

# RATING REPORT

## Shahtaj Textile Limited

### REPORT DATE:

November 24, 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	November 24, 2023		November 23, 2022	

### COMPANY INFORMATION

<b>Incorporated in 1990</b>	<b>External Auditors:</b> Yousuf Adil, Chartered Accountants
<b>Public Listed Company</b>	<b>Board Chairman:</b> Mr. Muneer Nawaz
<b>Key Shareholders (with stake 5% or more):</b>	<b>Chief Executive Officer:</b> Mr. M. Naeem
<i>Shahtaj Sugar Mills Limited ~11.90%</i>	
<i>Mrs. Amtul Bari Naeem ~8.65%</i>	
<i>Mr. M. Naeem ~6.82%</i>	
<i>Mr. Muneer Nawaz ~6.12%</i>	
<i>CDC-Trustee National Investment (Unit) Trust ~4.92%</i>	

### APPLICABLE METHODOLOGY(IES)

**VIS Entity Rating Criteria:** Industrial Corporates (May 2023)

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

### APPLICABLE RATING SCALE(S)

**VIS Issue/Issuer Rating Scale:** <https://docs.vis.com.pk/docs/VISRatingScales.pdf>

**Shahtaj Textile Limited**

**OVERVIEW OF THE INSTITUTION**

**RATING RATIONALE**

*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, is serving as the 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.*

**Corporate Profile**

Shahtaj Textile Limited (STL) is a public listed company with an operational track record spanning over 30 years. Specializing in the production and sale of grey fabric, STL is headquartered in Karachi, while its manufacturing facilitation is situated in Kasur, near Lahore. Total workforce of the company is above 480 employees.

Power requirement of nearly 3.8MW is primarily met by three gas generators of 2MW each. A diesel generator and WAPDA's national grid supply offer backup. Additionally, the company aims to install a 1MW solar power plant in the near future as part of their environmental commitment.

**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 & softwares
Shahnawaz (Pvt) Ltd	Automotive & Engineering (only importer for genuine Mercedes parts in Pakistan)

**Operational Performance**

The weaving unit located at Kasur, includes high speed Toyoda and Picanol Air Jet Looms within its facility. Distribution network is managed by STL's designated marketing team which is based in Lahore. Last year, STL replaced 49 looms, leading to a marginal increase in production capacity. However, the production figures during the review period remained consistent with FY22 levels, also evident by the similar utilization rates.

**Table 1: Capacity & Production Data (Units in millions)**

Capacity	FY21	FY22	FY23
<b>Fabric Weaving Unit</b>			
Number of looms installed	178	179	179
Number of looms worked	178	179	179
Plant capacity at 60 picks (sq. meters)	64.6	65.3	65.3
Production converted to 60 picks (sq. meters)	57.5	57.9	57.6
Capacity Utilization %	89.0%	88.7%	88.2%

Moving forward, management plans to replace a sizing machine which is anticipated to be shipped and installed later this year. The cost of replacement would be entirely financed by internal cash generation.

### Key Rating Drivers

**Business risk remain elevated amid weak macroeconomic environment, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand. All these factors pose a challenge to the sector in terms of 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 broke the threshold, clocking in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and provides employment to about 40% of the industrial labor force<sup>1</sup>. Contributing around 8.5% to the country's gross domestic product (GDP), with an estimated market size of around Rs. 4.0tr, textile sector has maintained an average share of about 60% in national exports over the years.

**Table 2: Pakistan Export Statistics (USD in Millions)**

	FY20	FY21	FY22	FY23
<b>PAKISTAN TOTAL EXPORTS</b>	22,536	25,639	32,450	27,911
<b>TEXTILE EXPORTS</b>	12,851	14,492	18,525	16,710
<b>PKR/USD AVERAGE RATE</b>	158.0	160.0	177.5	248.0

*Source: SBP*

The lingering effects of Covid-19 pandemic continue to shape the Pakistan's textile industry. Initially, as lockdowns lifted, the industry capitalized on opportunities, securing production contracts with western countries. This redirection of substantial volumes to Pakistan, was complemented by government import tax reductions and subsidized covid-related financing programs such Temporary Economic Refinance Facility (TERF), spurred robust export growth during FY22. However, a subsequent phase presented new challenges. Global interest rate hikes aimed at curbing post-pandemic inflation, coupled with geopolitical unrest such as the Ukraine conflict, led to supply chain disruptions and energy crisis. These factors led to a global demand slowdown in major textile economies, reflected in a 10% year-on-year decline in Pakistan's textile exports in FY23, totaling USD 16.7b (FY22: USD 18.5b). As per the data from Pakistan Bureau of Statistics (PBS), High Value-Added Segments made up over 82.2% (FY22: 80.7%) of the total textile exports in FY23.

