The Pakistan Credit Rating Agency Limited

Rating Report

Shahzad Textile Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
11-Apr-2023	A-	A2	Stable	Maintain	Yes
13-Apr-2022	A-	A2	Stable	Upgrade	-
30-Apr-2021	BBB+	A2	Stable	Maintain	Yes
30-Apr-2020	BBB+	A2	Stable	Maintain	Yes
30-Oct-2019	BBB+	A2	Stable	Maintain	-
30-Apr-2019	BBB+	A2	Stable	Maintain	-
27-Dec-2018	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Shahzad Textile Mills Limited is a public listed company that is engaged in the manufacturing of yarn and socks. The specifications include ring-spun yarn, synthetic blended yarns, and a wide range of socks. The Company is a sister concern of Sargodha Jute Mills and has a history of more than four decades. The Company’s management involves experienced professionals looking after the operations of the Company. Over the last few years, the business profile has strengthened manifold. The Company has successfully achieved diversification in the value-added segment of socks. During FY22, the Company’s net profit increased to PKR 377mln (FY21: PKR 306mln). However, afterward, the Company’s performance witnessed significant dilution. This was due to multiple factors, chief among them was the impact of a volumetric decline in exports and cotton price adjustment amidst inflation in the economy and sizable depreciation of the Pak Rupee. Furthermore, floods’ impact on crops resulted in a shortage of raw materials locally produced. This issue along with the price adjustment resulted in high raw material costs. During 6MFY23, the topline declined by ~17% as compared to its corresponding period last year. Whereas, the overall cost structure of the company reflected an increase. Consequently, the bottom line reflected a loss of PKR 77mln. Therefore, the margins of the company have reflected a declining trend. Moreover, the financial matrix reveals moderate leveraging, weakened coverages, and stretched working capital cycle. The Rating Watch incorporates the decline in performance, and resultant losses incurred. During 7MFY23, the textile exports were valued at $10.08bln compared to $10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand for yarn in international markets is also a challenge. The analysis of 5MFY23 reveals that among value-added items, bedwear has witnessed the largest decline of 19% (on an MoM basis), down to $217 million. Knitwear remained on the downward path in October 2022 and declined by 10% to $392 million. Among non-value-added items, cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is prevailing in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries. The demand pattern is expected to improve post-Jun-23.

The ratings are dependent upon the management's ability to improve the margins, profitability, and financial profile of the company. This includes avoiding any asset-liability mismatch that may arise and effectively managing its position in a competitive segment. Any deterioration in debt coverages leading to higher financial risk or subdued profitability will have a negative impact on ratings.

Disclosure

Name of Rated Entity	Shahzad 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 Shahzad Textile Mills Limited (The Company) is a public listed company, incorporated in 1978.

Background The Company was established by Mian Muhammad Aslam (late) and was part of the Sargodha Group. The Group had twelve textile mills, one jute mill, and one sugar mill. The group entities were later split among the sons of Mian Muhammad Aslam (late). Operations of Shahzad Textile Mills were handed over to his son Mian Parvez Aslam and passed on to his son (third generation) Mian Imran Aslam.

Operations The Company has three spinning units. Unit # 1 & 4 focus on PV yarn, while Unit # 2 produces polyester cotton yarn. The Company's current capacity is 63,648 spindles, as it has phased out one of its spinning units (Unit # 3) and installed a socks manufacturing unit in the same premises with a capacity of 180 knitting machines. The power requirements of the Company stand at ~4.7MW, which is met through a mix and match of in-house power generation (capacity: ~8.9MW) and LESCO's (sanctioned limit: 7.2MW) connection, whichever is more feasible.

Ownership

Ownership Structure Mr. Imran Aslam (CEO) along with other family members collectively own the majority (74.8%) stakes in the Company. The remaining shareholding of the Company is held by Corporates (4.8%) and institutions (20.4%).

Stability The fourth generation of the Aslam family has joined the business. Although, there is no formal succession plan the shareholding and business roles are equally divided between the two brothers (Imran Aslam and Irfan Aslam).

Business Acumen Mr. Imran Aslam - the CEO and major shareholder - has been managing the Company's operations for more than two decades. His ability to take strategic decisions and seize opportunities at the right time has kept the entity on the right track.

Financial Strength Mr. Imran Aslam has ~28% shareholding in Sargodha Jute Mills Limited, an associated company. Other than that, on a personal level, he is an active investor in real estate and the stock market. This portrays adequate financial muscle of sponsors to support the company if the need arises.

Governance

Board Structure The overall control of the Company vests in seven members board with Mian Pervez Aslam as Chairman of the board. The Company's board comprises two executive directors, and three non-executive directors while two members are independent directors.

