RATING REPORT

A.A. Spinning Mills Limited

REPORT DATE:
July 07, 2021

RATING ANALYSTS:
Maham Qasim
maham.qasim@vis.com.pk

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		Rating Watch Developing	
Rating Date	*02 July'21*		*27th Apr'20*	

COMPANY INFORMATION

Incorporated in 2003	External auditors: RSM Avais Hyder Liaquat Nauman Chartered Accountants
Unquoted Public Limited Company	Chairman: Mr. Asim Yaseen
Key Shareholders (More than 5%):	CEO: Mr. Atif Yaseen
Mr. Asim Yaseen – 35.3% Mr. Atif Yaseen – 35.3% Ms. Ammara Yaseen – 11.8% Ms. Ayesha Yaseen – 11.8% Ms. Samina Yaseen – 5.9%	

APPLICABLE METHODOLOGY(IES)

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

A.A. Spinning Mills Limited

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 made from cotton or man-made fiber.

Profile of the Chairman

Mr. Asim Yaseen is the Chairman of Board of Director at AASML. He has a Master of Computer Science from University of Wales, Cardiff U.K. He previously held directorship in Ibrahim Fibers Limited.

Profile of the CEO

Mr. Atif Yaseen has been serving AASML as the Chief Executive Officer (CEO) since 2005. He has a Master of Business Administration from University of Wales, Cardiff U.K. He previously held directorship in Ibrahim Fibers Limited and MCB Bank Limited.

Financial Snapshot

Total Equity: 3QFY21: Rs. 1.9b; end-FY20: Rs. 1.6b; end-FY19: Rs. 1.8b; end-FY18: Rs. 1.7b

Assets: 3QFY21: Rs. 4.7b; end-FY20: Rs. 4.8b; end-FY19: Rs. 4.4b; end-FY18: Rs. 3.9b

Profit After Tax: 3QFY21: Rs. 395m; end-FY20: Rs. (264m); FY19: Rs. 151m; FY18: Rs. 106m

RATING RATIONALE

The ratings assigned to A.A. Spinning Mills Limited (AASML) take into account the company's association with Ibrahim Group; one of the leading groups in Pakistan with sizable financial strength. Ratings are constrained by high cyclicality and competitive intensity of spinning industry coupled with volatility in cotton prices which translate into moderate to high business risk profile. On the other hand, holistically business risk profile of the textile industry is supported by stable and growing demand as US-China Trade disruption enhance sales given major buyers continue to diversify procurement. Ratings also incorporate sound financial risk manifested by significant improvement in margins & profitability indicators, declining trend witnessed in gearing indicators with limited reliance on long-term debt, sound liquidity and sizable debt service coverages. Further, owing to reduction in benchmark rates, the financing cost for the company has reduced, reflecting positively on the bottom line. However, the ratings remain sensitive to lack of revenue diversification and limited scale of operations. The management's focus on expanding current operations with setup of new spinning unit with 50,000 spindles bodes well for the company in terms of reaping economies of scale.

Given improvement in the company's operational performance owing to pandemic led boom in textile sector during the period under review, the outlook assigned to AASML's ratings has been revised to 'Stable'. Even though concerns of successive waves of Covid-19 are present, strong order book of the industry for the in the ongoing year along with vaccine rollout has largely subsided business risk concerns. The ratings remain dependent on mitigation of cyclicality risk inherent in spinning sector through maintenance of margins and cash flow generation, sustenance of gearing indicators at around current levels and realization of projected targets coupled with evolution of sector dynamics post ongoing pandemic.

Local Spinning Segment performance during COVID-19: The coronavirus pandemic led to 3% drop in global trade volumes in the 1QFY20 according to United Nations conference on Trade and Development forecasts. Given most of the textile companies in Pakistan are heavily reliant on local cotton produce; the supply side risk was largely curtailed. However, due to the recent heavy rainfall and pest attack, cotton crop was badly damaged and the same was reported at a multi-year low. Subsequently, reduction in local cotton production pushed the cotton prices to 11 year high in Feb'21. Movement in cotton prices and cotton crop levels drives performance of spinning sector players; the same have depicted seasonality historically. The increase in global demand for value-added textile products coupled with diversion of orders to Pakistan from competing neighboring countries on account of more severe pandemic situation prevalent supports the business risk environment for local spinning units. Going forward, the improvement in margins for the sector will remain contingent on investment in technology and capital expansion to reap economies of scale.

