RATING REPORT

Khalid Shafique Spinning Mills Limited

REPORT DATE:
June 11, 2021

RATING ANALYST:
Syed Fahim Haider Shah
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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*		*Rating Watch-Negative*	
Rating Action	Maintained		Maintained	
Rating Date	*11th June'21*		*14th April'20*	

COMPANY INFORMATION

Incorporated in 1992	External auditors: Ilyas Saeed & Co. Chartered Accountants.
Unlisted Public Limited Company	Chairman/CEO: Ch. Khalid Shafique
Key Shareholders (with stake 5% or more):	
Ch. Khalid Shafique – 75.51%	
Mr. Shargeel Khalid – 17.13%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (May 2019)
https://www.vis.com.pk/kc-meth.aspx

Khalid Shafique Spinning Mills Limited

OVERVIEW OF THE INSTITUTION

Khalid Shafique Spinning Mills Limited is a public limited unlisted company incorporated in Pakistan in April, 1992 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017).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 CEO. 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

Tier-1 Equity: end-9MFY21: Rs. 899m; end-FY20: Rs. 768m; end-FY19: Rs. Rs. 756m.

Assets: end-9MFY21: Rs. 1.94b; end-FY20: Rs. 1.66b; end-FY19: Rs 1.39.

Net Profit: 9MFY21: Rs. 131.2m; FY20: Rs. 12.2m; FY19: Rs. 69.8m.

RATING RATIONALE

Khalid Shafique Spinning Mills Limited (KSSML) is a spinning unit, majority owned and managed by the sponsoring family. The ratings assigned take into account increase in revenue and profitability during 9MFY21 underpinned by higher volumetric sales and favorable yarn prices. Overall liquidity indicators have remained adequate. The ratings also factor in improvement in debt coverage ratios supported by higher cash flows generation during 9MFY21. Gearing stood slightly lower as the impact of mobilization of long-term debt was more than offset by the decrease in short-term borrowings; while debt leverage ratio remained largely stagnant owing to increase in trade payables by end-9MFY21. The company has embarked upon balance, modernization, and replacement (BMR) of its spinning unit and will be funded majorly through the Temporary Economic Relief Facility (TERF) scheme of the State Bank of Pakistan (SBP). The repayment capacity is expected to remain adequate as the grace period of 18 months will allow the company to retire most of its exiting long-term debt by the time first installment of TERF becomes due. The ratings are constrained by scale of spinning operations as the BMR will only replace the old spindles, relatively small equity base, nearly full capacity utilization, and vulnerability of spinning sector to raw material prices and any adverse changes in regulatory duties.

Major BMR underway to improve operational efficiency

Total operational and installed spindles of KSSML were 33,408 at end-9MFY21. Capacity utilization remained stagnant at 98.7% (FY20: 85.8%) during 9MFY21. The decline in capacity utilization during FY20 was a result of closure of spinning operations for 50 days due to the Covid-19 lockdown. The company has recently embarked upon a major BMR of its spinning unit whereby new spindles will replace the old spindles. The BMR will be completed in two phases. The first phase will be completed by mid-July'2021 while the second phase is expected to be completed by mid-Oct'2021. Overall production capacity is expected to remain largely around current levels as the BMR is expected to yield 6% – 7% production gains as a result of higher speed on new spindles. The BMR will mainly be funded through the SBP's TERF scheme loan of Rs. 255m for a tenor of 6 years, including grace period of 18 months from the first drawdown date.

Growth in revenue and profitability supported by higher volumes and favorable pricing

Net revenue of the company increased to Rs. 2.8b (FY20: Rs. 2.8b) during 9MFY21 on account of a combination of higher volumetric sales and continued uptrend in the cotton/polyester yarn prices. Cotton yarn accounted for three-fifth of overall volume mix while remaining related to polyester yarn. Gross margins increased to 9.7% (FY20: 6.8%) during 9MFY21 mainly on account of higher yarn prices and availability of some cheaper cotton inventory from the previous year.