Members' Profile Mian Parvez Aslam – the Chairman – carries with him over 40 years of experience and has been associated with the board since its incorporation. The board comprises professionals with diverse expertise.

Board Effectiveness Shahzad Textile has two board committees: Audit Committee and HR & Remuneration Committee (HR&R). The audit committee meets quarterly to approve financial statements before board meetings. HR&R meets at least once in a financial year and may meet more often if requested by the board. Meanwhile, the director's attendance has remained strong and meeting minutes are formally recorded.

Financial Transparency The External Auditors of the Company are Crowe Hussain Chaudhury & Co. Chartered Accountants. Auditors have expressed an unqualified opinion on the Company's annual financial statements for FY22.

Management

Organizational Structure The organizational structure of the Company is divided into two main divisions: Head Office and Mills. The head of departments of both divisions reports directly to the CEO.

Management Team Mr. Imran Aslam manages day-to-day operations as CEO of the Company. He is supported by a team of experienced professionals. Most of the senior management has been associated with the Company for a reasonably long time.

Effectiveness The Company maintains adequate IT infrastructure and related controls. Moreover, monthly meetings are conducted to review the performance of all units.

MIS The Company has in place oracle based local ERP system by the name of Wizmen. Moreover, the company has also set in place customized Oracle Based ERP Software for Socks Units.

Control Environment The Company emphasizes the sustainable quality of yarn. For this, it is compliant with the latest version of ISO 9001-2008 Certification. This enhances the trust of the customer base.

Business Risk

Industry Dynamics During 7MFY23, the textile exports were valued at $10.08bln compared to $10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand for yarn in international markets is also a challenge. The analysis of 5MFY23 reveals that among value-added items, bedwear has witnessed the largest decline of 19% (on an MoM basis), down to $217 million. Knitwear remained on the downward path in October 2022 and declined by 10% to $392 million. Among non-value-added items, the cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is prevailing in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries. The demand pattern is expected to improve post-Jun-23.

Relative Position The Company possesses 63,648 spindles with 40,159,283 MT yarn production in FY22. The company possesses 180 knitting machines with a production of 1,132,710 dozen pairs. Hence, on a standalone basis, the Company has a minimal share in the local market.

Revenues During FY22, the Company's revenue inclined to PKR 9,983mln (FY21: PKR 6,927mln) on account of favorable yarn prices. The sales mix tilted towards local sales; however, exports increased to PKR 1,844mln (FY21: PKR 785mln) when compared to the same period last year. The yarn has a lion's share in the top line of the company. During 6MFY23, the company's revenue decreased by 11% to stand at PKR 3,697mln (6MFY22: PKR 4,444mln). The export share was 20% of the total revenue.

Margins During FY22, Shahzad Textile's gross margin inclined to 11.5% (FY21: 10.5%) on the back of favorable yarn prices. This translated into an improvement in operating margin clocking in at 6.6% (FY21: 6.2%). The net margin remained stagnant at 7.4% (FY21: 7.4%). The net profitability of the company improved to PKR 377mln (FY21: PKR 306mln). During 6MFY23, the gross margin of the company declined to 5.6% (6MFY22: 12.9%), which resulted in a decrease in the operating margin of -0.9% (6MFY22: 8.8%). Consequently, the net margin declined to -2.1% (6MFY22: 6.6%) on account of the net loss booked of PKR 77mln (6MFY22: PKR 294mln).

Sustainability Previously, the company had planned the expansion of the socks unit which was going to be financed through retained earnings and a long-term loan, the approximate cost of the expansion project is PKR 400mln in which production capacity of the sock unit will be increased from the 194 knitting machines to 300 knitting machines. But due to the current economic situation, the plan has been deferred. Moreover, the company is planning to enhance penetration in current export avenues.

Financial Risk

Working Capital At end-Dec22, the net working capital cycle days increased to 56 days (At end-Jun22: 39 days) on account of increased inventory days clocking in at 43 days (At end-Jun22: 29 days). The trade assets of the company increased by 3% to stand at PKR 1,573mln (At end-Jun22: PKR 1,525mln). The short-term trade leverage adequacy decreased to 38% (At end-Jun22: 43%).

Coverages During FY22, the company's FCFO increased to stand at PKR 590mln (FY21: PKR 458mln). The interest coverage declined to 6.8x (FY21: 7.7x) mainly attributable to increasing finance costs. However, the debt coverage of the company improved to 2.2x (FY21: 1.6x). Whereas, the debt repayment period of the company decreased to 1.1 years (FY21: 1.5 years). During 6MFY23, the free cash flows of the company declined to -37mln (6MFY22: 376mln) attributable to the loss incurred during the period under review. Consequently, the interest coverage decreased to -0.8x (6MFY22: 11.8x). The debt coverage declined to -0.3x (6MFY22: 2.7x).

