RATING REPORT

Zephyr Textiles Limited

REPORT DATE:
December 11, 2024

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	BBB+	A2	BBB+	A2
Outlook/Rating Watch	Stable		Positive	
Rating Action	*Maintained*		*Reaffirmed*	
Rating Date	*December 11, 2024*		*November 17, 2023*	

COMPANY INFORMATION	
Incorporated in 1999	**External Auditors:** BDO Ebrahim & Co., Chartered Accountants
Public Listed Company	**Chairperson:** Ms. Tehniyat Mussaid
Key Shareholders (with stake 10% or more):	**Chief Executive Officer:** Mr. Mussaid Hanif
Mr. Mussaid Hanif ~36.4%	
Ms. Sabah Burhan ~20.1%	
General Public (local) ~19.6%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporate *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*

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

RATING RATIONALE

Corporate Profile

Zephyr Textiles Limited ('ZTL' or 'the Company') is a textile convertor that operates a greige fabric and towel weaving unit, a towel dyeing and processing unit and a newly established garment processing unit. The Company's headquarters are located in Lahore, with its weaving and power plant situated in Bhai Pheru and the towel unit located in the Kasur District.

ZTL's total power requirement is approximately 5 MW, with the weaving unit consuming 4 MW and the dyeing and processing unit consuming 1 MW. Of the total, 4 MW is supplied by gas-powered generators and WAPDA, while 1 MW is sourced from solar panels.

Operational Performance

Table 1: Capacity and Production (Millions)

Fabric Weaving Unit	FY21	FY22	FY23	FY24
Installed Capacity (Square Meters in Millions)	84.6	84.6	81.9	49.1
Actual Production (Square Meters in Millions)	74.7	69.8	58.9	36.6
Capacity Utilization %	88.3%	82.5%	71.8%	74.6%
Towel Weaving Unit				
Installed Capacity (Tons)	4,835	4,835	4,835	5,362
Actual Production (Tons)	4,614	3,953	3,992	4,397
Capacity Utilization %	95.4%	81.8%	82.6%	82.0%
Towel Dyeing and Processing Unit				
Installed Capacity (Tons)	6,245	6,372	6,372	6,799
Actual Production (Tons)	4,556	4,783	4,393	5,339
Capacity Utilization %	73.0%	75.1%	68.9%	78.5%

Fabric Weaving Unit

In FY24, ZTL reduced the capacity of its fabric weaving unit as part of a strategic decision made in the previous year to discontinue the sale of greige fabric in the local market, resulting in lower production levels. The proceeds from the disposal of looms will be reinvested into the infrastructure for the Company's knitwear and garment business.

Towel Weaving Unit

Following the reduction in the fabric weaving unit, a number of looms were retained and repurposed for the towel weaving unit, optimizing equipment utilization and enhancing production capacity.

Towel Dyeing and Processing Unit

The capacity of the towel dyeing and processing unit increased, along with actual production, resulting in a rise in capacity utilization from 68.9% to 78.5% in FY24. Additionally, new dyeing, cutting and stitching units are being established to meet the growing demand from the export markets in Europe and America.

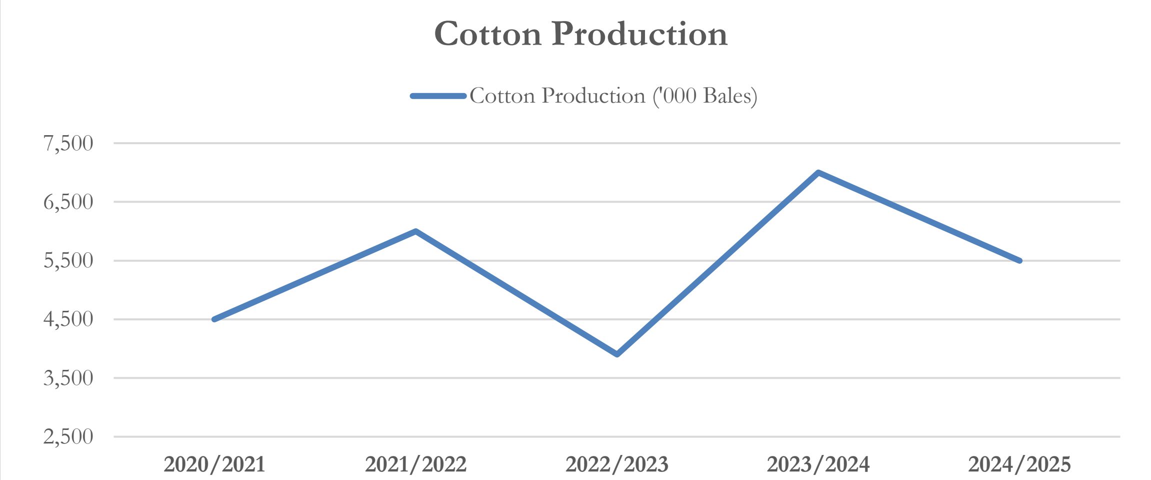
Sector Update

The business risk profile of Pakistan's textile sector is highly influenced by economic cyclicality and intense competition. The sector's performance is closely tied to broader economic conditions, making it particularly vulnerable to demand fluctuations driven by these factors.

experience in the textile industry.

