# RATING REPORT

## Shahtaj Textile Limited (STL)

**REPORT DATE:**
December 26, 2019

**RATING ANALYSTS:**
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| RATING DETAILS | | | | |
|---|---|---|---|---|
| **Rating Category** | **Latest Rating** | | **Previous Rating** | |
| | **Long-term** | **Short-term** | **Long-term** | **Short-term** |
| **Entity** | A- | A-2 | A- | A-2 |
| **Rating Outlook** | Stable | | Stable | |
| **Rating Date** | Dec 26, 2019 | | Jan 18, 2019 | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 1990** | **External auditors:** Deloitte Yousuf Adil, Chartered Accountants |
| **Public Listed Company** | **Chairman of the Board:** Mr. Muneer Nawaz |
| Shahtaj Sugar Mills – 11.90% | **Chief Executive Officer:** Mr. M. Naeem |
| Mr. Ahmed Naeem – 9.19% | |
| Mrs. Amtul Bari Naeem – 8.65% | |
| Treet Corporation Limited – 8.99% | |
| Mr. Muneer Nawaz – 8.62% | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| **VIS Entity Rating Criteria** |
| *Industrial Corporates (May 2019)*   **https://vis.com.pk/kc-meth.aspx** |

# Shahtaj Textile Limited

## RATING RATIONALE

Shahtaj Textile Limited (STL) is part of 'Shahnawaz Group'. The group consists of six companies including STL. The other five companies are Shezan International, Shahtaj Sugar Limited, Shahnawaz Engineering Ltd., Cornstar ISA and Nawazabad Farms. STL is engaged in the manufacturing, selling and marketing of grey fabric.

### Key Rating Drivers

### Textile Industry Dynamics

Overall export performance of the textile sector has been muted during the outgoing year despite significant rupee devaluation and notable measures having been undertaken by the Government of Pakistan (GoP) to uplift the textile sector; the latter included reduction in energy prices and regulatory duty on import of cotton. Non-value added exports contracted by 20.6%/19.9% in terms of volume and value during FY19 while value added exports depicted meager growth of 6.8%/3.0% in volume/value terms. Global demand of Pakistani yarn has experienced downward pressure, owing to the shifting of spinning mills from China to Vietnam coupled with reduced export orders from China in light of the prevailing US-China trade tensions. On the flip side, volume led growth in value added exports has enhanced local consumption for yarn resulting in limited export surplus for the same. Nevertheless signing of FTA phase 2 (free trade agreement) with China presents an opportunity for spinning mills to enhance yarn exports to China.

**Table 1: Pakistan's Textile Exports (Source: PBS)**

| (Mn Tons, USD Mn) | FY18 | | | FY19 | | |
| --- | --- | --- | --- | --- | --- | --- |
| | Volume | Value | USD/Unit | Volume | Value | USD/Unit |
| Raw Cotton | 35 | 58 | 1.66 | 12 | 20 | 1.67 |
| Yarn | 518 | 1,371 | 2.65 | 427 | 1,125 | 2.63 |
| **Non-Value Added** | **553** | **1,429** | **2.58** | **439** | **1,145** | **2.61** |
| Knitwear | 117 | 2,733 | 23.36 | 133 | 2,909 | 21.9 |
| Bedwear | 359 | 2,261 | 6.30 | 376 | 2,262 | 6.02 |
| Towels | 189 | 788 | 4.17 | 194 | 786 | 4.05 |
| Readymade Garments | 40 | 2,581 | 64.53 | 50 | 2,657 | 53.14 |
| **Value Added** | **705** | **8,362** | **11.86** | **753** | **8,612** | **11.44** |

Cost pressures for the industry are reflective of the global and local cotton production data which shows scaled down cultivation area and production at both fronts. Resultantly, local cotton prices have gone up. With respect to the spinning segment, dependence on imported cotton, particularly from India, has been on the higher side given its identical quality with local cotton. However sprained relations with India and significant rupee devaluation would further spike up raw material costs for the spinning segment. Margins and financial performance of



**Figure 1**

players in the industry have depicted volatility due to inherent cyclicality of crop levels and oscillations in cotton prices. VIS expects prices to sustain the high ground based on the ongoing
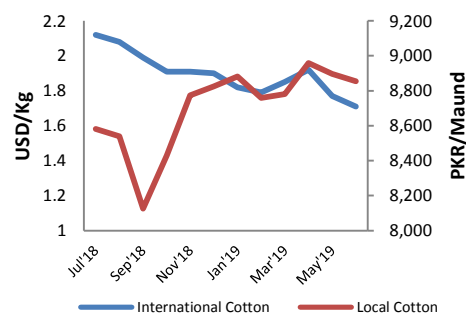
decline in cotton production. Nonetheless materialization of FTA phase 2 with China would provide some ease on the cost front in the form of a relief from duties and tariffs.

