



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
30-Apr-2019	BBB+	A2	Stable	Maintain	-
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 sponsors of the company have followed a conservative approach. The Company has largely maintained its revenues over the years. 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. The Company's financial profile is considered strong mainly on the back of low leveraged capital structure, efficient working capital and liquidity position.

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

Disclosure

Name of Rated Entity	Shahzad 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Legal Structure Shahzad Textile Mills was incorporated in 1978, as a Public Limited Company under the repealed Companies Act 1913 (now the Companies Act, 2017).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 then handed over to Mian Parvez Aslam s/o Mian Muhammad Aslam and then 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. 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 There is no formal succession plan but the ownership of shares and business roles are equally divided between the two brothers Mr. Imran Aslam and Mr. 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 for 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 is ~PKR 690mln. The Entity can get timely support from its sponsors in lean times if needed.

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 is associated with the board since its incorporation.

Board Effectiveness Shahzad Textile 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 half yearly financial statements December 31, 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 is associated with the Company for a reasonably long period of time. Mr. Hamayun Bakht holds the position of CFO and is working with the Company from last 33 years and similarly other senior management staff is also quite experienced.

Effectiveness Shahzad Textile 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% in FY18, backed by devaluation of the rupee, bailout package from the government and GSP Plus Scheme of the EU. During 9MFY19, however, exports stagnated. Even though major segments including cotton cloth, knitwear, garments and bedwear displayed strong quantitative growth, industry players needed to share the benefit of the currency depreciation with their buyers which resulted in a unit price dip across all major categories, curbing overall growth. This, coupled with cotton yarn displaying double-digit quantitative decline on account of the US-China trade war as well as strong domestic demand for yarn, resulted in overall increase in exports of only ~0.1% YoY. Going forward, the devalued currency, recently announced relief in electricity tariffs for textile players as well as expected payment of tax refunds is expected to boost exports.

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. In exports market, the Company has market share of 0.7% and in local market the Company has a market share of only 0.5%.

Revenues During 1HFY19, the Company's top-line clocked in at PKR 3,326mln (1HFY18: PKR 2,539mln), portraying an increase of ~31%. Local sales contribute 80% to the total revenue of the Company and 20% is contributed by the export sales. The main reason behind this is the increase in selling price in local market by ~PKR 15/pound.

Margins The gross margins of the Company increased to 7% in 1HFY19 (FY18: 5%). The main reason behind this is the increase in selling price of yarn in the local market combined with timely procurement of raw material. Consequently, operating margins increased to 4.6% (FY18: 2%) and net margin doubled to 2.6% in 1HFY19 (FY18: 1.3%).

Sustainability Shahzad Textile 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 LTFF 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. The machines from Italy are expected to reach Pakistan till June 19 and the project is expected to be fully operational by September 19. Going forward, diversification into Socks segment may improve overall dwindling margins of the company.

Financial Risk

Working Capital Inventory held days of the Company in 1HFY19 increased to 43 (FY18: 38 days), as the Company procured inventory in bulk due to cotton procurement season. In 1HFY19, the amount of raw materials increased to PKR 753mln (FY18: PKR 554mln). Consequently, the net working capital days of the Company increased to 45 in 1HFY19 (FY18: 42 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: 2.1x). In 1HFY19, FCFO of the Company increased to PKR 170mln (1HFY18: PKR 161mln), on the back of increased sales revenue. Finance cost of the Company also increased by ~50% and clocked in at PKR 25.5mln in 1HFY19 (1HFY18: PKR 17mln), due to higher interest rates. As a result, interest coverages improved to 6.7x (FY18: 3.0x) and debt coverages improved to 3.7x (FY18: 1.7x).

Capitalization The Company has a well managed and low leveraged capital structure. In 1HFY19, leveraging of the Company increased by only 1% to 22.8% (FY18: 21.7%), as the short-term borrowings increased to PKR 568mln in 1HFY19 (FY18: PKR 489mln). Short-term debt constitutes 94% in the total debt of the Shahzad Textile.



Shahzad Textile Mills Limited

Listed Public Limited

BALANCE SHEET

	Dec-18 6M	Jun-18 12M	Jun-17 12M	Jun-16 12M
a Non-Current Assets	1,878	1,922	1,699	1,590
b Investments (Incl. Associates)	420	398	371	345
Equity Instruments	420	398	371	345
Debt Instruments	-	-	-	-
c Current Assets	1,329	1,110	838	695
Inventory	893	657	478	363
Trade Receivables	88	103	93	46
Others	348	350	267	286
d Total Assets	3,627	3,430	2,909	2,630
e Debt/Borrowings	646	587	546	320
Short-Term	568	489	407	320
Long-Term (Incl. Current Maturity of Long-Term Debt)	78	99	140	-
Other Short-Term Liabilities	502	439	317	272
Other Long-Term Liabilities	295	290	293	324
f Shareholder's Equity	2,184	2,113	1,752	1,714
g Total Liabilities & Equity	3,627	3,430	2,909	2,630

INCOME STATEMENT

a Turnover	3,326	5,464	4,511	3,692
b Gross Profit	234	268	243	185
c Net Other Income	(9)	42	2	25
d Financial Charges	(25)	(53)	(36)	(32)
e Net Income	86	72	35	(13)

CASH FLOW STATEMENT

a Free Cash Flow from Operations (FCFO)	170	161	162	89
b Total Cashflows (TCF)	170	177	172	105
c Net Cash changes in Working Capital	(164)	(97)	(202)	(130)
d Net Cash from Operating Activities	(16)	39	(56)	(53)
e Net Cash from Investing Activities	(19)	(18)	(198)	-
f Net Cash from Financing Activities	41	23	226	59
g Net Cash generated during the period	6	44	(28)	6

RATIO ANALYSIS

a Performance				
Turnover Growth	22%	21%	22%	-12%
Gross Margin	7%	5%	5%	5%
Net Margin	3%	1%	1%	0%
ROE	8%	4%	2%	-1%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+U)	3.7	1.9	2.3	3.5
Interest Coverage (X) (FCFO/Gross Interest)	6.7	3.6	5.5	3.5
Debt Payback (Years) (Total Debt (excluding Covered Short T	0.3	0.9	1.1	0.0
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable D	45	42	36	29
d Capital Structure (Total Debt/Total Debt+Equity)	23%	22%	24%	16%

Shahzad Textile Mills Limited

Apr-19

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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(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

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- (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.
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- (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)
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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)
- (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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- (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 | 18-(a)
- (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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