



The Pakistan Credit Rating Agency Limited

Rating Report

Shahzad Textile Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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

The ratings of Shahzad Textile Mills Limited (Shahzad Textile) reflect improving business profile emanating from better margins and revenue growth. The Company has down-scaled its spinning capacity by disposing obsolete machinery and replacing it with socks manufacturing unit. Lately, textile industry has suffered from low international commodity prices due to global economic slowdown. However, the impact was largely mitigated by notable rupee devaluation in FY19. On standalone basis, the Company's margins witnessed an improvement, driven by; i) prudent inventory procurement, ii) subsidized rates for gas and electricity, and iii) cost rationalization by phasing out lesser efficient spindles. Meanwhile, the Company have a strong financial profile, characterized by lean working capital cycle, strong coverages and low leveraged capital structure. Additionally, predominant portion of long term borrowing is availed at the State Bank's concessionary rates which has insulated the Company's interest rate exposure, amidst high interest rate environment. The ratings drive comfort from Sponsor's long association with textile business.

The ratings are dependent on the Company's ability to uphold its profitability and strong coverages, given recent commencement of socks manufacturing unit. Meanwhile, prudent working capital management will remain critical.

Disclosure

Name of Rated Entity	Shahzad Textile Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Spinning(Sep-19)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

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

Background The Company established in 1981 by Mian Muhammad Aslam (late). Earlier in the times the Group had twelve textile mills, one jute mill and one sugar mill. Later on the operations of Shahzad Textile Mills were handed over to his son Mian Parvez Aslam and now to his son (third generation) Mian Imran Aslam.

Operations The Company comprised of three spinning units. Unit # 1 & 4 focus on PV yarn, Unit # 2 produces polyester cotton yarn. The Company's current capacity is 63,648 spindles, as the Company phased out one of its spinning unit (Unit # 3) and added socks manufacturing unit in its stead with a capacity of 100 knitting machines. The power requirements of the Company stands 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 Shahzad Textile is a family owned business with Mr. Pervez Aslam's family members collectively owns majority (~97.7%) shareholding. The remaining stake rests with general public (~2.1%) and corporates (0.2%).

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 Mr. Imran Aslam and Mr. Irfan Aslam. Formation of a group holding company would do well in clarifying the succession planning.

Business Acumen Mr. Imran Aslam - the CEO - 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. Sargodha Jute's net assets are worth ~PKR 1.48bln (FY18: PKR 1.75bln) in FY19. Other than that, on personal level he is an active investor in real estate and stock market. The net worth of Mr. Imran Aslam is ~PKR 758mln. This portrays adequate financial muscles 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 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 40 years of experience and has been association 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 shall meet 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 were formally recorded.

Financial Transparency The External Auditors of the Company are M/s Horwath Hussain Chaudhry & Co., Chartered Accountants. They have expressed an unqualified opinion on the Company's financial statements of FY19.

Management

Organizational Structure The organizational structure of the Company is divided into two main divisions Head Office and Mills. HoD's from both divisions reports directly to the CEO.

Management Team Mr. Imran Aslam manages day to day operations as CEO of the Company. Mr. Imran 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 Shahzad Textile maintains adequate IT infrastructure and related controls. Management meets on daily basis as cheque signatory is the CEO himself and holds the authority of the final approvals. This ensures close monitoring. Moreover, monthly meeting are conducted in order to review performance of all units.

MIS Shahzad Textile has in place oracle based local ERP system by the name of Wizmen.

Control Environment The Company trusts in sustainable quality of yarn to the complete satisfaction of its clients. For this, the Company is compliant with the latest version of ISO 9001-2008 Certification. This enhances the trust of new customers and boosts up the confidence of old clients as well.

Business Risk

Industry Dynamics The export performance of Pakistan's textile industry remained stagnated during FY19, despite ~34% currency devaluation and incentives introduced by the government to promote exports. Even though leading textile categories including ready-made garments, bed ware, knitwear and cotton cloth displayed double-digit volumetric growth, the hit to unit prices on account of exporters having to share the benefit of the currency depreciation with buyers in extremely competitive international market, curbed overall growth. Cotton crop for the year is expected to be lower than last last year due to crop diseases, despite higher Cotton sowing area. This will decidedly result in the need to import 4-5mln bales, making for much costlier input, given the current duty structure of imported cotton. Meanwhile, withdrawal of zero-rating status has pressurized the overall liquidity of textile industry. These factors are likely to impact margins of textile companies, going forward.

