

RATING REPORT

Feroze 1888 Mills Limited

REPORT DATE:

February 27, 2024

RATING ANALYSTS:

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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 Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	
Rating Date	February 27, 2024		January 13, 2023	

COMPANY INFORMATION

Incorporated in 1972	External Auditors: EY Ford Rhodes Chartered Accountants
Public Listed Company	Board Chairman: Mr. Abdul Rehman Yaqub
Key Shareholders (with stake 5% or more):	Chief Executive Officer: Mr. Rehan Rahman
<i>M/s. Liberty Mills Limited ~18.6%</i>	
<i>Mr. Shabbir Ahmed ~15.0%</i>	
<i>M/s. Grangeford USA Inc ~9.8%</i>	
<i>Mr. Perwez Ahmed ~5.9%</i>	
<i>Mr. Omair Rehman ~5.0%</i>	

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>

Feroze 1888 Mills Limited

OVERVIEW OF
THE
INSTITUTION

Feroze 1888 Mills Limited (the Company) was incorporated in Pakistan as a Public Limited Company in October 1972 under the Companies Act, VII of 1913 (repealed with the enactment of the Companies Act, 2017). The shares of the Company are quoted on Pakistan Stock Exchange Limited. The Company is principally engaged in the production and export of specialized yarn and textile products. The registered office of the Company is situated at H-23/4-A Scheme # 3, Landhi Industrial Area, Karachi.

Profile of Chairman:
Mr. Abdul Rehman Yaqub after completing his education in the US entered into textile industry almost 35 years back. Starting out as a young businessman with a strong work ethic, he started sales and distribution textile Company named at Eastern Imports Ltd. Within few years, he expanded the operation by acquiring manufacturing facilities in Bangladesh and Sri Lanka. While his company was growing internationally, he worked on expanding his US operations by merging with another niche textile company to become Eastern-Shelnor, Inc.

RATING RATIONALE

Corporate Profile

Incorporated in 1972, Feroze 1888 Mills Limited ('FML' or 'the Company') owns a vertically integrated spinning, weaving, dyeing, printing, stitching, finishing facility, and product packaging facility. In partnership with 1888Mills USA, FML is principally engaged in production and export of specialized yarn and textile products across the globe with keen focus on USA, UK and European markets. The product range encompasses a broad selection of terry and non-terry items, ranging from white, dyed, printed, dobby, and jacquard variations, available in a diverse array of sizes and categories, including hand towels, bath towels, bathrobes, kitchen towels, beach towels, blankets, baby t-shirts, and patient gown.

Environmental, Social, & Governance (ESG) Initiatives

FML is dedicated to environmental responsibility, demonstrated through certifications like GOTS, GRS, FSC, OEKO-TEX STeP, and RCS-100. Their Energy Management Policy aligns with ISO 50001, resulting in a 25.6% Y/Y increase in renewable energy production and expanded solar power capacity, reducing over 3,500 tons of CO2 emissions. Third-party assessments by PERAC Research and Development (PRD) confirm adherence to National Environmental Quality Standards (NEQS), showcasing an 8.38% Y/Y reduction in GHG emissions, saving 13.4m cubic meters of natural gas, and reducing CO2 emissions by 25,000 tons. In water conservation, FML achieved a 13% Y/Y reduction, reclaimed 250m gallons, and increased reclaimed water by 6% Y/Y. They planted 50,000 mangroves, conducted urban forestation, and reduced carbon emissions by 18% Y/Y. Using 87% recyclable grade paper, FML follows SOPs for waste reduction and engages in initiatives like SBTi, CDP, and CBD through the 'Feroze1888 Climate Change Committee.'

