RATING REPORT

Sunrays Textile Mills Limited

REPORT DATE:
December 30, 2019

RATING ANALYST:
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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A-	A-1
Rating Outlook	Stable	
Rating Date	*December 30, 2019*	

COMPANY INFORMATION	
Incorporated in 1987	**External auditors:** M/s Deloitte Yousuf Adil, Chartered Accountants
Public Limited Company	**CEO:** Mr. Kashif Riaz
Key Shareholders:	
Mr. Kashif Riaz- 30.96% *Mr. Imran Ahmad- 11.21%* *Mr. Naveed Ahmed- 11.16%*	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (May 2016)* ***http://www.vis.com.pk/docs/Corporate-Methodology-201605.pdf***

Sunrays Textile Mills Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

OVERVIEW OF THE INSTITUTION

Sunrays Textile Mills Limited (SUTM) was incorporated in Pakistan on August 27, 1987 as a public limited company. The principal activity of the Company is manufacturing and sale of yarn. The manufacturing facilities of the Company are located in Dera Ghazi Khan, Punjab.

RATING RATIONALE

Sunrays Textile Mills Limited (SUTM) is a part of the Indus Group of Companies which is a sizeable player in the country's textile business with an annual turnover of over $300m. Within textile sector, Indus Group has over five decades of experience and operates through five entities. The group is primarily engaged in the business of cotton ginning, yarn spinning, greige fabric manufacturing and home textiles (primarily towel business). Furthermore, the group is also investing in a 50MW wind power project.

Principal activities of SUTM include trade, manufacture and sale of yarn. The Company also operates ginning units and ice factories under leasing arrangements. Head office of the company is located in Karachi with the manufacturing facility located at Khanpur Shumali khewat no. 359, District Muzaffargarh, Dera Ghazi Khan Division, Punjab.

Operations

SUTM's core business relates to manufacturing of yarn from a mix of imported and local cotton. SUTM has an installed spinning capacity of 11.9m Kgs of yarn with 34,896 spindles. Historically, the company has been operating at high capacity utilization levels. Capacity utilization was reported at 87% (FY18: 85%) during FY19. Over the last 2 years, the company has replaced its old Chinese machinery with new Japanese ring frames through BMR activities thereby enhancing productivity and efficiency of its manufacturing unit.

Around three fourth of the yarn is produced on courser counts for Chinese denim manufacturers. The remaining is produced on finer counts for local denim, hosiery and knitwear manufacturers. All units of the company are operating continuously on gas based power generators. Grid based power is an alternate stand-by energy source in case of gas shortage.

Key Rating Drivers

High cyclicality and competitiveness in spinning sector and country concentration in exports translates into high business risk profile. However, business risk profile is supported by favorable government policies and demand dynamics in the backdrop of ongoing expansion in the value added segment.

Movement in cotton prices and cotton crop levels drives performance of spinning sector players. Historically, margins and financial performance of players have depicted variation. Moreover, competitive intensity is high due to commoditized nature of the product. As with other local producers in the spinning sector, reliance on China as the major export market translates into some country concentration risk. However, business risk profile is supported by China being a sizeable denim market and favorable government policies for the textile sector and given expected elevated local demand (with a number of players in the value added segment undergoing expansion). Supportive government policies for the textile sector are evident from availability of funding lines (for both expansion and working capital requirements) at concessionary rates and commitment for timely release of outstanding refunds. However, imposition of 17% GST on textile exports is expected to result in some increase in working capital borrowings. Actual quantum will depend on timing of release of refunds.

Sales revenue has depicted an increase over the last three years on the back of higher average selling prices and volumetric growth. Shift in sales mix has been noted over the past two years with share of exports being reported on the higher side. Management projects exports sales to continue to be the major contributor to topline, going forward.

Sales revenue of the company increased by 23% in FY19 and was reported at Rs. 6.1b (FY18: Rs. 4.9b). Growth in topline was a function of both higher average selling prices due to currency devaluation and increase in volumetric sales in the domestic market. Around 72% (FY18: 75%) of the total sales revenue was contributed by exports in FY19 with the remaining emanating from local market. Sales price of local sales is on the higher side vis-a-vis exports on account of finer count of yarn sold in the domestic market. Geographic concentration risk in exports sales is considered on the higher side with more than 80% of exports sales directed to Chinese stockists. Management projects exports sales to continue being the major contributor to topline, going forward. During 1QFY20, the company recorded sales revenue of Rs. 1.8b primarily being a function of higher average selling prices.

Gross margins improved during FY19 and in the ongoing year on the back of inventory gains. Additionally, exchange gains on foreign currency debtors have supported bottom line. Low carrying cost of cotton inventory vis-à-vis current prices bodes well for future margins. Continued efficient cotton procurement will be critical to future margins and profitability.

