RATING REPORT

KHALID SHAFIQUE SPINNING MILLS LIMITED (KSSML)

REPORT DATE:
February 18, 2019

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	BBB	A-2
Rating Outlook	*Initial*	
Rating Action	Stable	
Rating Date	*February 18, 2019*	

COMPANY INFORMATION	
Incorporated in 1992	External Auditors: Ilyas Saeed & Co., Chartered Accountants
Unlisted Public Company	Chairman of the Board/CEO: Ch. Khalid Shafique
Majority Shareholders:	
Ch. Khalid Shafique – 75.51%	
Mr. Shargeel Khalid – 17.13%	

APPLICABLE METHODOLOGY(IES)
JCR-VIS Entity Rating Criteria: Industrial Corporates (May 2016)
http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf

OVERVIEW OF THE INSTITUTION

Khalid Shafique Spinning Mills Limited (KSSML) is a public limited unlisted company incorporated in Pakistan in April, 1992 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). The principal activity of the company is manufacturing and sale of yarn. The registered office is located at M.M. Alam Road, Gulberg II, Lahore.

Profile of the Chairman/CEO

Ch. Khalid Shafique serves as the Chairman of the Board and Chief Executive Officer. He is a qualified Chartered Accountant from the Institute of Chartered Accountants of Pakistan. He has over 30 years of experience in the textile sector.

Financial Snapshot

Total Equity: end-FY18: Rs. 686.8m; end-FY17: Rs.637.8m; end-FY16: Rs. 626.9m

Assets: end-FY18: Rs. 1.3b; end-FY17: Rs. 1.0b; end-FY16: Rs. 941.6m

Profit After Tax: FY18: Rs. 50.0m; FY17: Rs. 10.9m; FY16: Rs. (22.4m)

RATING RATIONALE

The ratings assigned to Khalid Shafique Spinning Mills Limited (KSSML) take into account sound coverages amid adequate liquidity and low leverage indicators. Given procurement of cotton and sale of yarn mainly related to local market, the company's vulnerability to foreign exchange fluctuations is considered low. The ratings are largely constrained by KSSML's spinning unit running close to full capacity, small equity base and the vulnerability of spinning sector to raw material prices.

Spinning unit operating close to full capacity: Majority shareholding rests with Chairman/CEO; Ch. Khalid Shafique and his family. The CEO along with his son Mr. Shargeel Khalid are actively involved in the day to day operations of the company. The company is currently operating a single spinning unit consisting of 33,408 spindles. The manufacturing unit of the company is located at Manga Raiwind Road, District Kasur.

KSSML procures raw cotton, polyester and viscose to manufacture cotton yarn, PC yarn and PV yarn and has the ability to produce counts ranging from 20/s to 80/s depending on customer demand. The company has the capacity to produce 12.4 mkgs of 20/s yarn equivalent per annum. During FY18, the company utilized around 98.5% (FY17: 98.2%) of its production capacity and produced 178,917 bags of yarn (FY17: 180,227 bags; FY16: 174,825 bags). The following table shows KSSML's plant capacity and actual production:

Table 1: Capacity Utilization

	FY17	FY18
Installed Spindles	33,408	33,408
Operational Spindles	33,408	33,408
Shifts Per Day	3	3
Production Capacity mkgs	12.423	12.423
Actual Production mkgs	12.195	12.239
Capacity Utilization	98.2%	98.5%

The spinning unit requires 3.2MW of electricity. KSSML has four gas generators; two each from Caterpillar and Jen Bacher with cumulative potential output of 4.1MW. Alternatively, the company rely on WAPDA and utilize two connections with a cumulative output of 5.5MW. The company is utilizing Oracle-based ERP software comprising different modules to monitor production, sales, finance and inventory.

