The Pakistan Credit Rating Agency Limited

Rating Report

Kohat Textile Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
26-Jun-2024	A-	A2	Stable	Maintain	-
26-Jun-2023	A-	A2	Stable	Maintain	-
30-Jun-2022	A-	A2	Stable	Maintain	-
01-Jul-2021	A-	A2	Stable	Maintain	-
26-Jun-2020	A-	A2	Stable	Maintain	Yes
27-Dec-2019	A-	A2	Stable	Maintain	-
28-Jun-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan's spinning sector, with an estimated size of ~PKR 775bln, has lately come under pressure due to hightened commodity prices and high cost of business emanating from increased cotton/fibre prices leading to significant working capial requirements. This has eroded the bottom-line margins for the spinning sector players. The recent hike in energy tariffs further elevated the challenges for the industry. Overall, the industry's cash flow and inturn liquidity remains stretched. This led the industry's overall outlook to be placed on a Watch.

Kohat Textile Mills Limited ("Kohat Textile" or "the Company") ratings incorporate affiliation with Saif Group ('the Group'), having a substantial presence across various sectors of the economy. Kohat Textile was the Group’s first venture in the spinning sector. The Company is engaged in yarn production, and currently, operates with a capacity of 44,508 spindles. Over time, the Company has managed to show consistent performance. During FY23, revenues postes ~21% uptick, mainly supported by increase in yarn price. However, margins and inturn profitability has posted a declining trajectory due to substantial increase in raw material (fibre) cost along with high finance cost. Additionally, escalating energy prices and higher wages have significantly impacted the Company's manufacturing cost. Substantial CAPEX has been incured to shift on solar energy (currently its 2.1MW). This is expected to reduce the operational expenses, going forward. Moreover, the management believes that further enhancement in solar capaicty (expected another CAPEX of 3MW) may benefit the Company, going forward. On the financial risk front, the Company's is adequately leveraged. However, the working capital cycle is elongated and coverages are adequate. The Company requires a cautious approach to manage overall risk, along with sustaining its position in the industry.

The ratings are based on the Company's capacity to continue operating under the current circumstances. The ratings will be impacted if there is a significant decline in revenue and/or coverages as a result of the protracted downturn, which will increase financial risk. Support from Saif Group remains imperative to the ratings.

Disclosure

Name of Rated Entity	Kohat Textile Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-24),Methodology | Corporate Rating(Jul-23)
Related Research	Sector Study | Spinning(Sep-23)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Kohat Textile Mills Limited ("Kohat Textile" or " the Company") was incorporated as a public listed concern post its listing on Pakistan Stock Exchange in 1970.

Background Kohat Textile is the first textile venture of Saif Group. Later, the Group expanded its presence in textile sector through Saif Textile and Mediterranean Textile. The Company's production facilities are located in Kohat, KPK.

Operations Kohat Textile commenced operations in 1967. The Company operates with a single spinning unit having a capacity of 44,508 spindles. The Company manufactures specialized yarn from polyester, viscose, and acrylic. The Company caters to its power needs via in-house production. Energy requirement includes a power mix of three sources; Captive (4.5MW), PESCO (4.2MW), and Solar (2.1MW).

Ownership

Ownership Structure Kohat Textile's majority stake (~77.98%) is owned by Saif Group through Saif Holdings. Directors hold ~0.31% stake in the Company. The remaining shareholding vests with financial institutions (~10%), joint stock companies & others (~1.06%). Generla Public holds the stake of ~10.65%.

Stability The representation of Saif Group's textile ventures in Pakistan's spinning industry remains critical. The Group has a holding company in place, portraying a structured line of succession. However, the succession planning is not documented yet.

Business Acumen Saif Group is one of the oldest medium-sized business conglomerate in Pakistan with considerable interests in textile. The sponsors have a presence of five decades in local Spinning industry, eventually developing expertise. However, the Group's growth in textile sector was limited but it has sustained through the volatility of textile industry.

Financial Strength Saif Group holds interest in oil and gas exploration, power generation, textiles manufacturing, real estate development, and health care services, through 7 subsidiaries and 4 associated companies across different sectors. Saif Group holds stable financial muscle and the Sponsors are willing to support the Company, if needs be.

Governance

Board Structure The Board comprises seven members with a major concentration of Saif family members. The Board constitutes five non-executive directors, one executive director, and one member is an independent director.

Members' Profile Mr. Osman Saifullah Khan – Chairman – has overall experience of over two decades in the textile industry. The Board members have vast knowledge and expertise in the textile industry, though diversity in experiences exists as well, ensuring a requisite skill mix for strategic planning.

Board Effectiveness For effective management, the Board has formed two committees (Audit and HR) to assist the board on relevant matters. During FY23, 5 board meetings were held with majority attendance to discuss pertinent matters.

