The Pakistan Credit Rating Agency Limited

Rating Report

A.J. Textile Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
12-Oct-2022	A-	A2	Stable	Maintain	-
12-Oct-2021	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

AJ Textile, a private limited company is a group concern of Aziz group – one of the oldest conglomerates, with business ventures in Textile (Yarn Production); FMCG (Match Manufacturing), Laminated Boards, MDF and Particles Chip Board Production. The Group has entered into Real Estate Sector with its first project (AJ Tower) under development in Islamabad. Over the years, since its commencement, the Company has expanded into three units with an installed capacity of 109,432 spindles, producing blended, cotton, and plied yarns in Ring and Vortex spinning (equivalent to 15,000 spindles). The Company has installed a power generation capacity of 9 MW power plant and a 5.6 MW solar plant on its profile. Further solar plant capacity is expected to be raised by 1.4 MW. The ratings incorporate the Company's moderate yet improving business profile where the revenue is emanating from a single segment. Further improvement in the control environment remains vital. The management meetings are held regularly with follow-up points to resolve or proactively address operational issues, if any, eventually ensuring a smooth flow of operations. The Company largely caters to the needs of the local market. During 9MFY22, the revenue of the company increased by 46% YoY to stand at PKR 8.3bln along with sizably improved profitability. The Company has a moderately leveraged capital structure, maintained over the years. The strengthening of the equity base has enhanced the risk absorption capacity of the company. Coverages improved, whereas, the cash cycle remained intact. During FY22, Pakistan's textile exports surged to $19.3bln (recording a growth of 26%). Exports grew owing to increased volumetric growth of (16% YoY) in the value-added segment, a steep rise in global demand, and record high cotton prices. Under the value-added category, the knitwear segment remained the top performer by posting 34% YoY growth in exports to $5.1 billion in FY22 due to a sharp rise in global demand, especially in the US and European countries. Other value-added segments such as ready-made garments, bed wear, and towel posted YoY growth of 29%, 19%, and 19% to $3.9 billion, $3.3 billion, and $1.1 billion respectively. However, a slowdown is expected in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries.

The ratings are dependent on improving the business profile under the current economic conditions; and a strong financial profile with strong coverages. Improvement in governance framework and inclusion of independent oversight remains essential. The ability to generate ensuing cash flows to fulfill its financial obligations will remain critical for the ratings.

Disclosure	
Name of Rated Entity	A.J. Textile Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Spinning(Sep-22)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure AJ Textile commenced operations in 1993 with the establishment of its first blended and cotton yarn spinning mill i.e., Unit #1 located at Gadoon Amazai, Khyber Pakhtunkhwa. Followed by Unit #2, which started production in 2004, and Unit #3 in 2013 with Piled yarns followed by MVS yarns in 2016-17.

Background AJ Textile is associated with Aziz Group of Industries since its inception. Aziz Group is one of the oldest conglomerates, with business ventures in Textile (Yarn Production); FMCG (Match Manufacturing); Real Estate Sector (AJ Tower – project under development), Laminated Boards, MDF and Particles Chip Board Production.

Operations The Company's current operational capacity comprises 109,432 Spindles. The total energy requirement of the Company is 205,000 units/day which is met by the in-house power generation of 15.6 MW through ~5MW gas-based generators plus HFO and Solar based generation.

Ownership

Ownership Structure AJ Textile is a privately owned Company, through sponsoring individuals. The major shareholder is Mr. Mohsin Aziz, followed by Mr. Afan Aziz.

Stability The entire Aziz Group comprises private limited companies. Documentation is in place concerning the transfer of ownership to the next generation.

Business Acumen Aziz Group is one of the oldest conglomerates in Pakistan, which traces its roots as far back as the 1940s. Operating under the Aziz family for more than six decades, the Group has adequately expanded its operations manifolds despite the competitive textile industry.

Financial Strength Aziz Group comprises seven various business ventures which include six private limited companies, namely; i) AJ Textile Mills Limited, ii) Mohsin Match Factory (Pvt) Limited, iii) AJ Match (Pvt) Limited, iv) Premier Formica Industries Limited, v) Premier Chipboard (Pvt) Limited, and vi) Premier MDF (Pvt) Limited; along with an Ice factory by the name of Aziz Ice Factory and Cold Storage. Additionally, the Company has initiated a Real Estate project by the name of AJ Tower located in Islamabad. The project involves corporate, commercial, and residential buildings covering 500,000 sq. ft. in total. Currently, this project is in the execution stage and the development work is in full flow.

Governance

Board Structure AJ Textile's board consists of four members, all belonging to the Aziz family. The board is chaired by Mr. Mohsin Aziz.

Members' Profile Mr. Mohsin – the Chairman possesses 40 years of industrial experience. He was a former member of the Senate of Pakistan. His expertise is supplemented by Mr. Afan; who has 20 years of industrial experience.

