



The Pakistan Credit Rating Agency Limited

Rating Report

Zahidjee Textile Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Oct-2021	A	A2	Stable	Upgrade	-
29-Oct-2020	A-	A2	Positive	Maintain	-
30-Oct-2019	A-	A2	Positive	Maintain	-
30-Apr-2019	A-	A2	Stable	Maintain	-
28-Dec-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The rating upgrade incorporates Zahidjee Textile's improved business and financial risk profile with a good corporate governance framework. The business risk profile is supported by the Company's established track record of operating in spinning and weaving segments. Continuous BMR activities have led to significant growth in operations in recent years. The Company is adding 90,720 to its current capacity out of which 40,000 spindles CoD will be achieved in November 2021 while the loan approval of further 50,000 spindles is pending from the Bank. During FY21, the operating performance of the Company witnessed sizable improvement. Escalated domestic demand and rising exports resulted in improved revenues. The demand for exports has surged after Dec'20 and the Company capitalized on it. The exports increased by PKR 3.4bln YoY to clock in at PKR 6.2bln which primarily consists of Indirect exports – Yarn of PKR 4.1bln. Moreover, the Company has ramped up the capacity utilization significantly from June'20 and the capacity utilization as of date, reaching above 99% and 82% in spinning and weaving segments respectively, give a comfortable picture, ahead. The Company's financial risk profile remains strong, characterized by sufficient cash flows and, in turn, strong coverages, driven by augmented profitability. Borrowing at concessionary SBP rates has also provided some respite in the COVID-19 pandemic period. Going forward, the Company aims to undertake further expansion into spinning, financed through a mix of internal and external sources. Ratings are also underpinned by a moderately low leveraged capital structure and growth in the equity base. Zahidjee Textile has a stable and experienced senior management team which is supported by clear reporting lines as per a formalized organogram and satisfactory monitoring process.

The ratings are dependent on sustaining business margins as well as strong coverages and stability of financial matrix. Meanwhile, management of debt levels during upcoming capacity expansion is considered important.

Disclosure

Name of Rated Entity	Zahidjee Textile Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating(Jun-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Rating Modifiers(Jun-21)
Related Research	Sector Study Composite(Nov-20)
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Profile

Legal Structure Zahidjee Textile Mills Limited ("Zahidjee Textile" or "the Company") is a listed, public limited concern incorporated in 1990.

Background Zahidjee Textile was established in 1990 when Mr. Muhammad Sharif, Ex-Chairman of the Company, 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 (Polycotton) 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 majority stake (~96%) in Zahidjee Textile is held by the Zahid family through Mr. Zahid (21.28%) and Mr. Ahmad Zahid (75%), while the remaining stake lies with 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. Going forward, this is expected to reflect in the pattern of shareholding with a further increase in Mr. Ahmad Zahid's stake, while Mr. Zahid will remain the largest shareholder.

Business Acumen The Zahid family has over four decades of experience in textile manufacturing and trading. In addition, the family has an interest in investment banking.

Financial Strength The Zahid family also owns Zahidjee Towers (Pvt.) Limited along with a number of real estate properties at prime locations in Lahore and Faisalabad. The sponsor has shown a 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. The Board comprises four members of the sponsor family and three independent members.

Members' Profile Mr. Muhammad Sharif – Ex-Chairman and founder of the Company who had over five decades of experience in yarn trading resigned from the Company in Jun-21. Board has appointed Mr. Ahmed Zahid as a new Chairman effective from July 06th, 2021.

Board Effectiveness Board meetings have full attendance of directors, boding well for the Board's effectiveness. Meanwhile, the quality of discussion disclosed in meeting minutes has to room for improvement.

Financial Transparency RSM Avais Hyder Liaquat Nauman Chartered Accountants is the external auditor of the Company, placed in category "B" on the State Bank's panel of auditors. The auditors expressed an unqualified opinion on the financial statements of the Company for the year ended June 30th, 2021. 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 COO - Ms. Ayesha Shehryar, and the CFO - Mr. Anwar ul Haq. Departmentalization is done based on the various production units, wherein the Head of each manufacturing and power unit oversees the complete functions of their respective units.

Management Team The 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 while Mr. Zahid's daughter, Ms. Ayesha Shehryar, is the Chief Operating Officer. The management team constitutes well experienced, seasoned individuals.

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 has 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 performance are 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 reviews.

Business Risk

Industry Dynamics Textile exports of the country recorded an increase of 28.6% to stand at USD 2.9bln as compared to USD 2.3bln from July 21 to Aug21 due to an increase in demand for textile products internationally, led by good recovery around the globe post-pandemic. Going forward, the textile sector's outlook is expected to stay stable in the medium term where the demand for textile products is expected to increase. The probability of little attrition in demand remains on the horizon attributable to the outbreak of COVID-19 variants. In the local market, the textile sector has recorded strong performance. The relief measures introduced by the State Bank of Pakistan such as deferral of loan payments for one year, low-interest rates, and salary refinance scheme also provided comfort to the sector.

Relative Position Zahidjee Textile is one of the exporters of greige fabric in Pakistan who holds ~1% share. The Company is small in size relative to competitors in the spinning sector; however, it has witnessed a growth momentum in its revenues in recent years. The margins remained in line with the industry peers.

Revenues Despite many economic challenges, the sales revenue of Zahidjee Textile for FY21 increased by 19.5% from PKR 13.9bln to PKR 16.6bln, owing to enhancement of operational efficiencies and strong local demand resulting in volumetric growth in yarn sales. The Company's top line is dominated by yarn (62.9%), followed by fabrics (37.1%), whereas the same mix is expected to continue in the future. Yarn is sold locally while almost all fabric production is exported, mainly to the USA and Argentina.