Relative Position The Company's yarn production stood at ~38,000 MT in FY19, out of which 15% was exported i.e. ~5,700 MT. Whereas, the total cotton yarn exports of Pakistan clocked in at 433,583 MT (Market Share = 1.3%). Meanwhile, on stand alone basis the Company has minimal share in local market.

Revenues In FY19, the Company's top-line clocked in at PKR 6,071mln (FY18: PKR 5,464mln) up by ~11% YoY. Increase in top-line is on account of upsurge in local yarn's price despite lower volumetric production. In FY18, GoP incentivized local textile industry with 4% rebate on yarn exports, so the Company pushed for higher exports. However in FY19, unavailability of export rebate and more attractive prices in local market led to declined exports ~15% (FY18: 21%) of the Company. Going forward, local sales may come under pressure due to imposition of sales tax, eventually restricting sales to unregistered dealers.

Margins The Company's gross margin posted a notable growth (FY19: 8.1%, FY18: 4.9%) on account of subsidized utilities and improved prices in local market. This, coupled with phasing out of loss making unit in 2QFY19, has provided an upward lift to the Company's gross margins. Likewise, the operating margins of the Company witnessed an improvement (FY19: 5.4%, FY18: 2.0%). The Company's finance cost posted a minimal growth despite twofold increase in SBP policy rates. This has lifted the Company's net margins (FY19: 2.1%, FY18: 1.3%) and net profit reported at PKR 130mln (FY18: PKR 72mln) in FY19.

Sustainability Shahzad Textile has expanded its business operations by vertical integration to socks manufacturing. The Company replaced low performing PV yarn production unit (Unit#3) with socks manufacturing unit at cost of ~PKR 600mln. The socks manufacturing started its operations on 7th October, 2019. The installed capacity is 100 knitting machines. However, the management plans to expand this capacity, going forward. The focus is on 100% export sales of this unit. This project has diversified the product profile of the Company, while enabling the Company in generating higher revenues and better profitability.

Financial Risk

Working Capital In FY19, the Company's reliance on STB has decreased (FY19: PKR 285mln, FY18: PKR 489mln), on the back of lower working capital needs. Eventually, strengthening the short term trade leverage of the Company (FY19: 48%, FY18: 36%). Inventory declined by ~22% due to lower volumetric requirement, as the Company scaled down its spinning capacity by approximately 23%. This has yielded lower inventory days. (FY19: 35days, FY18: 38days). Similarly, the receivable days declined, eventually lowering gross working capital days of the Company (FY19: 40days, FY18: 44days).

Coverages The Company's operating cash flows (FCFO's) doubled in FY19 (FY19: PKR 344mln, FY18: PKR 158mln). This, coupled with lower than proportionate increase in finance cost has fortified the company's interest coverage (FY19: 7.3x, FY18: 3.5x). Likewise, debt coverage strengthened (FY19: 4.2x, FY18: 1.8x). Predominant portion of long term borrowing is availed at the State Bank's concessionary rates. This, along with low leveraged capital structure has kept the Company's interest rate exposure quite low, amidst high interest rate environment.

Capitalization The Company has a low leveraged capital structure ~22.4% (FY18: 21.7%) in FY19. The total debt stood at PKR 643mln with STB constituting 44.4%. Despite additional debt of PKR 300mln for expansion. The Company's leveraging remained intact due to proportional decline in STB. The additional borrowing of PKR 300mln, for socks manufacturing unit is on SBP concessionary rate with comfortable debt servicing.