Operational Performance**Table: Capacity & Production Data (Units in millions)**

	FY21	FY22	FY23
Spinning			
No. of Spindles installed	48,072	48,072	57,288
No. of Spindles worked	47,404	48,072	57,288
No. of rotors installed	2,116	2,116	3,312
No. of rotors worked	2,116	2,116	3,312
Installed Capacity – (lbs)	75.4	75.4	76.1
Actual Production – (lbs)	67.4	67.4	67.6
Capacity Utilization	89%	89%	89%
Weaving			
No. of looms installed	371	447	447
No. of looms worked	366	402	414
Installed Capacity – (mtr)	154.1	177.7	177.7
Actual Production – (mtr)	150.6	142.5	148.0
Capacity Utilization	98%	80%	83%

FML operates through various units at different locations, including Hub, SITE and Landhi, which comprise of spinning, weaving, dyeing, stitching, and packaging units. The Company has a strategic alliance with 1888 Mills USA with around 12% of FML's sales directed to the same. During FY23, the Company undertook a capital expenditure of Rs. 8.44b, focusing

(ESN). From the success and growth of ESN another merger came into play with him leading the way. ESN merged with a textile manufacturer and became 1888 Mills, LLC with manufacturing capabilities in the US.

Profile of the CEO:

Mr. Rehan Rahman was appointed Chief Executive Officer of Feroze 1888 Mills in April 2016 and has recently been re-appointed for the fourth term effective August 2023. He brings with him an extensive and cross functional hands on experience of now over 20 years in Feroze 1888 and legacy companies. Rehan became the first CEO of Nakshbandi Industries Limited (NBIL) after its acquisition by Feroze Textile Mills Limited in 2010 and played an instrumental role in the integration process and transformed a deteriorating unit into a gradually performing unit.

on enhancing the production capacities in spinning and civil infrastructure works in weaving, dyeing, and stitching divisions; hence, the actual production level increased in the weaving unit. This has led to an improvement in the division’s capacity utilization level to 83% (FY22: 80%), while it remained the same in spinning unit.

Rating Drivers

Business risk remain elevated amid weak macroeconomic environment, 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 in terms of margins sustainability and future growth.

In FY23, the performance of Pakistan's textile sector faced constraints due to the government's withdrawal of significant incentives previously enjoyed by the sector, such as RCET (Regionally Competitive Energy Tariff) and Subsidized Financing Schemes. The cost of production for the textile sector increased notably, with gas prices surging from Rs. 819 per MMBtu to Rs. 2,200 per MMBtu during FY23. This escalation was primarily attributed to depleting gas reserves in the country and a heightened dependence on RLNG.

The textile sector, being highly leveraged, encountered additional challenges with reduced support from the State Bank of Pakistan (SBP) and the government. The textile companies have had to borrow at a higher cost, amidst an elevated monetary policy rate in the country. Moreover, due to recessionary trends in both local and international economies, the demand for textile products remained low throughout FY23.

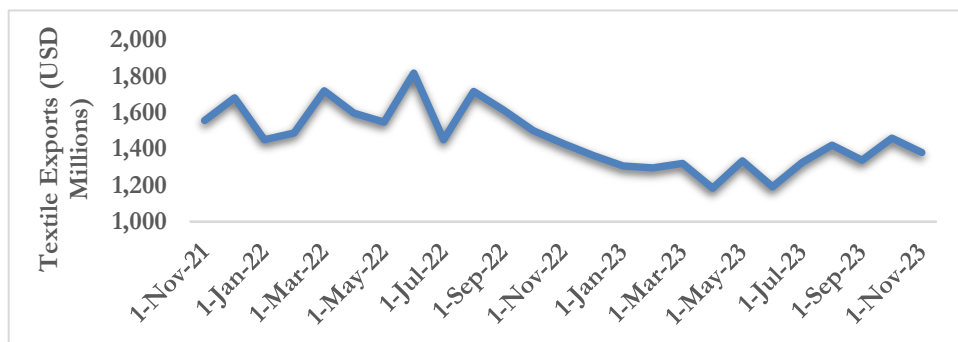


Figure 1: MoM Textile Exports (In USD Millions)

Source: SBP

Looking ahead, the demand outlook for the textile sector is anticipated to be constrained by prevailing economic uncertainties. Nevertheless, the depreciation of the rupee has rendered our exports slightly more competitive in international markets. Additionally, there is optimism as an anticipated bumper cotton crop in FY24 is expected to alleviate pressure on input costs and margins. The price of cotton per maund has already witnessed a decline from Rs. 22,000 to Rs. 18,000, contributing to a more favorable cost structure for the industry.