Board Effectiveness Two committees: Audit and Human Resource & Remuneration, are in place to assist the board in relevant matters and ensure proper oversight.

Financial Transparency The External Auditors of the Company are M/s. RSM Avais Hyder Liaquat Nauman, Chartered Accountants. They have expressed an unqualified opinion on the financial statements of the Company for FY21; whereas, the audit of the financial statements for FY22 is underway.

Management

Organizational Structure The management team is headed by the CEO Mr. Afan Aziz. The organizational structure of the Company is divided into various functional departments, namely; (i) Marketing, (ii) Finance, (iii) Legal, (iv) HR & IT, (v) Corporate Finance & Treasury, (vi) Purchase, and (vii) Internal Audit, (viii) Sales, (ix) Projects. Meanwhile, Cotton procurement is handled by the cotton purchase manager who makes all the decisions with the consultation of management.

Management Team Mr. Afan Aziz; son of Mr. Mohsin Aziz, holds a bachelor's degree from the illustrious London School of Economics; and has been associated with the company since 2002. He possesses over 20 years of industrial experience and has strong business acumen. Effectiveness The management meetings are held regularly with follow-up points to resolve or proactively address operational issues, if any, eventually ensuring a smooth flow of operations.

Effectiveness The management meetings are held regularly with follow-up points to resolve or proactively address operational issues, if any, eventually ensuring smooth flow of operations.

MIS AJ Textile has been using SAP Business One version 9.2 (9.20.160) PL: 06, since 2013. The following are the operating modules: Financials, Sale AR Module, Purchasing AP Module, Business Partners, Banking Module, Inventory Module, Production Module, Human Resource, and Project Management.

Control Environment The Company is accredited with multiple certifications for compliance and quality assurance, namely; Standard 100 by OEKO-TEX, Global Organic Textile Standards (GOTS), Organic Content Standard, and Sustainable (PRIMARK).

Business Risk

Industry Dynamics During FY22, Pakistan's textile exports surged to $19.3bln (recording a growth of 26%). Exports grew owing to increased volumetric growth of (16% YoY) in the value-added segment, a steep rise in global demand, and record high cotton prices. Under the value-added category, the knitwear segment remained the top performer by posting 34% YoY growth in exports to $5.1 billion in FY22 due to a sharp rise in global demand, especially in the US and European countries. Other value-added segments such as ready-made garments, bed wear, and towel posted YoY growth of 29%, 19%, and 19% to $3.9 billion, $3.3 billion, and $1.1 billion respectively. However, a slowdown is expected in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries.

Relative Position Aziz Group has a long operating history in Pakistan and has developed a prominent position in the local match manufacturing sector and regional spinning industry. Currently, AJ Textile's spinning capacity stands at 109,432 spindles; however, its share in the total revenue of the local spinning industry is minimal.

Revenues During 9MFY22, company's revenue grew by 46% to stand at PKR 8,344mln; (9MFY21: PKR 5,700mln) on the back of improved prices of yarn in local and international markets when compared to the same period last year. The company followed a sales mix dominated by local revenue, whereas, the composition of exports to total revenue was recorded at 9% (9MFY21: 0%).

Margins During 9MFY22, gross margin experienced a decline to stand at 12.7% (9MFY21: 14.5%) due to a higher costs incurred. This translated into a weakened operating margin standing at 10.6% (9MFY21: 12.4%). Net margin also witnessed attrition to stand at 7.2% (9MFY21: 9.2%). The finance cost increased to PKR 191mln (9MFY21: PKR 80mln) due to higher borrowing and a hike in the policy rate. Net profitability of the company inclined to PKR 1,184mln (9MFY21: PKR 451mln). The Company has an investment portfolio worth PKR 353mln (9MFY21: 232mln), which includes equity investments as well as property investments.

Sustainability Going forward, the Company expects the revenue to grow steadily, from FY22 onwards. Moreover, the company's expansion of the solar project by the additional 6 MW production power to the current power generation capacity. As of the end-Jun22, 4.6MW was completed out of the planned 6 MW remaining 1.4MW of the project will be completed by Nov22, the expected amount of this expansion project is around PKR 500mln. Furthermore, the expansion project comprises the addition of different kinds of types of machinery inclusive of an LMW frame, Draw Frame, TC Card, and Marzoli is in process and will be completed by Mar23.

Financial Risk

Working Capital At end-Mar22, A.J Textile fulfills its working capital needs through a mix of internal cash flows and short-term borrowing. The net working capital cycle largely remained intact at 111 days (FY21: 112 days). Furthermore, room-to-borrow at the trade level increased to PKR 1,697mln (FY21: PKR 1,638mln) due to a significant increase in trade assets clocking in at PKR 4,393mln (FY21: PKR 3,162mln).

