# RATING REPORT

# Akram Cotton Mills Limited (ACML)

**REPORT DATE:**
Jun 29th, 2021

**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 | | Rating Watch - Negative | |
| ***Rating Date*** | *June 29th, 2021* | | *April 24, 2020* | |

## 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 – 60.31% | |
| Mr. Mohammad Pervaiz Malik – 15.94% | |
| Mrs. Shaista Pervaiz – 21.96% | |

## APPLICABLE METHODOLOGY(IES)

**VIS Entity Rating Criteria: Industrial Corporates (May 2019)**
***https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf***

# 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 (unlisted) Public Limited Company. Registered office of the company is in Lahore while manufacturing unit is located in Pattoki, Punjab.

**Profile of Chairperson of the Board & 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 sixteen years. Previously he was engaged in the banking sector. He has also served as the Chairman of APTMA Punjab.

## RATING RATIONALE

Akram Cotton Mills Limited (ACML) is engaged in the business of manufacturing and sale of yarn. It specializes in the production of 100% carded cotton yarn, with a count range of 20/1 to 30/1, for hosiery purposes. The company has been providing yarn variants under the brand name 'Anmol', 'Super Anmol' and 'Mahnoor' mainly to local customers. The main raw material 'Cotton' is procured from the local market. Shareholding of the company is vested with sponsoring family who is actively involved in the business operations.

**Capacity Utilization**

ACML has 23,220 spindles installed with all the necessary back processes and in-house yarn testing equipment. Installed capacity is higher in FY20 due to production lower coarse count yarn during the year. The company's capacity utilization was down to 83.4% (FY19: 98.3%) on account of COVID-19 induced disruption. Production was halted for 45 days due to imposition of lockdown.

| | FY19 | FY20 |
|---|---|---|
| **No. of spindles installed** | 23,220 | 23,220 |
| **No. of spindles operating** | 23, 220 | 23, 220 |
| **Production at normal capacity in 20s count based on 3 shifts per day – kgs (in millions)** | 9.95 | 10.42 |
| **Actual production converted to 20s count based on 3 shifts per day – kgs (in millions)** | 9.79 | 8.69 |
| **Capacity Utilization** | **98.3%** | **83.4%** |

Going forward, the management will incur capex on Balancing, Modernization and Renovation (BMR), which will enable the company to increase its product line through inclusion of combed yarn.

**Key Ratings Drivers:**

**Business risk profile within spinning sector is characterized by volatility in raw material prices and high competition. Improvement in demand dynamics post ease in COVID-19 lockdown measures support the business risk profile of the company**

Movement in cotton prices and cotton crop levels drives performance of spinning sector players. Historically, margins and financial performance of players have depicted seasonality. Reduction in local cotton production pushed the cotton prices to 11 year high in February 2021. Management of ACML procured bulk quantity earlier at attractive rates, which contributed favorably to the profitability profile of the company as the yarn prices have also increased to keep pace with the higher cotton prices. Majority clients of ACML are engaged in production of value-added textile products. The increase in global demand for value-added textile products and diversion of orders from competitor countries (owing to more severe COVID-19 disruption in comparison to Pakistan) supports the business risk profile of the company. Even though impact of COVID-19's third wave remains elevated, we expect the order book for the industry to remain strong in the ongoing year, easing the business risk concerns.

**Topline of the company decreased in FY20 on account of COVID-19 induced disruption. However, volumetric increase and higher yarn prices are expected to translate to growth in net sales going forward**

Sales revenue decreased to Rs. 2.1b (FY19: Rs. 2.5b) during FY20 owing to reduction in the quantity sold on account of production halt as a result COVID-19 lockdown. Higher sales tax amounting to Rs. 371m (FY19: Rs. Nil) also impacted the reported revenue in FY20. Sales mix entirely comprises local sales. Client wise sales concentration has witnessed reduction with top 10 clients accounting for 30.9% (FY19: 39.5%) of net sales in FY20. Client wise concentration risk is mitigated by long term relationship with the clients.

During 1HFY21, the company reported sales revenue of Rs. 1.5b (1HFY20: Rs. 1.3b), thereby depicting growth of 25% in comparison to the corresponding period in the preceding year. This growth was a function of improvement in volumetric offtake and increase in yarn prices. Going forward, sales are expected to increase on account of adequate orders in pipeline and increase in average selling prices.

**Decrease in topline coupled with lower margins contributed to net losses in FY20; however, subsequent recovery in demand, increase in yarn prices and efficient procurement strategy have resulted in improvement in the profitability profile in 1HFY21**

The company posted net loss of Rs. 86.6m (FY19: Rs. 106.3m) in FY20 owing to decrease in topline as a result of COVID-19 led production halt and higher financial charges due to higher utilization of debt. Gross and net margins were also reported lower in FY20 in comparison to the preceding year. Recovery in demand, increase in yarn prices and efficient procurement of cotton have translated to improvement in profitability profile in 1HFY21. Resultantly, the company reported significantly higher net profit of Rs. 21.0m (1HFY20: Rs. 2.9m) in 1HFY21. Management expects the improvement trend in margins and profitability to continue over the rating horizon. Nevertheless, volatility in raw material prices will continue to remain a key risk factor.

**Liquidity profile depicts room for improvement**

Funds from Operations (FFO) has varied in line with the profitability of the company. With net losses in FY20, FFO was also negative in FY20. Hence, cash flow coverage was also insufficient. Debt Service Coverage Ratio (DSCR) was lower at 0.63x (FY19: 1.71x). Inventory and Trade Debts provide healthy coverage for short-term debt obligations and current ratio was reported above 1(x). With improvement in profitability in 1HFY21, internal cash flows have also increased and the debt servicing coverage is considered adequate. However, further improvement in the liquidity profile is considered important from the ratings perspective.

**Leverage indicators trended upwards on account of increase in short term borrowings for inventory procurement**

Changes in profitability were reflected in the equity base of the company, which stood at Rs. 449.9m (FY20: Rs. 429.3m; FY19: 529.3m) at end-HFY21. The company paid dividend to the tune of Rs. 13.9m pertaining to FY19 in FY20. Total debt of the company was reported higher at Rs. 1,491.3m (FY20: Rs. 779.3m; FY19: Rs. 494.6m) on account of increase in short term borrowings to fund the working capital requirements. As the management procures majority of its annual cotton required in first half of the year, significant increase has been observed in the short term borrowings at end-1HFY21. The same are expected to decrease at the end of the financial year. Consequently, gearing and leverage ratios increased to 3.31x (FY20: 1.82x; FY19: 0.93) and 4.28x (FY20: 2.46x; FY19: 1.14x), respectively. Going forward, the company will incur capex to the tune of Rs. 220m for BMR, out of which Rs. 20m will be financed through internally generated capital, while the remaining amount would be funded through debt financing. Given the projected increase in profitability and reduction in short term borrowings, leverage ratios are expected to improve going forward. Improvement in capitalization indicators remains a key rating sensitivity going forward.

## ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix 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 — 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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| **Due Diligence Meetings Conducted** | See table below |

**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| 29th Jun, 2021 | BBB | A-2 | Stable | Maintained |
| Apr 24, 2020 | BBB | A-2 | Rating Watch-Negative | Maintained |
| Dec 16, 2019 | BBB | A-2 | Stable | Upgrade |
| Jul 03, 2019 | BBB- | A-2 | Stable | Initial |

**Due Diligence Meetings Conducted**

| Name | Designation | Date |
|---|---|---|
| **Mr. Javed Ilyas** | Manager Accounts and Internal Controls | 04-May-2021 |