

RATING REPORT

Cotton Empire (Private) Limited

REPORT DATE:

December 31, 2021

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Initial Rating	
	Long-term	Short-term
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	December 31, 2021	

COMPANY INFORMATION

Incorporated in 2013	External auditors: Clarkson Hyde Saud Ansari Chartered Accountants
Private Limited Company	Chairman/CEO: Mr. Ahsan Dawood Moorad
Key Shareholders (with stake 5% or more):	
Mr. Ahsan Dawood Moorad – 96.8%	
Mrs. Sanober Ahsan – 3.2%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: *Industrial Corporates (August 2021)*

<https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf>

Cotton Empire (Private) Limited

OVERVIEW OF
THE
INSTITUTION

RATING RATIONALE

Cotton Empire (Private) Limited (CEPL) was incorporated in 2013 as a private limited company. The company is engaged in the manufacturing and sale of home textile products. The registered office of the company is situated at S.I.T.E, Karachi.

Profile of Chairman and CEO:
Ahsan Dawood Moorad is the Chairman and CEO of Cotton Empire Private Limited. He along with his spouse established Cotton Empire (Private) Limited and expanded the company's operations to UAE. Mr. Moorad also has a construction business by the name Azure Developers involved in the construction projects in Pakistan. He is also a member of the Board of Trustees in Iqra University. Mr. Dawood holds a bachelor's degree in Journalism from California State University.

Cotton Empire (Private) Limited (CEPL) is engaged in production and sale of home textile products primarily terry towels, bedding products and other textile made ups. The company is headquartered in Karachi with registered office and factory situated at S.I.T.E area. CEPL is a family owned business with the shareholding vested between two individuals *Mr & Mrs.* Dawood. Mr. Dawood leads the company as the Chief Executive, actively involved in the business operations. CEPL is primarily an export-oriented company with around 99% export sales.

Operations

CEPL's business operations encompass cutting, stitching and packing facility only and export of finished terry towels, bed sheet sets and other home textile variants. The Company has an installed annual stitching capacity of producing towels and bed sheets of 4.8m lbs and 1.56m meter, respectively, operating at high capacity levels. CEPL offers different variety of products in towels and fabric which includes wash cloth, bath and hand towels, bed sheet sets, Rot Fabric and Duvet Cover. The power requirements are met through K-Electric and power generators installed as the back-up.

The company has rolled out a CAPEX plan to expand business operations backwards into weaving operations to enhance operational efficiency. CEPL is in process of installing 24 looms at a new production site in Nooriabad which is expected to come online in the start of 2022. Total cost of the project is estimated at around Rs 800m –Rs.1bn, of which about ~Rs 291m will be financed through Islamic Long Term Financing Facility (ILTFF) and remaining will be contributed by sponsors and internal cash. The new construction facility is a green building with LEED Certification.

Key Rating Drivers

Strong growth prospects in the textile sector supports business risk of the company however volatility in raw material prices and increasing freight costs continue to remain key risks.

Textile exports of Pakistan recorded double digit growth of 23% for FY21 to stand at USD 15.4b, with the ambition of the government to enhance it further for FY22. Further growth of 27.3% was witnessed during 1QFY22 vis-à-vis 1QFY21. Value-added segment contributed mostly towards the textile export growth. Going forward, sector dynamics are considered sound as Pakistan continues to receive export orders, especially for value added textile products, from global economies. However, skyrocketing cotton prices and significant increase in freight cost continue to remain key business risk factors.

Consistent growth in revenues and improvement in margins on a timeline basis

Net sales have grown at a healthy CAGR of 19.8% during the last three financial years and reported at Rs. 1.8b (FY20: Rs. 1.6b; FY19: Rs. 1.5b) in FY21. Increase in business has largely been a function of higher selling prices achieved on a timeline. Wash cloth item continue to be major contributor in revenue followed by bath sheet and bath towel. The clientele of CEPL are mostly operating within discount retail market place like Ross, Family Dollar Service, Big Lots

and etc. CEPL also markets its products on Amazon USA through Bliss Casa- an online based company established in USA.

In terms of geographic concentration, around 43% of sales are generated from US, followed by Europe (32%) while remaining 25% are concentrated with related party Cotton Empire Textiles LLC, which in turn sells in the middle east region. Customer concentration is considered to be on the higher side; however it is partly mitigated through long standing relationship with the customers which remained intact even during pandemic related slowdown. Going forward, sales are expected to grow on account of adequate orders in pipeline and projected increase in average selling prices.

Margins of the company have remained strong over the years, depicting strong operational efficiencies and low gearing structure. Profitability as a result has grown over time, albeit remaining small. Limited scale of business remains a rating constraint.

Going forward, while the company is targeting higher revenues and profitability, we expect some pressure on net margins once long term debt related to expansion is drawn.

