

RATING REPORT

Faisal Spinning Mills Limited

REPORT DATE:

September 26, 2023

RATING ANALYSTS:

Muhammad Tabish

muhhammad.tabish@vis.com.pk

Syed Ilyas Afridi

ilyas.afridi@vis.com.pk

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 Action	Reaffirmed		Reaffirmed	
Rating Date	Sept 26, 2023		Aug 11, 2022	

COMPANY INFORMATION

Incorporated in 1985	External Auditors: M/s Mushtaq & Co. Chartered Accountants
Public Listed Company	Chairman: Mr. Mohammad Salim
Key Shareholders (with stake 5% or more):	Chief Executive Officer: Mr. Bilal Sharif
<i>Admiral (Pvt) Ltd. ~12.8%</i>	
<i>Ms. Samia Bilal ~5.3%</i>	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Industrial Corporates (May 2023)

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale: <https://docs.vis.com.pk/docs/VISRatingScales.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.

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

Founded in 1982, Umer Group of Companies stands as a prominent textile conglomerate in Pakistan, with an annual turnover of over USD 350m. Apart from its stronghold in textiles, the group has diversified into power generation, footwear, leather, dairy, and construction.

With over 40 years in the textile industry, Umer Group operates 3 textile entities, collectively running 7 spinning mills, 3 weaving mills, and 1 finishing unit. Every unit has its own dedicated power generation, totaling over 40MW, and ensuring consistent power supply. The group over the years has gained a significant market share on both domestic and export fronts. Major export destinations include China, Italy, Japan, Turkey, Belgium, and other European nations.

Table: Key Indicators – Umer Group (In PKR millions)

	FY19	FY20	FY21	FY22	FY23*
Total no. of Spindles	186,956	186,956	186,956	186,956	219,596
Total no. of Looms	567	567	567	567	567
Sales Revenue	41,036	41,921	50,493	71,358	74,274
- Exports	49%	52%	50%	62%	55%
- Locals	51%	48%	50%	38%	45%
Yarn Sales	21,970	21,894	28,555	29,085	41,199
Fabric Sales	13,752	14,283	15,083	40,571	33,075

* Tentative figures

The collective average energy demand of all three group textile companies exceeds 35 MW, met through an equal mix of 11 MW gas-based generators and a dedicated 30 MW national gridline. In addition, solar power has also been recently deployed.

Corporate Profile

Faisal Spinning Mills Limited (FSML), with a 38-year operational history, specializes in yarn production, primarily catering to the export market for utilization in denim manufacture, and offers made-up articles and fabrics (both greige & dyed). While production infrastructure is based in Sindh and Punjab, integrated structure and in-house power plants ensure uninterrupted operations. The sponsors actively manage daily business affairs, with an experienced senior management team in place while total staff strength (including labors) stands at over 1,700 employees. The company also holds numerous export standards and trade certifications, reflecting quality commitment.

Operating Performance

Headquartered in Karachi, the company operates via three manufacturing units: spinning, weaving, and finishing & stitching, located at Nooriabad, District Dadu, and Feroze Wattwan, District Sheikhpura. In the last 21 months, capital expenditure surpassed Rs. 2.8b, primarily backed by subsidized debt financing. Spinning capacity remained steady over time, while weaving capacity grew about ~6% in the last two fiscal years, mainly by the replacement of 14 air-jet looms and other related equipment. Despite varying yarn production trends, the weaving segment output has consistently grown with its capacity. The finishing division has seen a stable rise in both capacity and production.

Table: Capacity & Production Data (Units in millions)

	FY21	FY22	FY23
Spinning			
No. of spindles	38,208	38,208	38,208
Installed Capacity – Kgs	23.2	23.2	23.2
Actual Production – Kgs	19.9	22.8	20.1
Capacity Utilization	86%	99%	87%
Weaving			
No. of looms	265	265	265
Installed Capacity – Meters	64.3	67.6	68.4
Actual Production – Meters	40.2	41.2	49.4
Capacity Utilization	63%	61%	72%
Finishing & Stitching			
Installed Capacity – Meters	26.8	28.0	31.0
Actual Production – Meters	4.4	28.7	34.8
Capacity Utilization	99%*	102%	112%

**Based on the finishing unit commencing operations from Apr'21 onwards*

Key Rating Drivers

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand. All these factors pose a challenge to the sector over the medium term in terms of margins sustainability and future growth.

Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports broke the threshold, clocking in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and provides employment to about 40% of the industrial labor force. Contributing around 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr, textile sector has maintained an average share of about 60% in national exports over the years.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22	FY23
Pakistan Total Exports	22,536	25,639	32,450	27,911
Textile Exports	12,851	14,492	18,525	16,710
PKR/USD Average rate	158.0	160.0	177.5	248.0

Source: SBP

The lingering effects of Covid-19 pandemic continue to shape the Pakistan's textile industry. Initially, as lockdowns lifted, the industry capitalized on opportunities, securing production contracts with Western countries. This redirection of substantial volumes to Pakistan, complemented by government import tax reductions and subsidized covid-related financing programs such as TERF, spurred robust export growth during FY20-22. However, a subsequent phase presented new challenges. Global interest rate hikes aimed at curbing post-pandemic inflation, coupled with geopolitical unrest such as the Ukraine conflict, led to supply chain disruptions and energy crisis. These factors led to a global demand slowdown in major textile economies, reflected in a ~15% year-on-year decline in Pakistan's textile exports in FY23, totaling USD 16.5b (FY22: USD 19.3b). Knitwear, Readymade, and Bed wear segments remain key contributors, making up over 60% of the textile exports.

Table: Textile Export Details (in USD millions)

	FY20	FY21	FY22	FY23	YoY FY23
High Value-Added Segment	9,669	12,427	15,611	13,576	-13%
- Knitwear	2,794	3,815	5,121	4,437	-13%
- Readymade Garments	2,552	3,033	3,905	3,492	-11%
- Bed wear	2,151	2,772	3,293	2,692	-18%
- Towels	711	938	1,111	1,000	-10%
- Made-up Articles	591	756	849	693	-18%
- Art, Silk & Synthetic Textile	315	370	460	412	-10%
- Others	555	743	872	851	-2%
Low to medium Value-Added Segment	2,858	2,972	3,719	2,926	-21%
- Cotton Cloth	1,830	1,921	2,438	2,022	-17%
- Cotton Yarn	984	1,017	1,207	844	-30%
- Others	43	34	74	60	-20%
Total	12,527	15,399	19,330	16,502	-15%

Source: PBS

Flash floods in Sindh and Southern Punjab from last year's monsoon wreaked havoc on the cotton crop, washing away roughly 45% worth over USD 2.5b. This catastrophe led to a historic low yield of 4 million bales in 2022, compared to a 12 million bales annual demand. Local cotton prices subsequently reached a 12-year high of over Rs. 22,000 per 40kg during the year, and imports rose by ~20% in USD terms for FY22, vis-à-vis preceding year. This situation heightened working capital needs, adversely affecting profit margins and liquidity profile for textile entities, particularly spinners, weavers, and dyeing companies. On a positive note, the production target for the current season is set at 12.7 million bales, supported by favorable weather and timely government intervention.

Table: Cotton Prices Trend (In Rs.)

	June'19	June'20	June'21	June'22	June'23
Per Maund	8,770	8,860	13,000	17,380	17,735
YoY % Change	26%	1%	32%	34%	2%

The industry faces medium-term risks due to the current weak macroeconomic environment both globally and locally, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand, primarily from North America and Europe. Additionally, the potential expiration of Pakistan's GSP plus status in December 2023 could be impactful. This status, allowing duty-free access to the EU for over 6,300 tariff lines, fosters beneficial trade. Its loss could lead to reduced trade revenues and create market uncertainties.

Previously, the sector also enjoyed incentives provided by the government through a five-year textile policy (2020-25), including preferential energy rates, low-interest financing schemes, and timely payments of various refunds, easing liquidity constraints for local players. However, the prevailing economic instability led to the reduction or withdrawal of many of these supports. This along with contractionary monetary policy and political uncertainties in the country are the key present business risk factors. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future prospects of textile exports.

