



The Pakistan Credit Rating Agency Limited

Rating Report

Zahidjee Textile Mills Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Dec-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect stable business profile of Zahidjee Textile. The company mainly operates in spinning segment, followed by a weaving unit. Continuous expansion and BMR activities have led to significant growth in topline in recent years. While recent devaluation has benefitted the company, high input costs driven by rising cotton prices and power cost have kept gross margins relatively stagnant, though largely at par with peers. With currency devaluation and full operations of recently completed spinning unit, margins are expected to improve. Recent expansion and rise in working capital needs has increased financing requirements. However, leveraging remains modest. The company has utilized fixed interest rate lines that provide some respite in rising interest rate environment. The financial risk profile remains strong. This is supported by improving free cash flows and, in turn, strong coverages. The company is in the process of restructuring its Board through induction of new independent directors, which is expected to improve governance structure.

The ratings are dependent on sustaining business margins as well as strong coverages and financial profile. Meanwhile, optimal utilization of recent capacity enhancement is considered important. Going forward, buildup of a non-core income stream will have positive implications on ratings along with better governance framework.

Disclosure

Name of Rated Entity	Zahidjee Textile Mills 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 Zahidjee Textile Mills Limited (Zahidjee Textile) is a listed, public limited concern incorporated in 1990.

Background Zahidjee Textile was established in 1990 when Mr. Sharif purchased a sick spinning concern in Faisalabad and renamed it to Zahidjee Textile Mills Limited. Gradually, the company was expanded by setting up additional spindles as well as a weaving unit.

Operations The company is primarily engaged in the production and sale of cotton and blended (Poly cotton) yarns, greige fabric and processed fabric and captive power generation with an installed capacity of ~13.5MW. Production facilities are situated at three different locations in Faisalabad.

Ownership

Ownership Structure The Zahid family owns ~95% of the company, with majority stake lying with Mr. Muhammad Zahid and his son, Mr. Ahmad Zahid. The remaining stake lies with other family members, joint-stock companies and the general public.

Stability Though there is no formal succession plan, it is decided that Mr. Ahmad Zahid will be the successor. A documented agreement of the same would do well to improve the stability of the company, going forward.

Business Acumen The Zahid family has over four decades of experience in textile trading and manufacturing. In addition, the family has diversified its interest into investment banking. It has also planned to enter the real estate and retail business but this plan has not materialized as yet.

Financial Strength Other than interest in textile, the family also owns Zahidjee Towers (Pvt.) Limited (subsidiary of Zahidjee Textile Mills) and holds a controlling stake in InvestCapital Investment Bank Limited. It also owns a number of real estate properties at prime locations in Lahore and Faisalabad. The sponsor has shown willingness and ability to support the business if the need arises.

Governance

Board Structure Zahidjee Textile's Board of Directors comprises seven members and is Chaired by Mr. Muhammad Sharif. Presently, Board is dominated by sponsor family members with only one independent director. However, the company is in the process of restructuring its Board. This will involve replacement of inactive members and addition of two new directors: one independent and one non-executive. This process is expected to be completed during FY19 and will bode well for effective governance.

Members' Profile Mr. Muhammad Sharif has over five decades of experience in yarn trading. Remaining members comprise three housewives. Going forward, induction of new directors with diversified professional experience is likely to enhance the quality of the Board.

Board Effectiveness Board meetings have full attendance of directors, boding well for the board's effectiveness. Meanwhile, quality of discussion disclosed in meeting minutes has room for improvement. There are two sub-committees in place to assist the Board on relevant matters: Audit Committee and Human Resource Committee.

Financial Transparency RSM Avasi Hyder Liaquat Nauman Chartered Accountants are the external auditors of the company, placed in category "B" on the State Bank's panel of auditors. They have expressed an unqualified opinion on the financial statements of the company for the year ended June 30th, 2018. The board has also set up an internal audit function with the Head of Internal Audit reporting directly to the Board Audit Committee.

