

RATING REPORT

Quality Textile Mills Limited

REPORT DATE:

December 30, 2021

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Initial Rating	
	Long-term	Short-term
Entity	BBB	A-2
Rating Outlook	Stable	
Rating Date	December 30, 2021	

COMPANY INFORMATION

Incorporated in 1988	External auditors: A.D Akhawala & Co. Chartered Accountant
Public Limited Company	Chairman: Mr. Noor Muhammad Hashim
Key Shareholders (with stake 5% or more):	Chief Executive Officer: Mr. Tayyab Noor Muhammad
Mr. Noor Muhammad Hashim (45.70%)	
Mr. Tayyab Noor Muhammad (35.04%)	
M/s. Ambreen Noor Muhammad (11.1%)	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: *Corporates (August,2021)*<https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf>

Quality Textile Mills Limited

OVERVIEW OF
THE
INSTITUTION

Quality Textile Mills Limited was incorporated in Pakistan on May 03, 1998 as a public limited company under the repealed Companies Ordinance, 1984 (Repealed with the enactment of the Companies Act, 2017)

Profile of Chairman

Mr. Noor Muhammad Hashim is one the founding director of Quality Textile Mills Limited. He possess over 43 years of experience of business in various fields.

In 1969 he started 3S dealership of Toyota with the name of M/s Pakistan Motors Ltd. In the year 1981 he further acquired 3S dealership of Nissan with the name of M/s Fadoo Automobile Ltd. In 1985 he ventured in the field of Activated Bleaching Earth chemicals and laid foundation of M/s Pakistan National Chemical Ind. Ltd. Following his strategy of diversification in 1988 he started a textile spinning mill with the name of M/s Quality Textile Mills Limited.

Profile of CEO

Mr. Tayyab Noor Muhammad is the executive director of Quality Textile Mills Limited since 2004. He also hold directorship in M/s Phoenix Chemical (Pvt) Limited. He holds Master Degree in Mechanical Engineering from Imperial College of Science, Technology and

RATING RATIONALE

Quality Textile Mills Limited ('QTML' or 'the Company') was incorporated in Pakistan on May 03, 1988 as a public limited company under the repealed Companies Ordinance, 1984 (Repealed with the enactment of the Companies Act, 2017 on May 30, 2017). The Company was delisted from Karachi Stock Exchange (Now Pakistan Stock Exchange) on November 24, 2014. The principal activity of the Company is manufacture and sale of yarn. QTML is an ISO certified cotton spinner, and its plant has a total of 25,104 spindles.

Table 1: Capacity & Production

	2018	2019	2020	2021
Total number of spindles installed	25,104	25,104	25,104	25,104
Number of shift worked per day	3	3	3	3
Number of days worked	347	351	212	304
Number of shift worked	1,041	1,053	636	912
Average number of spindles worked	25,104	25,104	25,104	25,104
Installed capacity after conversion into 20/S (Kgs)	9,105,878	9,105,878	9,105,878	9,105,878
Actual Production after conversion into 20/S (Kgs)	8,273,738	7,700,310	4,304,450	8,419,482
Actual Production (Kgs)	8,070,336	7,502,922	4,814,966	5,918,399
Utilization	90.9%	84.6%	47.3%	92.5%

Sector Update

Table 2: Pakistan Export Statistics

	FY19	FY20	FY21	Q1'FY21	Q1'FY22
Pakistan Exports (In USD' Millions)	24,257	22,536	25,632	5,354	7,241
Textile Exports (In USD' Millions)	13,659	12,867	14,488	3,086	4,240
PKR/USD Rate (Average)	136.3	158.2	160.3	167.0	164.6