Rupee devaluation spurred growth in topline amid tumbling export volumes

Over the 7-year span (FY16-23), the Company’s revenue base achieved a CAGR of ~16.5% while in FY23, net sales upticked by ~16.6%, reaching Rs. 57.2b mark (FY22: Rs. 49.0b). The increase is primarily attributed to rupee devaluation during the period amidst declining sales volumes.

Although, the Company’s net sales during Q1’FY24 have increased by a stellar 96% corresponding to SPLY, registering at Rs. 17.7b (Q1’FY23: Rs. 9.0b) owing to both

volumetric and price gains, however, the Company's net profit for the period has declined by 43% Y/Y to Rs. 1.0b (Q1'FY23: Rs. 1.8b). The primary factor behind the higher profit in the corresponding period of the previous year was a net exchange gain of approximately Rs. 1 billion, in contrast to a minor net exchange loss experienced in the current period. Simultaneously, increased finance cost during Q1'FY24 also dented the net profit. Going forward, the management anticipates that the Company's revenue will maintain its upward trajectory, with a projected increase of around 10% Y/Y in FY24.

Nearly entire share of the revenue is derived from exports, while a minor fraction comprises local sales. Geographic sales diversification of the Company is low as nearly three-quarters of the total sales are directed towards the US. Top-10 client concentration also remains high with top-10 client accounting for ~86.7% of the net sales. Nonetheless, the company is expanding its customer base by exploring new markets to mitigate the concentration risk.

Historic high margins achieved on the back of Rupee devaluation, backward integration and minimal reliance on imported cotton

Both gross and net margins rebounded to 22.9% and 15.7% in FY23, primarily due to the significant devaluation of PKR. The proportion of domestically sourced raw materials to those imported stands at 45% to 55%. The increase in administrative overhead has outpaced the sales growth while distribution cost remains in line with the same. FML's profitability is further supported by exchange gains booked during FY23 amounting to Rs. 4.1b. Finance charges has also upticked amid higher benchmark rates and increased quantum of debt. However, the net margin, during 1QFY24, has declined to 5.7% (1QFY23: 19.6%), owing to higher finance charges and a slight exchange net loss incurred by the Company, whereas in the previous corresponding period, FML had earned a net exchange gain of Rs. 1 bn. Looking ahead, the management anticipates that profit margins will remain under pressure due to elevated finance costs and the challenges posed by customer pricing pressures.

Strong profitability profile translates into improved cash-flow coverage while DSCR weakened yet remains above peers; liquidity profile is supported by dividends received from short term investments.

On the back of strong bottom-line performance, substantial growth of 90.9% in the funds from operations (FFO) was achieved, reaching Rs. 11.4b (FY22: Rs. 6.0b) in FY23. However, contrasting trend is observed during Q1'FY24 as depicted by FFO to Total Debt and FFO to Long-term Debt of 0.22x (FY23: 0.44x; FY22: 0.25x) and 0.62x (FY23: 1.14x; FY22: 0.60x) respectively. Similarly, debt servicing coverage ratio has also declined in Q1'FY24 and stood at 1.71x (FY23: 3.60x; FY22: 2.82x).

The liquidity profile remains strong as current ratio remains above comfortable levels while short-term debt coverage with trade debts and inventory have improved significantly. However, net cash cycle has increased to 108 days (FY22: 99 days) owing to higher inventory days.

Capitalization profile remained intact despite increase in total debt

Overall debt of the Company displayed an upward trend due to increase in short term borrowings amid high working capital requirements, however, the Company has not mobilize any major long term debt during the review period. As at Sep'23, long term debt stood at Rs. 9.6b (Jun'23: Rs. 10.0b, Jun'22: Rs. 10.0b). In contrast, short term borrowings increased to Rs. 17.0b as at Sep'23 (Jun'23: 15.9b, Jun'22: Rs. 14.4b). Resultantly, total debt climbed up to Rs. 26.7b as at Sep'23 (Jun'23: 25.9b, Jun'22: Rs. 24.4b). Despite the increase in debt levels, capitalization ratios of the Company stood at same levels because of a proportionate increase in the equity base owing to improved profitability. Maintaining

gearing and leverage ratios at current levels will remain important from the ratings perspective.

