

RATING REPORT

Z.A. Corporation (Pvt.) Limited

REPORT DATE:

May 08, 2024

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		Reaffirmed	
Rating Date	May 08, 2024		April 03, 2023	

COMPANY INFORMATION

Incorporated in 1995**External auditors:** RSM Avais Hyder Liaquat Nauman**Private Limited Company****Chairman/CEO:** Mr. Sheikh Danish Ali**Key Shareholders (with stake 5% or more):**

Sheikh Danish Ali – 96.9%

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

RATING SCALE(S)

VIS Issue/Issuer Rating Scale:

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

Z.A. Corporation (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

RATING RATIONALE

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 Limited was incorporated in 1994 -1995 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017) as a trading company.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

Company Profile

Z.A. Corporation (Pvt.) Limited ('ZAC' or 'the Company') 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 principal activity of the Company is manufacturing and sale of yarn. Registered office and mills of the Company is located at 22 K.M Sheikhpura Road, Khurrianwala, District Faisalabad in the province of Punjab.

Operations & Capacity Utilization

ZAC produces a wide range of coarse and fine counts, from 16/s to 80/s. The Company can produce yarn of 100% cotton, blended and synthetic, and polyester/cotton blends, however, the sales mix depends on the customer orders. The Company produced 12.95m kgs (FY22: 12.77m kgs) of yarn by operating spinning units in 3 shifts per day during FY23. Installed capacity and production levels are tabulated below:

Production and Utilization	FY21	FY22	FY23
Number of Spindles	54,912	67,584	67,584
Installed Capacity (Thousand Tonnes)	9.98	13.35	13.35
Actual Production (Thousand Tonnes)	9.58	12.77	12.95
Capacity Utilization (%)	96.0%	95.7%	97.0%

Key Rating Drivers

Business risk profile constrained by cyclicity, and high competition in the sector.

The business risk profile of the spinning sector in Pakistan is characterized by high level of exposure to economic cyclicity and intense competition. This sector's performance is significantly influenced by the broader economic conditions in the country, making it inherently vulnerable to fluctuations in demand driven by economic factors.

In FY23, the spinning sector faced challenges due to various economic and environmental circumstances. These included damage to the cotton crop resulting from flooding in 1HFY23, escalating inflation, and diminishing foreign exchange reserves.

The spinning sector in Pakistan comprises ~407 spinning mills, which include both composite units and spinning units. This industry exhibits a competitive market structure with many players producing relatively homogenous products.

During FY23, Pakistan's yarn production registered a substantial decline, primarily due to reduced availability of cotton, because of crop damage and import restrictions. The sector's profitability was constrained by factors such as higher production costs, increased raw material costs, and rising energy expenses, all of which constrained the sector's profit margin. The industry's performance is closely intertwined with the outlook of the cotton and textile industries, both of which were affected in FY23. Global economic slowdown and contractionary economic policies led to a decrease in demand for textile products and, consequently, cotton yarn.

While the global outlook for cotton production is expected to rebound, local challenges persist. These challenges include high interest rates, increasing energy costs, and persistent inflationary pressures. These factors are likely to result in continued sluggish performance for the spinning sector in FY24.

Stable topline supported by increasing selling prices while elevated inflationary environment has exerted pressure on the Company's margins.

In FY23, the Company's topline exhibited a growth of ~12%, mostly attributed to selling price increases with increasing input costs. In 6MFY24, the Company recorded topline erosion of ~1.4% Y/Y. However, ZAC was unable to successfully pass on the entirety of cost pressures onto the customers with heightened inflationary pressure as well as escalating raw material costs exerting stress on margins during FY23. Gross and operating margins weakened to 8.4% (FY22: 9.7%) and 7.2% (FY22: 8.54%), respectively. However, a slight improvement was noted, with gross and operating margins reported at 8.52% and 7.23% in 6MFY24, on account of continued to adjust selling price.

Adequate capitalization profile with improving metrics in FY23 and 6MFY24.

The Company maintained an adequate capitalization profile between FY20-FY22, with an average gearing and leverage ratio of 0.9x and 1.3x, respectively. In FY23, gearing and leverage indicators improved to 0.6x and 0.9x and subsequently further to 0.5x and 0.7x, respectively in 6MFY24. This improvement is primarily attributed to a sizeable reduction in the debt utilization of the Company, particularly from short-term borrowings, which stems from a decrease in its working capital requirement.

Coverage profile constrained by weakening in profitability profile.

