RATING REPORT

Faisal Spinning Mills Limited

REPORT DATE:
April 22, 2020

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	*April 22, 2020*		*February 21, 2019*	
Rating Outlook	Rating Watch-Developing		Stable	
Rating Action	Reaffirmed		Reaffirmed	

COMPANY INFORMATION	
Incorporated in 1985	**External auditors:** M/S Mushtaq & Company Chartered Accountants
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%	
Mrs. Samia Bilal – 5.3%	

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

Faisal Spinning Mills Limited (FSML)

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 FY19 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 serving the board of UG for

RATING RATIONALE

Group Profile

Faisal Spinning Mills Limited (FSML) is a part of the Umer group of industries having diversified presence in footwear, retail, leather, dairy, power generation and construction; however, its core strength lies in textile business. Umer group operates through 3 companies in the textile sector.

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. 35.7b during FY19. Umer Group has a strong presence in the export market with more than 50% of total sales comprising exports to 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.

Umer Group of Companies (Rs. in m)				
	FY18	%	FY19	%
Sales	30,174		35,723	
Exports	15,075	50%	18,280	51%
Local	15,100	50%	17,445	49%
Yarn Sales	17,996	61%	21,035	61%
Fabric Sales	11,330	39%	13,576	39%
Spindles	186,960		186,960	
Looms	565		567	

Umer Group has a total installed capacity of 186,960 spindles and 567 looms at end-June'19. 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 and Operating 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-FY19 and Dec'19, capacity utilization of both segments 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. Utilization levels for 9MFY20 remained on the higher side till mid-March'20 and declined subsequently for the remaining half of the month owing to partial closure of the facilities. The manufacturing units have resumed operations since then. While the company has export order till June 2020, management envisages some decline in capacity utilization on account of decline in local demand due to ongoing lockdown situation.

Expansion Plans

In view of long term growth strategy the company has planned capex to expand business operations in the white sheet segment; expected COD of which is October'20. Around two-third of the project cost is being funded LTFF with the remaining planned to be financed through FSML's internal cash flows. This expansion will enhance & diversify revenues and improve margins of the company.

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.

Key Rating Drivers

Coronavirus outbreak is expected to result in uncertainty in textile sector dynamics due to prolonged lockdown, overall contraction in demand and challenging economic environment. It is expected that the entire value chain of the textile industry will be impacted these developments. However, comfort is drawn from export orders in hand, regulatory relaxations and relief measures provided by SBP including a moratorium on debt repayments.

Movement in cotton prices and cotton crop levels drives performance of spinning sector players. Historically, margins and financial performance of players have depicted variation. Moreover, competitive intensity is high due to commoditized nature of the product. As with other local producers in the spinning sector, reliance on China as the major export market translates into some country concentration risk. High country concentration risk and price volatility remains in the weaving sector as well with Bangladesh comprising the major fabric export market. Given the high degree of fragmentation specifically in the weaving segment; pricing power of companies operating in the segment remains limited. Business risk profile remains dependent on inherent cyclicality of prices, crop levels, and demand supply fluctuations. Over the years, management's strategy of cautiously building cotton inventory has resulted in margins oscillating in a narrow band of 9.9%-13.4%. However, sharp decline in cotton prices since the onset of the ongoing calendar year will result in inventory losses and pressure on margins. Timing and quantum of which will depend on average prices and quantity carried by different players.

Coronavirus outbreak is expected to result in uncertainty in textile sector dynamics due to prolonged lockdown, overall contraction in demand and challenging economic environment. It is expected that the entire value chain of the textile industry will be impacted these developments. However, players in the garment segment are expected to be impacted more while gradual opening up of Chinese market has allowed commencement of yarn exports. In general, exports are being impacted due to a number of countries being under partial or complete lockdown. Given the closure of large retail stores, risk of withheld shipment and future orders, delays or extension of payment timelines, and even cancelled orders remains. On the local market front, textile sales are being affected due to continued shut down which will impact revenues and may extend to Ramadan which constitutes a major sales period. A sizeable chunk of sales undertaken for prior months are on credit and delays in collections is expected to adversely impact cash flows. However, comfort is drawn from export orders in hand (up till June 2020) and regulatory relaxations and relief measures provided by SBP. Key measures announced by SBP include reduction in policy rates and allowance for deferral of principal payment for a period of one year. Both these measures will reduce financial burden on textile companies. Moreover, under the relief package announced by GoP, Rs. 30b have been allocated for textile exporters as payment of duty drawbacks providing liquidity support to textile exporters.

Topline of the company grew by 18.5% during FY19. Sales for FY20 are expected to be around FY19 level. Sales for FY21 will be impacted; quantum will depend on timing of opening of local and export markets & subsequent consumer behaviour along with contribution to revenues from the white sheet segment.

Sales have increased on a timeline basis to Rs. 14b (FY18: Rs. 11.8b) during FY19 largely provided by currency devaluation in the outgoing year. Around 70% of total sales are geared towards export market with the remaining comprising local sales. Segment wise, total yarn sales grew by 17% while fabrics sales grew by 20% during FY19. Given the revenues recognized till date, sales for FY20 are expected to be at-least around FY19 level. Going forward, sales for FY21 will be impacted; quantum will depend on timing of opening of local and export markets & subsequent consumer behaviour along with contribution to revenues from the white sheet segment.

