RATING REPORT

Zaman Textile Mills (Private) Limited

REPORT DATE:
March 07, 2023

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	
Rating Date	*Mar 07, 2023*		*Mar 08, 2022*	

COMPANY INFORMATION	
Incorporated in 1969	**External auditors:** M/s. Yousuf Adil
Private Limited Company	**Chairman:** Mr. Ebrahim Qassim
	CEO: Mr. Muhammad Jamil Qassim

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (August 2021) https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Zaman Textile Mills (Private) Limited

OVERVIEW OF THE INSTITUTION

Zaman Textile Mills (Private) Limited (ZTML) was incorporated in 1969 as a public company limited by shares. The company changed its status to a private company in May 2016. Principal activity of the company includes manufacturing, processing and sales of yarn and fabric.

RATING RATIONALE

Corporate Profile

Zaman Textile Mills (Private) Limited (ZTML) is a family-run enterprise that specializes in production, processing, sale and trading of yarn and fabric. Product range includes coarse yarn (20-40s), greige and dyed fabric that are sold within the country, while hospital gowns, home textiles, greige, and bleached fabric are exported. The company has been awarded various international standard certifications and has a workforce of over 4,000 employees.

Presently, average energy demand of 10MW is solely met through gas-powered generators; however, due to gas shortages and the need for uninterrupted energy supply, a 4.5MW line has been requested from KE, and alternate energy sources such as solar power plant, wood boilers, and generators backed by furnace-oil and diesel are being considered. Management estimates total investment cost to be ~Rs. 0.8b.

Operational Performance

ZTML is a vertically integrated mill & has its own spinning, weaving and processing facilities. The company operates through four production units in two locations; three units at Kotri Industrial Estate near Hyderabad are dedicated to yarn manufacturing while the facility for fabric weaving, dyeing, and printing is situated in Landhi Industrial Area, Karachi.

Figure: Capacity & Production Data

	FY20	FY21	FY22
Spinning			
Spindles Installed	79,008	79,008	97,248
Spindles Worked	24,268	79,008	79,008
Installed Capacity (million lbs.)	15.0	23.0	28.3
Installed Production (million lbs.)	13.7	22.7	25.4
Capacity Utilization	***91.2%***	***98.7%***	***89.6%***
Weaving			
Looms installed	357	385	545
Looms worked (excluding 3 looms as backup)	354	382	542
Installed Capacity (million meter)	77.9	74.0	92.1
Installed Production (million meter)	63.9	66.1	87.0
Capacity Utilization	***82.0%***	***89.4%***	***94.4%***

Business Segments & Capacity Expansion Plans

The operations and organizational structure of the company can be divided into three distinct segments, and each segment is currently undergoing capacity expansion:

- **Spinning Segment:** As of now, total 79,008 spindles are currently operational and plans are underway to add 65K new spindles, of which 18,240 have already been installed. It is expected that the remaining spindles will be added by Mar'23, bringing the total number of spindles to 144K+, thereby increasing production capacity by 2x to 55m Ibs. Additionally, the company is also utilizing 24K spindles from a third party, Dewaan Spinning Manufacturing, to fulfil yarn requirement. Total project cost is estimated to be around Rs. 10b, with ~80% of the cost attributed to import of machinery and the remaining to be used for construction. The debt to equity ratio is

60:40. Moreover, warehouse is also being constructed for additional yarn storage in line with increased production capacity.

- **Weaving Segment:** During the review period, the company added 160 new looms, increasing the installed weaving capacity to 92m meters. By adding 70 new looms, including 35 replacements, the loom count is expected to rise from 545 to 580, with the installed weaving capacity projected to increase to 110m meters. The new setup is expected to be operational from Apr'23 and financed by 80% equity and 20% debt.

