RATING REPORT

Kohinoor Mills Limited

REPORT DATE:
August 30, 2023

RATING ANALYSTS:
Muhammad Tabish
muhammad.tabish@vis.com.pk

Vernon Joseph Vellozo
vernon.joseph@vis.com.pk

RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	BBB+	A-2	BBB+	A-2
Rating Outlook	Positive		Stable	
Rating Action	Maintained		*Reaffirmed*	
Rating Date	*August 30, 2023*		*August 10, 2022*	

COMPANY INFORMATION	
Incorporated in 1987	**External Auditors:** M/s Riaz Ahmad & Company Chartered Accountants
Public Listed Company	**Board Chairman:** Mr. Rashid Ahmed
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Aamir Fayyaz Sheikh
Mr. Aamir Fayyaz Sheikh ~22.8%	
Mr. Ali Fayyaz Sheikh ~17.6%	
Mr. Ismail Amir Fayyaz ~10.0%	
Mrs. Imrat Amir Fayyaz ~10.0%	
Mr. Ehsan Amir Fayyaz ~10.0%	
General Public (Local) ~7.8%	

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*

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 the banking and financial services industry. He is also a member of the 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.

RATING RATIONALE

Corporate Profile

Kohinoor Mills Limited (KML), with over a 35-year operating history, specializes in the weaving, dyeing, finishing, and trading of white and dyed fabrics to top global fashion brands and retailers. Integrated operations and a captive power plant ensure continuity, while numerous export standards and trade certifications reflect quality commitment. Employing over 1,900 staff, products range from basic woven fabric to high-performance workwear materials. The company has recently launched 'Fabrik App,' a digital library platform facilitating interaction of design and sourcing teams with product portfolio.

Weaving Division – Starting as a 48-loom project on a green field site in 1988, the flagship division now operates 272 high-speed Picanol and Toyoda air jet looms. Over the review period, the company took measures to enhance capacity and efficiency by adding 14 new looms and upgrading 98 existing ones with more efficient models, an initiative financed through a 70:30 debt-to-equity mix. Annually, the division produces over 40m meters of grey fabric, partially consumed downstream by in-house dyeing and the rest exported to Europe, Asia, and Africa. Additionally, the company has also expanded into jacquard and dobby fabrics, catering to both local and international fashion brands in US and Europe.

Dyeing & Finishing Division – Set up in 2002 following a strategic move to ascend the apparel value chain and compete with European market on cost effectiveness, the division currently has a monthly capacity to produce 4m meters of white, dyed, and printed fabric. Innovations in fabrics and hand-feel finishes have positioned it as a key supplier for leading global brands such as Zara, Levi's, American Eagle, Next, and Ralph Lauren.

As part of vertical integration efforts, the company is expanding its product line to include stitched garments. Construction is currently in progress, and production is slated to commence by late 2023, targeting an output of around 5,000 garments daily. This integration strategy will complement dyeing division, serving the same customer base with finished products. The Rs. 1.2b project was funded via TERF.

Kohinoor Genertek Division – Since 2003, the division has been an Independent Power Producer (IPP) with a capacity of 30MW of electricity and 30 tons of steam per hour. It can use various fuels like furnace oil, gas, biomass, and coal, depending on cost and availability. With 7 generators, the division meets ~70% of total energy needs, and the national grid covers the rest.

Environmental, Social, & Governance (ESG) Initiatives

As part of the 2021-25 Environment & Climate Roadmap, KML has undertaken several sustainability measures. These include installing 1.5MW solar panels, recycling water through an effluent treatment plant for the dyeing and finishing process, employing waste heat recovery boilers on electricity generators, and using agricultural biomass for steam generation. Additionally, plans are in place to plant over 100,000 trees in and around the facility.

Operational Performance

All manufacturing units – including dyeing, weaving, and power generation – as well as registered and other offices are located on Raiwind Road in district Kasur. In the past 21 months, total capital expenditure reached over Rs. 2.5b, with nearly 80% directed towards machinery and supported by TERF. Installed capacity for the dyeing division has stayed consistent, but the weaving unit noted an increase of ~23% compared to FY21, owing to loom enhancements. Despite this growth, slowdown in global demand has led to a reduction in overall production levels.