Earning profile depicted improvement during FY19 largely on the back of currency devaluation yielding higher average selling prices and efficient raw material procurement. Profitability growth for FY20 may be impacted due to pressure on margins in the ongoing year.
Gross margins of the company improved to 13.4% (FY18: 11%; FY17: 10%) during FY19 largely on the back of higher average selling prices led by sizeable currency devaluation and efficient procurement. Overall operating expenses increased primarily due to higher distribution cost incurred. However, higher share of profit from associated undertaking (Blessed Textiles Limited) supported the bottom line, amounting to Rs. 918m (FY18: Rs. 578m) during FY19. Consequently, net margins also improved considerably to 6.5% (FY18: 4.9%) during the same period. During 1HFY20, gross margins of the company declined to 10.2% and are expected to be lower due to sharp reduction in cotton prices which will result in inventory losses.

Adequate liquidity profile and financial flexibility.
In absolute terms, Funds from Operations (FFO) increased to Rs. 1,404m (FY18: Rs. 1,064m) on account of higher overall profitability during FY19. Debt Service Coverage Ratio (DSCR) and FFO/Long-Term Debt remain strong at 2.86x (FY19: 3.47x, FY18: 4.04x) and 68.5% (FY19: 82.3%, FY18: 62.4%) during 1HFY20, respectively. Inventory and trade debts provide strong coverage for short-term debt obligations while current ratio was reported at 3.85x at end-Dec'19. While cash flows for FY21 may be impacted, liquidity profile draws support from the company's plans to avail SBP's allowance for deferral of principal payment for a period of one year. Maintaining working capital cycle and receivable days will also be important from a liquidity perspective.

Capitalization indicators supported by low leveraged capital structure and conservative financial policy.
On account of higher profit retention, net equity of the company was reported at Rs. 5.5b (FY19: Rs. 5.3b; FY18: Rs. 4.6b; FY17: Rs. 4.2b) at end-Dec'19. Total debt carried on balance sheet amounted to Rs. 1.9b at end-Dec'19; around 85% of the total debt is long-term in nature with a major portion of the same being LTFF, acquired at considerably lower rate and having extended payment period. With a larger equity base, leverage indictors have remained on lower side with gearing and debt leverage reported at 0.35x (FY19: 0.59) and 0.68x (FY19: 0.93) at end-1HFY20, respectively. While remaining within manageable levels, leverage indicators are expected to trend upwards as debt drawdown is undertaken to fund ongoing expansion project.

Faisal Spinning Mills Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**1HFY20***
Fixed Assets	3,499	3,511	3,557	3,601
Long term Investments	550	600	690	726
Stock-in-Trade	2,010	2,403	4,005	2,311
Trade Debts	396	1,035	991	851
Cash & Bank Balances	111	125	166	673
Total Assets	7,327	8,366	10,182	9,212
Trade and Other Payables	554	600	743	767
Long Term Debt	1,787	1,700	1,705	1,621
Short Term Debt	164	646	1,431	281
Total Debt	1,951	2,346	3,136	1,902
Paid Up Capital	100	100	100	100
Total Equity	4,171	4,575	5,278	5,498
INCOME STATEMENT				
Net Sales	10,564	11,843	14,029	7,881
Gross Profit	1,047	1,308	1,884	805
Profit Before Tax	494	721	1,102	492
Profit After Tax	431	578	918	405
RATIO ANALYSIS				
Gross Margin (%)	9.9%	11.0%	13.4%	10.2%
Net Margin	4.1%	4.9%	6.5%	5.1%
Net Working Capital	2,366	2,749	3,459	3,610
Trade debts/Sales	3.7%	8.7%	7.1%	5.4%
FFO	700	1,061	1,404	555
FFO to Total Debt (%)	35.9%	45.2%	44.8%	58.4%
FFO to Long Term Debt (%)	39.2%	62.4%	82.3%	68.5%
Current Ratio (x)	3.62	2.84	2.40	3.85
Debt Servicing Coverage Ratio (x)	3.12	4.04	3.47	2.86
Gearing (x)	0.47	0.51	0.59	0.35
Leverage (x)	0.76	0.83	0.93	0.68
Long Term Debt to TD (%)	92%	72%	54%	85%
Short Term Debt to TD (%)	8%	28%	46%	15%
(Stock+ Trade Debts)/STD	1467%	533%	349%	1125%
Dividend Payout	40%	40%	20%	37%
ROAA (%)	6%	7%	10%	8%
ROAE (%)	11%	13%	19%	15%

** Annualized numbers*

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	Textile Industry
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				
22/4/2020	A	A-1	Rating Watch-Developing	Maintained
21/2/2019	A	A-1	Stable	Reaffirmed
30/3/2018	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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Muhammad Salim	Chairman	07-April-2020
2	Mr. Anwar Hussain, FCA	CFO	07-April-2020