RATING REPORT

Sunrays Textile Mills Limited (SUTM)

REPORT DATE:
September 28, 2023

RATING ANALYST:

Asfia Amanullah
asfia.aziz@vis.com.pk

Shaheryar Khan
shaheryar.khan@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	*September 28, 2023*		*August 22, 2022*	
Rating Action	Reaffirmed		Reaffirmed	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION	
Incorporated in 1987	**External auditors:** M/s Yousuf Adil, Chartered Accountants
Public Limited Company	**CEO:** Mr. Kashif Riaz
Key Shareholders:	
Mr. Kashif Riaz- 20.65% *Ms. Fadia Kashif- 11.66%* *Mr. Shahzad Ahmad -9.40%Mr. Irfan Ahmad-8.51%*	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates (May 2023): **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**

Sunrays Textile Mills Limited

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, and home textiles (primarily towel business). Furthermore, the group also has a presence in the power sector through exposure in wind power project of 50MW by the name of Indus Wind Energy Limited.

Principal activities of SUTM include trade, manufacture and sale of yarn. 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.

Long-term Investment in Subsidiary

During FY22, SUTM made a long-term investment of Rs. 190.9m by purchasing 100% shares of Embee Industries (Private) Limited (EIL). EIL is a private company incorporated in Pakistan. The Company is primarily engaged in the business of manufacturing and sale of ice. The transaction was financed through surplus funds available with the Company.

Operations & Capacity Utilization

	FY21	FY22	9MFY23
Number of spindles installed	34,896	34,896	34,896
Number of spindles worked	34,792	34,802	33,605
Number of working days	365	365	270
Number of shifts per day	3	3	3
Installed capacity of yarn – Lbs (Avg. 20 Count)	11,948,706	11,916,060	8,937,045
Actual production of yarn - Lbs (Avg. 20 Count)	11,882,023	11,430,039	7,484,493
Capacity Utilization	99.4%	95.8%	84.3%

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. Capacity utilization has remained on the higher side during the review period, however, some contraction was noted in 9MFY23 due to economic slowdown. The Company has been consistently investing in BMR activities to replace the machinery with efficient ones 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

Business risk profile is constrained by current weak macroeconomic environment both globally and locally as evident by demand slowdown, high interest rate situation, inflationary pressures and ongoing energy crisis. These factors pose a challenge to margins sustainability and future growth.

The local spinning sector is highly organized, comprising of 477 small and large-scale spinning mills, making the industry competitive. During FY23, the overall textile industry faced significant challenges arising from flash flooding which inundated about a third of the country under water, destroying vast amounts of crops particularly in the Sindh, Southern Punjab and Baluchistan regions. About 45% of the total cotton crop was damaged, resulting in a significant drop in output to 4.76m bales during 9MFY23, against an annual target of 9m bales. Combined with higher input costs of fertilizers and energy, prices increased sharply to a 12-year high of Rs. 21,600/maund during March'23. Timeline price changes can be seen below:

Table: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	FY23	2M'FY24
Per Maund	8,770	8,860	13,000	17,380	18,500	19,200
YoY % Change	26%	1%	32%	34%	*6.4%*	*3.8%*

Moreover, quantum of raw cotton imports has decreased during FY23 due to import restrictions and severe currency devaluation, declining by about 13.2% YoY to 683,911 MT (FY22: 788,107 MT). Consequently, besides affecting profit margins, higher raw material prices increasing the working capital requirements have negatively affected the liquidity profile of the overall textile sector. Additionally, with supply and demand constraints, cotton yarn output has declined notably during FY23 by about 22.1% to 2.7m MT (FY22: 3.5m MT). Going forward, industry players expect cotton output to breach the 10m bales mark for FY24 due to favorable weather conditions, increase in minimum support price and governmental financial assistance to farmers for purchase of raw materials, particularly in Punjab. However, as per estimates, production is still projected to fall short of the annual target of 12.7m MT.

In terms of exports, textile proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally broke the threshold, coming in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr. Barring seasonal and cyclical fluctuations, textiles sector has maintained an average share of about 60% in national exports.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22	10M'FY22	10M'FY23
PAKISTAN TOTAL EXPORTS	22,536	25,639	32,450	26,858	23,211
TEXTILE EXPORTS	12,851	14,492	18,525	15,174	14,178
PKR/USD AVERAGE RATE	158.0	160.0	177.5	174.4	245.4

Source: SBP

Export revenues from textile sector have noted sizeable growth over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports in FY22. However, current fiscal year has been significantly impacted due to challenging global and local macroeconomic environment and 10M export proceeds (in value terms) reflect a year-on-year (YoY) decline of ~14%.