Production capacities remained unchanged: A.A. Spinning Mills Limited (AASML) is a mid-sized spinning unit involved in the manufacturing of 14s to 30s count yarn. During the period under review, the production capacities of spindles remained unchanged; AASML had total operational capacity of 17.7 million kgs (FY19: 17.7 million kgs) at end-FY20. In response to the ongoing pandemic resulting in dampened demand, the production activities and utilization took a downturn during FY20 as business activity was closed for two months. Installed capacities and actual production are tabulated below:

Capacity Analysis	FY18	FY19	FY20
Spinning Unit:			
Number of spindles installed	50,544	50,544	50,544
Number of spindles worked	50,544	50,544	50,544
Conversion into 20/s count Kgs'000:			
Installed Capacity (After conversion into 20/s count Kgs)	17,670	17,670	17,670
Actual Production (After conversion into 20/s count Kgs)	17,542	17,260	13,860
Capacity Utilization %	98	98	78

Topline and profitability took a hit during FY20; however, both picked pace during the ongoing year: Given the onslaught of COVID pandemic and subsequent depressed economic indicators, the revenues were recorded lower at Rs. 4.2b (FY19: Rs. 5.7b) in FY20; textile units not directly catering to export market were closed down completely for two months. In terms of business model, local sales are the main revenue driver comprising around 99% of the total sales mix. The company sold 254,968 bags locally during FY20 as opposed 372,945 bags in the preceding year in line with stressed economic dynamics amid pandemic crisis. The export sales also took a downturn with sale of 370 bags (FY19: 742 bags) during FY20; the exports pertain to sale of carded yarn to a single customer, a tire manufacturing company in Japan. Top 10 customers nearly constitute 30% of total revenue translating to moderate concentration risk; the same is considered manageable given strong long-standing business relations with customers coupled with high focus on quality sustenance. The three largest customers include Masood Fabrics Ltd, Gul Ahmad Textile Mills Ltd, and Sapphire Fibres Ltd with each accounting for around 4%-5% of the total revenue during FY20.

AASML fetched higher average price on local yarn sales amounting to Rs. 18,485/bag (FY19: 16,500/bag); moreover, average export sale price also increased to 16,924/bag (FY19: 15,982) during FY20 primarily owing depreciation of local currency during the concerned period. However, despite the increase in output prices, margins declined to 7.4% (FY19: 11.0%) in line with increase in average cotton prices to Rs. 9,172/maund (FY19: Rs. 8,645/maund) during FY20. Further, on account of reduced production stemming from covid-related lockdown, the company had surplus cotton stock available against which AASML has to book an inventory loss amounting to Rs. 94.6m during FY20; the same contributed to shrinkage in margins. Moreover as per the management, the dip in margins was also attributable to reduction in scale of operations on account of which absorption of fixed overhead portion of cost of sales, including salary and insurance expense, was hampered.

Selling and distribution expense was recorded lower at Rs. 16.0m (FY19: Rs. 22.0m) during FY20 primarily as a result of decline in freight cost; the same is correlated with reduction in scale of operations. In addition to this, administrative expense also declined to Rs. 116.6m (FY19: Rs. 137.2m) owing to decrease in employee related expenses as the average number of employees stood lower at 510 during the FY20 in comparison to 714 in the preceding year. In the backdrop of increasing average benchmark interest rates coupled with higher borrowings carried on the balance sheet, finance cost of the company increased to Rs. 381.1m (FY19: Rs. 259.1m) during FY20. Consequently, as a combined impact of decline in scale of operations, compression of margins and elevated finance cost, AASML reported a negative bottom line of Rs. 263.9m during FY20 as compared to net profit of Rs. 150.8m in the previous year.

