RATING REPORT

Arshad Corporation (Pvt.) Limited

REPORT DATE:
April 05, 2019

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	BBB+	A-2
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*April 03, '19*	

COMPANY INFORMATION	
Incorporated in 1973	External auditors: Zahid Jamil & Co. Chartered Accountants.
Private Limited Company	Chairman/CEO: Mr. Muhammad Arshad Sheikh
Key Shareholders (with stake 5% or more):	
Mr. Muhammad Arshad Sheikh – 27.50%	
Mr. Shahzad Ahmed Sheikh – 26.0%	
Mr. Nisar Ahmed Sheikh – 24.0%	
Mr. Sharhyar Arshad – 5.0%	

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

Arshad Corporation (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Arshad Corporation (Pvt.) Limited was incorporated in 1973 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017). The company is principally engaged in manufacturing of sale of fabric and made-ups.

Profile of the Chairman/CEO

Mr. Arshad Sheikh is the Chairman of the Board and Chief Executive Officer (CEO). Mr. Arshad is a graduate and has over 50 years of textile industry experience.

Financial Snapshot

Tier-1 Equity: end-FY18: Rs. 2.6b; end-FY17: Rs. 2.3b; end-FY16: Rs. 2.0.

Assets: end-FY18: Rs. 9.7b; end-FY17: Rs. 8.3b; end-FY16: Rs 8.4b.

Profit After Tax: FY18: Rs. 227m; FY17: Rs. 135m; FY16: Rs. 180m.

RATING RATIONALE

Arshad Corporation (Pvt.) Limited (ACL) is an export-oriented composite textile unit and primarily operates four business segments, including grey fabric, fabric processing, processed fabric and made-ups. The U.S. and Europe are primary target markets and account for 80% of total sales. Shareholding of the company is held by sponsoring family, who have been in the industry since 1954. The assigned ratings take into account ample experience of sponsors, established relations with the suppliers and customers, and integrated operations. ACL is one of few industry players in Pakistan who have capabilities to manufacture police and armed forces uniforms. The ratings also factor in maintenance of adequate margins over the years. Being primarily an export oriented company, recent rupee devaluation also bodes well for the profitability. However, the ratings are constrained by strong competition from local and regional textile players and vulnerability to changes in yarn and fabric prices amidst lack of pricing power. The ratings also incorporate relatively high leverage indicators and cash conversion cycle, though ACL's capacity to meet its long-term financial obligations is considered adequate.

Rating Drivers

More focus on fabric processing and value addition

ACL is an export-oriented composite textile unit involved in manufacturing and sale of fabric and made-ups, with the U.S. and Europe being the primary target markers. The product portfolio of ACL is composed of grey fabric, and a wide range of made-ups including home textile and work-ware garments. ACL also provides fabric processing services to other textile units. The upgradation of looms unit allowed the company to weave more fabric during FY18. In a bid to grow exports and improve profit margins, the company is increasing its focus on fabric processing and printing segments. Fabric processing facility at ACL is equipped with continuous thermasol dyeing and bleaching machines, having cumulative processing capacity of up to 31.5m meters per annum. ACL recorded 8% increase in fabric processing during FY18 with the enhancement of overall production capacity. The company also recorded 14% increase in fabric printing, though capacity utilization remained flat as the impact of increased capacity was offset by higher production during the year. ACL has adequate backup power arrangements.

Sales and profits uplifted by positive impact of rupee depreciation

After two years of decline, net sales of the company increased by 10.9% during FY18 on account of higher selling prices. Despite further decline in volumes, rupee depreciation and improved average selling prices positively impacted gross made-ups sales to international client. Cost of sales increased by 10.6% during FY18 mainly due to higher cost of raw material consumed and fuel & power costs. Resultantly, ACL reported higher gross profit. Gross margins of the company have remained largely stable on a timeline basis. Operating costs were recorded slightly higher with the increase in salaries & benefits and transposition expenses. The increase in financial charges was due to higher utilization of debt financing during FY18. Due to higher sales with largely stable gross margins, net profit was recorded higher during FY18. Sales and profits are expected to improve further in FY19 primarily on the back of realization of further impact of rupee depreciation.

Marginal improvement in liquidity and coverages led by higher cash flows generation

The cash flows position of the company improved with the increase in funds from operations (FFO) during FY18. The liquidity and debt coverage indicators have registered a slight improvement on a timeline basis. The current ratio improved slightly as the net working capital turned positive. Given the nature of operations, cash conversion cycle remained on the higher side during FY18. Despite higher cash flows, FFO to long-term debt ratio was recorded lower as the company procured further long-term borrowings during FY18, while FFO to total debt ratio remained on the lower side. The debt service coverage ratio, however, improved owing to higher FFO.

Increase in leveraged indicators led by higher working capital requirements and further long-term borrowings

Equity base of the company augmented further with continued retention of profits during FY18. Total liabilities stood higher mainly on account of higher utilization of debt financing during the year. Trade and other payables remained largely unchanged as the impact of increase in LC payable and accrued charges was offset by reduction in creditors. ACL depends on short-term borrowings to meet its working capital requirements. Outstanding balance of short-term borrowings increased as a result of higher working capital requirements. During FY18, ACL mobilized new long-term borrowings to finance machinery upgradation. With the notable increase in gearing and debt leverage indicators, the financial risk is considered on the higher side. ACL has no plan to mobilize further long-term debt in the next two years, and hence leverage indicators may improve with scheduled repayments of existing long-term loans and accumulation of profits.

Arshad Corporation (Pvt.) Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY16**	**FY17**	**FY18**
Non-Current Assets	2,520	2,619	2,576
Stores, Spares. And Loose Tools	306	334	369
Stock-in-Trade	3,234	3,301	3,679
Trade Debts	1,207	1,185	1,981
Other Receivables	304	253	389
Tax Refund Due From Government	496	390	391
Other Current Assets	381	211	289
Total Assets	**8,448**	**8,293**	**9,674**
Trade and Other Payables	1,311	1,392	1,387
Other Liabilities	60	42	75
Short-Term Borrowings	4,499	4,237	5,043
Long-Term Borrowings *(Inc. current matur)*	618	299	609
Total Liabilities	6,488	5,970	7,114
Tier-1 Equity	**1,960**	**2,323**	**2,561**
Total Equity	1,960	2,323	2,561
INCOME STATEMENT	**FY16**	**FY17**	**FY18**
Net Sales	7,682	7,373	8,174
Gross Profit	984	942	1,062
Operating Profit	554	486	577
Profit After Tax	180	135	227
FFO	256	210	364
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**
Gross Margin (%)	12.8	12.8	13.0
Net Working Capital	(65)	(120)	437
FFO to Long-Term Debt	0.41	0.70	0.60
FFO to Total Debt	0.06	0.05	0.07
Debt Servicing Coverage Ratio (x)	1.27	1.21	1.34
ROAA (%)	2.3	1.6	2.5
ROAE (%)	9.6	6.3	9.3
Gearing (x)	2.61	1.95	2.21
Debt Leverage (x)	3.31	2.57	2.78
Inventory + Receivable/Short-term Borrowings (x)	1.0	1.1	1.1

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Annexure 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	Annexure III
Name of Rated Entity	Arshad Corporation (Pvt.) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
03/04/2019	BBB+	A-2	Stable	Initial