



The Pakistan Credit Rating Agency Limited

## Rating Report

### Shahzad Textile Mills Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Dec-2018	BBB+	A2	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect modest business profile of Shahzad Textile Mills Limited accentuated by relatively lower margins when compared to its peers. The Company's financial profile is considered strong mainly on the back of low leveraged capital structure, efficient working capital and liquidity position. The sponsors of the company have followed a conservative approach. The Company has largely maintained its revenues over the years. Re-imposition of custom duties and sales tax on cotton & yarn imports, coupled with increased interest rates have made the local textile sector's situation more competitive. Meanwhile, the rupee devaluation and GoP initiative of subsidized gas prices has provided a requisite breather to the export oriented industry. However, on standalone basis, the company's revenues mainly tilt towards local sales.

Going forward, Shahzad Textile Mills intends to expand its business by vertical integration into socks business by setting up a manufacturing plant. The ratings are depended on improving business margins, especially post expansion into socks manufacturing. Meanwhile, prudent management of financial profile and maintaining financial discipline will remain critical.

#### Disclosure

<b>Name of Rated Entity</b>	Shahzad Textile Mills Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Ratings(Jun-18),Methodology   Criteria   Rating Modifier(Jun-18),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
<b>Related Research</b>	Sector Study   Textile(Oct-18)
<b>Rating Analysts</b>	Muhammad Hassan   muhammad.hassan@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Shahzad Textile Mills was incorporated in 1978, as a Public Limited Company under the Companies Act 1913 (now the Companies Act, 2017). The shares of the Company are quoted on Pakistan Stock Exchange.

**Background** The company was established by Mian Muhammad Aslam (late). The operations of Shahzad Textile Mills were handed over to Mian Parvez Aslam s/o Mian Muhammad Aslam and now to the third generation Mian Imran Aslam s/o Mian Parvez Aslam.

**Operations** Shahzad Textile is in the business of manufacturing of ring spun cotton and synthetic blended yarns, with a total installed capacity of 79,800 spindles. Additionally, the company is comprised of four production units. Unit # 1 & 3 focus on PV yarn, Unit # 2 produces polyester cotton yarn and Unit # 4 solely focus on cotton yarn.

## Ownership

**Ownership Structure** Mr. Imran Aslam (CEO) along with other family members collectively own majority (~73%) shares of the company. The remaining shareholding of the company is held by corporates (5.75%) and institutions (21.13%).

**Stability** Fourth generation of Aslam family has entered into the business. Although there is no formal succession plan but the ownership of shares and business roles are equally divided between the two brothers (Imran Aslam and Irfan Aslam). Formation of a group holding company or documented succession plan would do well to secure the future of the company.

**Business Acumen** Mr. Imran Aslam is the CEO of Shahzad Textile Mills Limited and is looking after the company's operations from more than two decades. His ability to take strategic decisions and to seize opportunities on the right time has kept the entity on the right track.

**Financial Strength** Mr. Imran Aslam has ~28% shareholding in his associate company i.e. Sargodha Jute Mills Limited. Other than that, on personal level he is an active investor in real estate and stock market. The net worth of assets in personal possession of Mr. Imran Aslam are ~PKR 690mln. So the entity can get timely support from its sponsors in lean times.

## Governance

**Board Structure** The overall control of the company vests in seven members. There are two executive, four non-executive and one independent director of the company.

**Members' Profile** The CEO (Mr. Imran Aslam) has ~26 years of association with the board. His brother Mr. Irfan Aslam is the director and brings in 23 years of experience. Their father Mian Parvez Aslam still holds the seat of Chairman, he has 40 years of experience and has association with the board since its incorporation.

**Board Effectiveness** Shahzad Textile Mills has two board committees: Audit Committee and HR & Remuneration Committee. The audit committee of the company is meeting every quarter of the financial year prior to the approved financial statements. HR & Remuneration Committee meets at least once in a financial year and sometimes meet more often if required.

