

RATING REPORT

Soorty Enterprises (Private) Limited

REPORT DATE:

July 07, 2023

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 Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	
Rating Date	July 07, 2023		May 30, 2022	

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)

VIS Entity Rating Criteria: Industrial Corporates (May 2023)

<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>

Soorty Enterprises (Pvt.) Limited

OVERVIEW OF
THE
INSTITUTION

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

Profile of CEO/MD:

Mr. Shahid Rashid Soorty is a major shareholder of the company. He has been associated with SEL since the past three decades and is currently the CEO & Managing Director of the Company.

RATING RATIONALE

Corporate Profile

Founded as a garment tailoring shop in the early 1980s, Soorty Enterprises (Private) Limited (SEL) has since grown to become a top-tier denim fabric and garment manufacturer with vertically-integrated operations. The company has a strong global presence with subsidiaries in Bangladesh and UAE and marketing offices in Netherlands and Turkey. Production infrastructure is based in Karachi, supported by a workforce of over 20,000 employees.

The average energy demand of 45 MW is primarily met through gas generators, with backup options including national gridline, diesel and furnace oil-based generators, and solar power. Additionally, the company is pursuing a biomass project for transitioning towards alternative energy sources.

Strategic Investment Portfolio

At present, long-term investments in subsidiaries comprise two entities, i.e., Soorty Textiles (BD) Limited and Soorty International Limited, while associated investments include Liberty Power Tech Limited, Pakistan Oxygen Limited, Lakson Private Equity Fund, and Pakistan Aluminum Beverage Cans Limited.

Environmental, Social, & Governance (ESG) Initiatives

SEL's denim fabric mill and garment factories are certified with LEED Platinum and Cradle-to-Cradle Gold, showcasing a commitment to energy efficiency, environmental design, and sustainability. ISO 9001:2000 certification further ensures international quality standards across production units. The company also holds Alliance for Water Stewardship (AWS) certification, operates a water recycling system, and actively pursuing a comprehensive Clean Water plan, collaborative partnerships, and knowledge-sharing events to promote responsible water usage. In terms of energy conservation, solar panels, wind power projects, and a Passive Denim Drying System have been introduced, which led to a 50% reduction in greenhouse gas emissions. Future plans involve replacing coal-fired boilers with high-efficiency boilers and waste heat recovery systems by 2027 and transitioning to biomass boilers by 2024.

SEL has implemented a comprehensive waste management system that categorizes waste into domestic and post-industrial segments, focusing on recycling and responsible practices to minimize operational waste impact. Additionally, the in-house recycling facility collects and sorts used denim, fabric waste, and garment waste bales, which are then shredded, refined, and transformed into recycled bales, serving as raw materials for various applications. The company also participates in tree plantation projects, such as Soorty Forest Rescue Initiative, utilizing WaterBoxx technology for urban forest creation, mass-plantation efforts in the Thar Desert, and partnering with WWF for mangrove plantation drives along Karachi's coastline.

Other initiatives include Prism Project, hiring hearing-impaired individuals in noisy laundry areas, and turning disabilities into strengths. Organic Cotton Initiative engages 1,000 farmers, promoting livelihoods, financial inclusion, women's training, and clean water access. Women's Service program uses street theater to advocate for female employment.

Capacity expansion project undertaken during the review period and future plans

Spinning Segment – Since the last review, installed capacity has risen with the installation of 24,000 spindles and 1,440 rotors in the Nooriabad spinning unit. Management plans to further expand capacity by ~59% through the installation of another 24,000 spindles by Dec’23, which will be funded through internal capital generation.

Weaving Division – The company added 98 new looms in FY22 and upgraded machinery this fiscal year to improve efficiency and productivity. This resulted in a ~17% increase in installed capacity.

Operating Performance

SEL, with its headquarters in Karachi, operates spinning, denim weaving, garment production, and washing units across locations such as Landhi, FBA, Korangi, and Nooriabad. Despite a timeline increase in production levels, capacity expansion in the spinning segment led to lower utilization this fiscal year. Conversely, denim fabric and garment production levels exhibited a contrasting trend, declining this fiscal year following an increase in FY22, attributed to the global demand slowdown. Management expects capacity utilization to range between 70-80% going forward.

