RATING REPORT

Al-Karam Textile Mills (Private) Limited (AKTMPL)

REPORT DATE:
March 28, 2019

RATING ANALYST:
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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A	A-2
Rating Outlook	Stable	
Rating Date	March 28, 2019	

COMPANY INFORMATION	
Incorporated on 22nd January 1986	**External auditors:** Kreston Hyder Bhimji & Co. Chartered Accountants
Private Limited Company	**Chief Executive Officer/ Managing Director:** Mr. Fawad Anwar
Key Shareholders (with stake 5% or more):	
Mr. Sajid Haroon - 5.1%	
Mr. Abid Umer - 5.0%	
Mr. Fawad Anwar - 5.6%	
Mr. Anwar Haji Karim - 6.8%	
M/s Amna Industries - 20.5%	
Mr. Anis Yakoob - 5.0%	
Mr. Noman Yakoob - 5.1%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (May 2016)*
http://www.vis.com.pk/docs/Corporate-Methodology-201605.pdf

Al-Karam Textile Mills (Private) Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Al-Karam Textile Mills (Private) Limited was incorporated in 1986 as a (Private) Limited entity. Financial Statements of the company for FY18 were audited by Kreston Hyder Bhimji & Co. Chartered Accountants

Al-Karam Textile Mills (Private) Limited (AKTMPL) is a part of Al-Karam Group. The group has a presence in textile, beverage, salt, trading house and retail business.

Al-Karam Group	
Al-Karam Textile Mills Pvt. Ltd	Al-Karam is a vertically integrated composite textile mill. It creates everything from shower curtains to apparel for men and women.
Amna Industries	A completely integrated spinning and finishing mill specialized in knitted fabric.
PSL Caps	PSL Caps is engaged in production of plastic and crown caps for the beverage industry.
Dhabeji Salt	Producer of salt for chemical Industries and table salt
Satter Ltd.	Local trading house

Profile of CEO

Mr Fawad Anwar has been the managing director of AKTMPL since 2010. He is also on the board of six other companies.

AKTMPL's is principally engaged in manufacturing and sale of textile products. Product portfolio of the company includes a variety of yarns ranging from coarse to fine counts, fabric, home textiles, institutional textiles and garments.

Figure 1: Product portfolio

Yarn
(from 7 Ne count to 100 Ne count)

- Ring Spun yarn
- Compact spund yarn
- Lycra yarn
- Novelty yarn

Fabric

- Greige Fabric
- Prints
- Plain dyed
- Dobby
- Jacquards
- Yarn Dyed Fabric

Finished Products

- Home Textiles
  - Quilt Covers/Comforters
  - Sheets
  - Curtains
  - Shower Curtains
  - Kitchen Linen
  - Pyjama suits
  - Fashion apparel
  - Bed in a bad
- Institutional Textiles
  - Healthcare Textiles
  - Hospitality Textiles
  - Workwear Textiles
- Garments
  - Fashion apparels
  - Pajama suits

Head office of the company is based in Karachi and the vertically integrated production factory is located in Landhi Industrial Area. The power requirement of the production unit is met through internal generation.

Rating Drivers

Industry Dynamics

Textile sector remains a key contributor to overall exports of Pakistan. The Government of Pakistan (GoP) has introduced a number of favorable measures in order to increase the competitiveness of textile exports of Pakistan vis-à-vis the regional competitors such as India and Bangladesh, which enjoy lower cost of production. Some of these measures included reduction in the electricity cost, exemption of sales tax on import of cotton & textile machinery, and elimination of custom duty on cotton imports to promote value addition. These factors coupled with currency depreciation are expected to provide much needed impetus to textile exports of Pakistan. In 7MFY19, growth of 1.2% was registered in overall low and value added textile exports. Growth was primarily driven by the value added segment as depicted below:

Exports			
USD mn	**7MFY19**	**7MFY18**	**% change**
Cotton Yarn	635	739	-14.1%
Cotton Cloth	1,234	1,249	-1.2%
Others	32	73	-56.2%
Total Low Value Added	**1,901**	**2,061**	-7.8%
Knitwear	1,732	1,557	11.2%
Bedwear	1,352	1,305	3.6%
Garments	1,517	1,482	2.4%
Others	1,321	1,323	-0.2%
Total Value Added	**5,922**	**5,667**	4.5%
Total	**7,823**	**7,729**	1.2%

Source: Pakistan Bureau of Statistics

In the long term, VIS expects double digit growth in textile exports over the medium term as impact of planned and ongoing capacity expansion along with supportive government policies kicks in. Nonetheless, business risk profile remains exposed to slow-down in major markets, and competition from other regional countries.

Production Capacity and Capacity Utilization

Spinning: With installation of rotors, total installed capacity of the segment increased by 8.6% to 17.2m kgs (FY17: 15.9m kgs) in FY18. Barring FY17, capacity utilization has remained more than 90% on timeline basis. Capacity utilization remained low in FY17 due to reduction in the number of installed spindles.

