RATING REPORT

Al-Karam Towel Industries (Pvt.) Limited

REPORT DATE:
August 01, 2023

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Action	*Reaffirmed*		*Reaffirmed*	
Rating Date	*August 01, 2023*		*May 25, 2022*	

COMPANY INFORMATION	
Incorporated in 2004	**External Auditors:** M/s. Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants
Private Limited Company	**Chief Executive Officer:** Mr. Hanif Bawa
Key Shareholders (with stake 5% or more):	
Mr. Rehan Mehtab Chawla ~25%	
Mr. Farrukh Mehtab ~25%	
Mr. Kashif Mehtab ~25%	
Mr. Noman Mehtab ~25%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (May 2023) *https://docs.vis.com.pk/docs/CorporateMethodology.pdf*

APPLICABLE RATING SCALE(S)
VIS Issue/Issuer Rating Scale: *https://docs.vis.com.pk/docs/VISRatingScales.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.

RATING RATIONALE

Corporate Profile

Al-Karam Towel Industries (Private) Limited (AKTI) is a family-owned entity specializing in towel and terry product production and export. Recently, it has entered the domestic yarn market. With a 19-year history, the company handles various operations such as spinning, weaving, dyeing, bleaching, stitching, packing, and finishing, supported by a workforce of over 2,900 employees. Product suite features terry towels, patterned bath and beach towels, bathrobes, kitchen towels, washcloths, hand towels, and shower wraps.

AKTI holds ISO and a range of globally recognized accreditations, emphasizing its commitment to high-quality standards. IT infrastructure commensurate with scale of operations, utilizing an Oracle-based ERP system. Power needs are met through an optimal mix of in-house gas generators, a solar power plant, and the national grid, with diesel generators as backup. Additionally, a 4.1 MW solar power project is in installation phase.

Environmental, Social, & Governance (ESG) Initiatives

AKTI is persistently committed to minimizing its environmental impact across all phases of operations and products - from design to end-of-life. Its eco-friendly initiatives encompass reducing carbon footprints, operating wastewater treatment facilities, and spearheading local tree-planting campaigns. Moreover, the company extends its emphasis on social responsibility by fostering equal opportunities, notably promoting women's empowerment, conducting health-centric campaigns such as blood testing and donations, and organizing breast cancer awareness sessions.

Recent capacity expansion initiatives in spinning and weaving divisions

***Spinning* –** In FY21, as part of capacity and efficiency enhancement initiatives, the company incurred capex to the tune of Rs. 3.7b, including installation of additional 13,200 spindles and 260 rotors at their existing spinning facility in Nooriabad. This resulted in a ~40% increase in installed capacity, reaching a total of 37,728 spindles and 580 rotors. The project was financed through a mix of debt (LTFF & TERF) and internal cash flows. Additionally, management stated that yarn dyeing is now completely in-house, as previously outsourced.

***Weaving* –** During the review period, the company established a new weaving unit in Nooriabad, amounting to Rs. 2.5b which includes 48 air-jet looms. This addition has led to a ~50% increase in installed capacity of the weaving segment, which now houses a mix of 108 air-jet looms, 674 power looms, and 52 shuttle-less looms.

Operational Performance

AKTI, headquartered in Karachi, operates a spinning facility in Nooriabad and has two weaving units in both Karachi and Nooriabad. While the spinning unit operated at nearly full capacity over time, towel facility production levels saw a dip this fiscal year, following a rise in FY22, due to a slowdown in global demand. The same is reflected in lower utilization ratio.

Table: Capacity & Production Data (Units in millions)

	FY20	FY21	FY22	FY23
Spinning				
Installed Capacity (kgs)	14.1	19.5	19.7	19.4
Actual Production (kgs)	6.3	18.4	19.7	18.9
Capacity Utilization	***44%***	***95%***	***100%***	***97%***
Weaving				
Installed Capacity (lbs)	44.0	44.0	66.3	66.3
Actual Production (lbs)	38.3	40.0	53.5	43.7
Capacity Utilization	***87%***	***91%***	***81%***	***66%***

Key Rating Drivers

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, demand slowdown, high interest rate situation, inflationary pressures and recent floods adversely affecting cotton crop while ongoing energy crisis in the country pose a challenge to margins sustainability and future growth.

Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally broke the threshold, coming in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr. Barring seasonal and cyclical fluctuations, textiles sector has maintained an average share of about 60% in national exports.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22		10M'FY22	10M'FY23
Pakistan Total Exports	22,536	25,639	32,450		26,858	23,211
Textile Exports	12,851	14,492	18,525		15,174	14,178
PKR/USD Average Rate	158.0	160.0	177.5		174.4	245.4

Source: SBP

Export revenues from textile sector have noted sizeable growth over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports in FY22. However, current fiscal year has been significantly impacted and 10M export proceeds (in value terms) reflect a year-on-year (YoY) decline of ~14%.

Table: Textile Export Details (in USD millions)

	FY20	FY21	FY22		10M'FY22	10M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**		**12,908**	**11,337**
- Knitwear	2,794	3,815	5,121		4,218	3,712
- Readymade Garments	2,552	3,033	3,905		3,214	2,905
- Bed wear	2,151	2,772	3,293		2,727	2,250
- Towels	711	938	1,111		928	825
- Made-up Articles	591	756	849		710	585
- Art, Silk & Synthetic Textile	315	370	460		385	343
- Others	555	743	866		725	718
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**		**3,074**	**2,372**
- Cotton Cloth	1,830	1,921	2,438		2,006	1,685

- Cotton Yarn	984	1,017	1,207		1,006	637
- Others	43	34	72		62	51
Total	**12,527**	**15,399**	**19,332**		**15,982**	**13,709**

Source: PBS

In FY22, towel exports reached $1.1b, marking an annual growth rate of ~18%, while the export volume rose ~4% from 213,150 MT to 221,489 MT. However, global demand slowdown this fiscal year had an impact on towel exports, reflecting the overall downturn in textile exports.

Cotton prices rose to a new 12-year high of ~Rs. 21,600/maund as of March'22, as a result of the shortage and higher input costs of fertilizer and energy. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Table: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	10M'FY23
Per Maund	8,770	8,860	13,000	17,380	20,235
YoY % Change	26%	1%	32%	34%	*n/a*

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than $2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dying companies.

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

High cyclicality and competitiveness in the spinning sector add to business risk profile.

Movement in cotton prices and cotton crop levels drives performance of spinning players in Pakistan. Given sizeable deficit in local cotton production compared to demand in recent years, cotton prices remained high. However, availability of imported yarn kept yarn prices competitive in the current fiscal year and thus resulting in weakening of profitability profile for spinning players.

Despite a recent dip in demand impacting exports, sales revenue keeps growing due to a notable increase in local yarn sales and consistent rupee depreciation. Geographic and client wise sales mix feature concentration.

After a substantial ~55% growth in FY21, sales revenue saw a further ~11% rise in FY22, reaching Rs. 18.9b, largely driven by volume increase. While most revenue is generated from terry towel product exports, local sales ratio has seen an upturn this fiscal year, particularly in the last quarter, largely driven by a spike in yarn sales amidst regional shortages. Local sales mainly encompass yarn sales, lower-grade towels, and toll manufacturing services. As per management, average pricing plan for customers ranges from 3 to 6 months.

Geographic sales mix shows concentration, with USA and UK remaining the primary export destinations, accounting for over 70% of exports. The rest is dispersed across regions such as Germany, Denmark, Canada, Georgia, Portugal, Greece, Saudi Arabia, among others. Client concentration remains high, with top ten clients producing nearly three-fourth of total revenues.

Despite a global economic downturn affecting export volumes, FY23 revenue reached Rs. 21b, propelled by a notable surge in yarn sales in the last quarter and consistent rupee depreciation. The sales outlook for FY24 is projected at around Rs. 24b.

Profitability margins have seen a marked improvement over the review period.
Both gross and net profitability margins have notably improved over time, largely driven by steady rupee devaluation and increased in-house spinning capacity. Nearly 85% of total yarn requirement is now met by in-house production, with the rest procured domestically. Management adjusts procurement proportions based on current orders. Adequate stock levels are maintained to meet confirmed sales orders, with overall raw materials sourced at an average ratio of 33:67 between imports and local procurement.

Operating overheads, including distribution and administration costs, significantly rose during the review period due to high inflation, increased freight charges, and salary hikes. Financial charges more than doubled compared to FY22 levels, owing to higher benchmarks rates, increased running finance utilization and fresh borrowings availed in FY21 to fund capacity expansion plans. Nonetheless, strong revenue growth and increasing gross margins have positively impacted bottom-line growth.