Table: Textile Export Details (in USD millions)

	FY20	FY21	FY22	10M'FY22	10M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**	**12,908**	**11,337**
- Knitwear	2,794	3,815	5,121	4,218	3,712
- Readymade Garments	2,552	3,033	3,905	3,214	2,905
- Bed wear	2,151	2,772	3,293	2,727	2,250
- Towels	711	938	1,111	928	825
- Made-up Articles	591	756	849	710	585
- Art, Silk & Synthetic Textile	315	370	460	385	343

- Others	555	743	866	725	718
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**	**3,074**	**2,372**
- Cotton Cloth	1,830	1,921	2,438	2,006	1,685
- Cotton Yarn	984	1,017	1,207	1,006	637
- Others	43	34	72	62	51
Total	**12,527**	**15,399**	**19,332**	**15,982**	**13,709**

Source: PBS

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

While sales revenue increased in FY22, the same depicted some slowdown in 9MFY23 due to overall economic slowdown

- Revenue base of the company witnessed an increase of 13% and was reported higher at Rs. 9.8b in FY22 (FY21: Rs. 8.6b; FY20: Rs. 6.5b) driven largely by higher average selling prices of yarn.
- Sales mix predominantly comprised yarn which accounted for 96% (FY21: 98%) of net sales during FY22. Product mix also consists a small proportion (4%) of doubling yarn and waste material sold.
- Export sales continue to account for a major proportion (around 85%) of revenue, with China being the main export destination followed by Turkey. Although geographic concentration is on the higher side, comfort is drawn from the fact that the entity has diversified client base in export and local markets. Company also expects Chinese market to continue to dominate.
- Top 10 customer concentration in the export sales division has increased to 93% (FY22: 78%, FY21: 84%) during 9MFY23. Meanwhile, concentration risk in the local sales category has declined (9MFY23: 57%; FY22: 66%) over the review period.
- As per management, overall client concentration risk is partially eliminated due to long-term association with the existing clientele.
- During 9MFY23, revenue of the Company was recorded at Rs. 7.6b, a decrease of 4.1% as compared to 9MFY22.
- Going forward, management expects revenue base to gradually increase. Expected ease in LC constraints will also contribute positively to the upward trend in the top line. Meeting projected revenue targets will be important.

Margins under pressure due to inventory losses through currency devaluation and higher other input & financial costs

- Supported by inventory gains, gross margins of the Company increased to 26.7% (FY21: 18.3%; FY20: 14.1%) during FY22.
- The same plunged to 8.9% during 9MFY23 on account of increase in prices of imported raw material led by currency devaluation, higher local cotton prices and elevated fuel expense.
- In percentage terms, 84% of the raw materials were imported while 16% were locally procured during 9MFY'23.
- Finance charges were maintained during FY22; however, interest costs sharply increased to Rs. 108m (FY22: Rs. 66m; FY21: Rs. 64m) in 9MFY23 contributed by higher benchmark rates and greater total borrowing levels in 9MFY23.

- Dividend income emanating from the short-term investment portfolio (9MFY23: Rs. 103m, FY22: Rs. 59m; FY21: Rs. 28m) also provide support to the profitability profile.
- Despite support from other income, net margins of the Company significantly weakened to 4.0% (FY22: 19.6%, FY21: 13.3%) in 9MFY23 due to subdued gross margins, and elevated finance and tax costs.
- Given uncertain macroeconomic environment, improving margins will be important from a ratings perspective.

Although liquidity profile weakened, the same remain at sufficient levels for the assigned ratings

- Funds from Operation (FFO) of the Company increased to Rs. 2,070.0m (FY21: Rs.1, 238.0m; FY20: Rs. 699.8m) in FY22 being a function of increase in quantum of profits in absolute terms. In line with the adequate profitability profile and limited additional debt drawdown, cash flow coverages against outstanding obligations also strengthened in FY22.
- However, the same declined during 9MFY23 due to low profitability and higher taxes & remunerations benefits paid. Albeit declining, liquidity ratios are considered adequate.
- FFO to Total Debt and FFO to Long-Term Debt were reported at 17% (FY22: 199%; FY21: 125%) and 22% (FY22: 199%; FY21: 125%) respectively during 9MFY23.
- Debt Servicing ratio (DSCR) also reduced to 3.43x (FY22: 10.64x; FY21: 11.36x) during 9MFY23.
- Current ratio as of end-Mar'23 stood at 2.8x, which is above the minimum threshold level. Short-term borrowing coverage is also deemed strong at 426% at end-Mar'23.
- Exposure in mutual funds, listed shares and TFCs to the tune of Rs. 699m (FY22: Rs. 1,980m; FY21; Rs. 835m) provides additional support to the liquidity profile.

