RATING REPORT

Z.A. Corporation (Pvt.) Limited

REPORT DATE:
March 08, 2022

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*		*Stable*	
Rating Action	Reaffirmed		Upgrade	
Rating Date	*March 08, 2022*		*February 26, 2021*	

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 – 99.9%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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 Limited (ZAC) was incorporated in 1994 - 1995 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017) as a trading company.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-HY22: Rs. 1.70b; end-FY21: Rs. 1.55b; end-FY20: Rs. Rs. 1.35b.

Assets: end-HY22: Rs. 4.09b; end-FY21: Rs. 3.51b; end-FY20: Rs 2.62b.

Net Profit: HY22: Rs. 144.6m; FY21: Rs. 237.2m; FY20: Rs. 123.4m.

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. Supported by improved cash flows generation, coverages are considered adequate despite some decline in FFO-to-total debt owing to mobilization of new long-term loan in order to fund the expansion plan. Leverage indicators, though increased by end-HY22 due to capex and 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 decades 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 and fourth phase was completed in December 2021 with the addition of 12,672 spindles, taking the total capacity to 67,584 spindles. In accordance with its long-term business plan to have 100,000 spindles, the company intends to add similar scale of spindles by end-December 2022.

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 11.62m kgs (FY21: 9.98m kgs; FY20: 7.81m kgs) on account of addition of new spindles. The company produced 5.65m kgs (FY21: 9.58m kgs) of yarn by operating spinning unit in 3 shifts per day during HY22.

Growth in revenue and profits supported by capacity enhancements and higher volumes

Net sales of ZAC increased at a healthy growth rate of 51% to Rs. 4.39b (FY20: Rs. 2.90b) during FY21, driven largely by volumetric gains. Sales mix predominantly comprised viscose yarn which accounted for 97% (FY20: 86%) of net sales during FY21. Viscose yarn sales increased to Rs. 4.25b (FY20: Rs. 2.46b) on account of higher volumetric sales of 11.08m kgs (FY20: 6.43m kgs), partially offset by lower average selling prices during the year. Meanwhile, cotton yarn sales amounted to Rs. 11.6m (FY20: Rs. 409m) owing to volumetric sales of just 0.33m kgs (FY20: 1.12m kgs) and lower average 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. 3.91b (FY20: Rs. 2.50b) during FY21. Raw materials accounted for three-fourths of total cost of sales which increased to Rs. 2.89b (FY20: Rs. 1.92b) mainly due to volumes and uptick in average procurement price, while salaries, wages & other benefits increased to Rs. 143m (FY20: Rs. 117m) owing to inflationary adjustments during the year. In line with the production levels, fuel and power cost increased to Rs. 503m (FY20: Rs. 352m) during FY21. Underpinned by notable growth in top-line, the company reported gross profit of Rs. 477m (FY20: Rs. 392m) despite decrease in gross margin 10.9% (FY20: 5.4%) mainly due to reduction in average selling price of yarn.

Operating expenses amounted to Rs. 80m (FY20: Rs. 51m) with increase emanating from staff salaries due to inflationary adjustments, higher workers' profit participation fund expense, and higher depreciation charge during FY21. Meanwhile, finance cost declined to Rs. 97m (FY20: Rs. 164m) as the impact of higher borrowings was more than offset by lower interest rates FY21. Resultantly, the company reported higher profit after tax of Rs. 237m (FY20: Rs. 123m) for FY21, with improved net margin of 5.4% (FY20: 4.3%).

Net sales of ZAC increased to Rs. 2.34b (HY21: Rs. 1.79b) mainly on account of notable increase in average selling price to Rs. 416/kg (HY21: Rs. 321/kg), partially offset by decrease in volumetric sales to 5.23m kgs (HY21: 5.47m kgs) of viscose yarn. For FY22, the company expects net sales of Rs. 4.9b. Cost of sales increased to Rs. 2.07b (HY21: Rs. 1.59b) due to higher production and average procurement rate of viscose during HY22. Despite that, the company reported higher gross profit of Rs. 274m (HY21: Rs. 195m) as higher selling prices led to improved gross margin of 11.7% (HY21: 10.9%) during the period. Net margin improved marginally to 6.2% (HY21: 6.0%) due to uptick in finance cost, resulting in net profit of Rs. 145m (HY21: Rs. 107m) during HY22.

