RATING REPORT

Bhanero Textiles Mills Limited

REPORT DATE:
September 26, 2023

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		**Previous Rating**	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A+	A-1	A+	A-1
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	
Rating Date	*Sept 26, 2023*		*Aug 15, 2022*	

COMPANY INFORMATION	
Incorporated in 1980	**External Auditors:** M/s Mushtaq & Co. Chartered Accountants
Public Listed Company	**Chairman:** Mr. Mohammad Salim
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Khurrum Salim
Admiral (Pvt) Ltd ~16.7%	
Mrs. Saima Bilal ~11.1%	
Mrs. Fatima Amin ~5.7%	
Mr. Muhammad Anim ~5.3%	
Mr. Muhammad Qasim ~5.3%	

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*

Bhanero Textiles Mills Limited

OVERVIEW OF THE INSTITUTION

Bhanero Textiles Mills Limited (BHAT), part of Umer Group of Companies, was incorporated as a public limited company in 1980, under the Companies Ordinance, 1984. BHAT is listed on Pakistan Stock Exchange (PSX) and registered office of the company is based in Karachi.

Profile of Chairman:
Mr. Mohammad Salim, serving as Board Chairman, was awarded certification from the Institute of Chartered Accountants of Pakistan on completion of Director Training program in April'16. Besides, commercial endeavors he actively participates in several social and welfare activities.

Profile of CEO:
Mr. Khurram Salim holds the position of CEO and is responsible for supervision of all divisions of the company.

RATING RATIONALE

Group profile
Founded in 1982, the Umer Group of Companies stands as a prominent textile conglomerate in Pakistan, with an annual turnover of over USD 350m. Apart from its stronghold in textiles, the group has diversified into power generation, footwear, leather, dairy, and construction.

With over 40 years in the textile industry, Umer Group operates 3 textile entities, collectively running 7 spinning mills, 3 weaving mills, and 1 finishing unit. Every unit has its own dedicated power generation, totaling over 40MW, and ensuring consistent power supply. The group over the years has gained a significant market share on both domestic and export fronts. Major export destinations include China, Italy, Japan, Turkey, Belgium, and other European nations.

Table: Key Indicators – Umer Group (In PKR millions)

	FY19	FY20	FY21	FY22	FY23*
Total no. of Spindles	186,956	186,956	186,956	186,956	219,596
Total no. of Looms	567	567	567	567	567
Sales Revenue	41,036	41,921	50,493	71,358	74,274
- *Exports*	*49%*	*52%*	*50%*	*62%*	*55%*
- *Locals*	*51%*	*48%*	*50%*	*38%*	*45%*
Yarn Sales	21,970	21,894	28,555	29,085	41,199
Fabric Sales	13,752	14,283	15,083	40,571	33,075

** Tentative figures*

The collective average energy demand of all three group textile companies exceeds 35 MW, met through an equal mix of 11 MW gas-based generators and a dedicated 30 MW national gridline. In addition, solar power has also been recently deployed.

Corporate Profile
Bhanero Textile Mills Limited (BHAT) has been manufacturing and trading yarn (cotton, rayon, ring-spun & carded) and knitted fabric (mix ranges of fine woven greige cloths from light to heavy, wider width, plain, textured, twills, and luxurious satins) for both domestic and international markets for over four decades. Integrated operations and an in-house power plant ensure continuity, while numerous export standards and trade certifications reflect quality commitment. The sponsors actively manage daily business affairs, with experienced senior management in place. Facilities in Sindh and Punjab employ over 1,400 staff.

The acquisition of Bhanero Energy Unit-I in Sindh targets enhanced management and energy efficiency.
Bhanero Energy Ltd (BEL), a non-listed entity, operated two power units in Sindh (BEL-I) and Punjab (BEL-II), with stated capacity of 3.7MW and 33.7MW, respectively. In Feb'22, the Board approved BEL-I's acquisition with BHAT through a Scheme of Arrangement, making BEL-II a standalone entity. Under the scheme, the BHAT-to-BEL share swap ratio was 0.27:1. As a result, 40,964 shares were issued to BEL's shareholders, worth Rs. 109m (book value of acquired assets). This allows BHAT to directly control the unit, ensuring stable and cost-effective energy.

