RATING REPORT

Shahtaj Textile Limited (STL)

REPORT DATE:
January 14, 2022

RATING ANALYST:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	*Jan 14, 2022*		*Dec 29, 2020*	

COMPANY INFORMATION	
Incorporated in 1990	**External auditors:** Yousuf Adil, Chartered Accountants
Public Listed Company	**Chairman of the Board:** Mr. Muneer Nawaz
Key Shareholding (more than 5%)	**Chief Executive Officer:** Mr. M. Naeem
Shahtaj Sugar Mills ~11.90%	
Mr. Ahmed Naeem ~9.19%	
Mrs. Amtul Bari Naeem ~8.65%	
Mr. Muneer Nawaz ~8.62%	
Mr. Muhammad Naeem ~6.8%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: *Industrial Corporates (May 2019)*
https://vis.com.pk/kc-meth.aspx

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

Corporate Profile

Headquartered in Karachi, Shahtaj Textile Limited (STL) is engaged in manufacturing and sale of grey fabric, with an annual production capacity of 64.6m sq. meters (looms installed: 178). The company has an established track record of two decades in the weaving business while sponsors are well-experienced and dedicated professionals. Manufacturing facility is located in Kasur, Lahore. STL's entire power requirement is met through 2000KW gas-based power generators.

Capacity utilization previously remained under pressure due to pandemic-induced slowdown in demand; however, the same has returned to historic levels of ~90% given subsequent economic recovery and sizeable jump in export orders. In view of same, the management has planned to replace 49 existing looms at a total capex of Rs. 500m; entire cost is being financed through TERF facility. As per management, post capex overall production capacity is expected to increase by ~10% and the project is expected to come online in the ongoing year.

Sponsor Group

The company belongs to 'Shahnawaz Group' which has diversified investments in various sectors including sugar, food, agricultural and engineering. The group has an extensive experience of more than six decades with a cumulative annual turnover of around Rs. 20-25b. Major group entities are enlisted below:

Name	Nature of Business
Shezan International	Food & Beverage Processing
Shahtaj Sugar Mills	Sugar Processing
Nawazabad Farms	Agriculture-Fruit & Crop Farming, Organic Farming
Information Systems Associates Limited (Comstar)	Info Security, Network Infrastructure & Odoo ERP
Shahnawaz (Pvt) Ltd	Automotive, Engineering and IT Equipment

<u>Key Rating Drivers</u>

Textile and clothing exports have registered a sizeable growth given the surge in demand on account of rerouting of orders to Pakistan and favorable sector policies. Outlook is favorable going forward.

The 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 Rs. 3.8tr (FY20: Rs. 3.3tr) in FY21. Barring seasonal and cyclical fluctuations, textiles products have maintained an average share of about 60% in national exports. Given post pandemic sustained economic recovery and diversion of export orders to Pakistan, export revenues from textile segment (as per PBS) stood at USD 15.4b (FY20: USD 12.5b; FY19: USD 13.6b) in FY21, registering a sizeable year-on-year growth of ~23%. The similar growth trend has been noted in the ongoing year with exports reaching at USD 6.0b during 4M'FY22, up by 27% vis-à-vis SPLY. Knitwear, Readymade and Bed wear segments continued to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While primarily a volumetric driven growth, the exports also received a boost from higher prices (excluding Knitwear). During the year, while average volumes increased by ~20-30% in various segments as compared to the lock down period, average prices increased by ~8-10%.

Segments	Value (US$ millions)		YoY(Δ)
	FY21	FY20	
Knitwear products	3,816	2,785	*37%*
Readymade Garments	3,033	2,549	*19%*
Bed wear	2,772	2,149	*29%*
Cotton Cloth	1,921	1,830	*5%*
Cotton Yarn	1,017	987	*3%*
Towels	938	711	*32%*
Made-up Articles	756	591	*28%*
Art, silk and synthetic textile	370	314	*18%*
Tents, canvas and tarpaulin	110	98	*12%*
Others	667	487	*37%*

Going forward, sector dynamics are favorable as Pakistan continues to receive export orders from global economies as competing regional countries remains hampered by the pandemic. Given the surge in demand, the industry is currently operating at full capacity and going through expansion and up-gradation to cater for additional demand.

5-Year (2020-25) textile policy continues to support the industry.
With the 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 would support liquidity constraints of local players. Initiatives are also being undertaken in order to increase production and yield of cotton to support the industry. Going forward, new Covid-19 variants (Omicron) and uncertainty of its impact on overall economy and political environment are the key present 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.

Akin to industry, sales revenue has posted significant recovery in the outgoing fiscal year on account of healthy growth in volumes and prices.
Sales revenue of the company has registered a strong rebound in the outgoing fiscal year, reporting similar to FY19 levels. In absolute terms, net sales amounted to Rs. 4.9b (FY20: Rs. 4.4b; FY19: Rs. 4.8b). The recovery in sales is attributable to both volumetric growth and higher average selling prices. The growth momentum has continued in the ongoing fiscal year with the topline amounting to Rs. 1.9b during 3M'FY22, increasing by ~61% SPLY. Going forward, the management is targeting sales revenue to reach Rs. 7.0b in FY22 on the back of enhanced capacities and strong demand outlook on both domestic and international fronts.

Proportionate share of exports (direct & indirect) to local sales stood at 50:50 ratio. More than one-half of export sales is concentrated in Italy though with diversified client portfolio while the remaining is shared by Spain, Belgium, Portugal, and USA. Client-wise concentration remains on the higher side with top ten clients constituting more than 70% of total sales (with 40% shared by 2 local clients). Nevertheless, the risk is partly mitigated given the long-term established relationships with these clients ensuring repeat business.