| Table 2: (Source: USDA) | | | |
|---|---|---|---|
| **Area Under Cultivation (Mn Hectres)** | **FY18** | **FY19** | **% Change** |
| World | 33.7 | 33.5 | -0.6% |
| Pakistan | 2.7 | 2.3 | -14.8% |
| **Production (Mn 480lb Bales)** | | | |
| World | 123.8 | 119.1 | -3.8% |
| Pakistan | 8.2 | 7.6 | -7.3% |

**Satisfactory existing governance framework.**

The Board of Directors comprises nine members including two independent directors. In order to ensure effective oversight, two committees, namely Board Audit Committee (BAC) and Board Human Resources and Remuneration Committee (BHRRC), are present at Board level. In line with best practices, board committees are chaired by independent Board members and woman representation is present on the Board.

**Efficiency enhancement initiatives are underway**

Under the company's Balancing, Modernization and Rebalancing Program (BMR), STL is in process of replacement of its 2 gas generators of 1,750KW with brand new 2000KW generators to achieve better energy efficiency. These machines will be installed at a cost of ~Rs. 160m and will be funded through long term financing. As per management, both these facilities will be fully operational in FY20, thereby translating into improved efficiency and reduction in running costs. Existing capacity utilization remains approximately 91%.

**Net sales have increased on the back of increase in average selling prices.**

Net sales of STL witnessed a growth of 22.0% during the outgoing year (FY19: 4.8b). More than 50% of the sales remain geared towards the local markets. Local Sales (including indirect export sales) increased by 65% to Rs. 3.0b (FY18: 2.3b). In contrast, export sales of the company increased at a relatively modest rate of 8% to Rs. 1.8b (FY18: Rs. 1.7b). Growth in sales was due to favorable rate variances both in export and local sales while volumes were maintained at around prior year levels. Country wise concentration in sales is considered moderate with top two European export markets constituting approximately 30% (FY18: 29%) of gross sales in FY19. Client wise concentration in sales is considered to be on the higher side with top 10 clients accounting for 84% (FY18: 73%) of gross sales in FY19. However, the concentration risk is partly mitigated by long term relationship with clients. Net sales of STL were reported at Rs. 1.1b (Q1'FY19: Rs. 1.1b) in Q1'FY20. Management has projected net sales of Rs. 4.9b for FY20.

**Margins have recovered on the back of rupee devaluation and lower energy costs**

Growth in topline outweighed the growth in costs of the company during FY19 and Q1'20, thereby resulting in higher gross and net margins. As a result, gross margin increased to 10.3% (Q1'19: 5.3%) and 9.4% (FY18: 7.5%) in the Q1'FY20 and FY19, respectively. Furthermore, finance cost of the company has trended upwards. However, net profit margins were reported higher (FY19: 3.93%; FY18: 1.73%). This was supported by increase in other income owing to exchange gain due to currency devaluation. Given aforementioned factors, management projects margins to be maintained in ongoing fiscal year.

**Liquidity profile has improved as a result of increase in company's profitability**

Funds From Operations (FFO) have exhibited an increase in FY19 on account of higher profitability to Rs. 259m (FY18: Rs. 174m). Resultantly, FFO as a proportion of total debt decreased to 22% (FY18: 16%). The cash flows of the company are sufficient to meet the outstanding the debt obligations as indicated by sizeable debt servicing coverage ratio (FY19: 2.6x; FY18: 2.9x). Stock in trade and trade debts provide adequate cushion over short term borrowings, while current ratio of the company also remains above 1.0x (FY19: 1.4x; FY18: 1.2x; FY17: 1.4x). Management expects moderate expenditure on capex in the rating horizon which is expected to support the liquidity and debt service profile of the company going forward.

**Despite growth in equity base, leverage indicators have remained high on account of similar increase in borrowings**

On a timelines basis, the equity base of the company has increased owing to profit retention. Equity base of the company amounted to Rs. 1,167.8m (FY19: Rs. 1,141.8m; FY18: Rs. 972.2m) at end-Q1'20. As a result, gearing and leverage ratios decreased to 1.0x (FY18: 1.1x) and 1.5x (FY18: 1.7x) respectively at end-FY19. Leverage indicators remained high. At end-Q1'20, gearing and leverage ratios stood at 0.9x and 1.3x respectively. Improvement in capitalization indicators is an important rating driver going forward.

