RATING REPORT

Feroze1888 Mills Limited

REPORT DATE:
December 07, 2020

RATING ANALYST:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AA-	A-1	AA-	A-1
Rating Date	*December 07, 2020*		*November 13, 2019*	
Rating Outlook	Stable		Stable	
Outlook Date	*December 07, 2020*		*November 13, 2019*	

COMPANY INFORMATION	
Incorporated in 1972	**External auditors:** M/S EY Ford Rhodes Chartered Accountants
Public Limited Company	**Chairman:** Mr. Jonathan R. Simon
Key Shareholders (with stake 5% or more)[1]:	**Chief Executive Officer:** Mr. Rehan Rahman
Mr. Shabbir Ahmed – 17.9%	
M/s Grangeford Ltd (Foreign Company) – 10.4%	
M/s EFU Life Assurance Limited – 6.3%	
Mr. Omair Rehman – 5.1%	
Mr. Perwez Ahmed – 5.8%	
M/s Liberty Mills Limited – 12.5%	

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

[1] *As of June 30th 2020*

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 continued to maintain its leading market position in total towel exports of Pakistan accounting for around one-fourth of total towel exports.

FML has a total of 45,888 (FY19: 38,688) spindles & 363 (FY19: 346) looms installed at end-FY20. Capacity utilization of the spinning and weaving segments declined during FY20 to 91.2% (FY19: 99.7%) and 94.6% (94.8%), respectively due to closure of plant for one month during 4QFY20 and lower production on account of COVID-19. Consequently, sales and production volumes witnessed a decrease in the outgoing year. However, the company overachieved in terms of sales and production during 1QFY21 owing to sizeable order backlogs with sales revenue being reported at Rs. 10b as compared to Rs. 7.7b in the corresponding period last year.

The Company meets its material requirement through internal production; however in some areas such as weaving, dying and printing, FML outsources to external third parties, when internal capacity falls short. However, FML continues to invest in capacity enhancement, in order to move towards complete in-house processing gradually. During FY20, the company installed additional spindles and looms along with replacement with air-jet looms that enhanced throughput. Consistent expansion plans across all segments is planned till FY25 with yearly capex quantum of around Rs. 2.5b-3b with the same projected to be financed through a mix of debt and equity.

Business risk profile supported by favorable demand outlook and increased opportunities for growth.

Pakistan's towel industry is dominantly export based with its growth being dependent on quality, price competitiveness and export outlets. Towel exports (in dollar terms) after peaking in FY16 have remained on the lower side due to high price competition and inability of industry to produce higher quality and value added towels. Towel exports, decreased by ~10% in FY20 due to one-off COVID-19 scenario. Share of towel exports in total exports and textile exports stood at 3.3% (FY19: 3.4%) and 5.8% (FY19: 6%), respectively during FY20. However, during 1QFY21, towel exports increased by 13.3% contributed by an 8.5% volumetric growth and a 4.4% increase average selling price. Given the ongoing expansion by a number of towel exporters, quantity sold is expected to increase from FY21.

At present, export of towels from Pakistan is diversified among 120 countries. Among all, USA is the major buyer followed by UK and other European Union (EU) countries. Over recent years, share of EU countries in total towel exports has increased. Given duty advantage due to Pakistan's EU GSP Plus Status and increased focus toward European markets, proportion of towel exports to EU is expected to increase going forward.

Business risk profile is supported by strong focus of government on enhancing exports for sustainable growth bodes well for towel exports. Improving perception and law order situation of the country has also increased interest from clients. US-China trade war has also resulted in buyers focusing on Pakistan to reduce geographical diversification risk. However, cost competitiveness remains a challenge particularly vis-à-vis regional peers (China, India and Bangladesh). Pricing power is limited as reflected by consistent decline in dollar pricing of products.

US market comprises bulk of total exports with increased efforts to diversify to other key markets. Lengthy association with large retailers supports business risk profile.

Given its association with the US-based 1888 Mills, the Company has strong outreach in the US market; sales in US market constitute around 85% of the total volumetric sales. Alongside, FML has embarked upon diversification towards other markets such as Australia, Canada, UAE, UK & Europe. The management has been somewhat successful in this regard, with reliance on US market gradually reducing on a timeline basis. Major clients include big US retailers- Target and Wal-Mart Stores with whom FML has long term association since the past ten years.

Profitability profile of the company weakened during FY20 due to declining gross margins and exchange loss. Going forward, volumetric growth in sales due to sizeable order backlog and healthy order pipeline is expected to derive recovery in profitability in FY21.

Sales revenue of the company increased to Rs. 31.2b (FY19: Rs. 29.2b) depicting an uptick of 7% as compared to the preceding year. Increase in sales was due to higher average selling prices on account of currency devaluation. Sales volumes decreased during the outgoing year due to plant closure for one month amidst COVID-19. Consequently, owing to higher fixed costs incurred in FY20 contracted gross margins to 24.1% (FY19: 26.1%). However, gross margins compare favorably vis-à-vis peers. Moreover, bottom line of the company was also impacted by exchange losses arising from currency devaluation. As an exporter, the Company avails debt at significantly subsidized rates, as a result of which FML remained sheltered from the hike in benchmark rates. Most of the Company's debt is outstanding at a rate of 2.5-3%. However, finance costs increased during FY20 due to higher debt levels on account of increase in short term debt. Due to aforementioned reasons, bottom line of the company declined by 51% during FY20 to Rs. 2.9b (FY19: Rs. 5.99b). Given significant order backlog, sales, gross margins and net profitability of the company increased during 1QFY21 being reported at Rs. 10b (1QFY20: Rs. 7.7b), 27.4% (FY20: 24.1%) and Rs. 1.6b (1QFY20: Rs. 743m), respectively. Going forward, volumetric growth in sales due to sizeable order backlog and healthy order pipeline is expected to derive recovery in profitability in FY21.