Figure: Capacity & Production Data (Units in millions)

	FY21	FY22	9M’FY23
Denim Spinning			
No. of spindles installed	56,400	56,400	80,400
No. of rotors installed	1,080	1,080	2,520
Installed Capacity – Kgs	31.1	32.2	37.6
Actual Production – Kgs	29.9	31.0	23.8
Denim Fabric			
No. of looms installed	478	576	576
Installed Capacity – Meters	78.0	91.2	68.4
Actual Production – Meters	56.2	76.0	38.0
Denim Garments			
Installed Capacity – Pieces	32.4	32.4	24.3
Actual Production – Pieces	23.2	31.0	17.8

Key Rating Drivers

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, demand slowdown, high interest rate situation, inflationary pressures and recent floods adversely affecting cotton crop while ongoing energy crisis in the country pose a challenge to margins sustainability and future growth.

Pakistan’s export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally broke the threshold, coming in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country’s GDP, with an estimated market size of around Rs. 4.0tr. In addition, textile sector has maintained an average share of about 60% in national exports.

Figure: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22	10M’FY22	10M’FY23
Pakistan Total Exports	22,536	25,639	32,450	26,858	23,211
Textile Exports	12,851	14,492	18,525	15,174	14,178
PKR/USD Average rate	158.0	160.0	177.5	174.4	245.4

Source: SBP

Export revenues from textile sector have noted sizeable growth over the years (FY22: \$19.3b FY21: \$15.4b; FY20: \$12.5b; FY19: \$13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports in FY22. However, current fiscal year has been significantly impacted and 10M export proceeds (in value terms) reflect a year-on-year (YoY) decline of ~14%.

Figure: Textile Export Details (in USD millions)

	FY20	FY21	FY22	10M'FY22	10M'FY23
High Value-Added Segment	9,669	12,427	15,605	12,908	11,337
- Knitwear	2,794	3,815	5,121	4,218	3,712
- Readymade Garments	2,552	3,033	3,905	3,214	2,905
- Bed wear	2,151	2,772	3,293	2,727	2,250
- Towels	711	938	1,111	928	825
- Made-up Articles	591	756	849	710	585
- Art, Silk & Synthetic Textile	315	370	460	385	343
- Others	555	743	866	725	718
Low to medium Value-Added Segment	2,858	2,972	3,717	3,074	2,372
- Cotton Cloth	1,830	1,921	2,438	2,006	1,685
- Cotton Yarn	984	1,017	1,207	1,006	637
- Others	43	34	72	62	51
Total	12,527	15,399	19,332	15,982	13,709

Source: PBS

Cotton prices rose to a new 12-year high of ~Rs. 22,935/maund as of Sept'22 driven by a scarcity of cotton resulting from the recent floods that impacted the local cotton production. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Figure: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	10M'FY23
Per Maund	8,770	8,860	13,000	17,380	20,235
YoY % Change	26%	1%	32%	34%	n/a

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than \$2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dyeing companies.

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

Ratings continue to drive strength from strong market position as a leading exporter.

With an operating history of over three decades, SEL is one of the leading manufacturers and exporters of denim fabric and garments, ranked sixth amongst the top ten exporters in

the country in FY22. Ratings also take into account the inherent business risk of the denim sector.

Robust growth in sales revenue in FY22; however, recent demand slowdown impacted volumetric sales growth this fiscal year.

Net sales, while reaching nearly Rs. 69b mark in FY22, reported a 5-Year CAGR of ~12% for the period (FY17-22). The sizeable YoY uptick of ~55% (exceeding projected growth) can be explained by a ~22% uptick in volumes, ~18% higher prices in dollar terms, and a ~15% rupee devaluation impact. In terms of segments, denim garment, and fabric volumetric sales noted YoY growth of ~32% and ~11%, respectively, in line with strong demand and increased capacity.

