RATING REPORT

A.A. Spinning Mills Limited (AASML)

REPORT DATE:
February 26, 2020

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity	A-	A-2	A-	A-2
Rating Date	*Feb 26, 2020*		*Sep 17, 2018*	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION

Incorporated in 2003	External Auditors: RSM Avais Hyder Liaquat Nauman Chartered Accountants
Unquoted Public Limited Company	Chairman of the Board: Mr. Asim Yaseen Chief Executive Officer: Mr. Atif Yaseen
Key Shareholders (with stake 5% or more):	
Mr. Asim Yaseen – 35.29%	
Mr. Atif Yaseen – 35.29%	
Ms. Ammara Yaseen – 11.76%	
Ms. Ayesha Yaseen – 11.76%	
Ms. Samina Yaseen – 5.88%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (May 2019)
https://www.vis.com.pk/kc-meth.aspx

OVERVIEW OF THE INSTITUTION

A.A. Spinning Mills Limited (AASML) was incorporated in October 2003 and commenced commercial operations in 2006. The principal business activity of the company is manufacturing and sale of yarn.

Profile of the Chairman/CEO

Mr. Asim Yaseen is the Chairman of Board of Director at AASML. He previously held directorship in Ibrahim Fibers Limited.

Mr. Atif Yaseen has been serving AASML as the Chief Executive Officer (CEO) since 2006. He previously held directorship in Ibrahim Fibers Limited and MCB Bank Limited.

Financial Snapshot

Total Equity: end-FY19: Rs. 1.81b; end-FY18: Rs. 1.66b; end-FY17: Rs. 1.55b

Assets: end-FY19: Rs. 4.43b; end-FY18: Rs 3.92b; end-FY17: Rs. 3.65b

Profit After Tax: FY19: Rs. 150.8m; FY18: Rs. 105.8m; FY17**:** Rs. 71.7m

RATING RATIONALE

A.A. Spinning Mills Limited (AASML) is a mid-sized spinning unit. Shareholding is vested with the sponsoring family who is actively involved in day-to-day operations of the company. The assigned ratings take into account AASML association with the Ibrahim Group, a large conglomerate with presence in textile and financial services. The ratings incorporate improvement in sales, margins and profitability driven by volumetric increase and higher yarn prices. Given low level of long-term borrowings, debt service coverage ratio has remained adequate with increasing cash flows. However, the ratings are constrained by nearly full capacity utilization, relatively high leverage indicators vis-à-vis peers, vulnerability of spinning sector to raw material prices and any adverse changes in regulatory duties. The ratings remain sensitive to maintenance of gearing levels within acceptable limits.

Decline in cotton production and yarn exports on a timeline basis: The lower end of textile value chain is faced with many challenges. Increase in distribution cost owing to higher fuel prices has also skewed the domestic players towards local markets. Cotton trade has also been affected as the Federal Board of Revenue imposed 10 percent sales tax on cotton that would be collected at the ginners' level while withholding tax was increased to 4.5 percent from one percent.

Cost pressures for the industry are reflective of the global and local cotton production data which shows scaled down cultivation area and production at both ends. Resultantly, local cotton prices have gone up. With respect to spinning segment, dependence on imported cotton, particularly from India, had been on the higher side given its identical quality with the local cotton. However, sprained relations with India and significant rupee devaluation would further spike up raw material costs for the spinning segment. Margins and financial performance of the players in the industry have depicted volatility due to inherent cyclicality of crop levels and oscillations in cotton prices.

Optimal capacity utilization; expansion plan shelved due to unfavorable economic conditions: The company largely produces 14s to 30s count yarn. Total installed and operational spindles of AASML were 50,544 (FY18: 50,544) at end-FY19. Converted to 20s count Kgs, capacity utilization has remained optimal at 98% (FY18: 99%) during FY19. Production is planned in accordance with the market demand. The management's plan to expand spinning operations, entailing addition of 39,185 spindles in first phase and 11,839 spindles in second phase, has been put on hold due to unfavorable economic scenario of higher interest rates and local currency depreciation.

Production is supported by capital expenditure carried out to improve operational performance of spindles. The company has added machinery costing Rs. 278.6m during FY19, which mainly constituted winding machine namely Savio Polar, lycra attachment for Ring machine, draw frame namely TD 10C compact while Rs. 163.5m of capital work in progress was transferred to operating assets.

Profitability underpinned by higher sales and increasing margins: During FY19, the company reported net sales of Rs. 5.7b (FY18: Rs. 4.5b) driven by volumetric increase in local sale of yarn along with increase in yarn prices. The company sold 372,945 bags locally during FY19 vis-à-vis 358,131 in the preceding year while only 742 bags (FY18: 2,586 bags) were exported. Average local yarn price fetched Rs. 14,875/Bag (FY18: Rs. 12,268/Bag) during FY19, while average export sale price stood higher at Rs. 15,982/Bag (FY18: Rs. 13,317/Bag). The contribution of export sales to the total sales mix has remained minimal at

0.2% (FY18: 0.8%). Other materials sale comprising zippers, amounted to Rs. 42.3m (FY18: Rs. 33.6m) during FY19. Customer concentration has remained almost the same, as sales to top ten customers accounted for 35% (FY18: 34%) of the total sales during FY19.

Cost of sales increased to Rs. 5.1b (FY18: Rs. 4.1b) during FY19. Raw material cost comprising 77% (FY18: 73%) of the cost of goods manufactured increased to Rs. 3.9b (FY18: Rs. 3.0b). The increase was mainly a function of general increase in cotton and polyester prices over time. AASML procured 9.4m Kgs of cotton (FY18: 12.8m Kgs), comprising around 53% (FY18: 62%) of the total procurement during FY19, at an average rate of Rs. 9,264 per maund (FY18: Rs. Rs. 6,759 per maund), while polyester constituted 44% (FY18: 38%) of the raw material mix, the price of which increased to Rs. 190/Kg (FY18: Rs. 148/Kg). The company also procured imported polyester during the outgoing year, forming around 2% of total procurement, at the rate of Rs. 239/Kg.

