The Pakistan Credit Rating Agency Limited

Rating Report

Shahzad Textile Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
13-Apr-2022	A-	A2	Stable	Upgrade	-
30-Apr-2021	BBB+	A2	Stable	Maintain	Yes
30-Apr-2020	BBB+	A2	Stable	Maintain	Yes
30-Oct-2019	BBB+	A2	Stable	Maintain	-
30-Apr-2019	BBB+	A2	Stable	Maintain	-
27-Dec-2018	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Shahzad Textile Mills Limited is a public listed company which is engaged in manufacturing of yarn and socks. The specifications include ring spun yarn, synthetic blended yarns and wide range of socks. The Company is sister concern of Sargodha Jute Mills and has history of four long decades. The Company’s management involves experienced professionals looking after operations of the Company. Over the last few years, the business profile has strengthened manifold. The Company has successfully achieved diversification in value added segment of socks. Also, recent rationalization of yarn capacity has enhanced revenue. Revenue base and margins of the company improved attributable to yarn export and expansion of socks unit. During FY21, the Company’s revenues displayed notable improvement to PKR 6.9bln (FY20: PKR 4.3bln). Along with revenue base, operating and net profitability recorded sizable upsurge. The Company has developed customer base at export avenues of North America, Europe and Africa. Further, penetration in Export markets is planned. The financial matrix reveals moderate leveraging, strengthened coverage and efficient working capital cycle. During the period July-December FY21-22, textile exports of the country surged 26 percent YoY, fielding $9.39 billion in total export remittances, as compared to $7.44 billion in the same period last year. This is attributable to increase in demand for textile products internationally and channeling of export orders towards Pakistani market. On a YoY basis, the exports of value-added textile items increased in both quantity and value in December 2021. Going forward, the textile sector’s outlook is expected to stay positive in the medium term where the demand for textile products is expected to sustain. In the local market, the textile sector has recorded strong performance. The relief measures introduced by the State Bank of Pakistan such as deferment of loan payments for one year, low-interest rates, and salary refinance scheme also provided comfort to the sector. Many players have also availed the TERF scheme announced by the Central Bank. This will lead to overall leverage of the sector to increase; however, on relaxed financing rates. The sustainability of demand pattern for the current higher orders from Europe and USA remains essential for the feasible utilization of added capacity by textile players.

The ratings are dependent upon the management's ability to capitalize on growth opportunities in a competitive landscape, operate at optimal level and sustain margins, going forward.

Disclosure

Name of Rated Entity	Shahzad Textile Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Spinning(Sep-21)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure Shahzad Textile Mills Limited (The Company) is a public listed company, incorporated in 1978.

Background The Company was established by Mian Muhammad Aslam (late) and was part of Sargodha Group. The Group had twelve textile mills, one jute mill and one sugar mill. The group entities were later split among sons of Mian Muhammad Aslam (late). Operations of Shahzad Textile Mills were handed over to his son Mian Parvez Aslam and passed on to his son (third generation) Mian Imran Aslam.

Operations The Company has three spinning units. Unit # 1 & 4 focus on PV yarn, while Unit # 2 produces polyester cotton yarn. The Company's current capacity is 63,648 spindles, as it has phased out one of its spinning unit (Unit # 3) and installed a socks manufacturing unit in the same premises with a capacity of 180 knitting machines. The power requirements of the Company stand at ~4.7MW, which is met through mix and match of in-house power generation (capacity: ~8.9MW) and LESCO's (sanctioned limit: 7.2MW) connection, whichever is more feasible.

Ownership

Ownership Structure Mr. Imran Aslam (CEO) along with other family members collectively own majority (~74%) stakes of the Company. The remaining shareholding of the Company is held by Corporates (5.67%) and institutions (20.50%).

Stability Fourth generation of Aslam family has joined the business. Although, there is no formal succession plan but the shareholding and business roles are equally divided between the two brothers (Imran Aslam and Irfan Aslam).

Business Acumen Mr. Imran Aslam - the CEO and major shareholder - has been managing 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 Sargodha Jute Mills Limited, an associated company. Other than that, on personal level he is an active investor in real estate and stock market. This portrays adequate financial muscle of sponsors to support the Company, if need arises.

Governance

Board Structure The overall control of the Company vests in seven members' board with Mian Pervez Aslam as Chairman of the board. The Company's board comprises two executive directors, three non-executive directors while two members are independent directors.

Members' Profile Mian Parvez Aslam – the Chairman – carries with him over 40 years of experience and has been associated with the board since its incorporation. The board comprises professionals with diverse expertise.

