RATING REPORT

Feroze 1888 Mills Limited

REPORT DATE:
January 13, 2023

RATING ANALYSTS:
Asfia Aziz
asfia.aziz@vis.com.pk

Muhammad Taha
m.taha@vis.com.pk

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	*January 13, 2023*		*January 07, 2022*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	

COMPANY INFORMATION

Incorporated in 1972	**External auditors:** EY Ford Rhodes Chartered Accountants
Public Listed Company	**Chairman:** Mr. Jonathan R. Simon
Key Shareholder (s) (with stake 5% or more):	**CEO:** Mr. Rehan Rahman
M/s. Liberty Mills Ltd.	
M/s. Grangeford USA Inc.	
M/s. EFU Life Assurance Limited	
Mr. Omair Rehman	
Mr. Shabbir Ahmed	
Mr. Perwez Ahmed	

APPLICABLE METHODOLOGY(IES)

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

Feroze 1888 Mills Limited

OVERVIEW OF THE INSTITUTION

Feroze1888 Mills Limited was incorporated in Pakistan as a Public Limited Company in October 1972. The shares of the Company are quoted on Pakistan Stock Exchange Limited. The Company is principally engaged in the production and export of towels. The registered office of the company is situated at H-23/4-A Scheme # 3, Landhi Industrial Area, Karachi.

RATING RATIONALE

Company Overview

Feroze1888 Mills Limited ('FML' or 'the Company') specializes in the production and export of terry products with its main export destinations being United States and Europe. The Company offers a wide selection of terry items, including hand towels, bath towels, bath robes, kitchen towels, and beach towels, in a variety of sizes and categories. FML is a vertically integrated company that processes materials from start to finish, from spinning to packing.

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 strategic alliance with 1888 Mills USA with around 12% of FML's sales directed to the same. During FY22, capacity of the weaving plant was expanded as additional looms were installed, while further enhancements machinery in are expected at both units (spinning and weaving) going forward. Capacity utilization levels have remained on the higher side over the years, although some reduction has been observed in recent months.

Spinning	FY21	FY22
Total number of spindles installed	48,072	48,072
Average number of spidles worked	47,404	48,072
Total number of rotors installed	2,116	2,116
Average number of rotors worked	2,116	2,116
Installed capacity after conversion into 12/s lbs	75,410,178	75,399,757
Actual production after conversion into 12/s lbs	67,382,160	67,393,597
Utilization	89%	89%
Weaving	**FY21**	**FY22**
Total number of looms installed	371	447
Average number of looms worked	366	402
Installed capacity meters	154,149,648	177,677,189
Actual production meters	150,612,635	142,473,386
Utilization	98%	80%

Sector Update

Table 1: Pakistan Export Statistics

	FY20	FY21	FY22	Q1'FY22	Q1'FY23
PAKISTAN EXPORTS (IN USD' MILLIONS)	22,536	25,639	32,450	7,201	7,594
TEXTILE (IN USD' MILLIONS)	12,851	14,492	18,525	4,241	4,777
PKR/USD RATE (AVERAGE)	158.0	160.0	177.5	164.4	229.1
SOURCE: SBP					

- Pakistan's export growth came in at 14% and 27% in FY21 and FY22 respectively. Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally grew beyond USD 32.4b.
- In FY22, textile exports were up 28%. Growth in textile exports played a significant role in this uptick, contributing 59% of the overall growth in export base. Share of textile exports in total exports has oscillated in the range of 54-59%, coming in at 57% during the past 3-years (FY20-22).
- As illustrated in the table below, the composition of textile exports has depicted improvement in the last 3-year period, with contribution from higher value added segment increasing from 77.2% in FY20 to 80.8% in FY22 of aggregate textile exports

.**Table 2: Segment-wise textile Exports (All Figures in USD' Millions, except for percentages)**