**Financial Transparency** The External Auditors of the Company are M/s Horwath Hussain Chaudhry & Co., Chartered Accountants. They expressed an unqualified opinion on the company's annual financial statements for the year ended June 30, 2018. State Bank of Pakistan has classified them as in "Category-A" on its panel of auditors.

## Management

**Organizational Structure** The organizational structure of the company is currently divided into two main divisions Head Office and Mills. CFO, purchase manager and general manager commercial from Head Office and mill managers from the mill all report to CEO of the company i.e. Mr. Imran Aslam.

**Management Team** Mr. Imran Aslam, CEO, manages day to day operations of the company. Mr. Imran is supported by a team of experienced professionals. Most of the senior management has been associated with the company for a reasonably long period of time. Mr. Hamayun Bakht is the company's CFO and is working with the company from last 33 years and similarly other senior management staff is also quite experienced.

**Effectiveness** Shahzad Textile Mills Limited maintains adequate IT infrastructure and related controls. Management meets on daily basis as cheque signatory is the CEO himself and hold the authority of the final approvals, due to which there is close monitoring.

**MIS** Shahzad Textile Mills uses oracle based local ERP system by the name of Wizmen. Regular reporting of sales figures, raw materials positions, payables & receivables and income statement on monthly basis is shared with top management.

**Control Environment** The Company trusts in sustainable quality of yarn to the complete satisfaction of its clients. For this the Company has obtained ISO 9001-2008 Certification, which is renewed every year after an extensive checking, and complete verification of its quality management system. This quality certification enhances the trust of new customers and boosts up the confidence of old clients as well.

## Business Risk

**Industry Dynamics** Textile exports of the country grew by ~9% for FY18 backed by devaluation of the rupee, bailout package from the government and GSP Plus Scheme of the EU. This growth was led mainly by the value added segment, including knitwear, home textile and ready-made garments. Re-imposition of custom duty and sales tax on cotton imports in FY19 budget may put pressure on industry margins. Going forward, exports are expected to remain strong on account of devalued currency.

**Relative Position** The company only possesses 79,800 spindles and is able to produce ~22,000 MT of yarn, out of which 17.5% is exported i.e. ~4,000 MT. Whereas, the total cotton yarn exports of Pakistan clocked in at 522,000 MT in June18 (Market Share = 0.7%). On the domestic side quantity available for local market is ~2.8mln MT and quantity sold in local market by Shahzad Textile Mills was only 16,400 MT. As a result giving the company a market share of only 0.5%.

**Revenues** During FY18, the company's top-line clocked in at PKR 5,464mln (FY17: PKR 4,511mln). Local sales contribute 80% to the total revenue of the company, and only 20% is contributed by the export sales consequently the company was unable to get benefit from revalued currency and export rebates. Overall the company's revenues have been hovering around ~5bln since last five years.

**Margins** Higher cotton prices have lead to decreased gross margins to 4.9% (FY17: 5.4%) as the company was unable to procure inventory at viable rates in FY18. Overall business margins of the company remained lower than its peers, factor of lower margin products i.e PV yarn and PC yarn. Net profit of the company clocked in at ~PKR 72mln (FY17: ~PKR 35mln) after incorporating profit from its associate. However, the company's profit from operations remained well below its peers, factor of stagnant and stale business model. In 1QFY19, the company's margins improved, however, they are expected to normalize by year end.

**Sustainability** Shahzad Textile Mills Limited is planning to expand its business operations by vertical integration to socks business. The cost of the project is estimated at PKR 550mln out of which PKR 300mln will be financed through LTFE loan. The company will manufacture cotton sports socks by initial installation of 100 knitting machines and future target is to raise it to 250 knitting machines. Going forward, diversification into Socks segment may improve overall dwindling margins of the company.

## Financial Risk

**Working Capital** In FY18 inventory increased by ~37.5% as company purchased significant amount of inventory and at a higher cost. As a result average inventory held days increased to 44 days (FY17: 39). On the other hand, amount of trade debtors increased by 10.75% on account of credit sales and delayed receipts from government owned entities and consequently increasing the net cash cycle to 48 days (FY17: 43 days, FY16: 34 days).