Administrative expenses amounted to Rs. 29.6m (FY20: Rs. 37.1m) during 9MFY21, with staff salaries and depreciation expense being the major components. The company also incurred selling and distribution expense of Rs. 13.7m (FY20: Rs. 15.6mm). Finance cost decreased to Rs. 38.6m (FY20: Rs. 91.2m) mainly due to decline in interest rates. Accounting for taxation, the company reported net profit of Rs. 131m (FY20: Rs. 12m) with improved net margins of 4.7% (FY20: 0.4%) during 9MFY21. Going forward, the sustainability of profit margins will remain dependent on cotton and yarn prices.

Liquidity supported by improved cash flows generation and adequate debt service coverage

Overall liquidity profile has depicted improvement during the review period. In line with the profits, the company generated higher funds from operations (FFO) amounting to Rs. 160m (FY20: Rs. 107m) during 9MFY21. The company's capacity to meet its financial obligations is considered adequate, as reflected in improved FFO-to-total debt ratio of 0.39x (FY20: 0.16x), due to higher annualized FFO and decrease in overall debt levels. Debt service coverage ratio (DSCR) also improved to 2.16x (FY20: 1.56x) during 9MFY21. Current ratio stood at 1.54x (FY20: 1.41x) as the impact of increase in trade & other payables was more than offset by increase in inventory and decrease in short-term borrowings by end-9MFY21. Moreover, inventory plus receivables to short-term borrowings ratio improved considerably to 3.24x (FY20: 1.84x).

Leverage indicators expected to increase due to mobilization of long-term loan for the BMR, though expected to remain manageable

Tier-1 equity increased to Rs. 899m (FY20: Rs. 768m) on account of retention of profits during 9MFY21. The debt profile comprised a mix of short-term facilities for working capital requirements and long-term borrowings for capex. Utilization of short-term borrowings decreased to Rs. 409m (FY20: Rs. 542m) while long-term debt increased to Rs. 132m (FY20: Rs. 110m) with the mobilization of new long-term borrowings of Rs. 28m during FY20 and Rs. 60m during 9MFY21 under the SBP Refinance Scheme for payment of wages & salaries for the period of April'2020 till September'2020. The facility is repayable in 8 quarterly installments, starting from January 01, 2021. Gearing ratio improved to 0.60x (FY20: 0.85x) by end-9MFY21 as the impact of increase in long-term debt was more than offset by decrease in short-term borrowings and higher equity base. Debt leverage remained largely stagnant at 1.15x (FY20: 1.17x) owing to notable increase in trade and other payables. Going forward, gearing ratio is projected to increase slightly to 0.80x by end-FY21 due to mobilization of TERF facility.

Khalid Shafique Spinning Mills Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**9MFY21**
Total Assets	**1,335**	**1,386**	**1,664**	**1,935**
Total Liabilities	648	631	897	1,037
Tier-1 & Total Equity	**687**	**756**	**768**	**899**
Paid up Capital	160	160	160	160
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**9MFY21**
Net Sales	2,424	3,076	2,774	2,770
Profit Before Tax	82	92	139	225
Profit After Tax	50	70	12	131
FFO	128	131	107	160
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**9MFY21**
Gross Margin (%)	6.7	7.3	6.8	9.7
Current Ratio	1.32	1.46	1.41	1.54
FFO to Long-Term Debt	2.84	1.82	0.97	1.62*
FFO to Total Debt	0.28	0.31	0.16	0.39*
Debt Servicing Coverage Ratio (x)	3.36	2.38	1.56	2.16
Gearing (x)	0.65	0.57	0.85	0.60
Debt Leverage (x)	0.94	0.83	1.17	1.15

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure 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	Annexure III
Name of Rated Entity	Khalid Shafique Spinning Mills Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	
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.
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Due Diligence Meeting Conducted	

Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
11-06-2021	BBB	A-2	Stable	Maintained
14-04-2020	BBB	A-2	Rating Watch-Negative	Maintained
18-02-2019	BBB	A-2	Stable	Initial

Due Diligence Meeting Conducted:

Name	Designation	Date
Mr. Muhammad Ashraf	CFO	April 29, 2021