RATING REPORT

J.K Spinning Mills Limited (JKSM)

REPORT DATE:
March 28, 2019

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	A-	A-1
Rating Outlook	Stable	
Rating Date	March 28, 2019	

COMPANY INFORMATION	
Incorporated in 1987	**External auditors:** Ernst & Young Ford Rhodes Sidat Hyder & Co. Chartered Accountants
Listed Public Limited Company	**Chairman of the Board:** Mr. Jawed Anwar
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Faiq Jawed
Mr. Jawed Anwar – 39.51%	
Mr. Faiq Jawed – 24.74%	
Mr. Shaiq Jawed – 15.56%	
Mr. Farhat Jehan – 15.47%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (May 2016)

https://www.vis.com.pk/kc-meth.aspx

J.K. Spinning Mills Limited (JKSM)

OVERVIEW OF THE INSTITUTION

J.K Spinning Mills Limited was incorporated as a public limited company in 1987 under the Companies Ordinance 1984. Registered office of the company is situated in Faisalabad.

Profile of Chairman

Mr. Jawed Anwar serves as chairman of the board. He has 60 years' experience of running an export house and spinning industry. He served as the vice chairman of Faisalabad Chamber of Commerce and chairman of Pakistan Textile Exporters Association .

Profile of CEO

Mr. Faiq Jawed serves as CEO of the company and has 34 years' experience of running export house and spinning industry. He served as the vice chairman of Faisalabad Chamber of Commerce

RATING RATIONALE

In 1987, J.K. Spinning Mills Limited (JKSM) was incorporated as a public limited company. The company commenced commercial production in 1989 with capacity of 14,400 spindles. JKSM operates spinning, weaving and stitching divisions with coarse yarn and home textile offered as its key products. Registered office and manufacturing facility of the company are both located in Faisalabad, Pakistan.

In 1975, J.K. Group commenced business by forming J.K. Brothers as an export house under a partnership. Later, in 1987, J.K. Spinning was incorporated as a public limited company which started commercial production in 1989 with 14,400 spindles. Subsequently in 1992, JK group established another mill named J K Fiber Mills ltd. In the same year, the group entity was segregated and J.K brothers' was transferred to other partners. Following the segregation, J.K Sons Private Limited was incorporated in 1994 to commence fabric and home textile export. In 2011, J.K. Fiber Mills Limited and J.K. Sons (Private) Limited were merged into JKSM. Currently, J.K. Group owns 5 companies namely J.K. Power (Private) Limited, J.K. Agriculture Farms (Private) Limited, Fine Fabrics (Private) Limited and J.K. Tech (Private) Limited.

Product Portfolio

Spinning

JKSM offers a broad range of ring spun yarn with counts ranging from 16/1 to 80/1. The coarser yarn mainly caters to denim and bottom weight fabrics, which are used for work wear and apparel towels. Fine compact yarn caters to higher thread count bed sheets and shirt fabric. The company also produces customized yarn as per customer requirements for work wear, technical fabrics, towels and knitted fabrics.

Spinning Products			
Yarn Type	**Count Range**	**Composition**	**End Use**
Carded	6/1-30/1	100% ring-spun cotton	Denim, Upholstery, work-wear, apparel towels
Combed	14/1-60/1	Pakistani, Australian, Extra-Long Staple CIS	Sheeting, Circular Knitting
Blended	16/1-40/1	Polyester Fiber blended with cotton	Work-wear, sports-wear, active wear, towels
Slubs	4.5/1-20/1	100% Cotton, Polyester-cotton in various blends	Denim, Curtains, Sweaters
SIRO Apparel	7/1-10/1	100% Cotton	Denim

Fabric , Home Textile and Hospitality Supplies

The fabric and weaving division offers a wide variety of fabric. The division is involved in processed cloth production as well as made ups like bed sheets, table covers, curtains, pillow covers, comforter shells etc. The dyed and printed sheeting range comprises high density fabrics with widths up to 340 cm and yarn count range of (Ne) 20/1 – 100/1. This segment includes Percales up to 400 thread count per square inch and Sateens up to 500 thread count per square inch. Moreover, JKSM offers a wide range of dyes and finishes in accordance with customer requirements. The options for dyeing and printing include Pigment, Vat, Reactive and Disperse through outsourcing.

and chairman of Pakistan Textile Exporters Association .

