RATING REPORT

Z.A. Corporation (Pvt.) Limited

REPORT DATE:
November 06, 2019

RATING ANALYSTS:
Syed Fahim Haider Shah
fahim.haider@vis.com.pk

Maimoon Rasheed
maimoon@vis.com.pk

RATING DETAILS		
Rating Category	Initial Rating	
	Long-term	Short-term
Entity	BBB	A-2
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*31 Oct '19*	

COMPANY INFORMATION	
Incorporated in 1995	External auditors: Deloitte Yousuf Adil Chartered Accountants.
Private Limited Company	Chairman/CEO: Sheikh Danish Ali
Key Shareholders (with stake 5% or more):	
Sheikh Danish Ali – 96.9%	

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

Z.A. Corporation (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Z.A. Corporation (Pvt.) Limited (ZAC) was incorporated in 1994 - 1995 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017) as a trading company. The company was converted into spinning unit by installing spindles in Oct'17.

Profile of the Chairman/CEO

Sheikh Danish Ali is the owner and CEO of the company. He is a business graduate with more than twenty years of textile experience in spinning, weaving, yarn and fabrics processing segments. Mr. Danish is a former director of Best Exports (Pvt.) Limited.

Financial Snapshot

Tier-1 Equity: end-FY19: Rs. 969m; end-FY18: Rs. 832m; end-FY17: Rs. 360m.

Assets: end-FY19: Rs. 2.5b; end-FY18: Rs. 1.6b; end-FY17: Rs 0.37b.

Profit After Tax: FY19: Rs. 90.3m; FY18: Rs. 52.7m; FY17: Rs. (0.9m).

RATING RATIONALE

Z.A. Corporation (Pvt.) Limited (ZAC) is a newly established medium-sized spinning unit located in Faisalabad. Shareholding of the company is vested with Sheikh Danish Ali who is actively involved in day to day affairs of the company. The assigned ratings take into account growth in revenue and positive bottom line after commencement of commercial operations in October 2017 and subsequent enhancement of production capacity in December 2018. Product portfolio comprises viscose and cotton yarn, and unregistered persons account for majority sales, however, the company manages the counterparty risk by making sales on cash/advance basis. Underpinned by healthy cash flows generation, the ratings draw comfort from adequate debt service coverage. However, liquidity indicator in terms of current ratio is at the minimum threshold level. The increase in gearing and debt leverage was witnessed during the period under review on account of elevated working capital requirements as the company made further enhancement in production capabilities and entered its first full-year of production cycle. Ratings are constrained by vulnerability of the spinning sector to raw material prices, foreign exchange risk as ZAC is heavily dependent on imported viscose, and any adverse changes in the regulatory duties structure.

Company Overview

ZAC was incorporated two and a half decade ago as a trading company. The transformation began in November 2016 when the management decided to establish a spinning unit. The company installed 29,568 spindles in the first phase which was completed in October 2017 and commercial operations were initiated during the same month. The second phase was completed in December 2018 whereby another 13,728 spindles were installed, taking the total capacity to 43,296 spindles. Barring auto plucker jintan and condenser, all the blow room machinery and draw frames of 2017 model were imported from Switzerland, card machine and auto coner from Germany, and simplex and ring from China. Going forward, the management intends to increase the number of spindles to 100,000 over the medium-term, for which the land is already available.

ZAC produces a wide range of coarse and fine counts, from 16/s to 80/s. The company has the ability to produce high-quality yarn of 100% cotton, blended and synthetic, and polyester/cotton blends, however, the sales mix depends on the customer orders.

Asset mix

Total asset were recorded higher at end-FY19 on account of higher fixed and current assets. Stock-in-trade also increased as the company entered its first full-year production cycle and new capacities came online. The company tends to maintain 90 days buffer stock of viscose, whereas cotton is procured as per customer orders in the pipeline. There were no trade receivables at end-FY19 as the company makes yarn sales on advance/cash basis. However, nearly 88% of total sales are made to unregistered persons during FY19.

Advances, deposits, prepayments and other receivables stood higher owing to increase in advance income tax, advances to suppliers and guarantee margin given custom authorities. Tax refund due from the govt. increased due to higher sales tax and income tax. However, cash and bank balance decreased owing to sizeable capex during the year.