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Financial Summary

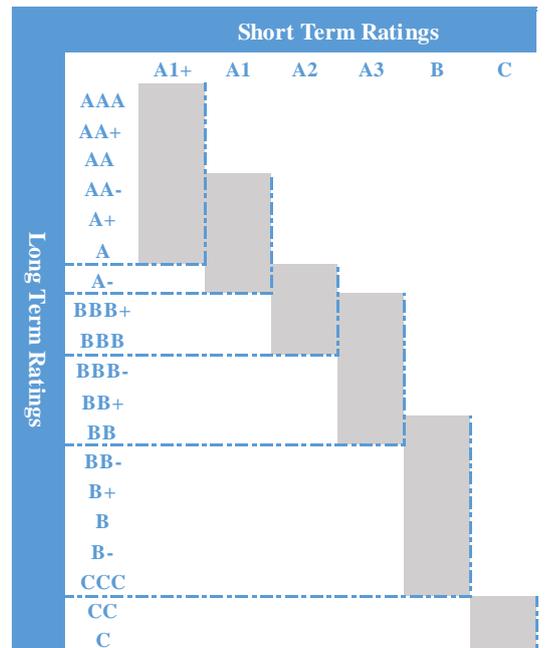
PKR mln

Shahzad Textile Mills Limited Spinning	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET			
1 Non-Current Assets	2,256	1,922	1,699
2 Investments	46	8	1
3 Related Party Exposure	370	390	371
4 Current Assets	986	1,110	838
<i>a Inventories</i>	512	657	478
<i>b Trade Receivables</i>	73	103	93
5 Total Assets	3,659	3,430	2,909
6 Current Liabilities	517	439	317
<i>a Trade Payables</i>	53	39	35
7 Borrowings	643	587	546
8 Related Party Exposure	-	-	-
9 Non-Current Liabilities	275	290	293
10 Net Assets	2,224	2,113	1,752
11 Shareholders' Equity	2,224	2,113	1,752
B INCOME STATEMENT			
1 Sales	6,071	5,464	4,511
<i>a Cost of Good Sold</i>	(5,580)	(5,197)	(4,268)
2 Gross Profit	492	268	243
<i>a Operating Expenses</i>	(166)	(156)	(145)
3 Operating Profit	326	112	98
<i>a Non Operating Income</i>	(79)	43	2
4 Profit or (Loss) before Interest and Tax	246	154	100
<i>a Total Finance Cost</i>	(58)	(53)	(36)
<i>b Taxation</i>	(58)	(29)	(29)
6 Net Income Or (Loss)	130	72	35
C CASH FLOW STATEMENT			
<i>a Free Cash Flows from Operations (FCFO)</i>	349	178	162
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	302	136	146
<i>c Changes in Working Capital</i>	157	(89)	(202)
1 Net Cash provided by Operating Activities	459	47	(56)
2 Net Cash (Used in) or Available From Investing Activities	(511)	(25)	(198)
3 Net Cash (Used in) or Available From Financing Activities	38	23	226
4 Net Cash generated or (Used) during the period	(14)	45	(28)
D RATIO ANALYSIS			
1 Performance			
<i>a Sales Growth (for the period)</i>	11.1%	21.1%	22.2%
<i>b Gross Profit Margin</i>	8.1%	4.9%	5.4%
<i>c Net Profit Margin</i>	2.1%	1.3%	0.8%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	7.7%	4.8%	4.7%
<i>e Return on Equity (ROE)</i>	6.0%	3.7%	2.0%
2 Working Capital Management			
<i>a Gross Working Capital (Average Days)</i>	40	44	40
<i>b Net Working Capital (Average Days)</i>	38	42	36
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	1.9	2.5	2.6
3 Coverages			
<i>a EBITDA / Finance Cost</i>	9.9	5.9	7.3
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	4.3	2.1	2.3
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	1.2	0.7	1.1
4 Capital Structure (Total Debt/Total Debt+Equity)			
<i>a Total Borrowings / Total Borrowings+Equity</i>	22.4%	21.7%	23.8%
<i>b Short-Term Borrowings / Total Borrowings</i>	0.4	0.8	0.7
<i>c Average Borrowing Rate</i>	7.7%	7.9%	6.8%

Credit Rating Scale & Definitions

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 Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

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

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(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

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- (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)
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- (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)

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