	FY20	FY21	FY22	1Q'FY22	1Q'FY23	FY20	FY21	FY22	1Q'FY22	1Q'FY23
HIGH VALUE-ADDED SEGMENT	**9,669**	**12,427**	**15,605**	**3,561**	**3,749**	**77.2%**	**80.7%**	**80.8%**	**80.6%**	**81.8%**
- KNITWEAR	2,794	3,815	5,118	1,145	1,321	22.3%	24.8%	26.5%	25.9%	28.8%
- READYMADE GARMENTS	2,552	3,033	3,905	861	912	20.4%	19.7%	20.2%	19.5%	19.9%
- BED WEAR	2,151	2,772	3,291	803	780	17.2%	18.0%	17.0%	18.2%	17.0%
- TOWELS	711	938	1,110	241	237	5.7%	6.1%	5.7%	5.5%	5.2%
- MADE-UP ARTICLES (EXCL. TOWELS & BED WEAR)	591	756	848	197	180	4.7%	4.9%	4.4%	4.5%	3.9%
- ART, SILK & SYNTHETIC TEXTILE	315	370	460	108	108	2.5%	2.4%	2.4%	2.4%	2.4%
- OTHERS	555	743	872	206	211	4.4%	4.8%	4.5%	4.7%	4.6%
LOW TO MEDIUM VALUE-ADDED SEGMENT	**2,858**	**2,972**	**3,717**	**860**	**835**	**22.8%**	**19.3%**	**19.2%**	**19.4%**	**18.2%**
- COTTON CLOTH	1,830	1,921	2,332	557	581	14.6%	12.5%	12.1%	12.6%	12.7%
- COTTON YARN	984	1,017	1,311	289	236	7.9%	6.6%	6.8%	6.5%	5.2%
- OTHERS	43	34	74	14	18	0.3%	0.2%	0.4%	0.3%	0.4%
TOTAL	12,527	15,399	19,332	4,421	4,584					
SOURCE: PBS										

- Cotton production in Pakistan, was at its lowest level in decades for FY21, albeit the same posted 18% uptick in FY22. Actual production at 8.33m bales still missed the targeted production of 10.5m bales. 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.
- According to United States Department of Agriculture (USDA), the 2022/23 harvested area has declined notably following devastation caused by recent flood in Sindh and Southern Punjab. Hence, the projected production has been brought down to 5m bales. To counter the shortage, import of 5.8m bales is expected during FY23, which is 29% higher than preceding year.

Table 3: Cotton Prices

	FY19	FY20	FY21	FY22
Per Maund (Rs.)	8,770	8,860	13,000	17,380
% Change	*26%*	*1%*	*32%*	*34%*

- After posting windfall margins in FY21 and H1'FY22, margins of textile operators came under pressure in H2'FY22, mainly on account of higher input costs and recessionary trend in export markets.

Topline exhibited growth in FY22 on the back of higher average selling prices.

Topline of the company experienced an increase of 15% and was reported at Rs. 49.0b (FY21 Rs. 42.6b, FY20: Rs. 31.2b) during FY22 with the uptick being attributable to higher average selling prices due to dollar devaluation and passing on the impact of higher inputs. Almost all of the company's output is exported (97%), a significant proportion (83%) of which is directed to the USA, followed by Europe (16%). Customer concentration in on the higher side, as top 10 customers account for 81% of revenue. Comfort is drawn from longstanding relationships with these clients. In addition to the big retail stores (Walmart and Target) in key markets, FML also has an institutional customer base in the hospitality segment, which is responsible for a relatively small share of total sales.

With a rise in inflationary pressure and resultant fall in consumer purchasing power, along with inventory pile-up with big retailers in the international market, demand from the export markets is subdued since April'22. Consequently, revenue for Q1FY23 was reported lower at Rs. 9b (1QFY22: Rs. 11.4b) vis-à-vis the previous year. The management is expecting a gradual recovery in the flow of orders which will be largely determined by the off-take in the current Christmas season.

Profitability indicators weakened during FY22 due to higher input costs, however witnessed an upward trend in the ongoing year contributed by PKR devaluation.

In line with surge in commodity prices globally, the entity faced the issue of a substantial rise in raw material costs. These were passed on to the customers only to certain extent, as the company offered price discounts at times to maintain volumetric sales volumes. Consequently, gross margin for FY22 was adversely impacted and was reported 15.6% (FY21: 22.4%, FY20: 22.5%.). Operating costs also surged mainly because of higher expenses related to freight and insurance. Other income for the period was noticeably higher due to exchange gain earned by the company, which supported bottom-line profitability in FY22. Depreciation of local currency and consequent improvement in average selling price during Q1FY23, along with a sizeable quantum of exchange gain yielded higher margins. Improving profitability profile in view of higher projected finance costs, stabilization of margins and subdued macroeconomic environment will be important for sustaining the ratings.

Weakening noted in cash flow coverages during the review period.

