RATING REPORT

J.K Spinning Mills Limited

REPORT DATE:
May 19, 2023

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		Positive	
Rating Action	Maintained		Maintained	
Rating Date	*May 19, 2023*		*April 26, 2022*	

COMPANY INFORMATION	
Incorporated in 1987	**External Auditors:** Riaz Ahmad & Co. Chartered Accountants
Public Listed Company	**CEO:** Mr. Faiq Jawed
Key Shareholders (with stake 10% or more):	
Mr. Jawed Anwar ~33.31%	
Mr. Faiq Jawed ~24.24%	
Mr. Shaiq Jawed ~19.00%	
Mrs. Farhat Jehan ~12.94%	

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

J.K Spinning Mills Limited

OVERVIEW OF THE INSTITUTION

J.K Spinning Mills Limited is a public listed company incorporated in Pakistan in January 1987, under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). The company is a composite textile unit that operates in spinning, weaving and stitching divisions. Head office of the company is located in Faisalabad.

Profile of Chairman:
Mr. Jawed Anwar serves as the Chairman of the Board. He has over 60 years of experience in 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 35+ 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.

RATING RATIONALE

Corporate Profile

J.K Spinning Mills Limited (JKSM), a composite textile unit of J.K Group, has been involved in the production of fine yarn, fabric and home textile made ups for over 35 years with operation divisions including spinning, weaving, processing and stitching divisions. Majority shareholding is held by the sponsoring family, which is actively involved in day-to-day business affairs. The company has been awarded various global standard certifications and has a workforce of over 2,500 employees.

JKSM has a 23MW gas-based power generation capacity that runs in parallel to national grid. It currently uses a mix of two sources, with either one being self-sufficient to fulfill the total requirement of 19MW. Additionally, a 1.4MW solar power plant in place, with plans to increase it to 7MW.

Group Profile

Founded in 1975, the group has undergone several restructuring efforts over the years. In 2011, the operations of two textile mills were consolidated into JKSM. Apart from JKSM, the group currently owns four other companies: J.K Power Limited, J.K Agriculture Farms (Private) Limited, Fine Fabrics (Private) Limited, and J.K Tech (Private) Limited.

Establishment of a new spinning unit and future expansion plans

As part of capacity enhancement initiatives, the company has recently installed 52,896 spindles in a newly established Unit-4, increasing the total number of spindles to over 200K. The machinery required for the project was imported and funded by TERF & LTFF facilities of Rs. 2.5b during the review period. Total project cost has risen by roughly ~20% from the initial estimation to Rs. 5b, primarily due to escalating construction and material expenses. The project has a 60:40 debt to equity mix. With production set to begin in June'23, management aims to achieve ~40% growth in yearly sales by targeting local yarn market.

In addition, the capacity expansion in processing unit from 3.5m meters to 5m meters per month is currently underway while management has expressed intention to setup another weaving unit in the future, with 144 air jet looms and a production capacity of 18m meters fabric per annum, targeting global markets.

Operational Performance

The company's headquarter and manufacturing facilities are situated in Faisalabad. Spinning segment production capacity remained consistent in FY22 but will increase by ~35% to 62m kgs per annum after the upcoming expansion. In contrast, the weaving division with total 110 looms experienced a minor reduction in capacity. Production levels have noted a decline in the outgoing fiscal year, which management attributed to power outages and slowdown in demand.

Table: Capacity & Production Data (Units in millions)

	FY20	FY21	FY22	6M'FY23
Production Capacity				
Spinning – Kgs	44,501	45,365	45,666	22,842
Weaving – Sq. Mtr.	18,667	22,263	20,986	10,639

Actual Production				
Spinning - Kgs	37,051	44,501	40,287	20,558
Weaving - Sq. Mtr.	14,934	18,667	16,964	8,724
Capacity Utilization				
Spinning	***83%***	***98%***	***88%***	***90%***
Weaving	***80%***	***84%***	***81%***	***82%***

Key Rating Drivers

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, demand slowdown, high interest rate situation, inflationary pressures and recent floods adversely affecting cotton crop while ongoing energy crisis in the country pose a challenge to 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 finally broke the threshold, coming in at USD 32.4b. 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 around Rs. 4.0tr. Barring seasonal and cyclical fluctuations, textiles sector has maintained an average share of about 60% in national exports.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
Pakistan Total Exports	22,536	25,639	32,450		23,706	21,088
Textile Exports	12,851	14,492	18,525		13,577	12,992
PKR/USD Average rate	158.0	160.0	177.5		171.5	235.5

Source: SBP

Export revenues from textile sector have noted sizeable growth 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.