Establishment of a new spinning unit
The company, in its bid to enhance capacity, inaugurated a new spinning facility, unit-IV, in Sheikhupura, Punjab. Operational since May'23, this facility boasts 19.6K spindles and can produce 1,000 bags daily. As a result, the total installed capacity has augmented by ~47% in FY23. The project, with an investment of Rs. 3.7b, was funded by a balanced 60:40 debt-to-equity mix. Machinery was funded via TERF and LTFF loans, while internal cash covered building construction.

Operating Performance
Headquartered in Karachi, the company operates 3 spinning and 1 weaving unit in Kotri, District Jamshoro and Ferozewatan, Shiekhupura. In the last 21 months, capital expenditure surpassed Rs. 6.5b, primarily for machinery, backed by subsidized debt financing. Weaving capacity expanded by ~28% in FY22 from a Rs. 1.9b investment in the replacement of 140 air-jet looms and other related equipment. Even with global demand slowdown, production levels have shown steady growth throughout the review period.

Table: Capacity & Production Data (Units in millions)

	FY21	FY22	FY23
Spinning			
No. of spindles	80,112	80,112	99,696
Installed Capacity - Kgs	14.8	14.8	21.8
Actual Production – Kgs	12.2	13.0	13.4
Capacity Utilization	***83%***	***88%***	***77%****
Weaving			
No. of looms	162	162	162
Installed Capacity – Meters	26.6	34.0	34.0
Actual Production – Meters	21.1	24.0	32.0
Capacity Utilization	***79%***	***71%***	***94%***

**Based on new spinning unit added capacity from May'23 onwards*

The weaving division sources 30% of its yarn needs from in-house production, with the bulk of the remainder procured locally and a small fraction imported.

<u>Key Rating Drivers</u>

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand. All these factors pose a challenge to the sector over the medium term in terms of 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 broke the threshold, clocking in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and provides employment to about 40% of the industrial labor force. Contributing around 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr, textile sector has maintained an average share of about 60% in national exports over the years.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22	FY23
Pakistan Total Exports	22,536	25,639	32,450	27,911
Textile Exports	12,851	14,492	18,525	16,710
PKR/USD Average rate	158.0	160.0	177.5	248.0

Source: SBP

The lingering effects of Covid-19 pandemic continue to shape the Pakistan's textile industry. Initially, as lockdowns lifted, the industry capitalized on opportunities, securing production contracts with Western countries. This redirection of substantial volumes to Pakistan, complemented by government import tax reductions and subsidized covid-related financing programs such TERF, spurred robust export growth during FY20-22. However, a subsequent phase presented new challenges. Global interest rate hikes aimed at curbing post-pandemic inflation, coupled with geopolitical unrest such as the Ukraine conflict, led to supply chain disruptions and energy crisis. These factors led to a global demand slowdown in major textile economies, reflected in a ~15% year-on-year decline in Pakistan's textile exports in FY23, totaling USD 16.5b (FY22: USD 19.3b). Knitwear, Readymade, and Bed wear segments remain key contributors, making up over 60% of the textile exports.

Table: Textile Export Details (in USD millions)

	FY20	FY21	FY22	FY23	YoY FY23
High Value-Added Segment	**9,669**	**12,427**	**15,611**	**13,576**	**-13%**
- Knitwear	2,794	3,815	5,121	4,437	-13%
- Readymade Garments	2,552	3,033	3,905	3,492	-11%
- Bed wear	2,151	2,772	3,293	2,692	-18%
- Towels	711	938	1,111	1,000	-10%
- Made-up Articles	591	756	849	693	-18%
- Art, Silk & Synthetic Textile	315	370	460	412	-10%
- Others	555	743	872	851	-2%
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,719**	**2,926**	**-21%**
- Cotton Cloth	1,830	1,921	2,438	2,022	-17%
- Cotton Yarn	984	1,017	1,207	844	-30%
- Others	43	34	74	60	-20%
Total	**12,527**	**15,399**	**19,330**	**16,502**	**-15%**

Source: PBS

Flash floods in Sindh and Southern Punjab from last year's monsoon wreaked havoc on the cotton crop, washing away roughly 45% worth over USD 2.5b. This catastrophe led to a historic low yield of 4 million bales in 2022, compared to a 12 million bales annual demand. Local cotton prices subsequently reached a 12-year high of over Rs. 22,000 per 40kg during the year, and imports rose by ~20% in USD terms for FY22, vis-à-vis preceding year. This situation heightened working capital needs, adversely affecting profit margins and liquidity profile for textile entities, particularly spinners, weavers, and dyeing companies. On a positive note, the production target for the current season is set at 12.7 million bales, supported by favorable weather and timely government intervention.

