RATING REPORT

Shahtaj Textile Limited (STL)

REPORT DATE:
January 18, 2019

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 Date	Jan 18, 2019		Dec 14, 2017	

COMPANY INFORMATION	
Incorporated in 1990	**External auditors:** Deloitte Yousuf Adil, Chartered Accountants
Public Listed Company	**Chairman of the Board:** Mr. Muneer Nawaz
Shahtaj Sugar Mills – 11.90%	**Chief Executive Officer:** Mr. M. Naeem
Mr. Ahmed Naeem – 9.19%	
Mrs. Amtul Bari Naeem – 8.65%	
Treet Corporation Limited – 8.99%	
Mr. Muneer Nawaz – 8.62%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria
Industrial Corporates (May 2016) ***https://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf***

Shahtaj Textile Limited

OVERVIEW OF THE INSTITUTION

Shahtaj Textile Limited (STL) was incorporated in 1990 as a public limited company. The company was later listed on Pakistan Stock Exchange (PSX). Head office of the company is situated in Karachi while the factory is located in Kasur.

Profile of the Chairman: The Board is chaired by Mr. Muneer Nawaz who possesses extensive experience in sugar and food industries. He has been associated with STL since 1990.

Profile of the CEO: Mr. M. Naeem, Chief Executive Officer (CEO). He holds an M.A.L.L.B degree and possesses more than four decades of experience in trading and textile industry. Mr. M. Naeem joined Shahnawaz Group in 1967 and assumed responsibilities of its Managing Director in 1972. He is the CEO of Shahtaj Textiles Ltd since inception. Along with this, he is also Chief Executive of Shahnawaz Private Limited and on the Board of Directors of other group companies.

RATING RATIONALE

Shahtaj Textile Limited (STL) is part of 'Shahnawaz Group'. The group consists of six companies including STL. The other five companies are Shezan International, Shahtaj Sugar Limited, Shahnawaz Engineering Ltd., Cornstar ISA and Nawazabad Farms. STL is engaged in the manufacturing, selling and marketing of grey fabric.

Key Rating Drivers

Satisfactory existing governance framework.

The Board of Directors comprises nine members including two independent directors. In order to ensure effective oversight, two committees, namely Board Audit Committee (BAC) and Board Human Resources and Remuneration Committee (BHRRC), are present at Board level. In line with best practices, board committees are chaired by independent Board members and woman representation is present on the Board.

Initiatives are underway to improve operational efficiency

Under the company's Balancing, Modernization and Rebalancing Program (BMR), the management successfully completed the installation of electrical equipment, while a new gas generator and waste heat recovery boiler are under erection phase. As per management, both these facilities will be fully operational in FY19, thereby translating into improved efficiency and reduction in running costs. Existing capacity utilization remains approximately 90%.

Improvement witnessed in topline of the company on the back of volumetric growth and increase in average selling prices.

Net sales of STL witnessed a growth of 12.2% during the outgoing year (FY18: 3.9b; FY17: Rs. 3.5b). More than 50% of the sales are geared towards the local markets. Local Sales (including indirect export sales) increased by 6.9% to Rs. 2.3b (FY17: Rs. 2.1b). Export sales of the company also increased by 18.1% to Rs. 1.7b (FY17: Rs. 1.4b). Growth in sales was partly due to an increase in average selling prices on account of higher yarn prices and partly due to volumetric growth. Country wise concentration in sales is considered moderate with top two European export markets constituting approximately 29% (FY17: 26%) of gross sales in FY18. Client wise concentration in sales is considered to be on the higher side with top 10 clients accounting for 73% (FY17: 76%) of gross sales in FY18. However, the concentration risk is partly mitigated by long term relationship with clients. Net sales of STL were reported at Rs. 1.1b (Q1'FY18: Rs. 768.8m) in Q1'FY19.

Margins have depicted a declining trend on account of competitive pressures, increase in cost of production and finance cost

Growth in costs outweighed the growth in topline of the company during FY18 and Q1'19, thereby resulting in declining gross and net margins. Cost of goods sold was reported higher on account of rising fuel prices and volatility in yarn prices. As a result, gross margin declined to 5.3% (Q1'18: 6.7%) and 7.5% (FY17: 9.5%) in the Q1'FY19 and FY18, respectively.

