RATING REPORT

Al-Karam Towel Industries (Pvt.) Limited

REPORT DATE:
April 20, 2021

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	*April 20, 2021*		*April 23, 2020*	
Rating Action	Maintained		Maintained	
Rating Outlook	Stable		Rating Watch-Developing	

COMPANY INFORMATION	
Incorporated on April, 2004	**External auditors:** M/s. Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants
Private Limited Company	**Chief Executive Officer (CEO):** Mr. Hanif Bawa
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%)	
Mrs. Ghazala Mehtab (8.0%)	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (May 2019)*
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Al-Karam Towel Industries (Private) Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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 Sarfaraz 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. 6.2b, June 2020: Rs. 5.5b

Net Revenue: HFY21: Rs. 8.8b, FY20: Rs. 11.0b

RATING RATIONALE

Corporate Profile: Incorporated in 2004, Al-Karam Towel Industries (Private) Limited is a leading manufacturer and exporter of towels and allied products with an estimated market share of ~8.9% in FY20, exporting mainly to the U.S.A and Europe. It's a family owned business with shareholding vested among members of the Chawla family. The company embraces a diversified product portfolio including terry towel, printed bath and beach towel, bathrobes, kitchen towel, wash cloth, hand towel, and shower wrap.

At present, the company has nine manufacturing units located at S.I.T.E. Super Highway, Karachi, and Nooriabad, Sindh. The facilities are equipped with modern plants incorporating backward integration (spinning, weaving, dyeing, bleaching, stitching, packing, and finishing), and are driven by in-house gas based generators.

Emphasis remains to enhance capacity and efficiency

To enhance efficiency and capacity, the company incurred capital expenditure of Rs. 1.6bn during FY20 including addition of 11,000 spindles. Additionally, they are in the process of adding 260 rotors, 2,150 spindles, and 48 air jet looms at a total cost of Rs. 1.5bn financed through Long Term Financing Facility (LTFF) and Temporary Economic Refinance Facility (TERF).

The weaving division was historically operating at full capacity, but remained under pressure during FY20 owing to pandemic. However, volumes recovered during H1FY21 and utilization levels have recovered. The spinning division became online in FY19, and is currently operating at high utilizations levels.

Shareholding changes

After the Chairman, Mr. Mehtab Uddin Chawla, who passed away in April 2020, the shareholding will be equally distributed among his sons who are actively involved in the management of Al-Karam Towels.

The Succession Miscellaneous Application has been filed in the High Court, Karachi, Sindh, and legal procedures are underway.

Rating Drivers:

Recovery in the industry post COVID-19 lockdown provides support to the business risk profile of the company

In the ongoing fiscal year, textile exports have started to show recovery. Pakistan has been able to attract orders diverted from the closure in other regions. The Government has also been supportive of the textile industry with various measures. Exports remained stagnant in USD terms during Q1'FY21, however recovery started to materialize during Q2'FY21 as export proceeds were 4% higher than SPLY. The sector posted a cumulative growth of 6.7% during 8M'FY21 vis-à-vis SPLY.

Sales volume declined in FY20, led by the pandemic, was offset partly by rupee

devaluation. Post year-end, strong recovery registered.

Sales revenues registered a minimal dip of 2% in FY20 despite a pandemic led decline of 15% in volumes offset partly by the rupee devaluation. Subsequent to year-end, volumes have recovered upon diversion of export orders to Pakistan and improving economy post-COVID. Net sales recorded an increase of 47% during HFY21 vis-à-vis previous period (HY21: Rs. 8.8bn; HY20: 6.0bn). The momentum is expected to continue on the back of rising international demand, with selling prices to remain stable over the rating horizon.

During FY20 and forward, the company diversified into new regions including U.A.E, Europe, and Asia. However, major client concentration remains with the U.S.A. with top ten clients constituting more than three-fifth of the sales. The company sustains long-term relationships with customers, thus ensuring repeat business and operational efficiencies.

Profitability indicators continue to depict improvement on a timeline basis. Going forward, management expects further increase on the back of higher sales, production, and efficiency enhancement projects.

Gross Margins continues to show improvement on a timeline basis, peaking at 20.7% in FY20 (FY19: 17.5%, FY18: 15.1%), attributable to rupee devaluation of 16% in FY20 (FY19: 24%). The same supported the bottom-line profitability which stood at 9.6% at end-FY20 (end-FY19: 7.9%). Finance Cost increased by approximately one-third vis-à-vis FY19 due to increasing debt levels which is being mobilized by the company at concessionary rates. The company posted profit after tax (PAT) of Rs. 1.1bn during FY20 (FY19: 0.9bn), and anticipates higher profitability going forward on the back of order receiving in excess of capacity, higher production, and efficiency enhancements.