Flash floods in Sindh and Southern Punjab monsoon wreaked havoc on the cotton crop last year. This catastrophe led to a historic low production level of 4 million bales of cotton in 2022, compared to a 12 million bales annual demand. Consequently, local cotton prices reached 12-year high of over Rs. 22,000 per 40kg during the year as well as import of raw cotton rose by ~20% in USD terms during FY22, as compare to the preceding year. This situation led to higher working capital requirements, adversely affecting profit margins and liquidity profile of textile entities, particularly spinners, weavers, and dyeing companies. Supported by favorable weather and timely government intervention, cotton production in the country is estimated to increase to 12.7 million bales during the current season (FY24). 4.0 million bales have already been produced during Q1FY24, marking an impressive 80.0% increase compared to the same period last year.

The industry is facing business risk due to weak macroeconomic environment both globally and locally, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand, primarily from North America and Europe.

Previously, the sector also enjoyed incentives provided by the government through a five-year textile policy (2020-25), including preferential energy rates, low-interest financing schemes, and timely payments of various refunds, easing liquidity constraints for local players. However, the prevailing economic instability along with advisory from the IMF led to the reduction or withdrawal of many of these fiscal supports. This along with contractionary monetary policy and political uncertainties in the country are the key business risk factors facing by the industry. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future prospects of textile exports.

**Topline growth remained subdued in FY23. Client concentration risk remains elevated.**

Revenue in FY22 surged by ~51% mainly due to higher prices and a modest increase volumes. In FY23 topline continued to grow by ~9%, surpassing the Rs. 8b mark, predominantly due to volumetric growth particularly in domestic and indirect sales. Despite this growth a 16% decrease is observed in the topline of 3M'FY24 compared to SPLY. Management attributed this decline to a global demand slowdown and the prevailing macroeconomic challenges in Pakistan which began emerging towards the end of FY23.

Direct and in-direct exports make up to ~55% of the total sales, while the remaining is attained from local sales. Major destination of exports include Italy, Turkey, Belgium, Korea, Spain and USA. Top ten clients make up approximately 80% of the entire revenue while two local clients alone contribute 42% of the total sales, indicating a significant concentration risk. However, this risk is managed as most production is pre-order based, where orders are typically placed at least two or three months in advance.

**Gross margins witnessed a slight decline in FY23, rise in financial charges further contracted profitability metrics.**

After a slight dip in FY23, gross margins recouped to 9.5% in 1Q'FY24. According to the management the decline was impacted by rising power costs and increase in yarn prices. Yarn is the primary material used for production; the majority of it is procured locally while a small portion is imported for better fabric. The procurement arrangements with suppliers are managed based on orders in hand.

On the cost front, financial charges more than doubled in FY23 and remained high in the ongoing year mainly due to higher benchmark rates. As a consequence, bottom-line contracted significantly, and net margins contracted to below 1.0x in 1Q'FY24. Going forward ratings are dependent on the improvement in net margins.

**Table 3: P&L extract**

Rs. in Mn.	FY21	FY22	FY23	1Q'FY24
Sales	4,938	7,456	8,085	1,942
<b>Gross Profit</b>	<b>550</b>	<b>733</b>	<b>641</b>	<b>185</b>
<b>Gross Margin (%)</b>	<b>11.1</b>	<b>9.8</b>	<b>7.9</b>	<b>9.5</b>
Operating Expenses	183	238	245	65
Other Expenses	33	31	20	12
Other Income	0.4	24	76	10
Finance Cost	47	87	214	94
<b>Profit before Tax</b>	<b>288</b>	<b>402</b>	<b>237</b>	<b>24</b>
<b>Profit after Tax</b>	<b>217</b>	<b>300</b>	<b>153</b>	<b>15</b>
<b>Net Margin (%)</b>	<b>4.4</b>	<b>4.0</b>	<b>1.9</b>	<b>0.8</b>

**Liquidity profile weakened, as cash coverage metrics deteriorated during the review period.**

Funds flow from operations (FFO) declined in FY23 mainly due to the decrease in gross income and higher financial charges paid. The trend persisted in 3M'FY24 as FFO recorded a ~41% decrease compared to 1Q'FY23. Cash coverage metrics also reflected weakening with FFO to total debt ratio of 0.11x (FY23: 0.18x, FY22: 0.25x) and FFO to long term debt of 0.24x (FY23: 0.34x, FY22: 0.47x) during 1Q'FY24. Similarly, debt service coverage ratio (DSCR) decreased by half during the review period and currently at 1.30x due to the mentioned decrease in FFO and higher financial charges.

Current ratio has remained stable above 1.5x and short-term debt coverage with trade debts and inventory is satisfactory. Ageing profile of trade debts remain sound with majority of debts settled within the first 3 months.