Table: Cotton Prices Trend (In Rs.)

	June'19	June'20	June'21	June'22	June'23
Per Maund	8,770	8,860	13,000	17,380	17,735
YoY % Change	*26%*	*1%*	*32%*	*34%*	*2%*

The industry faces medium-term risks due to the current weak macroeconomic environment both globally and locally, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand, primarily from North America and Europe. Additionally, the potential expiration of Pakistan's GSP plus status in December 2023 could be impactful. This status, allowing duty-free access to the EU for over 6,300 tariff lines, fosters beneficial trade. Its loss could lead to reduced trade revenues and create market uncertainties.

Previously, the sector also enjoyed incentives provided by the government through a five-year textile policy (2020-25), including preferential energy rates, low-interest financing schemes, and timely payments of various refunds, easing liquidity constraints for local players. However, the prevailing economic instability led to the reduction or withdrawal of many of these supports. This along with contractionary monetary policy and political uncertainties in the country are the key present business risk factors. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future prospects of textile exports.

Despite declining export volumes, revenue growth persists due to steady rupee depreciation. The sales mix, both geographically and by client, presents a balanced concentration risk.
In FY22, sales revenue surged by ~42% to an all-time high of Rs. 17.2b (FY21: Rs. 12.2b), fueled by increased fabric sales volume, higher dollar-based prices, and the impact of rupee devaluation. Yarn made up 60% of these sales, while fabric covered the rest. Although exports drove gains in both spinning (37%) and weaving (53%), yarn off-take slightly declined, contrasted with a rise in fabric sales volume. The sales composition settled at an average 39:61 export-to-local ratio. While yarn transactions are fairly balanced between export and local channels, the fabric segment has been primarily geared towards the domestic market, particularly this fiscal year. Local sales witnessed a 12% rise, while exports surged, registering a 2.3-fold increase.

Geographically, exports are spread out with Portugal leading, accounting for over a quarter, followed by countries like Japan, Italy, Bangladesh, Belgium, Korea, and several others. Client concentration remains low, as the top 10 clients generate one-fifth of total sales value. Management ensures that no single client exceeds a 5% concentration to mitigate risk. Notable contributors to export revenue include firms such as Zorluteks Tekstil, Vipe Trade, and Toyoshima, to name a few.

Despite global economic challenges affecting export volumes in FY23, revenues improved slightly to Rs. 18.3b, supported by consistent rupee depreciation. Moving forward, management expects growth in volumes on account of anticipated global demand recovery, expanded yarn capacity, and revision in sales contracts to accommodate rising operating overheads. The projected topline for FY24 is Rs. 23b, with a targeted net margin of 6.5%.

After peaking in last two fiscal years, profitability margins dropped considerably in FY23 due to increased reliance on imported cotton and rising costs across the board.
In line with industry trends, profit margins peaked in the last two fiscal years, driven by strong demand, strategic cotton buying, operational efficiencies, and benefits from rupee devaluation. Yet, FY23 noted a return to historic levels due to significant reductions in yarn margins, global economic downturns, and escalating raw material costs. Management foresees these margin levels to persist in FY24.

Most of the yarn is sourced locally, but imported cotton share surged from 50% to 90% owing to the prior season's local crop shortfall. Nevertheless, efforts are underway this year to reduce this dependency. Sufficient stock levels are kept to meet all confirmed sales orders while cotton is procured till Dec'23. The uptick in administrative and distribution costs is tied to inflation, increased freight charges from global supply chain challenges, and sales growth trend. Finance cost also saw a notable rise due to higher debt from expansions and elevated benchmark rates.

Reduction in cash flows has impacted debt servicing, yet even with an extended working capital cycle increasing short-term financing needs, liquidity profile stays strong.

In the past two fiscal years, strong profitability performance spurred a growth in funds flow from operations (FFO). However, during 9M'FY23, divergent cash flow pattern and a sizeable jump in debt levels led to a notable dip in cash-flow coverages. Additionally, the debt service coverage ratio (DSCR) fell below 3.0x, yet still aligned with industry peers.

The company boasts strong liquidity with a current ratio above 4x. Despite an extended cash conversion cycle of over 200 days due to a higher inventory holding period, short-term borrowings are covered over 2x by trade debts and inventory. Moreover, as yarn production rises given increased capacity, leading to more cotton needs, short-term financing reliance is set to grow further. Notably, only 3% of trade debts were overdue by a year, and no bad debts were reported.