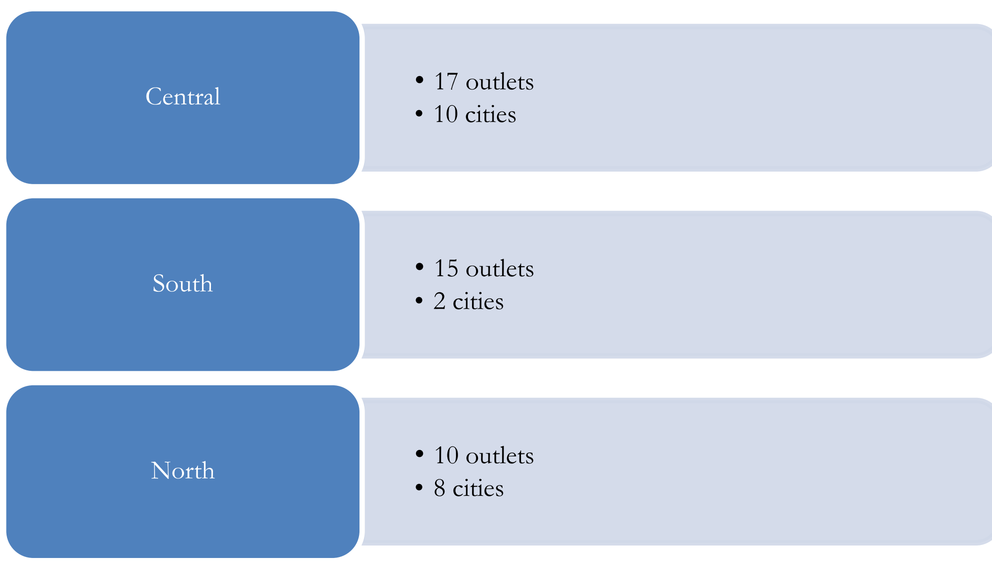
Weaving: Prior to FY18, capacity utilization remained low due to a considerable number of non-operational looms. However, both installed capacity and actual production of fabric have witnessed an increase due to addition of 66 looms in FY18. Capacity utilization was reported at 78.9% (FY17: 49.1%; FY16: 56.0%) in FY18.

Finishing: Given a diversified product mix involving varying processes of manufacturing and run length of order lots, capacity of this particular segment is undeterminable. However, as per management, capacity utilization is considered to be on the higher side.

Sales Mix

Sales of the company have grown at a 3 year Compound Annual Growth Rate (CAGR) of 5% in the period from FY16-FY18. Net Sales of the company grew by 18% in FY18 (FY18: Rs. 21.2b; FY17: Rs. 18.0b; FY16: Rs. 17.2b). The increase in net sales was a function of increase average selling price and growth in volumes. Around three fourth of the company's sales are geared towards the export markets and primarily constitute sales of home textiles. Quantum of export sales was reported at Rs. 16.0b (FY17: Rs. 14.1b; Rs. 13.9b) in FY18. Presently, the company has a showroom in USA for marketing its products in the US market. Recently, the company has launched a brand in Portugal to further penetrate the European market. Total export sales accumulated to Rs. 7.7b in HY19.

Local sales of the company constitute sales of yarn, fabric and garments. The company has established Al-Karam Studio outlets in the country which offer bedding, stitched and unstitched garments to retail clients in the local market. Local Sales of the company amounted to Rs. 3.1b (FY18: Rs. 5.2b; FY17: Rs. 3.8; FY16: Rs. 3.4b) in HY18. At end-FY18, total retail outlets of Al Karam Studio accumulated to 42. The following figure depicts the region wise retail footprint of Al-Karam studio outlets:



Country wise concentration is considered moderate as exports to one country constituted around 35.9% (FY17: 31.7%; FY16: 36.6%) of gross sales in FY18. Concentration is witnessed in terms of client wise sales as two clients accounted for 47.1% (FY17: 38.4%; FY16: 36.4%) of gross sales in FY18. However, client concentration risk is mitigated by long term association with these reputed international brands.

Profitability

Gross Margins of the company have depicted improvement on timeline basis (HY19: 15.5%; FY18: 13.5%; FY17: 10.8%; FY16: 10.3%). As per management, the growth in margins was witnessed on account of realization of economies of scale due to growth in production volume and production efficiencies. Currency depreciation also contributed to improvement in margins in HY19 and FY18

Improvement in gross margins has translated to growth in net profit margins (HY19: 3.1%; FY18: 2.6%; FY17: 2.4%; FY 2.3%) of the company albeit at a slower pace. Net Profit of the company was reported at Rs. 336.5m (FY18: Rs. 554.4m; FY17: Rs. 429.0m; FY16: 405.3m) in HY19. Sizeable exchange gains were also a factor in improving net margins. However, growth in selling and distribution costs created a drag on net profit. Distribution & selling costs have witnessed considerable growth primarily due to increase in salaries and wages and rental expenses associated with opening of new retail outlets. Finance cost of the company has also trended upwards due to higher average short term borrowings to meet working capital requirements and increase in interest rates.

Going forward, the management believes that the company's gross and net margin will improve due to realization of further economies of scale and government's focus on textile sector. Sustainability in margins in the given rating horizon would be an important rating determinant.