Table: Capacity & Production Data (Units in millions)

	FY21	FY22	9M'FY23
Weaving Division			
Number of looms in operation	260	230	272
Installed Capacity (mtr sq)	78.5	81.6	72.4
Production (mtr sq)	73.2	80.1	56.8
Capacity Utilization (%)	***93%***	***98%***	***79%***
Dyeing Division			
Installed Capacity (meters)	48.0	48.0	36.0
Production (meters)	30.8	33.3	26.5
Capacity Utilization (%)	***64%***	***69%***	***74%***
Power Generation			
Number of generators installed	**9**	**7**	**7**
Installed Capacity (MWh)	317,375	288,029	216,219
Generation (MWh)	41,476	40,689	27,060
Capacity Utilization (%)	***13%***	***14%***	***13%***

<u>Key Rating Drivers</u>

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 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.

Despite falling export volumes, revenue growth continues, supported by consistent rupee depreciation and higher local sales contribution. Geographic and client wise sales mix feature adequate concentration risk.
In FY22, sales revenue surged by ~62% to an all-time high of Rs. 21.4b (FY21: Rs. 13.2b), fueled by higher volumes, rising dollar prices, and rupee devaluation impact. Dyed cloth accounts for about 65% of this revenue, with weaving of greige and jacquard fabric making up the remainder while yarn trading, processing income, and wastages constitute a small portion. Though exports remain the primary source of revenue, local sales have seen a noticeable increase this year, with current export to domestic sales ratios standing at 80:20 for dyeing and 70:30 for weaving.

Geographically, most exports are aimed at Asia, including Bangladesh, Vietnam, and Cambodia, followed by the European region, primarily Italy and Turkey, and extending to Australia, the US, and Africa. Top ten clients consistently generate nearly half of all revenues, with only two exceeding 10% each, and the rest below 5%. Management ensures that no single client exceeds a 10% concentration to mitigate risk. Key revenue contributors include VF Kontoor, Levi's, Mango, H&M, American Eagle, Artistic Apparel, Gul Ahmed Textile and others.

Despite a worldwide economic slump impacting export volumes, FY23 revenue exceeded Rs. 27b, driven by a rise in the local sales ratio and ongoing rupee depreciation. Going forward, management foresees export growth due to anticipated global demand recovery, expanded weaving capacity and inclusion of a garment unit. Projected top-line revenue for FY24 stands at Rs. 40b, with 5% targeted net margin.

Profitability margins have seen a marked improvement over the last two fiscal years.
Significant improvement in both gross and net profitability margins has been observed, largely attributed to initiatives in efficiency enhancement, optimized energy usage, minimal reliance on imported raw materials and the favorable effects of rupee devaluation. About 60% of the grey fabric needed for the dyeing unit is produced in-house, with the rest sourced from the local market. Additionally, ~95% of the yarn required for the weaving division is locally obtained.

The rise in administrative and distribution costs correlates with inflation, elevated freight charges from global supply chain issues, and sales growth trends. Financial charges have more than doubled due to higher rates and increased running finance utilization but still remains limited. Meanwhile, robust revenue growth and better margins have quadrupled bottom-line growth over the review period.

Reflecting profitability growth, surge in cash flows has notably improved debt coverage metrics, aligning with industry peers.
Improved earnings in the last two years significantly increased funds flow from operations (FFO) to Rs. 1.9b (FY22: Rs. 1.4b; FY21: Rs. 0.7b) during 9M'FY23. Consequently, cash flow coverage metrics have depicted noticeable improvement while debt service coverage ratio (DSCR) has also risen to 2.73x, aligning with industry peers. The current ratio lags behind peers, and coverage of short-term borrowings by trade debts and inventory also suggests potential for improvement. Nevertheless, a 34-day cash conversion cycle is considered strong in comparison to industry. Aging profile of trade debts remains sound, with over 90% receivables settled within 90 days.

Retained earnings supported capitalization; leverage ratios are slightly elevated in comparison to peers.