Management

Organizational Structure Zahidjee Textile has a lean organizational structure, divided into various departments reporting to the CEO, Mr. Muhammad Zahid, and CFO, Mr. Anwar ul Haq. Departmentalization is done based on the various production units, wherein the Head of each manufacturing and power unit oversees complete functions of his respective units.

Management Team CEO – Mr. Muhammad Zahid – has overall thirty-five years of experience in the textile sector and is actively involved in day-to-day decision making in the company. In the near future, Mr. Zahid's daughter, Ayesha Shahryar, will be inducted as the Chief Operating Officer of the company. The management constitutes well-experienced, seasoned individuals, most of whom have been associated with the company for a reasonably long period of time.

Effectiveness While there are no formal management committees, all Unit Heads report to the CEO daily to discuss day-to-day developments and issues. The company maintains adequate IT infrastructure and related controls.

MIS Zahidjee Textile deployed an Oracle based ERP solution – Oracle EBS in 2012. This allows the company to streamline the flow of information from the dispersed operations and timely decision-making.

Control Environment Daily reports regarding the company's receivables and payables position, purchases and procurement, and bank position are prepared and submitted to higher management. Through MIS, the company is also able to monitor working capital management and exposure to related parties with automated limits and periodic review.

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. However, rising cost of utilities and the issue of outstanding refunds have kept industry liquidity strained. Going forward, exports are expected to remain strong on account of devalued currency while the recently announced relief in electricity tariffs announced for textile players is expected to boost exports, going forward.

Relative Position In FY18, Zahidjee contributed 0.7% to the country's greige fabric exports. The company is small in size relative to competitors such as Mahmood Textile; however, it enjoys better margins compared to peers including Mahmood Textile Mills and Suraj Cotton Mills.

Revenues Zahidjee Textile's topline has shown healthy growth over the years, dominated by pure cotton yarn (~47%) followed by Poly cotton yarn (~37%) and fabrics (~16%). Yarn is completely sold locally while almost all fabric production is exported, mainly to USA and Italy. For FY18, the company's topline clocked in at ~PKR 10,329m, a ~30% YoY increase attributable to i) currency devaluation and ii) sales of new spinning unit. Top ten customer concentration in local sales is moderately high (31%) while customer concentration in export sales is very high, with ~56% of export revenue being derived from a single customer.

Margins Business margins have largely remained stagnant over the past few years. Gross margins showed improvement, however, in 3MFY19 driven by higher revenues and increased efficiency owing to completion of new spinning unit. Thus, despite ~9% higher finance cost due to increased borrowing to finance working capital needs and capital expenditure, net profit increased ~50% YoY to stand at ~PKR 326m in FY18 while net margins improved to ~3.2% (FY17: ~2.7%).

Sustainability During the year, 17,472 spindles were installed in the new spinning unit which started commercial operations in March, 2018. The capex is expected to improve the performance and margins of the company, going forward. The company is also planning BMR for automation in its spinning units in FY19. The company is planning to install more spindles which will take total spinning capacity to ~150,000 spindles. This project is expected to be completed by end-FY19.

Financial Risk

Working Capital Zahidjee Textile's working capital needs emanate from financing inventories and trade receivables for which the company relies on both internal cash flows as well as short term borrowings. In FY18, the company imported a significant amount of inventory foreseeing the rupee devaluation as well as to provide raw material for newly installed spindles, resulting in an increase in working capital needs, reflecting in higher net cash cycle (FY18: 96 days, FY17: 76 days). The company maintains an adequate borrowing cushion at trade assets level.

Coverages During FY18, Zahidjee Textile's free cash flows grew ~36% to ~PKR 991m, owing to improved profitability. Resultantly, core debt coverage improved to 2.4x in FY18 (FY17: 1.4x) while debt-servicing coverage also improved to 4.4x (FY17: 3.5x). Coverages showed further improvement in 3MFY19 despite increasing interest rates due to strong cash flows and some repayment of short and long-term borrowings.

