RATING REPORT

Faisal Spinning Mills Limited

REPORT DATE:
Aug 11, 2022

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-1	A	A-1
Rating Outlook	Stable		Stable	
Rating Date	*Aug 11, 2022*		*May 27, 2021*	
Rating Action	Reaffirmed		Maintained	

COMPANY INFORMATION	
Incorporated in 1985	**External Auditors:** M/s Mushtaq & Co. Chartered Accountants
Public Listed Company	**Chairman:** Mr. Mohammad Salim
Key Shareholding (more than 5%)	**Chief Executive Officer:** Mr. Bilal Sharif
Admiral (Pvt) Ltd ~12.8%	
Mrs. Samia Bilal ~5.3%	

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

Faisal Spinning Mills Limited

OVERVIEW OF THE INSTITUTION

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

Financial Statements of the year FY21 were audited by 'Mushtaq & Co., Chartered Accountants', which belong to category 'B' on the approved list of auditors published by State Bank of Pakistan (SBP).

Profile of Chairman:

Mr. Mohammad Salim, serving as Board Chairman, was awarded certification from the Institute of Chartered Accountants of Pakistan on completion of Director Training program in April'16. Besides, commercial endeavors he actively participates in several social and welfare activities.

Profile of CEO:

Mr. Bilal Sharif has been serving as CEO since 2011. He completed bachelors in business administration from The American College, London. He is exempted from the mandatory requirement for attaining Director Training Program.

RATING RATIONALE

Group profile

Umer Group of Companies, founded in 1982, is one of the Pakistan's leading textile groups, with an annual turnover of more than USD 350m. The group has a diverse business profile and investments in various other sectors as well such as power generation, footwear manufacturing/retail, leather, dairy and construction.

The group has an extensive experience of over 34 years in the textile sector and comprises 3 textile companies, which are cumulatively operating 5 spinning mills, 3 weaving mills and 1 recently established finishing unit. In addition, industrial power generation for each unit is present, with a total capacity of 44.5MW, ensuring uninterrupted power supply. Over the years, the group has managed to achieve a sizable market share in both domestic and export sales. Major export destinations include China, Italy, Japan, Turkey, Belgium, and other European countries.

Figure: Key Financial Figures – Umer Group (Rs. in m)

	FY19	FY20	FY21	6M'FY22
Sales	41,036	41,921	50,493	33,586
Exports	20,148	22,216	25,418	15,380
Local	20,889	20,747	25,738	18,206
Yarn Sales	21,970	21,894	28,555	18,700
Fabric Sales	13,752	14,283	15,083	11,993
Spindles installed	186,956	186,956	186,956	186,956
Looms installed	567	567	567	567

Corporate profile

Faisal Spinning Mills Limited (FSML), headquartered in Karachi, operates three manufacturing units: spinning weaving and finishing (operations began in April'21); facilities are located at Nooriabad, District Dadu (Sindh) and Feroze Wattwan, District Sheikhupura (Punjab). With operating history of over 37 years, FSML has been engaged in manufacturing and sale of yarn (coarse to medium yarn with count range varying from 8-30 singles catering primarily to export markets for utilization in denim production), made-up articles and greige & dyed fabric. The sponsoring family is actively involved in business affairs, and a qualified senior management team with extensive experience is in place. Total staff strength, including labor, increased to 1,280 (2020: 1,037) employees.

Production capabilities

Installed capacity remains unchanged at 38,208 spindles and 265 air-jet looms, with capacity utilization in the yarn segment increasing post-FY19, while fabric division utilization has remained at similar levels over the years. Power requirement of 13.45MW is met through a mix of 3 sources; gas-based generators, national grid and furnace oil captive power plant. In addition, a solar power plant was recently installed.

Figure: Capacity & Production Data

	FY19	FY20	FY21	6M'FY22
Spinning				
Installed capacity (kgs)	19.9m	19.9m	19.9m	9.9m
Actual Production (kgs)	19.4m	20.6m	23.2m	11.621m
Utilization	*98%*	*104%*	*116%*	*117.38m*
Weaving				
Installed capacity (mtrs)	64.3m	64.3m	64.3m	32.2m
Actual Production (mtrs)	44.6m	43.8m	40.2m	20.1m
*Utilization**	*69%*	*68%*	*63%*	*63%*
Finishing & Home Textile				
Installed capacity (mtrs)	-	-	26.8m	100m
Actual Production (mtrs)	-	-	3.25m	35m
Utilization	-	-	*14%*	*55%*

**utilization is reported on the lower side due to conversion of picks*

Key Rating Drivers

Textile and clothing exports registered a sizeable growth given the surge in demand on account of rerouting of orders to Pakistan. The ongoing energy crisis in the country poses a challenge to future growth of the sector.

Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of Rs. 3.8tr (FY20: Rs. 3.3tr) in FY21. Barring seasonal and cyclical fluctuations, textiles products have maintained an average share of about 60% in national exports. Export revenues from textile sector have increased significantly over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports.

Figure: Textile Exports (as per PBS)

Segments	Value (US$ millions)		
	FY20	FY21	FY22
Knitwear products	2,785	3,816	5,121
Readymade Garments	2,549	3,033	3,905
Bed wear	2,149	2,772	3,293
Cotton Cloth	1,830	1,921	2,438
Cotton Yarn	987	1,017	1,207
Towels	711	938	1,111
Made-up Articles	591	756	849
Art, silk and synthetic textile	314	370	461
Tents, canvas and tarpaulin	98	110	110
Others	487	667	835

Given the looming global recession, commodities super-cycle, rising inflation, and monetary tightening in major world economies, textile export orders growth in Pakistan is expected to slow down in the medium-term. This, combined with the country's ongoing energy crisis and rising production costs, poses a challenge to the sector's margin sustainability and future growth.

5-Year (2020-25) textile policy continues to support the industry.
With an aim to double textile exports in five years, GoP through a five-year textile policy (2020-25) has provided incentives in form of preferential energy rates, low interest rates financing schemes (such as EFS, LTFF and TERF) and timely payments of DLTL, Income tax & Sales tax refund which support liquidity constraints of local players. Initiatives have also been undertaken to increase production and yield of cotton to support the industry. However, imposition of 10% super tax would have a negative effect on profitability profile of textile players. In addition, contractionary monetary policy and political uncertainties in the country are the present major business risk factors. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future of textile exports.

High cyclicality and competitiveness in the spinning sector translate into high business risk profile.
Movement in cotton prices and cotton crop levels drives performance of spinning players in Pakistan. Given sizeable deficit in local cotton production vis-à-vis demand in the recent years, cotton prices have remained elevated due to which inventory loss risk is considered limited. Business risk is supported by favorable government policies and healthy demand outlook.

Sizeable revenue growth is mainly attributable to addition of finishing segment sales (dyed fabric and made-up articles), volumetric increase in yarn exports and domestic fabric sales and higher average prices.
Over the last five fiscal years, topline has nearly doubled, reaching Rs. 17.1b (FY20: Rs. 14.9b) in FY21. The year-on-year uptick of ~17% was primarily due to the addition of finishing segment sales (dyed fabric and made-up articles), volumetric increase in yarn exports and domestic fabric sales, rising price trend and rupee depreciation impact. With similar growth momentum, revenues amounted to Rs. 22.3b during 9M'FY22, increasing significantly by ~79% vis-à-vis SPLY. As per management, sales revenues is targeted to cross the Rs. 30b mark for the year FY23, with major growth expected to emanate from home textile segment, which is now operating at full capacity.

At present, spinning segment generates ~45% of sales revenues, followed by weaving at ~40% and finishing at ~15%. Within finishing segment, major growth was driven by institutional sales given post pandemic demand surge in hospitality sector. Sales mix, in terms of exports and local sales, has hovered at around 80:20 while major growth over the review period emanated from exports (primarily yarn and made up articles). China, Portugal, Italy, Bangladesh, Japan, Belgium and Germany are currently among the major export destinations. Client-wise sale concentration risk has remained elevated over time; however, long-standing business relationships with major clients provide comfort and ensure repeat business.

Akin to industry, inventory gains significantly increased profitability margins.
Gross margins increased significantly on a timeline basis (9M'FY22: 20.1%; FY21: 14.6%; FY20: 9.5%; FY19: 13.4%) due to better absorption of per unit fixed costs, efficient cotton procurement, and favorable cotton price differential, which is consistent with the industry trend. In addition, ~90% cotton is procured from international market. On the cost front, higher debt utilization levels have led to an increase in financial charges, while distribution and administrative costs have surged largely in line with inflation. Given significant growth in revenues and margins, bottom-line noted a more than four-fold increase during FY21 and continued to grow further in 9M'FY22. Given that cotton procurement is covered till Dec'23, management expects margins to sustain in the current fiscal year FY23.

