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
08-Apr-2024	A-	A2	Stable	Maintain	Yes
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

Pakistan's spinning industry is highly fragmented and consists of ~368 dedicated spinning units with an estimated size of ~PKR 775bln and ~13.4mln number of spindles installed as of FY23 according to an economic survey of Pakistan. The projected cotton production estimate is revised and projected to be ~11.5mln bales and currently, the production has reached up to ~8.26mln bales, surpassing FY23 total production of ~4.91mln bales. During FY24, better local raw cotton yield is expected to supplement the industry for import substitution. Pakistan's requirement for imported cotton has increased from ~3.5mln bales to ~4mln bales for the ongoing year. The recent hike in energy tariffs further elevated the challenges for the industry. Overall, the industry's cash flow, thus liquidity remains stretched. Consequently, the industry's overall outlook is on the Watch.
Shazad Textile Mills Limited's ('Shahzad Textile' and “the Company”) ratings reflect its affiliation with Sargodha Jute Mills. The Company is in the manufacturing of yarn and socks, offering a range of products including ring-spun yarn, synthetic blended yarns, and various types of socks. Over the past years, the Company has significantly enhanced its business profile by successfully diversifying into the value-added segment of socks. During FY23, the Company experienced a decline in its topline, primarily attributed to challenges pertaining to the timely import of raw materials impacting the export volumes. Additionally, adjustments in cotton prices amidst inflationary pressure and substantial rupee depreciation further impacted the financial performance. This along with the surge in energy costs and increased wages has significantly impacted the manufacturing costs, leading to a downward trend in margins. The Company effectively managed challenges posed by import restrictions through its diversified procurement channels, which are not solely reliant on the local market. Despite these challenges, the Company managed to break even in terms of operating losses during 6MFY24. Nevertheless, it reported a net loss primarily attributed to high finance costs. On the financial risk front, the Company reaps the benefit of low leveraged capital structure. The coverages remain stretched with adequate working capital management. The ratings have been assigned a 'Watch' due to the decline in performance, and resultant losses incurred. This, if not curbed, may lead to equity erosion.

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(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Spinning(Sep-23)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Shahzad Textile Mills Limited ('Shahzad Textile' and 'the Company') is a public listed company, incorporated in 1978.

Background The Company was established by Mian Muhammad Aslam (late) and was part of 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 operates three spinning units. Unit #1 & 4 focus on PV yarn, while Unit #2 produces polyester cotton yarn. With a current capacity of 63,648 spindles, Unit #3 has been replaced with a socks manufacturing unit housing 194 knitting machines. Power needs (~4.7MW) are met through a mix of in-house generation (~8.9MW) and LESCO's connection (sanctioned limit: 7.2MW).

Ownership

Ownership Structure Mr. Imran Aslam (CEO) along with other family members collectively own the majority (~73.8%) stakes in the Company. The remaining shareholding of the Company is held by Corporates (~5.7%) and a free float of ~20.5%.

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

Business Acumen Mr. Imran Aslam is the CEO of Shahzad Textile Mills Limited. He has been managing the Company’s operations for more than two decades. His ability to make strategic decisions and seize opportunities at the right time has kept the entity on the right track.

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

Governance

Board Structure The overall control of the Company vests in a seven-member 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 41 years of experience and has been associated with the Board since its incorporation. He looks after the policies and other operational issues of the Company and guides his valuable experience in times of need.

Board Effectiveness Shahzad Textile has two Board committees: the Audit Committee and the HR & Remuneration Committee (HR&R). The audit committee meets quarterly to approve financial statements prior to 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. The auditors have expressed an unqualified opinion on the Company's annual financial statements for FY23.

Management

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

Management Team Mr. Imran Aslam manages day-to-day operations as the 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 in order to review the performance of all units.

MIS The Company has in place oracle Oracle-based local ERP system by the name of Wizmen.

