RATING REPORT

Zephyr Textile Limited (ZTL)

REPORT DATE:
December 09, 2019

RATING ANALYSTS:
Fahim Haider
fahim.haider@vis.com.pk

Maimoon Rasheed
maimoon@vis.com.pk

RATING DETAILS				
	Latest Rating		Initial Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	BBB+	A2	BBB+	A2
Rating Date	*4th Dec 2019*		*11th Oct 2018*	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION

Incorporated in 1999	**External auditors:** Azhar Zafar & Co. Chartered Accountants
Public Limited Company	**Chairperson of the Board:** Ms. Tahniat Mussaid
Key Shareholders (with stake 5% or more):	**CEO:** Mr. Mussaid Hanif
Mr. Mussaid Hanif – 35.86%	
Mr. Burhan Muhammad Khan – 32.98%	
Ms. Sabah Burhan – 9.45%	
The Bank of Punjab, Treasury Division – 8.01%	
Ms. Tahniyat Mussaid – 6.78%	

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria: Corporates (May 2019)

https://www.vis.com.pk/kc-meth.aspx

Zephyr Textile Limited

OVERVIEW OF THE INSTITUTION

Zephyr Textile Limited (ZTL) was established in 1999 as a private limited company which was later on converted into public limited company in 2004. The company is involved in the production and sale of grey & finished fabric, towels and made ups. The company is listed on the Pakistan Stock Exchange. Registered office of the company is in Lahore while weaving unit is situated at Balloki Bhai Pheru Road & towel unit is situated at district Kasur.

Profile of the Chairperson

Ms. Tahniat Mussaid is a graduate in Accountancy from UK and has worked in Barclays Bank for about 3 years after graduation. She is not involved on every day matters of the company.

Profile of the CEO

Mr. Mussaid Hanif serves as the Chief Executive of the company. He has an MBA degree from LUMS and has over 20 years of experience in marketing, sales, and corporate management in some of prestigious textile companies in Pakistan.

Financial Snapshot:

Tier-1 Equity: end-FY19: Rs. 1.30b; end-FY18: Rs. 1.19b; end-FY17: Rs. 1.06b

Total Assets: end-FY19: Rs. 4.2b; end-FY18: Rs. 4.2b; end-FY17: Rs. 3.7b

Profit After Tax: end-FY19: Rs. 118m; end-FY18: Rs. 103m; end-FY17: Rs. 69m

RATING RATIONALE

ZTL is a weaving and finishing unit and primarily operates in grey and finished fabric, towel and made-ups. Shareholding of the company is mainly vested with the sponsoring family which is actively involved in the day to day affairs of the company. The company's expansion plans in near future are expected to bode well in terms of sales and margins, amidst increase in leverage indicators. The ratings are constrained by comparatively high gearing indicators and limited scale of operations, leading to heightened competitive challenges for the company.

Shareholding mainly vested with sponsoring family with adequate experience in textile sector

Shareholding structure of the company is mainly vested with the sponsoring family with controlling stake of 85.15%. Remaining shareholding mainly rests with general public and other institutions. Mr. Mussaid Hanif (CEO) and Mr. Burhan Muhammad Khan (Executive Director) cumulatively hold 68.84% shares of the company. The Board of Directors of ZTL comprises seven members including two executive directors, three non-executive directors & two independent directors. Board meetings are held at least on a quarterly basis.

Product Portfolio – focused on textile products like grey & finished fabric, towel, made ups etc.

The company is mainly engaged in the production and sales of grey & finished fabric, towel & textile made ups. The grey fabric production facility comprises 199 Air Jet looms which can weave up to 84.62m square meters of grey fabric per annum. The towel manufacturing unit comprises 45 looms with production capacity of 4,835 tons per annum. The total processing capacity of towel dyeing and processing unit is 5,700 tons per annum. The company recorded Rs. 315m in revenue from the sale of men's unstitched finished fabric during FY19 (FY18: Rs. 398m, FY17: Rs. 186m). However, given relatively long credit period in the men fabric business, the company intends not to grow further in the said business. Meanwhile, considering demand dynamics, the company has started production of ladies fabric rather recently. In addition, the company has also started commercial dying of knitted fabric for other companies as well.

The power requirement of ZTL is fulfilled through gas-fired power generation facility which has a total capacity of 4.5 megawatts against the maximum demand of 4.2 megawatts. In addition to that, the company has also Wapda connection for electricity supply in case of emergency.