Liquidity metric have improved, with significant cash flow generation in line with increased profitability.
In line with improving profitability, Funds from Operations (FFO) increased significantly to Rs. 3.9b (FY21: Rs. 2.1b; FY20: Rs. 1.4b) at end-9M'FY22. As a result, FFO to total debt and FFO to long-term debt also increased considerably to 0.45x (FY21: 0.25x; FY20: 0.12x) and 0.89x (FY21: 0.35x; FY20: 0.23x), respectively. Healthy cash flow generation has positively impacted debt coverage metrics as reflected by strong growth in DSCR to 5.36x (FY21: 2.80x; FY20: 4.51x). At present, current ratio is reported at 1.8x while inventory and trade debts provide sound coverage for short-term debt obligations. Aging profile of trade debts remains within manageable levels.

Strong earnings growth and the overall group's conservative financial policy support capitalization levels.
Equity base (including sponsor's loan) has nearly doubled over the last 18 months, reaching to Rs. 11.7b (FY21: Rs. 8.8b) at end-9M'FY22. The dividend payout ratio stood at 9% (FY20: 29%) in FY21. Debt profile comprises a mix of short-term and long-term debt with total interest bearing liabilities increasing to Rs. 9.9b (FY21: Rs. 6.6b) at end-9M'FY22; short-term financing (ERF) constituted ~49% of total debt as mobilized to fund inventory levels. Long-term debt has also increased on a timeline basis on account of recently established finishing division. Given strong growth in equity base, leverage ratios have noted improvement.

Faisal Spinning Mills Limited **Appendix I**

FINANCIAL SUMMARY					*(amounts in PKR millions)*
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**9M'FY22**
Non-Current Assets	4,120	4,256	7,644	10,114	11,510
Stores, Spares. And Loose Tools	71	94	125	238	420
Stock-in-Trade	2,403	4,005	6,128	5,236	6,811
Trade Debts	1,035	991	824	1,370	3,290
Advances, Deposits and Other Receivables	611	669	1,188	957	1,799
Cash and Bank Balance	125	166	235	118	1,276
Total Assets	**8,366**	**10,812**	**16,144**	**18,034**	**25,105**
Trade and Other Payables	600	743	960	1,400	2,279
Long-Term Borrowings *(Inc. current maturity)*	1,700	1,705	4,129	4,764	5,014
Short-Term Borrowings	646	1,431	3,876	1,878	4,837
Total Liabilities	**3,791**	**4,904**	**10,207**	**9,280**	**13,404**
Paid-up Capital	100	100	100	100	100
Total Equity	**4,575**	**5,278**	**5,937**	**8,754**	**11,701**
INCOME STATEMENT					
Net Sales	11,843	14,029	14,896	17,065	22,321
Gross Profit	1,308	1,884	1,410	2,489	4,482
Profit Before Tax	721	1,102	690	2,540	3,423
Profit After Tax	578	918	524	2,359	3,165
RATIO ANALYSIS					
Gross Margin (%)	11.0%	13.4%	9.5%	14.6%	20.1%
Net Margin (%)	4.9%	6.5%	3.5%	13.8%	14.2%
Net Working Capital	2,749	3,459	3,493	4,220	5,852
Current Ratio	2.8	2.4	1.7	2.1	1.8
FFO to Long-Term Debt	0.62	0.82	0.23	0.35	0.89
FFO to Total Debt	0.45	0.45	0.12	0.25	0.45
DSCR (x)	3.32	3.45	4.51	2.80	5.36
Gearing (x)	0.51	0.59	1.35	0.76	0.84
Debt Leverage (x)	0.83	0.93	1.72	1.06	1.15
Inventory + Receivable/Short-term Borrowings (x)	533%	349%	179%	352%	209%

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
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				
11/Aug/2022	A	A-1	Stable	Reaffirmed
27/May/2021	A	A-1	Stable	Maintained
22/Apr/2020	A	A-1	Rating Watch-Developing	Maintained
21/Feb/2019	A	A-1	Stable	Reaffirmed
30/Mar/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 Meeting Conducted

Name	Designation	Date
Mr. Muhammad Salim	Chairman	July 21, 2022