Source: SBP

- Subsequent to posting export contraction in FY20 - owing to the pandemic-induced slowdown experienced in H2'FY20 - Pakistan's export base grew by 14% in FY21, which is partly attributable to a low base effect. Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21). So the uptick is largely aligned with historical numbers and is not considered material.
- Share of textile exports in total exports has oscillated in the range of 54-59%, coming in at 57% during the past 2-years (FY20-21). In FY21, owing to the similar low-base effect, as discussed above, textile exports were up 13%.
- In USD' terms textile exports have grown at a CAGR of 4.4% during the past 3-year period (FY19-FY21), despite depreciation in average USD/PKR parity of 24%, 16%, and 1% in FY19, FY20 and FY21 respectively.
- As illustrated in the table above, textile exports in Q1'FY22 were 37% higher than SPL.Y. Inclusive of textile exports for Oct'2021, the number for 4M'FY22 textile exports came in at USD 6b. With additional capacities coming online in January 2022, textile exports for FY22 are likely to exceed the annualized figure of USD 18b.
- As illustrated in the table below, the composition of textile exports has depicted improvement in the last 4-year period, but contribution from lower to medium value added segment has been decreasing from 27.1% in FY18 to 19.3% in FY21 of aggregate textile exports.

Medicine, London, UK.
He is also an MBA
(Finance) from Lahore
University of
Management Science.

Table 2: Segment-wise textile Exports (All Figures in USD' Millions, except for percentages)

	FY18	FY19	FY20	FY21	FY18	FY19	FY20	FY21
HIGH VALUE-ADDED SEGMENT	9,854	10,046	9,669	12,428	72.9%	75.4%	77.2%	80.7%
- KNITWEAR	2,711	2,900	2,794	3,816	20.1%	21.8%	22.3%	24.8%
- READYMADE GARMENTS	2,577	2,653	2,552	3,033	19.1%	19.9%	20.4%	19.7%
- BED WEAR	2,261	2,262	2,151	2,772	16.7%	17.0%	17.2%	18.0%
- TOWELS	797	786	711	938	5.9%	5.9%	5.7%	6.1%
- MADE-UP ARTICLES (EXCL. TOWELS & BED WEAR)	685	680	591	756	5.1%	5.1%	4.7%	4.9%
- ART, SILK & SYNTHETIC TEXTILE	310	297	315	370	2.3%	2.2%	2.5%	2.4%
- OTHERS	513	468	555	743	3.8%	3.5%	4.4%	4.8%
LOW TO MEDIUM VALUE-ADDED SEGMENT	3,667	3,282	2,858	2,972	27.1%	24.6%	22.8%	19.3%
- COTTON CLOTH	2,204	2,102	1,830	1,921	16.3%	15.8%	14.6%	12.5%
- COTTON YARN	1,372	1,125	984	1,017	10.1%	8.4%	7.9%	6.6%
- OTHERS	92	54	43	34	0.7%	0.4%	0.3%	0.2%
TOTAL	13,521	13,328	12,527	15,400				
SOURCE: PBS								

- Cotton production in Pakistan, on the other hand, was at its lowest level in decades for FY21. Cotton prices rose to a new 11-year high of ~Rs. 13,000/maund as a result of the production shortage, and cotton imports have climbed by 59.8% in quantity and 68.1% in USD terms, for FY21 vis-à-vis preceding year.

Table 3: Cotton Prices

	FY18	FY19	FY20	FY21
<i>Per Maund (Rs.)</i>	6,953	8,770	8,860	13,000
<i>% Change</i>	6%	26%	1%	32%

- Given favorable weather conditions, cotton production in Pakistan posted strong growth in FY22, with cotton crop for Jul-Nov'22 (Rabi) season being 81% higher than SPL.Y. Nevertheless, the upward momentum in cotton pricing continued in FY22, with prices as of November 2021 hovering at ~Rs. 16,000 per mound.
- The margins of textile operators have broadly depicted improvement despite the uptick in raw material costs, given that the same was offset by exchange rate movement. Nevertheless, higher raw material pricing has increased the working capital requirements for textile operators, which is likely to weigh on the liquidity of textile players

Business Review - QTML

Sales & Profitability

Table 3: P&L (Extract)

	FY18	FY19	FY20	FY21	Q1'FY22
Net Sales (PKR million)	2,597	2,755	1,759	2,470	833
Growth Rate	-	6.1%	(36.1%)	40.4%	NA
Gross Margin (%)	4.5%	4.8%	-1.7%	6.0%	4.0%
EBIT margin (%)	3.1%	3.4%	-3.7%	3.8%	2.5%
Net Margin (%)	0.5%	0.2%	-6.9%	1.8%	2.3%

- A 3-year review of QTML's topline and growth trend is indicative of mixed trends, mainly as the time frame includes the period of pandemic-induced slow down. The Company's production remained halted during the pandemic related lockdowns as it's

not an exporter, given that 96% of the Company's topline on average (FY18-FY21) comprises local sales.

