RATING REPORT

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

REPORT DATE:
May 30, 2022

RATING ANALYST:
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RATING DETAILS				
	Latest Ratings		Previous Ratings	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A	A-2	A	A-2
Rating Date	*May 30, 2022*		*March 04, 2021*	
Rating Action	Maintained		Maintained	
Rating Outlook	Negative		Stable	

COMPANY INFORMATION	
Incorporated on January 22, 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. Anwar Haji Karim – 28.75%	
Mr. Sajid Haroon – 37.76%	
Mr. Fawad Anwar – 7.44%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Industrial Corporates (August 2021) **https://docs.vis.com.pk/docs/CorporateMethodology202108.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 FY21 were audited by Kreston Hyder Bhimji & Co. Chartered Accountants

Profile of CEO

Mr Fawad Anwar has been affiliated with AKTMPL for more than 25 years and continues to serve as the managing director since 2010. He holds MBA degree from Drexel University, USA.

Al-Karam Textile Mills (Private) Limited (AKTMPL) is a part of Al-Karam Group. The group owns several companies engaged in diversified businesses; these include Al-Karam Textile Mills (Pvt.) Ltd. (integrated composite textile mill), Dhabeji Salt (Salt producer) and Sattar Ltd. (Local Trading house).

AKTMPL 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 captive power generation.

Improvement in capacity utilization levels in FY21

	FY20	FY21	HY22
Number of spindles installed	47,624	47,624	47,624
Number of Rotors installed	5,720	5,720	5,720
Number of looms installed	314	314	314
Number of spindles worked	47,624	47,624	47,624
Number of looms worked	267	225	210
Number of working days	365	365	182
Number of shifts per day	3	3	3
Installed capacity of yarn (LBs.) (000's)	55,205	57,165	28,817
Actual production of yarn (LBs.) (000's)	44,908	48,552	23,798
Capacity utilization	**81%**	**85%**	**83%**
Installed capacity of fabric - meters (000's)	32,000	33,800	13,956
Actual production of fabric - meters (000's)	26,243	29,161	11,811
Capacity utilization	**82%**	**86%**	**85%**

During FY21, the installed capacity of both cloth and yarn increased in comparison to the preceding year by 5% due to addition of new machines. Production volumes were higher in case of cloth and yarn in FY21 vis-à-vis FY20. Resultantly, capacity utilization for cloth and yarn stood higher at 86% (FY20: 82%) and 85% (FY20: 81%), respectively. Around 80% of the yarn produced is utilized in-house catering 30% of the fabric production demand with the remaining sold in the local market. During FY21 and the ongoing year, the company incurred Rs. 4.5b for addition of machineries in the dyeing house for which the company availed subsidized loans.

Management plans to install 35,000 spindles in the spinning segment to meet increasing demand. The expansion plan costs around Rs. 3.2b and the financing drawdown for the same is reflected in the books of the company in the ongoing year. The expected date of commencement is around Oct-Nov'22. 30% of the new capacity will be utilized in-house with the remaining sold in the local market.

Rating Drivers

Recovery in industry wide exports post ease in COVID-19 lockdown measures support business risk profile of the company.

- Subsequent to posting export contraction in FY20 - owing to the pandemic-induced slowdown experienced in H2'FY20 – Pakistan's export base grew by 14% in FY21, which is partly attributable to a low base effect. Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21). So the uptick is largely aligned with historical numbers and is not considered material.
- Share of textile exports in total exports has oscillated in the range of 54-59%, coming in at 57% during the past 2-years (FY20-21). In FY21, owing to the similar low-base effect, as discussed above, textile exports were up 13%.
- In USD' terms textile exports have grown at a CAGR of 4.4% during the past 3-year period (FY19-FY21), despite depreciation in average USD/PKR parity of 24%, 16%, and 1% in FY19, FY20 and FY21 respectively.

- As illustrated in the table above, textile exports in Q1'FY22 were 37% higher than SPLY. Inclusive of textile exports for Oct'2021, the number for 4M'FY22 textile exports came in at USD 6b. With additional capacities coming online in January 2022, textile exports for FY22 are likely to exceed the annualized figure of USD 18b.
- The composition of textile exports has depicted improvement in the last 4-yar period, with contribution from higher value added segment increasing from 72.9% in FY18 to 80.7% in FY21 of aggregate textile exports.
- Cotton production in Pakistan, on the other hand, was at its lowest level in decades for FY21. Cotton prices rose to a new 11-year high of ~Rs. 13,000/maund as a result of the production shortage, and cotton imports have climbed by 59.8% in quantity and 68.1% in USD terms, for FY21 vis-à-vis preceding year.
- Given favorable weather conditions, cotton production in Pakistan posted strong growth in FY22, with cotton crop for Jul-Nov'22 (Rabi) season being 81% higher than SPLY. Nevertheless, the upward momentum in cotton pricing continued in FY22, with prices as of November 2022 hovering at ~Rs. 16,000 per mound.
- The margins of textile operators have broadly depicted improvement despite the uptick in raw material costs, given that the same was offset by exchange rate movement. Nevertheless, higher raw material pricing has increased the working capital requirements for textile operators, which is likely to weigh on the liquidity of textile players. VIS expects the order book for the industry to remain adequate in the ongoing year along with transfer orders of neighboring countries, easing our business risk concerns