Excluding the impact of exchange gain in FY22 and 1QFY23, FFO coverages against outstanding obligations weakened with the same reported at 17% and 43%, at end-1QFY23 respectively. Similarly, DSCR also stood lower at 2.0x (FY22: 2.1x, FY21: 7.4x) at the end of the period, comparing significantly lower than peer average. Coverage of stock in trade and trade debts in relation to short-term financing also reduced to 126% at end-Sep'22 on the back of escalated short term borrowings to meet working capital needs. Consistency in terms of payment with suppliers and customers has also ensured stability in cash conversion cycle during FY22. However, the same escalated in the ongoing year due to volatility in macroeconomic dynamics Going forward, while exposed to currency volatility, improving profitability profile will be important to enhance liquidity coverages against benchmarks for the assigned ratings.

Sound capitalization indicators on the back of a persistent growth in equity base.

Equity base of the company (excluding surplus on revaluation of land) increased by 25% over the period Jul'21-Sep'22 and was reported at Rs. 28.7b (FY22: Rs 26.9b, FY21: Rs. 23.0b). In addition to the retention of profit, FML also issued right shares during FY22 with an overall value of Rs. 1.6b which has been utilized for capacity expansion related work at Hub plant. Quantum of debt went up by Rs. 6.0b over the same period to finance capital expenditure and to meet higher working capital requirements. With profit retention and issuance of right shares, despite dividend payout of 33% in FY22 gearing and leverage ratios were largely maintained with the same reported at 0.89x (FY22: 0.91x, FY21: 0.85x) and 1.21x (FY22: 1.20x, FY21: 1.19x) respectively at end-Sep'22. In view of management's representation to finance all future expansions through internal cash generation, maintaining short-term liquidity metrics and leverage levels in line with ratings benchmarks will be important from ratings perspective.

FINANCIAL SUMMARY	(amounts in PKR millions)		(Appendix I)		
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**	**Q1FY23**
Fixed Assets	13,459	17,595	20,308	27,799	29,336
Stock-in-Trade	6,411	8,270	8,437	9,897	13,663
Trade Debts	7,630	6,810	10,116	8,767	5,574
Cash & Bank Balances	3,268	2,248	1,625	1,529	1,785
Total Assets	20,304	25,456	31,473	34,403	36,950
Trade and Other Payables	4,911	6,481	5,958	5,796	6,744
Long Term Debt	2,267	5,531	7,740	9,977	10,149
Short Term Debt	6,490	9,640	11,750	14,400	15,324
Total Debt	8,757	15,171	19,490	24,377	25,473
Paid Up Capital	3,768	3,768	3,768	3,994	3,994
Total Equity (without surplus on revaluation of assets)	18,604	19,661	22,967	26,923	28,690
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**	**Q1FY23**
Net Sales	29,348	31,206	42,575	49,018	9,014
Gross Profit	7,311	7,034	9,551	7,623	2,006
Operating Profit	6,377	3,631	5,348	4,786	2,254
Profit Before Tax	6,221	3,284	4,789	4,121	1,963
Profit After Tax	5,990	2,937	4,311	3,408	1,767
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**FY22**	**Q1FY23**
Gross Margin (%)	24.9%	22.5%	22.4%	15.6%	22.3%
Net Margin (%)	20.4%	9.4%	10.1%	7.0%	19.6%
Net Working Capital	8,575	8,896	11,915	12,446	13,070
Trade debts/Sales	26%	22%	24%	18%	15%
FFO (excluding one-off exchange gain)	7,008	4,447	6,124	4,265	1,061
FFO to Total Debt (%)	80%	29%	31%	17%	17%
FFO to Long Term Debt (%)	309%	80%	79%	43%	42%
Debt Servicing Coverage Ratio (x)	24.9	8.8	7.4	2.1	2.0
Current Ratio (x)	1.7	1.5	1.6	1.6	1.5
Stock+Trade Debts/STD	216%	156%	158%	130%	126%
Gearing (x)	0.47	0.77	0.85	0.91	0.89
Leverage (x)	0.75	1.12	1.19	1.20	1.21
ROAA (%)	21%	8%	9%	6%	11%
ROAE (%)	36%	15%	20%	14%	25%
Dividend Payout	40%	30%	30%	33%	

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	Feroze 1888 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				
01/13/2023	**AA-**	**A-1**	**Stable**	**Reaffirmed**
01/07/2022	AA-	A-1	Stable	Reaffirmed
12/07/2020	AA-	A-1	Stable	Reaffirmed
11/13/2019	AA-	A-1	Stable	Reaffirmed
11/12/2018	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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Due Diligence Meeting Conducted

Name	Designation	Date
Javeria Siddiqui	CFO	November 25, 2022