Control Environment The Company places emphasis in 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 Pakistan's spinning industry comprises approximately ~368 dedicated spinning units, with an estimated size of ~PKR 775bln and ~13.4mln spindles installed as of FY23, as per an economic survey. The projected cotton production estimate has been revised to ~11.5mln bales, with current production reaching ~8.26mln bales, surpassing FY23's total of ~4.91mln bales. In FY24, better local raw cotton yield is expected to support import substitution. Pakistan's demand for imported cotton has risen from ~3.5mln bales to ~4 million bales this year. Challenges include recent energy tariff hikes and availability of locally procured raw cotton, impacting the industry's outlook.

Relative Position In FY23, the Company operated ~63,648 spindles, producing ~31,806,325MT of yarn. It also maintained ~194 knitting machines, producing ~942,838 dozen pairs. Despite this, the Company held only a minimal share of ~0.4% in the local market based on installed capacity.

Revenues During FY23, the Company's revenue declined to PKR 8,399mln (FY22: PKR 9,983mln), primarily attributed to reduced demand both domestically and internationally. Yarn sales constituted ~91% of the total revenue, with a notable shift towards local markets, while exports decreased to PKR 1,273 mln FY22: PKR 1,844). In 6MFY24, the Company's revenue surged by ~33.7% to PKR 4,943mln compared to PKR 3,697mln during 6MFY23, with export revenue contributing ~13% to the total revenue.

Margins During FY23, the Company reported a decline in its gross margins, dropping to ~2.8% (FY22: ~11.5%). This decline was primarily due to stagnant raw material costs, which were reported at PKR 6,193mln (FY22: PKR 6,394mln), despite a noticeable drop in revenue. Consequently, the Company's operating margin also declined to negative ~2.0% (FY22: ~6.6%). Additionally, there was a notable decline in net profitability, resulting in a loss of PKR 269mln compared to a profit of PKR 377mln during FY22. This led to a negative net margin of ~3.2% as opposed to a positive margin of ~4.0% in FY22. Despite efforts to mitigate the impact of challenging market conditions, the Company struggled to maintain its financial performance, reflecting broader industry challenges during the fiscal year.

Sustainability The Company has planned the expansion of the socks unit which will 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 ~180 knitting machines to ~300 knitting machines. Moreover, the Company is planning to enhance penetration in current export avenues.

Financial Risk

Working Capital Shahzad Textile manages its working capital primarily through internally generated cash flow and short-term borrowing. As of 6MFY24, the net working capital cycle days decreased to ~32 days, down from ~42 days in FY23. This reduction stemmed from decreased inventory days to ~29 days from ~32 days and trade receivable days declining to ~8 days from ~15 days in FY23. Additionally, the Company's trade assets increased by ~14% to PKR 1,448mln from PKR 1,263mln in FY23, while short-term trade leverage decreased to ~42.9% from ~56.4% in FY23. This reflects the Company's effective management of working capital and trade assets to bolster operational needs and financial stability.

Coverages In FY23, the Company's FCFO decreased to negative PKR 168mln (FY22: PKR 590mln). The interest coverage also declined to negative ~0.4x (FY22: ~6.8x) due to negative FCFO and increasing finance costs. Additionally, the debt coverage deteriorated to negative ~0.5x (FY22: ~2.2x), with the debt repayment period decreasing to negative ~1.6 years (FY22: ~1.1 years). During 6MFY24, the Company's free cash flows improved to PKR 32 mln (6MFY23: negative PKR 37mln) owing to improved EBITDA. Consequently, the interest coverage increased to ~0.4x (6MFY23: negative ~0.8x), and the debt coverage inclined to ~0.2x (6MFY23: negative ~0.3x).

