RATING REPORT

Ejaz Spinning Mills Limited

REPORT DATE:
June 27, 2022

RATING ANALYSTS:

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RATING DETAILS		
	Previous Rating	
Rating Category	Long-term	Short-term
Entity	A-	A-2
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*27th June' 22*	

COMPANY INFORMATION

Incorporated in 1990	External auditors: Rahman Sarfaraz Rahim Iqbal Rafique Chartered Accountants.
Unquoted Public Limited Company	Chairman/CEO: Mr. Gohar Ejaz
Key Shareholders (with stake 5% or more):	
Mr. Gohar Ejaz – 90.0% Mr. Ejaz Ahmed – 9.5%	

APPLICABLE METHODOLOGY(IES)

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

Ejaz Spinning Mills Limited

OVERVIEW OF THE INSTITUTION

Ejaz Spinning Mills Limited (ESML) was incorporated in Pakistan on April 24, 1990 as an unquoted public limited company. The company is engaged in manufacturing and sale of yarn. Head office is situated at 34/E-1, Gulberg III Lahore.

Profile of the Chairman/CEO
Gohar Ejaz is the founder and major shareholder of Ejaz Group. He has over three decades of experience in the textile and real estate sectors. He is a business graduate from Karachi University.

Financial Snapshot

Tier-1 Equity: end-HY22: Rs. 3.97b; end-FY21: Rs. 3.34b; end-FY20: Rs. Rs. 2.52b.

Assets: end-HY22: Rs. 6.62b; end-FY21: Rs. 6.45b; end-FY20: Rs 6.28b.

Net Profit: HY22: Rs. 627m; FY21: Rs. 795m; FY20: Rs. 259m.

RATING RATIONALE

Company Overview
Ejaz Spinning Mills Limited (ESML) was incorporated in Pakistan on April 24, 1990 as an unquoted public limited company. The company is engaged in manufacturing and sale of yarn vis its two spinning units, having 55,000 spindles of Japanese origin designed to produce fine yarn of 40-60 counts. The manufacturing facility is situated at Faisalabad Road, Sheikhupura. Shareholding of the company is mainly held by sponsoring family, with Mr. Gohar Ejaz being the largest shareholder with 90.0% stake in the company, while rest of the holding is with individual family members.

ESML is a part of Ejaz Group which established in 1950 in order to pursue commodities trading business including petroleum products, metals, edible oils, and industrial raw materials. 1980, the group set up its first industry unit under the name of Mian Nazir Sons Industries (Pvt.) Limited. Currently, the group is focused on textile and real estate businesses with three companies including ESML.

Ejaz Textile Mills Limited (ETML) was incorporated in 1987 as an unquoted public limited company under the name "Imran Spinning Mills Limited", which was later changed in May 2002. The company is engaged in manufacturing and sale of cotton yarn. The company has two spinning units with 32,000 spindles of Japanese/German origin, designed to produce coarse yarn of 10-30 counts. The manufacturing facility is situated at Multan Road, Bhai Pheru, District Kasur. Shareholding of the company is mainly held by sponsoring family, with Mr. Gohar Ejaz being the largest shareholder with 78.5% stake in the company, followed by 21.25% held by Ejaz Spinning Mills Limited.

Lake City Holdings (Pvt.) Limited (LCH) was established in 2005 with the aim to pursue real estate development business, consisting of 2,500 acers of residential society in Lahore with complete amenities on near ring road Lahore. Phase I comprises land of 12,000 kanal out of which 80% has been developed. Phase II comprises land of 12,000 kanal and has recently launched for development of residential and commercial areas. Shareholding of LCH is held by Ejaz Group 90.9% and Mayfair Group 9.1%.

Figure: Financial summary of Lake City

Rs. Million	FY20	FY21
Total Assets	25,998	25,136
Revenue	2,373	5,475
Profit	241	1,047
Total Liabilities	22,757	23,470

Note: Financial statements of the company have been audited by Rahman Sarfaraz Rahim Iqbal Rafique Chartered Accountants who have provided qualified opinion based on measurement of interest-free long-term loans and deferred interest of Rs. 107m and Rs. 7m, respectively, on historical costs where the IFRS-9 requires measure of the same at amortized costs. As per the management, previously this issue was expressed as 'Emphasis of Matter', however, this year the auditors have given as 'Qualified Opinion' due to change in format of audit's report.

