RATING REPORT

Soorty Enterprises (Private) Limited

REPORT DATE:
May 24, 2021

RATING ANALYSTS:

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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AA-	A-1	AA-	A-1
Rating Date	*May 24, 2021*		*March 25, 2020*	
Rating Outlook	Stable		Stable	
Outlook Date	*May 24, 2021*		*March 25, 2020*	

COMPANY INFORMATION	
Incorporated in 1984	**External auditors:** Kreston Hyder Bhimji & Co. Chartered Accountants
Private Limited Company	**Directors:** - Mr. Shahid Rashid Soorty (CEO & Managing Director) - Mrs. Nargis Shahid Soorty - Mr. Asad Shahid Soorty

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (April 2019) https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Soorty Enterprises (Private) Limited

OVERVIEW OF THE INSTITUTION

Soorty Enterprises (Private) Limited (SEL) was incorporated as a Private Limited Company on March 12, 1984.

SEL is a family owned business with major shareholding resting with Mr. Shahid Rashid Soorty. He has been associated with SEL since the past three decades and is currently the CEO & Managing Director of the company.

SEL is compliant with International Social and Environmental & Quality standards. SEL owns 99.99% shareholding in Soorty Textiles (BD) Limited which is involved in the manufacturing of denim garments. The company also has a wholly owned subsidiary in UAE involved in investment in securities and providing textile related services. The company has a Marketing and Display Center in Amsterdam and a Product Development Center in Turkey.

RATING RATIONALE

Soorty Enterprises (Private) Limited (SEL) is one of the leading denim fabric and garment manufacturers in the country with vertically integrated operations. SEL operates through various units at different locations in Landhi and Korangi, Karachi and Nooriabad, Pakistan, comprising spinning, denim weaving, garments and washing units. The Company also has international presence through a subsidiary in Bangladesh, a marketing company in United Arab Emirates, a Research, Development and Design Office in Amsterdam, Netherlands and a Product Development Center in Turkey.

The company has also diversified operations through investments in the power (Rs. 506.5m) and industrial gases (Rs. 863.954m) and Private Equity Fund (Rs. 0.487.216m) at end-Mar'21. Short term investment portfolio of the company was reported at Rs. 5.4b (FY20: Rs. 7.9b, FY19: Rs. 536m) at end-Mar'21 comprising shares of one marketable security and investment in mutual funds.

Key Rating Drivers

Satisfactory operating track record noted across all three segments with one-off decline noted in FY20 on account of COVID-19; however the same has been re-couped in the ongoing year.

During FY20, the company's installed capacity of the spinning and garments division increased. As a result of capacity growth and decline in productivity amidst COVID-19, utilization levels of the spinning and garments division decreased during FY20. However the same has witnessed an uptick in the ongoing year due to slight improvement in economic conditions. The company currently meets around 90% of its yarn requirement in-house. Utilization of the fabric division remained at high levels during FY20 and the ongoing year.

Expansion plans spread out all operating segments

Company's expansion plans are ongoing in all three operating segments which are targeted to be completed over the next 3 years. Financing of the expansion plans will be done through an estimated 65:35 mix of debt (concessionary rate borrowings comprising TERF and LTFF) to equity. In addition to capital expenditures pertaining to core operations, the company also has plans to incur investments for sustainability requirements and to remain compliant with best practices.

Moderate business risk profile supported by stable and growing demand for denim products; US-China Trade disruption has enhanced sales as major buyers continue to diversify procurement. Even though implications of the third wave of Covid-19 remain elevated, we expect the order book for the company to remain strong in the ongoing year, easing our business risk apprehensions.

Business risk profile is supported by stable and growing demand for denim products. VIS expects demand for denim products to remain stable over the medium term. Given the favorable policies & incentives of the government on enhancing exports and trade disruption between US and China, there is significant opportunity for local players to enhance exports. However, local and international expansion by major players is expected to keep pricing war which will keep margins in check. Moreover, significant investment required by customers as part of sustainability initiative is expected to add to cost pressures for denim manufacturers. Company is also increasing its share in US markets gradually and expect to gain pace with improvement in COVID-19 related issues. Increased expansion by leading denim and non-denim textile players is also on account of favorable demand and expected increase in orders. Even though implications of the third wave of Covid-19 remain elevated, we expect the order book for the company to remain strong in the ongoing year, easing our business risk apprehensions.

Sales growth witnessed in FY20 emanated from the denim fabric segment. Garments exports continue to dominate the company's sales mix. Going forward, in the medium term, management envisages sales revenue to depict surge on the back of expansions across the value chain.

