RATING REPORT

J.K Spinning Mills Limited

REPORT DATE:
April 28, 2021

RATING ANALYSTS:
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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*		*Rating Watch-Developing*	
Rating Action	Maintained		Maintained	
Rating Date	*28th April'21*		*24th April'20*	

COMPANY INFORMATION	
Incorporated in 1987	External auditors: Ernst & Young Ford Rhodes Sidat Hyder & Co. Chartered Accountants.
Public Quoted Limited Company	Chairman: Mr. Jawed Anwar CEO: Mr. Faiq Jawed
Key Shareholders (with stake 5% or more):	
Mr. Jawed Anwar – 38.15% Mr. Faiq Jawed – 24.74% Mr. Saiq Jawed – 15.56% Mrs. Farhat Jehan – 15.47%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (May 2019) ***https://www.vis.com.pk/kc-meth.aspx***

J.K Spinning Mills Limited

OVERVIEW OF THE INSTITUTION

J.K Spinning Mills Limited (JKSM) is a public limited company incorporated in Pakistan in January 1987, under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). Head office of the company is located in Faisalabad.

Profile of the Chairman
Mr. Jawed Anwar serves as the Chairman of the Board. He has over 60 years of experience the spinning industry. He served as the Vice-Chairman of Faisalabad Chamber of Commerce and Chairman of Pakistan Textile Export Association.

Profile of CEO
Mr. Faiq Jawed serves as the CEO of the company and has over 34 years of experience in the spinning industry. He has also served as the Vice-Chairman of Faisalabad Chamber of Commerce and Chairman of Pakistan Textile Export Association.

Financial Snapshot

Tier-1 Equity: end-HY21: Rs. 5.64b; end-FY20: Rs. 5.03b; end-FY19: Rs. Rs. 4.03b.

Assets: end-HY21: Rs. 12.19b; end-FY20: Rs. 11.25b; end-FY19: Rs 9.50b.

Profit After Tax: HY21: Rs. 683m; FY20: Rs. 1.14b; FY19: Rs. 716m.

RATING RATIONALE

J.K Spinning Mills Limited (JKSM), a part of J.K Group, is a composite textile unit that operates spinning, weaving and stitching divisions. Product portfolio of the company mainly comprises course yarn and home textile. Majority shareholding is held by the sponsoring family who is actively involved in the company affairs. Net sales comprise a mix of local and export sales, with yarn majorly sold in local markets, while processed fabric and made-ups are largely exported.

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, including JKSM, 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:
<u>Spinning</u>
JKSM offers a broad range of ring spun yarn with counts ranging from 16/1 to 100/1. The coarse 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 bedsheets and shirt fabric. The company also produces customized yarn as per customer requirements. Number of spindles currently stand at 151,944 (FY20: 151,944; FY19: 136,152) having yarn production capacity of 44.5m kgs (FY20: 44.5m kgs; FY19: 41.5m kgs) per annum.

<u>Fabric, Home Textile and Hospitality Supplies</u>
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 bedsheets, table covers, curtains, pillow covers, and 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. Number of Sulzer looms currently stand at 110 (FY20: 110; FY19: 100) which can weave up to 18.7m sq mtr fabric per annum (FY20: 18.7m sq mtr; FY19: 18.0m sq mtr).

<u>Key Rating Drivers:</u>
Long-term capacity enhancement plans underway
JKSM is continuously expanding its scale of operations to benefit from favorable demand outlook of the textile industry. The company has recently completed the enhancement of stitching division; the new unit can process up to 30m meters fabric per annum and is currently operating at 90% capacity. Capacity enhancement of spinning unit is also underway as the L/Cs for the import of 10,000 new spindles have already been opened that is expected to become operational by end-FY21. Besides that, JKSM has two major expansions projects in the pipeline. A new spinning unit having 52,896 spindles is underway as its building is under construction and is expected to come online by end-FY22. The second expansion project is regarding setting up of a new weaving unit having 144 air jet looms by end-FY24. Both project will be funded through a mix of 60% debt and 40% equity; the company

plans to mobilize bank borrowings of Rs. 2.4b for the spinning project during FY22 and Rs. 2.2b for the weaving project during FY24.

Asset base underpinned by growing scale of operations
Increase in asset base to Rs. 12.2b (FY20: Rs. 11.3b; FY19: Rs. 9.5b) was mainly a function of capital expenditure and higher working capital at end-HY21. Fixed assets representing two-fifth of asset mix accumulated to Rs. 5.1b (FY20: Rs. 4.6b; FY19: Rs. 4.3b) by end-HY21, including capital-work-in progress of Rs. 951m (FY20: Rs. 394m; Rs. 148m) which pertained to building and machinery for the processing unit (Rs. 480m), stitching unit (Rs. 250m) and the 3MW solar generation facility (Rs. 221m).

