RATING REPORT

Feroze1888 Mills Limited

REPORT DATE:
November 13, 2019

RATING ANALYST:
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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	AA-	A-1	AA-	A-1
Rating Date	*November 13, 2019*		*November 12, 2018*	
Rating Outlook	Stable		Stable	
Outlook Date	*November 13, 2019*		*November 12, 2018*	

COMPANY INFORMATION

Incorporated in 1972	**External auditors:** M/S EY Ford Rhodes Chartered Accountants
Public Limited Company	**Internal Auditors:** A. F. Ferguson & Co.
Key Shareholders (with stake 5% or more)[1]:	**Chairman:** Mr. Jonathan R. Simon
Mr. Shabbir Ahmed – 19.9%	**Chief Executive Officer:** Mr. Rehan Rahman
M/s Grangeford Ltd (Foreign Company) – 10.4%	**Chief Finance Officer:** Mr. Muhammad Faheem
M/s EFU Life Assurance Limited – 6.5%	**Company Secretary:** Mr. Muhammad Usama Siddiqui
Mr. Omair Rehman – 5.8%	
Mr. Perwez Ahmed – 5.5%	
M/s 1888 Mills LLC (Foreign Company) – 5.1%	
Mr. Sheikh Zafar Ahmed – 5.0%	

APPLICABLE METHODOLOGY(IES)

[1] As of June 30th 2019

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

Feroze1888 Mills Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

FML operates through various units at different locations, including Hub, SITE and Landhi, which comprise spinning, weaving, dyeing and stitching units. The company has a presence in the USA through a strategic alliance with 1888 Mills.

Feroze1888 Mills Limited ('FML' or 'the Company') is one of the largest terry textile exporters of Pakistan. FML is a vertically integrated company, engaged in end-to-end processing from spinning to product packaging.

FML has a total of 38,688 spindles & 346 looms installed. The Company meets its sales requirement through internal production; in some areas such as weaving, dying and printing, the Company outsources to external third parties, when internal capacity falls short. However, the Company continues to invest in capacity enhancement, in order to move towards complete in-house processing gradually.

Foreign ownership & presence has provided the company with a competitive advantage over other manufacturers.

Given its association with the US-based 1888 Mills, the Company has strong outreach in the US market; sales in US market constitute 85% of the total volumetric sales of the Company. Cognizant of its sales concentration in the US market, FML has embarked upon diversification of the exports towards Australia, Canada, UAE, UK & Europe. The management has been somewhat successful in this regard, with reliance on US market gradually reducing on a timeline (FY19: 85%; FY18: 89%; FY17: 90%).

Growth in profitability is largely owing to volumetric growth, enhanced efficiency, cost control measures and PKR Devaluation.

In FY19, FML's bottom line more than doubled, on the back of improving margins. Sales of the company were recorded at Rs 29.2 bn (FY18: 21.7bn) for the year FY19, depicting a growth of 34%. A quarter of the growth in topline can be attributed to the volumetric uptick.

Even the net margin depicted material improvement, amidst a challenging operating environment, wherein operating costs are rising at a higher rate, given sizable (31.7%) depreciation in local currency in FY19. Even though the administrative overheads grew (11%) roughly in line with inflation (9%), the uptick in distribution overheads was more pronounced at 27%, which can mainly be attributed to these expenses being largely foreign currency denominated. Given higher local currency depreciation vis-à-vis preceding year, the Company also recorded foreign exchange gain of Rs. 2.0bn (FY18: Rs. 0.7bn).

As an exporter, the Company avails debt at significantly subsidized rates, as a result of which FML is sheltered from the hike in benchmark rates. Most of the Company's debt is outstanding at a rate of 2.5-3%. The Company's pretax profits were higher by 122%.

Liquidity coverage remains sound

Owing to higher profitability, FFO was reported significantly higher at Rs 7.0b (FY18: Rs. 3.4b; FY17: Rs. 2.9b) in FY19 vis-à-vis the preceding year. The FFO to Debt coverage of 0.8x and debt service coverage ratio of 25x is indicative of very strong debt repayment ability.