The introduction of home textiles and dyed fabric mainly spurred growth in revenues, even with declining overall export volumes in FY23.

Net sales grew by more than 2x over the last two fiscal years, reaching an all-time high of Rs. 32.1b (FY21: Rs. 17.1b). The sizeable ~88% YoY growth is attributed to several factors:

~36% hike in dollar-based prices, ~29% surge in sales volume, and ~23% from the rupee devaluation impact. Exports continue to make up over three-quarters of total revenue, with the rest coming from domestic sales. In FY22, local sales surged by 87%, whereas exports rose by 88%. Delving deeper, export volumes increased by ~24%, while domestic volumes expanded by ~41%.

Currently, sales are distributed as 41% greige fabric, 35% yarn, 24% home textile made-ups (like bedsheets, quilts, and table covers), and the rest constituted by dyed fabric. While all segments noted growth, the addition of home textiles and dyed fabric primarily drove the uptick in the review period. Product-wise, average export-to-local sales ratios are 98:2 for yarn, 55:45 for greige fabric, 57:43 for dyed fabric, and home textiles are all exported.

The geographic mix features diversification, with close to two-fifths of exports directed towards the European region, followed by Asia, the Middle East, and the US. Other significant markets include Africa and Australia. The concentration among the top 10 clients is reasonably balanced, accounting for over 30% of total sales. Notable contributors to export revenue include firms such as Zorluteks Tekstil, Vipe Trade, Pincroft Dyeing & Printing, Mount Vernon Mills, China Ctexic Corporation, and Xiamen Port Commerce to name a few.

Despite FY23's global challenges reducing export volumes, revenue hit Rs. 37.8b, driven by continued rupee depreciation. With expected global demand recovery and operational expansions, management aims for a topline of Rs. 41b, with a net margin of 5% in FY24.

Profitability margins reverted to past levels due to higher cotton imports and operating cost hikes across the board.

Akin to the industry, profit margins soared in recent fiscal years due to strong demand, strategic cotton purchasing and price benefits, operational efficiency, and rupee depreciation gains. However, FY23 brought a return to historical levels influenced by shrinking yarn profits, global economic shifts, rising energy and borrowing costs, and escalating raw material prices. Management expects these margin trends to continue into FY24.

About 60% of fabric and 30% of yarn requirements are fulfilled internally, while the rest are procured locally. After a local crop shortage last season, the use of imported cotton surged from 50% to over 80%, but management aims to reverse this trend in the current year. The increase in operating overheads is linked to inflation, higher commissions and staff wages, freight charge hikes from global supply chain disruptions, and sales growth trend. Financial charges also noted a significant rise due to elevated debt levels and benchmark rates.

Profit decline affected cash flows and debt coverage, yet liquidity remains sound.

Over the past two years, unprecedented net profits spurred a sizeable growth in funds flow from operations (FFO). Yet, in 9M'FY23, divergent cash flows and a considerable rise in debt levels impacted coverage metrics, with the debt service coverage ratio (DSCR) slipping below 3.0x, aligning with the industry median. The liquidity profile remains sound, with a current ratio of over 1.5x and adequate coverage of short-term debts with inventory and receivables. The cash conversion cycle, influenced by extended inventory periods, lingers above 100 days. Notably, only 10% of trade debts were past due by a year, with no bad debts reported.

Retained profits supported capitalization. Despite rising debt levels, leverage ratios remain competitive with peers.

Since FY20, the equity base expanded roughly by 2.1x, reaching Rs. 13.7b (FY22: Rs. 12.5b) at end-9M'FY23, supported by healthy earnings and high retention. The dividends paid in

FY22 totaled Rs. 214m, a ~5% payout (FY21: 9%), below historical averages. This dividend amount was maintained in FY23. Furthermore, Rs. 2.7b was transferred to the general reserve to address any potential future contingencies.