Manageable capitalization profile

- Tier-I Equity base of the company accumulated to Rs. 6.4b (FY22: 6.0b; FY21: Rs. 4.1b) by end-Mar'23 through profit retention.
- The debt profile comprises a mix of long-term (26%) and short-term borrowings (74%) at end-Mar'23. Over the last three years, short-term debt proportion reflect an upward trend to finance elevated raw material costs. Short-term borrowings increased to Rs. 972.6m (FY22: Nil; FY21: Rs. 29.5m) at end-9MFY23 to meet higher working capital requirements on the back of rising raw materials costs.
- Growth in long-term debt during FY22 and 9MFY23 is attributable to the financing of BMR activities.
- With increase quantum of debt (9MFY23: Rs. 3.8b; FY22: Rs. 1.0b; FY21: Rs. 1.0b) being greater than profit retention in the review period, gearing and debt leverage ratios have depicted an uptick during 9MFY23 with the same reported within manageable levels at 0.60x (FY22: 0.17x; FY21: 0.25x) and 0.73x (FY22: 0.30x; FY21: 0.38x) respectively, at end-9MFY23.
- Given no plans for expansion, and projected improvement in profit generation, management expects capitalization levels to remain within similar ranges over the rating horizon. Maintaining the same will be important from a ratings perspective.

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 Yousuf Adil, Chartered Accountants. Auditors belong to category 'A' on the approved list of auditors published by the State Bank of Pakistan.

Sunrays Textile Mills Limited

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	FY19	FY20	FY21	FY22	9M23
Fixed Assets	1,848	1,811	1,661	4,224	7,311
Stock-in-Trade	1,766	1,824	1,650	2,189	1,660
Trade Debts	1,886	343	1,186	765	2,479
Short term investments	113	409	835	1,980	699
Cash & Bank Balances	73	33	121	97	59
Total Assets	6,042	4,911	5,967	9,921	13,050
Trade and Other Payables	381	339	262	515	590
Long Term Debt	842	969	988	1,043	2,828
Short Term Debt	1,479	19	29.5	-	972.6
Total Debt	2,321	988	1,017	1,043	3,800
Paid Up Capital	73	73	211	211	211
Total Equity (excluding revaluation surplus)	2,862	3,088	4,139	5,971	6,372
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**	**9M23**
Net Sales	6,085	6,476	8,641	9,758	7,631
Gross Profit	965	911	1,582	2,601	682
Profit Before tax	475	646	1,239	2,062	395
Profit After Tax	472	560	1,150	1,910	305
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**FY22**	**9M23**
Gross Margin (%)	15.9%	14.1%	18.3%	26.7%	8.9%
Net Margin (%)	7.8%	8.6%	13.3%	19.6%	4.0%
Net Working Capital	2,237	2,566	3,749	4,639	3,580
Trade debts/Sales	31%	5%	14%	8%	24%
FFO	661	700	1,238	2,070	472
FFO to Total Debt (%)	28%	71%	122%	199%	17%
FFO to Long Term Debt (%)	78%	72%	125%	199%	22%
Debt Servicing Coverage Ratio (x)	3.9	8.5	11.4	10.6	3.43
Current Ratio (x)	2.1	5.9	7.8	6.4	2.8
Stock+ Trade Debts/STD	247%	11491%	9601%	NA	426%
Gearing (x)	0.81	0.32	0.25	0.17	0.60
Leverage (x)	0.99	0.50	0.38	0.30	0.73
ROAA (%)	8%	10%	21%	24%	4%
ROAE (%)	18%	19%	32%	38%	7%

REGULATORY DISCLOSURES	Appendix II
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				
Sep-28-2023	A-	A-1	Stable	Reaffirmed
Aug-22-2022	A-	A-1	Stable	Reaffirmed
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.
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Due Diligence Meetings Conducted

Name	Designation	Date
Shafqat Masood	Senior Vice President	25th August, 2023
Yasir Anwar	Chief Financial Officer	