

## RATING REPORT

### Zephyr Textile Limited (ZTL)

#### REPORT DATE:

October 12, 2018

#### RATING ANALYSTS:

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RATING DETAILS		
Rating Category	Initial Rating	
	Long-term	Short-term
Entity	BBB+	A-2
Rating Outlook	Stable	
Rating Action	Initial	
Rating Date	October 11 <sup>th</sup> , '18	

#### COMPANY INFORMATION

Incorporated in 1999	External auditors: Azhar Zafar & Co. Chartered Accountants
Public Limited Company	Chairman of the Board/CEO: Mr. Mussaid Hanif
<b>Key Shareholders (with stake 5% or more):</b>	
Mr. Mussaid Hanif – 35.86%	
Mr. Burhan Muhammad Khan – 32.98%	
The Bank of Punjab, Treasury Division – 8.24%	
Ms. Tehniyat Mussaid – 6.78%	

#### APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: Industrial Corporates (May 2016)

<http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf>

## Zephyr Textile Limited

### OVERVIEW OF THE INSTITUTION

Zephyr Textile Limited (ZTL) was established in 1999 as a private limited company. The company is involved in the production and sale of grey fabric, towels and finished fabric. The company is now listed on the Pakistan Stock Exchange.

#### Profile of the Chairman/CEO

Mr. Mussaid Hanif serves as the Chairman of the Board and Chief Executive Officer. He has over 20 years of experience in marketing, sales, and corporate management.

#### Financial Snapshot

**Total Equity:** end-FY18: Rs. 1.2b; end-FY17: Rs. 1.1b; end-FY16: Rs. 964m

**Assets:** end-FY18: Rs. 4.2b; end-FY17: Rs. 3.7b; end-FY16: Rs. 3.4b

**Profit After Tax:** end-FY18: Rs. 105m; end-FY17: Rs. 69m; end-FY16: Rs. 107m

### RATING RATIONALE

#### Rating Rationale

ZTL is a weaving unit and primarily operates in three business segments, including grey fabric, towel and finished fabric. Shareholding of the company is mainly vested with the sponsoring family which is actively involved in the day to day affairs of the company. Recent CAPEX in upgradation of production facilities is expected to reduce cost and improve efficiency. Moreover, ZTL's strategy of increasing the proportion of finished products in the revenue mix would positively impact margins and profitability, going forward. The ratings are constrained by comparatively high gearing indicators and limited scale of operations, leading to heightened competitive challenges for the company.

#### A shift towards value-added textile products

ZTL has been making a gradual shift towards value-added textile products, particularly towel and finished fabric, which fetch comparatively better profit margins than grey fabric business. As a result of this strategic shift, towel has now become the largest business segment, accounting for 43% of total sales during FY18 of which 38% were from exports. On the contrary, contribution of grey fabric in sales mix stood at 39%, which is expected to decline further in the future. In the finished segments, the company specializes in men's branded unstitched fabric. While currently the revenue contribution from finished fabric segment is around 10%, the company aims to gradually increase its proportion to over 50% to augment its profitability.

#### Towel and finished fabric businesses deriving sales growth

ZTL registered a healthy 13% growth in net sales during FY18, mainly on account of higher towel related sales and a sizeable growth in finished fabric segment. Total towel dispatches declined marginally, but its sales exhibited a healthy 29% growth on account of higher selling prices in the international market. Meanwhile, the notable growth in conversion business also provided support to sales. Capacity enhancement in towel weaving and processing units along with the technology advancement is expected to further boost sales. Finished fabric segment has exhibited sizeable growth over the past three years along with healthy margins, however, its impact on the bottom-line is currently limited due to low quantum. Gross margins remained fairly stable at 11.4% as the impact of favorable prices was offset by increase in raw material costs. Going forward, overall profitability of the company is expected to steadily improve on account of increasing proportion of towel and finished fabric segments.