- **Processing Division**: Production capacity of the printing and dyeing unit is currently being expanded from 144 meters per annum to 160-170 meters per annum; total estimated project cost is Rs. 3b (one-third will go towards construction with remaining to be allocated for machinery). The project will be financed through a combination of debt and equity in a 60:40 ratio. As part of the expansion, the unit will designate two floors for the stitching unit, which can house up to 120 machines and will mainly be used for finished fabric exports.

Key Rating Drivers

Business risk profile is supported by industry wide growth in exports over the last year; however, with recent floods adversely affecting cotton crop and ongoing energy crisis in the country pose a challenge to margins sustainability and future growth.
Pakistan's export 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.

Figure: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22		5M'FY22	5M'FY23
Pakistan Total Exports	22,536	25,639	32,450		15,056	14,965
Textile Exports	12,851	14,492	18,525		7,239	7,706
PKR/USD Average rate	158.0	160.0	177.5		167.3	222.7

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.

Figure: Textile Export Details (in USD millions)

	FY20	FY21	FY22		6M'FY22	6M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**		**8,027**	**7,614**
- Knitwear	2,794	3,815	5,121		2,500	2,466
- Readymade Garments	2,552	3,033	3,905		1,832	1,833
- Bed wear	2,151	2,772	3,293		1,660	1,428
- Towels	711	938	1,111		524	492
- Made-up Articles	591	756	849		422	379
- Art, Silk & Synthetic Textile	315	370	460		225	209
- Others	555	743	866		864	807

Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**		**1,777**	**1,483**
- Cotton Cloth	1,830	1,921	2,438		1,135	1,066
- Cotton Yarn	984	1,017	1,207		610	382
- Others	43	34	72		32	35
Total	**12,527**	**15,399**	**19,332**		**9,803**	**9,097**

Source: PBS

Cotton prices rose to a new 12-year high of ~Rs. 21,600/maund as of March'22, as a result of the shortage and higher input costs of fertilizer and energy. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Figure: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22
Per Maund	8,770	8,860	13,000	17,380
YoY % Change	26%	1%	32%	34%

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than $2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dying companies.

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.

5-Year (2020-25) textile policy continues to support the industry.

With an aim to double textile exports in five years, GoP through a five-year textile policy (2020-25) has provided incentives in form of preferential energy rates, low interest rates financing schemes (such as EFS, LTFF and TERF) and timely payments of DLTL, Income tax & Sales tax refund which support liquidity constraints of local players. Initiatives have also been undertaken to increase production and yield of cotton to support the industry. However, imposition of 10% super tax would have a negative effect on profitability profile of textile players. In addition, contractionary monetary policy and political uncertainties in the country are the present major business risk factors. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future of textile exports.

Sizeable revenue growth is achieved through increased capacity, higher prices, and a strategic focus on high-value fabric products; provision of end-to-end solution for retail brands provides competitive advantage.

In the last two fiscal years, sales revenue has more than doubled and surpassed the Rs. 27b mark in FY22, with a YoY growth of ~37%, primarily attributable to increased capacity and higher prices. Fabric accounts for two-thirds of sales, while yarn contributes to the remainder; both segments experienced value-based growth of ~42% and ~49%, respectively, in the outgoing fiscal year. In addition, it is anticipated that yarn sales growth will slow down while emphasis on fabric sales will intensify in the future, as management aims to increase the in-house utilization of yarn, given that the weaving and dyeing divisions have a higher capacity than the spinning division. The fabric division provides two types of products: Cut to Pack, which is ready-to-stitch cloth, and ROT (tube rolls). Cut to Pack contributes to nearly two-thirds of the total fabric sales and has higher profit margins than ROT.

Almost entire revenue emanate from domestic sales, which have experienced sizeable growth over the years, while exports have remained relatively stagnant. Nevertheless, management intends to increase its focus on exports (mainly within home textile range) and aims to raise the proportion of export sales to 15-20% in the medium-term. Moreover, exports are well diversified, with major destinations including Italy, USA, Portugal, Spain, Turkey, and West African countries. Client concentration risk remains high, with top ten clients contributing to nearly three-fourth of total sales, and the largest contributor being Bonanza (single client concentration stands at ~25-30%) followed by U&I Garments, Eden Apparels, Khaadi, and others. Nevertheless, comfort is driven from well-established long-term partnerships with these leading apparel brands.