While predominantly export-oriented, with over 92% share in revenues on a timeline, the company has seen a notable increase in domestic sales this fiscal year, particularly in the yarn segment, driven by increased demand due to regional yarn shortages. Currently, denim garment exports generate more than two-thirds of total sales, while the remaining portion comes from denim fabric, yarn, and sewing thread sales, including both local and export segments. With the global slowdown in fabric demand, management anticipates a further increase in garment sales contribution in the future. The geographic sales mix is well-diversified, with Europe representing almost half of the total exports, while Bangladesh, US, and Canada contribute the rest. With the successful onboarding of key clients such as Levis, JC Penny, and Contour in the US, management expects its market share to grow in the coming years. Client concentration remains high, with the top ten clients consistently generating more than three-fifth of entire revenues.

Despite the global economic downturn impacting volumes and growth in the current fiscal year, revenues for 9M FY23 amounted to Rs. 53.9b. Management expects net sales to exceed the previous year's level, driven by improved sales order bookings in the last quarter and consistent rupee depreciation.

Record high bottom-line noted in FY22 due to sizeable exchange gains. Profitability margins returned to historic level in the current fiscal year; debt coverage metrics remain strong.

Profitability margins, both gross and net, following a surge (record-high levels) in FY22, have reverted to historic levels in the current fiscal year due to higher expenses for raw materials, salaries, and power. Cotton procurement cost has more than doubled in the past 21 months, while a significant dip is noted in procured volumes this fiscal year. Adequate stock levels are maintained to fulfill confirmed sale orders, with a balanced ratio of 50:50 between imported and locally sourced cotton. Administrative and selling overheads grew considerably over the review period, while financing charges have nearly doubled due to a sizeable jump in debt levels and higher benchmark rates. However, sizeable exchange gains and dividend income from equity and mutual fund investments provide significant support to the profitability profile.

Debt coverage metrics have remained strong and aligned with the peer median. The cash conversion cycle showed improvement, decreasing from 278 days in FY20 to 219 days in FY22, attributed to timeline reduction in inventory holding and debtor days. The aging profile of trade debts is sound, as ~99% of receivables are settled within 180 days, and no bad debt has been reported. As per management, export receipts are insured by customer trade insurance.

Sizeable capital buffers and abundant liquidity, elements that provide financial flexibility and support the ratings.

Sizeable internal capital generation and all-out profit retention continue to reinforce capital buffers, wherein net equity (excluding revaluation surplus) has nearly doubled over the last four fiscal years. The company has not paid dividends on a timeline basis. Around 60% of the debt profile is short-term, with the remaining being long-term debt. The company acquired Rs. 8.3b of long-term debt for expansion during the review period, with no further drawdown planned. Running finance lines currently amount to Rs. 22.5b, with nearly half allocated to the Islamic export refinance scheme. The overall capital structure remains conservative, as reflected by low leverage levels, while gearing is projected to remain range-bound and below 1.0x.

In addition, the company has sizable liquidity available on the balance sheet, previously invested in listed shares and mutual funds. However, management has recently divested a significant chunk of mutual fund investments and placed them in current and saving bank accounts.

Noticeable improvements in IT infrastructure.

SEL has implemented Datatex, an integrated suite of ERP and Product Lifecycle Management (PLM) software solutions for the textile and apparel industry. This system is linked with Oracle, enabling the company to optimize operations and achieve cost savings. Additionally, management has plans to upgrade its existing Oracle software as well.

REGULATORY DISCLOSURES					Appendix I
Name of Rated Entity	Soorty Enterprises (Pvt) 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				
	07-07-2023	AA-	A-1	Stable	Reaffirmed
	30-05-2022	AA-	A-1	Stable	Reaffirmed
	24-05-2021	AA-	A-1	Stable	Reaffirmed
	25-03-2020	AA-	A-1	Stable	Reaffirmed
	31-12-2018	AA-	A-1	Stable	Reaffirmed
	22-03-2018	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.				
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Due Diligence Meeting Conducted	Name	Designation	Date		
	Mr. Abid Lakhani	Senior Manager Finance	June 16, 2023		