Sales revenue of the company posted a growth of 4% in FY20 despite COVID led slowdown in the economy. Fabric segment sales reported an increase of 28% during FY20 provided with a combined sales mix. On the flip side, due to deferment of garments orders, garments sales declined by 2% during FY20 provided by a 19%

decline in volumes and 12% increase in average selling prices. Exports comprise around 96% of the sales revenue. Product mix of the company depicts contribution of denim fabric sales increasing to around 33% (FY19: 28%) of overall sales with remaining revenues emanating from garment sales. Going forward, management expects fabric: garments sales mix to clock in the ratio of 30:70. Geographic sales mix demonstrates higher concentration of fabric sales directed to Bangladesh and garment sales directed to the European market. The management is also looking to increasingly tap the US market with new clients added during the ongoing year. The company regained its sales growth in both segments during 9MFY21 led by sizeable order backlog.

Given higher concentration in the European market, uncertainty of order deferment remains given lockdowns in major countries of Europe. Increased focus on research and development and training and branding is being undertaken to sustain the company's image in the international markets. Going forward, in the medium term, management envisages sales revenue to depict surge on the back of expansions across the value chain.

Overall profitability of the company was subdued during FY20 on account of decline in gross margins, exchange losses on forward exchange contracts, provision for doubtful trade debts, limited exchange gain on exports, and reduced dividend income. Going forward, VIS expects profitability profile to improve on the back of volumetric growth in sales post increase in capacities over the rating horizon.

Gross Margins (GMs) of the company compare favorably to denim and non-denim textile operators in ongoing 9MFY21 period; however, the same witnessed a decline during FY20 primarily on the back of higher cotton prices, discounts to customers and depreciation charges. GMs of the company improved during 9MFY21 on account of volumetric growth along with inventory gains. The company envisages margins to maintain at similar levels in view of expansion across the value chain. Subdued operating profit during FY20 was on account of shut down in international retail sectors, exchange losses on forward exchange contracts, provision for doubtful trade debts, and limited exchange gain on exports. Quantum of dividend income reduced by half during FY20. Going forward, management expects dividend income to remain subdued but slightly improved as compared to FY20 levels. Risk of increase in interest rates on profitability is projected to remain limited due to low leveraged capital structure and concessionary rate borrowings. Going forward, VIS expects profitability profile to improve on the back of volumetric growth in sales post increase in capacities over the rating horizon.

Despite declining cash flow coverages during FY20, liquidity indicators are considered adequate. Moreover, liquidity profile of the company is considered strong given sizeable liquid assets on the balance sheet.

Albeit declining cash flow coverages amidst COVID-19, liquidity profile of the company is considered adequate in view of sufficient cash flows in relation to outstanding obligations and ageing profile of trade debts which remain within manageable levels. Funds flow from operations is expected to remain sufficient for funding all planned capital expenditure. Liquidity profile also draws strength from sizeable liquid assets on the balance sheet comprising cash and bank balances, and investments in mutual funds. With majority payment of cotton being made upfront (local cotton is procured on cash and imported cotton is obtained on site LC), and higher time to collect receivables and inventory days, SEL's working capital cycle necessitates utilization of short term borrowing. Given projected improvement in profitability profile, cash flow coverage of outstanding obligations is also expected to increase led by debt re-payments.

High equity base enabled the company to be resilient against economic shocks amidst COVID-19. Capitalization profile supported by low leveraged capital structure and conservative financial policy

The company's historical stance of maintaining very low dividend payouts and funding its expansions through limited debt is reflective of a conservative financial policy. Equity base of the company have grown at a healthy pace over the last three years due to profit retention. Debt carried on the balance sheet comprises short-term debt to fund working capital requirements and long term debt to finance expansion plants. Given company's projections to finance its expansions through internal cash flows and concessionary rates Long Term Financing Facility and Temporary Economic Refinance Facility, leverage and gearing indicators are expected to increase going forward; however the same are projected to remain commensurate with benchmarks for the assigned ratings.

Adequate corporate governance infrastructure

Overall scope and functioning of internal audit and IT function are considered adequate. Given the company's nature as a private limited company, there is significant room for improvement in board composition and oversight.

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY19**	**FY20**	**9MFY21**
Paid Up Capital	150	150	150
Total Equity	34,830	37,143	40,721
INCOME STATEMENT			
Net Sales	38,153	39,546	33,001
Profit Before Tax	5,960	2,382	3,909
Profit After Tax	5,933	2,229	3,579
RATIO ANALYSIS			
Adjusted FFO	8,193	4,540	5,952
Current Ratio (x)	1.7	1.6	1.7
Gearing (x)	0.35	0.44	0.44

ISSUE/ISSUER RATING SCALE & DEFINITION 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	Soorty Enterprises (Private) Limited
Sector	Textile Industry
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		
May 24, 2021	AA-	A-1	Stable	Reaffirmed
March 25, 2020	AA-	A-1	Stable	Reaffirmed
December 31, 2018	AA-	A-1	Stable	Reaffirmed
March 22, 2018	AA-	A-1	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. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Abid Lakhani	Manager Finance	04-May-2021
2	Mr. Waqas Moosani	Manager Finance	04-May-2021