**Coverages** During FY18 operating cash flows amount remained unchanged to PKR 161mln (FY17: 162). Whereas, finance cost was recorded at PKR 53mln (FY17: PKR 36mln) up by PKR 17mln due to which interest coverages took a negative effect and came down to 3.0x (FY17: 4.5x) and debt coverages also deteriorated to 1.7x (FY17: 2.1).

**Capitalization** Company's capital structure is extremely low leveraged with only 5% debt. Total debt of the company decreased to PKR 58mln (FY17: PKR 99mln) on account of long-term debt repayment by PKR 41mln. Leveraging is expect to go up to ~16% if the company decides to take LTFE of PKR 300mln for its new socks project.



**Shahzad Textile Mills Limited**

BALANCE SHEET	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
	3M	Annual	Annual	Annual
<b>Non-Current Assets</b>	<b>1,901</b>	<b>1,922</b>	<b>1,699</b>	<b>1,590</b>
<b>Investments (Incl. associates)</b>	<b>400</b>	<b>398</b>	<b>371</b>	<b>345</b>
Equity	400	398	371	345
Debt	-	-	-	-
<b>Current Assets</b>	<b>1,017</b>	<b>1,110</b>	<b>838</b>	<b>695</b>
Inventory	518	657	478	363
Trade Receivables	115	103	93	46
Others	384	351	267	286
<b>Total Assets</b>	<b>3,318</b>	<b>3,431</b>	<b>2,909</b>	<b>2,630</b>
<b>Debt</b>	<b>262</b>	<b>587</b>	<b>546</b>	<b>321</b>
Short-term	174	489	407	321
Long-term (Incl. Current Maturity of long-term debt)	89	99	140	-
Other shortterm liabilities	566	439	317	272
Other Longterm Liabilities	302	290	293	324
<b>Shareholder's Equity</b>	<b>2,187</b>	<b>2,114</b>	<b>1,752</b>	<b>1,714</b>
<b>Total Liabilities &amp; Equity</b>	<b>3,318</b>	<b>3,431</b>	<b>2,909</b>	<b>2,631</b>
<b>INCOME STATEMENT</b>				
<b>Turnover</b>	<b>1,685</b>	<b>5,464</b>	<b>4,511</b>	<b>3,692</b>
Gross Profit	163	268	243	185
Other Income	(13)	43	2	25
Financial Charges	(9)	(53)	(36)	(32)
<b>Net Income</b>	<b>72</b>	<b>72</b>	<b>35</b>	<b>(13)</b>
<b>Cashflow Statement</b>				
Free Cashflow from Operations (FCFO)	121	161	162	89
Net Cash changes in Working Capital	159	(97)	(202)	(130)
Net Cash from Operating Activities	280	39	(56)	(53)
Net Cash from Investing Activities	(6)	(18)	(198)	-
Net Cash from Financing Activities	(325)	23	226	59
<b>Ratio Analysis</b>				
<b>Performance</b>				
Turnover Growth	37.2%	21.1%	22.2%	-97.5%
Gross Margin	9.7%	4.9%	5.4%	5.0%
Net Margin	4.3%	1.3%	0.8%	-0.4%
ROE	4.4%	3.4%	2.0%	-0.8%
<b>Coverages</b>				
Interest Coverage (FCFO/Gross Interest)	13.4	3.0	4.5	2.8
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	3.1	1.7	2.1	2.8
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	3.1	1.9	2.2	3.3
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	0.6	0.9	1.1	0.1
<b>Liquidity</b>				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	31.5	48.1	43.4	34.2
<b>Capital Structure (Total Debt/Total Debt+Equity)</b>				
	10.7%	21.7%	23.8%	15.8%

## 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	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <b>AA</b> <b>AA-</b>	<b>Very high credit quality.</b> 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.	<b>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</b> <b>A-</b>	<b>High credit quality.</b> 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.	<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<b>Good credit quality.</b> 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.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</b> <b>BB-</b>	<b>Moderate risk.</b> 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>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</b> <b>B-</b>	<b>High credit risk.</b> 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>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> 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.		
<b>D</b>	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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(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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(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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