Excluding revaluation surplus, equity base grew by ~45% in the last 21 months, hitting Rs. 4.8b at end-9M'FY23, primarily driven by strong earnings and prudent profit retention. The company has a fixed dividend policy and history of dividend payments, but due to the pandemic, significant payouts were withheld. Debt profile is a blend of short-term and long-term debt, with total interest-bearing liabilities increasing to Rs. 9.0b (FY22: Rs. 6.8b; FY21: Rs. 5.2b) at end-9M'FY23; ~79% constituted short-term debt. Total running finance lines are nearly Rs. 7b, of which about 65% is ERF facility, and the rest are Kibor-based loans. Long-term financing includes LTFF and TERF facilities. Gearing indicators are slightly higher than peers.

Corporate governance framework remains sound; however, room for improvement exists in terms of segregating ownership and management.

KML has an adequate corporate governance framework, professional management team, and internal controls. The senior management has shown longevity with no vacant positions at top management level. KML is fully compliant with the code of ethics issued by International Federation of Accountants (IFAC). Board comprises 7 members, including 2 independent directors and 2 female representatives. To ensure effective supervision, there are established board audit and HR committees. However, ownership and managerial roles may be segregated for transparency. The 2022 audit report highlighted key audit matters concerning inventory presence and value, revenue recognition, and capital expenditures.

Kohinoor Mills Limited Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**9M'FY23**
Property, Plant & Equipment	5,028.0	7,026.8	7,912.8	8,984.3
Stock-in-Trade	1,949.8	2,915.1	4,052.2	5,466.3
Trade Debts	545.6	952.8	1,217.2	2,553.3
Advances, Deposits & Prepayments	422.4	266.0	449.5	643.7
Sales Tax Receivables	682.9	872.2	1,630.4	2,153.4
Cash & Bank Balances	765.9	659.8	606.2	942.4
Total Assets	**10,165.9**	**13,573.7**	**16,875.9**	**21,798.8**
Trade and Other Payables	2,074.6	2,883.5	3,643.2	4,842.7
Long Term Debt *(Incl. current maturity)*	702.6	1,515.5	1,735.6	1,920.6
Short Term Debt	3,072.6	3,681.2	5,082.3	7,045.2
Total Debt	**3,775.2**	**5,196.7**	**6,817.9**	**8,965.8**
Paid-up Capital	509.0	509.0	509.0	509.0
Tier-1 Equity	2,136.8	3,246.4	3,439.6	4,757.8
Total Equity	**3,959.2**	**5,101.5**	**6,003.6**	**7,275.7**
INCOME STATEMENT	**FY20**	**FY21**	**FY22**	**9M'FY23**
Net Sales	11,997.8	13,241.0	21,452.8	20,213.8
Gross Profit	1,866.7	1,719.8	3,446.7	4,057.2
Profit Before Tax	**485.8**	**466.7**	**1,222.2**	**1,649.2**
Profit After Tax	**365.2**	**267.6**	**928.4**	**1,375.5**
Funds from Operations (FFO)	581.3	716.5	1,409.5	1,911.0
RATIO ANALYSIS	**FY20**	**FY21**	**FY22**	**9M'FY23**
Gross Margin (%)	15.56	12.99	16.07	20.07
Net Margins (%)	3.04	2.02	4.33	6.80
Current Ratio (x)	0.92	0.90	0.95	1.01
FFO to Total Debt (x)	0.15	0.14	0.21	0.28*
FFO to Long Term Debt (x)	0.83	0.47	0.81	1.32*
Debt Leverage (x)	2.96	2.61	3.16	3.05
Gearing (x)	1.77	1.60	1.98	1.88
DSCR (x)	1.75	2.24	1.86	2.73*
ROAA (%)	3.47	2.25	6.10	9.46*
ROAE (%)	17.01	9.94	27.77	44.64*
(Stock in Trade + Trade Debt) to Short-Term Borrowing Ratio (x)	0.81	1.05	1.04	1.14

**Annualized*

REGULATORY DISCLOSURES — Appendix II

Name of Rated Entity	Kohinoor 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
30/08/2023	BBB+	A-2	Positive	Maintained
10/08/2022	BBB+	A-2	Stable	Reaffirmed
19/04/2021	BBB+	A-2	Stable	Maintained
24/04/2020	BBB+	A-2	Rating watch-Negative	Maintained
11/03/2019	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.
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Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Kamran Shahid	CFO	July 25, 2023
Mr. Bhatti	General Manager	