

RATING REPORT

A.A. Spinning Mills Limited

REPORT DATE:

December 27, 2023

RATING ANALYST:

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RATING DETAILS

Rating Category	Latest Ratings		Previous Ratings	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Date	December 27, 2023		August 15, 2022	
Rating Action	Reaffirmed		Reaffirmed	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION

Incorporated in 2003	External auditors: RSM Avais Hyder Liaquat Nauman
Unquoted Public Limited Company	Chairman of the Board: Mr. Asim Yaseen
Key Shareholding (more than 5%)	Chief Executive Officer: Mr. Atif Yaseen
<i>Mr. Asim Yaseen – 47.06%</i>	
<i>Mr. Atif Yaseen – 47.06%</i>	
<i>Ms. Samina Yaseen – 5.88%</i>	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Corporates:

<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>

A.A. Spinning Mills Limited

OVERVIEW OF
THE
INSTITUTION

RATING RATIONALE

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 Fibres Limited and MCB Bank Limited.

Company Profile

AA spinning Mills Limited ('AASML or 'the Company') was incorporated in 2003 and commenced its commercial operations in 2006. The principal business of the Company is manufacture and sale of yarn from cotton and / or man-made fiber. The Company has installed 50,544 spindles which have a capacity to produce ~17.6 mln kgs of 20/s count of yarn. The registered office of the Company is located at 1-A, Ahmad Block, New Garden Town Lahore, in the province of Punjab. The unit is located at 20th K.M, Sheikhpura Road, Khurrarinawala, Faisalabad, in the province of Punjab.

Key Rating Drivers

Business risk profile: Sensitivity to cyclical, and high competition in the sector a constraint on ratings

The business risk profile of the spinning sector in Pakistan is characterized by a high level of exposure to economic cyclical and intense competition. This sector's performance is significantly influenced by the broader economic conditions in the country, making it inherently vulnerable to fluctuations in demand driven by economic factors.

In FY23, the spinning sector faced challenges due to various economic and environmental factors. These included damage to the cotton crop resulting from flooding in 1HFY23, escalating inflation, and diminishing foreign exchange reserves.

The spinning sector in Pakistan comprises ~407 spinning mills, which include both composite units and spinning units. This industry exhibits a competitive market structure with a large number of players producing a relatively homogenous product.

During FY23, Pakistan's yarn production registered a substantial decline, primarily due to reduced availability of cotton, as a result of crop damage and import restrictions. The sector's profitability was constrained by factors such as higher production costs, increased raw material costs, and rising energy expenses, all of which constrained the sector's profit margin. The industry's performance is closely intertwined with the outlook of the cotton and textile industries, both of which were affected in FY23. Reduction in cotton supply, coupled with global economic slowdown and contractionary economic policies, led to a decrease in demand for textile products and, consequently, cotton yarn.

While the global outlook for cotton production is expected to rebound, local challenges persist. These challenges include high interest rates, increasing energy costs, and difficulties with obtaining letters of credit (LCs). These factors are likely to result in continued sluggish performance for the spinning sector in FY23-24. Additionally, the sector's vulnerability to global market dynamics and the domestic economic landscape further contribute to its high business risk profile.

Profitability: Dampened Demand and economic challenges weighed on financial performance in FY23. Improvement to be a key rating consideration going forward.

The profitability profile of AASML was impacted by macroeconomic challenges in FY23, leading to a decline in the Company's revenue. The topline reported a 26% decrease, primarily due to a slowdown in demand during the year. This decline in sales volumes, increased raw material costs and high inflationary pressure contributed to reduced gross and operating margins. Gross and operating margins were reported at 14.9% (FY22: 18.5%) and 10.7% (FY22: 14.8%), respectively during the period under review.

Furthermore, due to heightened finance costs the Company's bottom line faced further contraction. Resultantly, net margins of the Company dropped to 1.5% (FY22: 7.2%). Increased finance costs were a consequence of the Company's greater utilization of short-term debt in a high-interest-rate environment within the country.

Going forward, the Company's ability to recover its demand and enhance both its top-line and margins in line with its assigned ratings will be key rating considerations. The Company is expected to continue to face constraints with obtaining LCs that will constrict its ability to meet raw material requirements in the event demand outlook improves.

Capitalization: Higher short-term borrowing resulted in deterioration, however, remains adequate. Maintenance in line with assigned ratings will be important for future rating considerations.

During FY23, AASML experienced a marginal weakening in its capitalization profile, with gearing and leverage ratios increasing to 0.9x (FY22: 0.8x) and 1.3x (FY22: 1.2x), respectively. This was primarily attributable to the heightened drawdown of short-term debt, driven by increased working capital requirements. These elevated working capital needs were influenced by rising raw material costs, operational expenses, and a prolonged cash conversion cycle during FY23.

