RATING REPORT

Faisal Spinning Mills Limited

REPORT DATE:
May 27, 2021

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	*May 27, 2021*		*April 22, 2020*	
Rating Outlook	Stable		Rating Watch-Developing	
Rating Action	Maintained		Maintained	

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 FY20 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 more than 20 years. He

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. 41.9b and Rs. 23.5b during FY20 and 1HFY21, respectively. 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 56% 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)			
	FY19	**FY20**	**1HFY21**
Sales	41,036	41,921	23,524
Exports	20,148	22,216	10,792
Local	20,889	20,747	12,732
Yarn Sales	21,970	21,894	13,262
Fabric Sales	13,752	14,283	7,342
Spindles installed	186,956	186,956	186,956
Looms installed	568	568	568

Umer Group has a total installed capacity of 186,956 spindles and 568 looms at end-Dec'20. The group carries its operations through five spinning, three weaving units and one recently started finishing unit each producing a unique specialized product. Moreover, in order to ensure an uninterrupted power supply, the group has established Industrial power generation 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. On April 1, 2021, the company's third manufacturing unit related to the finishing segment commenced commercial operations. FSML's 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-FY20, capacity utilization of yarn segment was reported on the higher side at 104% (FY19: 98%) while utilization levels of the fabric segment was reported at similar levels at 68% (FY19: 69). The power unit for the spinning segment has a total capacity of 4.5 MW, while the weaving unit has the capacity of 10MW. Going forward, management envisages capacity utilization to report at pre-COVID levels. No further expansion plans are on board, as per management.

<u>Key Rating Drivers</u>

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

completed bachelors in business administration from The American College, London. He is exempted from the mandatory requirement for attaining Director Training Program.

With the objective of enhancing exports to support the economy, the Government of Pakistan (GoP), has provided incentives in the form of subsidized utility tariffs, low interest rates (Export Finance Scheme (EFS), Long Term Financing Facility (LTFF) and Temporary Economic Refinance Facility (TERF)) and sales tax refund to the textile industry. The textile policy 2020-25 has laid emphasis on fixed electricity and gas tariff for the next 5 years till 2025 at US cents 7.5 per KWh and USD 6.5 per MMBTU, respectively. Moreover, the limits of subsidized (LTFF) financing have been enhanced under this policy to facilitate exporters. Initiatives are also being undertaken in order to increase production and yield of cotton. However, the imposed sales tax has negatively impacted the textile industry. Even though impact of Covid-19's third wave remains elevated, we expect the order book for the industry to remain strong in the ongoing year, easing our business risk concerns.

Gross sales of the company increased by 11% during FY20 largely on account of higher average selling prices; however net revenue increased by 6% on account of imposition of 17% GST on local sales. Going forward, in the ongoing year, sales are expected to escalate on account of adequate orders in pipeline along with sales emanating from the value-added segment.

Sales have increased on a timeline basis to Rs. 14.9b (FY19: Rs. 14.0b) during FY20 largely provided by higher average selling prices led by currency devaluation in the outgoing year. Around 76% (FY19: 74%) of total sales are geared towards export market with the remaining comprising local sales. Segment wise, total yarn and fabric sales grew by 12% and 11.5%, respectively during FY20 contributing 48% (FY19: 47%) and 51% (FY19: 51%), respectively in the gross sales revenue of the company. During FY20, top 5 client concentration improved to 54% (FY19: 90%) with around 85% of the buyers emanating from China. During 9MFY21, the company reported sales revenue to the tune of Rs. 12.5b depicting an uptick in order pipeline. Going forward, in the medium term, sales are expected to escalate on account of adequate orders in pipeline along with sales emanating from the value-added segment yielding higher average selling prices.

Overall profitability profile of the company was impacted by higher cotton prices and currency devaluation on imported cotton during FY20. During 9MFY21, gross margins of the company improved on account of inventory gains impact of which shall reduce once the low price inventory is used up by Jan'22. Going forward, profitability profile of the company is expected to further improve on the back of sales emanating from value-added products yielding higher margins, post expansion.

Gross margins of the company declined to 9.5% (FY19: 13.4%) during FY20 largely on the back of higher cotton prices and currency devaluation. Overall operating expenses increased primarily due to higher distribution cost incurred. Other income increased to Rs. 46m (FY19: Rs. 30m) on account of one-off gain on disposal of fixed assets during FY20. Despite finance costs reported lower at Rs. 247m (FY19: Rs. 291m), net profit margin was reported lower at 3.5% (FY19: 6.5%). During 9MFY21, gross margins of the company improved to 14% on account of inventory gains impact of which shall reduce once the low price inventory is used up by Jan'22. Furthermore, profitability profile was further bolstered by share of profit of associated undertaking (FSML holds 18.5% shares in Blessed Textiles Limited) to the tune of Rs. 205m (FY20: 79m, FY19: 117m). Going forward, profitability profile of the company is expected to further improve on the back of sales emanating from value-added products yielding higher margins, post expansion.

