RATING REPORT

Sunrays Textile Mills Limited

REPORT DATE:
June 08, 2021

RATING ANALYST:

Asfia Aziz
asfia.aziz@vis.com.pk

Sundus Qureshi
sundus.qureshi@vis.com.pk

RATING DETAILS				
	Latest Ratings		**Previous Ratings**	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-1	A-	A-1
Rating Date	*June 08, 2021*		*April 22, 2020*	
Rating Action	Maintained		Maintained	
Rating Outlook	Stable		Rating Watch-Developing	

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)
Applicable Rating Criteria: Industrial Corporates (April 2019)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Sunrays Textile Mills Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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.

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 88% (FY19: 87%) during FY20. 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

Recovery in industry wide exports post ease in COVID-19 lockdown measures support business risk profile of the company.

With the objective of enhancing exports to support the economy, the Government of Pakistan (GoP), has provided incentives in the form of subsidized utility tariffs, low interest rates (Export Finance Scheme (EFS), Long Term Financing Facility (LTFF) and TERF) and sales tax refund to the textile industry. The textile policy 2020-25 has laid emphasis on fixed electricity and gas tariff for the next 5 years till 2025 at US cents 7.5 per KWh and USD 6.5 per MMBTU, respectively. Moreover, the limits of subsidized (LTFF) financing have been enhanced under this policy to facilitate exporters. Initiatives are also being undertaken in order to increase production and yield of cotton. However, the imposed sales tax has negatively impacted the textile industry. Even though impact of Covid-19's third wave remains elevated, we expect the order book for the industry to remain adequate in the ongoing year, easing our business risk concerns.

Topline of the company increased during FY20 on account both higher volumetric sales and average selling prices. Sales revenue during 9MFY21 further improved led by higher revenue emanating from the domestic market's hosiery segment. Going forward, sales are expected to escalate on account of adequate orders in pipeline and projected increase in average selling prices.

Sales revenue of the company increased by 6% in FY20 and was reported at Rs. 6.5b (FY19: Rs. 6.1b). Growth in topline was a function of both higher volumetric sales and average selling prices. Around 79% (FY19: 86%) of the total sales revenue was contributed by exports in FY20 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 9MFY21, the company recorded sales revenue of Rs. 5.9b primarily being a function of higher revenue emanating from the domestic market's hosiery segment. Going forward, sales are expected to escalate on account of adequate orders in pipeline and projected increase in average selling prices.

Gross profitability profile of the company was impacted by higher raw material prices led by disrupted production cycle due to COVID-19, and inventory losses during FY20 but overall it was supported by lower finance costs. During 9MFY21, gross and net margins of the company reflected an increase and are projected to witness continued improvement going forward on the back of projected gradual increase in demand and average selling prices.

Gross margins (GMs) of the company declined to 14.1% (FY19: 15.9%) during FY20 attributable to higher cotton prices, and inventory losses during the year. Overall operating expenses increased primarily due to higher administration and distribution costs (fuel expense, freight charges and higher quantum of impairment allowance for expected credit losses) incurred. Overall profitability was further supported by lower finance charges to the tune of Rs. 76m (FY19: Rs. 214m) during FY20 led by reduced levels of borrowings. Gross and net margins inclined to 14.4% and 9.6%, respectively during 9MFY21 owing to average higher selling prices and inventory gains. Going forward, management profitability indicators are expected to improve on the back of projected gradual increase in demand and average selling prices.

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 increased in line with improving profitability with FFO amounting Rs. 700m (FY19: Rs. 661m) during FY20. Furthermore, lower utilization of short term borrowings has resulted in improvement in cash flow coverage of outstanding debt. Debt Service Coverage Ratio (DSCR) has significantly improved and stands strong at 8.7x (FY20: 8.5x; FY19: 3.9x) at end-Mar'21. Liquidity profile of the company is further supported by reduced trade debts along with sizeable short term investments on the balance sheet amounting Rs. 202m (FY20: Rs. 409m, FY19: Rs. 113m) at end-Mar'21. 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).

Capitalization indicators supported by low leveraged capital structure and conservative financial policy.

On account of higher profit retention in the ongoing year, net equity of the company depicted increase on a timeline basis at Rs. 3.5b (FY20: Rs. 3.1b; FY19: Rs. 2.9b) at end-Mar'21. Total debt carried on balance sheet amounted to Rs. 1.5b at end-Mar'21; around 67% of the total debt is long-term in nature with a major portion of the same being LTFF, acquired at considerably lower rate with extended repayment period. Short term borrowings are acquired as per seasonal procurement requirements and resultantly vary throughout the year. Gearing and debt leverage indicators were reported at 0.41x (FY20: 0.32x; FY19: 0.81x) and 0.59x (FY20: 0.50x; FY19: 0.99x) at end-Mar'21, respectively on account of reduced short term borrowings. Given no such financing of capex plans through long term borrowings, and higher projected profitability, capitalization indicators of the company are expected to depict further improvement, going forward.

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	**FY18**	**FY19**	**FY20**	**9MFY21***
Fixed Assets	1,499	1,848	1,811	1,699
Stock-in-Trade	2,280	1,766	1,824	2,748
Trade Debts	1,364	1,886	343	689
Short term investments	119	113	409	202
Cash & Bank Balances	61	73	33	34
Total Assets	5,693	6,042	4,911	5,867
Trade and Other Payables	331	381	339	376
Long Term Debt	502	842	969	971
Short Term Debt	2,028	1,479	19	481
Total Debt	2,530	2,321	988	1,452
Paid Up Capital	73	73	73	73
Total Equity	2,427	2,862	3,088	3,526
INCOME STATEMENT				
Net Sales	4,952	6,085	6,476	5,864
Gross Profit	637	965	911	842
Profit Before tax	279	475	646	627
Profit After Tax	282	472	560	562
RATIO ANALYSIS				
Gross Margin (%)	12.9%	15.9%	14.1%	14.4%
Net Margin (%)	5.7%	7.8%	8.6%	9.6%
Net Working Capital	1,786	2,237	2,566	3,091
Trade debts/Sales	28%	31%	5%	9%
FFO	398	661	700	696
FFO to Total Debt (%)	16%	28%	71%	64%
FFO to Long Term Debt (%)	79%	78%	72%	96%
Debt Servicing Coverage Ratio (x)	5.1	3.9	8.5	8.7
Current Ratio (x)	1.7	2.1	5.9	3.9
Stock+ Trade Debts/STD	180%	247%	11491%	715%
Gearing (x)	1.04	0.81	0.32	0.41
Leverage (x)	1.23	0.99	0.50	0.59
ROAA (%)	5%	8%	10%	14%
ROAE (%)	12%	18%	19%	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				
	June-08-2021	A-	A-1	Stable	Maintained
	Apr-22-2020	A-	A-1	Rating Watch-Developing	Maintained
	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.				
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile. Copyright 2021 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				
Due Diligence Meetings Conducted	**Name**	**Designation**	**Date**		
	Mr. Zahid Masud	Group CFO	20-May-2021		
	Mr. Faiz Rasool	Manager Accounts	20-May-2021		