RATING REPORT

Faisal Spinning Mills Limited (FSML)

REPORT DATE:
March 14, 2019

RATING ANALYST:

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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A	A-1	A	A-1
Rating Date	*February 21, 2019*		*March 30, 2018*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Initial	

COMPANY INFORMATION	
Incorporated in 1985	**External auditors:** M/S Mushtaq & Company
Public Limited Company	**Chairman:** Mr. Mohammed Salim
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Bilal Sharif
Admiral (Pvt) Limited – 12.8%	
Mr. Faisal Shakeel – 7.4%	
Mrs. Adil Shakeel– 6.6%	
Mrs. Samia Bilal – 5.3%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (May 2016)*
http://www.vis.com.pk/docs/Corporate-Methodology-201605.pdf

Faisal Spinning Mills Limited

OVERVIEW OF THE INSTITUTION

Faisal Spinning Mills Limited (FSML) was incorporated as a public limited company in 1985, under the Companies Ordinance, 1984. The company is listed on Pakistan Stock Exchange (PSX) and registered office of the company is based in Karachi.

Financial Statements of the company for FY18 were audited by Mushtaq & Co., Chartered Accountants. Auditors belong to category 'B' on the approved list of auditors published by the State Bank of Pakistan (SBP).

Profile of Chairman

Mr. Mohammad Salim serves as a chairman of the board. He was awarded by the certification from the Institute of Chartered Accountants of Pakistan on completion of his Director Training program in April, 2016. Besides, commercial endeavors he actively participates in several social and welfare activities.

Profile of CEO

Mr. Bilal Sharif has been working in the capacity of chief executive officer (CEO) since 2011 while

RATING RATIONALE

Group Profile

Faisal Spinning Mills Limited (FSML) is a part of Umer Group (UG) of Companies which has presence in power generation, footwear, retail, leather manufacturing, dairy and construction; however, core strength of the group lies in textile (Spinning & Weaving) business. FSML's core business operations include production and sale of yarn and fabric to local and international markets. The company's segments are Spinning, Weaving and Power Generation.

Within textile sector, the group has over three decades of experience and is primarily engaged in the business of manufacturing and trading of grey and dyed yarn and greige fabric. The group is recognized as a prominent player in spinning and weaving segment with annual turnover of around Rs. 30b. Umer Group has a strong presence in the export market with more than 50% of total sales comprising exports with presence in China, Italy, Japan, Turkey and Belgium & other European countries. Around 60% of the total sales revenue of the Group has been generated through the spinning segment while the remaining comprises sales of greige fabric. Going forward, given the favorable incentives for enhancing exports along with significant rupee devaluation, management expects proportion of export sales in sales mix to increase to around two-third of total sales. Break up of segment-wise group sales and volume is tabulated below:

Segments	FY17				FY18			
	Sales (Rs. in million)	%	Volume (unit)	Selling price/ unit (Rs.)	Sales (Rs. in million)	%	Volume (unit)	Selling price/ unit (Rs.)
Spinning - Yarn	14,497.1	*57.8%*	47,032,361 (Kg)	308.2	18,213.9	*61.6%*	55,038,842 (Kg)	330.9
Weaving - Fabric	10,597.0	*42.2%*	68,720,448 (Mtr.)	154.2	11,343.2	*38.4%*	74,557,452 (Mtr.)	152.1
Total	**25,094.1**	***100.0%***			**29,557.1**	***100.0%***		

Umer Group has a total installed capacity of 186,960 spindles and 565 looms. The group carries its operations through five spinning and three weaving units each producing a unique specialized product. Moreover, in order to ensure an uninterrupted power supply, the group has established its own captive power generation plants for each unit with a total capacity of 37 megawatt (MW).

Company Profile

FSML has two manufacturing units, spinning and weaving, located at Nooriabad, District Dadu (Sindh) and Feroze Wattwan, District Sheikhupura (Punjab) respectively. Its production facilities are equipped with 38,208 spindles and 265 looms and each unit has its own ancillary power unit. Spinning unit is engaged in production of coarse to medium yarn with count range varying from 8-30 singles. The yarn is developed to cater to the demands of export markets and is primarily utilized by clients in production of denim. Weaving unit is utilized to produce griege fabric only. At end-FY18, capacity utilization was reported on the higher side. The power unit for the spinning segment has a total capacity of 4.5 MW, while the weaving unit has the capacity of 10MW.

serving the board of UG for more than 20 years. He completed bachelors in business administration from The American College, London. He is exempted from the mandatory requirement for attaining Director Training Program.

Financial Snapshot
Net Equity: *Sept 2018: Rs. 4.6b, June 2018: Rs. 4.2b*

Net Revenue: *1QFY19: Rs. 2.9b, FY18: Rs. 11.8b*

__Key Rating Drivers:__

High cyclicality & competitive intensity for spinning industry, volatility in cotton prices translate into high business risk profile. Diversification in the weaving segment, favourable cost of inventory carried on balance sheet, along with government's favourable policy towards the textile sector supports assessment of business risk profile

The assigned ratings take into account favorable textile industry dynamics with government of Pakistan (GoP) focused on facilitating textile sector in order to enhance country's exports. Measures undertaken include reduction in energy prices (gas at USD 6.5/mmBTU and electricity at 7.5 US cents/kWh) and reduction in regulatory duty to zero on imported cotton. Going forward, recent rupee devaluation and increased focus of GoP on enhancing exports (through reducing cost of doing business and commitment for timely release of refunds and rebates) bodes well for competitiveness of textile business. Nonetheless, business risk profile remains dependent on inherent cyclicality of prices, crop levels, and demand supply fluctuations. Given the high degree of fragmentation specifically in the weaving segment; pricing power of companies operating in the segment remains limited. Moreover, reduction in rebate rates and increase in cotton prices may impact margins; timing and quantum of which will depend on average prices and quantity carried by different players. Given the cost of inventory carried on balance sheet, FSML is well positioned in this regard.