Furthermore, finance cost of the company has trended upwards due to increase in short term borrowings to meet working capital requirements and shift to more rupee based borrowings in place of dollar based borrowings due to anticipated rupee devaluation. Resultantly, net profit margins were reported lower on timeline basis (FY18: 1.73%; FY17: 3.03%). Management expects profitability to remain under pressure in FY19 due to rising RLNG costs on account of projected rupee devaluation and higher finance costs as a result of projected increase in SBP policy rate. Furthermore, the government has also reduced export rebate on grey fabric during the outgoing year. Aforementioned factors have narrowed the margins in past three years; however the management is projecting the margins to recover going forward on the back of reduction in gas prices by the government.

Liquidity profile has weakened as a result of reduction in company's profitability

Funds From Operations (FFO) have exhibited a declining trend owing to reduction in profitability in Q1'19 and FY18. FFO for the outgoing year was reported lower at Rs. 174.4m (FY17: Rs. 189.8m). Resultantly, FFO as a proportion of total debt decreased to 16% (FY17: 25%). The cash flows of the company are sufficient to meet the outstanding the debt obligations as indicated by sizeable debt servicing coverage ratio (FY18: 2.9x; FY17: 2.6x). Stock in trade and trade debts provide adequate cushion over short term borrowings, while current ratio of the company also remains above 1.0x (FY18: 1.2x; FY17: 1.4x). Management expects nominal expenditure on capex in the rating horizon which is expected to support the liquidity and debt service profile of the company going forward.

Despite growth equity base, leverage indicators have trended upwards due to higher borrowings

On a timelines basis, the equity base of the company has increased owing to profit retention. Equity base of the company amounted to Rs. 974.7m (FY18: Rs. 972.2m; FY17: Rs. 950.2m) at end-Q1'19. However, gearing and leverage ratios increased to 1.1x (FY17: 0.8x) and 1.7x (FY17: 1.2x) respectively at end-FY18. This increase was attributed to an increase in short-term borrowings for working capital requirements. At end-Q1'19, gearing and leverage ratios stood at 1.2x and 1.6x. Improvement in capitalization indicators are important rating drivers going forward.

Shahtaj Textile Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	Q1'19	FY18	FY17	FY16
Non-current Assets	1,171.5	1,191.6	1,045.7	829.5
Stock-in-trade	602.9	507.9	420.2	355.9
Trade Debts	490.8	619.2	260.4	203.0
Cash & Bank Balances	7.7	25.0	6.5	13.1
Total Assets	2,630.5	2,683.1	2,077.7	1,636.3
Long-term borrowings	386.4	287.4	298.3	82.3
Short-term borrowings	722.8	776.3	430.4	305.0
Current Portion of long-term borrowings	44.2	44.2	29.6	50.2
Total Debt	1153.5	1,107.9	758.3	437.5
Trade Payables	302.4	393.5	236.4	193.4
Total Equity	974.7	972.2	950.2	890.5
Total liabilities	1,571.0	1,624.0	1,122.9	740.5
INCOME STATEMENT				
Net Sales	1,065.0	3,925.3	3,498.8	3,155.9
Gross Profit	56.9	295.8	328.4	325.1
Distribution Expenses	14.9	72.8	69.1	60.3
Administrative Expenses	22.7	93.8	101.3	100.7
Operating Profit/(Loss)	18.9	121.1	148.3	153.7
Profit/(Loss) After Tax	0.2	68.1	106.0	98.9
RATIOS & KEY NUMBERS				
Gross Margin	5.3%	7.5%	9.4%	10.3%
Net Margin	0.02%	1.7%	3.0%	3.1%
Net Working Capital	363.8	252.6	320.1	243.7
FFO	17.8	174.4	189.8	194.7
FFO/Total Debt	6.2%	16%	25%	45%
Gearing	1.2	1.1	0.8	0.5
Leverage	1.6	1.7	1.2	0.8
Debt Servicing Coverage	1.4	2.9	2.6	2.4
ROAA	0.03%	2.9%	5.7%	6.0%
ROAE	0.08%	7.1%	11.5%	11.6%

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Shahtaj Textile Limited
Sector	Textile
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				
01/18/2019	A-	A-2	Stable	Reaffirmed
12/14/2017	A-	A-2	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	JCR-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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