Revenue of the company has registered healthy growth in FY21 on account of increase in average selling price and growth in volumes; similar trend is expected to continue going forward given the adequate order book and quantum of export sales

Net Sales of the company grew by 24% in FY21 (FY21: Rs. 37.4b; FY20: Rs. 30.2b). The increase in net sales was a function of higher average selling price and a 58% 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. 29.7b (FY20: Rs. 24.5b) in FY21. Presently, the company has a showroom in USA for marketing its products in the US market. Total export sales accumulated to Rs. 17.5b in HY22.

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. 5.5b (FY21: Rs. 9.0b; FY20: Rs. 6.4b) in HY22. Growth in local market was on account of higher e-commerce sales amidst COVID-19. At end-FY21, total retail outlets of Al Karam Studio accumulated to 50.

Country wise concentration is considered sizeable as exports to one country (USA) constituted around 58% (FY20: 46%) of gross sales in FY21. Client wise concentration slightly improved as two clients accounted for 51% (FY20: 54%) of gross sales in FY21. Moreover, client concentration risk is mitigated by long-term association with these reputed international brands. With greater production capability and sufficient orders in hand, the management is projecting considerable growth in topline going forward.

Margins declined due to higher raw material prices and disruptions in supply chain of the company amidst COVID-19. However, realization of further economies of scale will help stabilize profitability. Ratings remain dependent on meeting projected profitability levels.

Gross Margins of the company have decreased on timeline basis (HY22: 11.9%; FY21: 14.3%; FY20: 14.9%). As per management, the decline in margins was witnessed on account of higher raw material prices and COVID led disruptions in supply chain of the company. Furthermore, margins compare on the lower side against other home-textile players in the industry. Finance charges inclined to Rs. 878m (FY20: Rs. 568m) in FY21 due to higher quantum of debt employed. Overall operating expenses increased primarily due to higher contribution to WPPF incurred during FY21. Overall profitability was supported by one-off elements including re-measurement gain on GIDC provision recorded in FY20 and gain on sale of machinery. Growth in distribution & selling costs during 1HFY22 is attributable to rental expenses associated with opening of new retail outlets during the ongoing year. Despite elevated costs, the company reported a higher net profit in the outgoing year due to one-off gains. Net margin was reported at 3.0% (FY21: 3.7%; FY20: 1.3%) during 1HFY22. Going forward, the management believes that the company's gross and net margins will improve in realization of further economies of scale. Sustainability in margins in the given rating horizon would be an important rating determinant.

Liquidity profile of the Company is considered adequate. Managing projected pressure on cash flow coverages in relation to elevated borrowings is considered important.

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. Current ratio has remained consistently above 1x within the company's financial performance timeline, thereby indicating adequate liquidity coverage. Stock in trade and trade debts as a proportion of short term borrowing provide adequate coverage in relation to short term borrowing (HY22: 172%; FY21: 188%; FY20: 182%). During HY22, liquidity coverages weakened on account of higher short term financings deployed to meet working capital needs. Managing working capital cycle and inventory days due to bulk buying of raw material in anticipation of increasing prices will also be important from a liquidity perspective.

Leverage indicators remain elevated over a timeline basis on account of higher quantum of debt employed to fund business developments. Furthermore, going forward, given plans to drawdown debt for expansion in the spinning division, capitalization indicators are expected to remain elevated on similar levels supported by higher projected profit retention. Leverage indicators warrant improvement to reduce the sensitivity of the ratings at the assigned level.

Equity base (excluding revaluation) of the company has grown to Rs. 7.2b (FY21: Rs. 6.5b; FY20: Rs. 6.1b) at end-HY22. On a timeline basis, equity base (excluding revaluation) of the company has observed a rising trend owing to profit retention. After a long period of no dividend policy, the company paid out 78% dividend in FY21. Total debt of the Cmpany was reported at Rs. 25.3b (FY21: 19.3b; FY20: Rs. 14.7b); short-term debt comprises more than 60% of the total debt. Short-term borrowings stood at 14.9b (FY21: Rs. 11.5b; FY20: Rs.9.3b) at end-HY22. Short term has witnessed an increasing trend due to increasing working capital requirements. Long-term borrowing (LTB) (including current maturity) was reported at Rs. 10.4b (FY21: 7.9b; FY20: 5.4b) at end-HY22. Long-term borrowing has increased on timeline basis to fund capital expenditure. Management availed Rs. 720m borrowing facility offered under the Refinance Scheme for Payment of Wages and Salaries to Workers and Employees launched by the State Bank of Pakistan, which also resulted in increase in long term borrowings.