Financial Transparency The External Auditors of the Company M/s Shinewing Hameed Chaudri & Co., Chartered Accountants have expressed an unqualified opinion on a financial statement for the period ended Jun'23. The auditors fall in Category "B" of the SBP's Panel of Auditors.

Management

Organizational Structure The Company is managed through Operations, Sales, After Sales, Production, Production Planning and Control, Supply Chain, Commercial and Planning, Engineering and Projects, Accounts, Finance, Information Technology, and HR & Administration. These departments report to the Chief Executive Officer (CEO), who subsequently reports to the Board of Directors (BoD).

Management Team Mr. Assad Saifullah Khan, the CEO, has been associated with the Company for a decade. He is supported by a team of seasoned professionals, most of them have been associated with the Company for a reasonably long period of time.

Effectiveness All deliberations are held at meetings conducted by department heads as per requirement. Though no formal meeting schedule exists at Tata Textile, daily and weekly meetings are done to manage affairs. The daily and weekly reports are generated for top management with a main focus on production and liquidity position whereas P&L is discussed on a need basis in the meetings.

MIS Kohat Textile has in place Microsoft Dynamics-based Enterprise Resource Planning (ERP) system that provides comprehensive MIS reporting.

Control Environment The Company maintains an in-house internal audit function which enhances risk management, control, and governance processes. Additionally, the Company's plant is connected to the head office through VPN, thereby reporting on a real-time basis.

Business Risk

Industry Dynamics Pakistan's spinning industry comprises approximately ~368 dedicated spinning units, with an estimated size of ~PKR 775bln and ~13.4mln spindles installed as of FY23, as per an economic survey. The projected cotton production estimate has been revised to ~11.5mln bales, with current production reaching ~8.26mln bales, surpassing FY23's total of ~4.91mln bales. In FY24, better local raw cotton yield is expected to support import substitution. Pakistan's demand for imported cotton has risen from ~3.5mln bales to ~4 million bales this year. Challenges include recent energy tariff hikes and the availability of locally procured raw cotton, impacting the industry's outlook

Relative Position The Company's maintains an adequate position in terms of the spindles installed. The installed capacity stands at 44,800 spindles.

Revenues The Company is primarily generating revenue from local sales. During FY23, the revenue of the Company witnessed a substantial uptake of ~20.7%, reported at ~PKR 5,952mln (FY22: ~PKR 4,931mln); improvement in revenue was attributed to an increase in demand coupled with price change. During 9MFY24, the revenue of the Company surged to ~PKR 5,603mln.

Margins During FY23, overall margins of the Company witnessed a decreasing trend owing to high procurement cost. the gross profit margin of the Company decreased to ~14.2% in FY23 (FY22: ~17.4%). This decrease was primarily driven by a 25% increase in the cost of sales, largely attributable to higher raw material costs, which constitute roughly 80% of the total CGS. Similarly, the operating profit margin of the Company decreased to ~10.2% in FY23 (FY22: ~13.8%). This decline was due to the trickle-down effect of higher procurement costs combined with an inflationary increase in operating expenses. Whereas, net profit margins of the Company decreased to ~1.4% in FY23 (FY22: ~5.9%). During 9MFY24, the gross margin stood at ~15.2%, while operating and net margins stands at ~11.6% and ~2.3% respectively.

Sustainability Going forward, the Company is planning to acquire debt to finance CAPEX. Material improvement in cash flows in line with upcoming debt obligations remains imperative.

Financial Risk

Working Capital As of FY23, the Company's net working capital days increased to 110 days (FY22: 78 days). This increase was primarily due to a rise in inventory days, which stood at 73 days in FY23 (FY22:69 days). The heightened inventory days were attributed to increased procurement of inventory during the period. Similarly, the company's receivable days also saw an uptick, reaching around 75 days in FY23 (FY22:58 days). This increase was a result of higher sales reported during the period, leading to an elevated receivable amount for the Company. However, Trade Payable days of the Company decreased to ~38 days in FY23 (FY22: ~49 days). The Company reported a short-term trade leverage of ~8.3% (FY2: 10.9%). As of 9MFY24, net working capital days of the Company surged to 109 days.