Production capabilities
The company's business activities include manufacturing and sale of fine yarn of count ranging from 40 to 60. The company has two spinning units having a total of 54,912 spindles which can produce up to 22.16m kgs of yarn per annum. The drop in capacity utilization during FY20 was due to closure of operations as result of coronavirus pandemic. Capacity utilization levels have remained largely stable over the years. No capacity enhancements or major BMRs were carried out in the past three years, as reflected in capex of Rs. 37m (FY20: Rs. 17m) during FY21. The company plans to add 16,000 spindles

over the next two years with an estimated capex of Rs. 1.0b that will mainly be funded through internal capital generation.

Figure: Capacity utilization

	FY19	FY20	FY21	HY22
Number of Spindles (No.)	54,912	54,912	54,912	54,912
Production Capacity (mil kg)	22.160	22.160	22.160	11.08
Actual Production (mil kg)	21.185	17.866	22.094	10.98
Capacity Utilization (%)	95.6%	80.6%	99.7%	99.1%

Assts Mix

Total assets of the company stood higher at Rs. 6.62b (FY21: Rs. 6.45b) at end-HY22. Property, plant & equipment increased slightly to Rs. 2.50b (FY21: Rs. 2.39b) on account of maintenance capex exceeding depreciation charge during the year. Long-term investment remained unchanged at Rs. 1.47b (FY21: Rs. 1.47b) which represents 21.25% equity stake in ETML and 29.31% equity stake in LCH. Stock in trade declined to Rs. 404m (FY21: Rs. 500m) by end-HY22, as the company continued to source cotton from international markets which is procured after every three months vis-à-vis local cotton which is procured for the entire year. Since the company makes sales on a credit period of 30 days to 60 days, trade receivables increased to Rs. 980m (FY21: Rs. 552m) by end-HY22 on account of increase in average price, higher sales, and extended credit period availed by some customers. Advances and other receivables decreased to Rs. 926m (FY21: Rs. 1.20b) which mainly include due from related party, divided receivable, letters of credit, and advances to employees. The company held properties for resale amounting to Rs. 119m (FY21: Rs. 119m) at end-HY22.

Sales and Profitability

Net sales of the company increased to Rs. 5.77b (FY20: Rs. 3.58b) during FY21, mainly on account of a combination of higher volumes of 201,212 bags (FY20: 146,480 bags) and improved average selling price of Rs. 28,679/bag (FY20: Rs. 24,404/bag). Majority of sales were made to local value-added textile units and amounted to Rs. 4.70b (FY20: Rs. 2.99b) while exports amounted to Rs. 451m (FY20: Rs. 94m) during FY21.

Figure: Breakdown of sales (Rs. mil)

		FY20			FY21	
Rs. Mil	**Local**	**Export**	**Total**	**Local**	**Export**	Total
Yarn	2,989	94	3,084	4,695	451	5,145
Waste	453	38	491	606	19	625
Total	3,443	132	3,575	5,301	470	5,770

Cost of sales increased to Rs. 4.87b (FY20: Rs. 3.45b) owing to higher production levels and average procurement price of Rs. 277/kg (FY20: Rs. 247/kg) during the year. Gross profit was reported higher at Rs. 903m (FY20: Rs. 128m) on account of higher sales and improvement in gross margin to 15.6% (FY20: 3.6%) during FY21. Operating expenses amounted to Rs. 336m (FY20: Rs. 248m) with increase mainly emanating from higher admin expenses to adjust the impact to inflation and other expense of Rs. 135m (FY20: Rs. 40m) owing to workers' welfare and profit participation funds. Profitability of the company is supported by other income which amounted to Rs. 447m (FY20: Rs. 541m), share of profit from associate of Rs. 405m (FY20: Rs. 102m), land resale gains of Rs. nil (FY20: Rs. 390m), and markup income of loans to related parties during FY21. The company incurred financial charges of Rs. 103m (FY20: Rs. 108m) during the year. Accounting for taxation, the company reported higher net profit of Rs. 795m (FY20: Rs. 259m) which translated into net margin of 13.8% (FY20: 7.3%) during FY21.

Figure: Cotton volumes and price

Year	Volume (Kgs)	Average Price/Kg
FY19	13,653,438	232
FY20	10,774,232	247
FY21	11,496,902	277

The company has reported net sales of Rs. 3.63b during HY22, driven largely by increase in average selling price to Rs. 37,644/bag and slightly higher volumetric sales. Gross profit amounted to Rs. 646m on account of higher sales and further improvement in gross margin of 17.8% as impact of higher cotton price was offset by favorable yarn price during the period. Share of profit from associate amounted to Rs. 200m during the period. Thereby, the company reported higher net profit of Rs. 627m during HY22.

