RATING REPORT

Al-Karam Textile Mills (Private) Limited

REPORT DATE:
August 27, 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 /Rating Watch	Stable		Negative	
Rating Action	Maintained		Reaffirmed	
Rating Date	*April 04, 2024*		*May 30, 2023*	
SUKUK 1	A		A	
Rating Outlook/Rating Watch	Stable		Stable	
Rating Action	Final		Preliminary	
Rating Date	*August 27, 2024*		*April 04, 2024*	

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. Sajid Haroon ~31.9%	
Mr. Fawad Anwar ~26.7%	
Mr. Anwar Haji Karim ~22.7%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Industrial Corporates
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

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 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 is serving as a Non-Executive Director, SBP Board, for Monetary Policy Committee. He also holds key positions on the board of several other companies including Dhabeji Aqua Foods, Indus Acre, Lakeside Energy. 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 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 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 commenced operations in August 2024, deviating from the initially scheduled commencing date of March 2024. It has a production capacity of approximately 1,200 bags per day. The plant has 5760 rotors/08 frames. 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 partially though solar power and remaining through owned captive power generators, as well as backup connection from HESCO. Al Karam has raised Rs. 2.2 billion through issuance of a Sukuk to fulfill the working capital requirements of the newly established spinning plant.

Sukuk Issue Details
AKTM has confirmed its financial close of the subject medium-term, secured, privately placed, Sukuk at Rs. 2.2 billion on August 15, 2024 against a planned Sukuk of Rs. 4.0 billion inclusive of a Green Shoe Option of Rs. 2.0 billion.

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 has 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 is covered against a mortgage by deposit of title deeds over the Mortgaged Property in favor of the Investment Agent (for the benefit of the Certificate Holders/Investors).

Operating Performance

AKTM operates via four production units, all located within the premises in Landhi Industrial Area. The Company has also established a new spinning plant at Nooriabad which has become operational as of August 2024.

Figure: Capacity & Production Data

	FY21	FY22	FY23	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	59.7*
Actual production of yarn – Lbs. (millions)	48.6	46.9	39.2	36.5
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	33.8
Actual production of fabric – Meters (millions)	29.2	27.1	24.5	28.4
Capacity Utilization	***86%***	***80%***	***82%***	***84%***

**The decrease in installed spinning capacity is a result of replacing some spindles with milanges. While this upgrade improves production quality, it also slows down the process.*

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 Nooriabad spinning plant, internal processing of yarn can 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.

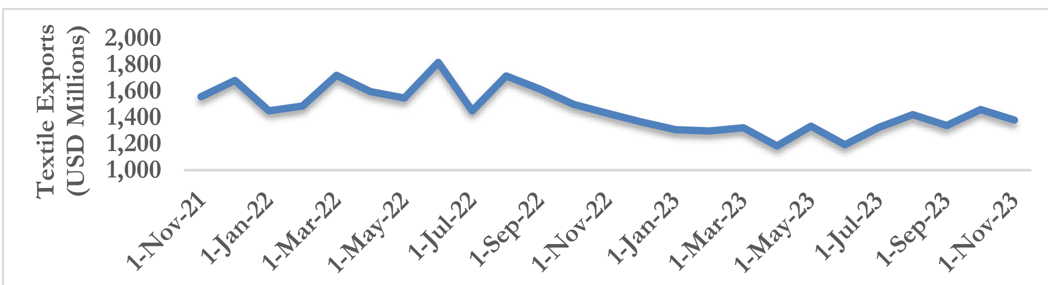

Figure 1: MoM Textile Exports (In USD' Millions)
Source: SBP

Key Rating Drivers

Topline growth mainly supported by local sales during the period under review. Gross Margins remained intact while net margins witnessed a decline attributed to high finance costs

Al Karam Textile has registered sales of Rs. 64.4b in FY24, up by 34% Y/Y. The component of local sales into total gross sales has increased to 23% during FY24 compared to 20% in prior year. The development arose from management's heightened emphasis on local sales, driven by the recognition of their superior margins compared to exports. The growth in sales is attributed to recovery in export demand during the current fiscal year, along with growth in local sales, Client concentration of AKTM is considered high as 84% of the sales are generated from top 10 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 share of 60% in FY23 (FY23: 61%) followed by Europe.

Table 1: Export vs Local

%'s of Gross Sales	FY22	FY23	FY24
Export	83%	80%	77%
Local	17%	20%	23%

On the gross margins front, AKTM's gross margin has remained intact at 20.7% in FY24. With the heightened finance cost of Rs. 4.3b in FY24 (FY23: Rs. 2.7b) due to notably high debt levels, the benefit of increased gross margin is eroded, resulting in a net margin of 2.2% compared to 5.1% in FY23. However, with higher gross margin and better operational efficiencies, along with cut in interest rates, management is projecting net margins to increase.

