RATING REPORT

Z.A. Corporation (Pvt.) Limited (ZAC)

REPORT DATE:
April 03, 2023

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	BBB+	A-2	BBB+	A-2
Rating Outlook	*Stable*		*Stable*	
Rating Action	Reaffirmed		Reaffirmed	
Rating Date	*April 03, 2023*		*March 08, 2022*	

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 – 99.998%	

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 Limited (ZAC) was incorporated in 1994 -1995 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017) as a trading company.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.

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. Product portfolio comprises viscose and cotton yarn account for majority sales; however, the company manages the counterparty risk by making sales on cash/advance basis. 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.

Operations & Capacity Utilization

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 13.35m kgs (FY21: 9.98m kgs; FY20: 7.81m kgs) on account of addition of new spindles in Dec'21. The company produced 12.77m kgs (FY21: 9.58m kgs) of yarn by operating spinning unit in 3 shifts per day during FY22. Installed capacity and production levels are tabulated below:

	FY20	FY21	FY22
Number of Spindles	43,296	54,912	67,584
Installed Capacity (mkg)	7.81	9.98	13.35
Actual Production (mkg)	7.65	9.58	12.77
Capacity Utilization (%)	98.0%	96.0%	96.0%

Additional spindles installed during FY22 reflected a total cost of Rs. 650m financed through a mix of TERF and internal cash resources to the tune of Rs. 400m and Rs. 250m respectively. The incremental spindles commenced operations in Dec'21. As per management, there are no expansion plans for FY23. However, the company is incurring cost from internal generation on a building construction so that it is available for capacity expansion after market stabilization.

<u>Sector Update</u>

Table 2: Pakistan Export Statistics

	FY20	FY21	FY22	H1'FY22	H1'FY23
PAKISTAN EXPORTS (IN USD' MILLIONS)	22,536	25,639	32,450	15,122	14,267
TEXTILE (IN USD' MILLIONS)	12,851	14,492	18,525	9,381	8,717
PKR/USD RATE (AVERAGE)	158.0	160.0	177.5	169.4	223.2
SOURCE: SBP					

- Pakistan's export growth came in at 14% and 27% in FY21 and FY22 respectively. Pakistan's export proceeds had oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally grew to USD 32.5b.
- In FY22, textile exports were up 28%. Growth in textile exports played a significant role in the uptick in Pakistan's export base, contributing 59% of the overall growth in exports. Share of textile exports in total exports has oscillated in the range of 54-59%, during the past 3-years (FY20-22).
- As illustrated in the table below, the composition of textile exports has depicted improvement in the on a timeline, with contribution from higher value added segment increasing from 77.2% in FY20 to 80.8% in FY22 of aggregate textile exports.

Table 3: Segment-wise textile Exports (All Figures in USD' Millions, except for percentages)

	FY20	FY21	FY22	H1'FY22	H1'FY23	FY20	FY21	FY22	H1'FY22	H1'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**	**7,604**	**7,235**	**77.2%**	**80.7%**	**80.7%**	**81.1%**	**83.0%**
- Knitwear	2,794	3,815	5,121	2,500	2,467	22.3%	24.8%	26.5%	26.7%	28.3%
- Readymade Garments	2,552	3,033	3,905	1,832	1,833	20.4%	19.7%	20.2%	19.5%	21.0%
- Bed wear	2,151	2,772	3,293	1,660	1,428	17.2%	18.0%	17.0%	17.7%	16.4%
- Towels	711	938	1,111	524	492	5.7%	6.1%	5.8%	5.6%	5.6%
- Made-up Articles (Excl. towels & bed wear)	591	756	849	422	378	4.7%	4.9%	4.4%	4.5%	4.3%
- Art, Silk & Synthetic Textile	315	370	460	225	209	2.5%	2.4%	2.4%	2.4%	2.4%
- Others	555	743	866	441	429	4.4%	4.8%	4.5%	4.7%	4.9%
Low to Medium Value-added Segment	**2,858**	**2,972**	**3,717**	**1,777**	**1,483**	**22.8%**	**19.3%**	**19.2%**	**18.9%**	**17.0%**
- Cotton Cloth	1,830	1,921	2,438	1,135	1,066	14.6%	12.5%	12.6%	12.1%	12.2%
- Cotton Yarn	984	1,017	1,207	610	382	7.9%	6.6%	6.2%	6.5%	4.4%
- Others	43	34	72	32	34	0.3%	0.2%	0.4%	0.3%	0.4%
Total	**12,527**	**15,399**	**19,332**	**9,381**	**8,717**					
Source: PBS										

