RATING REPORT

Umar Spinning Mills (Pvt.) Limited

REPORT DATE:
July 6, 2022

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	Positive		Stable	
Rating Date	*July 6, 2022*		*May 27, 2021*	
Rating Action	Maintained		Maintained	

COMPANY INFORMATION	
Incorporated in 1991	**External Auditors:** Reanda Haroon Zakaria & Co. Chartered Accountants
Private Limited Company	**Chief Executive Officer:** Mr. Pervaiz Umar
Key Shareholding (more than 5%)	
Pervaiz Umar ~60%	
Mohammad Faisal Pervaiz ~25%	
Shaheena Pervaiz ~15%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Umer Spinning Mills (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Umar Spinning Mills Private Limited (USMPL) was incorporated in1991 and became operational in 2003.

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

Corporate profile
Headquartered in Karachi, Umar Spinning Mills Private Limited (USMPL) is part of Pervaiz Group of Companies, which has presence in textile and clearing & forwarding business. With more than three-decade operating history, the Company has been engaged in manufacturing and sale of various types of yarn ranging from coarse to fine counts, serving both domestic and international markets. The sponsoring family is actively involved in business affairs and a qualified senior management team with extensive experience is in place. Total staff strength including labor workforce currently stands at 800+ employees. The company has installed a pink salt plant in Karachi, which will start production from July'22.

Production capabilities
Manufacturing facility is located in Raiwand, Lahore. The installed capacity remains unchanged at 43,776 spindles, which can produce up to 9.4m Kgs of yarn per annum. The drop in utilization during FY20 was due to closure of operations as result of pandemic. However, the same has largely remained stable over the years. Power requirement of 5.5MWh is met through a mix of two sources; national grid and gas-based generators. In order to achieve self-sufficiency and energy savings, management has recently deployed a 660 KWh solar power system, while further addition of 1.2MWh is currently underway.

Figure: Capacity & Production Data

	FY19	FY20	FY21	6M'FY22
Installed capacity of yarn (Kgs.)	9.4m	9.4m	9.4m	4.7m
Actual production of yarn (Kgs.)	8.5m	8.4m	8.6m	4.3m
Capacity Utilization	***90%***	***89%***	***91%***	***92%***

Establishment of open-end spinning unit is currently underway
With regards to capacity enhancement initiatives, an auto core-spinning project (open-end plant) is in the pipeline, which includes installation of 1,512 rotor spinning machines. Total estimated cost of the project is Rs. 1.8b; of which ~80% pertains to machinery which will be funded by LTFF while the remaining for construction of building is being financed through own sources. The production is scheduled to begin in Sept'22. As per management, this project is expected to result in ~30% increase in annual sales.

Key Rating Drivers

Textile and clothing exports registered a sizeable growth given the surge in demand on account of rerouting of orders to Pakistan. The ongoing energy crisis in the country poses a challenge to future growth of the sector.
Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of Rs. 3.8tr (FY20: Rs. 3.3tr) in FY21. Barring seasonal and cyclical fluctuations, textiles products have maintained an average share of about 60% in national exports. Export revenues from textile sector (in dollar terms) have increased on a timeline basis (FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). The strong growth trend is continued in the ongoing year with exports up by 29% (vis-à-vis SPLY) to $17.6b in July-May'22. Knitwear, Readymade and Bed wear segments continued to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While

primarily a volumetric driven growth, the exports also received a boost from higher prices (excluding Knitwear).

Figure: Textile Exports (as per PBS)

Segments	Value (US$ millions)		
	FY20	FY21	11M'FY22
Knitwear products	2,785	3,816	4,646
Readymade Garments	2,549	3,033	3,536
Bed wear	2,149	2,772	3,009
Cotton Cloth	1,830	1,921	2,237
Cotton Yarn	987	1,017	1,113
Towels	711	938	1,020
Made-up Articles	591	756	780
Art, silk and synthetic textile	314	370	422
Tents, canvas and tarpaulin	98	110	99
Others	487	667	738

Given rising inflation, the commodities super-cycle and monetary tightening in major global economies, export orders growth is expected to slow down in the medium-term. This, in addition to ongoing energy crisis in the country and increasing cost of production poses a challenge to future growth of the sector.

5-Year (2020-25) textile policy continues to support the industry.
With an aim to double textile exports in five years, GoP through a five-year textile policy (2020-25) has provided incentives in form of preferential energy rates, low interest rates financing schemes (such as EFS, LTFF and TERF) and timely payments of DLTL, Income tax & Sales tax refund which support liquidity constraints of local players. Initiatives have also been undertaken to increase production and yield of cotton to support the industry. However, imposition of 10% super tax would have a negative effect on profitability profile of textile players. In addition, tightening monetary policy environment and political uncertainties are the key present business risk factors. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future of textile exports.

High cyclicality and competitiveness in the spinning sector translate into high business risk profile.
Movement in cotton prices and cotton crop levels drives performance of spinning players in Pakistan. Given sizeable deficit in local cotton production vis-à-vis demand in the recent years, cotton prices have remained elevated due to which inventory loss risk is considered limited. Business risk is supported by favorable government policies and healthy demand outlook.

