RATING REPORT

Al-Karam Towel Industries (Pvt.) Limited

REPORT DATE:
March 3, 2020

RATING ANALYST:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Date	*March 3, 2020*		*December 17, 2018*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Initial	

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)
VIS Entity Rating Criteria *Industrial Corporates (May 2016)*
http://www.vis.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.

External auditors of the company are M/s. Rahman Safaraz Rahim Iqbal Rafiq Chartered Accountants. Auditors belong to category 'A' on the approved list of auditors published by the State Bank of Pakistan.

Financial Snapshot

Net Equity: Dec 2020: Rs. 4.8b, June 2019: Rs. 4.4b

Net Revenue: HFY20: Rs. 6.0b, FY19: Rs. 11.2b

RATING RATIONALE

Al-Karam Towel Industries (Private) Limited (AKTI) has more than 16 years of experience in textile business and exports a broad range of towel products primarily to large international retail stores in USA and European countries (top five major export markets are UK, Germany, Denmark, Canada and Greece). As per towel exports data, AKTI has an estimated market share of ~10% and is the second largest towel exporter in the country. The company has a diversified product portfolio comprising terry towel, printed bath & beach towel, bathrobes, kitchen towel, wash cloth, hand towel, shower wrap and embroidered towel. AKTI is a family owned business with shareholding vested among six members of Mehtab family.

The company has total eight manufacturing units for carrying out business operations (spinning, weaving, bleaching, dyeing and stitching); five of these units are located in SITE Super Highway, Karachi while three units are in Nooriabad Sindh. At present, the company is equipped with a total 1320 rotors, 950 looms and 980 stitching machines along with dyeing machines. All of AKTI's facilities operate at high capacity utilization levels and are powered by in-house gas based generators.

Focus remains on increasing vertical integration, efficiency and capacity enhancements

Given high demand levels of towels in international market, the management envisages 50% growth in its production capacity through a planned capex of Rs. 2.7b in weaving, dyeing and stitching segments. In weaving segment, the management has planned to add 144 air jet looms (in a phase wise manner) over a one year period. Besides catering to additional demand from existing customers, this capacity enhancement project will enable the company to diversify its product mix in order tap high value-added product markets.

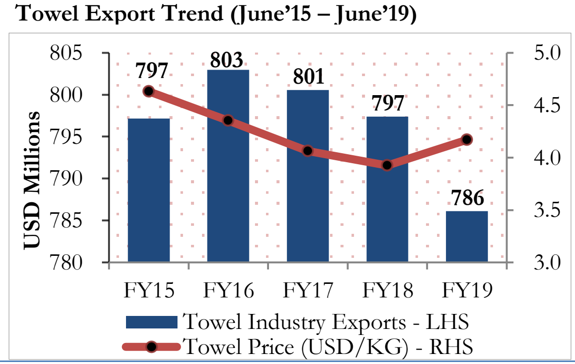
In FY19, AKTI initiated backward integration of operations through setting up a spinning facility by installation of rotors which currently fulfills one-third of the raw material requirement. In order to further reduce the dependence of yarn procurement through local market, the company is undergoing a second phase of expansion in spinning segment which includes installation of 11,000 spindles. The project is expected to come online in March 2020. Entire cost of the project (Rs. 1.3b) has been arranged through concessionary rate long-term financing facility (LTFF). Management anticipates that after completion of this project, in-house yarn production will fulfill two-third of procurement requirement and thus resulting in reduced cost of production and improved margins.

<u>Key Rating Drivers</u>

Business risk profile supported by favorable demand outlook and increased opportunities for growth. Pakistan's towel industry is dominantly export based with its growth being dependent on quality, price competitiveness and export outlets. Towel exports (in dollar terms) after peaking in FY16 have remained on the lower side due

Exhibit 1

Towel Export Trend (June'15 – June'19)



to high price competition and inability of industry to produce higher quality and value added towels. Towel exports, however, in rupee terms have increased by ~22.1% (FY18: 4.5%) in FY19 due to significant currency devaluation. During FY19, towel exports having a share of 3.4% in total exports and 6.0% in textile group, decreased both in quantity and in value by 7.2% and 1.4%, respectively. Average price (USD/Kg) has also declined by ~6%. Quantity sold, after increasing at a CAGR of 5.7% during FY15-FY18, depicted a sizeable decline in FY19. However, quantity is also a function of the quality towels being sold. Given the ongoing expansion by a number of towel exporters, quantity sold is expected to increase from FY21.

At present, export of towels from Pakistan is diversified among 120 countries. Among all, USA is the major buyer followed by UK and other European Union (EU) countries. Over recent years, share of EU countries in total towel exports has increased. Given duty advantage due to Pakistan's EU GSP Plus Status and increased focus toward European markets, proportion of towel exports to EU is expected to increase going forward.

Business risk profile is supported by strong focus of government on enhancing exports for sustainable growth bodes well for towel exports. Improving perception and law order situation of the country has also increased interest from clients. US-China trade war has also resulted in buyers focusing on Pakistan to reduce geographical diversification risk. However, cost competitiveness remains a challenge particularly vis-à-vis regional peers. Pricing power is limited as reflected by consistent decline in dollar pricing of products.

Sales have depicted healthy growth in FY19 and in the ongoing year. USA and Europe remain core markets while client concentration remains on the higher side.
Topline of the company has registered a double digit Compound Annual Growth Rate (CAGR) of ~24% over the past five fiscal years (FY15-19) while crossing the Rs. 10b mark during outgoing year FY19, registering a year-on-year (YoY) growth of ~34%. During HFY20, net sales were reported at Rs. 6.0b (FY19: Rs. 11.2b; FY18: Rs. 8.4b). This growth in recent years has largely been a function of significant rupee depreciation and higher volumes sold while over the time decrease in average selling prices (USD/Kg) in international market was supported by high dollar-rupee parity. Going forward, management has budgeted sales target of around Rs. 12b for FY20.

