

## RATING REPORT

### Arshad Textile Mills Limited

**REPORT DATE:**

April 05, 2019

**RATING ANALYSTS:**

Syed Fahim Haider Shah  
[fahim.haider@vis.com.pk](mailto:fahim.haider@vis.com.pk)

Maimoon Rasheed  
[maimoon@vis.com.pk](mailto:maimoon@vis.com.pk)

**RATING DETAILS**

Rating Category	Initial Rating	
	Long-term	Short-term
Entity	BB+	A-3
<i>Rating Outlook</i>	<i>Stable</i>	
Rating Action	Initial	
<i>Rating Date</i>	<i>April 03, '19</i>	

**COMPANY INFORMATION**

Incorporated in 1984	External auditors: Riaz Ahmed & Company Chartered Accountants.
Public Limited Company – Unquoted	Chairman/CEO: Shahzad Ahmed Sheikh
<b>Key Shareholders (with stake 5% or more):</b>	
Mr. Shahzad Ahmed Sheikh – 24.66%	
Mr. Muhammad Arshad Sheikh – 19.17%	
Mr. Sharhyar Arshad – 13.33%	
Mr. Nisar Ahmed Sheikh – 12.06%	

**APPLICABLE METHODOLOGY(IES)**

VIS Entity Rating Criteria: Industrial Corporates (May 2016)

<https://www.vis.com.pk/kc-meth.aspx>

## Arshad Textile Mills Limited

## OVERVIEW OF THE INSTITUTION

Arshad Textile Mills Limited (ATML) was incorporated in 1984 as a public limited company. The principal business activity of ATML is manufacturing and sale of cotton-blended yarn.

**Profile of the Chairman/CEO**

Mr. Shahzad Ahmed Sheikh is the Chairman of the Board and Chief Executive Officer (CEO). Mr. Shahzad holds a Master's degree in Commerce. He has over 25 years of textile industry experience.

**Financial Snapshot**

**Tier-1 Equity:** end-FY18: Rs. 503m; end-FY17: Rs. 469m; end-FY16: Rs. 509m.

**Assets:** end-FY18: Rs. 3.0b; end-FY17: Rs. 2.3b; end-FY16: Rs. 1.7b.

**Profit After Tax:** FY18: Rs. 41m; FY17: Rs. (8m); FY16: Rs. (14m).

## RATING RATIONALE

Arshad Textile Mills Limited (ATML) is a small-scale spinning unit involved in the manufacturing and sale of cotton-blended yarn. ATML is a part of Arshad Group and shareholding is vested with sponsoring family who are actively involved in the day-to-day operations. The assigned ratings take into account relevant experience of the sponsors, established business relations with suppliers and customers, sustained top-line growth and some improvement in profit margins. The business risk profile draws some comfort from recent Balancing, Modernization, and Replacement (BMR) of existing spinning unit and diversification into finished fabric and uniform business. Although ATML has been able to improve its competitiveness, the ratings are constrained by limited scale of spinning operations and susceptibility of margins to volatile cotton prices. The ratings also factor in relatively high financial risk depicted by elevated leverage indicators, low coverages and weak liquidity profile of the company.

**Rating Drivers****Business Strategy**

ATML has a single spinning unit, which houses 24,924 spindles with a production capacity of 6.9m kgs of yarn per annum. ATML manufactures three blends of carded and combed yarn, including PC, CVC, and PV yarn with count range of Ne 7/1 – Ne 40/1. The company has carried out two major BMRs of its spinning unit over the past four years to improve operational efficiencies and reduce overall cost of production. ATML sells its home textile products under the brand name “Araish” through an online store and men’s suiting fabric under the brand name “Shahsawar” to a network of 162 retailers across Pakistan. ATML is also involved in delivering uniform and protective cloth articles to police and other government departments via competitive bidding process.