Coverages During 9MFY22, free cash flows decreased by 6% to stand at PKR 1,079mln; (FY21: PKR 1,150mln). Higher finance cost weakened interest coverage to 6.1x (FY21: 8.7x). Whereas, debt coverage strengthened to 2.7x (FY21: 2.3x). The Debt repayment period declined to 2.7 years (FY21: 2.6 years).

Capitalization At end-Mar22, Company's leverage increased to 50.2% (FY21: 43.8%); a moderately leveraged capital structure. The equity base of the company increased to stand at PKR 5,647mln (FY21: PKR 5,046mln). Total borrowings increased to PKR 5,647mln (FY21: PKR 5,046mln); out of which, short-term borrowing constituted 43% (FY21: 33%).

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

AJ Textile Mills Limited
Textile | Spinning

	Mar-22	Jun-21	Jun-20	Jun-19
	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	7,034	6,299	4,556	3,503
2 Investments	353	232	225	270
3 Related Party Exposure	376	29	30	29
4 Current Assets	5,037	3,747	2,717	2,795
a Inventories	*2,598*	*1,896*	*1,319*	*1,132*
b Trade Receivables	*1,508*	*1,056*	*750*	*1,166*
5 Total Assets	12,801	10,307	7,529	6,596
6 Current Liabilities	836	697	671	514
a Trade Payables	*206*	*93*	*109*	*96*
7 Borrowings	5,690	3,936	1,931	2,671
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	628	628	833	456
10 Net Assets	5,647	5,046	4,094	2,956
11 Shareholders' Equity	5,647	5,046	4,094	2,955
B INCOME STATEMENT				
1 Sales	8,344	7,877	5,703	7,350
a Cost of Good Sold	*(7,282)*	*(6,781)*	*(5,043)*	*(6,496)*
2 Gross Profit	1,062	1,096	659	854
a Operating Expenses	(174)	(147)	(116)	(116)
3 Operating Profit	888	949	543	738
a Non Operating Income or (Expense)	*9*	*(38)*	*(3)*	*(22)*
4 Profit or (Loss) before Interest and Tax	897	911	540	716
a Total Finance Cost	*(191)*	*(142)*	*(203)*	*(194)*
b Taxation	*(105)*	*(42)*	*(119)*	*(106)*
6 Net Income Or (Loss)	601	727	218	416
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,079*	*1,150*	*751*	*916*
b Net Cash from Operating Activities before Working Capital Changes	*915*	*1,017*	*533*	*736*
c Changes in Working Capital	*(1,236)*	*(980)*	*369*	*(188)*
1 Net Cash provided by Operating Activities	(321)	37	902	548
2 Net Cash (Used in) or Available From Investing Activities	(1,493)	(2,069)	(27)	(701)
3 Net Cash (Used in) or Available From Financing Activities	1,820	2,010	(734)	76
4 Net Cash generated or (Used) during the period	7	(22)	141	(77)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	41.2%	38.1%	-22.4%	38.3%
b Gross Profit Margin	12.7%	13.9%	11.6%	11.6%
c Net Profit Margin	7.2%	9.2%	3.8%	5.7%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-1.9%	2.2%	19.6%	9.9%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	15.0%	15.9%	6.2%	15.2%
2 Working Capital Management				
a Gross Working Capital (Average Days)	116	116	140	107
b Net Working Capital (Average Days)	111	112	133	103
c Current Ratio (Current Assets / Current Liabilities)	6.0	5.4	4.1	5.4
3 Coverages				
a EBITDA / Finance Cost	5.6	9.7	4.2	5.1
b FCFO / Finance Cost+CMLTB+Excess STB	2.7	2.3	1.7	2.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.7	2.6	2.4	2.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	50.2%	43.8%	32.0%	47.5%
b Interest or Markup Payable (Days)	107.7	117.5	63.6	94.1
c Entity Average Borrowing Rate	5.2%	4.3%	8.4%	7.1%

Credit Rating

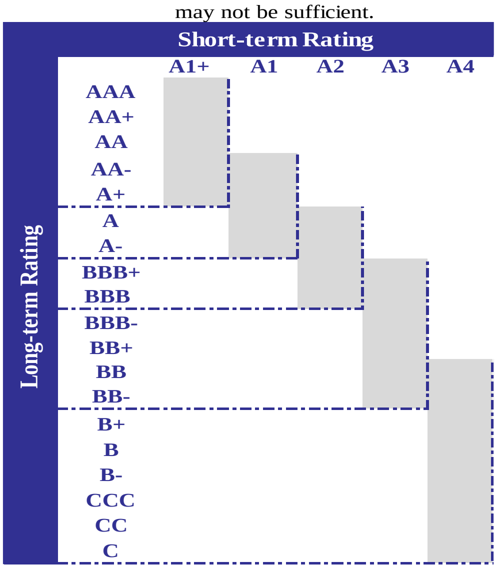
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



The correlation shown is indicative and, in certain cases, may not hold.

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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 | Clause 11-(A)(p).
(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