- Cotton production in Pakistan, was at its lowest level in decades for FY21, albeit the same posted 18% uptick in FY22. Actual production at 8.33m bales still missed the targeted production of 10.5m bales. Cotton prices rose to a new 12-year high of ~Rs. 21,600/maund as of March'22, as a result of the shortage and higher input costs of fertilizer and energy. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.
- According to United States Department of Agriculture (USDA), the 2022/23 harvested area has declined notably following devastation caused by recent flood in Sindh and Southern Punjab. Hence, the projected production has been brought down to 5m bales. To counter the shortage, import of 5.8m bales is expected during FY23, which is 29% higher than preceding year.

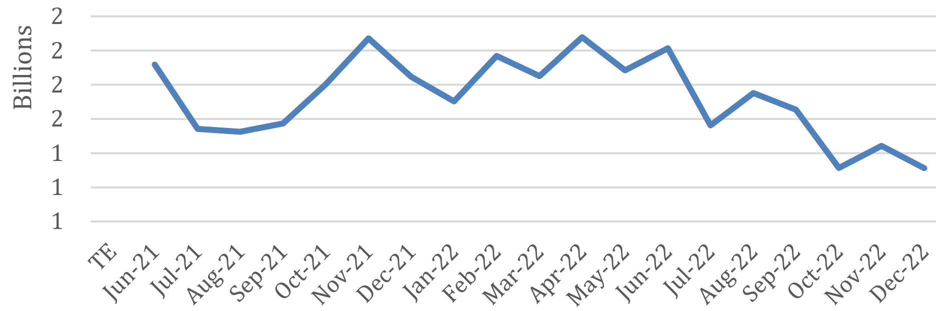
Table 4: Cotton Prices

	FY19	*FY20*	*FY21*	*FY22*
Per Maund (Rs.)	8,770	8,860	13,000	17,380
% Change	*26%*	*1%*	*32%*	*34%*

Future Outlook – Textile Industry

- After posting windfall margins in FY21 and H1'FY22, margins of textile operators, particularly spinners, weavers and dying units, have come under pressure during the period Jan-Sep'2022, mainly on account of higher input costs and recessionary trend in export markets.
- The recessionary trend in Pakistan's major export textile markets, mainly North America and EU, has started to materialize, with receipts for Q2'FY23 being 17% lower vis-à-vis corresponding period last year. The MoM decline in exports is illustrated in the graph below.

Figure 1: MoM Textile Exports (TE) (In USD' Billions)



- Given industrial gas load shedding during the period Dec-Feb'23, and prevailing recession in major export markets and peak inventory levels, export proceeds are expected to fall by 5-10% in FY23. Furthermore, profitability margins of textile operators, particularly spinners, weavers and dying companies, are expected to remain under pressure given higher input and financial costs.