Cash flow coverages and liquidity Indicators remain adequate

Deterioration in profitability led to a decrease in funds flow from operations (FFO) in FY24. FFO clocked in at Rs. 4.7b during FY24 compared to Rs. 5.8b in FY23. Resultantly, coverage has also declined, whereby, FFO to total debt has marginally reduced from 0.24x in FY23 to 0.18x in FY24. Similarly, Debt Service Coverage Ratio (DSCR) has declined to 1.48x in FY24 (FY23: 1.80x, FY22: 1.72x). Going forward, with the increase in debt during the rating horizon along with increase in profitability, management has forecasted DSCR to remain stable.

Moreover, current ratio of AKTM remained intact during the review period at 1.1x while the same is forecasted to stay in the same range during the rating horizon. The Company's cash conversion cycle days have also reduced from 144 days in FY23 to 124 in FY23. Moving forward, the Company projects the number of days to come down to 107 during FY25.

Capitalization metrics remains elevated despite slight improvement being noted

Equity base (excluding revaluation surplus) has grown at a CAGR of 15.18% and has doubled over the period of last five fiscal years amounting to Rs. 12.4b as of Jun'24 driven by healthy bottom-line enabling the Company to build strong capital buffers. Long-term debt of the Company has increased by Rs. 1.4b in FY24, totaling at Rs. 8.7b. Short-term debt of the Company increased to Rs. 17.9b as of Jun'24 (Jun'23: 16.8b) to meet the working capital requirements.

Debt profile is a mix of long term and short-term debt, with total interest-bearing liabilities increasing to Rs. 26.6b as at Jun'24 (Jun'23: 24.1b). Moreover, approximately 75% of the total debt is on subsidized rates, while the remaining is on kibor-plus financing. Gearing position of the Company has shown marginal improvement from 2.19x in Jun'23 to 2.15x in Jun'24. Owing to growing net equity, leverage indicators have shown marginal improvement over the review period yet remains elevated.

The Company has projected to reduce utilization of short-term credit lines during FY25 through improvements in cash conversion cycle. Going forward, management expects the gearing and leverage indicators to gradually improve 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 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 (Amount in PKR Millions)				Appendix I
BALANCE SHEET	**FY21**	**FY22**	**FY23**	**FY24**
Fixed Assets	16,885	19,779	24,212	25,547
Stock-in-Trade	14,656	16,627	17,976	20,346
Trade Debts	6,837	10,436	10,130	11,303
Cash & Bank Balances	744	588	600	296
Total Assets	43,133	51,190	58,389	63,100
Trade and Other Payables	11,394	10,630	10,203	10,351
Long Term Debt	7,864	10,121	8,307	8,745
Short Term Debt	11,445	15,031	16,759	17,880
Total Debt	19,309	25,151	25,065	26,625
Total Equity	6,490	8,555	10,992	12,392
Total Liabilities	33,277	39,549	41,634	44,946
Paid Up Capital	534	534	4,674	4,674
INCOME STATEMENT	**FY21**	**FY22**	**FY23**	**FY24**
Net Sales	37,367	44,202	48,149	64,404
Gross Profit	5,355	5,122	10,109	13,322
Operating Profit	2,560	3,802	5,947	6,515
Profit Before Tax	1,773	2,435	3,239	2,170
Profit After Tax	1,388	1,790	2,459	1,400
RATIO ANALYSIS	**FY21**	**FY22**	**FY23**	**FY24**
Gross Margin (%)	14.3%	11.6%	21.0%	20.7%
Net Margin (%)	3.7%	4.1%	5.1%	2.2%
FFO	2,939	3,890	5,751	4,702
FFO to Total Debt (%)	15.2%	15.5%	22.9%	18.0%
FFO to Long Term Debt (%)	37.4%	38.4%	69.2%	53.8%
Debt Servicing Coverage Ratio (x)	3.31	1.99	2.34	1.48
Current Ratio (x)	1.03	1.08	1.07	1.10
Inv.+ Rec. /STD	1.88	1.80	1.68	1.77
Gearing (x)	2.98	2.94	2.28	2.15
Leverage (x)	5.13	4.62	3.79	3.63
ROAA (%)	3.5%	3.8%	4.5%	2.3%
ROAE (%)	22.0%	23.8%	25.2%	12.0%

REGULATORY DISCLOSURES	Appendix II
Name of Rated Entity	Al-Karam Textile Mills (Pvt) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Sukuk 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				
27-08-2024	A	-	Stable	Final
04-04-2024	A	-	Stable	Preliminary

Instrument Structure	AKTM's previously planned medium-term rated, secured, privately placed Sukuk to eligible investors amounting to Rs. 4b inclusive of a Green Shoe Option of Rs. 2.0b has achieved its financial close of the subject Sukuk at Rs. 2.2 billion. The Issue will be utilized by AKTM to meet working capital requirements mainly of its newly established Nooriabad spinning plant. The instrument has 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. Quarterly profit payments will be made. The instrument carries pricing of 3M KIBOR+1.50% The sukuk is covered against a mortgage by deposit of title deeds over the Mortgaged Property.
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 debt issue will default.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information.

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Waqas Farooq	Gr. CFO	August 19, 2024
Mr. Tehseen Javaid	Gr. Sr. Manager Finance	