Board Effectiveness Shahzad Textile has two board committees: Audit Committee and HR & Remuneration Committee (HR&R). The audit committee meets on quarterly basis to approve financial statements prior to board meetings. HR&R meets at least once in a financial year and may meet more often, if requested by the board. Meanwhile, director's attendance has remained strong and meeting minutes are formally recorded.

Financial Transparency Crowe Hussain Chaudhury & Co. Chartered Accountants are External Auditors of the Company. The auditor has given an unqualified opinion for the year ending June 30th, 2021.

Management

Organizational Structure The organizational structure of the Company is divided into two main divisions: Head Office and Mills. Head of Departments of both divisions report directly to the CEO.

Management Team Mr. Imran Aslam manages day to day operations as CEO of the Company. He is supported by a team of experienced professionals. Most of the senior management has been associated with the Company for a reasonably long time.

Effectiveness The Company maintains adequate IT infrastructure and related controls. Moreover, monthly meetings are conducted in order to review performance of all unit.

MIS The Company has in place oracle based local ERP system by the name of Wizmen.

Control Environment The Company places emphasis in sustainable quality of yarn. For this, it is compliant with the latest version of ISO 9001-2008 Certification. This enhances the trust of the customer base.

Business Risk

Industry Dynamics During the period July-December FY21-22, textile exports surged 26 percent YoY, fielding $9.39 billion in total export remittances, as compared to $7.44 billion in the same period last year. This is attributable to increase in demand for textile products internationally and channeling of export orders towards Pakistani market. On a YoY basis, the exports of value-added textile items increased in both quantity and value in December 2021. Going forward, the textile sector's outlook is expected to stay positive in the medium term where the demand for textile products is expected to sustain. In the local market, the textile sector has recorded strong performance. The relief measures introduced by the State Bank of Pakistan such as deferment of loan payments for one year, low-interest rates, and salary refinance scheme also provided comfort to the sector. Many players have also availed the TERF scheme announced by the Central Bank. This will lead to overall leverage of the sector to increase; however, on relaxed financing rates. The sustainability of demand pattern for the current higher orders from Europe and USA remains essential for the feasible utilization of added capacity by textile players.

Relative Position The Company's relative position has improved over the years attributable to continuous BMR. The Company has enhanced its knitting capacity recently and is planning to enhance it further in future years.

Revenues The Company's revenues witnessed consistent growth over the year, mainly on account of operational enhancement through installation of knitting machines along with the upgradation of existing machines (spinning segment). During FY21, the Company's revenue grew significantly (FY21: PKR 6,927mln; FY20: PKR 4,315mln) up by 60.5% YoY on account increased production along with better prices of yarn. Sales mix is dominated by local sales and its contribution has slightly increased (FY21: 97.1%; FY20: 96.5%). The new sock unit showed promising results, as it recorded segmental revenue of PKR 719mln in FY21. During 1HFY22, company recorded turnover of PKR 4,444mln.

Margins During FY21, gross margin registered growth (FY21: 10.5%; FY20: 7.5%) on the back higher prices of yarn in both local and international market. This translated in to improved operating margin (FY21: 6.2%; FY20: 2.5%). Net margin also registered a significant improvement (FY21: 4.4%; FY20: 1.1%); resultant of increased net income (FY21: 306mln; FY20: 46mln). During 1HFY22, company's net profit margin recorded at 6.6%.

Sustainability Going forward, the management is planning expansion in knitting capacity. The production capacity will increase from 180 machines to 300 machines and further enhancement would require cost around PKR 400mln. Moreover, the company is planning to enhance penetration in current export avenues.

Financial Risk

Working Capital During FY21, net working capital cycle improved to stand at 39 days (FY20: 49 days). Furthermore, room-to-borrow at the trade level increased (FY21: PKR 626mln; FY20: PKR 377mln) due to a growth in trade assets (FY21: PKR 1,119mln; FY20: PKR 856mln); culminating in higher ST trade leverage adequacy (FY21: 56%; FY20: 44%). At end Dec21, net working capital cycle days increased to 52 days and ST trade leverage recorded at 45.9%.

Coverages During FY21, the Company recorded healthy improvement in FCFO amounting to PKR 458mln (FY20: PKR 188mln). This strengthened interest coverage (FY21: 7.7x; FY20: 2.6x). However, debt coverage inched down (FY21: 1.6x; FY20: 1.7x) attributable to increased total borrowings (FY21: PKR 946mln; FY20: PKR 795mln). During 1HFY22, FCFO recorded by company clocked at PKR 376mln while debt coverage improved to 2.7x. Debt repayment period declined to 0.8 year (end-Jun21: 1.5 years).