**Equity base experienced moderate growth, gearing and leverage ratios remain stable.**

Equity base (excluding revaluation surplus) remained adequate and grew by ~4% over the last 15 months, amounting to Rs. 1.61b at Sep'23 (Jun'22: Rs. 1.59b). The company has a history of dividend payouts and in FY23 the company paid a dividend of Rs. 114.6m. Debt profile includes long-term and short-term debt. Long-term borrowings include LTFF and TERF facility, while short-term debt predominantly includes KIBOR based borrowings. During the review period short-term borrowings increased by 16% amounting to Rs. 1.06b as at Sep'23 (Jun'22: Rs. 913m) while long-term loans decreased by 12% amounted to Rs. 858m as at Sep'23 (Jun'22: 959m) resulting in gearing and leverage ratios to remain at historic levels at 1.24x and 1.98x as of Sep'23. However, it is important to note that the company plans to install a solar power plant in the ongoing year which could result in drawing down new long term debt on balance sheet and affect capitalization.

**Shahtaj Textile Limited**
**Appendix I**

Financial Summary (amounts in PKR millions)					Appendix I
<b>BALANCE SHEET</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>1Q'FY24</b>
Non-Current Assets	1,185.7	1,443.1	1,794.3	1,665.8	1,642.1
Stock-in-Trade	690.7	1,016.6	1,801.5	1,253.2	1,583.0
Trade Debts	590.6	647.6	997.3	1,082.0	1,023.0
Cash & Bank Balances	49.2	50.4	17.2	42.6	21.4
<b>Total Assets</b>	<b>2,842.1</b>	<b>3,360.7</b>	<b>4,943.1</b>	<b>4,730.5</b>	<b>4,998.3</b>
Trade and Other Payables	544.5	628.2	955.8	881.3	938.4
Short Term Borrowings	390.5	298.2	913.0	819.5	1,060.1
Long Term Debt <i>(Incl. current maturity)</i>	540.7	658.0	1,053.0	952.0	939.83
<b>Total Interest Bearing Debt</b>	<b>931.2</b>	<b>956.2</b>	<b>1,966.0</b>	<b>1,771.9</b>	<b>2,000.0</b>
<b>Total Liabilities</b>	<b>1,627.0</b>	<b>1,777.3</b>	<b>3,176.7</b>	<b>2,942.1</b>	<b>3,195.9</b>
Paid up capital	96.6	96.6	96.6	96.6	96.6
<b>Total Equity <i>(Excl. revaluation surplus)</i></b>	<b>1,134.0</b>	<b>1,324.0</b>	<b>1,564.2</b>	<b>1,590.4</b>	<b>1,610.4</b>
<b>INCOME STATEMENT</b>					
	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>1Q'FY24</b>
Net Sales	4,365.8	4,937.5	7,455.5	8,085.2	1,942.2
Gross Profit	421.3	550.3	733.0	640.9	185.3
Profit Before Tax	<b>113.1</b>	<b>287.5</b>	<b>401.7</b>	<b>237.2</b>	<b>24.1</b>
Profit After Tax	<b>72.6</b>	<b>217.0</b>	<b>300.0</b>	<b>153.0</b>	<b>15.0</b>
<b>RATIO ANALYSIS</b>					
	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>1Q'FY24</b>
Gross Margin (%)	9.6%	11.1%	9.8%	7.9%	9.5%
Net Margin (%)	1.7%	4.4%	4.0%	1.9%	0.8%
Current Ratio (x)	1.6	1.8	1.5	1.6	1.5
Net Working Capital	636.0	868.9	1,117.6	1,160.2	1,178.6
Gearing (x)	0.82	0.72	1.27	1.11	1.24
Leverage (x)	1.43	1.34	2.05	1.85	1.98
FFO	204.7	376.9	493.8	321.9	55.3
FFO to Long Term Debt (x)*	0.38	0.57	0.47	0.34	0.24
FFO to Total Debt (x)*	0.22	0.40	0.25	0.18	0.11
Debt Servicing Coverage Ratio (x)*	2.23	5.77	3.32	1.74	1.30
ROAA (%)*	2.5%	7.0%	7.2%	3.2%	1.2%
ROAE (%)*	6.4%	17.6%	20.9%	9.8%	3.8%

\*Annualized

REGULATORY DISCLOSURES				Appendix II	
<b>Name of Rated Entity</b>	Shahtaj Textile Limited				
<b>Sector</b>	Textile				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Ratings				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	11/24/2023	A-	A-2	Stable	Reaffirmed
	11/23/2022	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
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	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.				
<b>Probability of Default</b>	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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<b>Due Diligence Meeting Conducted</b>	<b>Name</b>	<b>Designation</b>	<b>Date</b>		
	Mr. Amir Ahmed	Chief Financial Officer	October 24, 2023		
	Mr. Wasim	Manager Accounts and Finance			