AKTI is an export-oriented company with around 98% of total sales catering to foreign markets. Of total exports, more than one-half is concentrated in USA and within very few large retail clients. The company has established long term relationships with these customers over the years ensuring repeat business. On the flip side, it results in high client concentration with top 10 sales representing more than three-fifth of total sales. Moreover, as per management, large orders bring operational efficiencies and timely servicing to clients. Going forward, management intends to explore institutional clients in order to expand overall customer base.

Improvement witnessed in profitability margins on a timeline basis. Management expects margins to sustain on the back of efficiency enhancement projects being undertaken despite dilution in impact of rupee devaluation.
Over the last two fiscal years, gross margins have depicted improvement; peaking at 17.5% (FY18: 15.1%; FY17: 14.4%) in FY19. Improvement in margins along with exchange gain due to rupee devaluation supported the bottom-line profitability. Finance cost has more than doubled due to increase in debt levels; despite entire borrowings mobilized by the company being at concessionary rates. During HFY20, AKTI posted profit after tax (PAT) of Rs. 450.8m (FY18: Rs. 885.1m; FY17: Rs. 419.5m). Management is anticipating higher growth in profitability profile primarily by higher production, efficiency enhancements and some shift

towards higher value added product portfolio.

Liquidity profile is supported by adequate cash flows and sound debt servicing ability.
Higher profitability during FY19 has resulted in healthier cash flow generation which provides comfort to overall liquidity profile. Funds from Operations (FFO) improved to Rs. 1,250.3m (FY18: Rs. 688.5m: FY17: Rs. 652.9) in FY19. While increase in borrowing levels to fund expansion has resulted in reduction in DSCR and cash flow coverage multiples, the same remains at satisfactory level.

Trade debts and inventory levels have witnessed a significant increase in FY19 due to a shift product mix of select existing customers. Management expects the same to revert to normal levels over the rating horizon. Current ratio of the company remains over 1.0x, while trade debts and stock in trade are more than sufficient to cover short term borrowings.

Gearing and leverage indicators have trended upwards but are expected to remain within manageable levels.
Equity base of the company has grown on timeline basis due to profit retention. Debt profile of the company comprises a mix of short term and long term debt with total interest bearing liabilities amounting to Rs. 4.4b (FY19: Rs. 4.0b; FY18: Rs. 2.0b) as at end-HFY20; short-term debt constituted more than around three-fifth of total debt. With the utilization of a new financing facility being mobilized during ongoing year FY20 for AKTI's vertical integration & capacity expansion project, leverage indicators are expected to remain elevated.

Al-Karam Towel Industries (Private) Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**HFY20**	**FY19**	**FY18**	**FY17**
Fixed Assets (PP&E)	4,202.4	4,312.3	2,762.7	2,223.3
Long term Deposits	8.8	8.8	8.9	9.8
Stock-in-Trade	2,837.3	1,725.1	2,053.5	1,669.8.
Trade Debts	993.2	1,584.3	606.2	586.4
Cash & Bank Balances	944.0	783.8	265.4	234.0
Total Assets	10,418.8	9,484.1	6,214.1	5,163.1
Trade and Other Payables	933.4	918.3	832.5	586.2
Long Term Debt	1,377.6	1,342.6	412.3	256.1
Short Term Debt	3,094.1	2,665.0	1,636.8	1,435.0
Total Debt	4,471.7	4,007.6	2,049.1	1,691.1
Paid Up Capital	346.2	346.2	346.2	346.2
Total Equity	4,835.8	4,384.4	3,219.7	2,795.8
INCOME STATEMENT	**HFY20**	**FY19**	**FY18**	**FY17**
Net Sales	6,005.1	11,220.7	8,358.5	6,600.6
Gross Profit	1,019.8	1,960.8	1,259.5	953.7
Operating Profit	579.5	1,115.5	543.3	456.2
Profit Before Tax	504.5	994.0	491.5	406.1
Profit After Tax	450.8	885.1	419.5	351.5
RATIO ANALYSIS	**HFY20**	**FY19**	**FY18**	**FY17**
Gross Margin (%)	17.0%	17.5%	15.1%	14.4%
Net Working Capital	1,996.3	1,400.0	907.3	864.0
Current Ratio	1.11	1.01	1.15	1.24
FFO to Total Debt (%)	34.5%	31.2%	33.6%	38.6%
FFO to Long Term Debt (%)	112.0%	93.1%	167.0%	254.9%
Debt Servicing Coverage Ratio (x)	NA	8.44	8.85	9.22
ROAA (%)	9.1%	11.3%	7.4%	7.3%
ROAE (%)	19.6%	23.3%	13.9%	13.4%
Gearing	0.92	0.91	0.64	0.60
Leverage	1.15	1.16	0.93	0.85

ISSUE/ISSUER RATING SCALE &DEFINITIONS — Appendix II

VIS **Credit Rating Company Limited**

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

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

'SD' Rating: An 'SD' rating is assigned when 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	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**	
	RATING TYPE: ENTITY					
	3/3/2020	A-	A-2	Stable	Reaffirmed	
	12/17/2018	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 Meetings Conducted

	Name	Designation	Date
1	Mr. Ashraf	CFO	11-Feb-2020
2	Mr. Zain Anwar	Head of Business & Product Development	11-Feb-2020
3	Mr. Waqar khan	Finance Manager	11-Feb-2020