RATING REPORT

Al-Karam Textile Mills (Private) Limited

REPORT DATE:
April 04, 2024

RATING ANALYSTS:
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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	Stable		Negative	
Rating Action	Maintained		Reaffirmed	
Rating Date	*April 04, 2024*		*May 30, 2023*	
SUKUK 1	A		-	
Rating Outlook	Stable		-	
Rating Action	Preliminary		-	
Rating Date	*April 04, 2024*		-	

COMPANY INFORMATION	
Incorporated in 1986	**External Auditors:** Kreston Hyder Bhimji & Co. Chartered Accountants
Private Limited Company	**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 FY23 were audited by Kreston Hyder Bhimji & Co. Chartered Accountants.

Profile of 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 Lakeside Energy and is also a Non-Executive Director on the board of SBP as well as a memebers of its Monetary Policy Committee. Mr. Fawad has an MBA degree from Drexel University, USA.

RATING RATIONALE

Corporate Profile
Al-Karam Textile Mills (Private) Limited ('AKTM' or 'the Company'), part of Al-Karam Group, is a vertically integrated textile setup with operational history of nearly four decades. In addition to core textile operations, the group has strategic investments in salt production and trading business, and has more recently diversified into shrimph & agriculture farming and agritech. 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 62 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 18.1MW is fulfilled mainly by gas generators, with supplementary support from solar power plant currently providing 4.3MW while management plans to increase it to 14.1MW in the next 8-10 months. Additionally, a 4.8MW gridline from KE serves as a backup. The company holds multiple export standard and trade certifications and has a workforce of 10K+ 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 Installation of Solar Power Plant to produce green energy, installation of VFD on Boiler Blower Motors, replacement of conventional tube lights with LED Focus lights, installation of RO Plant for All the boilers, installation of fabric waste recycling plant. Moreover, a range of similar initiatives across all divisions is part of Environmental Conservation Plan for the year 2024.

Establishment of a new spinning unit in Nooriabad
Al Karam has started to develop an open end spinning facility with the establishment of new factory in Nooriabad spanning across 20 acres. The machinery was mainly imported in 2021 and funded through a TERF facility, with a repayment term of 10 years. The facility, set to commence operations in April 2024 with a capacity of around 1200 bags per day. The plant has 5760 rotors. This will double the Company's yarn production capacity and help cover another ~45% of the internal yarn requirement, taking it to a total of 90%. The plant has power requirement of 2.864 MW, powered through owned captive power generators, as well as backup connection from HESCO. Al Karam has planned to issue a Sukuk of Rs. 4bn to fulfill the working capital requirements of this newly established spinning plant.

Sukuk Issue Details

AKTM plans to issue a medium-term rated, secured, privately placed Sukuk to eligible investors amounting to Rs. 4b inclusive of a Green Shoe Option of Rs. 2.0b.

Purpose: The Issue will be utilized by AKTM to meet working capital requirements mainly of its newly established Nooriabad spinning plant.

Tenor & Repayments: The instrument will have a tenor of three years starting from the issue date inclusive of grace period of one year. The first profit/rental payment shall fall due at the end of three (3) months period falling immediately after the first Drawdown.

Profit Rate: The instrument carries pricing of 3M KIBOR+1.50%

Security Structure: The sukuk shall be covered against a mortgage by deposit of title deeds over the Mortgaged Property *(Landhi plant land of 52 acres)* in favour of the Investment Agent (for the benefit of the Certificate Holders/Investors).

Operating Performance

AKTM operates via twq production units, both located within the premises in Landhi Industrial Area. The Company has also established a new spinning plant at Nooriabad which is expected to become operational in April 2024. Additionally, the Company outsources its fabric-processing requirements through third party toll manufacturing.