Capitalization During FY21, Company's leverage remained stagnant at 25.3% (FY20: 25.3%) due to marginal increase in debt (FY21: PKR 946mln; FY20: PKR 795mln). Out of total debt, short term borrowing constituted 31% (FY20: 52.2%). Equity base of the company strengthened to PKR 2,790mln (FY20: PKR 2,348mln). At end Dec21, equity base of the company further improved to PKR 3,085mln while total borrowings of the company stands at PKR 1,445mln.

PKR mln

Shahzad Textile Mills Limited
Spinning | Textile

	Dec-21	Jun-21	Jun-20	Jun-19
	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	2,365	2,420	2,283	2,256
2 Investments	116	115	102	47
3 Related Party Exposure	628	592	498	370
4 Current Assets	2,505	1,522	1,129	986
a Inventories	*1,292*	*701*	*598*	*512*
b Trade Receivables	*522*	*230*	*83*	*73*
5 Total Assets	5,613	4,649	4,012	3,660
6 Current Liabilities	769	590	514	518
a Trade Payables	*132*	*93*	*53*	*53*
7 Borrowings	1,445	946	795	643
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	315	323	356	275
10 Net Assets	3,085	2,790	2,348	2,224
11 Shareholders' Equity	3,085	2,790	2,348	2,224
B INCOME STATEMENT				
1 Sales	4,444	6,927	4,315	6,071
a Cost of Good Sold	*(3,869)*	*(6,198)*	*(3,993)*	*(5,579)*
2 Gross Profit	575	729	322	492
a Operating Expenses	(185)	(298)	(214)	(166)
3 Operating Profit	389	432	108	326
a Non Operating Income or (Expense)	*17*	*81*	*33*	*(79)*
4 Profit or (Loss) before Interest and Tax	406	513	141	247
a Total Finance Cost	*(39)*	*(74)*	*(78)*	*(58)*
b Taxation	*(73)*	*(133)*	*(17)*	*(58)*
6 Net Income Or (Loss)	294	306	46	131
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*376*	*458*	*188*	*341*
b Net Cash from Operating Activities before Working Capital Changes	*349*	*402*	*125*	*294*
c Changes in Working Capital	*(821)*	*(161)*	*(79)*	*157*
1 Net Cash provided by Operating Activities	(472)	241	46	451
2 Net Cash (Used in) or Available From Investing Activities	(10)	(120)	(161)	(503)
3 Net Cash (Used in) or Available From Financing Activities	510	(74)	125	38
4 Net Cash generated or (Used) during the period	28	48	10	(14)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	28.3%	60.5%	-28.9%	11.1%
b Gross Profit Margin	12.9%	10.5%	7.5%	8.1%
c Net Profit Margin	6.6%	4.4%	1.1%	2.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-10.0%	4.3%	2.5%	8.2%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	20.0%	11.9%	2.0%	6.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	56	42	54	40
b Net Working Capital (Average Days)	52	39	49	38
c Current Ratio (Current Assets / Current Liabilities)	3.3	2.6	2.2	1.9
3 Coverages				
a EBITDA / Finance Cost	15.3	10.1	3.7	9.8
b FCFO / Finance Cost+CMLTB+Excess STB	2.7	1.6	1.7	4.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.8	1.5	3.3	1.2
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	31.9%	25.3%	25.3%	22.4%
b Interest or Markup Payable (Days)	147.4	121.9	108.8	93.5
c Entity Average Borrowing Rate	5.5%	6.5%	10.0%	8.8%

Credit Rating

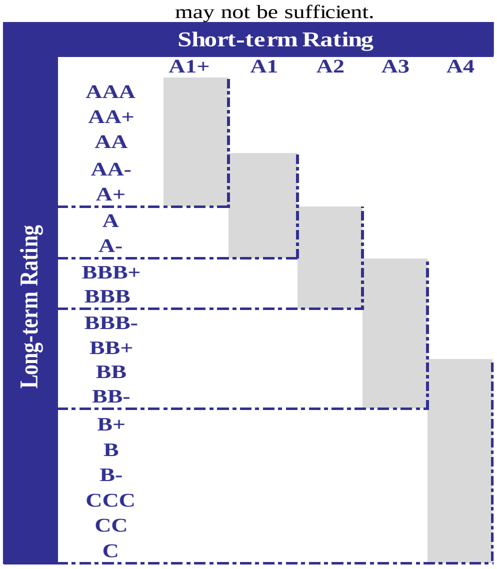
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

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

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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.
(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 | 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)

Proprietary Information

(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA’s prior written consent