RATING REPORT

Shahtaj Textile Limited

REPORT DATE:
November 22, 2022

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	*Nov 22, 2022*		*Jan 14, 2022*	

COMPANY INFORMATION	
Incorporated in 1990	**External Auditors:** Yousuf Adil, Chartered Accountants
Public Listed Company	**Board Chairman:** 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 (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.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.LL.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

Shahtaj Textile Limited (STL), headquartered in Karachi, manufactures and sells grey fabric, with an annual production capacity of 65.3m square meters (looms installed: 179). The company has a two-decade track record in the weaving industry, and the sponsors are highly experienced and dedicated professionals. Manufacturing facility is located in Kasur, Lahore. STL's entire power requirement is met by two 2000KW gas-powered generators. Total staff strength declined to 492 (Jun'21: 515) employees at end-Jun'22.

During the review period, 49 existing looms were replaced at a total capex of Rs. 500m, with the entire cost financed by TERF facility; all looms are currently operational. The same resulted in an increase in plant capacity during FY22, with an additional 5% to 6% increase expected given full year impact. Utilization levels have largely remained consistent with previous years.

Table: Plant Capacity & Actual Production

	FY19	FY20	FY21	FY22
Number of looms installed	178	178	178	179
Number of looms installed	178	178	178	179
Plant capacity at 60 picks (sq. meters in m)	64.6	64.6	64.6	65.3
Production converted to 60 picks (sq. meters in m)	58.6	54.8	57.5	57.9
Capacity Utilization	***90.7%***	***84.8%***	***89.0%***	***88.7%***

Sponsor Group

The company is part of 'Shahnawaz Group', which has diverse investments in industries such as sugar, food, agriculture, and engineering. The group has over six decades of experience and a cumulative annual turnover of ~Rs. 30b according to management. Following are major group entities:

Table: Group Companies *(By Common Directorship)*

Name	Business Nature
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>

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.

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 products have maintained an average share of about 60% in national exports. 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. Margins of textile companies have broadly depicted improvement despite the uptick in raw material costs, given that the same was offset by exchange rate movement.

Figure: Textile Exports (as per PBS)

Segments	Value (US$ millions)		
	FY20	**FY21**	**FY22**
Knitwear products	2,785	3,816	5,121
Readymade Garments	2,549	3,033	3,905
Bed wear	2,149	2,772	3,293
Cotton Cloth	1,830	1,921	2,438
Cotton Yarn	987	1,017	1,207
Towels	711	938	1,111
Made-up Articles	591	756	849
Art, silk and synthetic textile	314	370	461
Tents, canvas and tarpaulin	98	110	110
Others	487	667	835

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 sector's working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators.

Going forward, global and domestic challenges will weigh on the business risk profile, including a slowdown in global demand dynamics due to recession and monetary tightening in major world economies, the country's ongoing energy crisis, rising production costs due to inflation, and a domestic external account crisis. 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.

Robust growth in sales revenue mainly driven by increase in fabric prices. Increased production capacity will drive future revenue growth.

While crossing the Rs. 7b mark in FY22, STL's topline registered a sizeable growth of ~51% (FY21: ~13%) primarily driven by increase in fabric prices, while volumetric growth remained nominal. The growth trend in sales revenue has continued during 3M'FY23, amounting to Rs. 2.3b, increasing by ~22% vis-à-vis SPLY. As per management, the full-year impact of capacity addition will result in healthy volumetric growth, with FY23 sales targeted at Rs. 8.5b. Moreover, the company uses order-based production, and orders are fully booked until mid-December.

On average, sales have been evenly split between direct/indirect exports and local sales. More than half of all export sales are concentrated in Italy with a diverse client portfolio, while remainder shared among Spain, Belgium, Portugal, and the United States. Concentration risk in sales remains elevated, with top ten clients constituting more than 70% of total sales (45% shared by two local clients only). However, the risk is mitigated partially by established, long-term relationships with these entities, which ensure recurring revenues.

Profitability margins were impacted during the ongoing year due to significant rise in power cost.
Profitability margins (on both gross and net basis), following a decline in FY22, fell further in the ongoing year on the back of increasing trend in yarn prices and significant uptick in power cost in the recent months given energy shortages in the country. Majority of yarn is purchased locally given favorable pricing and no high quality requirements. Administrative overheads increased in line with inflation, while distribution costs nearly doubled, owing primarily to sizeable jump in export related ocean freight charges. Moreover, financing charges also have almost doubled during the year as debt levels increased. Exchange gain supported the bottom-line profitability during the period under review.