Margins The Company's gross margin increased to 14.3% during FY21 (FY20: 12.1%) on the back of controlled input cost. The Company was largely able to maintain its distribution cost and administration expenses as reflected in the operating margin (FY21: 12.6%; FY20: 10.1%). Dependency on debt finance has forced the Company to bear a heavy finance cost (FY21: PKR 283mln; 9MFY20: PKR 329mln) but showed a declining trend from last year due to lower interest rates. The net profit hence improved to (FY21: PKR 1.6bln; FY20: PKR 697mln) while net margin reported at 9.4% (FY20: 5%).

Sustainability Balancing, Modernization, and Replacement (BMR) is a regular feature at the company. BMR of ~PKR 400mln was carried out for FY20 for the installation of 2 gas generators for a newly built spinning unit to run the operations smoothly. Going forward, the Company is planning to increase the production capacity of spinning, moreover, installation of more spindles for the manufacturing of finer count yarn. The Company's spinning projects comprising 90,720 spindles are under implementation.

Financial Risk

Working Capital During FY21, short-term borrowings decreased to PKR 2.2bln in FY21 (FY20: PKR 2.8bln). Inventory days decreased to 65 days (FY20: 73days) while trade receivable days remained slightly high, reflected in the net cash cycle (FY21: 95 days, FY20: 103 days). Meanwhile, the company maintains a significant borrowing cushion at the trade assets level of 45% (FY20: 33%) backed by decreased short-term borrowings.

Coverages During FY21, the Company's free cash flows improved and reported at PKR 2.3bln (FY20: PKR 1.6bln), on account of a surge in profitability. In the absence of any major CAPEX, interest coverage improved YoY stand at 8.7x (FY20: 5.2x), core debt coverage also improved to 5.0x in FY21 (FY20: 3.1x) due to falling in finance cost on account of lower short-term borrowing YoY.

Capitalization For FY21, the company's capital structure remained moderately leveraged with a leveraging ratio of 39.2% (FY20: 40.1%). In absolute terms, total borrowing amounted to PKR 5bln in FY21 (FY20: PKR 4.1bln) comprised predominantly of STBs (50.7%) from various commercial banks. ~24% of the total borrowing consists of borrowings from SBP at concessionary rates.



Zahidjee Textile Mills Limited Textile Composite	Jun-21 12M	Jun-20 12M	Jun-19 12M	Jun-18 12M
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A BALANCE SHEET

1 Non-Current Assets	8,152	6,618	6,089	6,211
2 Investments	123	57	73	88
3 Related Party Exposure	359	360	360	360
4 Current Assets	6,175	5,386	4,623	4,722
<i>a Inventories</i>	2,950	2,927	2,604	2,987
<i>b Trade Receivables</i>	2,001	1,729	1,231	972
5 Total Assets	14,809	12,421	11,146	11,381
6 Current Liabilities	1,490	1,143	643	936
<i>a Trade Payables</i>	537	466	182	578
7 Borrowings	5,048	4,156	3,944	4,583
8 Related Party Exposure	6	173	249	139
9 Non-Current Liabilities	421	481	395	552
10 Net Assets	7,845	6,467	5,915	5,171
11 Shareholders' Equity	7,845	6,467	5,915	5,171

B INCOME STATEMENT

1 Sales	16,615	13,902	13,445	10,329
<i>a Cost of Good Sold</i>	(14,233)	(12,226)	(11,983)	(9,295)
2 Gross Profit	2,381	1,677	1,462	1,034
<i>a Operating Expenses</i>	(280)	(277)	(247)	(244)
3 Operating Profit	2,101	1,399	1,215	790
<i>a Non Operating Income or (Expense)</i>	(99)	(76)	(82)	9
4 Profit or (Loss) before Interest and Tax	2,002	1,323	1,133	799
<i>a Total Finance Cost</i>	(283)	(329)	(389)	(224)
<i>b Taxation</i>	(162)	(296)	37	(249)
6 Net Income Or (Loss)	1,557	697	782	326

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	2,354	1,655	1,666	991
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	2,071	1,303	1,305	768
<i>c Changes in Working Capital</i>	(355)	(261)	(199)	(1,398)
1 Net Cash provided by Operating Activities	1,716	1,042	1,106	(629)
2 Net Cash (Used in) or Available From Investing Activities	(1,928)	(1,034)	(451)	(934)
3 Net Cash (Used in) or Available From Financing Activities	533	(27)	(596)	1,531
4 Net Cash generated or (Used) during the period	321	(20)	59	(32)

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	19.5%	3.4%	30.2%	29.6%
<i>b Gross Profit Margin</i>	14.3%	12.1%	10.9%	10.0%
<i>c Net Profit Margin</i>	9.4%	5.0%	5.8%	3.2%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	12.0%	10.0%	10.9%	-3.9%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh</i>	21.6%	11.4%	13.1%	7.0%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	106	111	106	114
<i>b Net Working Capital (Average Days)</i>	95	103	95	96
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	4.1	4.7	7.2	5.0
3 Coverages				
<i>a EBITDA / Finance Cost</i>	9.3	5.8	4.6	4.8
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	5.0	3.1	3.0	2.4
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	1.3	1.1	1.0	1.6
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	39.2%	40.1%	41.5%	47.7%
<i>b Interest or Markup Payable (Days)</i>	99.0	68.3	79.7	92.1
<i>c Entity Average Borrowing Rate</i>	6.1%	7.2%	7.7%	5.9%

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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):

<p>Entities</p> <ul style="list-style-type: none"> 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 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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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)
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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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- (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)
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- (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)
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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

(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)

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