RATING REPORT

Zephyr Textiles Limited (ZTL)

REPORT DATE:
August 30, 2022

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	BBB+	A-2	BBB+	A-2
Rating Outlook	Positive		Positive	
Rating Date	*August 30, 2022*		*June 30, 2021*	

COMPANY INFORMATION	
Incorporated in 1999	External auditors: Azhar Zafar & Co. Chartered Accountants
Public Limited Company	Chairperson: Ms. Tehniyat Mussaid
Key Shareholders (More than 5%):	CEO: Mr. Mussaid Hanif
Mr. Mussaid Hanif – 35.9% Ms. Sabah Burhan – 20.1% Mr. Arbab Muhammad Khan – 8.9% Ms. Tehniyat Mussiad – 6.8%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (August 2021) *https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf*

Zephyr Textiles Limited

OVERVIEW OF THE INSTITUTION

Zephyr Textiles Limited (ZTL) was incorporated in 1999 as a private limited company which later on went public in 2004. The Company is involved in the production and sale of greige and finished fabric, towels and made ups. The company is listed on Pakistan stock Exchange. Registered office of the Company is in Lahore while weaving unit is situated at Balloki Bhai Pheru Road and towel unit at district Kasur.

Profile of the Chairperson

Ms. Tehniyat Mussaid is the chairperson of ZTL. She graduated in Accountancy from the UK, and has worked in the UK Barclays Bank for about three years.

Profile of the CEO

Mr. Mussaid Hanif is the CEO of ZTL. He holds an MBA from Lahore University of Management Sciences (LUMS) and has over twenty years of sales and management experience in the textile industry.

RATING RATIONALE

Zephyr Textiles Limited (ZTL) is a weaving and finishing unit and primarily operates in grey and finished fabric, towel and made-ups. In 2021, the Company added a new business segment of commercial dyeing of knit fabric for garment manufacturers. A public limited listed company, shareholding remains vested with the sponsoring family, which is actively involved in the day-to-day affairs of the company. Power requirement of ZTL when operating at full capacity is around 6 megawatts; the same is all internally provided through gas-fired power generation. Recently they have completed a 500KW solar power project while another 500KW is in the pipeline.

Strong performance across industry, however, sector remains exposed to inflationary pressures and risk of possible global slowdown in demand

Subsequent to posting export contraction in FY20 - owing to the pandemic-induced slowdown experienced in H2'FY20 – Pakistan's export base grew by 14% in FY21, which was partly attributable to a low base effect. As per SBP data, textile exports depicted growth of 28% during 11M'FY22 vis-à-vis corresponding period last year. In USD' terms textile exports have grown at a CAGR of 4.4% during the past 3-year period (FY19-FY21), despite depreciation in average USD/PKR parity of 24%, 16%, and 1% in FY19, FY20 and FY21 respectively.

The composition of textile exports has depicted improvement in the last 3-year period, but contribution from lower to medium value-added segment has decreased from 24.6% in FY19 to 19.2% in FY21 of aggregate textile exports

The margins of textile operators have broadly depicted improvement partly on account of inventory gains on sizable increase in cotton pricing and partly due to favorable exchange rate movement. Nevertheless, higher raw material pricing has increased the working capital requirements for textile operators, which is likely to weigh on the liquidity of textile operators. Going forward, challenges on the global economy front as well as the domestic front will weigh on the business risk profile of textile operators; these include waning demand dynamics internationally, and external account crisis on the domestic front, which may affect provision of utilities to exporters at competitive pricing.

Extension of business segment likely to contribute towards diversification

ZTL has been historically engaged in the production and sale of grey & finished fabric and, towels. Towels account for almost 50% of the total revenues and are mainly export based. Greige fabric sales on the other hand are predominantly locally based. However, both these segments have remained highly competitive and low margin. In addition, elevated working capital cycle more specifically with respect to local sales, prompted the Company to move into knitting segment. Initially, started shipments to mainly Srilanka with dyed knitted fabric for garment exporters. As per management, knitted sales for the full FY22 will account for about 10% of total sales. Company is committed to build further capacity in this segment for export of knitted garments and have been able to target a few European customers. This extension of product offering is likely to further improve diversification in the revenue stream as well as contribute towards margin improvement.

