The Pakistan Credit Rating Agency Limited

Rating Report

Allawasaya Spinning Mills (Pvt) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Apr-2019	BB+	A3	Stable	Maintain	-
28-Dec-2018	BB+	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the adequate business profile of Allawasaya Spinning Mills Limited and its association with an established business family in spinning sector of the textile industry. The Company is engaged in the manufacturing and sale of cotton yarn. Recent devaluation of Pakistani currency had little impact on the Company's revenue, since all its sales are made in the local market. The Company has a small size, low margins and limited profitability.The Company's margins were lower than other similar companies in the spinning sector, mainly due to higher finance cost. In the long term, the planned BMR is expected to bring in efficiency gains and improved margins. The financial profile of the Company is characterized by moderate leveraging and moderate coverages. Long- term debt occupies the major portion of total debt, while short term borrowings vary with seasons, increasing during the cotton procurement season.

The ratings are dependent upon the sponsor support and management's ability to improve margins, profitability and financial profile of the Company. This includes keeping the debt levels manageable and improve the Company's competitive position in the industry.

Disclosure

Name of Rated Entity	Allawasaya Spinning Mills (Pvt) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Textile(Oct-18)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure Allawasaya Spinning Mills (Pvt) Limited (The Company) was established in 2004

Background The Company is a venture of "Jamil Family", a well-respected family of industrialists in Multan. The Company is engaged in the production of cotton yarn and man-made fibres.

Operations The Company operates a single spinning unit with 17,500 spindles. The Company's head office and production facility are located in Multan, on a 38 acres facility that the Company shares with Allawasaya Textile and Finishing Limited.

Ownership

Ownership Structure Mian Muhammad Jamil owns the company (7%) directly and (36%) indirectly through his daughters. Mian Alamgir Jamil, son of Mian Jamil owns (43%) directly and (14%) indirectly through his wife.

Stability The Company was set up specially to engage and transfer over the technical and business skills of the first generation to the second generation of the Jamil family. The Company encompasses the advice and expertise of first-generation and leadership of the new generation. Although, no official succession plan has been announced till date.

Business Acumen Besides Allawasaya Spinning the family has a 34% stake in "Allawasaya Textile & Finishing Mills Limited" which is engaged in the production of yarn. The sponsors have vast experience and knowledge of various aspects of textile value-chain.

Financial Strength The total net worth of the Jamil family is established ~PKR500 mln. Sponsor's link with other group companies, provide comfort to the company in case of any need.

Governance

Board Structure The board comprises of two people i.e. Mian Muhammad Jamil in the capacity of Chairman and Mian Alamgir Jamil as the company CEO.

Members' Profile All the board members are highly qualified in different disciplines and carry ample experience in textile as well as other industries. Mian Muhammad Jamil is a textile engineer and carries 45 years of industry experience. Mian Alamgir has been associated with the textile business since 2002 and holds a BBA. Both the CEO and Chairman are also on the board of directors of Allawasaya Textile and Finishing Mills Limited.

Board Effectiveness Being a private Company, Allawasaya Spinning does not comply with code of corporate governance and there is no independent director on the board. There is no system to record the board minutes and the overall governance structure needs improvement.

Financial Transparency External auditors of the company "PKF F.R.A.N.T.S & Co" are listed under category "B" by SBP. The auditors issued an unqualified opinion on the Company's financial statements for FY18.

Management

Organizational Structure The organizational structure of the Company is divided into three main departments namely, i) Finance, Admin & Marketing, ii) Purchase, and iii) Production. The finance, admin and marketing department reports directly to the CEO while other departments report to the Chairman.

Management Team Mian Muhammad Jamil is a textile engineer by profession and carries 45 years of experience. The CEO has completed his BBA (Hons) and has been associated with the textile business since his graduation, earning him excessive experience to run to handle the affairs of the Company.

Effectiveness The Company has no management committees. Sponsor's close involvement in day to day affairs of the business bodes well with the effectiveness of the company.

MIS The Company has built an in-house ERP to cater the business needs. The senior management monitors the business performance through certain Key MIS reports.

