RATING REPORT

Khalid Shafique Spinning Mills Limited (KSSML)

REPORT DATE:
June 29, 2022

RATING ANALYSTS:

Tayyaba Ijaz, CFA
tayyaba.ijaz@vis.com.pk

RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	BBB+	A-2	BBB	A-2
Rating Outlook	Stable		Stable	
Rating Action	Upgrade		Maintained	
Rating Date	June 29, 2022		June 11, 2021	

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)
VIS Entity Rating Criteria: Corporates (August 2021) *https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf*

Khalid Shafique Spinning Mills Limited

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Spinning Mills Limited (KSSML) is a public limited unlisted company incorporated in Pakistan in April, 1992 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017).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

Total Equity: end-9MFY22: Rs. 1.3b; end-FY21: Rs. 1.0b; end-FY20: Rs. 767.8m

Total Assets: end-9MFY22: Rs. 2.5b; end-FY21: Rs. 1.6b; end-FY20: Rs. 1.7b

Profit After Tax: 9MFY22: Rs. 325.2m; FY21: RS. 251.8m; FY20: Rs. 12.2m

RATING RATIONALE

Khalid Shafique Spinning Mills Limited (KSSML) is a spinning unit, majority owned and managed by the sponsoring family. The assigned ratings take into account increase in revenue, margins and profitability during FY21 and 9MFY22 underpinned by higher volumetric sales and favorable yarn prices. The ratings also factor in considerable improvement in coverages and liquidity indicators. Coverages are projected to remain sound despite considerable decline in projected margins, going forward. Gearing has remained comfortable, that is in line with the assigned rating. The company has conducted balance, modernization, and replacement (BMR) of its spinning unit by replacing old ring frames in order to enhance production efficiencies; the impact of the same is expected to be seen, going forward. Whilst the ratings factor in high cyclicality and competitive intensity for spinning industry along with volatility in cotton prices, overall business risk profile of the textile industry is supported by stable demand and favorable regulatory regime. The ratings will remain dependent on maintaining liquidity and capitalization indicators at adequate levels while achieving projected revenue and profitability.

Execution of Balancing, Modernization and Replacement (BMR) in the ongoing year amidst nearly full capacity utilization: During the ongoing year, the management replace 36 old ring frames with a total cost of Rs. 280m out of which Rs. 255m has been financed through Temporary Economic Refinance facility (TERF) at a subsidized rate of rate of 5%. The first phase of this BMR entailing addition of 14 ring frames was completed in January'22 while the remaining 24 ring frames have arrived at end-March'22. After becoming operational, the production capacity is expected to increase by around 10%. The management also conducted some BMR to enhance backprocess efficiencies in FY21. Property, plant and equipment stood higher at Rs. 730m (FY21: 519.6m; FY20: Rs. 542.2m) at end-9MFY22 largely due to aforementioned additions. The company has been operating at nearly full capacity on a timeline basis, except for FY20, in which the capacity was lower due to closure of production facility amidst pandemic.

	FY19	FY20	FY21
Number of installed/worked spindles	33,408	33,408	33,408
Installed capacity after conversion into 20s count (m Kgs)	12,423	12,423	12,423
Actual Production (m Kgs)	12,245	10,654	12,170
Capacity Utilization	99%	86%	98%

Moreover, the management is also considering to go into value addition, going forward. As KSSML manufactures yarn for hosiery and knitting companies, the management intends to venture into socks knitting business. An expenditure of around Rs. 250m and Rs. 150m are planned for this in FY23 and FY24, respectively, which will be funded through own sources. The company is in process of hiring a third-party consultant to prepare feasibility of this project.

Growth in topline backed by higher yarn prices and volumetric increase in sales: The company's sales have exhibited upward trajectory in line with covid led growth in textile industry of the country. During FY21, the company reported higher net sales of Rs. 3.8b (FY20: Rs. 2.8b) with a YoY growth of ~36% on account of increase in average selling prices and quantity sold. The uptrend in revenues continued in the ongoing year with the net revenue reported at Rs. 3.7b (9MFY21: Rs. 2.8b) during 9MFY22, with a growth of ~33% on YoY basis. The breakdown of product mix with quantity and average selling prices is tabulated below:

Product Mix	FY20			FY21			9MFY22		
	QTY (000's Lbs.)	Value (in million Rs.)	Avg. rate/ Lbs.	QTY (000's Lbs.)	Value (in million Rs.)	Avg. Rate/ Lbs.	QTY (000's Lbs.)	Value (in million Rs.)	Avg. Rate/ Lbs.
Cotton Yarn	7,673	1,425	185.8	9,504	2,089	219.8	7,007	2,092	298.6
PC Yarn	8,771	1,328	151.4	9,731	1,670	171.6	6,643	1,586	238.7
Total	**16,444**	**2,753**		**19,235**	**3,759**		**13,650**	**3,678**	

Around 57% of the revenue emanated from cotton yarn while the rest constituted polyester yarn sales. Customer concentration, measured in terms of sales to top ten clients, increased notably to 63% (FY20: 46%) due to higher orders from certain parties during FY21.