Table: Textile Export Details (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**		**11,482**	**10,318**
- Knitwear	2,794	3,815	5,121		3,730	3,390
- Readymade Garments	2,552	3,033	3,905		2,864	2,657
- Bed wear	2,151	2,772	3,293		2,449	2,032
- Towels	711	938	1,111		820	745
- Made-up Articles	591	756	849		627	535
- Art, Silk & Synthetic Textile	315	370	460		344	309
- Others	555	743	866		650	650
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**		**2,760**	**2,158**
- Cotton Cloth	1,830	1,921	2,438		1,795	1,538
- Cotton Yarn	984	1,017	1,207		908	573
- Others	43	34	72		56	47
Total	**12,527**	**15,399**	**19,332**		**14,243**	**12,476**

Source: PBS

Cotton prices rose to a new 12-year high of ~Rs. 21,600/maund as of March'22, as a result of the shortage and higher input costs of fertilizer and energy. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Table: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	9M'FY23
Per Maund	8,770	8,860	13,000	17,380	18,935
YoY % Change	26%	1%	32%	34%	n/a

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than $2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dying companies.

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

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.

Robust revenue growth driven by volumetric increases, higher prices in dollar terms and rupee devaluation impact; future growth expected from recent capacity addition.
Sales revenue registered a strong YoY growth of ~57% in FY22, surpassing the Rs. 27b mark. This growth can be attributed to all factors – volumetric uptick, higher prices in dollar terms and significant rupee devaluation impact. This positive trend has continued in 6M'FY23, with sales amounting to Rs. 17b, up by ~38% vis-à-vis SPLY while the projected topline for full year FY23 is Rs. 35b. Going forward, capacity expansion in spinning segment is expected to drive future sales growth.

Overall sales comprise a mix of local and export sales, both direct & indirect while 3-year average proportionate share of exports to local sales remained at 60:40. In terms of value, both export and local sales experienced growth of ~74% and ~35%, respectively, during the outgoing fiscal year. Yarn is mainly sold locally, with a focus on catering the needs of lawn manufacturers, while processed fabric and made-ups, such as bed linen, curtains, table linen, patient gowns, scrub suits, hospital and hotel sheeting, are exported to US and European markets. Moreover, yarn sales represent more than half of the total revenue mix, followed by made-ups and fabric sales. Export sales feature high client concentration with top 10 clients generating around 60% to 70% of revenue whereas local sales are well-diversified among various buyers.

Record high bottom-line achieved by the company during FY22 due to sizeable revenue growth and timeline improvement in profitability margins. However, the

same depicted noticeable contraction in the current year, highlighting a contrasting trend.

Gross and net profitability margins noted an increasing trend over the past five fiscal years (FY18-22). However, the current fiscal year in line with industry has seen a sharp contraction, attributed to higher raw material costs, salaries, and power expenses. The production of fine yarn relies heavily on imported cotton, while yarn for fabric is mostly sourced locally (80-85%). Adequate inventory is kept to fulfill confirmed sales orders for the next three months.

Distribution expenses have more than doubled in the outgoing fiscal year due to higher freight and commission charges, while administrative overheads increased with inflation. Other expenses rose due to provisions against tax contingencies and workers' funds, and financial charges went up significantly due to higher debt levels and benchmark rates.

Contrasting cash flow trend mirrors the profitability performance over the review period while debt coverage metrics remain satisfactory; working capital days have improved due to decline in inventory holding days.