Packing material and stores and spares consumed increased to Rs. 61.9m and Rs. 108.7m (FY18: Rs. 52.6m and Rs. 93.1m) respectively due to currency depreciation and inflationary pressure. Fuel and power expenses increased to Rs. 531.9m (FY18: Rs. 517.6m) owing to higher energy prices, meanwhile salary, wages and benefits increased to Rs. 254.9m (FY18: Rs. 234.4m) due to annual salary adjustments. On back of increase in average selling prices of yarn and rationalization of overall cost of production, gross margins increased to 11% (FY18: 9.5%) during the period under review.

Operating expenses stood higher at Rs. 170m (FY18: Rs 155m) due to slight increase in both selling and administrative expenses. Finance cost increased to Rs. 259.1m (FY18: Rs. 150.1m) due to higher average short-term borrowings along with increase in markup rates. Accounting for taxation, net profits stood higher at Rs. 150.8m (FY18: Rs. 105.8m) during FY19. The management projects modest growth in sales to Rs. 6b during the ongoing year, on the back of some increase in product prices.

With minimal reliance on long-term funding and improvement in internal cash generation, debt service coverage remained adequate: Funds from Operations (FFO) has depicted a positive trend for the last three years; FFO increased to Rs. 350.1m (FY18: Rs. 250.6m) during FY19 is steered by higher profitability, non-cash adjustments and positive difference between incurred and paid finance cost. However, due to higher debt levels, FFO to total debt showed a marginal increase to 0.16x (FY18: 0.13x) during FY19. With overall minimal reliance on long-term funding and improvement in internal cash generation, debt service coverage increased to 2.1x (FY18: 1.5x) during the review period.

Stock in trade stood higher at Rs. 1.2b (FY18: 931.4m) due to higher raw material and work in process inventory; while finished goods stood lower at Rs. 63.6m (FY18: Rs. 128.7m) at end-FY19. Trade debts increased to Rs. 524.8m (Rs. 302.6m) by end-FY19. Aging analysis of receivables showed that almost all receivables are due for less than 30 days. Tax refunds due from government increased to Rs. 309m (FY18: Rs. 251.7m) by end-FY19. Further, advances, deposits and prepayments stood higher at Rs. 151.3m (FY18: Rs. 131.6m) mainly due to higher advance income tax paid in FY19. On the other hand, trade and other payables increased to Rs. 221m (FY18: Rs. 162.2m) mainly due to higher creditors by end-FY19. Interest payable on long term and short term borrowings stood higher at Rs. 72.1m (FY18: Rs. 43.0m) at end-FY19. Current ratio increased slightly to 1.02x (FY18: 0.95x) by the end-FY19. Coverage of short-term borrowings via stock in trade and trade debts, though increased, has remained low at 0.84x (FY18: 0.70x).

Leverage indicators witnessed slight increase despite higher equity base: Equity base expanded slightly as a result of profit retention during FY19. Less than 6% of total borrowings were long-term in nature. Short-term borrowings stood higher at Rs. 2.1m (FY18: Rs. 1.8m) by the end-FY19, to meet higher working capital needs. Mark-up on short term borrowings ranged between benchmark rate *plus* 0.85%-1.75% per annum. Gearing and leverage indicators have increased slightly to 1.20x and 1.45x (FY18: 1.17 and 1.37x) respectively due to increase in borrowings by end-FY19. Capitalization indicators are likely to improve on back of gradual increase in equity, while short-term borrowings are projected to remain around current levels.

BALANCE SHEET (PKR Millions)	FY17	FY18	FY19
Property, Plant & Equipment	1,865	1,917	1,896
Store, Spares and Loose Tools	80	98	111
Stock-in-Trade	878	931	1,191
Trade Debts	204	303	525
Advances, Deposits & Prepayments	149	132	151
Investment Property	124	124	124
Tax Refunds Due from Government	264	252	309
Cash & Bank Balances	26	111	71
Other Assets	56	54	54
Total Assets	3,646	3,922	4,432
Trade and Other Payables	81	162	221
Long Term Debt *(including current maturity)*	267	172	125
Short Term Debt	1,578	1,767	2,051
Other Liabilities	173	166	226
Total/Tier-1 Equity	1,547	1,655	1,809
Paid-up Capital	1,700	1,700	1,700
INCOME STATEMENT	**FY17**	**FY18**	**FY19**
Net Sales	4,365	4,546	5,742
Gross Profit	360	434	633
Profit Before Tax	117	133	207
Profit After Tax	72	106	151
Funds from Operations	212	251	350
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**
Gross Margin (%)	8.2	9.5	11.0
Net Margins (%)	1.6	2.3	2.6
Current Ratio (x)	0.96	0.95	1.02
Net Working Capital	(80)	(102)	40
FFO to Total Debt (x)	0.12	0.13	0.16
FFO to Long Term Debt (x)	0.80	1.46	2.79
Debt Leverage (x)	1.36	1.37	1.45
Gearing (x)	1.19	1.17	1.20
DSCR (x)	2.92	1.50	2.10
ROAA (%)	2.0	2.8	3.6
ROAE (%)	4.7	6.6	8.7
(Stock in Trade+Trade Debt) to Short-Term Borrowing Ratio (x)	0.69	0.70	0.84

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	A.A. Spinning Mills Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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				
26/02/2020	A-	A-2	Stable	Reaffirmed
17/09/2018	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Saad Khalid	Assistant Manager Finance	11th February, 2020