	FY21	%	9M FY22	%
Greige Fabric	1,973,056,654	32.6%	1,755,535,379	32.4%
Towel	3,187,188,378	52.6%	2,795,993,527	51.6%
Finished Fabric	195,472,194	3.2%	182,866,340	3.4%
Knitted	73,957,279	1.2%	128,252,404	2.4%
Yarn Sale	12,712,520	0.2%	1,584,280	0.0%
Conversion	618,405,808	10.2%	550,461,810	10.2%
	6,060,792,833		5,414,693,740	

Strong topline growth and margin improvement in the last two years

As a result of favorable demand dynamics as well as price increase, topline of the Company has experienced significant growth. *(FY22 expected to close at RS 7.2B)*. While volumes have increased, price increase impact has been more dominant. Moreover, in the recent outgoing year, rupee devaluation has also contributed towards margin improvement. Sustainability of the same going forward remains uncertain with possible slowdown expected in global markets especially in towel segment towards the 2nd quarter of FY23.

Sales remain mainly concentrated in Europe while client concentration is on the higher side.

Improvement in capitalization indicators. Adequate liquidity.

With higher profitability and improved cash generation pressure on short term working capital drawings reduced despite a large uptick in turnover. Long term debt also remained fairly contained. Higher profitability boosted equity base to Rs. 1.8b at the end of 9M FY22, leading to reduction in gearing and leverage indicators.

Liquidity indicators remain adequate with current ratio of 1.11x and short term debt coverage of 143% end-9MFY22. While no major capex is projected going forward, we remain cautious of the impact of inflationary pressures as well as raw material prices in the ongoing year in the wake of possible slowdown. VIS will continue to gauge maintenance of capitalization and liquidity indicators in line with the assigned ratings.

Zephyr Textiles Limited

Financial Summary (amounts in PKR millions)						Appendix I
	FY17	FY18	FY19	FY20	FY21	9MFY22
BALANCE SHEET						
Property Plant and Equipment	1,996	1,981	1,910	1,903	2,032	2,093
Stock-in-Trade	905	1,070	915	1,104	1,411	1,194
Trade Debts	350	659	712	709	824	627
Cash & Bank Balances	52	30	56	72	79	168
Total Assets	3,730	4,208	4,157	4,480	5,201	5,013
Trade and Other Payables	366	642	559	818	1,196	1,072
Long Term Debt (including current maturity)	744	581	472	416	501	320
Short Term Debt	982	1,159	1,250	1,320	1,269	1,272
Total Debt	1,726	1,740	1,722	1,736	1,769	1,592
Total Liabilities	2,333	2,667	2,570	2,866	3,290	2,924
Paid Up Capital	594	594	594	594	594	594
Total Equity (without surplus revaluation)	1,063	1,149	1,261	1,311	1,630	1,823
INCOME STATEMENT						
Net Sales	3,728	4,252	5,091	4,326	6,129	5,381
Gross Profit	409	466	524	402	808	597
Profit Before Tax	89	129	149	76	361	263
Profit After Tax	69	103	118	55	302	208
RATIO ANALYSIS						
Gross Margin (%)	10.97%	10.95%	10.29%	9.29%	13.18%	11.10%
Net Profit Margin	1.84%	2.43%	2.32%	1.27%	4.93%	3.86%
Current Ratio	1.09	1.10	1.08	1.10	1.11	1.11
Net Working Capital	141	196	170	228	307	295
FFO	298	340	310	253	485	264
FFO to Total Debt (%)	17.29%	19.51%	17.99%	14.58%	27.43%	22.02%
FFO to Long Term Debt (%)	40.10%	58.42%	65.64%	60.90%	96.97%	109.69%
Debt Servicing Coverage Ratio (x)	0.95	4.34	1.57	1.62	2.69	2.14
Short-term Debt Coverage (%)	1.28	1.49	1.30	1.37	1.76	1.43
ROAA (%)	0.92%	2.61%	2.82%	1.28%	6.24%	5.41%
ROAE (%)	3.22%	9.35%	7.64%	3.44%	17.14%	13.81%
Gearing (x)	1.62	1.51	1.37	1.32	1.09	0.87
Leverage (x)	2.19	2.32	2.04	2.19	2.02	1.60

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	Zephyr Textiles 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				
	30-08-2022	BBB+	A-2	Positive	Reaffirmed
	30-06-2021	BBB+	A-2	Positive	Maintained
	23-04-2020	BBB+	A-2	Rating Watch - Negative	Maintained
	12-04-2019	BBB+	A-2	Stable	Reaffirmed
	10-11-2018	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.				
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Due Diligence Meetings Conducted		**Name**	**Designation**	**Date**	
	1	Mr. Naveed Aleem	CFO	18-July-2022	