Management has planned to address these concerns by reducing existing inventory levels by limiting fresh stock acquisitions. As a result, management anticipates a reduced reliance on short-term debt across the rating horizon. Additionally, due to higher interest rates and the suspension of SBP's long-term financing facility (LTF), the Company has postponed its plans to expand its spinning capacity with 50,000 new spindles. Consequently, the capitalization benchmarks are not expected to face significant pressure from CAPEX going forward.

However, ratings will remain sensitive to the Company's ability to maintain its capitalization profile in line with assigned ratings.

Liquidity and Coverage: Despite deterioration, the Company continues to maintain an adequate liquidity and coverage profile in FY23.

AASML maintained an adequate liquidity position in FY23, with a current ratio of 1.4x (FY22: 1.4x). However, this liquidity is primarily a result of high levels of stock in trade and trade debt. Meanwhile, the Debt Service Coverage Ratio (DSCR) exhibited a notable decrease, falling to 1.4x (FY22: 4.8x). This reduction in DSCR was primarily attributable to the decline in the Company's top-line and profitability during the fiscal year, which impacted Funds from Operations (FFO).

Going forward, maintenance of these metrics commensurate with assigned ratings will be a key rating sensitivity.

A.A. Spinning Mills Limited
Appendix I

FINANCIAL SUMMARY				
	<i>(PKR Millions)</i>			
BALANCE SHEET	FY20	FY21	FY22	FY23*
Property, plant and equipment	1,796.1	1,676.2	1,822.0	1,887.8
Stock-in-trade	1,898.3	862.0	2,166.1	2,690.0
Trade debts	513.7	843.5	1,234.3	1,214.3
Cash & Bank Balances	15.4	172.9	103.4	92.0
Total Assets	4,788.2	4,418.4	6,147.9	6,691.1
Trade and Other Payables	185.3	441.9	405.7	511.7
Long-term Debt (incl. current portion)	84.7	97.5	207.3	304.7
Short-Term Borrowings	2,778.2	1,578.0	2,165.7	2,446.6
Total Debt	2,862.9	1,675.4	2,373.0	2,751.2
Total Liabilities	3,240.4	2,288.0	3,335.2	3,778.2
Paid up Capital	1,700.0	1,700.0	1,700.0	1,700.0
Equity (excl. Revaluation Surplus)	1,547.8	2,130.4	2,812.7	2,913.0
INCOME STATEMENT	FY20	FY21	FY22	FY23*
Net Sales	4,182.4	6,936.0	9,456.7	7,019.1
Gross Profit	309.5	1,144.7	1,754.2	1,045.4
Operating Profit	177.3	897.0	1,401.3	751.5
Finance Costs	381.1	215.1	318.7	567.4
Profit Before Tax	-200.7	704.5	1,090.3	194.3
Profit After Tax	-263.9	584.9	682.3	106.5
RATIO ANALYSIS	FY20	FY21	FY22	FY23*
Gross Margin (%)	7.4%	16.5%	18.5%	14.9%
Operating Margin (%)	4.2%	12.9%	14.8%	10.7%
Net Margin (%)	-6.3%	8.4%	7.2%	1.5%
Funds from Operation (FFO)	-122.8	653.0	1,222.7	253.9
FFO to Total Debt (%)	-4.3%	39.0%	51.5%	9.2%
FFO to Long Term Debt (%)	-145.0%	670.0%	589.8%	83.3%
Gearing (x)	1.8	0.8	0.8	0.9
Leverage (x)	2.1	1.1	1.2	1.3
Debt Servicing Coverage Ratio (x)	0.6	2.4	4.8	1.4
Current Ratio	0.9	1.1	1.4	1.4
(Stock in trade + trade debts) / STD (x)	0.9	1.1	1.6	1.6
Return on Average Assets (%)	-5.7%	12.7%	12.9%	1.7%
Return on Average Equity (%)	-15.7%	31.8%	27.6%	3.7%

* Management Accounts

REGULATORY DISCLOSURES				Appendix II	
Name of Rated Entity	A.A. Spinning Mills Limited				
Sector	Textile Industry				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	<u>RATING TYPE: ENTITY</u>				
	27-12-2023	A-	A-2	Stable	Reaffirmed
	15-08-2022	A-	A-2	Stable	Reaffirmed
	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.				
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Due Diligence Meeting Conducted	Name	Designation	Date		
	Mr. Mudassar Mukhtar	Chief Financial Officer	30-October-2023		
	Mr. Saad Khalid	Assistant Manager Finance			