Gross margins (GMs) of the company have been increasing on a timeline basis with the same being reported at 16.2% during 1QFY20 (FY19: 15.8%, FY18: 12.9%). The improvement in margins is attributable to inventory gains, and currency devaluation. Given average cost of cotton inventory is significantly lower than market prices, VIS expects gross margins to remain healthy during FY20. Overall profitability of the company is supported by other income generated through dividends. The company recorded a one-off reversal of WWF during FY19. Given healthy gross margins, net profit after tax of the company almost doubled during FY19 being reported at Rs. 472m (FY18: Rs. 282m). Going forward, profitability profile is expected to remain healthy during FY20.

Liquidity profile is supported by healthy cash flows and strong debt servicing ability.
Liquidity profile of the company is considered strong with healthy cash flows in relation to outstanding obligations. Cash flows of the company have increased in line with improving profitability with FFO amounting Rs. 201m (FY19: Rs. 661m, FY18: Rs. 398m) during 1QFY20. Furthermore, lower utilization of short term borrowings as at end-1QFY20 has resulted in improvement in cash flow coverage of outstanding debt. Debt Service Coverage Ratio (DSCR) remains strong at 5.6x (FY19: 3.9x, FY18: 5.1x) in 1QFY20. Trade debts after increasing in FY19 but have declined at end-1QFY20. Aging profile of trade debt remains within manageable levels. Stock in trade and trade debts are well in excess of short term borrowings while current ratio has historically remained consistently at over 2(x).

Sound capitalization profile
Equity base of the company has grown at a healthy CAGR of 54% over the past three years (FY16-FY19) on account of internal capital generation. Total debt of the company was reported at Rs. 880m (FY19: Rs. 2.3b, FY18: Rs. 2.5b) at end-September'2019. Around 95% of the total debt comprises long term debt at end-September 2019. The company utilizes short term debt to fund working capital requirements. Long term debt draw down was undertaken in FY18 and FY19 for BMR facilities. Entire long term financing has been obtained through concessionary LTFF scheme. Gearing and leverage indicators were recorded at 0.31x (FY19: 0.81x, FY18: 1.04x) and 0.51x (FY19: 0.99x, FY18: 1.23x), respectively at end-September 2019. Given no further projected increase in long term debt, leverage and gearing indicators are expected to remain within manageable levels. Future trend with respect to leverage indicators will be an important rating consideration.

Adequate Corporate Governance Framework
Board of Directors (BoD) includes eleven members comprising three independent directors, two executive directors, and six non-executive directors with extensive experience in textile sector. Presently, the company has implemented an in-house developed ERP system which has Sales, Finance and Payroll modules. External auditors of the company are M/s Deloitte Yousuf Adil, Chartered Accountants. Auditors belong to category 'A' on the approved list of auditors published by the State Bank of Pakistan. The company has also a separate Internal Audit department in place.

Sunrays Textile Mills Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**FY19**	**1QFY20***
Fixed Assets	1,168	1,176	1,499	1,848	1,818
Stock-in-Trade	815	1,217	2,280	1,766	1,542
Trade Debts	189	304	1,364	1,886	579
Short term investments	1,031	1,008	119	113	238
Cash & Bank Balances	42	35	61	73	73
Total Assets	3,456	4,045	5,693	6,042	4,658
Trade and Other Payables	246	249	331	381	431
Long Term Debt	-	-	502	842	835
Short Term Debt	723	1,190	2,028	1,479	45
Total Debt	723	1,190	2,530	2,321	880
Paid Up Capital	73	73	73	73	73
Total Equity	2,050	2,147	2,427	2,862	2,862
INCOME STATEMENT					
Net Sales	3,858	4,258	4,952	6,085	1,827
Gross Profit	230	372	637	965	296
Profit Before tax	77	191	279	475	199
Profit After Tax	38	144	282	472	167
RATIO ANALYSIS					
Gross Margin (%)	6.0%	8.7%	12.9%	15.9%	16.2%
Net Margin (%)	1.0%	3.4%	5.7%	7.8%	9.1%
Net Working Capital	1,279	1,359	1,786	2,237	2,230
Trade debts/Sales	5%	7%	28%	31%	8%
FFO	156	249	398	661	201
FFO to Total Debt (%)	22%	21%	16%	28%	91%
FFO to Long Term Debt (%)	NA	NA	79%	78%	96%
Debt Servicing Coverage Ratio (x)	NA	14.9	5.1	3.9	5.6
Current Ratio (x)	2.28	1.9	1.7	2.1	4.7
Stock+ Trade Debts/STD	139%	128%	180%	247%	4756%
Gearing (x)	0.35	0.55	1.04	0.81	0.31
Leverage (x)	0.52	0.74	1.23	0.99	0.51
ROAA (%)	NA	4%	6%	8%	12%
ROAE (%)	NA	7%	12%	18%	23%

** Ratios Annualized*

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix 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	Appendix III
Name of Rated Entity	Sunrays Textile Mills Limited
Sector	Textiles
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				
Dec-30-2019	A-	A-1	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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