RATING REPORT

Z.A. Corporation (Pvt.) Limited

REPORT DATE:
February 26, 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 Action	Upgrade		Maintained	
Rating Date	*26th Feb'21*		*28th April'20*	

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 Limited (ZAC) was incorporated in 1994 - 1995 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017) as a trading company.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-HY21: Rs. 1.45b; end-FY20: Rs. 1.35b; end-FY19: Rs. Rs. 1.0b.

Assets: end-HY21: Rs. 3.17b; end-FY19: Rs. 2.62b; end-FY18: Rs 2.49b.

Net Profit: HY21: Rs. 107.1m; FY20: Rs. 123.4m; FY19: Rs. 90.3.

RATING RATIONALE

Z.A. Corporation (Pvt.) Limited (ZAC) is a 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 profits that is being driven mainly by enhanced volumes, an outcome of phase-wise capacity expansion of the company. 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. While cash flows generation remained adequate, coverages have witnessed a decreasing trend which needs to get arrested. Leverage indicators, though increased by end-HY21 due to capex and higher working capital requirements, have remained manageable. However, the ratings are constrained by vulnerability of the spinning sector to availability and prices of raw materials, 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. Third phase was completed in June 2020 by adding 11,616 new spindles, taking the total capacity to 54,912 spindles. In accordance with its long-term business plan to have 100,000 spindles, the company intends to add another 12,000 spindles in FY22.

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. Installed capacity after conversion into 40/s count increased to 9.06m kgs (FY20: 7.81m kgs; FY19: 7.81m kgs) on account of addition of new spindles. The company produced 4.44m kgs (FY20: 7.65m kgs; FY19: 7.23m kgs) of yarn by operating spinning unit in 3 shifts per day.

Growing asset base

Total assets of the company were recorded higher at Rs. 3.17b (FY20: Rs. 2.62b; FY19: Rs. 2.49b) by end-HY20 with the increase in property, plant, and equipment to Rs. 1.67b (FY20: Rs. 1.29b; FY19: Rs. 1.28b) on account of addition of new spindles for a capex of Rs. 441m during the period. In line with the growing scale of operations, stock-in-trade stood higher at Rs. 1.21b (FY20: Rs. 1.02b; FY19: Rs. 1.04b) mainly due to increase in raw material inventory of Rs. 1.05b (FY20: Rs. 889m; FY19: Rs. 977m) mainly comprising imported viscose, whereas work-in-progress inventory amounted to Rs. 62m (FY20: Rs. 51m; FY19: Rs. 42m) and finished goods amounted to Rs. 93m (FY20: Rs. 84m; FY19: Rs. 19m) at end-HY20. The company tends to maintain 90 days buffer stock of viscose, whereas cotton is procured as per customer orders in the pipeline. As the company makes yarn sales on advance/cash basis, trade receivables remained low at Rs. 25m (FY20: Rs. 28m; FY19: nil) at end-HY20. Majority of sales are made to unregistered persons while corporate clients account for less than 15% of overall sales mix.

At end-HY21, advances, deposits, and prepayments amounted to Rs. 81m (FY20: Rs. 55m; FY19: Rs. 54m) and mainly pertained to advance income tax, advances to suppliers, and letter of credit & guarantee margin given to banks and customer authorities for import of viscose. Tax refund due from the govt. stood at Rs. 54m (FY20: Rs. 50m; FY19: Rs. 43m) due to slight increase in sales tax. Cash and bank balance accumulated to Rs. 110m (FY20: Rs. 78m; FY19: Rs. 25m) by end-HY20.

