RATING REPORT

Arshad Textile Mills Limited (ATML)

REPORT DATE:
August 27, 2021

RATING ANALYSTS:
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RATING DETAILS				
	Latest Ratings		Previous Ratings	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	BB+	A-3	BB+	A-3
Rating Date	August 27, 2021		April 03, 2019	
Rating Action	Maintained		Maintained	
Rating Outlook	Positive		Rating Watch – Negative	

COMPANY INFORMATION		
Incorporated in 1984	**External auditors:**	Riaz Ahmed & Company. Chartered Accountants.
Public Limited Company – Unquoted	**Chairman/CEO:**	Shahzad Ahmed Sheikh
Key Shareholders (with stake 5% or more):		
Mr. Shahzad Ahmed Sheikh – 24.66%		
Mr. Muhammad Arshad Sheikh – 19.17%		
Mr. Shehryar Arshad – 13.33%		
Mr. Nisar Ahmed Sheikh – 12.06%		

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria: Corporates (May 2019)
https://www.vis.com.pk/kc-meth.aspx

Arshad Textile Mills Limited (ATML)

OVERVIEW OF THE INSTITUTION

Arshad Textile Mills Limited (ATML) was incorporated in 1984 as a public limited company. The principal business activity of ATML is manufacturing and sale of cotton-blended yarn.

Profile of the Chairman/CEO

Mr. Shahzad Ahmed Sheikh holds a Master's degree in Commerce. He has over 25 years of textile industry experience.

Financial Snapshot

Tier 1 Equity: end-9MFY21: Rs. 904m; end-FY20: Rs. 737m; end-FY19: Rs. 624m.

Assets: end-9MFY21: Rs. 3.4b; end-FY20: Rs. 3.5b; end-FY19: Rs. 3.1b.

Profit After Tax: 9MFY21: Rs. 120m; FY20: Rs. 93m; FY19: Rs. 113m.

RATING RATIONALE

Arshad Textile Mills (Pvt.) Limited (ATML) is principally involved in the manufacturing and sale of cotton-blended yarn. ATML is a part of Arshad Group and shareholding is mainly vested with the sponsoring family who are actively involved in the day-to-day operations of the company. The ratings incorporate growth in sales in the ongoing year mainly on back of higher yarn sales. Sales declined in FY20 as the company was not able to secure tender sales order from government departments. Given involvement of competitive bidding process, fabric sales have witnessed volatility over the years. The leverage indicators somewhat improved during 9MFY21. However, given mobilization of bank borrowings for the purpose capital expenditure, the same has increased again by end-FY21. The ratings are constraint due to small scale of operations. Given capacity constraints amidst nearly full capacity utilization, the management has embarked upon capacity enhancement, expected to come online by end-CY21. Debt service coverage has remained adequate. Positive outlook of the textile sector due to higher demand in export markets coupled with additional support to industry on the regulatory front bodes well for the company. Meanwhile, the ratings will remain sensitive to any further increase in gearing, maintenance of adequate coverages while achieving projected growth in topline and profitability.

Key Rating Drivers:

Capacity constraints amidst nearly full capacity utilization; the company is in process of enhancing capacity expected to come online by end-Dec'21: ATML remained closed for 10 days in the last quarter of FY20 on account of pandemic. Production capacity (converted into 20s count) stood slightly lower at 7.1m Kgs (FY19: 7.3m Kgs) as the number of operational spindles was lower at 22,824 (FY19: 24,924) in FY20 while capacity utilization remained unchanged at 99%.

Property, plant and equipment (PP&E) stood at Rs. 1.56b (FY20: Rs. 1.61b; FY19: Rs. 1.59b) at end-9MFY21. In FY20, total additions in PP&E amounted to Rs. 98.7m, out of which Rs. 40.6m pertained to vehicles and Rs. 4.4m to plant and machinery. Capital work in progress mainly related to plant and machinery amounted to Rs. 48.5m in FY20, which was capitalized in 9MFY21. Addition in machinery was related to purchase of autocone winding machine.

Currently, ATML is in process of enhancing capacity by adding 12,500 spindles (ring spinning frames/closed-end) and 720 open-end spindles (Rotor spinning) machines; subsequently, total number of spindles will increase to 36,044. Total capex of Rs. 1.5b is expected for the aforementioned expansion and some other machinery, gas generator and electrical installations. In 4QFY21, the company mobilized bank borrowing of Rs. 1.2b for the import of machinery while local machinery, civil work, import duties and installation will be funded through equity injection of Rs. 300m. Borrowings amounting Rs. 950m has been mobilized through Temporary Economic Refinance Facility (TERF) while the rest has been financed through Long-Term Financing Facility (LTFF), both priced at the rate of 5% per annum. The shipments are expected to arrive in Sep'21 while the machinery is expected to be operational by end-Dec'21.

Current power requirements of ATML are 2.3 MW, which is being met through gas generators having cumulative capacity of 3 MW. The company has also sanctioned load of 2.1 MW from national grid. The company has also power backup source arrangements with Arshad Energy Limited (AEL) (An associated concern). Given capacity expansion, power requirements are expected to enhance by 2 MW for which a gas generator of the said capacity will be procured along with an additional sanctioned load of 1.8 MW from national grid.