Stock in trade stood slightly higher at Rs. 5.1b (FY20: Rs. 4.8b; FY19: Rs. 3.7b), comprising cotton/viscose inventory of Rs. 3.6b (FY20: Rs. 3.1b; FY19: Rs. 2.5b), work-in-progress of Rs. 733m (FY20: Rs. 403m; FY19: Rs. 477m) and finished goods inventory of Rs. 759b (FY20: Rs. 1.3b; FY19: Rs. 749m) at end-HY21. Trade receivables amounted to Rs. 1.3b (FY20: Rs. 1.3b; FY19: Rs. 786m), including foreign receivables of Rs. 465m (FY20: Rs. 459m; FY19: Rs. 395m) and local receivables of Rs. 819m (FY20: Rs. 809m; FY19: Rs. 391m) at end-HY21. Increase in local receivables during FY20 was due to higher sales to top-10 customers availing a credit of up to 15 days; these customers accounted for 43% (FY19: 23%) of local sales during the year. The aging profile as of December 31, 2020, shows that 72% of total receivables were not due yet, 25% were due within 1 month bracket, and remaining 3% receivables were in 1 month to 6 month bracket.

Advances, deposits, and prepayments amounted to Rs. 206m (FY20: Rs. 66m; FY19: Rs. 42m) mainly on account of higher advances given to suppliers. Other receivables amounted to Rs. 61m (FY20: Rs. 33m; FY19: Rs. 57m) which largely pertained to duty drawback and export rebate. Amount due from the government against sales and income tax adjustments amounted to Rs. 201m (FY20: Rs. 283m; FY19: Rs. 304m) at end-HY21. Cash and bank balance stood at Rs. 153m (FY20: Rs. 113m; FY19: Rs. 125m).

Notable improvement in profit generation on account of both higher sales and better margins
Net revenue of the JKSM increased steadily to Rs. 14.8b (FY19: Rs. 13.7b; FY18: Rs. 9.9b) during FY20 as the impact of notable growth in exports was partially offset by decrease in local sales. Local sales mainly comprising yarn stood lower at Rs. 7.2b (FY19: Rs. 8.4b) on account of lower dispatches of 399,595 bags (FY19: 431,241 bags), partially offset by higher selling price of Rs. 21,565 per bag (FY19: Rs. 19,109 per bag). Meanwhile, exports mainly comprising fabric increased to Rs. 7.5b (FY19: Rs. 5.2b; FY18: Rs. 4.0b) driven largely by higher volumetric sales of 36.3m meters (FY19: 31.2m meters) and improved selling price of Rs. 166 per meter (FY19: Rs. 153 per meter).

Cost of sales amounted to Rs. 2.5b (FY19: Rs. 1.9b; FY18: Rs. 1.0b) with raw material consumption accounting for 71% (FY19: 73%) of overall cost structure, followed by processing, sizing, & conversion charges 10% (FY19: 9%), fuel & power 8% (FY19: 8%), and employee costs 7% (FY19: 6%). Gross margins stood higher at 16.9% (FY19: 14.0%; FY18: 10.6%) mainly on the back of favorable pricing for yarn and fabric during FY20.

Distribution costs decreased to Rs. 336m (FY19: Rs. 375m; FY18: Rs. 276m) as the impact of increase freight expense due to higher exports was more than offset by reduction in commission & brokerage expense owing to higher direct sales to the client without the involvement of third-party brokers. Meanwhile, administration costs increased to Rs. 338m (FY19: Rs. 298m; FY18: Rs. 274m) mainly due to inflationary impact in staff salaries and others benefits. Other expenses amounted to Rs. 134m (FY19: Rs. 170m; FY18: Rs. 40m), mainly comprising net exchange loss of Rs. 37m (FY19: nil), loss on forward rate agreements of Rs. 15m (FY19: Rs. 13m), and WPPF amounting Rs. 69m (FY19: Rs. 48m). Other income declined to Rs. 12m (FY19: Rs. 209m; FY18: Rs. 178m) in the absence of exchange gain (FY19: Rs. 199m) during FY20. Some increase in finance cost to Rs. 397m (FY19: Rs. 386m; FY18: Rs. 202m) was a result of higher debt utilization. Accounting for taxation, the company reported net profit of Rs. 683m (FY19: Rs. 1.1b; FY18: Rs. 716m) while net margins stood higher at 16.9% (FY19: 14.0%%; FY18: 10.6%).

Net revenue of the company increased to Rs. 7.9b (HY20: Rs. 7.3b) during HY21, driven largely by higher yarn dispatches of 249,548 bags (HY20: 203,685 bags) at a slightly improved selling price of Rs. 21,788 per bag (HY20: Rs. 21,535 per bag), partially offset by lower fabric sales of 15.8m meters (HY20: 17.4m meters). Gross profit remained largely stable at Rs. 1.3b (HY20: Rs. 1.3b) as the impact of higher revenue was offset by decrease in gross margins to 16.7% (HY20: 17.5%). Operating expenses also remained largely stable at Rs. 406m (HY20: Rs. 411m) during the period, however, finance cost declined to Rs. 114m (HY20: Rs. 251m) owing to lower interest rates. Resultantly, the company reported net profit of Rs. 682m (HY20: Rs. 508m) as the net margin improved to 8.7% (HY20: 7.0%). Despite higher sales due to capacity expansion, the management is projecting largely stagnant bottom line on account of some decrease in margins, going forward.

