RATING REPORT

Umar Spinning Mills (Private) Limited

REPORT DATE:
March 13, 2023

RATING ANALYSTS:
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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		Positive	
Rating Action	Maintained		Maintained	
Rating Date	*Mar 13, 2023*		*July 06, 2022*	

COMPANY INFORMATION

Incorporated in 1991	**External auditors:** Reanda Haroon Zakaria & Co. Chartered Accountants
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 (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Umar 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 over three-decade operating history, USMPL 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 highly qualified senior management team with extensive experience is in place. Total staff strength including labor workforce currently stands at 800+ employees. Since last review, there has been no change in shareholding pattern and board of directors.

Average energy requirement of 7.5 MW is met through a mix of three-sources, with majority (~59%) being supplied by gas generators, followed by 36% from LESCO gridline, and remaining 5% from solar plant. The company recently installed a pink salt plant in Karachi, but commencement of operations delayed due to vendor issues. As per management, new expected production timeline is April'23 onwards. In addition, the organization has upgraded its Oracle ERP version.

New open-end spinning unit has been set up within the same premises
The capacity expansion project, which began last year with the construction of a new building on the same premises, is now complete. The newly installed machinery, comprising 1,512 Autocoro spindles, has been operational since Jan'23 and can produce 350 bags per day of open-ended yarn. Total project cost stood at Rs. 1.85b, with ~86% being used for machinery and funded by LTFF while the remainder financed through own sources for the building construction.

Operational Performance
Manufacturing facility is located in Raiwand, Lahore. The installed capacity (43,776 ring spindles) has remained unchanged while utilization levels have shown an increasing trend over the years, with slight drop in the same during the current year due to recent reduction in market demand. Management anticipates that the annual production capacity will increase to 14.3m kgs following the recent capacity enhancement and addition of Autocoro spindles.

Figure: Capacity & Production Data

	FY20	FY21	FY22	6M'FY23
Number of spindles installed	43,776	43,776	43,776	43,776
Installed capacity of yarn (Kgs.)	9.4m	9.4m	9.4m	4.7m
Actual production of yarn (Kgs.)	8.4m	8.6m	8.6m	4.2m
Capacity Utilization	***89%***	***91%***	***92%***	***89%***

Key Rating Drivers

Business risk profile is supported by industry wide growth in exports over the last year; however, with recent floods adversely affecting cotton crop and ongoing energy crisis in the country pose a challenge to margins sustainability and future growth.
Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally broke the threshold, coming in at USD 32.4b.

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 around Rs. 4.0tr. In addition, textile sector has maintained an average share of about 60% in national exports.

Figure: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22		7M'FY22	7M'FY23
Pakistan Total Exports	22,536	25,639	32,450		17,285	16,882
Textile Exports	12,851	14,492	18,525		10,369	10,377
PKR/USD Average rate	158.0	160.0	177.5		170.0	224.7

Source: SBP

Export revenues from textile sector have noted sizeable growth over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports.

Figure: Textile Export Details (in USD millions)

	FY20	FY21	FY22		7M'FY22	7M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**		**8,853**	**8,326**
- Knitwear	2,794	3,815	5,121		2,888	2,803
- Readymade Garments	2,552	3,033	3,905		2,163	2,126
- Bed wear	2,151	2,772	3,293		1,924	1,639
- Towels	711	938	1,111		615	583
- Made-up Artides	591	756	849		491	435
- Art, Silk & Synthetic Textile	315	370	460		263	239
- Others	555	743	866		509	500
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**		**2,080**	**1,714**
- Cotton Cloth	1,830	1,921	2,438		1,352	1,225
- Cotton Yarn	984	1,017	1,207		688	449
- Others	43	34	72		41	39
Total	**12,527**	**15,399**	**19,332**		**10,933**	**10,040**

Source: PBS

Cotton prices rose to a new 12-year high of ~Rs. 21,600/maund as of March'22, as a result of the shortage and higher input costs of fertilizer and energy. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Figure: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22
Per Maund	8,770	8,860	13,000	16,236
YoY % Change	26%	1%	32%	34%

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than $2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dying companies.

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

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, contractionary monetary policy and political uncertainties in the country are the present major 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 projected recovery in demand.

Strong revenue growth driven by timeline increase in yarn prices and limited rupee devaluation impact, with future growth expected from recent capacity addition.
The company's overall sales mix comprises local and export sales (direct & indirect). In the past four fiscal years, net sales have more than doubled, reaching over Rs. 7b mark in FY22. The YoY increase of ~54% was driven by sizeable uptick in average sale price of yarn per bag and limited rupee devaluation impact (as direct yarn exports make up ~30% of sales) whereas volumetric off-take stood slightly lower than the previous year. Korea and Italy were the top two destinations for direct exports, followed by Bangladesh, Vietnam, China and Belgium. Client concentration remains high, with top ten clients consistently generating more than three-fifths of total sales on a timeline, led by Nishat Mills Limited and Kohinoor Mills Limited. However, comfort is drawn from long standing relationship with major clients.

Owing to a similar price growth trend, sales in 6M'FY23 were up by ~13% vis-à-vis SPLY, amounting to Rs. 3.9b despite ~17% decline in volumes due to reduced demand. Going forward, management expects volumes to recover in the subsequent quarters with recent capacity addition to derive future revenue growth.

Historic high bottom-line achieved by the company during FY22 due to sizeable revenue growth and jump in profitability margins. The same depicted noticeable contraction in the current year, highlighting a contrasting trend.
In FY22, gross margins soared to ~26% owing to better absorption of fixed costs and efficient cotton procurement at a favorable price differential, which is consistent with industry trend. Consequently, with significantly high gross margin and sizeable revenue growth, bottom-line reached a historic high, increasing by 3x in absolute terms.