Gearing and leverage ratios stood at 3.51x (FY21: 2.98x; FY20: 2.40x) and 5.53 x (FY21: 5.13x; FY20: 4.24x) at end-HY22. Going forward, given plans to drawdown debt for expansion in the spinning division, capitalization indicators are expected to remain elevated on similar levels supported by higher projected profit retention. Leverage indicators warrant improvement to reduce the sensitivity of the ratings at the assigned level.

Financial Summary (amounts in PKR millions)					Appendix I
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**HY22**
Fixed Assets	10,131	10,858	13,609	16,885	18,815
Stock-in-Trade	8,462	10,161	11,491	14,656	15,603
Trade Debts	5,225	8,125	5,397	6,837	9,959
Cash & Bank Balances	95	207	1,309	744	476
Total Assets	26,868	32,344	35,488	43,133	50,351
Trade and Other Payables	6,210	8,974	10,165	11,394	11,995
Long Term Debt	2,542	2,935	5,391	7,864	10,420
Short Term Debt	9,125	10,229	9,284	11,445	14,883
Total Debt	11,668	13,164	14,676	19,309	25,303
Total Equity	4,770	5,816	6,113	6,490	7,208
Total Liabilities	18,673	23,104	25,920	33,277	39,836
Paid Up Capital	540	540	540	534	534
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**FY21**	**HY22**
Net Sales	21,228.6	26,045.5	30,194.0	37,366.7	21,885.6
Gross Profit	2,864.7	3,626.6	4,512.1	5,355.0	2,607.4
Operating Profit	1,215.3	1,961.7	1,644.2	2,559.9	1,170.3
Profit Before Tax	763.9	1,410.4	728.0	1,773.2	808.3
Profit After Tax	554.4	1,124.1	380.4	1,388.1	658.3
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**FY21**	**HY22**
Gross Margin (%)	13.5%	13.9%	14.9%	14.3%	11.9%
Net Margin (%)	2.6%	4.3%	1.3%	3.7%	3.0%
Net Working Capital	564	1267	1426	833	1989
Trade debts/Sales	24.6%	31.2%	17.9%	18.3%	22.8%
FFO	1,329	2,084	1,922	2,939	1,166
FFO to Total Debt (%)	11%	16%	13%	15%	9%
FFO to Long Term Debt (%)	52%	71%	36%	37%	22%
Debt Servicing Coverage Ratio (x)	2.1	2.7	2.3	3.3	1.4
Current Ratio (x)	1.04	1.06	1.07	1.03	1.07
Stock+Trade Debts/STD	1.50	1.79	1.82	1.88	1.72
Gearing (x)	2.45	2.26	2.40	2.98	3.51
Leverage (x)	3.91	3.97	4.24	5.13	5.53
ROAA (%)	2.33%	3.80%	1.12%	3.53%	2.82%
ROAE (%)	12.32%	21.24%	6.38%	22.03%	19.22%

** Annualized*

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.

<table>
<tr><th colspan="2">REGULATORY DISCLOSURES — Appendix III</th></tr>
<tr><td>Name of Rated Entity</td><td>Al-Karam Textile Mills (Private) Limited</td></tr>
<tr><td>Sector</td><td>Textiles</td></tr>
<tr><td>Type of Relationship</td><td>Solicited</td></tr>
<tr><td>Purpose of Rating</td><td>Entity Rating</td></tr>
<tr><td>Rating History</td><td>
<table>
<tr><th>Rating Date</th><th>Medium to Long Term</th><th>Short Term</th><th>Rating Outlook</th><th>Rating Action</th></tr>
<tr><td colspan="5">RATING TYPE: ENTITY</td></tr>
<tr><td>05/30/2022</td><td>A</td><td>A-2</td><td>Negative</td><td>Maintained</td></tr>
<tr><td>03/04/2021</td><td>A</td><td>A-2</td><td>Stable</td><td>Maintained</td></tr>
<tr><td>24/04/2020</td><td>A</td><td>A-2</td><td>Rating Watch - Negative</td><td>Maintained</td></tr>
<tr><td>28/03/2019</td><td>A</td><td>A-2</td><td>Stable</td><td>Initial</td></tr>
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</td></tr>
<tr><td>Instrument Structure</td><td>N/A</td></tr>
<tr><td>Statement by the Rating Team</td><td>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.</td></tr>
<tr><td>Probability of Default</td><td>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.</td></tr>
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<tr><td>Due Diligence Meetings Conducted</td><td>
<table>
<tr><th>S.No.</th><th>Name</th><th>Designation</th><th>Date</th></tr>
<tr><td>1.</td><td>Mr. Jawed Isani</td><td>Company Secretary</td><td>March 05, 2022</td></tr>
<tr><td>2.</td><td>Mr. Saleem Advani</td><td>Director Finance</td><td>March 05, 2022</td></tr>
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