RATING REPORT

Kohinoor Mills Limited (KML)

REPORT DATE:
March 12, 2019

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	BBB+	A-2
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*11 March '19*	

COMPANY INFORMATION	
Incorporated in 1987	External Auditors: Riaz Ahmad & Company Chartered Accountants
Listed Public Limited Company	Chairman of the Board: Mr. Rashid Ahmed Chief Executive Officer: Mr. Aamir Fayyaz Sheikh
Key Shareholders (with stake 5% or more):	
Mr. Aamir Fayyaz Sheikh – 24.11%	
Mr. Asad Fayyaz Sheikh – 21.53%	
Mr. Ali Fayyaz Sheikh – 21.46%	
NBP – Trustee Department NI(U)T Fund – 6.06%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (May 2016) *https://www.vis.com.pk/kc-meth.aspx*

Kohinoor Mills Limited

OVERVIEW OF THE INSTITUTION

Kohinoor Mills Limited (KML) is a listed public limited company incorporated in December 1987 under the Companies Ordinance, 1984 (now Companies Act, 2017). The company is principally engaged in the business of textile manufacturing encompassing weaving, bleaching, and dyeing.

Profile of the Chairman

Mr. Rashid Ahmed is the Chairman of the Board. He is an MBA from IBA, Karachi. Mr. Ahmed has over 40 years of experience in banking and financial services industry. He is also a member of Board of Governors of Lahore University of Management Sciences.

Profile of the CEO

Mr. Aamir Fayyaz Sheikh is the Chief Executive Officer at KML. He has previously served as the Chairman of All Pakistan Textile Mills Association; playing a pivotal role in acquiring GSP plus status.

Financial Snapshot

Tier-1 Equity: end-1QFY19: Rs. 1,555.0m; end-FY18: Rs. 1,503.5m; end-FY17: Rs. 1,292.3m

Assets: end-1QFY19: Rs. 9,152.9m; end-FY18: Rs. 8,864.9m; end-FY17: Rs. 6,538.2m

Profit After Tax: FY18: Rs. 239.1m; FY17: Rs. 134.0m; FY16: Rs. 118.8m

RATING RATIONALE

The ratings assigned to Kohinoor Mills Limited (KML) take into account its reasonable scale of integrated textile operations. The ratings incorporate moderate business risk profile; the company has been able to consistently increase its revenues and largely sustain profitability in a highly competitive international market. The ratings incorporate KML as a key supplier to globally renowned brands while maintaining an adequate customer concentration. Furthermore, recent devaluation of the rupee and favorable government policies bodes well for the company. The ratings also draw comfort from the company's strong BoD profile, experienced management team and adequate corporate governance.

Although debt service coverage remains adequate, high gearing and leverage indicators expose KML to relatively higher financial risk and act as a constraint to the ratings. While KML been successful in steadily increasing turnover, decreasing margins and increasing international competition are key challenges faced by the company.

Rating Drivers

Integrated business unit

The company has three divisions, namely, Kohinoor Weaving, Kohinoor Dyeing and Kohinoor Genertek. The weaving division currently operates 258 air jet looms with a production capacity of 72.5 million meters per annum (FY17: 48.9 million meter per annum). The dyeing division procures greige fabric from the weaving division as well as from outside and has a production capacity of 43.2 million meter per annum (FY17: 36.0 million meters per annum). Kohinoor Genertek is the power generation center of the company with a generation capacity of 33.3MW.

Growing revenues amid declining margins

Net sales of KML increased with a CAGR of 11.2% during the last three years (FY18: Rs. 10.9b; FY17: Rs. 10.7b; FY16: Rs. 8.6b). Export sales comprised 77.4% (FY17: 78.6%) of net sales in FY18. During FY18, revenue from the company's dyeing division accounted for 72% (FY17: 77%) while revenue from weaving division accounted for the remaining 28% (FY17: 23%) of net sales. As a result of higher proportion of sales from relatively lower margin weaving division coupled with an increase in fuel and power related costs, gross margin of the company declined to 12% in FY18 (FY17: 14%). However, given lower tax incidence due to tax rebate U/S 65D in FY18, net margin of the company increased to 2.2% (FY17: 1.3%). The company registered a notable increase in sales during 1HFY19 on account of both currency depreciation and volumetric growth.

BMR expected to enhance turnover, as a result of increase in production capacity and operational efficiency

During FY18, KML undertook Balancing Modernization and Replacement (BMR) to increase production capacity. KML made a CAPEX of Rs. 721m on plant and machinery including addition of 84 state of the art air jet looms, installation of additional equipment and a dyeing range during FY18. The BMR resulted in a 48% increase in weaving's existing production capacity and a 20% increase in dyeing's production capacity. The positive impact of the BMR is expected in FY19 onwards as the additional looms became operational in November 2018. In line with 1HFY19 numbers, KML as a result of the BMR is projecting a 45% increase in net sales during FY19.