- Given the closure of operations, the Company's topline receded by 36%, as capacity utilization fell to 47%.vis-a-vis pre-pandemic level of 85%. Subsequently, capacity utilization has revived to 92.5%, albeit the topline for FY21 remained lower than pre-pandemic level, as illustrated in the table above.
- In FY21, QTML has made changes to its product switching from 100% cotton to polyester cotton. As a result, the Company's clientele has changed, while gross margin has depicted improvement.
- The Company's topline depicts inherent concentration, albeit the same has depicted improvement - particularly in FY21 - as indicated by proportion of Top 10 customers comprising 44.2% of the topline (FY20: 69.3%, FY19: 61.7%).
- The Company's gross margin has depicted volatility over a time line, as illustrated in table 3. Given change in product offering, gross margin has improved and is projected to remain elevated during the rating horizon.
- The Company is in the process of installing a waste processing plant, which is planned to become operational by Jan'22. Inclusive of growth from the same and expected uptick in pricing, the management expects to grow the topline in the range of Rs. 100-105m for FY22.
- Given limited gross margins and relatively higher burden of overheads and finance cost, net margins remained miniscule historically, averaging 0.3% for the two year period (FY18-19), which was pre-pandemic. The Company posted a one-off loss in FY20. Post-pandemic and product switch, QTML's net margin has depicted improvement, coming in 1.8% and further improving to 2.3% for Q1'FY22.

Short Cash Conversion Cycle and Adequate Cash flow Coverage Indicators

- QTML operates with a relatively short cash conversion cycle, as illustrated in the table below. Given lower inventory holdings as of Jun'21, the cash conversion cycle is notably improved as of end-FY21.
- The receivable days have also posted improvement, in line with increasing quantum of cash sales at 38% of the aggregate sales for FY21. As of Sep'21, trade debts comprised 42% of the Company's equity base, which is indicative of significant credit risk exposure. As per management 90% of all trade debts were outstanding for less than 1 month as of Sep'21. Cumulative bad debt provisions over the past 5-year period (FY17-21) amounts to Rs. 2.5m.
- Short-term borrowings are fully covered by stock of inventory and trade debts. Stock in trade and trade debts account for 2.1x of short-term borrowings.

Table 4: Cash Conversion Cycle (in Days)

	FY19	FY20	FY21
Cash Conversion Cycle	79	80	28
- Days Inventory Outstanding	68	78	35
- Days Sales Outstanding	32	33	20
- Days Payable Outstanding	21	32	27

Table 5: Cash flow Analysis

	FY18	FY19	FY20	FY21	Sept'21
FFO (Mn.) (PKR million)	96	79	(101)	129	N/A
FFO to Total Debt (%)	18.9%	12.5%	(59.6%)	54.8%	N/A
FFO to Long Term Debt (%)	485.4%	421.6%	(670.1%)	373.5%	N/A
Debt Servicing Coverage Ratio (x)	-	1.98	(0.74)	4.59	N/A
Current Ratio	1.13	1.17	1.15	1.42	1.32
(Stock in trade+ trade debts)/STD (x)	1.37	1.28	1.92	2.11	1.31

- Given the increase in offtake and margins, cash flow coverage indicators have improved recently and are projected to be maintained.

QTML maintains leveraging at manageable level

Table 6: Balance Sheet (Extract)

	FY18	FY19	FY20	FY21	Sept'21
Total Assets (PKR million)	1,750	1812	1267	1467	1678
Total Liabilities (PKR million)	848	909	481	552	829
Total Equity (PKR million)	569	582	476	532	539
Long Term Debt (PKR million)	20	19	15	35	36
Short Term Debt (PKR million)	490	617	154	201	494
Total Debt (PKR million)	510	636	169	235	531
Leverage (x)	1.49	1.56	1.01	1.04	1.54
Gearing (x)	0.90	1.09	0.35	0.44	0.98

- As illustrated in the table above, the Company's gearing which used to stand close to 1x as of FY18-19, dropped below 0.5x as end-FY20-21. We have noted an increase in gearing as of Sep'21, albeit this is generally the case with the spinning segment wherein demand for working capital is elevated as of end-September.
- Going forward, the management plans to maintain gearing at low levels, with strategy mainly focused on organic growth.

