RATING REPORT

Umar Spinning Mills (Private) Limited

REPORT DATE:
February 13, 2024

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		Stable	
Rating Action	Reaffirmed		Maintained	
Rating Date	*Feb 13, 2024*		*Mar 13, 2023*	

COMPANY INFORMATION

Incorporated in 1991	**External auditors:** Reanda Haroon Zakaria & Co. Chartered Accountants
Private Limited Company	**Chief Executive Officer:** Mr. Mohammad Faisal Pervaiz
Key Shareholders (with stake 5% or more):	
Mohammad Faisal Pervaiz ~85%	
Shaheena Pervaiz ~15%	

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

Umar Spinning Mills (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

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

RATING RATIONALE

Corporate Profile

Umar Spinning Mills Private Limited ('USMPL' or 'the Company') was incorporated in Pakistan as a private limited company in 1991. The registered office of the Company is located at Commerce Centre, Hasrat Mohani Road, Karachi, while its manufacturing facility is situated in Raiwind, Lahore. The Company is principally engaged in the manufacturing and sale of yarn.

Operational Performance

The installed capacity (43,776 ring spindles) has remained unchanged while utilization levels have shown an increasing trend over the years. During FY23, the Company has installed new Auto Coro (open-end) plant, with 1,512 rotors, for manufacturing of yarn at Raiwind, Lahore, increasing the installed capacity of yarn to 10.6m Kgs.

Figure: Capacity & Production Data

	FY21	FY22	FY23	1QFY24
Number of spindles installed	43,776	43,776	43,776	43,776
Auto Coro (Open-end) Rotors	-	-	1,512	1,512
Installed capacity of yarn (Kgs.)	9.4m	9.4m	10.6m	3.1m
Actual production of yarn (Kgs.)	8.6m	8.6m	9.8m	2.9m
Capacity Utilization	***91%***	***92%***	***93%***	***95%***

Key Rating Drivers

Business risk profile constrained by cyclicality, and high competition in the sector.

The business risk profile of the spinning sector in Pakistan is characterized by high level of exposure to economic cyclicality 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 circumstances. 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. 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 persistent inflationary pressures. These factors are likely to result in continued sluggish performance for the spinning sector in FY24.

Sponsor support provides comfort to ratings.

Ratings derive comfort from the sponsor support extended to the Company. This support is evident from the contributions made historically, with loans from directors standing at Rs.341.6m in 1QFY24.

This helped the company sustain operations despite deteriorations in profitability and severe stress on the coverage profile. Notably, during FY23, these loans were reclassified from short-term borrowings to equity due to their non-interest-bearing nature and the Company's entitlement to pay back the loan.

Profitability strained by volatility in economic environment.

The Company's topline increased in FY23 to PKR 9,293 mln (FY22: PKR 7,616 mln) due to higher selling prices, while volumetric sales faced pressure from reduced demand in both export and local markets. However, gross margins contracted due to rising input costs attributed to high inflation, currency exchange volatility, increased energy costs, and heightened raw material expenses. During the year, the company faced constraints in procuring local cotton owing to a lack of availability, primarily due to floods that inundated the major crops of the country. Consequently, the Company increased its reliance on imported cotton procured at higher prices. USMPL faced challenges in passing these cost pressures on to customers, and gross margins continued to be under pressure in 1QFY24, coming in at 4.9% (FY23: 7.4%, FY22: 26.2%). Going forward, management expects gross margins to normalize as higher cotton crop production and eased letter of credit restrictions will lead to lower costs and improved operations in FY24.

Net margins came under further pressure from escalation in finance cost. This is attributed to an 825-bps increase in domestic policy rates as well as higher drawdown of debt during the period. This pressure was sustained in 1QFY24 with net margins reported at -4.6% in 1QFY24 (FY23: -0.4%, FY22: 19.6%).

Adequate capitalization profile.

The Company reported deterioration of its capitalization metrics on account of higher debt utilization during FY23. Gearing and leverage ratios were reported at 1.3x (FY22: 0.7x) and 1.6x (FY22: 1.1x), respectively. Higher working capital requirements led to elevated short-term debt drawdowns, while installation of Auto Coro plant and BMR projects contributed to increase in long-term borrowings. However, in 1QFY24, the capitalization profile reported slight recovery, mainly driven by reduced short-term debt utilization with gearing and leverage of 1.1x and 1.4x, respectively. However, despite the loss incurred during FY23, the equity base of the Company witnessed an improvement on account of the reclassification of debt from directors to equity. Subsequently, the equity base depicted deterioration in 1QFY24 in tandem with the loss reported during the period. Overall, the capitalization profile remains adequate with assigned ratings.