While liquidity remained limited, long-term coverages remained largely adequate

Overall cash flow generation ability of the company has depicted some improvement. Funds from Operations (FFO) increased to Rs. 434.7m during FY18 (FY17: Rs. 388.0m; FY16: Rs. 389.0m). FFO to long term debt stood at 0.46x (FY17: 0.53x; FY16: 0.43x) while FFO to total debt was reported at 0.10x (FY18: 0.12x; FY17: 0.14x) at end-1QFY19 on account of increase in both long and short-term borrowings. DSCR stood at 1.47x (FY17: 1.24x; FY16: 0.50x) during FY18. However, current ratio of the company remained below 1x at 0.8x (FY17: 0.78; FY16: 0.75x) at end-FY18.

Overall cash conversion cycle deteriorated to 28 days (FY17: 17 days; FY16: 16 days) as an increase in days receivable and inventory offset the increase in days payable during FY18. Days' receivable increased to 34 days (FY17: 19 days) due to the company's decision to use documents against acceptance (previously used to discount documents immediately instead of sending them on collection) in order to benefit from exchange rate gain which resulted in considerable increase in trade debts on the balance sheet (FY18: Rs. 1.4b; FY17: 642.5m: FY16: Rs. 465.4m). Similarly, days in inventory increased to 40 days (FY17: 34 days) due to higher inter divisional sales. Days' payable also increased to 46 days (FY17: 36 days) due to a significant increase in trade payables (FY18: Rs. 1.4b; FY17: Rs. 943.2m) as the company renegotiated credit terms with some of the suppliers.

High gearing and leverage indicators

The debt profile of the company comprises both short-term and long-term debt. With the increase in borrowings, the gearing ratio deteriorated to 2.57x (FY18: 2.47x; FY17: 2.21x) by end-1QFY19. Similarly, with increasing trend in trade payables, debt leverage stood higher at 3.69x (FY18: 3.65x; FY17: 3.24x).

Spending on R&D proving beneficial

The company, through its research and development facility, has been able to develop unique and innovative fabrics such as the 360 degrees stretch as well as several hand-feel finishes. This has enabled the company to differentiate its product abroad and become key supplier for globally renowned brands.

Plan to add a garments unit in the near future

KML is planning to set up a garments unit in the near future. The projections shared by the management do not reflect any further capex however as per the management, the project cost is estimated at Rs. 500m. The said project is planned to be financed by internal sources.

Adequate Corporate Governance

KML has an adequate corporate governance infrastructure in place as evident from satisfactory board oversight, professional management team and adequate IT and internal controls. Minutes of the BoD as well as the Audit and HR committees were documented. The senior management has depicted longevity with no vacant positions at the senior management level.

Kohinoor Mills Limited (KML) Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**	**Dec 31, 2018**
Non-Current Assets	3,761.3	3,695.8	5,031.7	5,016.5
Store, spares and loose tools	416.8	404.1	367.4	404.9
Stock-in-Trade	806.1	909.1	1,153.5	1,444.0
Trade Debts	465.4	642.5	1,359.2	1,892.7
Cash & Bank Balances	53.9	69.4	95.0	189.1
Advances, Trade Deposits & Prepayments	89.2	73.9	141.1	208.2
Other receivables	311.1	486.6	563.7	646.3
Tax Refunds due from the Government	449.0	256.8	153.3	193.6
Total Assets	6,352.9	6,538.2	8,864.9	9,995.3
Trade and Other Payables	849.0	943.2	1,431.6	1,889.3
Short-Term Borrowings	1,917.4	2,132.8	2,766.3	3,279.5
Long-Term Borrowings *(Inc. current mat)*	898.6	727.1	945.2	906.5
Other Liabilities	467.1	381.3	342.8	376.6
Total Liabilities	4,132.1	4,184.4	5,486.0	6,451.9
Tier-1 Equity (including sponsor's loan)	1,139.4	1,292.3	1,503.5	1,687.5
Surplus on revaluation of fixed assets	1,081.4	1,061.4	1,875.4	1,856.1
Total Equity	2,220.8	2,353.7	3,378.9	3,543.6
INCOME STATEMENT	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**	**Dec 31, 2018**
Net Sales	8,551.1	10,656.4	10,855.7	6,871.9
Gross Profit	1,393.0	1,445.3	1,303.0	841.9
Operating Profit	653.6	507.6	559.4	455.0
Profit After Tax	118.8	134.0	239.1	216.8
FFO	389.2	388.0	434.7	402.0
RATIO ANALYSIS	**June 30, 2016**	**June 30, 2017**	**June 30, 2018**	**Dec 31, 2018**
Gross Margin (%)	16.3%	13.6%	12%	12.3%
Net Working Capital	(882.6)	(805.8)	(950.6)	(827.0)
Current Ratio	0.75	0.78	0.80	0.86
FFO to Long-Term Debt	0.43	0.53	0.46	0.89*
FFO to Total Debt	0.14	0.14	0.12	0.19
Debt Servicing Coverage Ratio (x)	0.50	1.24	1.47	1.85
ROAA (%)	1.9%	2.1%	3.1%	4.6%
ROAE (%)	10.7%	11.0%	17.1%	27.2%
Gearing (x)	2.47	2.21	2.47	2.48
Debt Leverage (x)	3.63	3.24	3.65	3.82

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	Kohinoor 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				
	March 11, '19	**BBB+**	**A-2**	**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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