Liquidity supported by health cash flows generation with adequate coverages

Liquidity of the company is supported by internal capital generation. In line with profits, the company generated higher funds from operations (FFO) amounting to Rs. 1.6b (FY19: Rs. 1.2b; FY18: Rs. 611m) during FY20. FFO amounted to Rs. 875m in HY21. The company's capacity to meet its financial obligations remained adequate as reflected in improved debt service coverage ratio of 3.15x (FY20: 2.90x; FY19: 2.65x) in HY21. FFO-to-total debt ratio remained stable at 0.34x (FY20: 0.34x; FY19: 0.29x). Improved current ratio to 1.58x (FY20: 1.50x; FY19: 1.39x) by end-HY21 was underpinned by higher inventory levels and largely stable short-term borrowings.

Capitalization being maintained at prudent levels

Paid up capital of the company increased to Rs. 1.0b (FY20: Rs. 731m; FY19: Rs. 731m) on account of bonus issue during HY21. Tier-1 equity accumulated to Rs. 5.6b (FY20: Rs. 5.0b; FY19: Rs. 4.0b) with retention of profits. Total liabilities increased to Rs. 6.2b (FY20: Rs. 5.8b; FY19: Rs. 5.2b) by end-HY21 mainly on account of higher long-term borrowings. Long-term debt stood higher at Rs. 1.9b (FY20: Rs. 1.5b; FY19: Rs. 1.5b) as the company mobilized SBP's TERF and LTFF amounting Rs. 1.04b for capex on spindles, processing division, solar plant, and as salaries loan, out of which Rs. 630m was availed by end-HY21. As of date, the facilities have been fully utilized. The tenor of facilities is 5-year including 1 year grace period and markup rate ranges between 3.0% and 3.5% per annum. Short-term borrowings remained stable at Rs. 3.2b (FY20: Rs. 3.2b; FY19: Rs. 2.6b). Despite increase in overall borrowings, gearing and debt leverage improved marginally to 0.90x (FY20: 0.93x; FY19: 1.02x) and 1.09x (FY20: 1.16x; FY19: 1.30x) on account of internal capital generation during HY21. Going forward, leverage indicators are projected to be maintained at comfortable levels over the rating horizon.

J.K Spinning Mills Limited — Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**HY21**
Non-Current Assets	3,571	4,347	4,579	5,120
Stores, Spares. And Loose Tools	95	87	105	132
Stock-in-Trade	2,461	3,747	4,806	5,048
Trade Debts	867	786	1,267	1,266
Advances, Deposits and Other Receivables	200	99	99	267
Tax Refund Due From Government	340	304	283	201
Cash and Bank Balance	59	125	113	153
Total Assets	**7,594**	**9,495**	**11,252**	**12,188**
Trade and Other Payables	470	662	813	657
Long-Term Borrowings *(Inc. current matur)*	1,136	1,489	1,493	1,919
Short-Term Borrowings	2,098	2,645	3,173	3,168
Other Liabilities	275	442	347	409
Tier-1 Equity	**3,390**	**4,033**	**5,029**	**5,639**
Total Equity	3,615	4,258	5,425	6,035
Paid-up Capital	731	731	731	1,023
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**HY21**
Net Sales	9,900	13,687	14,827	7,867
Gross Profit	1,045	1,914	2,499	1,315
Operating Profit	632	1,280	1,704	926
Finance Cost	202	386	397	114
Profit Before Tax	430	894	1,307	812
Profit After Tax	338	716	1,142	683
FFO	611	1,212	1,567	875
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**HY21**
Gross Margin (%)	10.6	14.0	16.9	16.7
Net Margin (%)	3.4	5.2	7.7	8.7
Net Working Capital	1,145	1,445	2,215	2,589
Current Ratio	1.40	1.39	1.50	1.58
FFO to Long-Term Debt	0.54	0.81	1.05	0.91*
FFO to Total Debt	0.19	0.29	0.34	0.34*
DSCR (x)	2.15	2.65	2.90	3.15
Gearing (x)	0.95	1.02	0.93	0.90
Debt Leverage (x)	1.17	1.30	1.16	1.09
Inventory + Receivable/Short-term Borrowings (x)	1.59	1.71	1.91	1.99

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure 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	Annexure III				
Name of Rated Entity	J.K 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**
	RATING TYPE: ENTITY				
	28-04-2021	A-	A-1	Stable	Maintained
	24-04-2020	A-	A-1	Rating Watch-Developing	Maintained
	28-03-2019	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. Ghulam Muhammad	Director Finance	March 16, 2021		