Sound liquidity profile.

The Company has historically maintained a sound liquidity profile with a 5-Year average current ratio of 1.6x. The current ratio in 1HFY24 was reported at 1.9x (FY23: 1.6x, FY22: 1.9x). Much of USMPL's liquidity is in the form of stock in trade with a 5-Year average quick ratio of 0.7x due to the inventory intensive nature of the business. Quick ratio in 1QFY24 was reported at 0.8x (FY23: 1.0x, FY22: 0.7x).

Debt service coverage strained by weakening profitability profile.

The Company has also sustained a healthy coverage profile over the years, with a 5-Year average debt service coverage (DSCR) and short-term debt coverage ratios of 2.6x and 2.8x, respectively. However, owing to significant stress on the Company's profitability the DSCR contracted to 0.5x (FY23: 1.0x, FY22: 5.5x) in 1QFY24. Nevertheless, with elevated inventory and trade debts, USMPL's short-term debt coverage remained sound at 3.0x (FY23: 1.7x, FY22: 4.8x).

Consideration for future reviews

Going forward ratings are underpinned by continued sponsor support and will remain sensitive to the Company's ability to improve its profitability and coverage profiles. Moreover, maintenance of capitalization and liquidity metrics commensurate with assigned ratings will also be important considerations for future reviews.

Umar Spinning Mills (Pvt.) Limited — Appendix I

FINANCIAL SUMMARY (PKR Millions)				
BALANCE SHEET	**FY21**	**FY22**	**FY23**	**3MFY24**
Property, plant and equipment	1,482.6	2,245.7	3,126.7	3,026.8
Stock In Trade	1,795.4	2,864.3	2,493.6	3,491.5
Trade debts	771.2	1,100.3	2,008.2	1,788.8
Cash & Bank Balances	190.5	217.5	164.1	232.4
Total Assets	4,562.5	6,800.6	9,434.8	8,830.6
Trade & Other payables	479.1	780.8	813.5	853.5
Long-term Debt (incl. current portion and lease liability)	1,009.1	1,343.1	2,108.4	2,080.1
Short Term Borrowing	755.0	826.2	2,577.0	1,778.6
Total Debt	1,764.1	2,169.2	4,685.5	3,858.7
Total Liabilities	2,725.4	3,485.3	5,758.3	4,941.7
Paid up Capital	290.0	290.0	290.0	290.0
Equity (excl. Revaluation Surplus)	1,837.1	3,315.2	3,676.5	3,494.4
INCOME STATEMENT	**FY21**	**FY22**	**FY23**	**3MFY24**
Net Sales	4,955.4	7,616.1	9,293.3	2,797.2
Gross Profit	629.9	1,995.5	686.6	136.0
Operating Profit	473.8	1,712.6	470.9	66.7
Finance Costs	88.5	116.4	426.2	168.7
Profit Before Tax	371.3	1,573.6	82.6	-92.7
Profit After Tax	367.0	1,491.2	-40.3	-129.1
RATIO ANALYSIS	**FY21**	**FY22**	**FY23**	**3MFY24**
Gross Margin (%)	12.7%	26.2%	7.4%	4.9%
Net Margin (%)	7.4%	19.6%	-0.4%	-4.6%
Funds from Operation (FFO)	700.9	1,727.9	200.1	-53.4
FFO to Total Debt* (%)	39.7%	79.7%	4.3%	-5.5%
FFO to Long Term Debt* (%)	69.5%	128.7%	9.5%	-10.3%
Gearing (x)	1.0	0.7	1.3	1.1
Leverage (x)	1.5	1.1	1.6	1.4
Debt Servicing Coverage Ratio* (x)	2.9	5.5	1.0	0.5
Current Ratio	1.6	1.9	1.6	1.9
(Stock in trade + trade debts) / STD (x)	3.4	4.8	1.7	3.0
Return on Average Assets* (%)	8.2%	26.2%	-0.5%	-5.8%
Return on Average Equity* (%)	22.2%	57.9%	-1.2%	-15.2%

* *Annualized, if required*

REGULATORY DISCLOSURES	Appendix II
Name of Rated Entity	Umar Spinning Mills (Pvt) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
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				
13-02-2024	BBB+	A-2	Stable	Reaffirmed
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

Due Diligence Meeting Conducted

Name	Designation	Date
Faraz Ameer	CFO	February 6, 2024
Muhammad Faisal Pervaiz	CEO	February 6, 2024