Rating Drivers

Topline of the company grew by 47% during FY22 largely driven by higher average selling prices and incremental capacity commenced in the second half

- Net sales of the Company witnessed a sizeable jump of 47% and were reported at Rs.6.5b (FY21: Rs. 4.4b; FY20: Rs. 2.9b) in FY22 driven by a 12% growth in volumes and 32% increase in prices.
- Sales mix predominantly comprised viscose yarn which accounted for 95% (FY21: 97%) of net sales during FY22. Viscose yarn sales increased to Rs. 6.12b (FY21: Rs. 4.25b) on account of higher volumetric sales of 12.06 kgs (FY21: 11.08m kgs) along with higher average selling prices during the year. Meanwhile, cotton yarn sales amounted to Rs. 308.1m (FY21: Rs. 116.5m) owing to elevated volumetric sales of 0.71m kgs (FY21: 0.33m kgs) and increased average selling price. Going forward, the management expects viscose yarn to remain the major revenue contributor; however, sales mix may change according to customer demand. Breakdown of sales is tabulated below:

Sales Breakdown	FY21	FY22
Cotton – m Kgs	0.33	0.71

Cotton – m Rs.	116.5	308.1
Cotton - Price / Kg	348	432
Viscose – m Kgs	11.08	12.06
Viscose – m Rs.	4,249	6,120
Viscose - Price / Kg	383	508

- Net sales of ZAC comprises of local sales only. Customer concentration is fairly on the higher side with top 10 customers accounting for 46% of total sales. However, client concentration risk is partially eliminated due to the Company's long-term association with its clientele. Raw material coverage for six months in advance and consistent demand are also attributable for the uplift in the top line during the outgoing year.
- During 1HFY23, revenue of the Company was recorded at Rs.3.5b and management expects gradual increase in the top line with ease in LC constraints over the remaining part of the ongoing fiscal year.

Margins under pressure due to currency devaluation

- Gross profit of the Company increased to Rs.628.8m (FY21: Rs.476.8m; FY20: Rs. 392.3m), albeit gross margins dipped on a timeline basis and were reported at 9.7% (FY21: 10.9%; FY20: 13.6%) in FY22 on account of increase in prices of imported raw material led by currency devaluation, higher cotton prices and elevated fuel expense.
- Administrative expenses increased primarily due to higher remuneration and benefits expensed during the year. Finance charges were reported higher at Rs. 168.7m (FY21: Rs. 97.2m; FY20: Rs. 163.6m) mainly due to higher benchmark rates and elevated short-term borrowing levels in FY22.
- Net margin of the Company depict notable decline on account of higher financial charges. Consequently, net margins dipped to 4.8% (FY21: 5.4%; FY20: 4.3%) in FY22 which have further reduced to 2.4% in 1HFY23 as financial costs continue to drag down profitability.
- Given uncertain macroeconomic environment, improving margins will be important from a ratings perspective.

Liquidity profile of the Company depicts room for improvement.

- Funds from Operation (FFO) of the Company increased to Rs. 493.1m (FY21: Rs.439.3m; FY20: Rs. 260.5m) in FY22 being a function of increase in quantum of profits in absolute terms; however with rising debt, coverages of the same against outstanding obligations have witnessed weakening in the review period.
- FFO to Long-Term Debt and FFO to Total Debt declined to 78% (FY21: 161%; FY20: 109%) and 25% (FY21: 28%; FY20: 27%) respectively during FY22. The same furthered deteriorated significantly to 25% and 9% respectively during 1HFY23.
- Similarly, Debt Servicing ratio also sharply declined to 1.13x (FY22: 3.3x; FY21: 5.3x) during 1H'23.
- Ratings remain dependent on improvement of the liquidity indicators as per the benchmarks for the assigned ratings.

- Current ratio as of 1H'23 end stood at 1.33x while short-term borrowing coverage was at 168%; both of which are deemed adequate.
- Aging profile of trade debts is considered manageable with approximately 98% of outstanding trade receivables due within two months.

Improvement in capitalization indicators underpinned by profit retention

- Equity base of the company accumulated to Rs. 1.9b (FY22: 1.8b; FY21: Rs. 1.70b) by end-Dec'22 on account of profits retention.
- Equity profile comprises interest free loan from director to the tune of Rs. 329.1m which is payable at the discretion of the company.