During 6M'FY23, net sales have nearly reached Rs. 14b, and with ongoing capacity expansion, the management is expecting to reach Rs. 32-34b for the entire year. The company has a sufficient order backlog of 4-6 months, although prices are not fixed and are subject to renegotiation based on budget analysis.

Significant improvement in profitability margins in the current year outpace several industry peers.
Gross margins have sustained at above 16% for the past two fiscal years owing to efficient procurement and increased share of value-added products. The company's heavy reliance on cotton imports, primarily from USA, and its focus on the domestic market expose it to rupee devaluation risk. Nonetheless, the company has sufficient stock buffers to maintain its operations until Aug'23. Administrative and selling overheads increased noticeably in line with topline growth, and financing charges surged due to higher debt utilization. Higher taxation in FY22 led to a contraction in bottom-line, although profitability margins (both on gross and net basis) improved significantly during 1H'FY23 and compared favorably to peers.

Elevated debt levels offset improvement in cash flows, resulting in declining debt coverage metrics. Working capital cycle is elevated due to sizeable inventory holding and debtor days.
In FY22, funds flow from operations noted considerable upswing, reaching Rs. 4.2b (FY21: Rs. 3.2b) in line with improved net profitability and sizable surge in depreciation expense. Conversely, cash flow coverages declined over time due to elevated debt levels, as noted in FFO to total debt of 0.14x (FY22: 0.18x; FY21: 0.19x) and FFO to long-term debt of 0.28x (FY22: 0.40x; FY21: 0.42x) at end-1H'FY23. Similarly, debt servicing coverage ratio also declined to 2.06x (FY22: 2.42x; FY21: 3.17x).

Although the company's liquidity position seems satisfactory with current ratio consistently reported above 1x and sound coverage of short-term borrowing in relation to trade debts and inventory, working capital cycle remains elevated due to sizeable inventory holding and debtor days. Trade debts and stock levels have increased in tandem with increased production and business growth. Aging profile of trade debts indicates room for improvement, as ~ 43% receivables are outstanding for more than 90 days.

Capitalization has been strengthened over time by retained profits and sponsor loan; leverage ratios have trended upwards.
Equity base has doubled over the period of last four fiscal years, reaching Rs. 10.6b at end-1H'FY23 on account of healthy bottom-line and all-out retention, with additional support in

	form of interest-free loan from sponsors of over Rs. 2b. Debt profile constitutes blend of both long-term and short-term debt, with total interest-bearing liabilities increasing significantly to Rs. 28.2b (FY22: Rs. 22.4b; FY21: Rs. 16.8b) at end-1H'FY23; ~ 52% constituted short-term debt. This has led to an increase in gearing and leverage ratios over time.

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix I

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 II
Name of Rated Entity	Zaman Textile Mills (Pvt) Limited					
Sector	Textile					
Type of Relationship	Solicited					
Purpose of Rating	Entity Ratings					
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**	
	Rating Type: Entity					
	07-03-2023	A-	A-2	Stable	Reaffirmed	
	08-03-2022	A-	A-2	Stable	Reaffirmed	
	25-01-2021	A-	A-2	Stable	Maintained	
	24-04-2020	A-	A-2	Rating Watch-Developing	Maintained	
	29-11-2019	A-	A-2	Stable	Reaffirmed	
	22-11-2018	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.					
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.					
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Due Diligence Meeting Conducted	**Name**	**Designation**	**Date**			
	Mr. Shakeel Dhanani	CFO	February 15, 2023			
	Mr. Bilal Qasim	Export Director				
	Mr. Fayaz	Commercial Director				