Capitalization At end-Jun18, the company had a moderately leveraged capital structure with a leveraging ratio of ~48%. In FY18, total borrowings swelled to ~PKR 4.7bln (Jun17: ~PKR 3.2bln), comprising majorly of short-term borrowings to finance import of inventory. Long-term borrowings swelled due to capex on the import of plant and machinery for new spinning unit. Going forward there is planned BMR and installation of additional spindles to be financed 40% through equity and the remaining to be borrowed. The company is in process of repaying its borrowings and largely plans to maintain leveraging at same level.



Zahidjee Textile Mills Limited

BALANCE SHEET	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
	3M	FY	FY	FY
Non-Current Assets	6,136	6,211	5,533	4,742
Investments (Incl. Associates)	453	447	426	417
Equity	453	447	426	417
Loans to Associates/Debt Securities	-	-	-	-
Investment Property	-	-	-	-
Current Assets	4,953	4,723	3,190	2,252
Inventory	3,112	2,987	1,813	1,019
Trade Receivables	1,041	972	687	632
Others	800	764	689	601
Total Assets	11,542	11,381	9,149	7,411
Debt/Borrowings	4,670	4,722	3,191	2,799
Short-term	3,573	3,599	2,589	2,082
Long-term (Incl. Current Maturity of Long-Term Debt)	1,097	1,123	602	718
Other short-term liabilities	957	936	700	616
Other long-term liabilities	585	552	417	55
Shareholders' Equity	5,329	5,171	4,842	3,942
Total Liabilities & Equity	11,542	11,381	9,149	7,411

INCOME STATEMENT

Turnover	3,093	10,296	7,966	6,696
Gross Profit	344	1,001	806	656
Net Other Income	(3)	42	7	9
Financial Charges	(73)	(224)	(207)	(140)
Net Income	153	326	217	308

Cashflow Statement

Free Cash Flow from Operations (FCFO)	396	991	729	546
Net Cash changes in Working Capital	(180)	(1,398)	(802)	(64)
Net Cash from Operating Activities	152	(629)	(263)	343
Net Cash from Investing Activities	(42)	(934)	(137)	(1,115)
Net Cash from Financing Activities	(93)	1,531	392	831

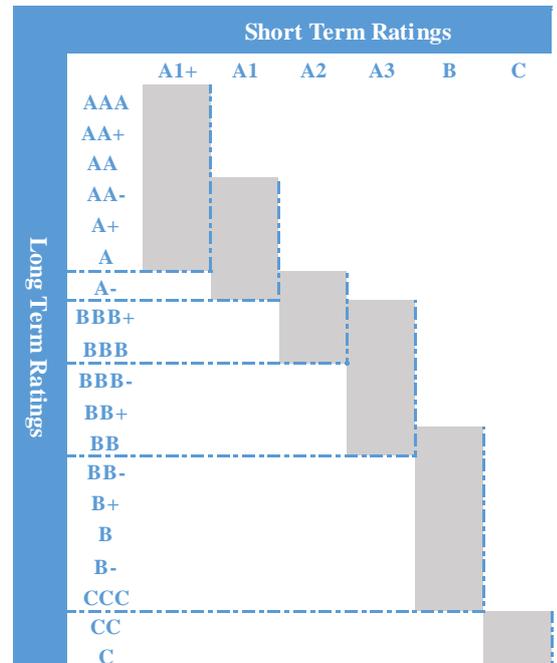
Ratio Analysis

Performance				
Turnover Growth (vs. SPLY)	32%	29%	19%	0%
Gross Margin	11%	10%	10%	10%
Net Margin	5%	3%	3%	5%
Coverages				
Interest Coverage (FCFO/Gross Interest)	5.4	4.4	3.5	3.9
Core: (FCFO) / (Gross Interest+CMLTD+Uncovered Total STB)	3.0	2.4	1.4	0.8
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	3.0	2.4	1.4	0.8
Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO- Gross Interest)	0.8	1.5	1.2	2.7
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	72	97	76	68
Capital Structure (Total Debt/Total Debt+Equity)	47%	48%	40%	42%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

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2) Conflict of Interest

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- 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

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Conduct of Business

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- (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.
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- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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- (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)

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- (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

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