Figure: Share of profits from associates

Rs. Million	FY19	FY20	FY21
Ejaz Textile	61.5	31.2	98.9
Lake City	95.5	70.7	306.9

Liquidity

Liquidity profile is supported by internal cash flows generation and satisfactory working capital cycle. In line with the higher profits, the company generated funds from operations (FFO) of Rs. 458m (FY20: Rs. 297m) during FY21. The company's repayment capacity is considered satisfactory, as reflected in the debt service coverage of 1.61x (FY20: 1.88x) and FFO-to-total debt ratio of 0.80x (FY20: 0.30x) at end-FY21, which is partially a function conservative capital structure. Current ratio has steadily improved on a timeline basis to 1.53x (FY21: 1.12x) by end-HY22. Cash conversion cycle is satisfactory at 11 days (FY21: -9 days) while short-term coverage ratio stood higher at 6.03x (FY21: 14.1x) at end-HY22.

Capitalization

Equity base of the company accumulated to Rs. 4.0b (FY21: Rs. 3.34b) by end-HY22 on account of profits retention. Total liabilities decreased to Rs. 1.58b (FY21: Rs. 2.05b) with trade payable being the largest component. Trade & other payable stood at Rs. 1.03b (FY21: Rs. 1.08b) which also included advances against land amounting to Rs. 650m (FY21: Rs. 688m). Utilization of short-term borrowings stood at Rs. 229m (FY21: Rs. 75m) to fund the working capital requirements. Long-term loans declined to Rs. 231m (FY21: Rs. 496m) on account of schedule repayments. Gearing and debt leverage ratios have steadily decreased on a timeline basis to 0.12x (FY21: 0.17x) and 0.40x (FY21: 0.62x) by end-HY22. Given no plan to mobilize new long-term over the ratings horizon, leverage indicators are expected to improve further owing to equity accumulation, going forward.

Related Party Transactions

The company entered into following transactions with the related parties during the year:

Name	Nature	FY20	FY21
ETML/LCH	Interest income short-term loans to ESML/LCH	Rs. 46m	Rs. 34m
LCH	Divided Income	Rs. 69m	Rs. 264m
LCH	Transfer of Land against short-term loans	Rs. 400m	-
ETML/LCH	Short-term loans given	-	Rs. 349m
LCH	Advances against property	Rs. 213m	Rs. 106m

The company also has following outstanding balances with the related parties:

Name	Nature	FY20	FY21
LCH	Divided Receivable	Rs. 44m	Rs. 264m
ETML	Due from Related Parties	Rs. 337m	Rs. 686m
ESML	Interest Receivable	Rs. 46m	Rs. 80m

Ejaz Spinning Mills Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**HY22**
Property, Plant & Equipment	2,474	2,419	2,390	2,498
Long-term Investment	1,298	1,331	1,473	1,473
Stock-in-Trade	715	944	500	404
Trade Debts	840	682	552	980
Advances, Deposits and Other Receivables	350	445	1,201	926
Other Assets	483	455	338	336
Total Assets	**6,159**	**6,275**	**6,454**	**6,617**
Trade and Other Payables	1,325	1,265	1,084	1,027
Deferred Liabilities	275	275	7	7
Other Liabilities	90	132	388	80
Short-Term Borrowings	267	265	75	229
Long-Term Borrowings *(Inc. current matur)*	863	733	496	231
Total Liabilities	2,821	2,673	2,058	1,575
Tier-1 Equity	**2,241**	**2,523**	**3,339**	**3,967**
Paid up Capital	**1,000**	**1,000**	**1,000**	**1,000**
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**HY22**
Net Sales	4,452	3,575	5,770	3,629
Gross Profit	277	128	903	646
Other Income	479	541	447	201
Profit Before Tax	455	313	881	673
Profit After Tax	375	259	795	627
FFO	341	297	458	673
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**HY22**
Gross Margin (%)	6.2	3.6	15.6	17.8
Net Margin (%)	8.4	7.3	13.8	17.3
Current Ratio	1.07	1.12	1.53	1.99
Net Working Capital	143	261	886	1,305
FFO to Long-Term Debt	0.40	0.41	0.92	-
FFO to Total Debt	0.30	0.30	0.80	-
Debt Servicing Coverage Ratio (x)	1.46	1.88	1.61	-
Gearing (x)	0.50	0.40	0.17	0.12
Debt Leverage (x)	1.26	1.06	0.62	0.40
Inventory + Receivable/Short-term Borrowings (x)	5.83	6.13	14.11	6.03

**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	Ejaz Spinning Mills Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see table below
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
June 27, 2022	A-	A-2	Stable	Initial

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Muhammad Abid	CFO	25th April, 2022