Fabric Products	Stitching products
Griege	Flat Sheets
Dyed	Fitted Sheets
Bleached	Pillowcases
Print Shape weaving	Pillow Shams
Twill	Dec Pillows
Drill	Bed Skirts
Duck	Duvet Covers
Flannel	Comforter Shells

Operating Performance

Presently, JKSM has 121,560 spindles with production capacity of 39m kgs of yarn converted to 20s whereas the weaving division has currently 90 looms with a production capacity of 18 m sq. meters at 50 picks. Currently, the spinning production facility is undergoing capex for an addition of 15,440 spindles by end-FY19. Out of the existing spindles, more than 50,000 spindles are dedicated for fine count yarn. Average capacity utilization has been on the higher side. However, utilization during FY18 remained relatively lower for both divisions due to gradual addition of looms and spindles during FY18.

Spinning	FY17	FY18
Spindles	97,848	121,560
Installed Capacity Converted 20s Count (Mn Kgs)	31.2	39
Actual Production (Mn Kgs)	29.6	32
Utilization Rate	95%	82%
Weaving	**FY17**	**FY18**
Looms	30	36
Installed Capacity at 50 picks (Mn sq. meters)	3.4	7.2
Actual Production (Mn sq. meters)	3	4.3
Utilization	88%	60%

Key Rating Drivers

Enhanced government focus on textile sector supports industry risk profile while limited spinning exposure to export market and diversification into weaving and fabrics mitigates business risk for the company.

Notable measures have been undertaken by the Government of Pakistan (GoP) to uplift the textile sector including reduction in energy prices and regulatory duty on import of cotton. Recent episodes of rupee devaluation have also been favorable for the sector. Nonetheless, margins and financial performance of players in the industry have depicted volatility due to inherent cyclicality of crop levels and oscillations in cotton prices. Integrated business profile reduces JKSM's core reliance on cotton and yarn prices and places the company in a comfortable position. Moreover, change in international spinning dynamics has been witnessed following the shifting of spinning mills from China to Vietnam. Demand side of yarn has felt downward pressure and is expected to negatively impact export trade volumes of yarn from Pakistan. However, given higher concentration of the spinning segment in local market, JKSM is positioned well in this regard.

Rupee devaluation and better yarn and fabric prices were key factors behind growth in sales. The impact of new addition of spindles and international clients to bode well for the topline going forward.

The proportion of local sales was 60% in net revenue while the rest relates to export sales. Net sales of the company have increased at a Compound Annual Growth Rate (CAGR) of 11% over the past three years (FY15-1HFY19) based on annualized sales of 1HFY19. Net sales amounted to Rs. 9.9b (FY17: Rs. 9.05b; FY16: Rs. 8.2b) in FY18. Growth in sales has been a function of increasing yarn and fabric prices coupled with multiple rounds of PKR devaluation. Overall volumes did not witness a major increase due to shift of 50, 000 spindles from course count to fine count. Fabric products have strong presence in export market as this division has been recording 100% export sales over a timeline basis while yarn products cater to the domestic market with 95% local sales. As per management, the company has witnessed strong global demand for its stitched fabric products mainly from hospitals and hospitality industry which has driven the per unit prices upwards. Resultantly, the company is expecting improved sales performance from the fabric division on account of better prices and growing volumes, going forward. Also, with regards to the spinning and weaving division, the impact of additional spindles and newly added looms will also be witnessed in the form of enhanced sales of yarn, going forward.