Profitability margins have depicted improvement on the back of efficient yarn procurement. Going forward, increase in production capacity will drive the future

growth in earning profile.

Gross margins continue to witness an upward trend over the past three consecutive years (FY21: 11.1%; FY20: 9.6%; FY19: 9.4%). The improvement in margins over the review period is mainly due to efficient yarn procurement, operational efficiencies and the impact of rupee devaluation. In value terms, ~90% of yarn is procured locally due to favorable pricing whereas the remaining proportion is imported to meet the client's specific standard requirement. On the cost front, distribution expenses largely remained at similar levels while administrative overheads noted a slight increase. Financial charges remain on the lower side given limited debt present on the balance sheet with the same being mobilized at concessionary rates. With improved gross margins and topline growth, the company posted profit after tax (PAT) of Rs. 86.7m (FY21: Rs. 217.0m; FY20: Rs. 72.6m) during 3M'FY22 with net margin of 4.6% (FY21: 4.4%, FY20: 1.7%).

Liquidity profile is sound; healthy recovery in earnings has led to improvement in cash flow coverages.

Liquidity profile is considered sound with healthy cash flow generation in line with improving profitability. In absolute terms, Funds from Operations (FFO) increased to Rs. 382.9m (FY20: Rs. 204.7m) in FY21. As a result, FFO to total debt and FFO to long-term debt were reported higher at 40.0% (FY20: 22.0%; FY19: 22.0%) and 58.2% (FY20: 37.8%; FY19: 76.4%), respectively. Similarly, Debt Service Coverage Ratio (DSCR) has more than doubled, reporting at 5.77x (FY20: 2.23x). Current ratio of the company remains strong and over 1.5x while trade debts and stock in trade are more than sufficient to cover short term borrowings. Aging profile of trade debts remain within manageable levels.

Leverage indicators have improved on account of increase in equity base; the same are expected to remain at similar levels over the rating horizon.

Equity base grew by ~25% since last review on account of higher profitability. The dividend payout ratio stood at 51.2% (FY20: 53.2%) in FY21. Debt profile comprises a mix of short term and long term debt with total interest bearing liabilities amounting to Rs. 1.2b (FY21: Rs. 956.2m; FY20: Rs. 931.2m) at end-1Q'FY22; short-term debt (ERF) constituted around one-half of total debt. Gearing and leverage indicators have improved and were reported at 0.86x (FY21: 0.72x; FY20: 0.82x) and 1.36x (FY21: 1.34x; FY20: 1.43x), respectively at end-1Q'FY22.

Corporate governance framework is considered sound.

At present, Board of Directors (BoD) comprises 10 members including three independent directors. During the period under review, three director were appointed replacing two outgoing members along with one additional director. For effective oversight, three board level committees, namely Audit Committee, Human Resources Committee and Executive Committee are in place. Moreover, as per best governance practices, board committees are chaired by independent Board members while woman representation is also present on the Board.

Shahtaj Textile Limited **Appendix I**

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**3M'FY22**
Non-Current Assets	1,131.3	1,185.7	1,443.1	1,416.2
Stock-in-Trade	529.3	690.7	1,016.6	1,042.0
Trade Debts	948.9	590.6	647.6	876.1
Cash & Bank Balances	32.2	49.2	50.4	53.4
Total Assets	**2,899.0**	**2,842.1**	**3,360.7**	**3,596.2**
Trade and Other Payables	353.8	544.5	628.2	496.6
Short Term Borrowings	791.2	390.5	298.2	568.2
Long Term Debt *(Including current maturity)*	386.4	540.7	658.0	647.4
Total Interest Bearing Debt	1,177.6	931.2	956.2	1,215.6
Total Liabilities	**1,681.3**	**1,627.0**	**1,777.3**	**1,926.0**
Paid up capital	96.6	96.6	96.6	96.6
Total Equity *(Excluding Revaluation Surplus)*	**1,141.8**	**1,134.0**	**1,325.0**	**1,418.2**
INCOME STATEMENT				
Net Sales	4,787.6	4,365.8	4,937.5	1,894.2
Gross Profit	448.8	421.3	550.3	200.5
Administrative Expenses	98.3	105.8	113.0	30.0
Finance Cost	87.3	80.2	47.4	16.2
Profit before Tax	251.4	113.1	287.5	110.8
Profit After Tax	188.0	72.6	217.0	86.7
RATIO ANALYSIS				
Gross Margin (%)	9.4%	9.6%	11.1%	10.6%
Net Margin (%)	3.9%	1.7%	4.4%	4.6%
Current Ratio (x)	1.4	1.6	1.8	1.8
Net Working Capital	541.4	636.0	868.9	978.8
Gearing (x)	1.03	0.82	0.72	0.86
Leverage (x)	1.47	1.43	1.34	1.36
FFO	259.0	204.7	382.9	145.8
FFO to Long Term Debt (x)	0.76	0.38	0.58	0.90
FFO to Total Debt (x)	0.22	0.22	0.40	0.48
Debt Servicing Coverage Ratio (x)	2.63	2.23	5.77	4.23
ROAA (%)	6.7%	2.5%	7.0%	10.0%
ROAE (%)	17.8%	6.4%	17.6%	25.3%

ISSUE/ISSUER RATING SCALE & DEFINITIONS 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	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				
	01/14/2022	A-	A-2	Stable	Reaffirmed
	12/29/2020	A-	A-2	Stable	Reaffirmed
	4/23/2020	A-	A-2	Rating Watch Developing	Maintained
	12/26/2019	A-	A-2	Stable	Reaffirmed
	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	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. Amir Ahmed	Chief Financial Officer	Dec 9, 2021		