The Company's coverage profile reported deterioration in FY23, mainly due to declining operating margins, coupled with higher financial charges paid due to a surge in local interest rates during the year. The debt service coverage ratio (DSCR) depicted weakening to 1.8x (FY22: 2.4x), albeit remaining healthy. In 1HFY24, DCSR improved marginally to 1.9x. Additionally, the short-term debt coverage is considered sufficient at 1.6x (FY23: 2.1x, FY22: 1.4x) in 6MFY24. In addition, the equity base of the Company witnessed an uptick in line with the profits reported during the period.

Adequate liquidity profile.

The Company maintains an adequate liquidity profile, with a 3-year average current ratio of 1.2x. In 6MFY24, the current ratio improved further, surpassing the average at 1.6x (FY23: 1.5x, FY22: 1.2x). Meanwhile, the cash conversion cycle slightly improved in FY23 to 69 days (FY22: 73 days), driven by reduced stock in trade, with days to sell inventory improving to 91 days (FY22: 101 days). However, this improvement was offset by a simultaneous reduction in payable days to 22 days (FY22: 29 days). Both inventory and payable days continued to decline in 1HFY24, although payable days contracted significantly to 4 days, while inventory days reduced to 73 days during the period, resulting in a net cash cycle increase to 76 days.

Considerations for Future Reviews

Going forward ratings will remain sensitive to the Company's ability to recover its profitability and coverage to be commensurate with assigned ratings. Moreover, maintenance of the capitalization and liquidity profile will also be key rating considerations for future reviews.

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

Financial Summary					
Balance Sheet (PKR Millions)	FY20	FY21	FY22	FY23	6MFY24
Property, plant, and equipment	1,291.7	1,696.9	2,080.8	1,911.8	1,875.5
Stock-in-trade	1,024.3	1,434.7	1,984.2	1,514.7	1,060.1
Trade debts	28.3	20.1	3.7	3.0	146.3
Cash & Bank Balances	77.5	96.3	65.2	10.2	18.3
Total Assets	2,621.3	3,509.0	4,538.5	3,875.4	3,610.5
Trade and Other Payables	150.9	164.0	465.4	405.1	70.7
Long-term Debt (incl. current portion)	238.9	273.1	631.1	533.1	395.1
Short-Term Borrowings	722.1	1,272.4	1,358.6	617.5	687.4
Total Debt	960.9	1,545.5	1,989.7	1,150.6	1,082.5
Total Liabilities	1,273.9	1,958.3	2,745.6	1,868.0	1,509.8
Paid up Capital	650.0	650.0	650.0	650.0	650.0
Equity (excl. Revaluation Surplus)	1,347.4	1,550.7	1,792.9	2,007.4	2,100.7
Income Statement (PKR Millions)					
Income Statement (PKR Millions)	FY20	FY21	FY22	FY23	6MFY24
Net Sales	2,895.0	4,385.1	6,466.6	7,268.5	3,451.0
Gross Profit	392.3	476.8	628.8	607.7	293.9
Operating Profit	342.5	409.5	552.0	519.4	249.3
Finance Costs	163.6	97.2	168.7	180.2	112.9
Profit Before Tax	178.8	312.3	383.3	339.2	136.4
Profit After Tax	123.4	237.2	309.7	213.0	93.3
Ratio Analysis					
Ratio Analysis	FY20	FY21	FY22	FY23	6MFY24
Gross Margin (%)	13.6%	10.9%	9.7%	8.4%	8.5%
Operating Margin (%)	11.8%	9.3%	8.5%	7.1%	7.2%
Net Margin (%)	4.3%	5.4%	4.8%	2.9%	2.7%
Funds from Operation (FFO) (PKR Millions)	260.5	439.3	493.1	405.3	223.9
FFO to Total Debt* (%)	27.1%	28.4%	24.8%	35.2%	41.4%
FFO to Long Term Debt* (%)	109.1%	160.9%	78.1%	76.0%	113.3%
Gearing (x)	0.7	1.0	1.1	0.6	0.5
Leverage (x)	0.9	1.3	1.5	0.9	0.7
Debt Servicing Coverage Ratio* (x)	2.4	3.8	2.4	1.8	1.8
Current Ratio	1.4	1.2	1.2	1.5	1.6
(Stock in trade + trade debts) / STD (x)	1.6	1.2	1.4	2.1	1.6
Return on Average Assets* (%)	4.7%	7.7%	7.7%	5.1%	5.2%
Return on Average Equity* (%)	9.2%	16.4%	18.5%	11.2%	8.9%
Cash Conversion Cycle (days)	122.6	97.4	72.6	69.4	76.1

*Annualized, if required

A - Actual Accounts

M - Management Accounts

REGULATORY DISCLOSURES		Annexure II			
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				
	08-05-2024	BBB+	A-2	Stable	Reaffirmed
	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.				
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Due Diligence Meeting Conducted	Name	Designation		Date	
	Mr. Aziz-ur-Rehman	CFO		April 26, 2024	