Sustained growth in revenue and profitability underpinned by capacity enhancements and growing volumes

Net sales of ZAC increased to Rs. 2.90b (FY19: Rs. 2.59b; FY18: Rs. 1.0b) during FY20, mainly on account of volume expansion and higher selling price for viscose yarn. Sales mix predominantly comprised viscose yarn which accounted for 85% (FY19: 76; FY18: 54%) of net sales during FY20. Viscose yarn sales increased to Rs. 2.46b (FY19: Rs. 2.0b; FY18: Rs. 539m) as the company sold 6.43m kgs (FY19: 5.32m kgs; FY18: 1.49m kgs) at a higher average selling price of Rs. 383m (FY19: Rs. 372/kg; FY18: Rs. 362/kg). Meanwhile, cotton yarn sales amounted to Rs. 409m (FY19: Rs. 597m; FY18: Rs. 456m) on account of lower volumes of 1.12m kgs (FY19: 1.51m kgs; FY18: 1.24m kgs) and lower selling price. 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 enhanced scale of business, ZAC reported cost of sales of Rs. 2.50b (FY19: Rs. 2.30b; FY18: Rs. 868m) during FY20. Raw materials accounted for three-fourths of total cost of sales which increased to Rs. 1.92b (FY19: Rs. 1.73b; FY18: 0.64b), despite lower imported viscose price of Rs. 224 per kg (FY19: Rs. 263 per kg; FY18: Rs. 172 per kg) and local cotton price of Rs. 239 per kg (FY19: Rs. 230 per kg; FY18: Rs. 175 per kg) during FY20. Salaries, wages & other benefits expense decreased to Rs. 117m (FY19: Rs. 136m; FY18: Rs. 41m) owing to decrease in average number of employees to 505 (FY19: 550; FY18: 295) due to COVID-19. In line with the production levels, fuel and power cost increased to Rs. 352m (FY19: Rs. 314m; FY18: Rs. 129m) during the year. In line with notably higher volumes and relatively higher selling prices, the company reported gross profit of Rs. 392m (FY19: Rs. 291m; FY18: Rs. 134m), with higher gross margin of 13.6% (FY19: 11.3%; FY18: 13.4%) during FY20.

Operating expenses amounted to Rs. 51m (FY19: Rs. 44m; FY18: Rs. 33m) during FY20. Meanwhile, finance cost increased significantly to Rs. 164m (FY19: Rs. 98m; FY18: Rs. 27m) mainly on account of higher average borrowings during FY20. Accounting to taxation, the company reported net profit of Rs. 123m (FY19: Rs. 90m; FY18: Rs. 53m) for FY20, with improved net margin of 4.3% (FY19: 3.5% FY18: 5.3%).

During HY20, net sales of ZAC amounted to Rs. 1.79b as the company managed to sold 5.47m kgs of viscose yarn at a lower selling price of Rs. 321 per kg and 0.10m kgs of cotton yarn at a lower selling price of Rs. 314 per kg. For FY21, the company expects net sales of Rs. 4.0b. Cost of sales were recorded at Rs. 1.59b with slightly higher viscose import price of Rs. 229 per kg during the period. Resultantly, the company reported lower gross margin of 10.9%. Net margin, however, improved to 6.0% due to combined impact of largely curtailed operating expenses and notably lower finance cost of Rs. 48m on account of decline interest rates, resulting in net profit of Rs. 107m during HY21.

Liquidity supported by health cash flows generation with adequate debt servicing capacity

The liquidity position is underpinned by healthy generation of funds from operations (FFO) which amounted to Rs. 145m (FY20: Rs. 261m; FY19: Rs. 264m) and improved cash & bank balance of Rs. 110m (FY20: Rs. 78m; FY19: Rs. 25m) at end-HY21. Current ratio decreased slightly to 1.2x (FY20: 1.4x; FY19: 1.0x) due to higher utilization of short-term borrowings by end-HY21. The debt service coverage ratio decreased to 1.13x (FY20: 1.30x; FY19: 3.0x) due to higher scheduled repayments of long-term borrowings. FFO-to-long-term debt and FFO-to-total debt ratios stood at 0.79x (FY20: 1.09x; FY19: 0.73x) and 0.21x (FY20: 0.27x; FY19: 0.20x), respectively.