Revenue and profitability

The company reported higher net sales on the back of volumetric gains and higher selling price. The contribution of viscose yarn in sales mix increased to 76% while cotton yarn accounted for 23% of total sales. Going forward, the management expects viscose yarn to remain the major revenue contributor, albeit sales mix may change according to customer demand.

In line with increased business scale and higher raw material prices, ZAC reported higher cost of sales during FY19. Raw materials accounted for three-fourths of total cost of sales the year. Salaries, wages & other benefits expense was also recorded higher owing to increase in number of employees and inflationary adjustment. Fuel and power cost amounted higher on account of higher production activity and increase in power tariff during the year. The depreciation expenses on the newly deployed spinning unit stood higher. In line with higher sales, the company reported increased gross profit, however, gross margin decreased as during FY19 the impact of some improvement in selling price was more than offset by viscose purchase price escalation owing to rupee depreciation.

Administrative and other expenses also showed increase during FY19 to reflect growing scale of operations. Meanwhile, finance cost increased significantly as a result of elevated working capital requirement and higher utilization of short-term borrowings. Accounting to taxation, the company reported improved net profit, though net margin was lower during FY19.

Liquidity and Capitalization

The liquidity position of the company is underpinned by healthy cash flows generation, as depicted by considerably higher funds from operations (FFO) of Rs. 263.8m during FY19 (FY18: Rs. 130.8m), driven largely by growth in profits. However, current ratio decreased to 1.0x by end-FY19 (FY18: 1.5x), mainly due to significant reduction in cash and bank balance. Meanwhile, inventory plus receivables to short-term borrowings ratio of 1.1x at end-FY19 (FY18: 1.3x) reveals the company is matching its working capital requirements with short-term borrowings. Despite increase in debt burden, the company's capacity to meet its financial obligations is considered adequate as reflecting in the debt service coverage ratio of 3.0x (FY18: 6.4x). The FFO-to-long-term debt and FFO-to-total debt rations have improved to 0.73x (FY18: 0.33x) and 0.20x and (FY18: 0.18x) on the back of higher cash flows generation.

Equity base of the company stood higher at end-FY19 on account of profits retention and increase in interest-free sponsors' loan. Total liabilities were recorded higher mainly due to higher short-term borrowings. Trade & other payables increased mainly on account of higher accrued liabilities and advances from customer. The debt profile comprises a mix of long and short-term borrowings. In line with the increased production levels, short-term borrowings were recorded higher, resultantly, gearing and debt leverage ratios increased to 1.36x (FY18: 0.87x) and 1.57x (FY18: 0.94x) respectively by end-FY19.

Z.A. Corporation (Pvt.) Limited — Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY17**	**FY18**	**FY19**
Non-Current Assets	295.0	1,036.1	1,279.1
Stock-in-Trade	-	372.9	1,038.7
Total Assets	**368.7**	**1,615.3**	**2,488.0**
Trade and Other Payables	8.7	26.5	79.0
Short-Term Borrowings	-	328.2	961.8
Long-Term Borrowings *(Inc. current matur)*	-	400.0	360.0
Total Liabilities	8.7	782.9	1,519.4
Tier-1 & Total Equity	**360.0**	**832.4**	**968.5**
Paid-up Capital	**357.0**	**650.0**	**650.0**
INCOME STATEMENT	**FY17**	**FY18**	**FY19**
Net Sales	-	1,001.4	2,586.2
Gross Profit	-	133.8	291.2
Operating Profit	(0.9)	103.1	248.2
Profit/(Loss) Before Tax	(0.9)	76.3	149.9
Profit After Tax	(0.9)	52.7	90.3
FFO	(1.6)	130.8	263.8
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**
Gross Margin (%)	-	13.4	11.3
FFO to Long-Term Debt	-	0.33	0.73
FFO to Total Debt	-	0.18	0.20
Debt Servicing Coverage Ratio (x)	-	6.4	3.0
ROAA (%)	(0.4)	5.3	4.4
ROAE (%)	(0.4)	8.8	10.0
Gearing (x)	-	0.87	1.36
Debt Leverage (x)	0.02	0.94	1.57
Current Ratio	8.5	1.5	1.0

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	Z.A. Corporation (Pvt.) 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
RATING TYPE: ENTITY				
31-10-2019	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.
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. Copyright 2019 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.