Fund flow from operations (FFO) nearly doubled in FY22, reaching Rs. 4.4b (FY21: Rs. 2.4b), which aligns with record-high net profit. However, the contrasting cash flow trend during 6M'FY23, led to a weakening in debt coverage metrics yet remains at satisfactory levels as reflected from FFO to total debt and FFO to long-term debt of 0.29x (FY22: 0.74x; FY21: 0.44x) and 0.63x (FY22: 2.13x; FY21: 1.41x). Similarly, debt servicing coverage ratio has also declined to 3.34x (FY22: 5.01x; FY21: 4.27x).

Current ratio is consistently reported above 1.5x for the last three fiscal years and coverage of short-term borrowings in relation to trade debts and inventory remains sufficient, indicating a sound liquidity profile. In the last 18 months, working capital days have reduced significantly from 147 days in FY21 to 102 days in 6M'FY23 mainly due to drop in inventory holdings and better receivable days. Aging profile of trade debts remain strong as all receivables are settled within a 6-month period.

Healthy growth in equity base; leverage ratios have improved over time but increased slightly in the current fiscal year due to elevated debt levels.

Supported by strong bottom-line and healthy retention, equity base (excluding revaluation surplus) grew by ~65% over the period of last 18 months and reached Rs. 11.8b in 6M'FY23. In FY22, dividend payout ratio remained steady at 4%, while the dividend amount increased to Rs. 153.5m (FY21: Rs. 73.1m). Debt profile is a mix of short-term and long-term debt with total interest bearing liabilities increasing to Rs. 8.7b (FY22: Rs. 5.9b; FY21: Rs. 5.5b) at end-6M'FY23; ~53% constituted short-term debt, with majority being the ERF facility. Gearing and leverage ratios improved over time, but increased slightly in the current fiscal year due to elevated debt levels.

J.K Spinning Mills Limited Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**6M'FY23**
Non-Current Assets	4,579	5,502	7,224	10,806
Stock-in-Trade	4,806	5,810	6,911	8,177
Trade Debts	1,267	1,698	3,050	2,174
Tax Refund Due From Government	283	368	529	1,232
Cash and Bank Balance *(Incl. ST Investments)*	113	147	1,125	179
Total Assets	**11,252**	**13,887**	**19,218**	**23,172**
Trade and Other Payables	813	871	1,935	1,902
Long-Term Debt *(Incl. Current Maturity)*	**1,493**	**1,733**	**2,074**	**4,078**
Short-Term Debt	**3,173**	**3,817**	**3,920**	**4,661**
Paid-up Capital	731	1,023	1,023	1,023
Total Equity *(Excl. Revaluation Surplus)*	**5,029**	**6,768**	**10,276**	**11,162**
INCOME STATEMENT				
Net Sales	**14,827**	**17,403**	**27,333**	**17,011**
Gross Profit	2,499	3,332	6,161	2,647
Operating Profit	1,704	2,409	4,460	1,602
Profit Before Tax	**1,307**	**2,142**	**4,088**	**1,328**
Profit After Tax	**1,142**	**1,812**	**3,662**	**1,091**
RATIO ANALYSIS				
Gross Margin (%)	16.9	19.1	22.5	15.6
Net Margin (%)	7.7	10.4	13.4	6.4
Net Working Capital	2,215	3,038	5,396	4,903
Current Ratio	1.50	1.57	1.82	1.66
FFO to Long-Term Debt	1.05	1.41	2.13	0.63*
FFO to Total Debt	0.34	0.44	0.74	0.29*
DSCR (x)	2.90	4.25	5.01	3.34*
Gearing (x)	0.93	0.82	0.58	0.78
Debt Leverage (x)	1.16	0.99	0.81	1.02
Inventory + Receivable/Short-term Borrowings (x)	1.91	1.97	2.54	2.22

**Annualized*

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	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				
19/05/2023	A-	A-1	Stable	Maintained
26/04/2022	A-	A-1	Positive	Maintained
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.
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Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Nadeem Abbas	CFO	April 11, 2023
Mr. Muhammad Ghulam	Director Finance	