Despite a strong growth in equity, rising debt levels have pushed leverage ratios upward yet they still align with industry medians.

The equity base has grown over twofold since FY20, exceeding the Rs. 10b mark this fiscal year backed by sustained earnings and high retention. The dividends of Rs. 215m were paid in FY22, marking ~8% (FY21: 12%) payout, below past historical trends. This dividend amount was maintained in FY23. Furthermore, Rs. 1.7b was transferred to the general reserve to address any potential future contingencies.

Debt profile is a blend of short-term and long-term debt, with total interest-bearing liabilities increasing to Rs. 9.1b (FY22: Rs. 3.1b; FY21: Rs. 1.3b) at end-9M'FY23, ~53% constituted short-term debt while aggregated running finance lines stands at nearly Rs. 9.2b. Management highlighted that average running finance utilization stands at Rs. 2b while the average cost of long-term debt is 450 bps. Despite rising, leverage ratios remain on par with industry medians.

Sound corporate governance framework

The 10-member board includes three independent, two executive, and four non-executive directors including one female representative. Dedicated committees for Audit HR and remuneration are headed by independent members, with two non-executive directors filling the remaining positions. A separate internal audit function further ensures effective oversight. The 2022 audit report highlighted key audit matters concerning revenue recognition.

Bhanero Textiles Mills Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**9M'FY23**
Fixed Asset	3,004.7	2,912.0	4,607.5	4,266.8
Stock-in-Trade	3,956.4	2,659.4	5,101.9	9,512.4
Trade Debts	957.5	1,628.1	1,883.5	1,756.8
Cash and Bank Balance	114.4	1,739.1	640.8	752.3
Total Assets	**8,788.9**	**9,493.3**	**15,545.1**	**22,959.6**
Trade and Other Payables	631.6	862.0	1,579.5	1,682.8
Long-Term Borrowings *(Incl. current maturity)*	1,112.1	1,289.5	3,153.8	4,250.3
Short-Term Borrowings	1,570.6	-	-	4,888.2
Total Borrowing	2,682.7	1,289.5	3,153.8	9,138.5
Total Liabilities	**3,869.8**	**2,730.3**	**6,239.2**	**12,799.3**
Paid-up Capital	30.0	30.0	30.0	30.0
Total Equity *(Incl. loan from directors)*	**4,919.1**	**6,763.1**	**9,305.9**	**10,160.3**
INCOME STATEMENT				
Net Sales	8,923.6	12,158.1	17,252.5	12,841.8
Gross Profit	823.6	2,731.7	4,074.4	1,890.9
Operating Profit	477.4	2,160.7	3,078.3	1,350.6
Profit Before Tax	**455.6**	**2,161.0**	**3,183.2**	**1,152.7**
Profit After Tax	**329.4**	**1,850.7**	**2,758.2**	**919.3**
RATIO ANALYSIS				
Gross Margin (%)	9.2%	22.5%	23.6%	14.7%
Net Margin (%)	3.7%	15.2%	16.0%	7.2%
Net Working Capital	3,476.9	5,289.7	6,703.5	11,983.3
Current Ratio (x)	2.54	5.89	4.31	4.31
FFO	525.4	2,285.8	3,279.7	1,236.9
FFO to Long-Term Debt (%)	47.2%	177.3%	104.0%	38.8%*
FFO to Total Debt (%)	19.6%	177.3%	104.0%	18.0%*
DSCR (x)	2.18	17.11	10.41	2.49*
Gearing (x)	0.55	0.19	0.34	0.90
Debt Leverage (x)	0.79	0.40	0.67	1.26
Inventory + Receivable/Short-term Borrowings (x)	3.13	-	-	2.31
ROAA (%)	3.8%	20.2%	22.0%	6.4%*
ROAE (%)	6.7%	31.7%	34.3%	12.6%*

**Annualized*

REGULATORY DISCLOSURES — Appendix II

Name of Rated Entity	Bhanero Textiles Mills 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				
26/09/2023	A+	A-1	Stable	Reaffirmed
15/08/2022	A+	A-1	Stable	Reaffirmed
27/05/2021	A+	A-1	Stable	Maintained
22/04/2020	A+	A-1	Rating Watch-Developing	Maintained
21/2/2019	A+	A-1	Stable	Reaffirmed
17/12/2018	A+	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.
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Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Mohammad Salim	Group Chairman	August 02, 2023