Gross margins improved notably to 13.0% (FY20: 6.9%) largely on account of favorable yarn prices relative to low-cost inventory procured during FY21. Cost of sales amounted to Rs. 3.3b (FY20: Rs. 2.6b) while raw material consumed as a percentage of cost of goods manufactured remained at 75% (FY20: 74%). Salaries and wages have increased due to inflationary adjustments. During FY21, KSSML procured 9.6m Kgs of cotton (FY20: 7.8m Kgs) from local market at an average rate of Rs. 9,805.6/maund (FY20: Rs. 9,010.4/maund) while 2.4m Kgs (FY20: 1.9m Kgs) of Polyester was procured at an average rate of 182.75/Kg (FY20: Rs. 181/Kg). Average procurement rates of local and imported cotton have witnessed hike in the outgoing year owing to decline in domestic aggregate output of cotton to 5.6m bales (FY20: 10.8m bales), dropping to the lowest level in the last three decades mainly as a result of heavy rainfall, pest attack and lack of farmers' interest.

Administrative expenses amounted to Rs. 43.9m (FY20: Rs. 37.1m) during FY21. Distribution expenses were recorded at Rs. 20.0m (FY20: Rs. 15.6m). Finance cost decreased notably to Rs. 46.1m (FY20: 91.2m) due to lower average debt levels along with decrease in average markup rates during the outgoing year. Accounting for taxation, net profits were reported notably higher at Rs. 251.8m (FY20: Rs. 12.2m) with improvement in net margins to 6.7% (FY20: 0.4%) as a result of higher gross profits, rationalization of operating cost and lower finance cost.

During 9MFY22, gross profit was recorded higher at Rs. 609.5m (9MFY21: Rs. 268.7m) with increase in gross margins to 16.5% (9MFY21: 9.7%). Profit after tax was reported higher at Rs. 325.2m (FY20: Rs. 131m) with net margins of 8.8%. The management projects net sales of Rs. 4.9b in FY22 with gross margins of 20.0%. Meanwhile, the management expects that due to upsurge in cotton prices, the benefit of low-cost inventory would no longer be available, therefore, the margins are expected to be rationalized, going forward.

Adequate liquidity as reflected by cash flows in relation to outstanding obligations: Liquidity profile of the company has improved notably in FY21 and the ongoing year as a result of higher profitability. The company generated Rs. 456.1m (FY21: 286.1m; FY20: 107.0m) in funds from operations (FFO) during 9MFY22. Resultantly, FFO to total debt and FFO to long-term debt remained sizeable at 0.99x (FY21: 1.11x; FY20: 0.16x) and 1.94x (FY21: 2.17x; FY20: 0.97x), respectively, despite increase in overall debt levels. Debt service coverage has remained strong on a timeline basis (9MFY22: 5.27x; FY21: 7.51x; FY20:

1.84x).

Stock in trade increased to Rs. 1.3b (FY21: 712.0m; FY20: Rs. 865.6m) by end-9MFY22, on account of higher raw materials inventories. During 9MFY22, the company procured raw cotton at around 48% higher average cost vis-à-vis FY21. (i.e., Rs. 14,547.3/maund). Raw cotton constitutes around 85% of the raw material mix. Trade debts amounted to Rs. 254.2m (FY21: Rs. 226.7m; FY20: Rs. 130.3m) at end-9MFY22. Aging profile is satisfactory given all receivables are outstanding for less than 60 days. Credit terms have remained unchanged with around 70% of sales being made on credit of 15 to 45 days while rest of the sales are made on cash or advance basis. Advances, deposit and prepayments amounted to Rs. 67.1m (FY21: Rs. 50.8m; FY20: 37.9m). Meanwhile, trade and other payables have increased to Rs. 386.2m (FY21: Rs. 238.4m; FY20: Rs. 181.9m) owing to higher trade creditors and accrued expenses related to GIDC payable. The management procures around 95% of the cotton on payment on delivery terms while the remaining amount is settled at the end of the season. Polyester is procured on 100% advance basis and around 80% of store supplies are purchased on 30 to 90 days of credit. Net operating cycle has remained manageable at 81 days (FY21: 81 days; FY20: 92 days). Current ratio was reported at 2.28x (FY21: 2.44x; FY20: 1.41x) at end-9MFY22. Coverage of short-term borrowings via trade debts and stock in trade remained sizeable at 5.27x (FY21: 7.51x; FY20: 1.84x). Liquidity position of the company is projected to remain adequate in terms of cash flows coverages and working capital management, going forward.

