RATING REPORT

Umar Spinning Mills (Pvt.) Limited (USMPL)

REPORT DATE:

March 16, 2020

RATING ANALYST:

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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	BBB+	A-2	BBB+	A-2
Rating Outlook	Stable		Stable	
Rating Date	March 16, 2020		February 13, 2019	
Rating Action	*Reaffirmed*		*Initial*	

COMPANY INFORMATION		
Incorporated on March 10, 1991		**External auditors:** Reanda Haroon Zakaria & Company
Private Limited Company		**Chief Executive Officer:** Mr. Pervaiz Umar
Key Shareholders (with stake 5% or more):		
Pervaiz Umar	60%	
Mohammad Faisal Pervaiz	25%	
Shaheena Pervaiz	15%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (April 2019)* *https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf*

Umar Spinning Mills (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Umar Spinning Mills Private Limited (USMPL) was incorporated in1991 and became operational in 2003. Financial Statements of the company for FY19 were audited by Reanda Haroon Zakaria & Company.

Profile of CEO

Mr. Pervaiz Umar has been associated with the company since 1991. He is also associated with one of the largest clearing, forwarding and customs advisory house since 1968.

RATING RATIONALE

Umar Spinning Mills Private Limited (USMPL) is a part of Pervaiz Group of Companies which has presence in textile and clearing & forwarding business. USMPL is primarily engaged in the manufacturing and sale of various types of yarn ranging from coarse to fine counts to both local and international markets. Head office of the company is based in Karachi, while a representation office is based in Lahore.

Production

Production factory of USMPL is based in Raiwand, Lahore. No change was observed in the installed capacity as the company operated with 43,776 (FY18: 43,776) at end-FY19. Capacity details are as follows:

Figure 1: Capacity details

	FY18	FY19
Number of spindles installed	43,776	43,776
Number of spindles worked	43,776	43,776
Number of working days	364	364
Number of shifts per day	3	3
Installed capacity of yarn (Lbs.)	20,816,137	20,816,137
Actual production of yarn (Lbs.)	20,541,522	18,720,502
Capacity utilization	98.7%	89.9%

As per management, the overall production was lower in FY19 vis-à-vis the preceding year due to greater proportion of higher count yarn in overall mix. Going forward, overall installed capacity is expected to remain at similar level; however, actual production may witness an increase due to BMR activities that the management plans to undertake.

Rating Drivers

High cyclicality, volatility in cotton prices and competitive intensity in the spinning industry translate to moderate to high business risk profile

Non-value added textile exports of Pakistan contracted by 20.6%/19.9% in terms of volume and value during FY19. Global demand of Pakistani yarn has experienced downward pressure, owing to reduced export orders from China in light of the prevailing US-China trade tensions. On the flip side, volume led growth in value added exports enhanced local consumption for yarn resulting in limited export surplus for the same.

Figure 2: Pakistan non value added exports (Source: PBS)

	FY18			FY19		
(Mn Tons, USD Mn)	Volume	Value	USD/Unit	Volume	Value	USD/Unit
Raw Cotton	35	58	1.66	12	20	1.67
Yarn	518	1,371	2.65	427	1,125	2.63

Figure 3: Cultivated Area (Source: USDA)

Area Under Cultivation (Mn Hectres)	FY18	FY19	% Change
World	33.7	33.5	-0.6%
Pakistan	2.7	2.3	-14.8%
Production (Mn 480lb Bales)			

Cost pressures for the industry are reflective of the global and local cotton production data which shows scaled down cultivation area and production. Reduction in cotton production coupled with an increase in demand from the local value added sector has resulted in an upward trend in the local cotton prices in FY19 and the ongoing year. International cotton prices have trended downwards during the same period despite decrease in production area due to weaker demand from China, which is a major consumer in the world.

Margins and financial performance of players in the spinning segment in Pakistan have depicted volatility due to inherent cyclicality of crop levels and oscillations in cotton prices. VIS expects prices to sustain increasing trend due to decline in cotton production. Waiver of all duties and taxes on imported cotton is expected to provide relief to the market players in the short term. Inherent cyclicality of cotton price and crop levels will continue to drive the performance of players operating in the spinning sector. Historically, margins and financial performance of players have depicted seasonality and the same trend is expected going forward. Comfort is drawn from USMPL's product diversity and presence across a wide count range. Nevertheless, business risk is considered to be on the higher side.

Topline has witnessed adequate growth on account of rupee devaluation

Net sales of the company increased by 13.7% to Rs. 4.0b (FY18: Rs. 3.5b) in FY19. Growth in sales was a function of higher average selling prices due to rupee devaluation and higher demand. Sales mix also witnessed change as proportion of direct exports decreased to 32.7% (FY18: 41.3%) in overall net sales. Management gave preference to local markets as average prices were higher vis-à-vis export markets. As per management, average prices are lower in export markets due to higher competition. Client wise concentration continues to remain on the higher side as top 10 clients constituted 67.4% (FY18: 64.1%) of total net sales. However, client concentration is partly mitigated due to long term association with clients. Country wise export sales mix was also altered as preference was given to European markets over China due to higher profit margins; however, Korea continues to remain the largest export market for the company.

