RATING REPORT

Al-Karam Towel Industries (Pvt.) Limited

REPORT DATE:
May 25, 2022

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	*May 25, 2022*		*April 20, 2021*	
Rating Action	Reaffirmed		Maintained	
Rating Outlook	Stable		Stable	

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 (August 2021)*
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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.

RATING RATIONALE

Corporate Profile: Incorporated in 2004, Al-Karam Towel Industries (Private) Limited is a manufacturer and exporter of towels and allied products, 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.

Consistent increase in production capacities supported by growing demand

	FY20	FY21
Spinning		
Installed Capacity (lbs)	14,054,060	19,498,592
Actual Production (lbs)	6,252,454	18,447,746
Capacity Utilization	44%	95%
Weaving		
Installed Capacity (lbs)	44,000,000	44,000,000
Actual Production (lbs)	38,343,927	40,040,896
Capacity Utilization	87%	91%

To enhance efficiency and capacity, the company incurred capital expenditure to the tune of Rs. 3.7b in FY21 encompassing installation of 13,200 spindles and 260 rotors. With recovery in macroeconomic environment post affects of COVID-19, demand of the end products witnessed improvement in the outgoing and ongoing year. The capital expenditure in FY21 was financed through a mix of debt and internal cash flows. For financing, a blend of Long Term Financing Facility (LTFF) and Temporary Economic Refinance Facility (TERF) was utilized. Going forward, the management plans to further increase the spinning capacity for which 12,000 Chinese spindles will be imported. The project is expected to have a cost of around Rs. 1.0b, all of which will be financed using debt. This will enable the company to fulfill around 80% of its yarn requirement using in-house production as compared to 60% currently.

Business risk profile is supported by industry wide growth in exports over the last year

Surge in textile exports has continued in FY22 as COVID-19 related restriction are lifted across the globe. In the period July-January 2022, businesses in Pakistan earned $10.9b from the export of textile and apparel products, an increase of 26% year-on-year. With an investment plan of $3.5b in place for the sector, exports are projected to reach a figure of $21b for FY22, which will be a 40% increase over the last year. A similar trend has been noticed in the exports of denim apparels as well.

The margins of textile companies have broadly depicted improvement despite the uptick in raw material costs, given that the same was offset by exchange rate movement. Nevertheless, higher raw material pricing has increased the working capital requirements for the companies in the sector, which is likely to weigh on the liquidity of textile players. Due to relatively high demand in comparison to the supply, cotton prices in Pakistan have depicted a rise of around 50% over the last six months. The order book for the industry is expected to remain adequate in the ongoing year along with transfer orders of neighboring countries, easing our business risk concerns. The issues of freight cost and raw material prices continue to pose challenge for the sector though.

Sales have depicted a rising trend on the back of volumetric growth.

Revenue registered a growth of 55% during FY21 as economic activity resumed worldwide post COIVD-19. This was mainly attributable mainly to higher sales volumes. The proportion of local sales increased during the outgoing year because of greater demand of yarn in the market. However, exports continue to contribute the major share in sales mix (about 90%) and is expected to remain the same going forward. Historically, the concentration of customers has been in the USA. WalMart USA and Asda Stores UK contributed around 35% to the total exports sales in FY21. Going forward, management envisages further diversification in clientele portfolio based in USA, Europe, as well as Gulf countries. Client concentration is also noted to be on the higher side in local sales with 35% of the local sales provided by United Towel Exporters (Pvt). Limited.

Stability in sales revenue was noted in the ongoing year with topline reported at Rs. 8.4b for the first six months (FY21: Rs. 16.9b, FY20: Rs. 10.9b). Considering the projected growth in the industry and AKTI's capacity expansion plans, sales revenue is expected to exhibit consistent uptick going forward.