In FY23, the textile sector faced several challenges stemming from both economic and environmental factors. These included damage to the cotton crop due to flooding in the 1HFY23, escalating inflation, and import restrictions resulting from dwindling foreign exchange reserves. As a result, Pakistan's yarn production saw a substantial decline, primarily driven by the reduced availability of cotton caused by crop damage and import restrictions. The sector's profitability was further constrained by rising production costs, including higher raw material and energy expenses, which impacted profit margins.

In FY24, cotton production increased by 79% compared to FY23, but this surge was largely due to the low base of cotton production in FY23. When compared to FY22, cotton production in FY24 saw only a 17% increase. While global cotton production is expected to rebound in FY25 due to higher yields, Pakistan's cotton production was down 59.4% as at October'24 compared to the same period in 2023, with only 2.04 million bales produced. The USDA forecasts that Pakistan will produce 5.55 million bales of cotton in 2024/25. Further, the USDA Foreign Agricultural Service estimates that the cotton area in 2024/25 will be reduced to 2 million hectares, down from previous years. The country faces rising energy costs, the absence of subsidies for agricultural inputs, and a lack of an organized market system, which further complicates production. Additionally, climate change has severely impacted cotton crops, with extreme heat, heatwaves, torrential rains, and pest infestations, including whitefly, pink bollworm, and cotton leaf curl virus, contributing to decreased yields. Furthermore, the area under cultivation has been steadily shrinking, exacerbating these challenges.



Source: USDA

Despite the decline in local cotton production, Pakistan's textile exports have experienced growth in the 1QFY25 compared to the same period last year. This growth can be attributed to the reliance on imported cotton which is cheaper now a days compared to local cotton along with the increasing focus on value-added segment. While the global demand of textile is on a recovery phase, the global and local cotton market dynamics and local inflation including fuel and power prices along with FX risk in imported cotton pricing will play a crucial role in terms of profitability of the textile exporters.

Figure 1: MoM Textile Exports (USD Million)
Source: SBP

Key Rating Drivers

Topline Witnessed Subdued Growth

In FY24, revenue increased by 3.6%, reaching Rs. 8.4 billion, compared to Rs. 8.1 billion in FY23. This growth was primarily driven by a significant Y/Y increase in export volumes, which rose by 224%, while local volumes declined by 21%, in line with the management's strategy. It is important to note that the Company decided to phase out the sale of greige fabric locally two years ago, shifting its focus to knitted products and a newly launched garment segment. Despite the overall growth, the increase in sales for FY24 was relatively modest due to a lower depreciation of the rupee compared to FY23.

In FY24, the share of export sales rose to 69% (FY23: 64%), driven by the Company's strategic shift towards international markets. This increase in export focus is aligned with the management's long-term vision to further expand in the global market. Going forward, the Company expects the proportion of export sales to rise to 80% in FY25, reflecting their continued emphasis on strengthening their export segment and reducing reliance on the local market.

Table 2: Sales Breakup

Export vs Local			
	2022	**2023**	**2024**
Local Sales	50%	36%	31%
Export Sales	50%	64%	69%

Regarding the client base, the top 10 clients contributed 53% of total revenue in FY24 (FY23: 58%), with the top five clients contributing 37% indicating a moderate level of client concentration. Furthermore, ZTL uses letters of credit and export cash against documents, ensuring guaranteed payment.

The Company's key export markets in FY24 remained consistent with FY23, including Italy, France and Germany contributing 19%, 17% and 14%, respectively. Cumulatively, the share of the top 3 export destinations stood at 52% in FY24 (FY23: 54%). Looking ahead, management anticipates modest growth in the top line.

Profitability Adversely Impacted by Higher Cost of Sales, Operating Expenses and Finance Cost

The cost of sales exhibited a modest increase to Rs. 7.5 billion in FY24, up from Rs. 6.9 billion in FY23, primarily due to an exceptional rise in energy costs because of the withdrawal of subsidies previously provided to the export industry. Additionally, ZTL acquired slightly less yarn in FY24 in comparison to FY23, driven by a strategic shift from producing greige fabric to focusing more on value-added products, such as knitwear and garments. However, the cost of yarn increased by 3% Y/Y. As a result, gross profit declined to Rs. 0.9 billion from Rs. 1.2 billion in FY23 leading to a gross margin of 10.7% (FY23: 15.1%).

Operating expenses grew in line with increased sale and inflation with a significant decrease in other operating expenses due to a decrease in Workers' Profit Participation Fund, Workers' Welfare Fund and expected credit loss against trade debtors. Despite the decrease, operating profit margin declined to 2.3% (FY23: 5%). On the other hand, other income primarily increased due to dividend income and proceeds from sale of fixed assets.

