

RATING REPORT

Khalid Shafique Spinning Mills Limited

REPORT DATE:

June 03, 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		Negative	
Rating Date	June 03, 2024		June 20, 2023	
Rating Action	Maintained		Maintained	

COMPANY INFORMATION

Incorporated in 1992

External auditors: Ilyas Saeed & Co. Chartered Accountants

Public Unlisted Company

Chairman/CEO: Mr. Ch. Khalid Shafique

Key Shareholders (with stake 5% or more):

Mr. Ch. Khalid Shafique – 53.62%

Mr. Shargeel Khalid – 23.39%

Ms. Maha Khalid – 17.42%

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

RATING SCALE(S)

VIS Issue/Issuer Rating Scale:

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

Khalid Shafique Spinning Mills Limited

OVERVIEW OF THE INSTITUTION RATING RATIONALE

Khalid Shafique Spinning Mills Limited is a Public Limited Company incorporated on April 23, 1992. The registered office of the Company is situated at 115-P. M. M. Alam Road, Gulberg - II. Lahore in the Province of Punjab. The manufacturing unit of the Company is located at 1.6 KM Off Roosa Village Stop, 8 KM Manga Raiwind Road, District Kasur. The principal activity of the Company is textile spinning.

Company Profile

Khalid Shafique Spinning Mills Limited (‘KSSML’ or ‘the Company’) is a Public Limited Company incorporated on April 23, 1992. The registered office of the Company is situated at 115-P. M. M. Alam Road, Gulberg - II. Lahore in the Province of Punjab. The manufacturing unit of the Company is located at 1.6 KM Off Roosa Village Stop, 8 KM Manga Raiwind Road, District Kasur. The principal activity of the Company is textile spinning.

Key Rating Drivers

Business risk profile constrained by cyclical, 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 cyclical 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 many players producing relatively homogenous products.

During FY23, Pakistan's yarn production registered a substantial decline, primarily due to reduced availability of cotton, because 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.

Topline growth driven by higher average selling prices amid weak macroeconomic environment in FY23. Reported constraint in 3QFY24 on account of a fire incident resulting in inventory damage.

During FY23, KSSML recorded a topline growth of approximately 5.50% (FY22: 34.49%). This growth primarily resulted from higher average selling prices, despite a decrease in volumetric sales. However, during 3QFY24, the topline has been constrained due to lower production resulting from limited inventory availability following a fire incident. The fire incident resulted in the destruction of a large portion of the Company’s cotton stock. Damages were covered by insurance.

Revenue exclusively originates from domestic sales, with approximately 49% derived from cotton yarn transactions and 51% from polyester yarn sales. In 3QFY24, cotton yarn dominated the revenue mix, accounting for around 64%, while polyester yarn constituted approximately 36% of total sales.

Profitability margins are under pressure due to elevated input costs and inflation in FY23. Also remains constrained in 3QFY24 on account of the fire incident.

KSSML's profitability margins witnessed a significant decline in FY23. The gross margin decreased to 3.1% (FY22: 14.5%), while the operating margin dropped to 1.6% (FY22: 12.1%). This decline was attributed to notably elevated input costs, driven by constrained cotton supply and a high inflationary environment. In

3QFY24, gross and operating margins remained constrained at 4.22% and 2.55%, respectively, due to a fire incident causing inventory damage, leading to reduced production. Additionally, increasing gas tariffs during this period added to the margin pressure.

Consequently, the Company's net margin decreased to 0.6% (FY22: 7.5%) in FY23. Increased finance costs resulting from a higher policy rate and greater debt utilization were contributing factors. In 3QFY24, the net margin further deteriorated to -0.62%.

Liquidity profile remained healthy despite noted erosion in FY23. Improved again in 3QFY24.

KSSML's liquidity profile has remained healthy despite challenges, although there has been some erosion. The current ratio declined to 1.77x (FY22: 2.46x) in FY23 but improved to 2.93x in 3QFY24. Moreover, due to a significant inventory buildup amidst demand slowdown in FY23, the days to sale inventory increased to 79 days (FY22: 65 days). Additionally, the payable cycle decreased to 13 days (FY22: 23 days) in FY23. Consequently, the cash conversion cycle ("CCC") extended to 94 days (FY22: 65 days). However, with the destruction of available cotton stock, inventory halved, resulting in a shorter inventory period, thereby leading to a slight recovery in the CCC to 84 days in 3QFY24.

Conservative capitalization profile.

In FY23, due to an increase in the CCC, the Company raised its short-term debt drawdown, leading to a deterioration in the capitalization profile, though remaining at manageable levels. The gearing and leverage ratio rose to 0.71x (FY22: 0.42x) and 0.99x (FY22: 0.76x), respectively. However, in 3QFY24, as the CCC eased and KSSML received its insurance claim on damaged inventory, it cleared all short-term debt and payables, resulting in a conservative capitalization profile with gearing and leverage of 0.15x and 0.43x, respectively.

Coverage profile depicts severe stress.

In FY23, subdued profitability and higher financial charges led to constrained Funds from Operations (FFO), resulting in negative figures. Consequently, the debt servicing coverage ratio (DSCR) depicted severe weakening, standing at 0.35x (FY22: 5.63x) in FY23. However, some recovery is noted in 3QFY24, with a ratio of 0.69x, although it remains under stress, despite profitability being impacted by the fire incident.

Considerations for Future Reviews

Going forward, ratings will remain sensitive to the Company's ability to recover its eroded profitability, coverage profiles to historical levels, while maintaining its capitalization and liquidity profiles to be commensurate with assigned ratings.

REGULATORY DISCLOSURES		Appendix I			
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
	<u>RATING TYPE: ENTITY</u>				
	03-Jun-24	BBB+	A-2	Stable	Maintained
	20-June-23	BBB+	A-2	Negative	Maintained
	29-June-22	BBB+	A-2	Stable	Upgrade
	11-June-21	BBB	A-2	Stable	Maintained
	14-Apr-20	BBB	A-2	Rating Watch - Negative	Maintained
	18-Feb-19	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.				
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Due Diligence Meetings Conducted	Name	Designation		Date	
	Mr. Muhammad Ashraf	General Manager - Finance		May 31, 2024	