

RATING REPORT

Shadab Textile Mills Limited

REPORT DATE:

January 8, 2024

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Ratings		Previous Ratings	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Action	Reaffirmed		Maintained	
Rating Outlook	Negative		Negative	
Rating Date	January 8, 2024		December 02, 2022	

COMPANY INFORMATION

Incorporated in 1979	External Auditors: M/s. Fazal Mehmood & Company Chartered Accountants
Public Limited Company	Chairman: Mian Farrukh Naseem
Key Shareholders (More than 5%):	Chief Executive Officer: Mian Aamir Naseem
Mr. Aamir Naseem – 14.8%	
Mrs. Rukhasan Abdul Rasheed – 13.8%	
Mrs. Fatima Aamir – 11.1%	
Mr. Farrukh Naseem – 6.3%	
Mr. Saad Naseem – 5.8%	
Mr. Hamza Naseem – 5.8%	
Mr. Ahmed Naseem – 5.7%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Corporates:<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

Shadab Textile Mills Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE
<p>Shadab Textile Mills Limited (STML) is engaged in the business of manufacturing, selling, buying and dealing in all types of yarn including different counts of blended yarn. The company was listed on the stock exchange in 1985.</p> <p>Profile of the Chairman</p> <p>Mian Farrukh Naseem, Chairman/Director of the Company is a commerce graduate from Karachi University. He possesses over three decades of experience in the textile business. He has been associated with the company since 1981.</p> <p>Profile of the CEO</p> <p>Mian Aamir Naseem, Chief Executive of the company has Masters in Business Administration from USA. He joined the Group in 1990 and looks after the operational, Technical, Marketing and Financial respects of the project.</p>	<p>Corporate Profile</p> <p>Shadab Textile Mills Limited ('STML' or 'the Company') was incorporated as a public limited company in August 1979. The Company is registered as a public limited company in Pakistan and listed on the Pakistan Stock Exchange ('PSX'). STML is engaged in the business of manufacturing, selling, buying and dealing in yarn of all types. The registered office of the Company is situated on the 6th Floor, A-601/A, City Towers, Main Boulevard, Gulberg-II, Lahore. The manufacturing facilities of the Company are located at Faisalabad Road, Nasimabad, Shakhkot, District Nankana Sahib & 1-KM Chunian Road, Habibabad, District Kasur.</p> <p>Key Rating Drivers</p> <p>Ratings consider constrained business risk profile by cyclicalities, and high competition in the sector.</p> <p>The business risk profile of the spinning sector in Pakistan is characterized by high level of exposure to economic cyclicalities and intense competition. This sector's performance is significantly influenced by the broader economic conditions in the country, making it inherently vulnerable to fluctuations in demand driven by economic factors.</p> <p>In FY23, the spinning sector faced challenges due to various economic and environmental circumstances. These included damage to the cotton crop resulting from flooding in 1H FY23, escalating inflation, and diminishing foreign exchange reserves.</p> <p>The spinning sector in Pakistan comprises ~407 spinning mills, which include both composite units and spinning units. This industry exhibits a competitive market structure with a large number of players producing a relatively homogenous product.</p> <p>During FY23, Pakistan's yarn production registered a substantial decline, primarily due to reduced availability of cotton, as a result of crop damage and import restrictions. The sector's profitability was constrained by factors such as higher production costs, increased raw material costs, and rising energy expenses, all of which constrained the sector's profit margin. The industry's performance is closely intertwined with the outlook of the cotton and textile industries, both of which were affected in FY23. Global economic slowdown and contractionary economic policies led to a decrease in demand for textile products and, consequently, cotton yarn.</p> <p>While the global outlook for cotton production is expected to rebound, local challenges persist. These challenges include high interest rates, increasing energy costs, and difficulties with obtaining letters of credit (LCs). These factors are likely to result in continued sluggish performance for the spinning sector in FY24.</p> <p>Ratings take into account severe deterioration in profitability during the period.</p> <p>The Company's topline marginally increased in FY23 to PKR 5,963 mln (FY22: PKR 5,297 mln) due to higher selling prices, while volume faced pressure from reduced demand in both export and local markets. In 1QFY24, net revenue continued this trend at PKR 1,593 mln (1QFY23: PKR 1,373 mln). However, gross margins contracted in both periods due to escalating input costs driven by high inflation, currency exchange volatility, increased energy costs, and heightened raw material expenses, specifically Viscose and Polyester prices. STML struggled to pass these cost pressures to customers. Looking ahead, as the Company gradually adjusts prices and raw material costs stabilize with PKR/USD parity and international commodity prices normalizing, management anticipates a recovery in gross margins to historical levels. Gross margins stood at 4.0% in 1QFY24, compared to 3.1% in FY23 and 9.7% in FY22.</p>

Net margins of the Company turned negative in FY23 due to pressure from escalating finance costs as a result of an 825-bps increase in domestic policy rates during the period. This pressure was sustained in 1QFY24; however, slight improvement was observed. Net margins were reported at -0.8% in 1QFY24, up from -1.8% in FY23 (FY22: 3.7%).

