RATING REPORT

Al-Karam Textile Mills (Private) Limited

REPORT DATE:
May 30, 2023

RATING ANALYSTS:
Muhammad Tabish
muhammad.tabish@vis.com.pk

Syed Ilyas Afridi
ilyas.afridi@vis.com.pk

RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-2	A	A-2
Rating Outlook	Negative		Negative	
Rating Action	Reaffirmed		Maintained	
Rating Date	*May 30, 2023*		*May 30, 2022*	

COMPANY INFORMATION

Incorporated in 1986	**External Auditors:** Kreston Hyder Bhimji & Co. Chartered Accountants
Private Limited Company	**CEO/ MD:** Mr. Fawad Anwar
Key Shareholders (with stake 5% or more):	
Mr. Anwar Haji Karim ~28.7%	
Mr. Sajid Haroon ~37.8%	
Mr. Fawad Anwar ~7.4%	

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

Al-Karam Textile Mills (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Al-Karam Textile Mills (Private) Limited was incorporated in 1986 as a (Private) Limited entity. Financial statements for the year FY22 were audited by Kreston Hyder Bhimji & Co. Chartered Accountants.

Profile of CEO/MD: *Mr Fawad Anwar has been affiliated with the group for over 25 years and he continues to serve as managing director since 2010. He also holds key positions on the board of several other companies including Bank Islami, TPL properties, Lakeside Energy and Adira Capital Holdings. Mr. Fawad has an MBA degree from Drexel University, USA.*

RATING RATIONALE

Corporate Profile

Al-Karam Textile Mills (Private) Limited, part of Al-Karam Group, is a vertically integrated textile setup with operational history of nearly four decades. It has established itself as one of the leading textile manufacturers and exporters in Pakistan, ranking thirteenth among the country's top 20 exporters. In addition to core textile operations, the group has strategic investments in salt production and trading business, and has more recently diversified into fish and agriculture farming. Product portfolio includes a variety of yarns ranging from coarse to fine counts, fabric, home textiles, institutional textiles and garments. The company has a global footprint, with showrooms and design offices in the US, UK, France, and Portugal. Alkaram Studio, the retail arm of the group, was founded in 2010 and has since become a prominent local brand, with total 52 retail outlets spread nationwide. In addition to that, various international specialty brands, both private and franchised, have been established for export markets.

Power requirement of 13MW is fulfilled mainly by gas generators, with supplementary support from solar power plant currently providing 4.3MW while management plans to increase it to 6.5MW in the next 6-8 months. Additionally, a 4.5MW gridline from KE serves as a backup. The company holds multiple export standard and trade certifications and has a workforce of 9K+ employees.

Environmental, Social, & Governance (ESG) Initiatives

As part of its commitment to environmental sustainability, the company carried out several initiatives during the year, which included replacing gas burners, installing daylight sensors, insulating steam pipes with fresh cladding to minimize heat loss, and implementing the use of HDPE reusable tubes for fabric rolling. Moreover, a range of similar initiatives across all divisions is part of Environmental Conservation Plan for the year 2023.

Establishment of a new spinning unit in Nooriabad

Under capacity enhancement initiatives, a spinning facility is currently being established in Nooriabad, and the construction of the building is already underway. It will house 30,000 spindles and the project is scheduled to go live by July'23. The machinery was imported in 2021 and funded through a TERF facility, with a repayment term of 10 years. Total project cost has risen by roughly ~22% from the initial estimate primarily due to escalating construction and material expenses. The RLNG captive power plant will meet the plant's 3MW power demand, while a 1MW backup from HASCO is available, with plans to increase it to 3MW to prevent any disruptions.

Operating Performance

Headquarter in Karachi, the company operates via four production units; all located within the same premises in Landhi Industrial Area. Additionally, the company outsources its fabric-processing requirements through third party toll manufacturing. In the review period, the company installed 5,000 new spindles and replaced inefficient looms, increasing the installed capacity of spinning and weaving segments by ~12% and ~7%, respectively. However, production volumes were slightly lower vis-à-vis previous year due to slowdown in demand.

Figure: Capacity & Production Data

	FY21	FY22	6M'FY23
Spinning			
No. of spindles installed	47,624	47,624	49,064
No. of rotors installed	5,720	5,720	6,280
No. of spindles worked	47,624	47,624	49,064
Installed capacity of yarn – Lbs. (millions)	57.2	57.2	32.1
Actual production of yarn – Lbs. (millions)	48.6	46.9	20.2
Capacity Utilization	***85%***	***82%***	***63%***
Weaving			
No. of looms installed	314	254	254
No. of looms worked	225	254	254
Installed capacity of fabric – Meters (millions)	33.8	33.8	18.2
Actual production of fabric – Meters (millions)	29.2	27.1	15.1
Capacity Utilization	***86%***	***80%***	***83%***

Management conducts a quarterly cost-benefit analysis to determine the optimal allocation of yarn for internal usage and sale in the local market. At present, around one-third of the fabric production relies on in-house yarn, while the rest is sourced from local and international markets given the difference in produced and required yarn counts, quality and pricing. In the same vein, the weaving division meets nearly two-thirds of the fabric processing needs, while the remaining portion is outsourced to multiple mills for toll manufacturing.