**Shahtaj Textile Limited**                                                          **Appendix I**

| FINANCIAL SUMMARY | | | *(amounts in PKR millions)* |
|---|---|---|---|
| **BALANCE SHEET** | **1Q20** | **FY19** | **FY18** |
| **Non-Current Assets** | 1,112.99 | 1,131.33 | 1,191.65 |
| **Stock-in-Trade** | 673.36 | 529.34 | 507.91 |
| **Trade Debts** | 646.4 | 948.9 | 619.2 |
| **Cash & Bank Balances** | 32.2 | 25.0 | 6.5 |
| **Total Assets** | 2,796.02 | 2,899.03 | 2,683.13 |
| **Trade and Other Payables** | 336.6 | 353.8 | 393.5 |
| **Short Term Borrowings** | 682.07 | 791.17 | 776.30 |
| **Long Term Debt (Inc Current Maturity)** | 383.8 | 386.4 | 331.6 |
| **Total Liabilities** | 1,554.11 | 1,681.30 | 1,623.99 |
| **Paid up capital** | 96.6 | 96.6 | 96.6 |
| **Total Equity (Exc Revaluation Surplus)** | 1,167.80 | 1,141.75 | 972.19 |
| **INCOME STATEMENT** | **1Q20** | **FY19** | **FY18** |
| **Net Sales** | 1,149.55 | 4,787.65 | 3,925.33 |
| **Gross Profit** | 118.1 | 448.8 | 295.8 |
| **Distribution Expenses** | 17.2 | 77.1 | 72.8 |
| **Administrative Expenses** | 26.7 | 98.3 | 93.8 |
| **Other Income** | 0.454 | 87.178 | 20.041 |
| **Finance Cost** | 25.2 | 87.3 | 47.9 |
| **Profit before Tax** | 34.4 | 251.4 | 85.6 |
| **Profit After Tax** | 24.1 | 188.0 | 68.1 |
| **RATIO ANALYSIS** | **1Q20** | **FY19** | **FY18** |
| **Gross Margin (%)** | 10.27% | 9.37% | 7.54% |
| **Net Margin (%)** | 2.10% | 3.93% | 1.73% |
| **Current Ratio (x)** | 1.5 | 1.4 | 1.2 |
| **Net Working Capital** | 583 | 541 | 253 |
| **Gearing (x)** | 0.9 | 1.0 | 1.1 |
| **Leverage (x)** | 1.3 | 1.5 | 1.7 |
| **FFO** | 52.3 | 259.0 | 174.4 |
| **FFO to Long Term Debt (x)** | 0.62 | 0.76 | 0.61 |
| **FFO to Total Debt (x)** | 0.20 | 0.22 | 0.16 |
| **Debt Servicing Coverage Ratio (x)** | n/a | 2.6 | 2.9 |
| **Stock in trade+trade debt/short term borrowings (%)** | 193% | 187% | 145% |
| **ROAA (%)** | 3.39% | 6.74% | 2.86% |
| **ROAE (%)** | 17.79% | 7.09% | 11.52% |

## ISSUE/ISSUER RATING SCALE & DEFINITIONS　　　Appendix II

**VIS Credit Rating Company Limited**

### RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

#### Medium to Long-Term

**AAA**
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

**AA+, AA, AA-**
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

**A+, A, A-**
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

**BBB+, BBB, BBB-**
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

**BB+, BB, BB-**
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

**B+, B, B-**
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

**CCC**
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

**CC**
A high default risk

**C**
A very high default risk

**D**
Defaulted obligations

#### Short-Term

**A-1+**
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

**A-1**
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

**A-2**
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

**A-3**
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

**B**
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

**C**
Capacity for timely payment of obligations is doubtful.

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**Rating Watch:** VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

**Rating Outlooks:** The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

**(SO) Rating:** A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

**(blr) Rating:** A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

**'p' Rating:** A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

**'SD' Rating:** An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

| REGULATORY DISCLOSURES | | | | | Appendix III |
|---|---|---|---|---|---|
| **Name of Rated Entity** | Shahtaj Textile Limited | | | | |
| **Sector** | Textile | | | | |
| **Type of Relationship** | Solicited | | | | |
| **Purpose of Rating** | Entity Rating | | | | |
| **Rating History** | **Rating Date** | **Medium to Long Term** | **Short Term** | **Rating Outlook** | **Rating Action** |
| | **RATING TYPE: ENTITY** | | | | |
| | 12/26/2019 | A- | A-2 | Stable | Reaffirmed |
| | 01/18/2019 | A- | A-2 | Stable | Reaffirmed |
| | 12/14/2017 | A- | A-2 | Stable | Initial |
| **Instrument Structure** | N/A | | | | |
| **Statement by the Rating Team** | VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities. | | | | |
| **Probability of Default** | VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default. | | | | |
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