Geographic concentration remains high while client concentration is on the lower side. Recent trade rift between USA and China may shift US customers to neighboring regional substitutes.
The company's fabric products have strong global presence. However, high geographic concentration has been witnessed in Europe which accounted for 74% of total fabric exports (FY17: 82%; FY16: 66%) in FY18. The recent trade war between USA and China has restricted cotton trade for USA; as a result the company expects a diversification in its regional sales with an addition of more US based clients, going forward. In contrast, client concentration is considered on a lower side as top 10 clients represented 21% of total sales (FY17: 20%; FY16: 16%) during FY18.

High dependence on local cotton limits JKSM's exposure to adverse currency movements. A shift from Indian cotton is expected amid recent tariff imposition by India.
Out of the total cotton requirement, around two-third was procured locally while the remaining was imported mainly from India, Spain and Brazil during FY18. A similar trend has been witnessed historically. Management remains proactive with respect to adjusting its cotton procurement mix based on availability and feasibility of cotton.

Cost Mix	FY16		FY17		FY18	
	% of cotton used	Average Cost	% of cotton used	Average Cost	% of cotton used	Average Cost
Pakistani Cotton	52%	144	65%	169	64%	174
Indian Cotton	29%	162	22%	211	20%	240
Rest of World	19%	163	13%	171	16%	198

Margin expansion has been a function of increase in yarn prices, strategic cotton procurement, rupee devaluation and enhanced fabric demand in export markets. Growth trajectory in profitability is expected to sustain on the back of diversified segment sales, favorable cost of inventory carried on the balance sheet and low cost debt profile.
Although yarn volumes were almost stagnant due to the shift to fine yarn counts from coarse yarn counts, higher growth in local yarn prices vis-à-vis cotton rates, efficient raw material procurement, significant rupee devaluation and healthy global demand for made up fabric products has contributed towards enhanced gross margins (1HFY19: 14%; FY18: 11%; FY17: 8%; FY16: 8%).

In FY18, JKSM booked exchange gains of Rs. 114.7m (FY17: Rs. 59.1m). On the other hand, finance cost increased by 51% on account of higher average utilization of short term and long term borrowings to meet working capital requirements and finance capex, respectively. However, supported by increase in gross profitability, the company reported higher Profit before Tax (PBT) of Rs. 429.8m (FY17: Rs. 151.8m; FY16: Rs. 86.8m) in FY18.

Growth in asset base has been supported by significant capacity additions coupled with sizeable inventory procurement. Ongoing addition of spindles would further expand the asset size going forward

Non-Current Assets of the company have grown at a 3 year CAGR of 16% due to considerable capacity enhancements in the spinning and weaving divisions. Also addition of spindles by the end of FY19 would further augment the asset base. In addition to this; current assets have witnessed a 3 year CAGR of 7%. Stock in trade dominates the overall current asset mix as it represented 61% of the total current assets at end-FY18 (FY17: 59%; FY16: 61%) due to procurement of raw material in advance. In line with inventory procurement, advances to suppliers have also increased in FY18 vis-à-vis FY17. Moreover, receivables in relation to total sales has increased on a timeline basis (FY18: 9%; FY17: 8%; FY16: 6%; FY15: 7%) as JKSM stopped discounting of receivables during FY18 in an anticipation of currency devaluation.

Adequate FFO provides sufficient room to service debt while inventory and trade receivables have maintained sufficient coverage of short term borrowings.

Funds From Operations (FFO) has exhibited significant growth on the back of improved profitability. In FY18, FFO amounted to Rs. 610m depicting a 78% increase vis-à-vis last year (FY17: Rs. 342m; FY16: Rs. 241m). Better cash generation has resulted in Debt Service Coverage Ratio (DSCR) of 2.15x (FY17: 1.77; FY16: 2.91) whereas FFO/Long Term Debt has shown a slight decline this year reported at 0.54x (FY17: 0.73x; FY16: 0.48x) owing to additional funds mobilized for capex. While quantum of debt repayments is expected to increase on account of increase in long term debt financing, enhanced FFO is projected to provide a healthy cushion to repay future financial obligations. Inventory and trade receivables provide sufficient coverage of Short Term Borrowings (1HFY19: 1.38x; FY18: 1.59x; FY17: 1.51x; FY16: 1.50x) while current ratio was also reported to be at satisfactory levels (1HFY19: 1.25x; FY18: 1.40x; FY17: 1.41x; FY16: 1.39x).