Earning margins reduced in the outgoing year due to higher input and freight costs, however depicted recovery in the ongoing year

Gross Margins of the company went down to 18.3% (FY20: 20.7%, FY19: 17.5%) in FY21 led by a rise in raw cotton prices over the period. Furthermore, higher export freight and clearing & forwarding charges negatively impacted the bottom-line of the company with net margins recorded at 8.1% (FY20: 9.6%, FY19: 7.9%) in FY21. Net profit in absolute terms increased to Rs. 1.4b (FY20: Rs. 1b) in FY21. Gross margins exhibited improvement in HY22 on account of inventory gains and increase in average selling price. For HY22, gross margins and net margins were reported at 22.7% and 9.5%, respectively. Going forward, addition of spinning capacity is expected to further improve operational efficiency. However, persistent rise in raw material costs and rising interest rates are likely to keep profitability indicators range bound.

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

Funds from Operations (FFO) increased to Rs. 1.6bn during FY21 (FY20: Rs. 917m) on the back of higher profitability in absolute terms. Hence, despite a rise in the quantum of debt to finance expansion, FFO to Long Term Debt and FFO to Total Debt ratios improved to 32% (FY20: 29%) and 17% (FY20: 13%) at end-FY21, respectively. Liquidity coverages strengthened further in HY22 on account of greater margins. Going forward, additional borrowings as part of the company's expansion plan may have some impact on the cash flow coverages. However, comfort is drawn from the projected growth in topline and improvement in operational efficiency translating into higher profits going forward.

Leverage indicators continue to trend upwards, despite a growing equity base.

The equity base of the company has exhibited persistent growth on a timeline basis on the back of profit retention. However, borrowings have also elevated in the same period to finance capacity expansion projects. Short-term borrowings constitute more than half of the total debt owing to higher working capital requirements led by rising cost of doing business. Consequently, leverage and gearing ratios continue to trend upwards with gearing and leverage reported at 1.41x and1.67x (FY21: 1.45x and 1.71x; FY20: 1.29x and 1.64x) respectively at end-Dec'21. However, these remain within manageable levels. Despite planned addition in long-term debt to finance expansion, capitalization indicators are projected to commensurate with the benchmarks for the assigned ratings.

Financial Summary (Rs. in milllions)				
Balance Sheet	**1HFY22**	**FY21**	**FY20**	**FY19**
PPE	10,058	9,592	6,710	4,312
Stock-in-Trade	5,791	3,825	3,069	1,725
Trade Debts	1,268	1,962	1,197	1,584
Cash & Bank Balances	890	1,316	1,685	784
Total Assets	20,198	18,468	14,403	9,484
Trade and Other Payables	1,546	1,161	1,452	771
Long Term Debt	5,231	4,591	2,964	1,189
Short Term Debt	5,415	4,705	3,946	2,812
Total Debt	10,646	9,296	6,910	4,001
Paid Up Capital	346	346	346	346
Total Equity	7,570	6,818	5,450	4,384
Income Statement				
Net Sales	8,458	16,938	10,955	11,221
Gross Profit	1,899	3,094	2,273	1,961
Operating Profit	1,107	1,840	1,324	1,116
Profit Before Tax	896	1,559	1,165	994
Profit after Tax	803	1,370	1,055	885
Ratio Analysis				
Gross Margin	22.4%	18.3%	20.7%	17.5%
Net Margin	9.5%	8.1%	9.6%	7.9%
Net Working Capital	3052	2321	2126	1400
Current Ratio	1.43	1.35	1.38	1.37
FFO (Annualized)	2,411	1,643	917	1,250
FFO to Total Debt	45%	17%	13%	30%
FFO to Long Term Debt	46%	32%	29%	93%
Debt Servicing Coverage Ratio	8.29	5.46	3.63	8.44
(Trade Debts + Inventory)/Short term Borrowigs	1.30	1.23	1.08	1.18
Gearing	1.41	1.45	1.29	0.95
Leverage	1.67	1.71	1.64	1.16
ROAA	8%	8%	9%	11%
ROAE	22%	22%	21%	23%

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	
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	

Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
5/25/2022	A-	A-2	Stable	Reaffirmed
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	06-April-2022