RATING REPORT

Al-Karam Towel Industries (Pvt.) Ltd.

REPORT DATE:
December 17, 2018

RATING ANALYST:
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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	*December 17, 2018*	

COMPANY INFORMATION	
Incorporated on April, 2004	**External auditors:** M/s. Rahman Safaraz Rahim Iqbal Rafiq Chartered Accountants
Private Limited Company	**Chairperson & Chief Executive Officer (CEO):** Mr. Mehtab Uddin Chawla
Key Shareholders (with stake 5% or more):	
Mr. Mehtab Uddin Chawla (52.0%)	
Mr. Rehan Mehtab Chawla (10.0%)	
Mr. Farrukh Mehtab (10.0%)	
Mr. Kashif Mehtab (10.0%)	
Mr. Noman Mehtab (10.0%)	
Mr. Ghazala Mehtab (8.0%)	

APPLICABLE METHODOLOGY(IES)
JCR-VIS Entity Rating Criteria *Industrial Corporates (May 2016)*
http://www.jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf

Al-Karam Towel Industries (Private) Limited

OVERVIEW OF THE INSTITUTION

Al-Karam Towel Industries (Private) Limited (AKTI) was incorporated as a private limited company in April 2004, under the companies' ordinance 1984 with its head office and production facilities based in Karachi, Pakistan.

The company's production facilities comprise eight manufacturing units including a new unit being currently developed. AKTI is equipped with a total of 950 looms and 980 stitching machines along with dyeing machines. Given the demand level of towel industry, all of AKTI's facilities operate at full capacity.

RATING RATIONALE

Assigned ratings of Al-Karam Towel Industries (Private) Limited (AKTI) take into account the company's market position amongst top three players of the towel industry. Currently, there are two small-sized entities under the ambit of AKTI; one belongs to the textile sector while the other operates in the real estate industry. AKTI functions as a family owned business with the shareholding vested among six individuals of the same family. Similar to other private limited companies, governance and policy framework of the company depict significant room for improvement.

Rating Rationale

1. **Sales** - Sales revenue of the company has grown at a CAGR of 20% over the past two years. Majority of total sales revenue comprises direct exports to other countries while the remaining chunk represents local sales. Growth in revenue base was largely a function of both higher volumes sold and increase in average yarn prices, during the year. All sales are dovetailed against orders from international customers.
2. **Customer Profile** - During the years, AKTI has developed a number of relationships with international customers belonging to the USA and UK, especially. As a result, significant concentration was witnessed in its top 10 sales. With concerted efforts of management to reduce the same, top 10 sales as a percentage of total turnover declined to 78.6% (FY16: 83.6%) in FY17. However, business risk is on the higher side given the greater concentration (client and geographic) in sales. AKTI has been considerably reliant on US clientele which represents the company's repeated business.
3. **Expansion Project** - In view of increasing yarn prices in the previous years, the company has planned to set up a facility comprising 15,000 spindles through backward integration. This would enable the company to reduce the dependence of procuring yarn from local market. The project is currently in the negotiation phase with suppliers and is expected to come online by March 2019. Almost 80% of total project cost will be arranged through long term debt financing while remaining will be financed by equity.
4. **Profitability** - With higher yarn prices, gross margins of the company witnessed a decline to 14.4% in FY17 vis-à-vis previous year; gross margin was reported higher at 15.1% in FY18. The same translated in lower operating and net margin in the year with a reported bottom line of Rs. 351.5m vis-à-vis Rs. 434.5m in FY16. The same picked up pace and amounted to Rs. 421.5m in FY18. Given the concentration of sales in exports, recent depreciation in rupee value also had a positive impact on the profitability of the company during FY18. However, this impact will only be visible in the short term; customers usually revise their contract prices to account for any changes in rupee-dollar parity in the long term.
5. **Liquidity** - Higher profitability has resulted in healthier cash flow generation; nonetheless, higher utilization of borrowings reduced debt servicing coverage and Funds from Operations (FFO) in relation to long-term debt multiples of AKTI. Meanwhile, Debt Service Coverage Ratio (DSCR) is considered sound at 9.22x for FY17. Liquidity indicators will need to be monitored on a timeline basis as the new financing facility is mobilized. With the utilization of a new financing facility being mobilized for AKTI's backward integration project, management targets a sales level of Rs. 10.7b by end-June 2021 with improving margin levels. As a result, management also anticipates increasing its FFO levels to the Rs. 1b mark.
6. **Funding & Capitalization** - While total debt levels of the company increased to fund its operations, leverage indicators remained range bound within manageable levels. With a higher quantum of short term financing availed during the years; gearing increased on a timeline basis. However, both gearing and leverage indicators remained comfortable below 1.0x criterion. Moreover, with higher utilization in long term borrowings, the company projects to completely taper off its utilization of short term borrowings. Leverage indicators are also expected to remain comfortable below 1.0x. Rating will remain dependent upon materialization and smooth integration of the spinning unit within targeted performance and financial indicators.

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Al-Karam Towel Industries Private Limited
Sector	Terry / Textiles
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	JCR-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	JCR-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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
12/17/2018	A-	A-2	Stable	Initial