High internal cash generation has supported equity base; leverage indicators are projected to remain within manageable limits.

Equity base of the company has expanded at a 4-year CAGR of 7% during FY15-18. In FY18, total equity increased to Rs. 3.39b (FY17: 3.08b) on account of higher profitability and lower dividend payout (FY18: 22%; FY17: 42%; FY16: 44%; FY15: nil). More than two-thirds of the debt profile is short term while remaining is long term debt which entirely consists of Long Term Financing Facility (LTFF). Short term borrowings are expected to increase in line with increase in sales and proportion of long term borrowings in the financing mix is also projected to increase to fund capex. Gearing and leverage indicators were reported at 0.95x and 1.17x in FY18 witnessing a slight increase due to higher utilization of debt in the outgoing year. Despite additional debt projected to be undertaken, gearing and debt leverage are forecasted to remain within manageable limits on account of healthy internal capital generation, going forward.

J.K Spinning Mills Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**30-Jun-16**	**30-Jun-17**	**30-Jun-18**	**31-Dec-18**
Non-Current Assets	2,755	2,801	3,571	3,710
Stock-in-Trade	1,756	1,926	2,461	4,741
Trade Debts	514	688	867	961
Short Term Loans & Advances	50	42	84	65
Cash & Bank Balances	68	89	28	21
Other Assets	483	539	583	633
Total Assets	5,626	6,085	7,594	10,131
Trade and Other Payables	400	402	502	672
Short Term Borrowings	1,517	1,731	2,098	4,147
Long Term Finances - Secured	358	281	872	866
Total Interest Bearing Debt	2,018	2,198	3,234	5,282
Other Liabilities	176	172	243	325
Total Liabilities	2,594	2,772	3,979	6,279
Total Equity	2,853	3,088	3,390	3,627
Surplus on Revaluation of Assets	179	225	225	225
INCOME STATEMENT	**30-Jun-16**	**30-Jun-17**	**30-Jun-18**	**31-Dec-18**
Net Sales	8,289	9,050	9,902	6,090
Cost of Sales	7,638	8,292	8,855	5,255
Gross Profit	651	758	1,047	835
Distribution Expenses	276	270	276	146
Administrative Expenses	212	231	274	140
Other Income	32	79	176	57
Finance Cost	96	134	202	165
Profit before Tax	87	152	430	399
Taxation	11	69	92	86
Profit After Tax	76	83	338	312
RATIO ANALYSIS	**30-Jun-16**	**30-Jun-17**	**30-Jun-18**	**31-Dec-18**
Gross Margin (%)	8%	8%	11%	14%
PBT Margin (%)	1%	2%	4%	7%
Net Margin (%)	1%	1%	3%	5%
Current Ratio (x)	1.39	1.41	1.40	1.25
(Trade Debts + Inventory)/ Short Term Borrowings	150%	151%	159%	138%
Net Working Capital	802	947	1,145	1,264
Working Capital Cycle	81	87	100	264
Gearing (x)	0.71	0.71	0.95	1.46

Debt Leverage (x)	0.91	0.90	1.17	1.73
FFO	241	342	610	597
FFO to Total Debt (%)	0.12	0.16	0.19	0.23*
FFO/Long Term Debt	0.48	0.73	0.54	1.05*
Debt Servicing Coverage Ratio (x)	2.91	1.77	2.15	2.89*
ROAA (%)	1%	1%	5%	7%*
ROAE (%)	3%	3%	10%	18%*

*Annualized

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

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	J.K Spinning Limited
Sector	Textiles
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
28-March-19	A-	A-1	Stable	Initial