In FY19, the Company's debt increased from Rs. 3.5bn to Rs. 8.8bn. The proportion of short term debt has been maintained at 74% of aggregate, and the uptick can mainly be attributed to rising working capital requirements. At the same time we have also noted a slight prolongation in the cash conversion cycle, particularly on account of high inventory days (Cash Conversion Cycle: FY19: 145 days; FY18: 130 days. Nevertheless, short term assets i.e. stock in trade and trade debt provides adequate coverage of short term borrowings at 2.2x (FY18: 3.6x). We expect adequate coverage of short term borrowings to be maintained, despite the expected uptick in working capital requirements.

Capitalization buffers have been reinforced on the back of improved profitability

At end-FY19, adjusted equity amounted to Rs. 18.6b (FY17, Rs. 14.7b), posting a growth of 27%. Moreover, the capital structure of the company has changed on account of higher debt financing for capacity expansion, which has increased the gearing and leverage indicators of the Company. (Gearing: FY19: 0.47x; FY18: 0.24x; Leverage: FY19: 0.74x; FY18: 0.49x).

The gearing and leverage indicators were reported at levels of 0.47x and 0.74x (FY18: 0.24x and 0.49x) respectively at end-FY19. The higher long term debt is adequately covered by higher FFO translating FFO to long term debt coverage of 3.09x. Going forward, these indicators are expected to remain within manageable levels.

Going forward, there are plans in place to incur capital expenditure, about half of which is planned to be financed by debt; however, the debt will mainly be undertaken, at subsidized rates under the Long Term Finance Scheme, and accordingly we expect interest coverage to remain intact. Given prudent profit retention, 57% of the profit generated in the past 3 years has been retained, we expect gearing to remain within VIS benchmarks for the assigned rating.

Financial Summary (amounts in PKR millions)			Appendix I
Rs in m	**FY17**	**FY18**	**FY19**
Property, Plant & Equipment	8,262.2	10,847.0	13,458.9
Stock-in-trade	3,637.7	3,892.3	6,411.1
Trade debts-considered good	4,354.2	5,191.5	7,630.0
Cash and bank balances	92.9	203.4	3,267.7
Paid-up Capital	3,768.0	3,768.0	3,768.0
Equity	13,008.8	14,668.2	18,604.4
Long term finance form-secured	437.1	750.3	1,991.5
Trade and other payables	3,177.3	3,701.9	4,910.7
Short term borrowings- secured	500.0	2,550.0	6,490.0
Accrued markup	5.1	18.6	50.9
Current portion of long term finance	110.0	162.5	275.4
Sales	20,937.3	21,775.4	29,243.5
Gross Profit	4,874.3	4,825.0	7,637.7
Administrative cost	(791.9)	(948.4)	(1,030.5)
Distribution cost	(1,421.0)	(1,511.8)	(1,922.0)
Other income/expenses	(156.6)	506.4	1,691.8
Finance cost	(55.0)	(85.7)	(155.9)
Profit before taxation	2,449.7	2,804.1	6,221.1
Profit after taxation	2,489.7	2,752.1	5,989.8
FFO	2,850.6	3,392.4	7,008.0
Ratios			
Gross margin (%)	23%	22%	26%
Operating Margin (%)	12%	13%	22%
Net Margin (%)	12%	13%	20%
Leverage	0.33	0.49	0.75
Gearing	0.08	0.24	0.47
ROAA(%)	15%	13%	21%
ROAE(%)	20%	20%	34%
Current ratio (x)	2.76	1.94	1.73
FFO/Long Term Debt (%)	521%	372%	309%
FFO/Total Debt (%)	272%	98%	80%
DSCR (x)	50.54	19.01	24.92

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Feroze1888 Mills Limited				
Sector	Textiles				
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				
	13-Nov-2019	AA-	A-1	Stable	Initial
	12-Nov-2018	AA-	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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