Key Rating Drivers – QTML

Ratings incorporate QTML's size, margins and business risk of the spinning segment

QTML is a small-sized spinning segment player. The assigned ratings incorporate the quantum and customer concentration inherent in QTML's revenue base. The contraction in QTML's topline and gross margins in FY20 has been assessed; however, from a ratings perspective, we view it as a one-off pandemic related impact unlikely to repeat during the rating horizon. Given the addition of waste processing capacity, recent change in product mix and resultant improvement in margins, topline is likely to grow in line with management estimates and margins are assumed to be maintained during the rating horizon.

QTML operates in the cotton yarn spinning business, wherein the performance is sensitive to cyclical in cotton prices, which further determined by crop yield. Historically, margins and

financial performance of players have depicted seasonality. Moreover, competitive intensity is high due to commoditized nature of the product.

Rating incorporates historical track record of well-maintained leveraging and adequate cash flow coverage

Historically, the management has focused on organic growth and leveraging has been maintained at manageable level. Accordingly financial risk profile of the entity has remained moderately low. Furthermore, apart from the one-off FY20 topline contraction, cash flow coverage indicators have remained adequate. The increase in cash sales in recent period and resultant contraction of cash conversion cycle is viewed positively from ratings purview.

Ratings incorporate QTML's operations as an unlisted family owned entity

QTML rating reflects its operational status as an unlisted family owned entity. The Company was de-listed in 2014.

Quality Textile Mills Limited

Appendix I

FINANCIAL SUMMARY <i>(amounts in PKR millions)</i>					
<u>BALANCE SHEET</u>	FY18	FY19	FY20	FY21	Sept'21
Fixed Assets	935	877	820	868	759
Stock-in-Trade	444	535	233	211	423
Trade Debts	227	257	62	213	224
Cash & Bank Balances	11	5	11	35	16
Total Assets	1,750	1,812	1,267	1,467	1,678
Trade and Other Payables	182	120	193	152	25
Long Term Debt	20	19	15	35	36
Short Term Debt	490	617	154	201	494
Total Debt	510	636	169	235	531
Paid Up Capital	160	160	160	160	160
Total Equity	569	582	476	532	539
<u>INCOME STATEMENT</u>					
Net Sales	2,597	2,755	1,759	2,470	833
Gross Profit	118	131	(29)	148	33
Operating Profit	81	94	(66)	93	21
Profit Before Tax	41	25	(112)	98	35
Profit After Tax	12	4	(121)	43	19
<u>RATIO ANALYSIS</u>					
Gross Margin (%)	4.5%	4.8%	-1.7%	6.0%	4.0%
Net Margin (%)	0.5%	0.2%	-6.9%	1.8%	2.3%
Net Working Capital	92	136	58	177	219
Trade debts/Sales	8.8%	9.3%	3.5%	8.6%	26.9%
FFO	96	79	(101)	129	NA
FFO to Total Debt (%)	18.9%	12.5%	-59.6%	54.8%	NA
FFO to Long Term Debt (%)	485.4%	421.6%	-670.1%	373.5%	NA
Debt Servicing Coverage Ratio (x)	NA	1.98	(0.74)	4.59	NA
Current Ratio (x)	1.13	1.17	1.15	1.42	1.32
Stock+Trade Debts/STD	137%	128%	192%	211%	131%
Gearing (x)	0.90	1.09	0.35	0.44	0.98
Leverage (x)	1.49	1.56	1.01	1.04	1.54
ROAA (%)	NA	0.3%	-7.9%	3.2%	1.2%
ROAE (%)	NA	0.8%	-22.9%	8.6%	3.6%

ISSUE/ISSUER RATING SCALE & DEFINITION

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	Quality Textile Mills Limited				
Sector	Textile Industry				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	<u>RATING TYPE: ENTITY</u>				
	December 30, 2021	BBB	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 Meetings Conducted	Name	Designation	Date		
	Mr. Tayyab Noor Muhammad	CEO	15 th Dec 2021		
	Mr. Ali Asghar	CFO			