Liquidity profile continues to be supported by adequate cash flow coverage indicators and debt servicing ability.

Funds from Operations (FFO) increased to Rs. 1.6bn during FY20 (FY19: 1.3bn) on the back of higher profitability. Thus, ratings draw comfort through healthier cash flow generation which supports the liquidity profile. Debt financing continue to increase during FY20 to fund expansion, and even though this has resulted in the reduction of cash flow coverage multiples and DSCR, the same remains at satisfactory levels.

During FY20; owing to the pandemic, day's receivable outstanding and day's payable outstanding rose to 46 and 68 days respectively. Alongside, Day's inventory outstanding also rose to 101 days on the back of higher safety stocks and cotton procurement for the new spinning unit. The current ratio remained at 1.32x at end-FY20 (FY19: 1.37x), and short-term borrowings are adequately covered through trade debts and inventory by multiple of 1.08x (FY19: 1.18x).

Leverage and gearing indicators continue to trend upwards, but are expected to remain within manageable levels going forward.

The equity base of Al-Karam Towels continues to grow on a timeline basis on the back of higher profit retention. The debt profile encompasses a combination of short term and long term debt, and the total interest bearing liabilities stands at Rs. 8.5bn at end-H1FY21 (end-FY20: Rs. 7bn). Short-term borrowings constitute more than half of the total debt owing to higher working capital requirements of the business. Leverage indicators continue to remain elevated on account of higher debt utilization due to capacity expansion projects. However, ratings draw comfort from higher profitability and cash flow coverage indicators.

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

FINANCIAL SUMMARY					*(amounts in PKR millions)*
BALANCE SHEET	**HFY21**	**FY20**	**HFY20**	**FY19**	**FY18**
Fixed Assets (PP&E)	7,474.7	6,709.6	4,202.4	4,312.3	2,762.7
Long term Deposits	8.9	8.9	8.8	8.8	8.9
Stock-in-Trade	4,562.0	3,068.6	2,837.3	1,725.1	2,053.5
Trade Debts	1,479.1	1,196.7	933.2	1,584.3	606.2
Cash & Bank Balances	1,951.4	1,684.7	944.0	783.8	265.4
Total Assets	16,615.8	14,403.4	10,418.8	9,484.1	6,214.1
Trade and Other Payables	1,634.7	1,696.8	933.4	771.3	832.5
Long Term Debt	3,854.0	3,072.7	1,377.6	1,342.6	412.3
Short Term Debt	4,667.5	3,946.4	3,094.1	2,812.0	1,636.8
Total Debt	8,521.5	7,019.0	4,471.7	4,154.7	2,049.1
Paid Up Capital	346.2	346.2	346.2	346.2	346.2
Total Equity	6,207.2	5,450.1	4,835.8	4,384.4	3,219.7
INCOME STATEMENT	**HFY21**	**FY20**	**HFY20**	**FY19**	**FY18**
Net Sales	8,843.4	10,955.4	6,005.1	11,220.7	8,358.5
Gross Profit	1,608.1	2,272.5	1,019.8	1,960.8	1,259.5
Operating Profit	993.2	1,323.8	579.5	1,115.5	543.3
Profit Before Tax	859.3	1,165.0	505.1	994.0	491.5
Profit After Tax	757.1	1,055.4	451.4	885.1	419.5
RATIO ANALYSIS	**HFY21**	**FY20**	**HFY20**	**FY19**	**FY18**
Gross Margin (%)	18.2%	20.7%	17.0%	17.5%	15.1%
Net Working Capital	2,654.5	1,881.1	1,996.3	1,400.0	907.3
Current Ratio	1.41	1.32	1.47	1.37	1.36
FFO to Total Debt (%)	29.2%*	22.7%	34.5%*	30.1%	33.6%
FFO to Long Term Debt (%)	64.5%*	51.8%	112.0%*	93.1%	167.0%
Debt Servicing Coverage Ratio (x)	NA	6.03	NA	8.44	8.85
ROAA (%)	11.0%*	8.8%	7.9%*	11.3%	7.4%
ROAE (%)	27.5%*	21.5%	18.4%*	23.3%	13.9%
Gearing	1.37	1.29	0.92	0.95	0.64
Leverage	1.68	1.64	1.15	1.16	0.93

Annualized

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
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
4/20/2021	A-	A-2	Stable	Maintained
4/23/2020	A-	A-2	Rating Watch - Developing	Maintained
3/3/2020	A-	A-2	Stable	Reaffirmed
12/17/2018	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Ashraf	CFO	10-March-2021