The declining trend in volumetric sales was rescued during the ongoing year with the company's operations back at full capacity. AASML's topline was recorded higher at Rs. 4.8b during 3QFY21 as a combined outcome of increase in prices of final product along with higher quantum of goods sold; the revenue recorded is higher than the full year revenue of the preceding year. Further, the company was able to reap higher average price of yarn amounting to Rs. 19,300/bag (FY20: Rs. 18,485/bag) which reflected positively on the margins, the same therefore were reported higher than the pre-covid values at 15.3% during 3QFY21. The enhancement of margins is also a function of improved business risk dynamics of the spinning and textile sector in line with capitalizing of market gap presented by prolonged lockdowns in competitor countries. The operating expenses including administrative and selling & distribution expenses were recorded slightly higher at Rs. 125.8m during 3QFY21 vis-à-vis Rs. 132.2 in FY20; however, the same is in sync with higher business volumes. On the other hand, the finance cost was rationalized to Rs. 167.7m during 3QFY21 owing to sharp dip in benchmark interest rates along with reduced average utilization of short-term credit. As a result of positive trajectory of revenues, improved margins and curtailment of interest expense, AASML reported sizable profit of Rs. 395.2m during 3QFY21; the bottom line of the company for the ongoing year is higher than the last three fiscal years. Going forward, the management projects to close FY21 with a topline of Rs. 6b; the company is on track of meeting the projected target as orders of over Rs. 1.0b are currently in the pipeline.

Liquidity position depicts volatility with significant improvement witnessed during the ongoing year: Liquidity profile of the company has exhibited positive trajectory with significant improvement during the ongoing year in line with growth in margins and profitability indicators. Funds from Operations (FFO) were recorded sizable at Rs. 538.5 during 3QFY21 owing to growth in scale of operations and enhancement of margins. As a result, FFO to total debt and FFO to long-term debt were recorded significantly higher at 0.37x and 7.91x at end-3QFY21. The company has limited reliance on long-term funding therefore FFO to long-term debt is significantly huge. However, the FFO have depicted volatility during the review period as the same were recorded negative during FY20; the volatility in liquidity position was directly linked to the trend in profitability indicators.

Stock in trade increased on a timeline basis to Rs. 1.4b (end-FY20: Rs. 1.9b; end-FY19: Rs. 1.2b) at end-3QFY21 owing to sizable raw material inventory held to meet forecasted demand; the same is linked with growth in scale of business operations. The inventory peaked at end-FY20 due to scaled down production during the outgoing year on account of lockdowns imposed; however, the same is being subsided to optimal levels during the ongoing year. The company owns investment property with book value of Rs. 124.4m at end-1QFY21; however, the market value of the property is estimated considerably higher at Rs. 2.3b as the revaluation surplus on the same has not been recorded in the books yet. Trade debts largely remained range bound during the rating review period while the slight increase manifested was an outcome of increase in scale of operations. The aging of receivables is considered satisfactory since all of the receivables fall due within the three months bracket. Advances, deposits and prepayments increased on a timeline basis on account of higher advance income tax paid by the company. Further, liquidity of the company is slightly impacted due to sizable tax refunds amounting to Rs. 353.1m (end-FY20: Rs. 98.7m; end-FY19: Rs. 309.0m) due from government at end-3QFY21; the company is unable to rectify the situation given it is an exogenous factor and inherent in the local textile industry. Trade and other payables increased to Rs. 528.7m (end-FY20: Rs.

185.3m; end-FY19: Rs. 221.0m) at end-3QFY21 on account of higher procurement of raw material made; given the company is based in the spinning sector the increase in payables has an element of cyclicity attached. Given increase in inventory and reduction in short-term borrowings, current ratio of the company showcased slight improvement during the rating review period. The company made capital investment amounting to Rs. 36.2m pertaining to expansion of power generation capacity from 1 Megawatt to 2 Megawatts during the rating review period.

Leveraged indicators exhibited improvement on timeline basis owing to equity augmentation: The equity base of AASML took a dent during the outgoing year on account of negative bottom line; however, the same augmented to Rs. 1.9b at end- 3QFY21 as a result of internal capital generation. The debt matrix is heavily tilted towards short term credit owing to limited reliance of the company on long-term borrowings. There was a sizable increase in utilization of short-term borrowings witnessed during FY20 owing to higher inventory stock held; however, the same is being offloaded in the current year therefore a declining trend in short-term credit is also evidenced at end-3QFY21. Short-term funding is almost equally made under cash finances and running finances; the former are secured against pledge of cotton, polyester and yarn and carry an effective markup charge ranging from 9.3% to 15.8% per annum. On the other hand, running finances are secured against first and joint pari passu charge over present and future current assets of the company. Further, a declining trend was witnessed in the long-term credit procured in line with timely repayment of periodic installments due. Subsequently, total debt levels of the company decreased on a timeline basis by end-3QFY21. As a result of decline in total borrowings coupled with augmentation of equity base, gearing trended downwards during the rating period and was recorded lower at 0.99x (FY20: 1.85x; FY19: 1.20x) at end-3QFY21. Further, debt leverage was maintained at FY19's level as the decline in borrowings was offset by higher trade payables during 3QFY21; however, the same still remains within the benchmark criteria for the assigned rating.

