RATING REPORT

Sohail Textile Mills Limited

REPORT DATE:
December 18, 2019

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	Initial Rating	
	Long-term	Short-term
Entity	BBB-	A-2
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*December 13, 2019*	

COMPANY INFORMATION

Incorporated in 1981	External auditors: Munaf Yusuf & Co. Chartered Accountants.
Public Limited (Unlisted) Company	Chairman: Mr. Muhammad Nasir Chief Executive Officer: Mr. Najib Usman
Key Shareholders (with stake 5% or more):	
Directors – 57.39% Rizmar International (Pvt.) Limited – 11.91% S&R Associates (Pvt.) Limited – 11.91% Ahmed Rahim Associates (Pvt.) Limited – 11.65%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (May 2019)
https://www.vis.com.pk/kc-meth.aspx

Sohail Textile Mills Limited

OVERVIEW OF THE INSTITUTION

Sohail Textile Mills Limited (SOT) was incorporated in 1981 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). The company is engaged in manufacturing and sale of yarn. The spinning unit is located at 9-KM Sheikhupura, Sargodha Road, and head office is located at 45-50 Industrial Area, Gulberg III Lahore.

Financial Snapshot

Tier-1 Equity: end-FY19: Rs. 303.5m; end-FY18: Rs. 272.2m; end-FY17: Rs. 270m.

Assets: end-FY19: Rs. 1.4b; end-FY18: Rs. 1.36b; end-FY17: Rs 879.3m.

Profit After Tax: FY19: Rs. 23.6m; FY18: Rs. 86.1m; FY17: Rs. 1.5m.

RATING RATIONALE

Sohail Textile Mills Limited (SOT) is a part of Ayesha Group, which is one of the renowned players in yarn spinning industry of Pakistan. The assigned ratings take into account extensive experience, spanning nearly half a century, of the sponsoring family, and established relations with customers. Customer concentration risk is considered manageable while risk of bad debts is low as the company makes major portion of sales on cash. The ratings factor in sustained revenue and improvement in profit margins, led by marginal increase in production, and favorable yarn pricing. Given considerable decline in the country's cotton produce this year, the company is planning to import nearly half of cotton required which would expose it to foreign exchange risk. Liquidity position of the company is underpinned by increasing cash flows generation, while current ratio has remained largely stable. The company's capacity to meet its financial obligation is considered adequate. However, given relatively small equity base and presence of subordinated loan from the directors, the leverage indicators are relatively high, though some improvement was noted by end-FY19.

Key Rating Drivers

Sustained growth in sales and profitability resulting from steady increase in volumes and favorable pricing
Ayesha Group entered the spinning industry with the establishment of Ayesha Spinning Mills Ltd. in 1972. Since then, the group has grown into four spinning units, a leather tannery, a leather shoe factory, a shoe retail chain under the brand name of 'EPCOT", socks factory, an embroidery factory and a fashion retail chain under the brand name of 'Cross Stitch'. SOT has a spinning unit blended polyester-cotton (PC) and chief-value-cotton (CVC) yarn of counts ranging from 10/1 to 36/1 is made. Over the years, the company has steadily upgraded its spinning infrastructure to enhance efficiencies. The company has depicted stability in business relations with major customers, and concentration risk is considered manageable as top-10 customers on average account for nearly half of total sales.

SOT has shown growth in revenue on a timeline basis. Net revenue of the company increased by 24% during FY19 on account of increased volumes and higher selling price. Cost of raw materials was recorded higher owing to increase in cotton and polyester rates. With further improvement in margin, gross profit was recorded higher during FY19. Operational costs increased due to inflationary adjustment in salaries & amenities and electricity expenses, whereas the increase in finance cost was owing to higher average utilization of both short-term and long-term borrowings and increase in markup rates. Accounting for tax expense vis-à-vis tax benefit in the corresponding period, the company reported lower net profit during FY19.

Liquidity profile underpinned by improving cash flows generation
The company liquidity indicators are considered adequate. Current ratio remained largely stable over the review period, with largely flat cash conversion cycle. Inventory plus receivables to short-term debt ratio increased to 1.45x by end-FY19, as the company used internally generated capital to partially fund its working capital requirements. In line with higher cash flows before working capital changes, funds from operations (FFO) generation increased to Rs. 72.2m during FY19. FFO to long-term debt and FFO to total-debt ratios improved to 0.44x and 0.23x due to higher cash flows generation and slight decrease in debt. The debt service coverage ratio (DSCR) moderated to 2.1x by end-FY19 owing to higher repayment of principal against finance lease.

Capitalization
Tier-1 equity of the company accumulated during FY19 with profits retention. There was no unsecured, interest-free and payable on demand loan from directors/sponsors at end-FY19. Total liabilities stood lower at period end mainly due to reduction in deferred taxation, though trade and other payables were recorded higher, mainly reflecting the impact of higher cotton price. The debt profile of the company comprises a mix of short-term borrowings from commercials banks, subordinated long-term loan from directors, and finance lease. Short-term borrowings were largely stable at end-FY19 while sub-ordinated long-term loan from the directors remained unchanged. Finance lease obligations, inclusive of current maturity, decreased slightly on account of scheduled repayments. Resultantly, gearing and debt leverage indicators improved to Rs. 1.02x and 1.73x, respectively by end-FY19. Given no significant debt-financed capex plan, the leverage indicators are expected to improve steadily, going forward.

Sohail Textile Mills Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY17**	**FY18**	**FY19**
Total Assets	879.3	1,357.2	1,400.1
Total Liabilities	399.9	540.5	524.1
Total Equity	479.4	816.7	876.1
Paid-up Capital	30.0	69.0	69.0
INCOME STATEMENT	**FY17**	**FY18**	**FY19**
Net Sales	1,523.1	1,760.3	2,190.8
Profit Before Tax	14.9	32.4	47.9
Profit After Tax	1.5	86.1	23.6
FFO	27.8	42.9	72.2
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**
Gross Margin (%)	5.2	6.7	7.7
FFO to Long-Term Debt	5.47	0.25	0.44
FFO to Total Debt	0.22	0.13	0.23
Debt Servicing Coverage Ratio (x)	2.6	3.0	2.1
Gearing (x)	0.46	1.16	1.02
Debt Leverage (x)	1.48	1.94	1.73
Current Ratio	1.16	1.12	1.12

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Annexure 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.

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	Annexure III
Name of Rated Entity	Sohail Textile Mills Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see below
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
13-12-2019	BBB-	A-2	Stable	Initial