Higher selling prices coupled with rupee devaluation has led to a strong growth in topline during the period under review.
Topline of the company has registered a 5-Year CAGR of ~14% for the period (FY17-21), and amounted to Rs. 4.9b (FY20: Rs. 4.1b) in FY21. The year-on-year uptick of ~22% was mainly attributable to higher selling prices coupled with rupee devaluation. Owing to same, growth momentum continued in the ongoing fiscal year, with revenues amounting to Rs. 6.8b during 10M'FY22.

Overall sales comprise a mix of local and export sales (direct & indirect). Korea and Italy are the top two destinations for direct exports, followed by Japan, Taiwan, Malaysia and others. Client-wise sale concentration risk is high, with top 10 clients accounting for more than half of total sales on a timeline basis. However, comfort is drawn from long-standing business relationships with major clients that ensures repeat business.

Profitability margins have depicted a strong growth trend. Ratings are underpinned by sustainability of net margins, going forward.
Gross margins have depicted a strong growth trend on a timeline basis (6M'FY22: 25.6%; FY21: 12.7%; FY20: 7.6%) on the back of better absorption of per unit fixed cost, efficient cotton procurement and inventory gains. The significant increase in margins over the review period pertains to favorable cotton price differential, which is consistent with the industry trend. In value terms, more than three-fifth of raw material (cotton) is procured from international market. On the cost front, financial charges remains limited given that entire debt is mobilized on concessionary rates while administrative overheads increased largely in line with inflation. Given the sizeable growth in revenues and margins, bottom-line turned positive in FY21 and has depicted further improvement in the ongoing year. Sustainability of the same is considered important from a rating perspective.

Liquidity metrics have noted improvement in line with growing profitability.
In absolute terms, Funds from Operations (FFO) increased to Rs. 723.1m (FY21: Rs. 700.9m; FY20: Rs. 202.1m) at end-6M'FY22. As a result, FFO to total debt and FFO to long-term debt also increased considerably to 0.79x (FY21: 0.40x; FY20: 0.10x) and 1.45x (FY21: 0.69x; FY20: 0.24x), respectively. Healthy cash flow generation has positively impacted the debt coverage metrics as reflected by strong growth in DSCR to 5.68x (FY21: 5.56x; FY20: 1.42x). Current ratio is above 2.0x, and the coverage of short-term borrowings in relation to stock in trade and trade debts is more than sufficient.

Capital structure supported by profit retention and improving leverage ratios.
Equity base (including loan from directors) grew by ~54% over the period of last 18 months on account of increasing profitability and no dividend payout. Debt profile comprises a mix of short-term and long-term debt with total interest bearing liabilities amounting to Rs. 1.8b at end-6M'FY22; short-term debt (ERF) constituted ~46% of total debt as mobilized to fund inventory levels. Given healthy growth in equity base, leverage ratios have improved considerably over the review period. The same are expected to depict increase given additional debt drawdown planned for financing capex over the rating horizon, albeit remaining within comfortable levels on account of projected profitability.

Umar Spinning Mills (Pvt.) Limited — Appendix I

FINANCIAL SUMMARY			*(amounts in PKR millions)*		
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**6M'FY22**
Non-Current Assets	1,497	1,442	1,517	1,483	1,363
Stores, Spares. And Loose Tools	51	47	75	78	69
Stock-in-Trade	1,019	1,373	1,887	1,795	1,947
Trade Debts	363	361	544	771	919
Advances, Deposits and Other Receivables	654	351	17	141	988
Cash and Bank Balance	36	55	109	190	465
Total Assets	**3,876**	**3,904**	**4,409**	**4,562**	**6,013**
Trade and Other Payables	321	379	480	479	1,177
Long-Term Borrowings *(Inc. current maturity)*	615	653	841	1,009	997
Short-Term Borrowings	1,103	897	1,146	755	841
Total Liabilities	**2,097**	**2,018**	**2,536**	**2,309**	**3,132**
Paid-up Capital	290	290	290	290	290
Total Equity *(Inc. loan from directors)*	**1,778**	**1,886**	**1,872**	**2,253**	**2,881**
INCOME STATEMENT					
Net Sales	3,548	4,035	4,077	4,955	3,487
Gross Profit	267	349	310	630	891
Operating Profit	136	218	171	474	779
Profit Before Tax	76	118	25	371	699
Profit After Tax	80	70	(6)	367	628
RATIO ANALYSIS					
Gross Margin (%)	7.5%	8.6%	7.6%	12.7%	25.6%
Net Margin (%)	2.3%	1.7%	-0.1%	7.4%	18.0%
Net Working Capital	807	949	1,092	1,540	2,453
Current Ratio	1.54	1.67	1.64	2.07	2.12
FFO to Long-Term Debt	0.43	0.49	0.24	0.69	1.45
FFO to Total Debt	0.15	0.20	0.10	0.40	0.79
DSCR (x)	3.18	2.96	1.42	5.56	5.68
Gearing (x)	0.97	0.82	1.06	0.78	0.64
Debt Leverage (x)	1.18	1.07	1.35	1.02	1.09
Inventory + Receivable/Short-term Borrowings (x)	125%	193%	212%	340%	341%

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	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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
6/7/2022	BBB+	A-2	Positive	Maintained
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

Due Diligence Meeting Conducted

Name	Designation	Date
Faraz Ameer	CFO	June 1, 2022
Muhammad Faisal Pervaiz	Managing Director	June 1, 2022