Topline of the company grew by 12.1% during FY18. Rupee devaluation, higher volumes sold and increase in selling price per unit supported the increase in total sales

Sales have increased on a timeline basis to Rs. 11.8b (FY17: Rs. 10.6b) in FY18. Although more than two-third of total sales are geared towards international market, an increasing trend was witnessed in local sales during FY18 as compared to previous year. Segment wise, total yarn sales grew by 10.8% while fabrics sales grew by 11.3%. Presently, total export sales comprise more than one-half of greige fabric sales and around 95% of yarn sales. Moreover, currency devaluation, higher volumes sold, increase in average selling prices and rebate on export sales have positively impacted the total sales in FY18.

Efficient raw material procurement translated in to improved gross and operating margins. Growth trajectory in profitability projected to continue

Profitability of the company was reported higher in 1QFY19 and FY18 vis-à-vis the corresponding periods. Operating margins (gross and net) were also reported higher on account of increase in topline, efficient raw material procurement and increasing demand of fabric in local market. Overall operating expenses increased slightly during FY18 primarily due to increase in administrative expenses (Rs. 21.2m were written-off as bad debt expense). The company posted profit after tax of Rs. 577.9m (FY17: Rs. 431.0m) during FY18 while net profit stood at Rs. 155.3m (1QFY18: Rs. 107.4m) in 1QFY19. Going forward, future margins are expected improve further given that average inventory carried on balance sheet is significantly lower than current cotton prices.

Sound liquidity profile due to healthy cash flows in relation of outstanding debt obligations

Improvement in profitability during 1QFY19 and FY18 led to healthier cash flows for FSML for the same period. Funds From Operations (FFO) for FY18 increased to Rs. 1,061.1m (FY17: Rs. 700.5m) translating into improvement in FFO/Long-term debt multiple which stood at 48.5% (FY18: 62.4%; FY17: 39.2%) during 1QFY19. Debt Service Coverage Ratio (DSCR) remains sound at 2.6x (FY18: 4.0x; FY17: 3.1x) during 1QFY19, exhibiting sufficiency of internal cash flows to cover debt servicing. Inventory and trade debts represented more than 4.1x (FY18: 5.3x) times of outstanding short-term debt at end-1QFY19.

Conservative financial Policy

Equity base of FSML has increased over time on the back of increased retained earnings. Dividend payout ratio was reported at 40.1% (FY17: 40.0%; FY16: 29.5%) during FY18. The company's total debt was reported at Rs. 2.7b (FY18: Rs. 2.3b, FY17: Rs. 1.9b) at end-1QFY19 owing to an increase in short-term debt in order to finance working capital requirements. Short term borrowings are acquired on seasonal basis and resultantly impact leverage ratios. However, debt profile is majority (62%) long-term in nature. While remaining manageable, gearing and leverage indicators increased marginally to 0.56x (FY18: 0.51x) and 0.92x (FY18: 0.83x) respectively at end-1QFY19 due to increase in interest bearing debt.

FINANCIAL SUMMARY *(amounts in PKR millions)*				Appendix I
BALANCE SHEET	**FY15**	**FY16**	**FY17**	**FY18**
Fixed Assets	2,466.9	3,196.3	3,499.2	3,511.2
Investments	496.4	510.1	549.6	599.5
Stock-in-Trade	1,703.0	1,998.9	2,010.3	2,403.3
Trade Debts	267.4	497.6	395.9	1,035.2
Cash & Bank Balances	77.2	53.8	110.7	125.2
Total Assets	5,437.2	7,005.5	7,327.0	8,365.7
Trade and Other Payables	552.8	751.1	559.9	606.9
Long Term Debt *(*incl. current maturity)*	1,025.3	1,478.2	1,786.6	1,700.0
Short Term Debt	0.0	753.0	164.0	645.7
Total Equity	3,664.4	3,790.3	4,171.0	4,757.1
INCOME STATEMENT				
Net Sales	9,281.0	9,282.0	10,563.7	11,843
Gross Profit	807.1	676.0	1,047.0	1,308.5
Operating Profit	237.8	158.3	449.0	653.3
Profit After Tax	174.5	169.2	431.0	577.8
RATIO ANALYSIS				
Gross Margin (%)	8.7%	7.3%	9.9%	11.0%
Net Margin	1.9%	1.8%	4.1%	4.9%
Net Working Capital	1,578.9	1,649.4	2,366.4	2,749.2
FFO to Total Debt (x)	0.41	0.17	0.36	0.45
FFO to Long Term Debt (x)	0.41	0.26	0.39	0.62
Gearing	0.28	0.59	0.47	0.51
Leverage	0.48	0.85	0.76	0.83
Debt Servicing Coverage Ratio (x)	1.3	1.1	3.1	4.0
ROAA (%)	3.1%	2.7%	6.0%	7.4%
ROAE (%)	4.8%	4.5%	10.8%	13.2%

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	Faisal Spinning 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				
	2/21/2019	A	A-1	Stable	Reaffirmed
	3/30/2018	A	A-1	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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