Debt profile is a blend of short-term and long-term debt, with total interest-bearing liabilities increasing to Rs. 13.9b (FY22: Rs. 10.1b; FY21: Rs. 6.6b) at end-9M FY23, ~65% constituted short-term debt while aggregated running finance lines stands at nearly Rs. 11.9b, with about half being ERF/EFS facility. Management highlighted that the average cost of long-term debt is 300 bps. Despite rising leverage, it remains competitive with peers.

Sound corporate governance framework

The 10-member board includes three independent, six non-executive, and one executive director including one female representative. Dedicated committees for Audit HR and remuneration are headed by independent members, with two non-executive directors filling the remaining positions. A separate internal audit function further ensures effective oversight. The 2022 audit report highlighted key audit matters concerning revenue recognition.

Faisal Spinning Mills Limited

Appendix I

FINANCIAL SUMMARY				
<i>(amounts in PKR millions)</i>				
<u>BALANCE SHEET</u>	FY20	FY21	FY22	9M'FY23
Fixed Asset	3,860.6	8,619.8	10,256.4	10,187.4
Stock-in-Trade	6,128.0	5,236.3	5,537.5	13,552.8
Trade Debts	823.7	1,369.5	3,259.1	3,949.6
Cash and Bank Balance	235.0	117.9	4,442.5	575.5
Total Assets	16,143.5	18,033.9	27,234.1	34,343.0
Trade and Other Payables	960.4	1,400.1	3,027.8	4,667.4
Long-Term Borrowings <i>(Incl. current maturity)</i>	4,128.6	4,763.9	5,247.0	4,886.6
Short-Term Borrowings	3,876.0	1,878.2	4,872.2	9,018.4
Total Debt	8,004.6	6,642.0	10,119.2	13,905.0
Total Liabilities	10,206.6	9,280.3	14,764.7	20,605.6
Paid-up Capital	100.0	100.0	100.0	100.0
Total Equity <i>(Incl. loan from directors)</i>	5,936.9	8,753.5	12,469.4	13,737.3
<u>INCOME STATEMENT</u>				
Net Sales	14,895.6	17,065.2	32,074.4	26,901.7
Gross Profit	1,410.3	2,488.8	6,372.4	3,567.6
Operating Profit	812.3	1,612.0	4,467.2	1,973.5
Profit Before Tax	690.4	2,540.3	4,725.2	1,783.4
Profit After Tax	523.9	2,359.3	4,098.3	1,347.5
<u>RATIO ANALYSIS</u>				
Gross Margin (%)	9.5%	14.6%	19.9%	13.3%
Net Margin (%)	3.5%	13.8%	12.8%	5.0%
Net Working Capital	3,492.6	4,220.5	6,693.8	7,677.9
Current Ratio (x)	1.70	2.14	1.78	1.52
FFO	960.7	1,664.9	4,592.4	2,092.7
FFO to Long-Term Debt (%)	23.3%	34.9%	87.5%	57.1%*
FFO to Total Debt (%)	12.0%	25.1%	45.4%	20.1%*
DSCR (x)	4.51	2.80	4.93	2.57*
Gearing (x)	1.35	0.76	0.81	1.01
Debt Leverage (x)	1.72	1.06	1.18	1.50
Inventory + Receivable/Short-term Borrowings (x)	1.79	3.52	1.81	1.94
ROAA (%)	4.0%	13.8%	18.1%	5.8%*
ROAE (%)	9.3%	32.1%	38.6%	13.7%*

*Annualized

REGULATORY DISCLOSURES						Appendix II
Name of Rated Entity	Faisal Spinning Mills Limited					
Sector	Textile					
Type of Relationship	Solicited					
Purpose of Rating	Entity Ratings					
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action	
	<u>Rating Type: Entity</u>					
	26/09/2023	A	A-1	Stable	Reaffirmed	
	11/08/2022	A	A-1	Stable	Reaffirmed	
	27/05/2021	A	A-1	Stable	Maintained	
	22/04/2020	A	A-1	Rating Watch-Developing	Maintained	
	21/02/2019	A	A-2	Stable	Reaffirmed	
30/03/2018	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. Mohammad Salim	Group Chairman	August 02, 2023			