Figure: Capacity & Production Data

	FY21	FY22	FY23	1H'FY24
Spinning				
No. of spindles installed	47,624	47,624	49,064	49,064
No. of rotors installed	5,720	5,720	4,880	4,880
No. of spindles worked	47,624	47,624	49,064	49,064
Installed capacity of yarn – Lbs. (millions)	57.2	57.2	64.3	32.1
Actual production of yarn – Lbs. (millions)	48.6	46.9	39.2	19.5
Capacity Utilization	***85%***	***82%***	***61%***	***61%***
Weaving				
No. of looms installed	314	254	262	262
No. of looms worked	225	254	262	262
Installed capacity of fabric – Meters (millions)	33.8	33.8	33.8	18.2
Actual production of fabric – Meters (millions)	29.2	27.1	24.5	15.5
Capacity Utilization	***86%***	***80%***	***82%***	***85%***

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, more than 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. However, with the operations of upcoming Nooriabad spinning plant, internal processing of yarn will cater around ~90% of the need. Weaving division meets nearly two-thirds of the fabric processing needs, while the remaining portion is outsourced to multiple mills for toll manufacturing.

Sector Update

The business risk profile of the textile sector in Pakistan is characterized by a high level of exposure to economic cyclicality and intense competition. This sector's performance is significantly influenced by the broader economic conditions in the country, making it inherently vulnerable to fluctuations in demand driven by economic factors.

In FY23, the textile sector faced challenges due to various economic and environmental factors. These included damage to the cotton crop resulting from flooding in 1HFY23, escalating inflation, and import restrictions due to diminishing foreign exchange reserves.

During FY23, Pakistan's yarn production registered a substantial decline, primarily due to reduced availability of cotton, as a result of crop damage and import restrictions. The sector's profitability was constrained by factors such as higher production costs, increased raw material costs, and rising energy expenses, all of which constrained the sector's profit margin. The industry's performance is closely intertwined with the outlook of the cotton and textile industries, both of which were affected in FY23. Reduction in cotton supply, coupled with global economic slowdown and contractionary economic policies, led to a decrease in demand for textile products and, consequently, cotton yarn.

While the global outlook for cotton production is expected to rebound, local challenges persist. These challenges include high interest rates, increasing energy costs and inflationary pressures. Additionally, the sector's vulnerability to global market dynamics and the domestic economic landscape further contribute to its high business risk profile. However, there is optimism as an anticipated bigger cotton crop in FY24 is expected to alleviate some pressure on input costs and margins.

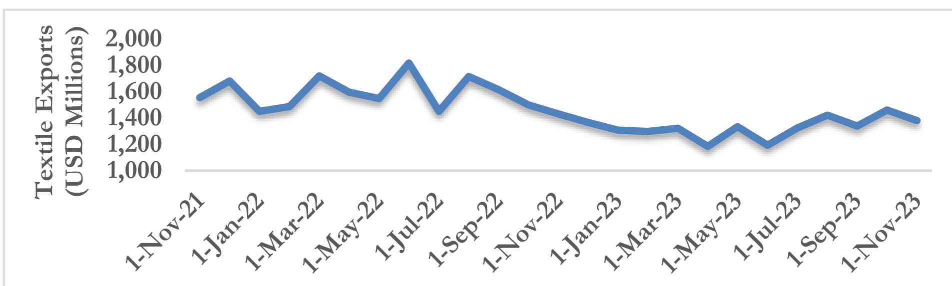

Figure 1: MoM Textile Exports (In USD' Millions)
Source: SBP

Key Rating Drivers

Topline growth mainly supported by local sales during the period under review. Margins witnessed an increase both due to higher local sales and rupee depreciation on export front

Al Karam Textile has registered a sales of Rs. 48.1b in FY23, up by 9% Y/Y. This was largely in line with the peer's topline growth of roughly 10-11%. Increase of 32% in local sales mainly supported the topline in FY23 while export sales number witnessed a marginal uptick of 2% Y/Y due to rupee depreciation. However, volumetric export sales registered a drop in FY23. The component of local sales into total gross sales has increased to 20% during FY23 compared to 17% an year earlier. The aforementioned development arose from management's heightened emphasis on local sales, driven by the recognition of their superior margins compared to exports. With the recovery in export demand during the current fiscal year, along with growth in local sales, AKTM posted a net sales of Rs. 29.8b in 1HFY24.

