RATING REPORT

Akram Cotton Mills Limited (ACML)

REPORT DATE:
July 09, 2019

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	BBB-	A-2
Rating Outlook	Stable	
Rating Date	*3rd July'19*	

COMPANY INFORMATION	
Incorporated in 1993	**External auditors:** EY Ford Rhodes Chartered Accountants
Public Limited Company (Unlisted)	**Chairman of the Board:** Mr. Ali Pervaiz
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Ali Pervaiz
Mr. Ali Pervaiz – 32.54%	
Mr. Ahmed Pervaiz – 22.39%	
Mr. Mohammad Pervaiz Malik – 15.94%	
Mrs. Shaista Pervaiz – 21.96%	
Mrs. Saadia Kamran – 7.18%	

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria: Corporates (May 2019)

https://www.vis.com.pk/kc-meth.aspx

Akram Cotton Mills Limited (ACML)

OVERVIEW OF THE INSTITUTION

Akram Cotton Mills Limited is a spinning mill engaged in the production of 100% carded cotton yarn. The company commenced operations in 1993 as Public Limited Company (Unlisted). Registered office of the company is in Lahore while manufacturing unit is located in Pattoki, Punjab.

Profile of Chairman& CEO

Mr.Ali Pervaiz is the Chairman of board and CEO of the company. He has been working as the CEO of the company for the last fourteen years. Previously he was engaged in banking sector. He has also served as Chairman APTMA Punjab.

RATING RATIONALE

Akram Cotton Mills Limited (ACML) is a spinning mill specialized in the production of carded cotton yarns ranging from 20/1 to 30/1 counts for hosiery purposes. ACML has undertaken balancing, modernization, replacement & expansion (BMR&E) program in FY18. The company has installed 23,220 spindles with all necessary back processes and in-house yarn testing equipment.

The mill is situated in Pattoki, Punjab, which is located at a distance of 90km from Lahore on the Lahore-Multan National Highway. The mill is spread over approximately 25 acres of land and it has a total constructed area of over 200,000 square feet. The company has procured machinery from various countries including Japan, Germany, Switzerland, China, etc. Main raw material of the company is cotton which is mainly procured from local market. The company installed compact devices on ring frames in early FY18 in order to optimize production. The cumulative power requirement of the unit is 2.5 MW which is met primarily through gas fired generators of 3.0 MW. The company also has backup arrangement in the form of 1 MW diesel generator and WAPDA connection of 2.6 MW. The ownership of the company is vested with the sponsoring family which holds 100% shareholding in the company.

Product Portfolio – focused on manufacturing of cotton yarn

ACML manufactures 100% cotton carded compact yarn mainly from locally procured cotton with counts ranging from 20/1 to 30/1 for hosiery purposes.

Spinning Products			
Yarn Type	**Count Range**	**Composition**	**End Use**
Carded Compact Yarn	20/1 - 30/1	100% cotton yarn	Hosiery

Operational Capabilities & Performance – higher capacity utilization on a timeline basis

ACML has 23,220 spindles with production capacity to produce 9.95m kg of yarn annually converted to 20/1. Capacity utilization remained relatively higher during FY18 as tabulated below:

Spinning	FY17	FY18
Total Spindles (All operational)	23,460	23,220
Installed Capacity Converted to 20/1 Count (m Kgs)	9.91	9.95
Actual Production (m Kgs)	8.81	9.20
Capacity Utilization %	88.93%	92.46%

Sales growth emanating from increase in volumetric sales and favorable prices – Trade debts remains negligible on account of sales being primarily on cash

During FY18, the company reported net sales of Rs. 2.07b (FY17: Rs. 1.75b; FY16: Rs. 1.45b) driven largely by increase in volumetric sales and favorable average selling prices of yarn in the local market. While major portion of sales emanated from local sales, company generated export sales of Rs. 32.4m (FY17: Rs. 24.1m, FY16: Nil) during FY18. With installation of compact devices on ring frames in beginning FY18, the company was able to improve yarn quality and hence fetch higher prices. Resultantly, gross margins improved to 8.1% (FY17: 4.5%; FY16: 0.3%) during FY18. Operating expenses of the company increased to Rs. 70m (FY17: Rs. 57m; FY16: Rs. 55m) mainly on account of higher distribution & other operating expenses. The finance cost of the company increased to Rs. 43m (FY17: Rs. 33m, FY16: Rs. 22m) on account of higher average utilization of debt. The company was able to generate net profit of Rs. 37m during FY18 as against losses during last two years (FY17: Rs. 20m loss; FY16: Rs. 80m loss) while net profit margin stood modest at 1.8% (FY17: -1.1%; FY16: -5.6%). The company generated net sales of Rs. 1.11b with a bottom line of Rs. 22m during 1HFY19. Similarly the company projects net sales of Rs. 2.41b with a bottom line of Rs. 24 m for FY19 mainly on account of improvement in yarn prices.