- The debt profile comprises a mix of long-term (36%) and short-term borrowings (64%). The outstanding balance of long-term borrowings, inclusive of current maturity, increased to Rs. 631.1m (FY21: Rs. 273.1m) on account of mobilization of new temporary economic refinance facility of Rs. 400m during FY22 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. Short-term borrowings also increased to Rs. 1.36b (FY21: Rs. 1.27b) at end-FY22 to meet higher cost of raw materials.
- With profit retention greater than growth in debt during FY22 and decline in total debt level during HFY23 (HFY23: Rs. 1.6b; FY22:Rs. 2.0b; FY21: Rs. 1.6b) due to reduced cash conversion cycle, gearing and debt leverage ratios have improved on a timeline basis. The same were reported at 0.82x (FY22: 1.10x; FY21: 1.00x) and 1.24x (FY22: 1.53x; FY21: 1.26x) respectively, at end-HY23.
- Given no expansion plans in FY23, debt levels are expected to remain at similar levels.
- However, given the challenging market dynamics and pressure on margins, maintaining financial risk profile over the rating horizon will remain critical for ratings.

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

Financial Summary					
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**	**HYFY23**
Fixed Assets	1,279.0	1,291.7	1,696.9	2,080.8	1,986.0
Stock-in-Trade	1,038.7	1,024.3	1,434.7	1,984.2	1,546.9
Trade Debts	-	28.3	20.1	3.7	109.8
Cash & Bank Balances	25.0	77.5	96.3	65.2	160.0
Total Assets	2,488.0	2,621.3	3,509.0	4,538.5	4,209.8
Trade and Other Payables	79.0	150.9	164.0	485.4	451.2
Long Term Debt	360.0	238.9	273.1	631.1	562.1
Short Term Debt	961.8	722.1	1,272.4	1,358.6	986.1
Total Debt	1,321.8	960.9	1,545.5	1,989.7	1,548.3
Total Liabilities	1,519.4	1,273.9	1,958.3	2,745.6	2,331.5
Paid Up Capital	650.0	650.0	650.0	650.0	650.0
Total Equity (Including Directors' Loan)	968.5	1,347.4	1,550.7	1,792.9	1,878.3
	27%				
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**	**HYFY23**
Net Sales	2,586	2,895	4,385.1	6,466.6	3,500
Gross Profit	291	392.3	476.8	628.8	294
Profit Before Tax	150	179	312.3	383.3	129
Profit After Tax	90	123	237.2	309.7	85
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**FY22**	**HYFY23**
Gross Margin (%)	11.3%	13.6%	10.9%	9.7%	8.4%
Net Margin	3.5%	4.3%	5.4%	4.8%	2.4%
Net Working Capital	44	387	259.2	414.7	548
Trade debts/Sales	NA	1.0%	0.0	0.0	2%
FFO	263.8	260.5	439.3	493.1	70.7
FFO to Total Debt (%)	20.0%	27.1%	28%	25%	9%
FFO to Long Term Debt (%)	73.3%	109.1%	161%	78%	25%
Current Ratio (x)	1.04	1.41	1.2	1.2	1.33
Debt Servicing Coverage Ratio (x)	3.00	1.71	5.3	3.3	1.13
Gearing (x)	1.36	0.71	1.0	1.1	0.82
Leverage (x)	1.57	0.95	1.3	1.53	1.24
Long Term Debt to TD (%)	27%	25%	0.2	0.3	36%
Short Term Debt to TD (%)	73%	75%	0.8	0.7	64%
(Stock+Trade Debts)/STD	108%	146%	1.1	1.5	168%
ROAA (%)	4%	5%	0.1	0.1	4%
ROAE (%)	10%	11%	0.2	0.2	9%

**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				
03-04-2023	BBB+	A-2	Stable	Reaffirmed
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	Feb 23, 2023