# RATING REPORT

# Umar Spinning Mills (Pvt.) Limited (USMPL)

**REPORT DATE:**

May 27, 2021

**RATING ANALYST:**

Asfia Aziz
asfia.aziz@vis.com.pk

Sundus Qureshi
sundus.qureshi@vis.com.pk

| 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 | | Rating Watch Negative | |
| **Rating Date** | May 27, 2021 | | April 29, 2020 | |
| **Rating Action** | *Maintained* | | *Maintained* | |

| COMPANY INFORMATION | | |
|---|---|---|
| **Incorporated on March 10, 1991** | | **External auditors:** M/s. 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 | RATING RATIONALE |
|---|---|

Umar Spinning Mills Private Limited (USMPL) was incorporated in1991 and became operational in 2003. Financial Statements of the company for FY20 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.

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 spindles at end-9MFY21. Capacity details are as follows:

**Figure 1: Capacity details**

| | FY19 | FY20 | 9MFY21 |
|---|---|---|---|
| **Number of spindles installed** | 43,776 | 43,776 | 43,776 |
| **Number of spindles worked** | 43,776 | 43,776 | 43,776 |
| **Number of working days** | 364 | 364 | 364 |
| **Number of shifts per day** | 3 | 3 | 3 |
| **Installed capacity of yarn (Kgs.)** | 9,442,138 | 9,442,138 | 7,081,603 |
| **Actual production of yarn (Kgs.)** | 8,491,564 | 8,443,700 | 6,272,805 |
| **Capacity utilization** | 89.9% | 89.4% | 88.5% |

As per management, the overall production was lower during FY20 vis-à-vis the preceding year due to shutdown of production amidst the first wave of Covid-19 and greater proportion of higher count yarn in overall mix. Going forward, overall installed capacity is expected to increase due to BMR activities planned over the next two years. Moreover, management also plans to set up a solar plant in order to achieve energy efficiencies. Total cost of the expansion plans is estimated at Rs. 1.7b (including duties and taxes), 85% of which shall be financed through long term debt (interest rate of 5%), with the remaining projected to be funded through internal cash generation along with additional equity injection by sponsors to the tune of Rs. 50m. *Following are the details pertaining to the expansion plans of the company:*

1. ***Auto Coro Spinning Project***

*Total 1512 Rotors are going to be installed that can produce 350 bags (100 LBS Each) of open ended yarn counts of 10/s and 20/s per day. Average selling price are taken into consideration Rs.180 per Lbs. and Raw Cotton Rs.281/Lbs. with Noil Rs.160/- (internally generated from our existing Spinning plant).*

2. ***Organic Rankin Cycle (ORC) Project***

*ORC project that converts Power Generation units emissions that is engine's waste heat into usable electrical energy units, initially the company shall install one unit with Power House engines. As a result of the same, energy savings will improve margins of the company. Each unit is expected to contribute annually free of cost 564,710 KWh of energy approximately, as per management.*

***3. Solar Energy (663.6 KW)***

*The company plans to install its Solar Energy project in consultation with most renowned company Orient Energy Systems (Pvt.) Ltd. They will install within three to four months Solar Project at out mill site Raiwind and this system is expected to contribute 956,800KWh annually for self-consumption and thereby generate energy savings.*

**Rating Drivers**

**Recovery in industry wide exports post ease in COVID-19 lockdown measures support business risk profile of the company.**

With the objective of enhancing exports to support the economy, the Government of Pakistan (GoP), has provided incentives in the form of subsidized utility tariffs, low interest rates (EFS, LTFF and TERF) and sales tax refund to the textile industry. The textile policy 2020-25 has laid emphasis on fixed electricity and gas tariff for the next 5 years till 2025 at US cents 7.5 per KWh and USD 6.5 per MMBTU, respectively. Moreover, the limits of subsidized (LTFF) financing have been enhanced under this policy to facilitate exporters. Shutdown of textile production amongst various countries due to COVID-19 led to surge in Pakistan based orders in FY20. Initiatives are also being undertaken in order to increase production and yield of cotton. However, the imposed sales tax has negatively impacted the textile industry. Even though impact of COVID-19's third wave remains elevated, we expect the order book for the industry to remain adequate in the ongoing year, easing our business risk concerns.