In line with weakening profitability profile due to one-off impact of global pandemic, liquidity coverage of the company were impacted along with sizeable money being tied up in sales tax refundable. Moreover, extended working capital cycle due to uncollected receipts and elevated stock levels owing to undisrupted cotton procurement cycle, necessitates utilization of short term borrowings. However, liquidity indicators are considered satisfactory from ratings perspective.

Owing to lower profitability, FFO was reported lower at Rs 4.4b (FY19: Rs. 7b) in FY20 vis-à-vis the preceding year. The FFO to Debt coverage and debt service coverage ratio weakened to 29% (FY19: 80%) and 8.8x (FY19: 25x) in FY20. However, Cash flow coverages of total and long term debt improved to 51% and 128%, respectively at end-

Sep'20. At end-FY20, the Company's debt increased from Rs. 8.7b to Rs. 15.2b. Short term debt increased to Rs. 9.6b (FY19: Rs. 6.5b) to finance increased working capital requirements. At the same time extended cash conversion cycle was noted, particularly on account of high inventory days (Cash Conversion Cycle: FY20: 171 days; FY19: 147 days). Nevertheless, short term assets i.e. stock in trade and trade debt provides adequate coverage of short term borrowings at 1.56x (FY19: 2.16x). Going forward, in lieu of management's plans of drawing debt for expansion, VIS expects interest coverage to remain within manageable levels supported by subsidized rates available on LTFF limiting the impact of market interest rates. Liquidity indicators are considered satisfactory from a ratings perspective.

Despite stunted growth in equity base during FY20; capitalization profile of the company is considered strong from ratings perspective. Going forward, management forecasts debt levels to increase with capitalization indicators projected to be maintained.

At end-FY20, equity base amounted to Rs. 19.7b (FY19: Rs. 18.6b), posting a growth of 5.7% with dividend payout reducing to 20% (FY19: 40%, FY18: 50%) Moreover, the capital structure of the company has changed on account of higher debt financing for capacity expansion and working capital requirements. Gearing and leverage indicators of the Company were reported at 0.77x (FY19: 0.47x) and 1.12x (FY19: 0.75x), respectively at end-FY20. Debt levels of the company are expected to further increase; however the same are projected to be maintained in accordance with the assigned ratings.

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**FY20**	**1QFY21**
Fixed Assets	8,262	10,847	13,459	17,595	17,943
Stock-in-Trade	3,638	3,892	6,411	8,270	8,076
Trade Debts	4,354	5,191	7,630	6,810	9,314
Cash & Bank Balances	93	203	3,268	2,248	1,393
Total Assets	10,466	12,495	20,304	25,456	27,607
Trade and Other Payables	3,177	3,702	4,911	6,481	6,203
Long Term Debt	547	913	2,267	5,531	6,483
Short Term Debt	500	2,550	6,490	9,640	9,840
Total Debt	1,047	3,463	8,757	15,171	16,323
Paid Up Capital	3,768	3,768	3,768	3,768	3,768
Total Equity	13,009	14,668	18,604	19,661	21,276
INCOME STATEMENT	**FY17**	**FY18**	**FY19**	**FY20**	**1QFY21**
Net Sales	20,937	21,775	29,244	31,206	10,062
Gross Profit	4,874	4,825	7,638	7,507	2,752
Operating Profit	2,505	2,890	6,377	3,631	1,826
Profit Before Tax	2,450	2,804	6,221	3,284	1,719
Profit After Tax	2,490	2,752	5,990	2,937	1,615
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**	**FY20**	**1QFY21**
Gross Margin (%)	23.3%	22.2%	26.1%	24.1%	27.4%
Net Margin (%)	11.9%	12.6%	20.5%	9.4%	16.1%
Net Working Capital	6,672	6,060	8,575	8,896	10,889
Trade debts/Sales	21%	24%	26%	22%	23%
FFO	2,851	3,392	7,008	4,437	2,079
FFO to Total Debt (%)	272%	98%	80%	29%	51%
FFO to Long Term Debt (%)	521%	372%	309%	80%	128%
Debt Servicing Coverage Ratio (x)	50.5	19.0	24.9	8.8	10.6
Current Ratio (x)	2.8	1.9	1.7	1.5	1.7
Stock+ Trade Debts/STD	1598%	356%	216%	156%	177%
Gearing (x)	0.08	0.24	0.47	0.77	0.77
Leverage (x)	0.33	0.49	0.75	1.12	1.07
ROAA (%)	15%	13%	21%	8%	15%
ROAE (%)	20%	20%	36%	15%	32%

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				
07-Dec-2020	AA-	A-1	Stable	Reaffirm
13-Nov-2019	AA-	A-1	Stable	Reaffirm
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile. Copyright 2020 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.
Due Diligence Meetings Conducted	

Name	Designation	Date
Murad Talpur	Treasury, Finance & Accounts	29-Sept-2020
Javeria Siddiqui	CFO	29-Sept-2020