The company carried out CAPEX of Rs. 209m during FY18 and installed ring spinning frames, QPRO winders, compact devices on ring frames which helped to improve the quality of yarn. Out of 45 ring frames, 38 frames are now equipped with compact devices.The company follows the practice of procuring local cotton between August and February while maintaining a buffer stock of around eight months. At end-FY18, ACML held total inventory worth Rs. 374m (FY17: Rs. 370m; FY16: Rs. 179m) which included raw material inventory of Rs. 277m (FY17: Rs. 267m; FY16: Rs. 127m) during FY18. Although trade receivables of the company increased during FY18 but still remained modest at Rs. 86m (FY17: Rs. 19m; FY16: Rs. 48m) as yarn is mostly sold on the cash basis. Balance with Statutory authorities increased to Rs. 69m (FY17: Rs. 49m; FY16: Rs. 77m) during FY18 which includes sales tax & income tax receivable from authorities.

Better coverages with improvement in cash flows in FY18 while liquidity has remained adequate

Funds from operations (FFO) improved to Rs. 83m (FY17: Rs. -8m; FY16: Rs. -46m) in line with positive bottom line during FY18. The company has the policy of meeting working capital requirements from short term borrowings which stood at Rs. 317m at end-FY18 (FY17: Rs. 308m; FY16: Rs. 142m). FFO to total debt ratio improved to 0.17x (FY17: -0.03x; FY16: -0.31x) while FFO to long-term debt improved to 0.46x (FY17: -1.42x; FY16: -6.17x). The debt service coverage ratio remained sound at 2.85x (FY17: 0.70x; FY16: -1.02x). The current ratio remained largely stable at 1.29x (FY17: 1.22x; FY16: 1.40x). Meanwhile, inventory plus trade receivables to short-term borrowings improved to 1.39x (FY17: 1.20x; FY16: 1.48x), which also highlights adequate liquidity position of the company.

Manageable leverage indicators amid relatively small equity base

Total equity base augmented to Rs. 422m by end-FY18 (FY17: Rs. 386m; FY16: Rs. 406m) on the back of profit retention. During FY18, the company incurred capital expenditure of Rs. 209m which was financed through long term finance facility of Rs. 178m mobilized from various banks. Given the increase in total borrowings, gearing and debt leverage stood higher at 1.18x and 1.57x (FY17: 0.81x and 1.14x), respectively, by end-FY18. Leverage indicators increased by end-1HFY19 mainly on account of procurement of raw material; as per management the said indicators, given utilization of raw material, will be normalized by end-FY19. Given no major capex projected in the foreseeable future, leverage indicators are expected to remain within manageable levels.

Governance & Audit

The Board of Directors of ACML comprises three members; out of which two representatives are from sponsoring family whereas board meeting is held once in a year. The company has Oracle based ERP in place. The company has internal audit department headed by 'Manager Internal Audit & Control' while "EY Ford Rhodes Chartered Accountants" are external auditors of the company.

Akram Cotton Mills Limited — Appendix I

FINANCIAL SUMMARY *(Amounts in PKR millions)*

BALANCE SHEET	30-Jun-16	30-Jun-17	30-Jun-18	31-Dec-18
Non-Current Assets	378	372	529	570
Stock-in-Trade	179	370	374	1,082
Trade Debts	48	19	86	71
Balance with Statutory Authorities	77	49	69	78
Other Assets	22	9	20	17
Cash & Bank Balances	21	7	8	18
Total Assets	725	826	1,086	1,836
Trade and Other Payables	59	45	76	167
Short Term Borrowings	142	308	317	914
Long Term Loan	8	6	180	221
Total Interest Bearing Debt	150	314	497	1,135
Other Liabilities	110	81	91	89
Total Liabilities	319	440	664	1,391
Tier 1 Equity	406	386	422	444
Revaluation Reserves	-	-	-	-
Total Equity including Revaluation Reserves	406	386	422	444
INCOME STATEMENT	30-Jun-16	30-Jun-17	30-Jun-18	31-Dec-18
Net Sales	1,452	1,753	2,073	1,112
Gross Profit	4	79	168	86
Operating Profit	(48)	25	104	55
Finance Cost	22	33	43	33
Profit after Tax	(82)	(20)	37	22
RATIO ANALYSIS	30-Jun-16	30-Jun-17	30-Jun-18	31-Dec-18
Gross Margin (%)	0.3	4.5	8.1	7.7
Net Margin (%)	(5.6)	(1.1)	1.8	2.0
Current Ratio (x)	1.40	1.22	1.29	1.13
Net Working Capital	98	83	124	149
Debt Leverage (x)	0.79	1.14	1.57	3.13
Gearing (x)	0.37	0.81	1.18	2.55
FFO	(46)	(8)	83	107
FFO to Total Debt (x)	(0.31)	(0.03)	0.17	0.09
FFO to Long Term Debt (x)	(6.17)	(1.42)	0.46	0.48
Debt Servicing Coverage Ratio (x)	(1.02)	0.70	2.85	5.16
Inventory + Receivables/Short-term Borrowings (x)	1.48	1.20	1.39	1.24
ROAA (%)	(11.3)	(1.3)	1.9	1.2
ROAE (%)	(20.1)	(2.5)	4.6	5.0

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	Akram Cotton Mills Limited
Sector	Textiles
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see table 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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
03-07-19	BBB-	A-2	Stable	Initial