**Sales and profitability**

Net sales of ATML have increased on a timeline basis. The company registered 30% growth in sales during FY18, driven largely by higher volumes and selling prices of both yarn and fabric division. The proportion of fabric division was recorded higher on account of notable growth in men’s suiting and home textile businesses as well as execution of police uniform orders. The increase in cost of sales was due to increase in yarn procurement and fabric processing charges. The augmentation of ATML’s gross profits on a timeline basis is primarily a function of higher sales and improved margins. Diversification into relatively higher margin fabric business also positively impacted gross margins during FY18. The increase in distribution cost was due to higher commission paid to agents in an effort to grow fabric business. There was a notable increase in finance cost during FY18 mainly due to higher average utilization of debt financing and fair value adjustment against sponsors’ loan. Net profit, though still modest, stood higher during FY18 against loss in previous years.

**Liquidity and Cash Flows**

Cash flows position of the company has somewhat improved over the past three years. In line with the higher profits, funds from operations (FFO) generation increased during FY18. However, FFO to long-term debt ratio decreased slightly as the company procured fresh long-term debt during the year. Due to growth in FFO and slightly reduced repayment of long-term debt, ATML recorded further improvement in the debt service coverage (DSCR) during FY18. The current ratio remained below the minimum benchmark of 1.0x owing to a sizeable increase in advances from customers and slightly higher short-term borrowings. Meanwhile, the diversification into men’s suiting business has an adverse impact the net operating cycle as inventory days and receivable days have increased on account of higher lead-time and credit period availed by retailers.

**Capital and Funding**

With profit retention, equity base of the company increased at a modest growth rate. ATML obtained long-term borrowings from commercial banks during FY18 to finance upgradation of its spinning unit. ATML is meeting its increasing working capital requirements from a mix of short-term borrowings and advances from customers. Short-term borrowings stood higher at end-FY18 owing to increase in working capital requirements. Resultantly, ATML recorded further increase in gearing and debt leverage indicators, and hence financial risk is considered on a higher side.

<b>FINANCIAL SUMMARY</b> <i>(amounts in PKR millions)</i>			
<b><u>BALANCE SHEET</u></b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>
Non-Current Assets	1,074	1,099	1,312
Stores, Spares. And Loose Tools	16	26	37
Stock-in-Trade	300	484	710
Trade Debts	98	318	366
Other Receivables	184	210	259
Other Current Assets	51	120	321
<b>Total Assets</b>	<b>1,723</b>	<b>2,257</b>	<b>3,005</b>
Trade and Other Payables	198	439	937
Other Liabilities	101	98	83
Short Term Borrowings	488	864	905
Long-Term Borrowings <i>(Inc. current matur)</i>	191	155	352
<b>Total Liabilities</b>	<b>978</b>	<b>1,557</b>	<b>2,276</b>
Tier-1 Equity	<b>509</b>	<b>469</b>	<b>503</b>
<b>Total Equity</b>	<b>745</b>	<b>700</b>	<b>729</b>
<b><u>INCOME STATEMENT</u></b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>
Net Sales	1,811	2,478	3,213
Gross Profit	96	202	273
Operating Profit	32	88	138
Profit After Tax	-14	-8	41
FFO	11	46	69
<b><u>RATIO ANALYSIS</u></b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>
Gross Margin (%)	5.3%	8.2%	8.5%
Net Working Capital	(122)	(236)	(260)
FFO to Long-Term Debt	0.06	0.29	0.20
FFO to Total Debt	0.02	0.04	0.06
Debt Servicing Coverage Ratio (x)	0.57	0.85	1.04
ROAA (%)	(-0.9)	(0.4)	1.6
ROAE (%)	(2.7)	(1.7)	8.4
Gearing (x)	1.33	2.17	2.50
Debt Leverage (x)	1.92	3.32	4.53
*Adjusted Debt Leverage (x)	1.85	3.08	2.92
Current Ratio (x)	0.84	0.83	0.87
Inventory + Receivable/Short-term Borrowings (x)	0.82	0.93	1.19

\*Excluding advances against govt. institutions uniform orders

## 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.

**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](http://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](http://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](http://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

Annexure III

<b>Name of Rated Entity</b>	Arshad Textile Mills Limited				
<b>Sector</b>	Textile				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	<b>RATING TYPE: ENTITY</b>				
	03/04/2019	BB+	A-3	Stable	Initial
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	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.				
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