Cash flows noted a positive trend while liquidity profile is adequate with slightly elevated working capital days.
Improved profitability coupled with a substantial increase in depreciation expense led to a strong growth in funds flow from operations (FFO). This allowed cash flow coverage metrics to stay satisfactory despite elevated debt levels. However, debt servicing coverage ratio (DSCR) has shown a downward trend due to a timeline increase in current portion of long-term debt.

Current ratio has consistently remained above 1.3x over the years, with short-term borrowings adequately covered by trade debts and inventory, reflecting a healthy liquidity profile. Proceeds from liquidation of short-term investments offer further stability. However, cash conversion cycle has more than doubled in the past 21 months due to bulk buying, increased inventory, and debtor days, while credit payable days have declined.

High-retained profits supported capitalization keeping leverage metrics at manageable levels.
Equity base noted a robust ~40% growth over the last 21 months, reaching Rs. 9.5b at end-9M'FY23, fueled by healthy bottom-line growth and high profit retention. Although no dividend was paid in FY21, a dividend of Rs. 255m was paid in FY22 with a 16% payout ratio. Debt profile is a blend of short-term and long-term debt, with total interest-bearing liabilities rising to Rs. 14.9b (FY22: Rs. 12.8b, FY21: Rs. 9.9b) at end-9M'FY23; ~63% constituted short-term debt. Aggregated running finance lines total Rs. 11.3b, entirely from the ERF facility, while long-term financing includes LTFF and TERF facilities. Gearing and leverage ratios have slightly increased over the review period yet remain at manageable levels.

Al-Karam Towel Industries (Private) Limited Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**9M'FY23**
PPE	6,709.6	9,591.9	9,737.5	10,860.6
Stock-in-Trade	3,068.6	3,825.3	7,424.2	10,308.3
Trade Debts	1,196.7	1,962.2	2,405.1	2,004.4
Cash & Bank Balances	1,684.7	1,316.2	1,037.8	572.7
Total Assets	**14,403.4**	**18,469.5**	**23,614.2**	**26,445.1**
Trade and Other Payables	1,451.9	1,163.0	1,842.3	1,034.3
Long Term Debt	2,964.0	4,498.6	4,360.9	4,930.9
Short Term Debt	3,946.4	4,704.9	7,730.1	9,335.5
Total Debt	**6,910.3**	**9,203.5**	**12,091.0**	**14,266.4**
Paid Up Capital	346.2	346.2	346.2	346.2
Total Equity	**5,450.1**	**6,807.9**	**8,178.8**	**9,539.6**
INCOME STATEMENT				
Net Sales	10,955.4	16,938.2	18,881.8	15,416.3
Gross Profit	2,272.5	3,092.5	4,180.8	4,320.6
Operating Profit	1,323.8	1,839.6	2,260.3	2,556.1
Profit Before Tax	**1,165.0**	**1,548.6**	**1,886.8**	**1,802.9**
Profit after Tax	**1,055.4**	**1,359.4**	**1,618.7**	**1,620.2**
RATIO ANALYSIS				
Gross Margin (%)	20.7	18.3	22.1	28.0
Net Margin (%)	9.6	8.0	8.6	10.5
Net Working Capital	2126.0	2247.7	3350.5	4276.0
Current Ratio (x)	1.4	1.34	1.3	1.4
FFO	917.2	1,872.4	2,793.0	1,941.9
FFO to Total Debt (x)	0.13	0.19	0.22	0.17*
FFO to Long Term Debt (x)	0.29	0.37	0.55	0.46*
Debt Servicing Coverage Ratio (x)	3.6	6.13	3.8	2.1*
(Trade Debts + Inventory)/Short term Borrowings (x)	1.1	1.23	1.3	1.3
Gearing (x)	1.3	1.44	1.6	1.6
Leverage (x)	1.6	1.71	1.9	1.8
ROAA (%)*	8.8	8.3	7.7	8.6*
ROAE (%)*	21.5	22.2	21.6	24.4*

**Annualized*

REGULATORY DISCLOSURES	Appendix II
Name of Rated Entity	Al-Karam Towel Industries (Private) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
01/08/2023	A-	A-2	Stable	Reaffirmed
05/25/2022	A-	A-2	Stable	Reaffirmed
04/20/2021	A-	A-2	Stable	Maintained
04/23/2020	A-	A-2	Rating Watch-Developing	Maintained
03/03/2022	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 Meeting Conducted	

Name	Designation	Date
Mr. Kamran Anwer	CFO	July 12, 2023
Mr. Waqar Khan	Senior Manager-Finance	
Mr. Fahad Shaukat	Senior Manager-Accounts	