**Topline of the company reported a meager increase of 1% during FY20 led by subdued economic environment amidst COVID-19. However sales revenue witnessed an uptick in 9MFY21 led by higher selling prices, rupee devaluation and higher demand for organic yarn.**

Topline of the company increased to Rs. 4.1b (FY19: Rs. 4.0b) in FY20 being a function of higher average selling prices. In terms of sales mix, management gave preference to local markets as average prices were higher vis-à-vis export markets with proportion of local sales in total revenue base increasing to 37.5% (FY19: 33.75%) during FY20.

Client wise concentration has slightly decreased but continues to remain on the higher side as top 10 clients constituted 62% (FY19: 67.4%) of total net sales in FY20. 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 yielding higher profit margins; however, Korea continues to remain the largest export market for the company. USMPL plans to add Taiwan and Portugal in its export market clientele, going forward.

Net sales in 9MFY21 amounted Rs. 3.4b. Management expects growth momentum in sales to continue going forward through projected increase in demand, especially from the local value added sector along with higher revenue emanating from the expansion plan.

**Overall profitability profile of the company was impacted by higher cotton prices led by currency devaluation on imported cotton, higher utilities & freight cost and exchange losses on FE loans during FY20. During 9MFY21, gross margins of the company improved on account of higher sales and inventory gains. Going forward, management envisages gross margins to improve on account of competitive advantage of higher quality yarn, greater sales revenue backed by expansion along with energy savings expected to realize from the solar plant.**

Gross margins of the company declined to 7.6% (FY19: 8.6%) during FY20 largely on the back of higher cotton prices led by currency devaluation on imported cotton and higher utilities charges. Overall operating expenses increased primarily due to higher other charges comprising of an exchange loss of Rs. 79m on FE loans in FY20 along with uptick noticed in freight costs. Finance charges were reported lower at Rs. 77.9m (FY19: Rs. 95.8m) in FY20 on account of reduced markup on short term borrowings. Given reducing margins and inclining expenses, the company reported net margins of -0.1% (FY19: 1.7%) during the outgoing year.

During 9MFY21, gross and net margins of the company improved to 8.2% and 3.6%, respectively on the back of higher sales and inventory gains. Going forward, management envisages gross margins to improve on account of competitive advantage of higher quality yarn, greater sales revenue backed by expansion along with energy savings expected to realize from the solar plant.

**Liquidity indicators weakened in FY20 due to subdued profitability; however the same improved in 9MFY21 and are expected to remain in line with projected increase in overall profitability, going forward.**

In absolute terms, Funds from Operations (FFO) decreased to Rs. 202.1m (FY19: Rs. 316.9m) on account of lower overall profitability during FY20. However, in line with improvement in profitability during 9MFY21, Debt Service Coverage Ratio (DSCR), FFO/Long-Term Debt, and FFO/ Total Debt were reported higher at 2.6x (FY20: 1.4x, FY19: 2.8x), 35% (FY20: 24%, FY19: 49%), and 18% (FY20: 10%, FY19: 20%) at end-Mar'21, respectively. Inventory and trade debts provide strong coverage for short-term debt obligations while current ratio was reported at 1.9x at end-Mar'21. Improvement in extended working capital cycle and receivable days going forward is considered important. Ratings are underpinned on maintenance of projected cash flow coverages going forward.

**Capitalization indicators have depicted an increase during FY20 to finance working capital needs, import of plant & machinery and SBP facility for payment of salaries and wages. Going forward, leverage indicators are expected to increase on account of expansion plans but are projected to remain within manageable level over the ratings horizon.**

Equity base of the company increased to Rs. 1.97b (FY20: Rs. 1.87b FY19: Rs. 1.89b) on account of profit retention at end-9MFY21. Quantum of total debt increased to Rs. 2.1b (FY20: Rs. 1.9b; FY19: Rs. 1.6b) at end-9MFY21 to finance working capital requirements, import of plant & machinery and SBP facility for payment of salaries and wages. Resultantly, leverage ratios have inclined during the same period. Gearing and leverage ratios were reported at 1.06x (FY20: 1.06x; FY19: 0.82x) and 1.40x (FY20: 1.35x; FY19: 1.07x), respectively at end-Mar'21. Management plans to drawdown additional long term debt to fund expansion plans encompassing Auto Cora spinning mill and solar plant project. Hence, leverage indicators are expected to increase, going forward on account of expansion plans but are projected remain within manageable level over the ratings horizon.