Low leveraged capital structure supported by profit retention: Tier-1 equity of the company stood higher at Rs. 1.3b (FY21: 1.0b; FY20: Rs. 767.8m) at end-9MFY22 on the back of internal capital generation. Provision of directors' loan amounting Rs. 136.0m as interest free, unsecured and payable on discretion of the company, has continued to support the equity base.

During 9MFY22 and the outgoing year, the company mobilized long-term loan for BMR, as discussed earlier in this report. Short-term borrowings have increased to Rs. 302.6m (FY21: Rs. 124.9m; FY20: Rs. 541.7m) by end-9MFY22. However, despite increase in debt levels, gearing and leverage have remained at fairly comfortable level on a timeline basis. A snapshot of funding mix and leverage indicators is presented below:

(In million Rs.)	FY20	FY21	9MFY22
Tier-1 Equity	767.8	1,017.1	1,342.3
Long-Term Debt (including current portion)	110.3	132.1	312.5
Short-Term Borrowings	541.7	124.9	302.6
Total Liabilities	897	583	1,128
Gearing (x)	0.85	0.25	0.46
Debt Leverage (x)	1.17	0.57	0.84

The management does not intend to mobilize any long long-term loan in the medium term for any capital expenditure amidst availability of sufficient cash flows. Therefore, the capitalization is projected to be supported by reinvestment of internally generated capital along with decrease in debt levels in line with scheduled repayment of long-term borrowings.

Khalid Shafique Spinning Mills Limited — Appendix I

BALANCE SHEET (PKR Millions)	FY19	FY20	FY21	9MFY22
Property, Plant & Equipment	543	542	520	730
Stock-in-Trade	538	866	712	1,340
Trade Debts	139	130	227	254
Advances, Deposits & Prepayments	60	38	51	67
Cash & Bank Balances	56	35	36	48
Other Assets	50	53	54	40
Total Assets	**1,386**	**1,664**	**1,600**	**2,470**
Trade and Other Payables	165	182	238	386
Long Term Debt *(including current maturity)*	72	110	132	313
Short Term Debt	356	542	125	303
Total Debt	**428**	**652**	**257**	**615**
Other Liabilities	37	63	88	127
Total Liabilities	**630**	**897**	**583**	**1,128**
Tier-1/Total Equity	756	768	1,017	1,342
Paid-up Capital	160	160	160	160
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**9MFY22**
Net Sales	3,076	2,774	3,784	3,691
Gross Profit	224	190	491	610
Profit Before Tax	92	44	349	461
Profit After Tax	70	12	252	325
Funds from Operations	131	107	286	456
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**9MFY22**
Gross Margin (%)	7.3	6.9	13.0	16.5
Net Margins (%)	2.3	0.4	6.7	8.8
Current Ratio (x)	1.46	1.41	2.44	2.28
Net Working Capital	263	323	633	973
Cash Conversion Cycle (Days)	63	92	81	81
FFO to Total Debt (x)	0.31	0.16	1.11	0.99*
FFO to Long Term Debt (x)	1.82	0.97	2.17	1.94*
Debt Leverage (x)	0.83	1.17	0.57	0.84
Gearing (x)	0.57	0.85	0.25	0.46
DSCR (x)	2.38	1.56	2.98	5.52
ROAA (%)	5.1	0.8	15.4	21.3*
ROAE (%)	9.7	1.6	28.2	36.7*
(Stock in Trade+Trade Debt) to Short-Term Borrowing Ratio (x)	1.90	1.84	7.51	5.27

**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	Khalid Shafique Spinning Mills Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see 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.
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. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile. Copyright 2022 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
29/06/2022	BBB+	A-2	Stable	Upgrade
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 Meetings Conducted

	Name	Designation	Date
1	Mr. Muhammad Ashraf	General Manager Finance	22nd June, 2022