<u>Key Rating Drivers</u>

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, demand slowdown, high interest rate situation, inflationary pressures and recent floods adversely affecting cotton crop while ongoing energy crisis in the country pose a challenge to margins sustainability and future growth.
Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally broke the threshold, coming in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr. In addition, textile sector has maintained an average share of about 60% in national exports.

Figure: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
Pakistan Total Exports	22,536	25,639	32,450		23,706	21,088
Textile Exports	12,851	14,492	18,525		13,577	12,992
PKR/USD Average rate	158.0	160.0	177.5		171.5	235.5

Source: SBP

Export revenues from textile sector have noted sizeable growth over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports.

Figure: Textile Export Details (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**		**11,482**	**10,318**
- Knitwear	2,794	3,815	5,121		3,730	3,390
- Readymade Garments	2,552	3,033	3,905		2,864	2,657

- Bed wear	2,151	2,772	3,293		2,449	2,032
- Towels	711	938	1,111		820	745
- Made-up Articles	591	756	849		627	535
- Art, Silk & Synthetic Textile	315	370	460		344	309
- Others	555	743	866		650	650
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**		**2,760**	**2,158**
- Cotton Cloth	1,830	1,921	2,438		1,795	1,538
- Cotton Yarn	984	1,017	1,207		908	573
- Others	43	34	72		56	47
Total	**12,527**	**15,399**	**19,332**		**14,243**	**12,476**

Source: PBS

Cotton prices rose to a new 12-year high of ~Rs. 22,935/maund as of Sept'22 driven by a scarcity of cotton resulting from the recent floods that impacted the local cotton production. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Figure: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	9M'FY23
Per Maund	8,770	8,860	13,000	17,380	18,935
YoY % Change	26%	1%	32%	34%	*n/a*

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than $2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dying companies.

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

Competitive edge from top three global retail brands as major customers drives revenue growth through price, volume, and rupee devaluation impact. However, demand slowdown impacted sales growth in the current year.

Net sales have more than doubled over the last four fiscal years, with YoY uptick of ~18% which can be attributed to two factors – one-half is due to price and volumetric growth and the rest is rupee devaluation impact. Over the years, the average proportionate share of exports to local sales has remained at around 75:25. In terms of value, both export and local sales experienced growth of ~10% and ~29%, respectively, during the outgoing fiscal year.

In terms of product segments, home textiles are classified into woven and knit made-ups, which constitute the entirety of export sales. Bedding, curtains and bedsheets constitute the majority of home textile products. Meanwhile, yarn is sold in the local market, and fabric and garments are sold through Al-Karam Studio as retail sales. In addition, a shift towards woven made-ups was noted due to demand slowdown in the knit segment over the review period.

Geographic sales mix depict concentration as more than four-fifth of exports are directed towards US and Sweden, followed by France and other European markets. Client concentration also remains high, with top ten clients consistently generating more than three-fifths of total sales on a timeline, led by IKEA, Walmart Stores & Target Global Trade; albeit comfort is drawn from long-standing relationship with these reputed international brands. It is worth noting that such big brands offer support and technical collaboration, conduct social compliance audits and retain its suppliers based on their reasonable performance. Moreover, senior management attends exhibitions in Europe and US to expand its customer base and explore new markets in these regions.

Sales growth has remained sluggish in the ongoing fiscal year given recent slowdown in demand due to economic downturn in major world economies, as well as overstocking in the US caused by aggressive procurement until July'22.

Historic high bottom-line achieved by the company during FY22 due to sizeable one-off gains. Profitability margins though have recouped in the ongoing year yet remains on the lower side compared to similar rated peers.
Despite experiencing contraction in FY22 due to increased raw material costs, as well as higher salaries and power expenses, gross margins have recouped to historic levels in the current fiscal year. Average cost of yarn and cotton procured increased by ~36% and ~59%, respectively during the review period. Adequate stocks have been maintained to fulfill confirmed sales orders for the next three months, and one-year master contracts with major international clients provide a cushion. As per management, cotton is generally stocked for 60 days and yarn for 90 days. In FY22, the ratio of domestic to imported yarn and cotton procurement has remained around 80:20 and 40:60, respectively.

On the cost front, administrative and selling overheads increased considerably in line with inflation and revenue growth. Financing charges also rose due to higher debt levels and benchmark rates. Moreover, bottom-line received significant support from other income mainly derived from exchange gains and realized gain on sale of machinery. However, in the absence of same, net margin declined slightly during 6M'FY23.

Cash flows noted a positive trend; however, stress on working capital cycle and overall liquidity is elevated.
Improved profitability due to exchange gains and higher depreciation charges led to an increase in funds flow from operations (FFO). Owing to same, cash flow coverage metrics remained stable despite elevated debt levels. However, debt service coverage ratio depicted a decline due to higher finance cost and debt repayment in the current year. Working capital days have doubled, rising to 167 days in the last 18 months mainly due to uptick in inventory holdings (bulk buying of raw material in anticipation of increasing prices) and backlog of receivables from one major export client. This backlog has remained stuck in more than 145 days overdue category for almost a year, causing stress on the trade debts aging profile and resulting in higher utilization of short-term debt to meet working capital requirements. As per management, entire payment has been settled in Feb'23.