Capitalization and Funding

Equity base (excluding revaluation) of the company has grown to Rs. 5.1b (FY18: Rs. 4.8b; FY17: Rs. 4.2b; FY16: Rs. 3.8b) at end-HY19. On a timeline basis, equity base (excluding revaluation) of the company has observed a rising trend owing to profit retention and no dividend payout policy of the company. Total debt of the company was reported at Rs. 12.8b (FY18: 11.6b; FY17: Rs. 11.1b; FY16: Rs. 8.0b); short term debt comprises more than three-fourth of the total debt. Short-term borrowings stood at 10.3b (FY18: Rs. 9.1b; FY17: Rs.8.3b; FY16: Rs. 6.8b) at end-HY19. Short term has witnessed an increasing trend due to increasing working capital requirements. Long-term borrowing (LTB) (including current maturity and contingencies & commitments) was reported at Rs. 2.6b (FY18: 2.6b; FY17: 2.9b; FY16: Rs. 1.2b) at end-FY18. Long term borrowing has increased on timeline basis to fund capital expenditure.

Gearing and leverage ratios stood at 2.5x (FY18: 2.4x; FY17: 2.6x; FY16: 2.1x) and 3.8x (FY18: 3.9x; FY17: 3.9x; FY16: 3.4x), respectively primarily owing to increase in short term borrowings. With moderate increase in debt drawdown, and expected improvement in profitability, capitalization indicators are expected to improve going forward.

Liquidity

Fund From Operations (FFO) has grown at a CAGR of 14.6% over the past three years (FY16-FY18). FFO of the company amounted to Rs 1.3b (FY17: Rs. 0.7b; FY16: Rs. 0.6b) in FY18. Fund From Operations (FFO) has exhibited a rising trend owing to increase in company's profitability and depreciation. Overall liquidity profile of the company is considered adequate in view of sufficient cash flows in relation to outstanding obligations and satisfactory debt servicing ability which remain within manageable levels. Current ratio has varied overtime, however the same has remained consistently above 1.0x (FY18: 1.04x; FY17: 1.03x; FY16: 1.1x), thereby indicating adequate liquidity coverage. Stock in trade & trade debts as a proportion of short-term borrowing provide adequate coverage in relation to short term borrowings (FY18: 1.5x; FY17: 1.4x; FY16: 1.6x).

Internal controls and Information Technology (IT) framework

AKTMPL has segregated its internal audit departments catering to Al-Karam Textile Mills and Al-Karam Studio needs separately. The internal audit (IA) department follows a risk based audit approach with observations classified into 'high', 'medium' and 'low' risk categories. The company has defined internal audit Standard Operating Procedure's (SOP) for every process; employee are required to adhere to these SOPs.

The company has deployed a completely integrated ERP system. AKTMPL is currently using Oracle standard solutions, which constitutes modules for various administrative departments barring the production department. A customized solution is in place for the production department. As per management, Research and Development (R&D) remains a forte of the company and the company continues to make sizeable investment to ensure continuous innovation.

Financial Summary (amounts in PKR millions)			Appendix I
	FY16	**FY17**	**FY18**
BALANCE SHEET			
Property, Plant and Equipment	3,967.6	6,629.2	10,131.3
Other Fixed Assets	147.1	207.0	266.0
Stock-in-Trade	5,816.4	7,170.5	8,462.4
Trade Debts	4,906.6	4,286.2	5,224.7
Cash & Bank Balances	58.1	13.4	95.1
Total Assets	16,915.1	20,741.8	26,867.9
Trade and Other Payables	4,381.8	4,779.7	6,210.4
Long Term Debt (including contingencies and commitments)	1,191.1	2,815.5	2,542.3
Short Term Debt	6,810.4	8,262.3	9,106.7
Total Debt	8,001.6	11,077.8	11,649.0
Total Liabilities	13,048.2	16,504.1	18,653.9
Total Equity (excluding revaluation)	3,866.8	4,237.7	4,790.1
Total Equity (including revaluation)	3,866.8	4,237.7	8,213.9
INCOME STATEMENT			
Net Sales	17,276.0	17,996.5	21,228.6
Gross Profit	1,778.3	1,947.8	2,864.7
Operating Profit	865.5	693.2	1,215.3
Profit After Tax	458.7	405.3	429.0
RATIO ANALYSIS			
Gross Margin (%)	10.3%	10.8%	13.5%
Net Profit Margin	2.3%	2.4%	2.6%
Net Working Capital	1,253.2	360.3	583.1
FFO to Total Debt (%)	8.0%	6.5%	11.4%
FFO to Long Term Debt (%)	53.7%	25.4%	52.3%
Debt Servicing Coverage Ratio (x)	1.6	1.7	2.1
ROAA (%)	2.54%	2.28%	2.33%
ROAE (%)	11.1%	10.6%	12.3%
Gearing (x)	2.1	2.6	2.4
Leverage (x)	3.39	3.91	3.91

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: 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	Al-Karam Textile Mills (Private) 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				
	28/03/19	A	A-2	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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