Capitalization At end-Dec22, the leveraging of the company increased to 25.5% (end-Jun22: 22.9%) as the total borrowings increased to PKR 1,051mln (end-Jun22: PKR 933mln). ST borrowings constitute 52% of total borrowings. Whereas, the equity base declined to PKR 3,077mln (end-Jun22: PKR 3,144mln).

PKR mln

Shahzad Textile Mills Limited Textile | Spinning	Dec-22 6M	Jun-22 12M	Jun-21 12M	Jun-20 12M
A BALANCE SHEET				
1 Non-Current Assets	2,535	2,559	2,420	2,283
2 Investments	123	122	115	102
3 Related Party Exposure	692	658	592	498
4 Current Assets	1,952	1,967	1,522	1,129
a Inventories	*953*	*795*	*701*	*598*
b Trade Receivables	*243*	*447*	*230*	*83*
5 Total Assets	5,303	5,307	4,649	4,012
6 Current Liabilities	680	726	590	514
a Trade Payables	*92*	*90*	*93*	*53*
7 Borrowings	1,051	933	946	795
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	494	504	323	356
10 Net Assets	3,077	3,144	2,790	2,348
11 Shareholders' Equity	3,077	3,144	2,790	2,348
B INCOME STATEMENT				
1 Sales	3,697	9,383	6,927	4,315
a Cost of Good Sold	*(3,491)*	*(8,308)*	*(6,198)*	*(3,993)*
2 Gross Profit	206	1,074	729	322
a Operating Expenses	(240)	(459)	(298)	(214)
3 Operating Profit	(33)	615	432	108
a Non Operating Income or (Expense)	*53*	*84*	*81*	*33*
4 Profit or (Loss) before Interest and Tax	19	699	513	141
a Total Finance Cost	*(56)*	*(100)*	*(74)*	*(78)*
b Taxation	*(40)*	*(221)*	*(133)*	*(17)*
6 Net Income Or (Loss)	(77)	377	306	46
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*(37)*	*590*	*458*	*188*
b Net Cash from Operating Activities before Working Capital Changes	*(83)*	*514*	*402*	*125*
c Changes in Working Capital	*(13)*	*(344)*	*(161)*	*(79)*
1 Net Cash provided by Operating Activities	(96)	169	241	46
2 Net Cash (Used in) or Available From Investing Activities	(35)	(276)	(120)	(161)
3 Net Cash (Used in) or Available From Financing Activities	122	102	(74)	125
4 Net Cash generated or (Used) during the period	(9)	(5)	48	10
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-21.2%	35.5%	60.5%	-28.9%
b Gross Profit Margin	5.6%	11.5%	10.5%	7.5%
c Net Profit Margin	-2.1%	4.0%	4.4%	1.1%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-1.4%	2.6%	4.3%	2.5%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	-4.9%	12.7%	11.9%	2.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	60	42	42	54
b Net Working Capital (Average Days)	56	39	39	49
c Current Ratio (Current Assets / Current Liabilities)	2.9	2.7	2.6	2.2
3 Coverages				
a EBITDA / Finance Cost	1.6	9.4	10.1	3.7
b FCFO / Finance Cost+CMLTB+Excess STB	-0.3	2.2	1.6	1.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-3.0	1.1	1.5	3.3
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	25.5%	22.9%	25.3%	25.3%
b Interest or Markup Payable (Days)	132.7	114.6	121.9	108.8
c Entity Average Borrowing Rate	8.3%	7.4%	6.5%	10.0%

Credit Rating

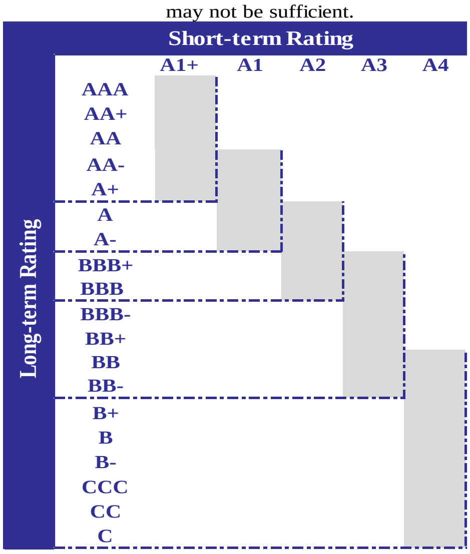
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

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

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

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(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)

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i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
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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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(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).
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(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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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)
(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)
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(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)
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(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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