Sales growth in towel segment increased on the back of both quantity and price increase while fabric sales stood marginally lower owing to decline in quantity despite higher average sales price

During FY19, sales of the company increased to Rs. 5.09b (FY18: Rs. 4.25b, FY17: Rs. 3.72b). The sales are mainly segregated into two segments, Fabric and Towel. Despite higher average price, the revenue from fabric segment decreased slightly to Rs. 2.22b during FY19 (FY18: Rs. 2.27b, FY17: Rs. 2.31b) on account of lower sales quantity. Contribution of sales from grey fabric (local sales) continues to decline to Rs. 1.47b (FY18: Rs. 1.61b, FY17: Rs. 1.83b) on a timeline basis. The towel sales stood higher at Rs. 2.85b during FY19 (FY18: Rs. 1.88b, FY17: Rs. 1.42b). The sales of towel segment is the largest segment in the revenue mix that constituted 56.1% (FY18: 44.4%, FY17: 38.02%) of overall sales in FY19 mainly (99%) emanating from export sales.

While gross profit increased to Rs. 524m during FY19 (FY18: Rs. 466m, FY17: Rs. 409m), gross margins decreased slightly to 10.3% (FY18: 10.9%; FY17: 11.0%) during

FY19 mainly due to relatively higher raw material price (mainly local yarn) which increased to Rs. 174/lbs (FY18: Rs. 154/lbs, FY17: Rs. 140/lbs) during FY19. The operating expenses of the company increased to Rs. 235m (FY18: Rs. 182m; FY17: Rs. 221m) mainly on account of higher distribution & administration expenses. Distribution expenses stood higher primarily on account of increase in freight charges. The freight charges increased in line with higher quantum of export sales along with increase in fuel prices. Administrative expenses increased in line with inflationary impact and also due to provision for credit sales amounting Rs. 5.6m (FY18: nil) during FY19. The said provision was recognized owing to change in accounting treatment of overdue receivables with the adoption of IFRS 9. Barring lower unwinding of discount of Rs. 10.3m (FY18: Rs. 48.8m) related to previously restructured loans, the finance cost increased to Rs. 134m (FY18: Rs. 109.1m) mainly on account of higher average interest rates during FY19. It is pertinent to note that the effective interest rate of the company is relatively low owing to utilization of SBP refinancing (ERF & LTFF) which carry discounted rates. Net profit stood slightly higher at Rs. 118m (FY18: Rs. 103m; FY17: Rs. 69m) during FY19 while net profit margin remained at 2.3% (FY18: 2.4%; FY17: 1.8%).

Days receivables decreased despite some increase in trade debts

The fixed assets of the company stood at Rs. 1.96b (FY18: Rs. 2.00b, FY17: Rs. 2.02b) at end-FY19. The company carried out CAPEX of Rs. 131m (FY18: Rs. 87.7m, FY17: Rs. 437m) during FY19. The company installed EPT Water Treatment plant during the year in order to comply with environmental regulations required by international buyers. At end-FY19, ZTL held total inventory worth Rs. 932m (FY18: Rs. 1,070m; FY17: Rs. 905m) which comprised finished goods inventory worth Rs. 564m (FY18: Rs. 760m, FY17: Rs. 609m). Trade receivables of the company increased to Rs. 712m during FY19 (FY18: Rs. 659m, FY17: Rs. 350m) while receivable days reduced to 51 days during FY19 (FY18: 57 days, FY17: 34 days). It is pertinent to note that more than 97% of these receivables are having ageing between 3 to 6 months. Trade deposits, prepayments & balances with statutory authorities stood at Rs. 213m during FY19 (FY18: Rs. 189m, FY17: Rs. 197m) which mainly constituted sales tax refundable of Rs. 153m (FY18: Rs. 139m, FY17: Rs. 147m) from government. Cash & bank balances remained modest and stood at Rs. 57m at end-FY19 (FY18: Rs. 30m, FY17: Rs. 52m).

