

## RATING REPORT

### Suraj Cotton Mills Limited

**REPORT DATE:**

February 09, 2024

**RATING ANALYSTS:**

M. Amin Hamdani

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**RATING DETAILS**

Rating Category	Latest Ratings		Previous Ratings	
	Long-term	Short-term	Long-term	Short-term
Entity	A+	A-1	A+	A-1
Rating Date	February 09, 2024		December 29, 2022	
Rating Action	Reaffirmed		Reaffirmed	
Rating Outlook	Stable		Stable	

**COMPANY INFORMATION**

Incorporated in 1984	<b>External Auditors:</b> Riaz Ahmad & Co. Chartered Accountants
Listed Public Limited Company	<b>Chairman of the Board:</b> Mr. Khalid Bashir
<b>Key Shareholders (with stake 5% or more):</b>	<b>CEO:</b> Mr. Nadeem Maqbool
Crescent Powertec Limited– 44.19%	
Mrs. Humera Iqbal – 7.44%	
Mr. Adil Bashir – 7.16%	
Mr. Ahsan Bashir– 5.90%	

**APPLICABLE METHODOLOGY(IES)**

**VIS Entity Rating Criteria: Corporates**

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

**VIS Rating Scale:**

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

**Suraj Cotton Mills Limited**

**OVERVIEW OF THE INSTITUTION**

**RATING RATIONALE**

*Suraj Cotton Mills Limited was established as a public limited company in December 1984. The Company is involved in manufacturing of yarn and griege fabric through its integrated spinning and weaving facilities.*

**Profile of the Chairman**

*Mr. Khalid Bashir has over four decades of association with textile and sugar industry, as well as with financial institutions. He has led the Board of Directors of Crescent Group and held directorships at other companies. He also serves as a member of APTMA electing committee.*

**Profile of the CEO**

*Mr. Nadeem Maqbool has around 30 years of experience in textile industry. Apart being director at various companies, he also acted as the Chairman of APTMA (Southern Region).*

**Company Profile**

Suraj Cotton Mills Limited (‘SURC’ or the ‘Company’) was incorporated in 1984 and commenced its commercial operations in 1985. The principal business of the Company is manufacture and sale of yarn, cloth, as well as processing of fabric. The registered office of the Company is located at 7-B-III, Aziz Avenue, Gulberg-V, Lahore, in the province of Punjab.

**Operational Performance**

The Company currently has 122,304 spindles and 358 looms installed across three units in Nooriabad (Sindh), Raiwind and Shahkot (Punjab), with an annual cumulative capacity of 55.2m Kgs of yarn and 130.7m Sq Mtr. of fabric, respectively. During FY23, production figures have depicted a significant decrease compared to SPLY. Management has attributed the reduced production in FY23 to a decrease in demand orders. Installed capacities, actual production and capacity utilization are tabulated below:

**Table 1: Capacity & Production Data (Figures in thousand)**

Capacity	FY22	FY23
<b>Spinning Unit:</b>		
Installed Capacity (kgs)	55,216	55,216
Actual Production (kgs)	52,392	29,354
Capacity Utilization %	95%	53%
<b>Weaving Unit:</b>		
Installed Capacity (Sq. Mtr.)	130,654	130,654
Actual Production (Sq. Mtr)	104,755	79,790
Capacity Utilization %	80%	61%

**Key Rating Drivers**

**Business risk profile constrained by cyclicity, and high competition in the sector.**

The business risk profile of the textile sector in Pakistan is characterized by a high level of exposure to economic cyclicity 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.

In FY23, the textile sector faced challenges due to various economic and environmental factors. These included damage to the cotton crop resulting from flooding in 1HFY23, escalating inflation, and diminishing foreign exchange reserves.

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.

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. Reduction in cotton supply, coupled with global economic slowdown and contractionary economic policies, led to a decrease in demand for textile products and, consequently, cotton yarn.

While the global outlook for cotton production is expected to rebound, local challenges persist. These challenges include high interest rates, increasing energy costs and inflationary pressures. These factors are likely to result in continued sluggish performance for the spinning sector in FY23-24. Additionally, the sector's vulnerability to global market dynamics and the domestic economic landscape further contribute to its high business risk profile.

**Profitability: Financial performance in FY23 was adversely affected by dampened demand and economic challenges.**

SURC experienced an impact from macroeconomic challenges during FY23, resulting in reduction in the Company's revenue. The top-line witnessed a 19.7% decrease, primarily attributed to demand slowdown throughout the year. This decline in sales volumes, coupled with elevated raw material costs and heightened inflationary pressure, contributed to a contraction in both gross and operating margins in FY23. Gross and operating margins were reported at 2.4% (FY22: 19.9%) and -0.1% (FY22: 17.6%), respectively, during FY23. However, there is a significant improvement noted in 1QFY24 with gross margin reported at 7.8%. However, the Company's bottom line remained under pressure due to increased finance costs. Consequently, the net margin turned negative at -2.2% (FY22: 11.9%). The escalation in finance costs was a result of the Company's heightened utilization of short-term debt in a high-interest-rate environment.

However, During 1QFY24, topline has increased by 53% Y/Y mainly on the back of rebound in volumes while gross margins also increased to 6.6% in 1QFY24 (compared to 2.4% in FY23). Management expects the topline to close FY24 roughly at around ~Rs. 30b with a net margin of around 3.5%-4.0%. Looking ahead, the Company's ability to recover demand and improve both its top-line and margins in alignment with its assigned ratings will be pivotal considerations for the credit rating.