Control Environment Production is completely order driven, there is a rigorous quality check done on the end product by the QC department. The Company has obtained ISO 9001 certification.

Business Risk

Industry Dynamics Textile exports of the country grew by ~9% in FY18, backed by devaluation of the rupee, bailout package from the government and GSP Plus Scheme of the EU. During 9MFY19, however, exports stagnated. Even though major segments including cotton cloth, knitwear, garments and bedwear displayed strong quantitative growth, industry players needed to share the benefit of the currency depreciation with their buyers which resulted in a unit price dip across all major categories, curbing overall growth. This, coupled with cotton yarn displaying double-digit quantitative decline on account of the US-China trade war as well as strong domestic demand for yarn, resulted in overall increase in exports of only ~0.1% YoY. Going forward, the devalued currency, recently announced relief in electricity tariffs for textile players as well as expected payment of tax refunds is expected to boost exports.

Relative Position With 17,500 operational Spindles, Allawasaya Spinning Mills position in Pakistan's Spindle capacity is considered small. The Company plans to carry out a BMR to add 7,500 more Spindles to its existing capacity. After the execution of this proposed BMR, the Company's total Spindle capacity will grow significantly, consequently strengthening the Company's market position. However, on standalone basis, the Company's share in local spinning industry is minimal.

Revenues The Company does not have brand-based clientele and sells all of its output locally in Faisalabad through sales brokers. The Company's revenues have followed an upward trend during 1HFY19. During 1HFY19, the Company's revenues clocked in at PKR 659mln and is projected to be PKR 1,383mln at the end of FY19 (FY18: 992mln) a 40% growth, owing to better yarn prices in the market.

Margins Gross margins in 1HFY19 remained under pressure (1HFY19: 3.3%, FY18: 3.5%) due to increase in the cost of cotton. Operating margins remained stagnant in 1HFY19 (1HFY19: 2.5%, FY18:2.5%), while net profitability improved to 0.5% (FY18: 0.3%) due to lower finance cost compared to the previous period.

Sustainability In line with improving business environment, the Company is planning to start a BMR, which will add 7,500 Spindles to existing capacity. The total cost of CAPEX is estimated to be PKR 130mln, which will entirely be funded from equity. BMR is expected to bring in efficiency gains, lowering cost per spindle and will consequently improve margins.

Financial Risk

Working Capital The Company's net working capital cycles increases with higher receivable days and during cotton procurement season. Net working capital cycle increased to 16 days in IHFY19 (FY18: 8 days) due to decrease in payable days in IHFY19 to 19 days (FY18: 29 days). Average inventory days decreased in IHFY19 to 25 days (FY18: 27 days) on the back of increase in the total revenue compared to previous period.

Coverages Despite proportionate decrease in finance cost (1HFY19: 3.8mln, FY18: 9.5mln) due to a major drop in the current portion of long term borrowings., the Company's cash flow from operations (FCFO) decreased significantly in 1HFY19 to 8mln, when compared to last period (FY18: 28 mln), Consequently, decreasing interest coverage ratio in 1HFY19 to 2.2x (FY18: 3.2x) and debt coverage ratio to 0.5x (FY18: 0.6x).

Capitalization The Company has a highly leveraged capital structure. In 1HFY19, leverage increased to 58.6% (FY18: 68.7%) mainly due to a reduction in long-term borrowings and injection of PKR 30mln owner's equity to serve as the first installment of the proposed BMR . STB maintained their share in the total borrowing with only negligent variance in IHFY19 at 30.8% (FY18: 30%).