Going forward, the management plans to add dyeing unit for expansion of its processing capacity; for the same capacity extension AASML plans to keep debt to equity investment at 50:50, therefore total debt procurement is estimated at Rs. 150.0m. The financial close for the project is to be achieved by end-Dec'21. In addition, the company has also planned capacity expansion in view of set up of another spinning unit with total of 50,000 spindles; total capex requirement estimated for the project is around Rs. 5.0b with equity contribution to be capped at Rs. 1.5b. The remaining funds amounting to Rs. 3.5b will be arranged through commercial borrowings; the timeline for setup of the spinning unit is contingent upon completion of dying unit and sale of investment property. Given the expansion plans in perspective, the leverage indicators are projected to increase in the medium to long-term.

A.A. Spinning Mills Limited Appendix I

BALANCE SHEET (Millions)	June 30, 2018	June 30, 2019	June 30, 2020	March 31, 2021
Non-Current Assets	1,961.8	1,939.4	1,869.7	1,806.8
Stock-in-Trade	931.4	1,190.9	1,898.3	1,382.3
Trade Debts	302.6	524.8	513.7	592.3
Cash & Bank Balances	110.9	71.2	15.4	47.5
Investment Property	124.4	124.4	124.4	124.4
Advances, Deposit & Prepayments	131.6	151.3	116.0	180.9
Total Assets	3,921.9	4,431.7	4,788.2	4,743.9
Trade and Other Payables	162.2	221.0	185.3	528.7
Short Term Borrowings	1,767.0	2,050.6	2,778.2	1,831.0
Long Term Borrowings	171.7	125.4	84.7	90.8
Total Debt	1,938.7	2,176.0	2,862.9	1,921.7
Total Liabilities	2,267.1	2,622.8	3,240.4	2,800.9
Paid Up Capital	1,700	1,700	1,700	1,700
Tier 1 Equity/Total Equity	1,654.8	1,808.9	1,547.8	1,943.0
INCOME STATEMENT	June 30, 2018	June 30, 2019	June 30, 2020	March 31, 2021
Net Sales	4,546.0	5,741.5	4,182.4	4,761.3
Gross Profit	434.1	632.6	309.5	728.8
Profit Before Tax	133.0	206.7	(200.7)	466.2
Profit After Tax	105.8	150.8	(263.9)	395.2
FFO	251.0	350.1	(122.8)	538.5
RATIO ANALYSIS	June 30, 2018	June 30, 2019	June 30, 2020	March 31, 2021
Gross Margin (%)	9.5	11.0	7.4	15.3
Current Ratio (x)	0.95	1.02	0.92	1.10
FFO to Total Debt (x)	0.13	0.16	(0.04)	0.37
FFO to Long Term Debt (x)	1.46	2.79	(1.45)	7.91
Debt Service Coverage Ratio (x)	1.50	2.10	0.59	4.34
ROAA (%)	2.8	3.6	(5.7)	11.0
ROAE (%)	6.6	8.7	(15.7)	30.1
Gearing (x)	1.17	1.20	1.85	0.99
Debt Leverage (x)	1.37	1.45	2.09	1.44
Stock+ Trade debts/ Short-term Borrowings (x)	0.70	0.84	0.87	1.08

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

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
02-07-2021	A-	A-2	Stable	Maintained
27-04-2020	A-	A-2	Rating Watch - Developing	Maintained
26-02-2020	A-	A-2	Stable	Reaffirmed
17-09-2018	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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2021 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mudassar Mukhtar	CFO	31-May-2021
2	Saad Khalid	Assistant Manager Finance	31-May-2021