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

The liquidity position is supported by healthy cash flows generation and improving working capital cycle. In line with the higher profits, the company generated funds from operations (FFO) of Rs. 439m (FY20: Rs. 261m) during FY21 and Rs. 148m during HY22. Meanwhile, working capital cycle of the company has improved on a timeline basis to 101 days (FY21: 120 days) during HY22, driven largely by reduction in inventory days to 121 days (FY21: 134 days) and receivable collection in just 2 days (FY21: 2 days) during the period. Current ratio remained stable 1.2x (FY21: 1.2x) at end-HY22. Inventory and receivables provide adequate coverage against short-term borrowings, which stood at 1.15x (FY21: 1.14x). The company's capacity to meet its financial obligation is considered adequate as reflected in the debt service coverage ratio of 2.65x (FY21: 1.72x) and FFO-to-total debt ratio of 0.16x at end-HY22.

ZAC continues to maintain leverage indicators at manageable levels in the growth mode

Equity base of the company accumulated to Rs. 2.16b (FY21: Rs. 1.70b) by end-HY22 on account of profits retention and interest-free sponsor loan of Rs. 396m (FY21: Rs. 396.4m) that is repayable on the company's discretion. Total liabilities were recorded higher at Rs. 2.40b (FY21: Rs. 1.96b) by end-HY22 mainly due to higher borrowings and payables. Trade & other payables increased to Rs. 243m (FY21: Rs. 164m) on account of increase in accrued liabilities and creditors 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. 660m (FY21: Rs. 273m) on account of mobilization of new temporary economic refinance facility of Rs. 400m to during HY22 to meet the capex requirement pertaining to new spindles; the facility has a tenor of 5 years and carries markup rate of 5% per annum. Meanwhile, short-term borrowings remained largely stable at Rs. 1.21b (FY21: Rs. 1.27b) at end-HY22. Resultantly, gearing and debt leverage ratios increased to 1.10x (FY21: 1.00x) and 1.41x (FY21: 1.26x) respectively, at end-HY22. Going forward, the leverage indicators are expected to improve gradually on account of scheduled repayments and funding of capex for new spindles through internal capital generation.

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

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY20**	**FY21**	**HY22**
Non-Current Assets	1,291.9	1,697.0	2,159.3
Stores, Spares. And Loose Tools	94.7	115.6	65.4
Stock-in-Trade	1,024.3	1,434.7	1,371.0
Trade Debts	28.3	20.1	21.7
Advances, Deposits and Other Receivables	54.9	80.5	138.1
Tax Refund Due From Government	49.6	64.8	198.9
Cash and Bank Balance	77.5	96.3	137.8
Total Assets	**2,621.3**	**1,812.0**	**1,932.8**
Trade and Other Payables	150.9	164.0	243.4
Deferred Tax	92.7	162.4	162.4
Other Liabilities	69.4	86.4	124.4
Short-Term Borrowings	722.1	1,272.4	1,206.5
Long-Term Borrowings *(Inc. current matur)*	238.9	273.1	660.1
Total Liabilities	1,273.9	1,958.3	2,396.8
Tier-1 & Total Equity	**1,347.4**	**1,550.7**	**1,695.4**
Paid up Capital	**650.0**	**650.0**	**650.0**
INCOME STATEMENT	**FY20**	**FY21**	**HY22**
Net Sales	2,895.0	4,385.1	2,344.4
Gross Profit	392.3	476.8	274.2
Profit Before Tax	178.8	312.3	173.9
Profit After Tax	123.4	237.2	144.6
FFO	260.5	439.3	148.4
RATIO ANALYSIS	**FY20**	**FY21**	**HY22**
Gross Margin (%)	13.6	10.9	11.7
Net Margin (%)	4.3	5.4	6.2
Current Ratio	1.4	1.2	1.2
Net Working Capital	386.6	259.2	314.5
FFO to Long-Term Debt	1.09	1.61	0.45*
FFO to Total Debt	0.27	0.28	0.16*
Debt Servicing Coverage Ratio (x)	1.30	1.72	2.65
Gearing (x)	0.71	1.00	1.10
Debt Leverage (x)	0.95	1.26	1.41
Inventory + Receivable/Short-term Borrowings (x)	1.46	1.14	1.15

**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				
08-03-2022	BBB+	A-2	Stable	Reaffirmed
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	March 03, 2022