be a drag on the profitability of the company in the medium term.

Gross margins of the company improved to 20.1% (FY20: 12.9%) during FY21 largely on the back of inventory gains. Overall operating expenses increased primarily due to higher distribution and other operating costs incurred. Finance charges decreased to Rs. 169.5m (FY20: Rs. 334.2m) in FY21 due to subsidized rates on 90% of debt financing. Consequently, net margins also increased considerably to 14.9% (FY20: 4.4%) during the same period. During 1QFY22, gross and net margins of the company improved to 23.9% and 16.1%, respectively on the back of higher sales revenue and inventory gains. However, increasing interest rate levels on short-term running finances are expected to be a drag on the profitability of the company in the medium term. Going forward, management expects improvement in overall profitability due to higher projected revenue base in lieu of successful completion of the planned expansion.

Despite debt drawdown, cash flow coverage of outstanding obligations improved in FY21 on account of higher profitability. Overall liquidity profile is considered satisfactory in view sufficient cash flows in relation to outstanding liabilities and adequate debt servicing ability. Maintenance of liquidity coverages is considered important from ratings perspective.

In absolute terms, Funds from Operations (FFO) amounted to Rs. 1.5b (FY20: Rs. 0.3b) depicting a sizeable increase on account of higher overall profitability during FY21. In line with improvement in profitability, Debt Service Coverage Ratio (DSCR), FFO/Long-Term Debt, and FFO/ Total Debt were reported higher at 6.2x (FY20: 1.2x), 41.3% (FY20: 28.6%) and 22.6% (FY20: 10.6%) at end-June'21, respectively. Inventory and trade debts provide strong coverage for short-term debt obligations while current ratio was reported at 1.13x at end-June'21. Similarly, cash flows for 1QFY22 have further strengthened and the liquidity profile draws support from the company's improved profitability in the ongoing year. Maintaining projected improvement in working capital cycle and liquidity coverages is considered important from ratings perspective.

Elevated capitalization indicators to finance working capital requirements and expansion in the spinning segment in FY21. Given no additional funds planned to be drawn for the expansion in the medium-term, leverage indicators are expected improve over the rating horizon.

At end-Sep'21, total debt was reported higher at Rs. 6.4b (FY21: Rs. 6.7b, FY20: Rs. 3.2b) on account of increase in both short-term and long-term debt. Additional long term debt was acquired to fund expansion, while short term debt increased to fund working capital requirements. Under short-term borrowing, exchange rate risk prevails with around 68.5% of the same comprising foreign currency loans. However, the risk of the same is largely off-set by higher sales price passed on to the export customers. Around 90% of the long-term debt comprises concessionary rate financings offered by the SBP. Equity base has increased on a timeline basis due to profit retention with the same reported at Rs. 4.3b (FY21: Rs. 3.6b, FY20: Rs. 2.2b) at end-Sep'21. However, as the increase in debt was greater than the increase in the equity base, both leverage and gearing indicators were reported higher at 2.09x (FY20: 1.68x) and 1.84x (FY20: 1.46x) at end-FY21. Gearing and leverage indicators were reported lower at end-Q1'FY22 on account of lower working capital requirements. Given no additional funds planned to be drawn for the expansion in the medium-term, leverage indicators are projected to improve over the rating horizon.

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				
	31/12/2021	A-	A-2	Stable	Upgrade
	20/11/2020	BBB+	A-2	Stable	Maintained
	24/4/2020	BBB+	A-2	Rating Watch - Negative	Maintained
	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.				
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
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Due Diligence Meetings Conducted		**Name**	**Designation**	**Date**	
	1	Mr. Muhammad Junaid	CFO	December 20, 2021	
	2	Mr. Hasan Saleem	General Manager Accounts & Finance	December 20, 2021	