Coverages The liquidity positioning of the Company remains adequate. As of FY23 the Company reported FCFO of ~PKR 671mln (FY22: ~726mln); decrease in FCFO was attributed to low profitability. Whereas, finance cost also witnessed a substantial increase reported at ~PKR 470mln in FY23 (FY22: ~200mln). Interest coverage ratio (FCFO/Finance Cost) of the Company decreased to 1.5x as of FY23 (FY22: 3.8x). However, the Company maintains sufficient amounts to meet its obligations. As of 9MFY24, interest coverage ratio o the Company stands at 1.6x

Capitalization The Company maintains an adequately leveraged capital structure with a (D/E ratio) of ~43% as of FY23 (FY22: 38.7%). The Equity of the Company stands at ~PKR 3,709mln as of FY23 (FY22: ~PKR 3,625mln). Total borrowings of the Company stands at ~PKR 2,794mln in FY23 (FY22: ~PKR 2,231mln). The Company majorly relies on STB's to manage working capital cycle which stood at ~PKR 1,941mln as of FY23 (FY22: ~PKR 1,203mln). As of 9MFY24, the equity of the Company stands at ~PKR 2,654mln.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Kohat Textile Mills Limited	Mar-24	Jun-23	Jun-22	Jun-21
Textile & Allied	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	5,001	5,068	5,000	2,930
2 Investments	5	5	2	2
3 Related Party Exposure	-	-	-	-
4 Current Assets	3,084	2,726	2,290	1,300
a Inventories	*1,558*	*1,234*	*1,157*	*714*
b Trade Receivables	*1,435*	*1,398*	*1,055*	*513*
5 Total Assets	8,090	7,799	7,293	4,232
6 Current Liabilities	1,097	793	866	589
a Trade Payables	*703*	*472*	*772*	*564*
7 Borrowings	2,654	2,794	2,231	1,277
8 Related Party Exposure	-	-	62	82
9 Non-Current Liabilities	501	503	509	335
10 Net Assets	3,838	3,709	3,625	1,949
11 Shareholders' Equity	3,838	3,709	3,625	1,949
B INCOME STATEMENT				
1 Sales	5,603	5,952	4,931	3,620
a Cost of Good Sold	*(4,752)*	*(5,105)*	*(4,073)*	*(2,875)*
2 Gross Profit	851	847	857	745
a Operating Expenses	(201)	(239)	(179)	(137)
3 Operating Profit	650	608	678	607
a Non Operating Income or (Expense)	*(5)*	*2*	*(27)*	*(29)*
4 Profit or (Loss) before Interest and Tax	645	610	651	578
a Total Finance Cost	*(459)*	*(470)*	*(200)*	*(112)*
b Taxation	*(57)*	*(55)*	*(159)*	*(154)*
6 Net Income Or (Loss)	129	85	292	312
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*705*	*671*	*726*	*653*
b Net Cash from Operating Activities before Working Capital Changes	*233*	*282*	*571*	*527*
c Changes in Working Capital	*(50)*	*(558)*	*(788)*	*(78)*
1 Net Cash provided by Operating Activities	184	(276)	(217)	449
2 Net Cash (Used in) or Available From Investing Activities	(44)	(225)	(729)	(539)
3 Net Cash (Used in) or Available From Financing Activities	(145)	511	944	83
4 Net Cash generated or (Used) during the period	(5)	10	(2)	(7)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	25.5%	20.7%	36.2%	39.7%
b Gross Profit Margin	15.2%	14.2%	17.4%	20.6%
c Net Profit Margin	2.3%	1.4%	5.9%	8.6%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	11.7%	1.9%	-1.3%	15.9%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	4.5%	2.3%	10.5%	17.3%
2 Working Capital Management				
a Gross Working Capital (Average Days)	137	149	127	121
b Net Working Capital (Average Days)	109	110	78	72
c Current Ratio (Current Assets / Current Liabilities)	2.8	3.4	2.6	2.2
3 Coverages				
a EBITDA / Finance Cost	1.7	1.7	4.0	6.4
b FCFO / Finance Cost+CMLTB+Excess STB	1.1	1.0	1.7	1.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.0	4.1	2.0	1.7
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	40.9%	43.0%	38.7%	41.0%
b Interest or Markup Payable (Days)	74.9	106.9	113.8	77.3
c Entity Average Borrowing Rate	20.9%	16.8%	9.5%	8.0%

Credit Rating

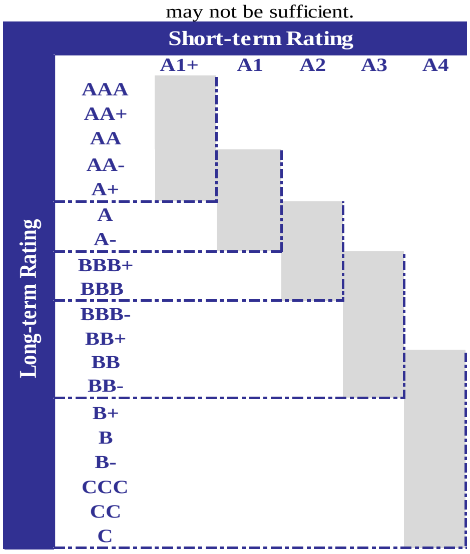
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
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.
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.
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+ 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.
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.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(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

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(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 | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(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)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(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)

Monitoring and review
(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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
Proprietary Information