With healthy cash flow generation against outstanding debt repayments, liquidity profile remains strong.
Funds from Operations (FFO) noted an increasing trend over the years as profitability improved, totaling Rs. 493.8m (FY21: 376.9m; FY20: Rs. 204.7m) in FY22. However, as debt levels have increased (primarily due to higher utilization of running finance), cash flow coverages have shown a slight decline, reflected by FFO to total debt of 0.25x (FY21: 0.39x) and FFO to long term debt of 0.47x (FY21: 0.57x). Similarly, the debt service coverage ratio also declined to 3.32x (FY21: 5.69x). Debt coverage metrics have been impacted further in the ongoing year as a result of margin declines, but remain within comfortable levels.

Overall liquidity profile remains strong as sufficient cash flow generation against outstanding debt repayments. Current ratio remains comfortably high at more than 1.5x, while coverage of short-term borrowings in relation to trade debts and stock in trade is deemed adequate. The trade debt ageing profile is sound.

Leverage indicators have trended upwards on account of increase in debt levels.
Over the last 15 months, equity base grew by ~21%, reaching to Rs. 1.6b (FY22: Rs. 1.5b; FY21: Rs. 1.3b) at the end-Sept'22. The pay-out ratio stood at 41.8% (FY21: 51.2%) in FY22. Debt profile comprises a mix of short-term and long-term debt, with total interest bearing liabilities increasing to Rs. 1.9b at end-Sept'22; short-term debt accounted for nearly half of total debt. As a result, leverage indicators have trended upwards over the review period.

Corporate governance framework is considered sound.
Board comprises ten members, including three independent directors. For effective oversight, three board level committees, namely Audit Committee, Human Resources Committee and Executive Committee are in place. As per best governance practices, there is female representation on the board while committees are chaired by independent members. Since last review, there has been no change in board composition or senior management team.

Shahtaj Textile Limited **Appendix I**

FINANCIAL SUMMARY					*(amounts in PKR millions)*	
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**	**3M'FY22**	**3M'FY23**
Non-Current Assets	1,131.3	1,185.7	1,443.1	1,794.3	1,416.2	1,771.5
Stock-in-Trade	529.3	690.7	1,016.6	1,801.5	1,042.0	1,729.7
Trade Debts	948.9	590.6	647.6	997.3	876.1	1,076.8
Cash & Bank Balances	32.2	49.2	50.4	17.2	53.4	13.4
Total Assets	**2,899.0**	**2,842.1**	**3,360.7**	**4,943.1**	**3,596.2**	**4,927.1**
Trade and Other Payables	353.8	544.5	628.2	955.8	496.6	856.3
Short Term Borrowings	791.2	390.5	298.2	913.0	568.2	952.9
Long Term Debt *(Incl. current maturity)*	386.4	540.7	658.0	1,053.0	647.4	1,036.30
Total Interest Bearing Debt	1,177.6	931.2	956.2	1,966.0	1,215.6	1,989.2
Total Liabilities	**1,681.3**	**1,627.0**	**1,777.3**	**3,176.7**	**1,926.0**	**3,114.2**
Paid up capital	96.6	96.6	96.6	96.6	96.6	96.6
Total Equity *(Excl. revaluation surplus)*	**1,141.8**	**1,134.0**	**1,325.0**	**1,546.2**	**1,418.2**	**1,599.8**
INCOME STATEMENT						
Net Sales	4,787.6	4,365.8	4,937.5	7,455.5	1,894.2	2,317.2
Gross Profit	448.8	421.3	550.3	733.0	200.5	164.4
Administrative Expenses	98.3	105.8	113.0	125.7	30.0	33.1
Finance Cost	87.3	80.2	47.4	86.4	16.2	55.8
Profit before Tax	**251.4**	**113.1**	**287.5**	**401.7**	**110.8**	**71.2**
Profit After Tax	**188.0**	**72.6**	**217.0**	**300.0**	**86.7**	**47.9**
RATIO ANALYSIS						
Gross Margin (%)	9.4%	9.6%	11.1%	98%	10.6%	7.1%
Net Margin (%)	3.9%	1.7%	4.4%	4.0%	4.6%	2.1%
Current Ratio (x)	1.4	1.6	1.8	1.55	1.81	1.59
Net Working Capital	541.4	636.0	868.9	1,117.6	978.8	1,174.7
Gearing (x)	1.03	0.82	0.72	1.27	0.86	1.24
Leverage (x)	1.47	1.43	1.34	2.05	1.36	1.95
FFO	259.0	204.7	382.9	493.8	145.8	94.1
FFO to Long Term Debt (x)	0.76	0.38	0.58	0.47	0.90	0.36
FFO to Total Debt (x)	0.22	0.22	0.40	0.25	0.48	0.19
Debt Servicing Coverage Ratio (x)	2.63	2.23	5.77	3.32	4.23	1.89
ROAA (%)	6.7%	2.5%	7.0%	7.2%	10.0%	3.9%
ROAE (%)	17.8%	6.4%	17.6%	20.9%	25.3%	12.2%

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				
11/22/2022	A-	A-2	Stable	Reaffirmed
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	Nov 04, 2022