**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** | **FY18** | **FY19** | **FY20** | **9M21** |
| Fixed Assets | 1,496.9 | 1,442.4 | 1,517.5 | 1,580.2 |
| Stock-in-Trade | 1,018.6 | 1,372.7 | 1,886.6 | 1,791.9 |
| Trade Debts | 362.8 | 361.1 | 543.5 | 639.0 |
| Cash & Bank Balances | 35.6 | 55.2 | 108.5 | 467.6 |
| Refunds Due from Government | 167.9 | 165.8 | 162.6 | 25.5 |
| Total Assets | 3,875.5 | 3,904.3 | 4,409.0 | 4,715.7 |
| Trade and Other Payables | 321.2 | 379.3 | 480.4 | 570.2 |
| Long Term Debt (including current maturity) | 614.8 | 652.7 | 837.0 | 1,078.8 |
| Short Term Debt | 1,102.6 | 897.0 | 1,146.5 | 1,013.9 |
| Total Debt | 1,717.4 | 1,549.7 | 1,983.4 | 2,092.7 |
| Total Liabilities | 2,097.3 | 2,017.9 | 2,536.5 | 2,747.0 |
| Paid Up Capital | 290.0 | 290.0 | 290.0 | 290.0 |
| Total Equity (without surplus revaluation) | 1,778.3 | 1,886.4 | 1,872.5 | 1,968.7 |
| | | | | |
| **INCOME STATEMENT** | **FY18** | **FY19** | **FY20** | **9M21** |
| Net Sales | 3,548.3 | 4,035.1 | 4,077.1 | 3,402.2 |
| Gross Profit | 267.3 | 348.7 | 309.6 | 278.8 |
| Profit Before Tax | 76.3 | 118.1 | 25.2 | 123.3 |
| Profit After Tax | 80.2 | 70.2 | (5.9) | 123.3 |
| | | | | |
| **RATIO ANALYSIS** | **FY18** | **FY19** | **FY20** | **9M21** |
| Gross Margin (%) | 7.5% | 8.6% | 7.6% | 8.2% |
| Net Profit Margin | 2.3% | 1.7% | -0.1% | 3.6% |
| FFO | 265.7 | 316.9 | 202.1 | 282.2 |
| FFO to Total Debt (%) | 15.5% | 20.4% | 10.2% | 18.0% |
| FFO to Long Term Debt (%) | 43.2% | 48.5% | 24.1% | 34.9% |
| Debt Servicing Coverage Ratio (x) | 3.2 | 2.8 | 1.4 | 2.6 |
| ROAA (%) | 5.2% | 4.8% | -0.4% | N/a |
| ROAE (%) | 4.7% | 3.8% | -0.3% | N/a |
| Gearing (x) | 0.97 | 0.82 | 1.06 | 1.06 |
| Leverage (x) | 1.18 | 1.07 | 1.35 | 1.40 |
| Current Ratio (x) | 1.5 | 1.7 | 1.6 | 1.9 |
| (Stock in trade + Trade Debts) / Short Term Borrowings (%) | 125.3% | 193.3% | 212.0% | 239.8% |

## 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** | | | | |
| 27/5/2021 | BBB+ | A-2 | Stable | Maintained |
| 29/4/2020 | BBB+ | A-2 | Rating Watch-Negative | Maintained |
| 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. |
| **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. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile. 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** | Mr. Mohammad Faisal Pervaiz | MD | May 05, 2021 |
| **2** | Mr. Ayaz Ali | CFO | May 05, 2021 |
| **3** | Mr. Fazal Abbas | GM | May 05, 2021 |