Leverage metrics remains elevated despite slight improvement being noted.
Equity base (excluding revaluation surplus) has nearly doubled over the period of last four fiscal years driven by healthy bottom-line enabling the company to build strong capital buffers. Additionally, interest-free loans from sponsors was provided during the review period. While no dividend was paid out in FY22, the previous year's pay-out ratio was reported at 78%. Debt profile is a mix of short-term and long-term debt, with total interest bearing liabilities increasing to Rs. 25.2b at end-6M'FY23; ~60% constituted short-term debt

while aggregated running finance lines stands at Rs. 16.3b with majority being the ERF facility. Owing to growing net equity, leverage indicators have noted slight improvement over the review period yet remains elevated.

Experienced senior management team. Noticeable improvements in overall governance and IT Infrastructure.

Sponsors have nearly four decades of experience in the textile sector and senior management team comprises seasoned professionals. Overall governance framework has seen notable improvement with establishment of Advisory Board in Sept'22 and segregating ownership and management. The Board includes two independent directors and a Chief Operating Officer (COO) was also appointed during the review period. The board has already met twice and plans to convene meetings on a quarterly basis going forward. Additionally, an Audit Committee and HR Committee were established with specific Terms of Reference (TORs), and both committees are chaired by independent directors.

The COO has formed a steering committee, core committee and its sub-committees comprising members from the cross-functional leadership team. In addition, the finance department has been merged into a single finance team under the CFO, consolidating the mill finance and head office finance teams.

As part of digitization roadmap, Oracle ERP system with complete modules was implemented over the review period. Among other software tools, SCADA has been implemented to monitor real-time machine performance and Power BI is used to generate reports and dashboards. The company has also deployed a performance evaluation system, resulting in better decision-making, increased transparency, and cost savings through waste reduction and more efficient operations.

Al-Karam Textile Mills (Pvt.) Limited **Appendix I**

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**9M'FY23**
Fixed Asset	13,608.7	16,884.9	19,778.6	21,168.9
Stock-in-Trade	11,490.7	14,656.1	16,626.6	17,569.7
Trade Debts	5,396.9	6,836.9	10,436.4	8,386.7
Cash and Bank Balance	1,308.5	743.9	588.3	545.1
Total Assets	**35,487.7**	**43,133.1**	**51,189.5**	**51,822.1**
Trade and Other Payables	10,164.8	11,394.1	10,630.3	8,841.1
Long-Term Borrowings *(Inc. current maturity)*	5,391.5	7,863.5	10,120.6	10,058.8
Short-Term Borrowings	9,284.2	11,445.2	15,030.7	17,052.7
Total Borrowing	**14,675.7**	**19,308.7**	**25,151.3**	**27,111.5**
Total Liabilities	**25,920.1**	**33,276.5**	**39,548.7**	**38,989.0**
Paid-up Capital	540.0	534.0	534.0	534.0
Total Equity ***(Inc. loan from directors)***	**6,112.5**	**6,489.9**	**8,555.0**	**9,747.2**
INCOME STATEMENT				
Net Sales	30,194.0	37,366.7	44,202.3	33,157.1
Gross Profit	4,512.1	5,355.0	5,122.2	8,619.0
Operating Profit	1,644.2	2,559.9	3,801.9	3,059.5
Profit Before Tax	**728.0**	**1,773.2**	**2,435.0**	**1,449.4**
Profit After Tax	**380.1**	**1,388.1**	**1,790.3**	**1,192.2**
RATIO ANALYSIS				
Gross Margin (%)	14.9%	14.3%	11.6%	26.0%
Net Margin (%)	1.3%	3.7%	4.1%	3.6%
Net Working Capital	1,426.0	833.1	2,251.1	2,803.1
Current Ratio	1.07	1.03	1.08	1.10
FFO to Long-Term Debt	35.7%	37.4%	38.4%	33.1%*
FFO to Total Debt	13.1%	15.2%	15.5%	12.3%*
DSCR (x)	2.26	3.31	1.99	1.65*
Gearing (x)	2.40	2.98	2.94	2.78
Debt Leverage (x)	4.24	5.13	4.62	4.00
Inventory + Receivable/Short-term Borrowings (x)	1.82	1.88	1.80	1.52
ROAA	1.1%	3.5%	3.8%	3.1%*
ROAE	6.4%	22.0%	23.8%	17.4%*

**Annualized*

REGULATORY DISCLOSURES	**Appendix II**
Name of Rated Entity	Al-Karam Textile Mills (Pvt) 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
Rating Type: Entity				
30-05-2023	A	A-2	Negative	Reaffirmed
30-05-2022	A	A-2	Negative	Maintained
04-03-2021	A	A-2	Stable	Maintained
24-04-2020	A	A-2	Rating Watch - Negative	Maintained
28-03-2019	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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Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Waqas Farooq	CFO	March 02, 2023
Mr. Aleem Aqeel	DGM Finance	