Primarily local procurement of raw material:

According to the management, the company procures raw cotton with 95% of payment on delivery while the remaining 5% is payable on close of season. Cotton is mainly procured from local sources along with viscose while polyester is totally purchased locally with 100% of payment made in advance. The percentage of imported raw material, though remained low, has witnessed an increase during FY18 as depicted in the table below:

Table 2: Value of Raw Material (Rs. in millions)

	FY16	FY17	FY18
Raw Cotton – Local	1,080.6	1,191.2	1,291.5
Rate (Rs.)/maund	5,483	6,453	6,608
Raw Cotton – Imported	8.2	-	112.5
Rate (Rs.)/maund	6,226		8,100
Polyester – Local	129.5	319.2	385.2

Rate (Rs.)/Kg	113	121	146
Viscose – Local	7.9	5.7	-
Rate (Rs.)/Kg	237	226	
Viscose – Imported	5.5	32.7	21.6
Rate (Rs.)/Kg	221	226	225
Total Value of Raw Material	1,231.7	1,548.8	1,810.8
% or Raw Material Imported	**1.1**	**2.1**	**7.4**

Customer concentration declining on a timeline basis:

According to the management, 30-40% of sales are made on cash or advance payment basis while the remaining 60-70% sales are made on credit within 15 to 45 days. All sales are made locally with majority of sales being made to textile houses in Karachi and Faisalabad. Customer concentration has decreased over the years with top-10 customers representing 40% (FY17: 47%; FY16: 52%) of the total revenues during FY18. The ageing of receivables in the table below shows that majority of receivables were within 30 days bracket.

Table 3: Ageing of receivables

(in Rs. millions)	FY16	FY17	FY18
30 days	46.5	71.3	103.1
60 days	2.4	12.5	12.5

Improvement in gross margins witnessed as a result of higher price/bag:

Over the last three years, net sales of the company have grown at a CAGR of 8%. Sales increased to Rs. 2.4b (FY17: Rs. 2.2b; FY16: Rs. 1.9b) in FY18 and reached Rs. 1.45b in 1HFY19. Cotton yarn sales remained the major revenue driver during FY18; contributing around 57% of the sales mix (FY17: 60%; FY16: 82%) while revenue from PC yarn has shown consistent increase and accounted for nearly 34% (FY17: 26%; FY16: 14%) during FY18 as depicted in the table below:

Table 4: Product-wise sales mix (Rs. in million)

	FY16	FY17	FY18
Cotton Yarn	1,575.1	1,304.8	1,381.4
PC Yarn	272.9	554.9	821.0
PV Yarn	54.4	284.0	162.4
Total	1,902.4	2,143.7	2,364.8

Net sales stood higher mainly on account of increase in average yarn prices during FY18. Moreover, the proportion of higher count yarn increased during the outgoing year, leading to increase in gross margins to 6.7% (FY17: 4%; FY16: 0.7%). The table below shows average price per bag fetched by the company over the past three years:

Table 5: Av. Price/bag (Rs.)

	FY16	FY17	FY18
Cotton Yarn	11,196	13,290	14,621
PC Yarn	9,804	10,696	12,103
PV Yarn	8,623	9,413	9,781
Av. Price/bag	10,882	11,895	13,217

Operating expenses increased during FY18 primarily on account of increase in administrative expenses, an outcome of annual salary adjustments together with higher headcount reported during FY18. In the backdrop of increase in average benchmark interest rates coupled with higher average short-term borrowings, finance cost of the company stood higher at Rs. 33.9m (FY17: Rs. 25.7m; FY16: Rs. 17.9m) during FY18. Despite the aforementioned, the company reported higher net profit on the back of considerable increase in gross profit. Resultantly, net margins of the company improved, albeit modestly, to 2.1% (FY17: 0.5%; FY16: (1.1%)) during FY18.

Favorable credit terms resulting in controlled receivables:

Total asset base of the company stood considerably higher by end-1HFY19 primarily on account of increase in stock-in-trade as the company procures its cotton for the entire financial year during September-December. Property, plant and equipment comprised 28% of asset base (FY18: 42%; FY17: 51%) at end-1HFY19. The company regularly adds/upgrades machinery under its BMR program to enhance operational efficiency as it made a CAPEX of Rs. 88.2m (FY17: Rs. 14.6m) during FY18. Advances, deposits and prepayments increased due to an increase in sales tax refundable by end-1HFY19 while cash and bank balances also stood higher. By end-1HFY19, trade debts continued to account for less than 10% of total asset base and less than 5% of net sales, which is in line with the company's credit policy.