Capitalization Shahzad Textile maintains a low-leveraged capital structure. As at 6MFY24, the Company's leverage increased to ~27.4% from ~22.5% at FY23, with total borrowings rising to PKR 1,102mln from PKR 868mln. The Short-term borrowings constitute ~59% of the total borrowings. Meanwhile, the equity base declined to PKR 3,921mln as at 6MFY24 (FY23: PKR 3,011mln)

Financial Summary
PKR mln

The Pakistan Credit Rating Agency Limited

Shahzad Textile Mills Limited Spinning	Dec-23 6M	Jun-23 12M	Jun-22 12M	Jun-21 12M
A BALANCE SHEET				
1 Non-Current Assets	2,421	2,480	2,559	2,420
2 Investments	133	129	122	115
3 Related Party Exposure	874	859	658	592
4 Current Assets	1,856	1,677	1,967	1,522
a Inventories	*884*	*689*	*795*	*701*
b Trade Receivables	*182*	*235*	*447*	*230*
5 Total Assets	5,284	5,145	5,307	4,649
6 Current Liabilities	872	877	726	590
a Trade Payables	*137*	*133*	*90*	*93*
7 Borrowings	1,102	868	933	946
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	389	390	504	323
10 Net Assets	2,921	3,011	3,144	2,790
11 Shareholders' Equity	2,921	3,011	3,144	2,790
B INCOME STATEMENT				
1 Sales	4,943	8,399	9,383	6,927
a Cost of Good Sold	*(4,729)*	*(8,164)*	*(8,308)*	*(6,198)*
2 Gross Profit	214	234	1,074	729
a Operating Expenses	(212)	(402)	(459)	(298)
3 Operating Profit	2	(168)	615	432
a Non Operating Income or (Expense)	*61*	*116*	*84*	*81*
4 Profit or (Loss) before Interest and Tax	62	(52)	699	513
a Total Finance Cost	*(89)*	*(136)*	*(100)*	*(74)*
b Taxation	*(63)*	*(81)*	*(221)*	*(133)*
6 Net Income Or (Loss)	(90)	(269)	377	306
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*32*	*(168)*	*590*	*458*
b Net Cash from Operating Activities before Working Capital Changes	*(44)*	*(287)*	*514*	*402*
c Changes in Working Capital	*(209)*	*315*	*(344)*	*(161)*
1 Net Cash provided by Operating Activities	(253)	28	169	241
2 Net Cash (Used in) or Available From Investing Activities	(1)	(42)	(276)	(120)
3 Net Cash (Used in) or Available From Financing Activities	234	(61)	102	(74)
4 Net Cash generated or (Used) during the period	(20)	(75)	(5)	48
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	17.7%	-10.5%	35.5%	60.5%
b Gross Profit Margin	4.3%	2.8%	11.5%	10.5%
c Net Profit Margin	-1.8%	-3.2%	4.0%	4.4%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-3.6%	1.8%	2.6%	4.3%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	-6.1%	-8.7%	12.7%	11.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	37	47	42	42
b Net Working Capital (Average Days)	32	42	39	39
c Current Ratio (Current Assets / Current Liabilities)	2.1	1.9	2.7	2.6
3 Coverages				
a EBITDA / Finance Cost	1.3	0.3	9.4	10.1
b FCFO / Finance Cost+CMLTB+Excess STB	0.2	-0.5	2.2	1.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-4.4	-1.6	1.1	1.5
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	27.4%	22.4%	22.9%	25.3%
b Interest or Markup Payable (Days)	104.0	97.6	114.6	121.9
c Entity Average Borrowing Rate	15.8%	12.7%	7.4%	6.5%

Credit Rating

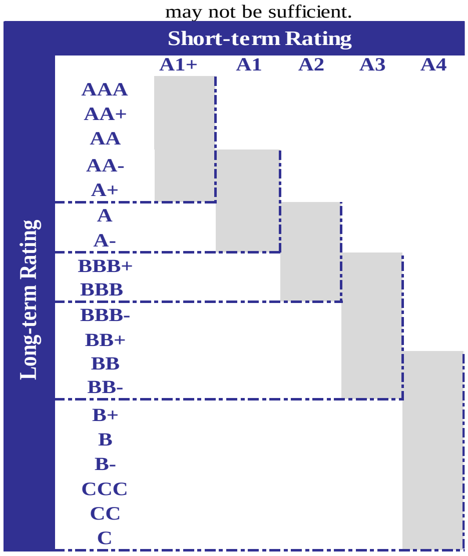
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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)

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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
Proprietary Information