#### Improving cash flows and liquidity position

With higher sales and improved margins, funds from operations (FFO) grew to Rs. 360m during FY18 (FY17: Rs. 299m; FY16: Rs. 276m), representing a notable 3-year CAGR of 15%. Consequently, FFO to total debt improved marginally to 0.21x at end-FY18 (FY17: 0.17x; FY16: 0.19x) despite an uptick in short-term borrowings. The debt service coverage stood comfortable at 1.47 x at end-FY18 (FY17: 0.95x; FY16: 1.21x). Going forward, the cash flows position is likely to be strengthened from an ongoing shift towards value-added textile.

#### Gearing remains slightly higher

The equity base stood at Rs. 1.2b at end-FY18. Total debt remained largely stable at just over Rs. 1.7b at end-FY18 (FY17: Rs. 1.7b; FY16: Rs. 1.5b), as reduction in long-term debt was offset by higher utilization of short-term borrowings to finance the working capital requirements. The outstanding balance of long-term debt declined to Rs. 581m (FY16: Rs. 744m) on account of scheduled repayments. Gearing indicator improved to 1.46x at end-FY18 (FY17: 1.62x; FY16: 1.51x), though considered to be on a higher side. During FY19, the company plans to mobilize Rs. 300m as long-term financing for new plant and machinery.

#### Corporate governance can be improved

The Board of Director of ZTL comprises seven members appointed by the sponsoring family. In line with best corporate governance practices, the Board is splitting the roles of the Chairman and CEO. The senior management team comprises experienced resources from textile sector and has largely depicted stability.

#### Adequate IT and internal audit functions

ZTL uses Oracle-based ERP platform which comprises five modules. Integration of looms with the ERP platform provides real-time data on production. The internal audit team comprises four members and reports to the internal audit committee.

**Zephyr Textile Limited**

**Annexure I**

<b>FINANCIAL SUMMARY</b> <i>(amounts in PKR millions)</i>			
<b><u>BALANCE SHEET</u></b>	<b>June 30, 2016</b>	<b>June 30, 2017</b>	<b>June 30, 2018</b>
Non-Current Assets	1,805	2,025	2,004
Stores, Spares. And Loose Tools	112	135	104
Stock-in-Trade	775	905	1,090
Trade Debts	447	350	659
Other Assets	280	316	355
<b>Total Assets</b>	<b>3,419</b>	<b>3,730</b>	<b>4,212</b>
Trade and Other Payables	388	367	666
Accrued Mark-up	14	16	22
Short Term Borrowings	710	982	1,159
Long-Term Borrowings <i>(Inc. current matur)</i>	747	744	581
Deferred Liabilities	232	225	225
Tier-1 Equity	<b>964</b>	<b>1,063</b>	<b>1,191</b>
<b>Total Equity</b>	<b>1,328</b>	<b>1,397</b>	<b>1,559</b>
<b><u>INCOME STATEMENT</u></b>	<b>June 30, 2016</b>	<b>June 30, 2017</b>	<b>June 30, 2018</b>
Net Sales	3,933	3,749	4,252
Gross Profit	397	430	486
Operating Profit	259	212	305
Profit After Tax	107	69	105
FFO	276	299	360
<b><u>RATIO ANALYSIS</u></b>	<b>June 30, 2016</b>	<b>June 30, 2017</b>	<b>June 30, 2018</b>
Gross Margin (%)	10.1%	11.5%	11.4%
Net Working Capital	325	142	197
FFO to Long-Term Debt	0.37	0.40	0.62
FFO to Total Debt (%)	0.19	0.17	0.21
Debt Servicing Coverage Ratio (x)	1.21	0.95	1.09
ROAA (%)	3.2%	1.9%	2.6%
ROAE (%)	11.8%	6.8%	9.3%
Gearing (x)	1.51	1.62	1.46
Debt Leverage (x)	2.17	2.19	2.23

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Annexure 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](http://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](http://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](http://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					Annexure III
<b>Name of Rated Entity</b>	Zephyr Textile Limited				
<b>Sector</b>	Textile				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<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>
	<b>RATING TYPE: ENTITY</b>				
	11/10/2018	BBB+	A-2	Stable	Initial
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	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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