**Capitalization: Slight deterioration was observed as a consequence of increased short-term borrowing; nevertheless remains in line with assign rating**

During the period under review, a marginal weakening was observed in SURC's capitalization profile, as evidenced by increase in gearing and leverage ratios to 0.52x (Jun'23: 0.48x, Jun'22: 0.39x) and 1.03x (Jun'23: 0.94x, Jun'22: 0.79x) as at Sep'23, respectively. This change was primarily attributable to the heightened utilization of short-term debt, driven by increased working capital requirements. The elevated working capital needs were influenced by rising raw material costs, operational expenses, and a prolonged cash conversion cycle. Going forward, ratings will remain sensitive to the Company's ability to maintain its capitalization profile in line with assigned ratings.

**Liquidity and Coverage: Despite the observed deterioration, an adequate liquidity and coverage profile is being maintained by the Company during the review period**

Cash flow coverage profile of the Company deteriorated during FY23 primarily due to the downturn in the Company's top-line and negative profitability during the fiscal year. Funds from operation (FFO) was recorded at negative Rs. 201m during FY23. Debt Service Coverage Ratio (DSCR) also witnessed a notable decrease, declining to 0.09x (FY22: 6.82x) as of Jun'23.

However, the same has recovered to 2.22x in 1QFY24. Liquidity position remained sound as indicated by a current ratio of 1.69x (FY23: 1.85x; FY22: 2.29x) and short term coverage of 5.18x (FY23: 7.23x; FY22: 12.07x) in 1QFY24.

<b>BALANCE SHEET</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>Q1'FY24</b>
Property, Plant and Equipment	5,571	7,830	9,118	8,910
Investment Properties	478	478	478	478
Long-Term Investments	972	772	626	657
Stock-in-Trade	3,204	6,165	5,819	7,211
Stores & Spares	219	257	470	473
Trade Debts	1,440	2,605	3,047	3,514
Short-Term Investments	3,211	1,623	602	481
Income Tax Refundable (net)	137	0.0	0.0	0.0
Other Receivables	23	217	486	26
Cash & Bank Balances	283	421	143	492
Other Assets	193	298	322	493
<b>Total Assets</b>	<b>15,731</b>	<b>20,665</b>	<b>21,177</b>	<b>22,735</b>
Trade and Other Payables	2,207	3,014	3,280	3,860
Short Term Borrowings	430	727	1,226	2,069
Long-Term Borrowings (Inc. current maturity)	2,964	3,849	4,055	3,860
Other Liabilities	863	1,275	1,283	1,876
<b>Total Liabilities</b>	<b>6,463</b>	<b>9,205</b>	<b>10,380</b>	<b>11,665</b>
<b>Total Debt</b>	<b>3,393</b>	<b>4,577</b>	<b>5,281</b>	<b>5,929</b>
Paid Up Capital	403	443	443	443
Tier-1 Equity	<b>9,258</b>	<b>11,645</b>	<b>11,056</b>	<b>11,299</b>
<b>Total Equity</b>	<b>9,268</b>	<b>11,460</b>	<b>10,797</b>	<b>11,070</b>
<b>INCOME STATEMENT</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>Q1'FY24</b>
Net Sales	17,375	23,501	18,860	7,674
Gross Profit	3,447	4,685	458	598
Operating Profit	2,959	4,133	(12)	445
Other Income	553	402	332	69
Finance Cost	165	214	320	119
Profit Before Tax	3,086	3,719	(115)	367
Profit After Tax	2,559	2,791	(412)	244
<b>RATIO ANALYSIS</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>Q1'FY24</b>
Gross Margin (%)	19.8	19.9	2.4	7.8
Net Margin (%)	14.7	11.9	-2.2%	3.2%
Net Working Capital	5,217	6,522	5,019	5,188
Current Ratio (x)	2.50	2.29	1.85	1.69
FFO	3,017	3,968	-201	502
FFO to Long-Term Debt(x)	0.89	1.03	(0.05)	0.52
FFO to Total Debt (x)	0.79	0.87	(0.04)	0.34
Debt Servicing Coverage Ratio (x)	5.9	6.8	0.1	2.2
ROAA (%)	17.8	15.3	-2.0	4.4
ROAE (%)	31.8	26.7	-3.6	8.7
Gearing (x)	0.41	0.39	0.48	0.52
Debt Leverage (x)	0.70	0.79	0.94	1.03
(Stock in Trade+ Trade Debts) to Short-term Borrowings (x)	10.8	12.1	7.2	5.2

REGULATORY DISCLOSURES					Appendix II
<b>Name of Rated Entity</b>	Suraj Cotton Mills Limited				
<b>Sector</b>	Textile				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Ratings				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	<b>RATING TYPE: ENTITY</b>				
	09/02/2024	A+	A-1	Stable	Reaffirmed
	29/12/2022	A+	A-1	Stable	Reaffirmed
	01/12/2021	A+	A-1	Stable	Initial
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	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.				
<b>Probability of Default</b>	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.				
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<b>Due Diligence Meetings Conducted</b>	<b>Name</b>		<b>Designation</b>		<b>Date</b>
	1.	Naeem Shaikh			23 January 2024
	2.	Ansab Zafar			