Coverages and liquidity ratios remained adequate during FY19 which shows stability

Funds from operations (FFO) remained adequate and stood at Rs. 310m (FY18: Rs. 340m; FY17: Rs. 298m). In order to meet the working capital requirements, the company relies on short term borrowing which increased to Rs. 1.25b by end-FY19 (FY18: Rs. 1.16b; FY17: Rs. 982m) in line increase in sales. FFO to total debt ratio decreased to 18.0% (FY18: 19.5%; FY17: 17.3%) owing to slight decrease in FFO while FFO to long-term debt improved to 65.6% (FY18: 58.4%; FY17: 40.1%) on the back of declining trend in long-term borrowings. The debt service coverage ratio improved to 1.57x during FY19 (FY18: 1.41x; FY17: 0.95x). The current ratio remained stable at 1.10x (FY18: 1.10x; FY17: 1.09x). Inventory plus trade receivables to short-term borrowings decreased to 1.32x during FY19 (FY18: 1.49x; FY17: 1.28x).

Manageable leverage indicators with adequate equity base

Total equity base stood higher at Rs. 1.30b by end-FY19 (FY18: Rs. 1.19b; FY17: Rs. 1.06b) on the back of profit retention. Long term loan facility stood lower at Rs. 472m (FY18: Rs. 581m, FY17: Rs. 744m) on account of repayment of borrowings. During FY19, overall loan facilities remained at Rs.1.72b (FY18: Rs. 1.74b, FY17: Rs. 1.72b). Debt leverage decreased, though remained high at 1.99x (FY18: 2.24x, FY17: 2.19x) while gearing decreased to 1.32x (FY18: 1.46x, FY17: 1.62x) by end-FY19.

Plans for expansion in weaving and dying & stitching segments

The company plans major CAPEX of Rs. 1.27b during FY20. The said financing is proposed at debt to equity ratio of 70:30. The company intends to install 70 new looms worth Rs. 750m including 62 Picanol AirJet looms and 8 Jacquard looms while 32 existing Tsudakoma looms will be scrapped. In addition, the company is also planning to install new Yarn as well as Knit fabric dying, finishing & stitching machines. This will help in generating higher export orders thereby improving profit margins & sales of the company. The company is projected to generate sales of around Rs. 5.8b during FY20 while additional revenues from CAPEX would fully materialize during FY21 that are projected to reach Rs. 7.94b. Resultantly, leverage indictors are expected to increase while coverages are projected to remain adequate.

Zephyr Textile Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**June 30, 2017**	**June 30, 2018**	**June 30, 2019**
Non-Current Assets	2,025	2,004	1,963
Stock-in-Trade	905	1,070	932
Trade Debts	350	659	712
Loans and Advances	33	36	101
Trade Deposits, Prepayments & Balance with Statutory Authorities	197	189	213
Other Current Assets	168	220	237
Cash & Bank Balances	52	30	57
Total Assets	3,730	4,208	4,215
Trade and Other Payables	366	642	576
Short Term Borrowings	982	1,159	1,250
Long-Term Borrowings *(Inc. current matur)*	744	581	472
Total Interest Bearing Borrowings	1,726	1,740	1,722
Other Liabilities	241	285	289
Total Liabilities	2,333	2,667	2,587
Tier-1 Equity	1,063	1,190	1,301
Revaluation Reserves	334	351	326
Total Equity	1,397	1,541	1,627
INCOME STATEMENT	**June 30, 2017**	**June 30, 2018**	**June 30, 2019**
Net Sales	3,728	4,252	5,091
Gross Profit	409	466	524
Operating Profit	211	287	293
Profit After Tax	69	103	118
FFO	298	340	310
RATIO ANALYSIS	**June 30, 2017**	**June 30, 2018**	**June 30, 2019**
Gross Margin (%)	11.0	10.9	10.3
Operating Profit Margin (%)	5.7	6.8	5.8
Net Margin (%)	1.8	2.4	2.3
Current Ratio	1.09	1.10	1.10
Net Working Capital	141	196	210
FFO to Long-Term Debt (%)	40.1	58.4	65.6
FFO to Total Debt (%)	17.3	19.5	18.0
Debt Servicing Coverage Ratio (x)	0.95	1.41	1.57
(Inventory + Receivables) / S.T Borrowing	1.28	1.49	1.32
Debt Leverage (x)	2.19	2.24	1.99
Gearing (x)	1.62	1.46	1.32
ROAA (%)	0.9	1.3	4.2
ROAE (%)	3.2	4.6	11.2

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure 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	Zephyr Textile Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
4th Dec 2019	BBB+	A-2	Stable	Reaffirm
11th Oct 2018	BBB+	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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2019 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.