In addition, finance costs increased by 54% to Rs. 293 million in FY24 from Rs. 190 million. Consequently, net profit decreased to Rs. 45 million from Rs. 238 million in FY23 bringing the net profit margin to 0.5% from 3% in FY23. In FY25, operating and net profit margins are anticipated to remain stable.

Liquidity profile remained adequate despite a decline in Cash Flow and Debt Coverage

In FY24, ZTL's liquidity position was kept within a manageable range as the current ratio decreased to 1.00x (FY23: 1.07x) and the short-term debt coverage from inventory and trade receivables remained intact. The Company's net operating cycle remained stable with a marginal decline in receivable, inventory and payable days. Going forward, enhancing the liquidity position is crucial from the rating perspective.

In FY24, ZTL's FFO significantly decreased to Rs. 33 million from Rs. 679 million in FY23 led primarily due to a sharp decline in net profit. The reduction in FFO resulted in a deterioration in FFO to long-term debt to 0.51x (FY23: 9.09x) and FFO to short-term debt to 0.02x (FY23: 0.52x). Additionally, the decline in cash flow coverage led to a decrease in the debt service coverage ratio (DSCR) to 0.99x (FY23: 1.95x), reflecting the significant drop in profitability.

Looking ahead, an improvement in cash flow coverage ratios is anticipated, driven by a strategic focus on high margin, value-added products and ongoing efforts to enhance operational efficiencies.

Gradual Improvement in Capitalization Indicators

At the end of FY24, ZTL's equity base, excluding surplus on revaluation, increased marginally to Rs. 2.1 billion, up from Rs. 2 billion at the end of FY23 due to higher accumulated profit. Furthermore, total debt increased to Rs. 1.44 billion (FY23: 1.38 billion), driven by a 4% increase in short-term debt, which grew to Rs. 1.4 billion (FY23: Rs. 1.3 billion). Despite the increase in debt, the Company's gearing and leverage improved to 0.69x (FY23: 0.71x) and 1.50x (FY23: 1.71x) at the end of FY24, respectively, reflecting a reduction in financial risk.

Looking ahead, ZTL plans to invest in stitching machines for which funding will be sourced internally. As a result, capitalization indicators are anticipated to remain stable.

Zephyr Textiles Limited Appendix I

Financial Summary (amounts in PKR millions)				Appendix I
BALANCE SHEET	**FY21**	**FY22**	**FY23**	**FY24**
Property Plant and Equipment	2,032	2,050	2,421	2,675
Stock-in-Trade	1,411	1,342	1,457	1,539
Trade Debts	824	661	557	558
Cash & Bank Balances	79	65	156	58
Total Assets	5,201	5,177	5,875	5,700
Trade and Other Payables	1,196	1,196	1,603	1,413
Long Term Debt (including current maturity)	501	330	119	87
Short Term Debt	1,269	1,295	1,313	1,371
Total Debt	1,769	1,625	1,432	1,458
Total Liabilities	3,290	3,074	3,345	3,125
Paid Up Capital	594	594	594	594
Total Equity (without surplus revaluation)	1,630	1,735	1,956	2,088
INCOME STATEMENT	**FY21**	**FY22**	**FY23R**	**FY24**
Net Sales	6,129	7,384	8,103	8,394
Gross Profit	808	739	1,222	897
Profit Before Tax	361	261	371	151
Profit After Tax	302	182	238	46
RATIO ANALYSIS	**FY21**	**FY22**	**FY23**	**FY24**
Gross Margin (%)	13.2%	10.0%	15.1%	10.7%
Net Profit Margin	4.9%	2.5%	2.9%	0.5%
Current Ratio	1.11	1.07	1.07	1.00
Net Working Capital	307	203	211	-6
FFO	485	278	679	33
FFO to Total Debt (x)	0.27	0.18	0.49	0.02
FFO to Long Term Debt (x)	0.97	0.98	9.09	0.51
Debt Servicing Coverage Ratio (x)	2.22	0.78	1.95	0.99
Short-term Debt Coverage (x)	1.76	1.55	1.53	1.53
ROAA (%)	6.2%	3.5%	4.3%	0.8%
ROAE (%)	17.1%	9.1%	10.3%	1.8%
Gearing (x)	1.09	0.91	0.71	0.69
Leverage (x)	2.02	1.77	1.71	1.50
Net Operating Cycle (days)	63	47	27	24

REGULATORY DISCLOSURES — Appendix II

Name of Rated Entity	Zephyr Textiles Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Outlook/Rating Watch	Rating Action
11-12-2024	BBB+	A2	Stable	Maintained
17-11-2023	BBB+	A2	Positive	Reaffirmed
30-08-2022	BBB+	A2	Positive	Reaffirmed
30-06-2021	BBB+	A2	Positive	Maintained
23-04-2020	BBB+	A2	Rating Watch – Negative	Maintained
12-04-2019	BBB+	A2	Stable	Reaffirmed
10-11-2018	BBB+	A2	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. Naveed Aleem	CFO	November 27, 2024