ZAC continues to maintain leverage indicators at prudent levels despite growing scale of spinning operations

Equity base of the company augmented to Rs. 1.45b (FY20: Rs. 1.35b; FY19: Rs. 969m) by end-HY21 on account of profits retention and interest-free sponsor loan of Rs. 430m (FY20: Rs. 430m; FY19: Rs. 174m) that is repayable on the company discretion. Total liabilities were recorded higher at Rs. 1.71b (FY20: Rs. 1.27b; FY19: Rs. 1.52b) by end-HY21 mainly due to higher borrowings. Trade & other payables decreased to Rs. 108m (FY20: Rs. 151m; FY19: Rs. 79m) in the absence of any advances from customers and lower outstanding payables against workers' profit participation and welfare funds during the period.

The debt profile comprises a mix of long and short-term borrowings. The outstanding balance of long-term borrowings, inclusive of current maturity, increased to Rs. 366m (FY20: Rs. 239m; FY19: Rs. 360m) on account of mobilization of new long-term loan of Rs. 251m availed in HY21 to partially meet the capex requirement. In line with the increased production levels, short-term borrowings were recorded higher at Rs. 1.05b (FY20: Rs. 722m; FY19: Rs. 962m) at end-HY21. The total current sanctioned limit is Rs. 1.60b. Resultantly, gearing and debt leverage ratios stood at 0.97x (FY20: 0.71x; FY19: 1.36x) and 1.18x (FY20: 0.95x; FY19: 1.57x) respectively, at end-HY21. Going forward, the management intends to maintain leverage indicators around current levels as FY22 capex estimated at around Rs. 700m would mainly be financed through own sources.

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

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**HY21**
Non-Current Assets	1,036.1	1,279.1	1,291.9	1,665.1
Stores, Spares. And Loose Tools	5.2	35.7	94.7	23.6
Stock-in-Trade	372.9	1,038.7	1,024.3	1,209.1
Trade Debts	53.3	-	28.3	24.9
Advances, Deposits and Other Receivables	21.5	66.4	54.9	81.3
Tax Refund Due From Government	26.2	43.1	49.6	53.8
Cash and Bank Balance	100.1	25.0	77.5	109.6
Total Assets	**1,615.3**	**2,488.0**	**2,621.3**	**3,167.2**
Trade and Other Payables	26.5	79.0	150.9	107.6
Deferred Tax	22.4	66.7	92.7	92.7
Other Liabilities	5.8	51.9	69.4	100.7
Short-Term Borrowings	328.2	961.8	722.1	1,045.6
Long-Term Borrowings *(Inc. current matur)*	400.0	360.0	238.9	366.1
Total Liabilities	782.9	1,519.4	1,273.9	1,712.7
Tier-1 & Total Equity	**832.4**	**968.5**	**1,347.4**	**1,454.5**
Paid up Capital	650	650	650	650
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**HY21**
Net Sales	1,001.4	2,586.2	2,895.0	1,789.5
Gross Profit	133.8	291.2	392.3	195.4
Operating Profit	103.1	248.2	342.5	181.9
Profit Before Tax	76.3	149.9	178.8	133.9
Profit After Tax	52.7	90.3	123.4	107.1
FFO	130.8	263.8	260.5	144.8
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**HY21**
Gross Margin (%)	13.4	11.3	13.6	10.9
Net Margin (%)	5.3	3.5	4.3	6.0
Current Ratio	1.5	1.0	1.4	1.2
Net Working Capital	180.7	43.7	386.6	249.6
FFO to Long-Term Debt	0.33	0.73	1.09	0.79*
FFO to Total Debt	0.18	0.20	0.27	0.21*
Debt Servicing Coverage Ratio (x)	6.42	3.00	1.30	1.13
Gearing (x)	0.87	1.36	0.71	0.97
Debt Leverage (x)	0.94	1.57	0.95	1.18
Inventory + Receivable/Short-term Borrowings (x)	1.30	1.08	1.46	1.18

**Annualized*

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 Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
26-02-2021	BBB+	A-2	Stable	Upgrade
28-04-2020	BBB	A-2	Rating Watch-Negative	Maintained
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.
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Due Diligence Meeting Conducted	Name	Designation	Date
	Mr. Aziz-ur-Rehman	CFO	February 01, 2020