Corporate Governance Framework

In line with requirement of Companies Act, 2017 and Code of Corporate Governance, the Company has included three independent director, seven non-executive director and one executive director including female representation with each processing adequate level of knowledge and expertise. Board of Directors have constituted Audit Committee and Human Resource and Remuneration Committee to work under its guidance. The audit committee consists of four members including its Chairman. Two members are Non-Executive Directors, while Chairman and one member of Committee are Independent Directors including a female director. The Human Resource and Remuneration Committee consists of three Board members, with two Independent Directors and one Non-Executive Director. The Chairperson of the Committee is an Independent female director.

Feroze 1888 Mills Limited
Appendix I

FINANCIAL SUMMARY					
	<i>(amounts in PKR millions)</i>				
BALANCE SHEET	FY20	FY21	FY22	FY23	Q1'FY24
Property Plant and Equipment	17,595.0	20,308.1	27,798.5	33,939.1	34,727.2
Stock in trade	8,269.6	8,437.2	9,896.7	15,449.6	19,511.8
Trade debts	6,809.5	10,115.9	8,766.6	13,259.2	17,144.6
Cash and Bank Balance	2,248.0	1,625.1	1,529.0	1,336.6	711.4
Total Assets	43,096.7	51,866.9	62,291.3	76,912.5	79,625.7
Trade & Other Payables	6,481.1	5,958.1	5,796.3	10,863.5	11,915.8
Short-term investments	9,640.0	11,750.0	14,400.0	15,900.0	17,076.1
Long-term investments	5,530.8	7,739.6	9,977.1	10,028.4	9,673.4
Total Debt	15,170.8	19,489.6	24,377.1	25,928.4	26,749.5
Total Liabilities	21,949.6	27,414.1	32,358.0	40,226.6	41,933.9
Paid Up Capital	3,768.0	3,768.0	3,994.1	3,994.1	3,994.1
Total Equity (without surplus revaluation)	19,660.8	22,966.6	26,923.2	33,675.7	34,681.6
INCOME STATEMENT	FY20	FY21	FY22	FY23	Q1'FY24
Net Sales	31,205.7	42,575.5	49,018.5	57,171.9	17,699.0
Gross Profit	7,497.1	9,551.2	7,623.5	13,089.3	3,704.7
Profit Before Tax	3,283.6	4,789.3	4,120.7	9,775.7	1,282.6
Profit After Tax	2,937.2	4,311.3	3,408.5	8,969.5	1,005.9
RATIO ANALYSIS	FY20	FY21	FY22	FY23	Q1'FY24
Gross Margin (%)	24.0%	22.4%	15.6%	22.9%	20.9%
Net Margin (%)	9.4%	10.1%	7.0%	15.7%	5.7%
Current Ratio (x)	1.54	1.61	1.57	1.47	1.43
FFO	4,399.1	6,176.7	5,991.6	11,435.3	1,486.1
FFO to Total Debt (%)	29.0%	31.7%	24.6%	44.1%	22.2%*
FFO to Long Term Debt (%)	79.5%	79.8%	60.1%	114.0%	61.5%*
Debt Servicing Coverage Ratio (x)	7.56	7.36	2.82	3.60	1.71*
Gearing (x)	0.77	0.85	0.91	0.77	0.77
Leverage (x)	1.12	1.19	1.20	1.19	1.21
(Stock in trade + Trade debt)/Short term Borrowing (x)	1.56	1.58	1.30	1.81	2.15
ROAA (%)	7.6%	9.1%	6.0%	12.9%	5.5%*
ROAE (%)	14.2%	18.9%	12.5%	26.9%	11.6%*

*Annualized

REGULATORY DISCLOSURES					Appendix II
Name of Rated Entity	Feroze 1888 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
	02/27/2024	AA-	A-1	Stable	Reaffirmed
	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		17 th November, 2023	