Net sales in HY20 amounted to Rs. 2.3b, with top 10 clients accounting for 60.8% of total sales. Management expects growth momentum in sales to continue going forward due to increase in demand, especially from the local value added sector. Government's export oriented initiatives and ban on imports from India will be the major demand drivers. Management also plans to increase its quantum of export sales to European markets.

Growth in topline translated to improvement in gross profitability and gross margins; however, bottom line and net margins decreased due to higher finance costs and tax expense

Increase in average selling prices on the back of higher demand and rupee devaluation along with efficient procurement of raw materials contributed to higher gross margins in FY19 (FY19: 8.6%; FY18: 7.5%). However, overall profitability and net margins were reported lower due to considerable increase finance costs and taxation expense. Higher average interest rates and expiration of tax credits resulted in higher finance costs and taxes, respectively.

Subsequently, gross margins decreased to 8.1% in HY20 due to absence of rupee devaluation impact. Net margins and net profit were reported at 2.9% and Rs. 65m, respectively. Going forward, management expects gross margins to sustain at similar level in view of existing demand. Overall profitability is expected to remain a function of average selling prices and cotton prices.

Capitalization indicators have depicted improvement during FY19

Equity base of the company increased to Rs. 1.9b (FY18: Rs. 1.8b) on account of profit retention. Quantum of total debt decreased to Rs. 1.5b (FY18: Rs. 1.7b) at end-FY19. Resultantly, leverage ratios have improved during the same period. Gearing and leverage ratios were reported at 0.82x (FY18: 0.97x) and 1.07x (FY18: 1.18x), respectively. Management plans to undertake additional debt to fund BMR plans. Hence, leverage indicators are expected to increase slightly but will remain at manageable level over the ratings horizon.

Liquidity profile is considered satisfactory

Overall liquidity profile of the company draws support from growing cash flows, and sound debt coverage metrics. With improvement in profitability, cash flows also increased during FY19. FFO in relation to long term and total debt increased to 49.2% (FY18: 43.2%) and 20.7% (FY18: 15.5%), respectively. Current ratio was reported at 1.7x (FY18: 1.5x). Inventory and trade debt provide significant coverage for short term borrowings.

Corporate Governance framework depicts room for improvement

As the company is a family owned entity, Board comprises three family members including the CEO. Overall board composition and oversight has room for improvement through inclusion of independent directors. Furthermore, committees pertaining to audit and HR functions may also be established at Board level in line with best practices.

Financial Summary (amounts in PKR millions)			Appendix I
BALANCE SHEET	**FY17**	**FY18**	**FY19**
Fixed Assets	1,603.4	1,582.7	1,540.4
Stock-in-Trade	954.9	1,018.6	1,372.7
Trade Debts	193.0	362.8	361.1
Cash & Bank Balances	26.3	35.6	55.2
Refunds Due from Government	189.7	167.9	165.8
Total Assets	3,210.0	3,875.5	3,904.3
Trade and Other Payables	229.0	321.2	379.3
Long Term Debt (including current maturity)	594.4	614.8	652.7
Short Term Debt	680.9	1,102.6	897.0
Total Debt	1,275.4	1,717.4	1,549.7
Total Liabilities	1,557.3	2,097.3	2,017.9
Paid Up Capital	290.0	290.0	290.0
Total Equity (without surplus revaluation)	1,652.7	1,778.3	1,886.4
INCOME STATEMENT	**FY17**	**FY18**	**FY19**
Net Sales	2,575.7	3,548.3	4,035.1
Gross Profit	166.0	267.3	348.7
Profit Before Tax	42.8	76.3	118.1
Profit After Tax	39.9	80.2	70.2
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**
Gross Margin (%)	6.4%	7.5%	8.6%
Net Profit Margin	1.5%	2.3%	1.7%
FFO	180.8	265.7	321.0
FFO to Total Debt (%)	14.2%	15.5%	20.7%
FFO to Long Term Debt (%)	30.4%	43.2%	49.2%
Debt Servicing Coverage Ratio (x)	3.4	3.2	3.0
ROAA (%)	1.5%	2.3%	1.8%
ROAE (%)	2.4%	4.7%	3.8%
Gearing (x)	0.77	0.97	0.82
Leverage (x)	0.94	1.18	1.07
Current Ratio (x)	1.7	1.5	1.7
(Stock in trade + Trade Debts) / Short Term Borrowings (%)	168.6%	125.3%	193.3%

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	Umar Spinning Mills (Pvt.) Limited
Sector	Textiles
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
16/3/2020	BBB+	A-2	Stable	Reaffirmed
13/2/2019	BBB+	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.
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Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Mohammad Faisal Pervaiz	MD	February 20, 2020
2	Mr. Ayaz Ali	CFO	February 20, 2020