Client concentration of AKTM is considered high as 97% of the export sales are based on 6 customers, however, comfort is drawn from long term relationships with the client. Simultaneously, management is also focusing to diversify its client based wherein some new renowned customers from international market are in the pipeline. On the geographic front, USA remained the major export destination with an increased share of 61% in FY23 (FY22: 52%) followed by Europe.

Table 1: Export vs Local

%'s of Gross Sales	FY22	FY23	1HFY24
Export	83%	80%	79%
Local	17%	20%	21%

On the gross margins front, AKTM's gross margin has improved to 21.0% and 23.7% in FY23 and 1HFY24. This was due to several factors including better operational efficiency as the Company has installed 4.8MW solar plant, inventory gains, rupee depreciation and increased contribution of local sales during the period under review. Going forward, management's foresee gross margins to come in the range of around ~21-23% due to higher operational efficiency amid newly established spinning plant and other measures including upcoming additions in solar plant, boilers and steam generations along with strict focus on raw material procurement strategy. This will result in a shift from historical gross margins of around 14-15% in FY20 and FY21.

With the heightened finance cost of Rs. 2.7b in FY23 (FY22: Rs. 1.4b), the benefit of an increased gross margin remain subdued, resulted in a net margin of 5.1%. During 1HFY24, AKTM has increased its debt levels notably which resulted in finance cost to clock in at Rs. 2.0b in 1HFY24. Consequently, net margins stood at 0.6% in 1HFY24. Going forward, the Company is issuing medium term Sukuk of Rs. 4b along with a plan to mobilize another Rs. 1b debt, the same will result in increased finance cost. However, with higher gross margin and better operational efficiencies, management is projecting net margins to stay around ~5%.

Adequate cashflow coverage and liquidity Indicators

Improvement in profitability led to an increase in funds flow from operations (FFO) in FY23. FFO clocked in at Rs. 5.8b during FY23 compared to Rs. 3.9b in FY22. Resultantly, Debt Service Coverage Ratio (DSCR) has improved to 1.80x in FY23 (FY22: 1.72x, FY21: 2.70x). However, DSCR depicted a decline due to higher finance cost and debt repayment in the current year. Going forward, with the increase in debt during the rating horizon, management has forecasted DSCR to remain at manageable levels.

Working capital cycle of AKTM has increased over time with a cycle of 144 days recorded in FY23 from 115 days in FY22. The core reason for stretched working capital cycle was higher day's inventory outstanding while payable days were also marginally declined. During 1HFY24, the working capital cycle witnessed some improvement with better inventory management. Going forward, management is committed to improve this further with continued focus on improving inventory days. Moreover, current ratio of AKTM remained intact during the review period with a marginal decline while the same is forecasted to stay in the same range during the rating horizon.

Capitalization 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. The Company has also repaid a sponsor interest free loan of Rs. 140m during the period under review, which was previously taken in FY22. Debt profile is a mix of long term and short term debt, with total interest bearing liabilities increasing to Rs. 29.2b as at Dec'23 (Jun'23: 25.1b, Jun'22: 25.2b). AKTM is further issuing a Sukuk of Rs. 4b wherein Rs. 2.5b is expected to mobilize on balance sheet during the current fiscal year while the remaining Rs. 1.5b is expected in next fiscal year. After incorporating the Rs. 2.5b, subsidized loans portion will become around ~52% of the total long term loans at end Jun'24. While on the short term front, around ~81% of the loan is Export Refinance Facility (ERF). Given the addition of Rs. 2.5b, the expected effective cost of debt of the Company is calculated to stand at around 14% in FY24. Owing to growing net equity, leverage indicators have noted slight improvement over the review period yet remains elevated. Going forward, management expects the leverage indicators to gradually improve further during the rating horizon.