On average, the imported-domestic cotton procurement ratio has remained around 84:16 while management expects the import proportion to elevate further given the scarcity of local cotton due to recent floods in the region. The average procurement cost rose by ~60% during the review period while adequate stock level is maintained against confirmed sale orders for the next three months. Distribution expenses have increased significantly as a result of higher outbound freight cost and commission charges, while administrative overheads increased in line with topline growth. In addition, there has been a notable surge in financial charges, which is linked to the increase in debt levels.

Profitability margins (both on gross and net basis) noted significant contraction and returned to FY21 levels during the ongoing fiscal year due to reduced demand, increasing cotton prices and uptick in power costs in recent months given energy shortages in the country.

Contrasting cash flow trend mirrors the profitability performance over the review period; working capital days have increased due to uptick in inventory holding and receivables days.

Funds flow from operations (FFO) increased significantly to Rs. 1.7b (FY21: Rs. 700.9m) during FY22, reflecting the historic high net profitability achieved by the company. However, the contrasting profitability performance and decline in cash flow generation during 6M'FY23 along with the increase in debt levels, led to a weakening in debt coverage metrics as reflected from FFO to Total Debt and FFO to long-term debt of 0.14x (FY22: 0.67x; FY21:0.32x) and 0.28x (FY22: 1.29x; FY21: 0.69x), respectively at end-6M'FY23. Debt servicing coverage ratio also declined to 2.36x (FY22: 6.56x; FY21: 5.56x).

Liquidity positon is satisfactory, with current ratio consistently reported above 1.5x, and sufficient coverage of short-term borrowings in relation to trade debts and inventory. However, uptick in inventory holding and receivables days has stretched the working capital cycle from 34 days in FY19 to 65 days in FY22. Trade debts have increased in tandem with business growth while ageing profile is sound, with ~8% receivables being overdue for more than 90 days and no bad debt has been reported.

Sizeable profit in the outgoing fiscal year leads to considerable improvement in equity base; leverage ratios have increased slightly yet remains manageable.

Supported by strong bottom-line in the previous year and all-out retention, equity base grew by ~92% over the period of last 18 months and reached Rs. 3.5b in 6M'FY23. Debt profile is a mix of short-term and long-term debt with total interest bearing liabilities increasing to Rs. 3.8b (FY22: Rs. 2.1b; FY21: Rs. 1.8b) at end-6M'FY23; ~49% constituted short-term debt which is not mobilized on concessionary rate. Given the increase in debt levels, leverage ratios have weakened yet remains within comfortable levels.

Umar Spinning Mills (Pvt.) Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**6M'FY23**
PPE	1,517.5	1,482.6	2,245.7	3,098.6
Stores, Spares. And Loose Tools	75.1	78.3	103.6	103.9
Stock-in-Trade	1,886.6	1,795.4	2,864.3	3,116.6
Trade Debts	543.5	771.2	1,100.3	1,272.6
Advances, Deposits and Other Receivables	16.5	140.5	138.5	541.9
Cash and Bank Balance	108.5	190.5	217.5	262.4
Total Assets	**4,409.0**	**4,562.5**	**6,800.6**	**8,721.6**
Trade and Other Payables	480.4	479.1	780.8	690.5
Long-Term Borrowings *(Inc. current maturity)*	837.0	1,009.1	1,343.1	2,213.9
Short-Term Borrowings	1,544.6	1,171.1	1,242.2	2,134.9
Total Liabilities	**2,934.6**	**2,725.4**	**3,485.3**	**5,200.2**
Paid-up Capital	290.0	290.0	290.0	290.0
Total Equity *(Inc. loan from directors)*	**1,474.4**	**1,837.1**	**3,315.2**	**3,521.4**
INCOME STATEMENT				
Net Sales	4,077.1	4,955.4	7,616.1	3,930.2
Gross Profit	309.6	629.9	1,995.5	505.1
Operating Profit	170.9	473.8	1,712.6	388.5
Profit Before Tax	**25.2**	**371.3**	**1,573.6**	**262.8**
Profit After Tax	**(5.9)**	**367.0**	**1,491.2**	**206.2**
RATIO ANALYSIS				
Gross Margin (%)	7.6%	12.7%	26.2%	12.9%
Net Margin (%)	-0.1%	7.4%	19.6%	5.2%
Net Working Capital	693.9	1,123.6	2,149.3	2,492.6
Current Ratio	1.33	1.60	1.93	1.82
FFO to Long-Term Debt	0.24	0.69	1.29	0.28*
FFO to Total Debt	0.08	0.32	0.67	0.14*
DSCR (x)	1.42	5.56	6.56	2.36*
Gearing (x)	1.62	1.19	0.78	1.23
Debt Leverage (x)	1.99	1.48	1.05	1.48
Inventory + Receivable/Short-term Borrowings (x)	157.3%	219.2%	319.1%	205.6%

**Annualized*

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 Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
Rating Type: Entity				
13-03-2023	BBB+	A-2	Stable	Maintained
06-07-2022	BBB+	A-2	Positive	Maintained
27-05-2021	BBB+	A-2	Stable	Maintained
29-04-2020	BBB+	A-2	Rating Watch - Negative	Maintained
16-03-2020	BBB+	A-2	Stable	Reaffirmed
13-02-2019	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.

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Faisal Pervaiz	MD	Feb 27, 2023
Mr. Faraz Ameer	CFO	