Textile and Allied
Financials (Summary) in PKR mln
The Pakistan Credit Rating Agency Limited

PKR mln

Allawasaya Spinning Mills (Pvt) Limited
Private Limited

	A BALANCE SHEET	Dec-18	Jun-18	Jun-17	Jun-16
		6M	12M	12M	12M
1	**Non-Current Assets**	**300**	**303**	**313**	**323**
2	**Investments**	**-**	**-**	**-**	**-**
a	Equity Instruments	-	-	-	-
b	Debt Instruments	-	-	-	-
3	**Current Assets**	**145**	**182**	**129**	**180**
a	Inventory	98	85	59	67
b	Trade Receivables	15	52	6	16
c	Others	31	44	64	97
4	**Total Assets**	**465**	**505**	**442**	**503**
5	**Borrowings**	**207**	**248**	**210**	**289**
a	Short-Term	47	47	31	91
b	Long-Term (Incl. CMLTB)	161	201	178	198
6	Other Short-Term Liabilities	105	144	122	104
7	Other Long-Term Liabilities	5	-	-	-
8	**Shareholder's Equity**	**147**	**113**	**110**	**110**
9	**Total Liabilities & Equity**	**465**	**505**	**442**	**503**
	B INCOME STATEMENT				
1	**Sales**	**659**	**992**	**665**	**821**
2	**Gross Profit**	22	34	10	16
3	Non Operating Income	(1)	(0)	19	0
4	Total Finance Cost	(4)	(10)	(14)	(16)
5	**Net Income**	**3**	**3**	**0**	**(15)**
	C CASH FLOW STATEMENT				
1	Free Cash Flow from Operations (FCFO)	13	28	10	12
2	Total Cashflows (TCF)	13	28	10	12
3	Net Cash changes in Working Capital	(0)	(75)	98	(41)
4	Net Cash from Operating Activities	8	(54)	93	(46)
5	Net Cash from InvestingActivities	(1)	(19)	17	0
6	Net Cash from Financing Activities	(11)	48	(79)	49
7	Net Cash generated during the period	(4)	(26)	31	3
	D RATIO ANALYSIS				
1	**Performance**				
a	Sales Growth (for the period)	33%	49%	-19%	#DIV/0!
b	Gross Profit Margin	3%	3%	1%	2%
c	Net Profit Margin	1%	0%	0%	-2%
d	Return of Equity	5%	3%	0%	-13%
2	**Working Capital Management**				
a	Gross Working Capital (Inventory Days + Receivable Days)	34.7	37.2	40.7	29.4
b	Net Working Capital (Inventory Days + Receivable Days - Payable Days)	15.6	8.3	4.1	4.8
3	**Coverages**				
a	Debt Service Coverage (FCFO / Finance Cost+CMLTB+Excess STB)	0.8	0.6	0.2	0.2
b	Interest Coverage (FCFO / Finance Cost)	3.7	3.2	0.8	0.8
c	Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	8.6	10.9	-62.8	-80.0
4	**Capital Structure (Total Debt/Total Debt+Equity)**				
a	Capital Structure (Current Borrowings / Total Borrowings)	16	8	4	5
b	Capital Structure (Total Borrowings / Total Borrowings+Equity)	59%	69%	66%	72%

Apr-19

Rating Scale

Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

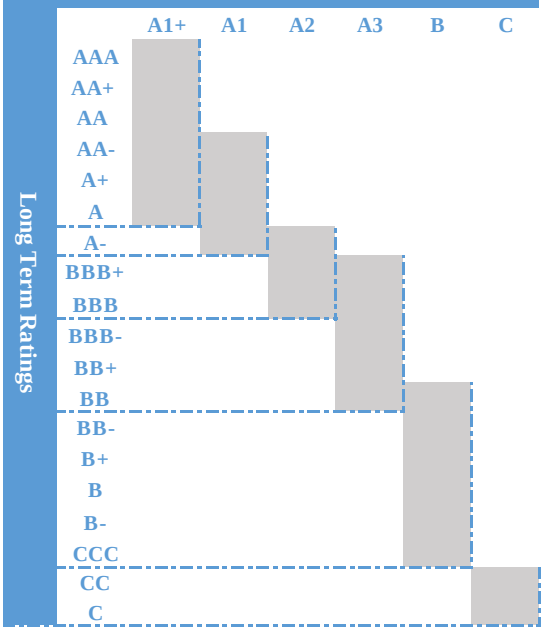
Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.

Short Term Ratings



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information