Recovery and improvement in the profitability profile of the Company will be a key sensitivity for future ratings.

Ratings incorporate adequate capitalization profile.

Despite a negative bottom line and reduction in the equity base, the Company has managed to keep its capitalization metrics intact with reduced debt utilization during FY23. Gearing and leverage ratios were reported at 0.5x (FY22: 0.5x) and 1.0x (FY22: 0.9x) in FY23. Slight deterioration is noted in 1QFY24, on account of continued net loss and equity erosion, as well as an increase in short-term debt. Gearing and leverage were recorded at 0.6x and 1.0x, respectively.

Going forward, maintenance of the capitalization profile commensurate with assigned rating will be an important consideration for future review.

Pressure on the coverage profile; a strain on ratings.

Historically, the Company's cash flow coverages have remained strong, averaging around 4.7x between FY19 and FY22. However, due to deterioration in margins, the Company's DSCR has seen significant erosion in recent years to 0.7x in FY23 (FY22: 3.7x). It recovered to 1.1x in 1QFY24 on account of improved operational profitability. STML's DSCR is expected to remain under stress throughout the rating horizon at ~1.0x with FFO to total debt remaining constrained at ~10%. Consequently, the Company's stressed coverage profile will continue to exert pressure on ratings.

Given the stress in the profitability profile, cash flow coverage indicators have fallen below peer median and averages in FY23. Going forward, improvement in the coverage profile will be an important consideration for ratings.

Adequate Short-term debt and liquidity metrics provide support to assigned ratings.

Despite severe strain on the debt service coverage profile, the Company continues to maintain short-term debt coverage and liquidity which provides sufficient cushion to ratings. Reported short-term debt coverage in 1QFY24 and FY23 was 1.7x and 2.0x (FY22: 2.1x), respectively. Moreover, the current ratio was recorded at 1.3x in 1QFY24, against 1.4x in FY23 (FY22: 1.5x). However, it is noted that the current ratio has been on a declining trend in recent years from a peak of 2.0x in FY20.

Maintenance of the short-term debt coverage and liquidity profile in line with assigned ratings will also be key sensitivities going forward.

FINANCIAL SUMMARY (PKR Millions)				Appendix I
BALANCE SHEET	FY21	FY22	FY23	3MFY24
Property, plant and equipment	1,502.4	1,478.9	1,428.6	1,444.5
Stock in Trade	405.2	747.6	577.8	616.3
Trade debts	226.5	333.2	373.9	361.7
Cash and Bank Balances	23.0	16.3	12.5	34.8
Total Assets	2,442.9	2,969.9	2,849.3	2,911.1
Trade and Other Payables	251.7	257.7	364.7	357.1
Long-term Debt (incl. current portion and lease liability)	406.0	421.6	352.9	339.9
Short term Borrowing	218.2	515.7	475.3	560.4
Total Debt	624.3	937.4	828.2	900.3
Total Liabilities	1,040.4	1,397.7	1,396.7	1,470.4
Paid up Capital	166.0	166.0	166.0	166.0
Equity (excl. Revaluation Surplus)	1,402.5	1,571.2	1,452.7	1,440.7
INCOME STATEMENT	FY21	FY22	FY23	3MFY24
Net Sales	3,305.2	5,297.4	5,962.8	1,592.6
Gross Profit	382.8	513.0	183.7	63.0
Operating Profit	260.0	378.9	41.5	28.4
Finance Costs	32.6	71.7	137.0	40.8
Profit Before Tax	239.5	292.5	-92.6	-11.6
Profit After Tax	170.6	195.3	-107.7	-12.0
RATIO ANALYSIS	FY21	FY22	FY23	3MFY24
Gross Margin (%)	11.6%	9.7%	3.1%	4.0%
Net Margin (%)	5.2%	3.7%	-1.8%	-0.8%
Funds from Operation (FFO)	292.6	403.1	8.4	23.8
FFO to Total Debt* (%)	53.5%	48.1%	1.1%	11.7%
FFO to Long Term Debt* (%)	89.0%	125.1%	3.2%	37.6%
Gearing (x)	0.4	0.5	0.5	0.6
Leverage (x)	0.7	0.9	1.0	1.0
Debt Servicing Coverage Ratio* (x)	3.0	3.1	0.7	1.1
Current Ratio	1.5	1.5	1.4	1.3
(Stock in trade + trade debts) / STD (x)	2.9	2.1	2.0	1.7
Return on Average Assets* (%)	8.9%	7.2%	-3.7%	-1.6%
Return on Average Equity* (%)	15.1%	13.1%	-7.1%	-3.3%

* Annualized, if required

REGULATORY DISCLOSURES					Appendix II
Name of Rated Entity	Shadab Textile Mills Limited				
Sector	Textile				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	RATING TYPE: ENTITY				
	08-Jan-2024	A-	A-2	Negative	Reaffirmed
	02-Dec-2022	A-	A-2	Negative	Maintained
	22-Nov-2021	A-	A-2	Stable	Initial
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.				
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Due Diligence Meetings Conducted					
		Name	Designation	Date	
	1	Adeel Khan	CFO	15-Dec-2023	