

# RATING REPORT

## Al-Karam Textile Mills (Private) Limited

### REPORT DATE:

January 16, 2025

### RATING ANALYSTS:

M. Amin Hamdani

[amin.hamdani@vis.com.pk](mailto:amin.hamdani@vis.com.pk)

Faisal Naseem Khan

[Faisal.naseem@vis.com.pk](mailto:Faisal.naseem@vis.com.pk)

### RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A2	A	A2
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 4, 2024	
SHORT TERM SUKUK 1	A1		A1	
Rating Action	Final		Preliminary	
Rating Date	February xx, 2025		August 27, 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 Dhabaji 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.

**Short Term Sukuk (STS-1) Issue Details**

AKTM issued a short-term, partially secured, privately placed Sukuk (STS-1) to eligible investors amounting to Rs. 4.0b inclusive of a Green Shoe Option of Rs. 1.0b on 15<sup>th</sup> October, 2024.

**Purpose:** The purpose of the Issue is to fulfill the enhanced working capital requirements of the Company arising from its newly established Nooriabad Spinning Unit.

**Tenor & Repayments:** The instrument will have a tenor of up to six months starting from the issue date and profit will be payable at the time of redemption of ST Sukuk on the outstanding principal amount. Profit payment will fall due 06 months from Issue Date.

**Profit Rate:** The instrument carries profit rate of 6M KIBOR+ 1.00%

**Security Structure:** The Sukuk shall be secured against a lien and right of set-off over IPS account in respect of GoP securities maintained with the Account bank for a secured amount equal to 40% of the Sukuk issue amount.

The issuer will maintain and effectively manage a Debt Payment Account (DPA) under the Investment Agent's lien and right of set-off. The funds in the DPA will be sufficient to cover 60% of the total issue amount (since 40% is already secured through liquid securities) at least 10 days before the maturity date.

**Shariah Structure:** The Sukuk is based on Musharaka (Shirkat-ul-Aqd) based structure.

**Call Option:** The issuer will have an option to redeem in full or part the outstanding face value of the Sukuk certificates. The option can be exercised on or after one month from the issue date by giving at least 15 (fifteen) days prior notice in writing to certificate holders.

### 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
<b>Spinning</b>				
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
<b>Capacity Utilization</b>	<b>85%</b>	<b>82%</b>	<b>61%</b>	<b>61%</b>
<b>Weaving</b>				
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
<b>Capacity Utilization</b>	<b>86%</b>	<b>80%</b>	<b>82%</b>	<b>84%</b>

*\*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 cyclicalities 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.

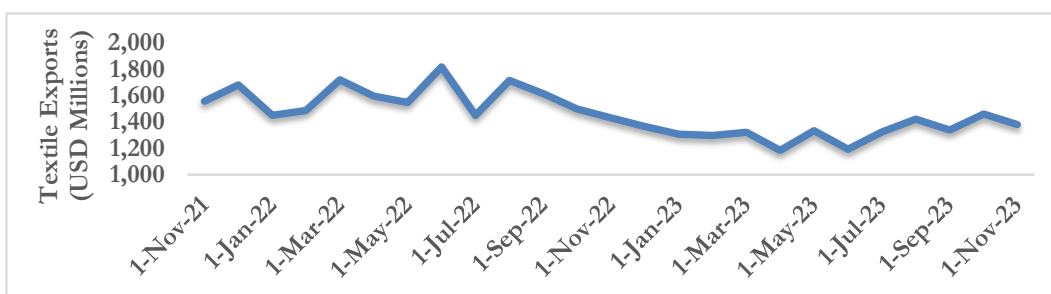


Figure 1: MoM Textile Exports (In USD Millions)

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 31.5% Y/Y. The component of local sales into total gross sales has increased to 23% during FY24 compared to 20% in prior year. The aforementioned 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
<b>Export</b>	83%	80%	77%
<b>Local</b>	17%	20%	23%

On the gross margins front, AKTM's gross margin has remained intact at 20.6% 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 has eroded, resulting in a net margin of 2.2% compared to 5.1% in FY23. During 6M<sup>FY25</sup> the sales were recorded at Rs. 29.48b. However, Gross Margin was 20%. Moreover, Operating expenses of the company were recorded at Rs. 3.3 b and Finance cost was recorded at 2.14b as a result Net Income was recorded at Rs. 106m translating into Net margin of 0.4%. Going forward, management is planning to add renewable energy sources to improve its cost structure and recent reduction in interest rates will provide support to the margins of the company.

#### **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 1.31x in FY24 (FY23: 1.84x, 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 1.04x 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 151 days in FY23 to 115 days in FY24. During 6M<sup>FY25</sup> the current ratio remained largely unchanged at 1.06x (FY24: 1.04x). Meanwhile, CCC has increased to 166 days (*annualized*) (FY24: 115 days) due to reduction in Payable days and higher inventory days.

#### **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. 0.8b in FY24, totaling at Rs. 8.1b. Short-term debt of the Company increased to Rs. 17.8b 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. 25.95b as at Jun'24 (Jun'23: 24.1b). Moreover, approximately 75% of the total debt is on subsidized rates, while the remaining is on kibar-plus financing. Gearing position of the Company has shown marginal improvement from 2.19x in Jun'23 to 2.05x in Jun'24. Owing to growing net equity, leverage indicators have shown marginal improvement over the review period yet remains elevated. However, at end of 6M<sup>FY25</sup> Gearing ratio has surged to 2.49x (FY24: 2.05x) as company has primarily relied on short term borrowings to finance

working capital and leverage ratio has increased to 3.82x (FY24: 3.75x) as a result of surge in short term borrowings.

The Company has projected to reduce utilization of short-term credit lines during FY25 through improvements in cash conversion cycle mainly. 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**

<b>REGULATORY DISCLOSURES</b>					<b>Appendix II</b>
<b>Name of Rated Entity</b>	Al-Karam Textile Mills (Pvt) Limited				
<b>Sector</b>	Textile				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	STS-I Ratings				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	<b>Rating Type: Entity</b>				
	04-04-2024	A	A2	Stable	Maintained
	30-05-2023	A	A2	Negative	Reaffirmed
	30-05-2022	A	A2	Negative	Maintained
	04-03-2021	A	A2	Stable	Maintained
	24-04-2020	A	A2	Rating Watch - Negative	Maintained
	28-03-2019	A	A2	Stable	Initial
	<b>Rating Type: SUKUK-I</b>				
	04-04-2024	A	-	Stable	Preliminary
	27-08-2024	A	-	Stable	Final
	<b>Rating Type: SHORT-TERM SUKUK (STS-I)</b>				
	15-01-2025		A1		Final
	27-08-2024		A1	-	Preliminary
<b>Instrument Structure</b>	AKTM plans to issue a short-term rated, partially secured, privately placed Sukuk to eligible investors amounting to Rs. 4b inclusive of a Green Shoe Option of Rs. 1.0b. 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 six months starting from the issue date. The first profit/rental payment shall fall due at the end of six months period from issue date. The instrument carries pricing of 6M KIBOR+1%. The Sukuk shall be covered against a pledge over GoP Ijara Sukuk or similar security covering up to 40% of the issue amount.				
<b>Statement by the Rating Team</b>	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.				
<b>Probability of Default</b>	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.				
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Due Diligence Meeting Conducted	Name	Designation	Date
	N/A		