Adequate liquidity profile and debt service ability: Liquidity profile of the company is considered sound in view of adequate cash flows in relation to outstanding obligations. On account of increased profit before taxation and higher non-cash adjustments, Funds from Operations (FFO) exhibited a notable increase during FY18. Given increase in short-term borrowings by end-1HFY19, FFO to total debt decreased; however, with expected decline in short-term borrowing during 2HFY19, the said ratio is expected to recoup for the full year FY19. FFO to long-term debt and debt service coverage remained sizeable in FY18 and 1HFY19. Trade payables increased primarily on account of higher accrued expenses. Accrued expenses increased mainly owing to employee bonus payable and higher accrued electricity bills from WAPDA. However, cash conversion cycle of the company deteriorated to 64 days (FY17: 45 days; FY16: 51 days) primarily on account of increase in days inventory outstanding. The company has been able to maintain its current ratio above 1x over the year. (Stock-in-trade+receivables)/borrowing ratio decreased, though remained adequate, at 1.4x (FY18: 1.6x; FY17: 1.6x), at end-1HFY19.

Low leverage indicators: The equity base of the company has expanded on the back of profit retention and amounted to Rs. 713m (FY18: Rs. 686.8m; FY17: Rs. 637.8m) by end-1HFY19. Equity base of the company included interest free director's loan of Rs. 136m repayable at the discretion of the company. KSSML procured long-term debt worth Rs. 45m during FY18 to finance import of new machinery as part of its BMR program. It is repayable in 10 quarterly installments commencing on October 31, 2018 after a grace period of 6 months. The loan carries markup at 3 months KIBOR + 1.75% per annum. The bank has cumulative short term borrowing lines of about Rs. 1.0b, which were nearly fully utilized for purchase of cotton at end-1HFY19 resulting in increase in leverage indicators. With utilization of raw material inventory and subsequent adjustment of borrowings, gearing and debt leverage are expected to decline to a comfortable level by end-FY19. The company has projected capex of Rs. 80m each year during the next three years as a part of its BMR program, which is planned to be funded through internal sources.

Khalid Shafique Spinning Mills Limited (KSSML) ANNEXURE I

FINANCIAL SUMMARY				
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**1HFY19**
Non-Current Assets	541.9	525.9	558.5	583.2
Stock-in-Trade	237.6	321.0	544.3	1,219.2
Trade Debts	48.9	83.8	115.6	115.1
Advance, deposits & prepayments	17.8	33.4	46.0	53.3
Cash & Bank Balances	25.2	13.7	24.4	48.1
Other Assets	70.2	52.2	46.0	45.8
Total Assets	941.6	1,030.0	1,334.8	2,064.7
Trade and Other Payables	73.8	105.0	161.4	265.7
Short Term Borrowings	171.5	248.7	404.8	953.9
Long-Term Borrowings *(Inc. current maturity)*	37.8	16.2	45.0	81.0
Other Liabilities	31.6	22.2	36.8	51.3
Total Liabilities	314.7	392.2	648.0	1,351.8
Total Equity	626.9	637.8	686.8	712.9
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**1HFY19**
Net Sales	1,923.0	2,166.2	2,424.4	1,445.3
Gross Profit	12.8	87.0	162.8	91.5
Operating Profit	(19.9)	51.9	121.0	69.3
Profit After Tax	(22.4)	11.0	50.0	26.1
FFO (*annualized*)	(13.7)	50.4	128.0	141.7
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**1HFY19**
Gross Margin (%)	0.67	4.02	6.72	6.33
Net Margin (%)	(1.16)	0.50	2.06	1.80
Net Working Capital	129.1	129.4	189.0	213.4
FFO to Long-Term Debt (x)	(0.36)	3.11	2.84	1.75
FFO to Total Debt (x)	(0.07)	0.19	0.28	0.14
Debt Servicing Coverage Ratio (x)	0.20	1.62	3.36	3.82
Stock-in-trade + receivables/St Borrowings (x)	1.67	1.63	1.63	1.40
Current Ratio (x)	1.48	1.35	1.32	1.17
Gearing (x)	0.33	0.42	0.65	1.45
Debt Leverage (x)	0.50	0.61	0.94	1.90

ISSUE/ISSUER RATING SCALE & DEFINITIONS ANNEXURE II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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					**ANNEXURE III**
Name of Rated Entity	Khalid Shafique Spinning Mills Limited				
Sector	Textile				
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				
	18/02/19	BBB	A-2	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	JCR-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	JCR-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.				
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