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 advisory board meets quarterly and plans to continue 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)					Appendix I
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**FY23**	**H1'FY24**
Fixed Assets	13,609	16,885	19,779	24,212	26,074
Stock-in-Trade	11,491	14,656	16,627	17,976	20,251
Trade Debts	5,397	6,837	10,436	10,130	10,107
Cash & Bank Balances	1,309	744	588	600	188
Total Assets	35,488	43,133	51,190	58,389	62,386
Trade and Other Payables	10,165	11,394	10,630	10,203	11,136
Long Term Debt	3,602	6,121	8,166	7,334	8,698
Short Term Debt	9,284	11,445	15,031	16,759	18,030
Total Debt	12,886	17,566	23,197	24,093	26,728
Equity (Ajusted for Reval. Surplus)	6,113	6,490	8,555	10,992	11,170
Total Liabilities	25,920	33,277	39,549	41,634	45,454
Paid Up Capital	540	534	534	4,674	4,674
INCOME STATEMENT	**FY20**	**FY21**	**FY22**	**FY23**	**H1'FY24**
Net Sales	30,194	37,367	44,202	48,149	29,813
Gross Profit	4,512	5,355	5,122	10,109	7,060
Operating Profit	1,644	2,560	3,802	5,947	2,526
Profit Before Tax	728	1,773	2,435	3,239	527
Profit After Tax	380	1,388	1,790	2,459	178
RATIO ANALYSIS	**FY20**	**FY21**	**FY22**	**FY23**	**H1'FY24**
Gross Margin (%)	14.9%	14.3%	11.6%	21.0%	23.7%
Net Margin (%)	1.3%	3.7%	4.1%	5.1%	0.6%
Net Working Capital	1,426.0	833.1	2,251.1	2,339.9	1,528.6
Trade debts/Sales	17.9%	18.3%	23.6%	21.0%	33.9%
FFO	1,922	2,939	3,890	5,751	1,775
FFO to Total Debt (%)	14.9%	16.7%	16.8%	23.9%	13.3%
FFO to Long Term Debt (%)	53.4%	48.0%	47.6%	78.4%	40.8%
Debt Servicing Coverage Ratio (x)	2.26	3.31	1.99	2.34	1.37
Current Ratio (x)	1.07	1.03	1.08	1.07	1.04
Stock+Trade Debts/STD	1.82	1.88	1.80	1.68	1.68
Gearing (x)	2.11	2.71	2.71	2.19	2.39
Leverage (x)	4.24	5.13	4.62	3.79	4.07
ROAA (%)	1.1%	3.5%	3.8%	4.5%	0.6%
ROAE (%)	6.4%	22.0%	23.8%	25.2%	3.2%

**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					
	04-04-2024	A	A-2	Stable	Maintained	
	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	
	Rating Type: SUKUK-I					
	04-04-2024	A	-	Stable	Preliminary	
Instrument Structure	AKTM plans to issue a medium-term rated, secured, privately placed Sukuk to eligible investors amounting to Rs. 4b inclusive of a Green Shoe Option of Rs. 2.0b. The Issue will be utilized by AKTM to meet working capital requirements mainly of its newly established Nooriabad spinning plant. The instrument will have a tenor of three years starting from the issue date inclusive of grace period of one year. The first profit/rental payment shall fall due at the end of three (3) months period falling immediately after the first Drawdown. The instrument carries pricing of 3M KIBOR+1.50%. The sukuk shall be covered against a mortgage by deposit of title deeds over the Mortgaged Property in favour of the Investment Agent (for the benefit of the Certificate Holders/Investors).					
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, 2024			
	Mr. Tehseen Javaid	Gr. Sr. Mgr. Finance				