Liquidity indicators weakened in FY20 due to subdued profitability; however the same improved in 9MFY21 and are expected to remain in line with projected increase in overall profitability, going forward.

In absolute terms, Funds from Operations (FFO) amounted to Rs. 961m (FY19: Rs. 1,404m) depicting a sizeable decrease on account of lower overall profitability during FY20. However, in line with improvement in profitability during 9MFY21, Debt Service Coverage Ratio (DSCR), FFO/Long-Term Debt, and FFO/ Total Debt were reported higher at 4.85x (FY20: 2.71x, FY19: 3.47x), 31.8% (FY20: 23.3%, FY19: 82.3%), and 20.3% (FY20: 12%, FY19: 44.8%) at end-Mar'21, respectively. Inventory and trade debts provide strong coverage for short-term debt obligations while current ratio was reported at 2.27x at end-Mar'21. Maintaining working capital cycle and receivable days will also be important from a liquidity perspective.

Leverage indicators have increased on a timeline basis due to debt drawdown to finance expansion in the finishing segment; while the same are expected to improve going forward through debt repayments and growth in equity base from profit retention.

On account of higher profit retention in the ongoing year and limitation on dividend payout under SBP's deferment terms, net equity of the company was reported at Rs. 7.5b (FY20: Rs. 5.9b; FY19: Rs. 5.3b) at end-Mar'21. Total debt carried on balance sheet amounted to Rs. 7.7b (FY20: Rs. 8b, FY19: Rs. 3.1b) at end-Mar'21; around 64% of the same long-term in nature with a major portion of the same being LTFF, acquired at considerably lower rate and having extended payment period. Due to debt drawdown to fund expansion over the years, leverage indictors have increased on a timeline basis with gearing and debt leverage reported at 1.03x (FY20: 1.35x, FY19: 0.59x) and 1.33x (FY20: 1.72x, FY19: 0.93x) at end-Mar'21, respectively. Going forward, capitalization indicators are expected to improve going forward through debt repayments and growth in equity base from profit retention.

Faisal Spinning Mills Limited **Appendix I**

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**FY20**	**9MFY21**
Fixed Assets	3,499	3,511	3,557	3,861	8,450
Long term Investments	550	600	690	717	922
Stock-in-Trade	2,010	2,403	4,005	6,128	5,056
Trade Debts	396	1,035	991	824	1,281
Cash & Bank Balances	111	125	166	235	283
Total Assets	7,327	8,366	10,182	16,144	17,511
Trade and Other Payables	554	600	743	960	1,178
Long Term Debt	1,787	1,700	1,705	4,129	4,945
Short Term Debt	164	646	1,431	3,876	2,792
Total Debt	1,951	2,346	3,136	8,005	7,737
Paid Up Capital	100	100	100	100	100
Total Equity	4,171	4,575	5,278	5,937	7,521
INCOME STATEMENT					
Net Sales	10,564	11,843	14,029	14,896	12,463
Gross Profit	1,047	1,308	1,884	1,410	1,746
Profit Before Tax	494	721	1,102	690	1,221
Profit After Tax	431	578	918	524	1,123
RATIO ANALYSIS					
Gross Margin (%)	9.9%	11.0%	13.4%	9.5%	14.0%
Net Margin	4.1%	4.9%	6.5%	3.5%	9.0%
Net Working Capital	2,366	2,749	3,459	3,493	3,254
Trade debts/Sales	3.7%	8.7%	7.1%	5.5%	7.7%
FFO	700	1,061	1,404	961	1,180
FFO to Total Debt (%)	35.9%	45.2%	44.8%	12.0%	20.3%
FFO to Long Term Debt (%)	39.2%	62.4%	82.3%	23.3%	31.8%
Current Ratio (x)	3.62	2.84	2.40	1.70	1.73
Debt Servicing Coverage Ratio (x)	3.12	4.04	3.47	2.71	4.85
Gearing (x)	0.47	0.51	0.59	1.35	1.03
Leverage (x)	0.76	0.83	0.93	1.72	1.33
Long Term Debt to TD (%)	92%	72%	54%	52%	64%
Short Term Debt to TD (%)	8%	28%	46%	48%	36%
(Stock+Trade Debts)/STD	1467%	533%	349%	179%	227%
ROAA (%)	6%	7%	10%	4%	9%
ROAE (%)	11%	13%	19%	9%	23%

** 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				
	27/5/2021	A	A-1	Stable	Maintained
	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.				
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Due Diligence Meetings Conducted		**Name**	**Designation**	**Date**	
	1	Mr. Muhammad Salim	Executive Director	26-April-2021	
	2	Mr. Anwar Hussain, FCA	CFO	26-April-2021	