Lack of business integration elevates business risk of the company.

At present, company's operations encompass only cutting, stitching and packing facility. Lack of business integration remains a key business risk with respect to limitations arising on account of product availability, lead time and product quality. While historically the company has been able to navigate through successfully, evident from consistent financial performance, it remains a key risk. However, current expansion into weaving operations will mitigate this risk to some extent, going forward.

Liquidity profile is considered adequate

The company's funds from operations have increased on a timeline based on improved profitability. In absolute terms, FFO amounted to Rs. 186.8m (FY20: Rs. 107.4m; Rs. 103.1m) during FY21 with FFO/Total debt standing at 46.5% (FY20: 48.9%). Historically, with no long term debt, debt servicing has remained comfortable, however, we expect some pressure on debt servicing once expansion related debt is drawn, albeit remaining within satisfactory levels. Working capital of the company depicts some weakening with cash conversion cycle increasing on a timeline basis (FY21: 149 days; FY20: 126 days; FY19: 85 days) on account of increased credit to sister concern, Cotton Empire Textiles LLC. Going forward, working capital discipline is considered important for rating purposes. Current ratio stands at 1.74x (FY20: 1.82) at end FY21. Inventory and Receivables provide adequate coverage for short term borrowings.

Conservative financial management supports risk profile of the company

Equity base of the company has grown at a CAGR of 36.8% over the last 3 years (FY19-FY21) due to profit retention. The Sponsors have injected interest free loan of Rs. 53.5m during FY21 and further additions expected during FY22 to fund the expansion Debt profile of the company comprises solely short term borrowings. During FY21, adjusting for director's loan within equity, gearing and leverage ratios stood at 0.60x (FY20: 0.50x) and 1.11x (FY20: 1.19), respectively in FY21. Leverage indicators are projected to increase due to debt drawdown for ongoing funding required for backward expansion (mobilized concessionary loan facility of Rs. 291m); however are projected to remain manageable over the rating horizon. Ratings remain dependent upon maintaining sound capitalization indicators.

Corporate Governance reflective of Company's operational status as a family-owned unlisted entity.

Corporate Governance infrastructure in place is reflective of company's operational status as a family-owned unlisted entity. At present, the Board Chairman and CEO position is held by the same individual. Corporate governance setup may be strengthened through improvement in board composition and oversight.

Internal controls commensurate with the size of the company. IT systems are well established with SAP Business One PL Version 9.4 installed for operational and financial management. The external auditors of the Company possess QCR approved rating.

Cotton Empire (Pvt) Ltd
Appendix I

BALANCE SHEET	FY18	FY19	FY20	FY21
Property, plant and equipment	22.6	22.4	21.6	256.8
Stock-in-Trade	256.8	344.8	434.0	305.6
Trade Debts	146.6	282.4	493.2	829.1
Cash & Bank Balances	1.3	8.2	18.6	9.9
Total Assets	429.6	659.2	970.1	1,404.3
Trade and Other Payables	169.4	197.4	300.6	322.1
Long Term Debt	-	-	-	3.2
Short Term Debt	10.0	114.0	219.5	398.8
Total Debt	10.0	114.0	219.5	402.0
Total Liabilities	190.3	329.3	527.0	792.1
Paid Up Capital	50.0	50.0	50.0	50.0
Total Equity	239.4	329.9	443.1	612.2
INCOME STATEMENT	FY18	FY19	FY20	FY21
Net Sales	1,092.9	1,525.3	1,621.9	1,876.9
Gross Profit	195.7	252.7	291.6	347.2
Profit Before Tax	73.9	104.2	126.8	184.2
Profit After Tax	63.4	90.6	113.2	169.1
RATIO ANALYSIS	FY18	FY19	FY20	FY21
Gross Margin (%)	17.9%	16.6%	18.0%	18.5%
Net Margin (%)	5.8%	5.9%	7.0%	9.0%
FFO	71.3	103.1	107.4	186.8
FFO to Total Debt (%)	713.0%	90.5%	48.9%	46.5%
Current Ratio (x)	2.26	2.04	1.82	1.59
Debt Servicing Coverage Ratio (x)	10.2	7.9	9.1	13.3
Gearing (x)	0.04	0.35	0.50	0.60
Leverage (x)	0.79	1.00	1.19	1.11
(Stock in Trade + Trade Debts)/STD	4034.6%	550.1%	422.4%	284.5%
ROAA (%)		16.6%	13.9%	14.2%
ROAE (%)		31.8%	29.3%	32.1%

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						Appendix III
Name of Rated Entity	Cotton Empire (Private) 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/Dec/2021	A-	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 Meetings Conducted	Name	Designation		Date		
	Mr. Shahzaib Qureshi	Chief Financial Officer		October 12, 2021		
	Mr. Ahsan Dawood	Chairman/CEO		November 08, 2021		