During FY20, revenue decreased in the absence of lower tender sales while the same showed an increasing trend in the outgoing year: During FY20, gross sales decreased to Rs. 3.6b (FY19: Rs.

4.1b) due to lower local sales of 3.0b (FY19: Rs. 3.85b) while export sales were recorded higher at Rs. 532.6m (FY19: Rs. 291.4m). Net sales were even lower at Rs. 3.1b (FY19: Rs. 4.1b) due to higher sales tax of Rs. 437.7m in FY20 vis-à-vis Rs. 69.2m in the preceding year, as the government imposed 17% sales tax (previously zero rated) on local sale of all textile products, effective from July 1, 2019. Local sales mix of ATML comprises yarn, fabric sales, doubling and conversion income and waste sales while export sales only comprises fabric sales. Yarn sales, constituting 70% of the gross sales, amounted to Rs. 2.4b (FY19: Rs. 2.7b) in FY20. The company was able to sell 144.3K bags of yarn (FY19: 193.7K bags) while average rate was higher at Rs. 16,891 per bag (FY19: Rs. 13,851 per bag). ATML's fabric trading division purchases grey fabric from weaving mills and obtains dyeing, finishing, and stitching services from Arshad Corporation Limited (ACL), an associate concern. Overall fabric sales (both local & export) proportion in gross sales mix decreased to 22% (FY19: 32%). Revenue from fabric sales in local market was recorded lower at Rs. 252.9m (FY19: Rs. 1.0b) in FY20 on account of decrease in volumetric sales to 0.4m meters (FY19: 2.9m meters), as the company was not able to win tender orders of police uniforms; revenue from tender sales amounted to Rs. 890m in FY19. However, average selling rate of fabric was higher at Rs. 650 per meter (FY19: Rs. 355 per meter). In FY20, doubling income amounted to Rs. 25.6m (FY19: 16.8m), the company sold 9.6K bags of doubled yarn (FY19: 7.6K) at a higher average rate of Rs. 2,685 per bag (FY19: Rs. 2,200 per bag). Revenue from conversion of fabric through ACL increased to Rs. 293.8m (FY19: Rs. 82.1m) in FY20 on account of higher quantity sold of 30.5K bags (FY19: 20.8K bags) at an average selling price of Rs. 9,649 per bag (FY19: Rs. 3,945 per bag). Waste sales amounted to Rs. 33.4m (FY19: Rs. 41.3m) in FY20. Volumetric export of fabric increased to 2.2m meters (FY19: 1.9m meters) at a higher average selling price of Rs. 241 per meter (FY19: Rs. 153 per meter). Breakdown of sales into its components, volume sold and average selling price are tabulated below:

	FY19			FY20		
	Volume	Average Price Rs. /Unit	Total Sales Million Rs.	Volume	Average Price	Total Sales
Local Sales:						
Yarn (Bags)	193,682	13,851	2,683	144,262	16,891	2,437
Fabric (meters)	2,904,664	355	1,031	389,183	650	253
Doubling Income (Bags)	7,615	2,200	17	9,640	2,658	26
Conversion (Bags)	20,799	3,945	82	30,453	9,649	294
Waste (Kgs)	1,088,078	38	41	825,140	40	33
Export Sales:						
Fabric (Meters)	1,904,850	153	291	2,213,013	241	533
Total Gross Sales			**4,145**			**3,575**
Less Sales Tax			**69**			**438**
Net Sales			**4,076**			**3,138**

Gross profit increased to Rs. 491.9m (FY19: Rs. 442.6m) in FY20 with improvement in gross margins to 15.7% (FY19: 10.9%) as a result of higher average rates of all products coupled with decrease in cost of goods sold. Cost of sales was recorded lower at Rs. 2.6b (FY19: Rs. 3.6b) in FY20. While raw material consumed amounted to Rs. 2.4b (FY19: Rs. 2.4b), cost decreased mainly due to lower processing/CMT/conversion and other charges of Rs. 64.4m (FY20: Rs. 486m) in line with decrease in fabric sales. Raw material consumed accounted for 82% (FY19: 70%) of cost of goods manufactured in FY20 due to increase in cost of fabric and higher procurement of cotton. Fabric procurement was lower at 2.4m meters (FY19: 3.0m meters) while average rate was notably higher at Rs. 251 per meter

(FY19: Rs. 128 per meter) in FY20. In addition, the company procured 35,209 bales (FY19: 30,400 bales) of local cotton at slightly lower average rate of Rs. 34,475 per bale (FY19: Rs. 35,010 per bale). Meanwhile, the company procured lower quantity of polyester of 9.4K bales (FY19: 11.8K bales) at an average rate of Rs. 63,248 per bale (FY19: Rs. 65,979 per bales). Due to hike in imported cotton prices, import was minimal at 1% (FY19: 7%) in FY20. Salaries, wages and other benefits and stores consumed increased due to inflationary pressure. Fuel and power cost remained at Rs. 207.8m (FY19: Rs. 204.3m). Distribution expenses stood at Rs. 64.7m (FY19: Rs. 60.6m) in FY20. Administrative expenses increased slightly to Rs. 108.7m (FY19: Rs. 99.4m) in FY20. Other expenses amounted to Rs. 10.2m (FY19: Rs. 7.9m) and were mainly of employees related expense and allowance for expected credit losses. Finance cost increased to Rs. 178.4m (FY19: Rs. 153.1m) on account of higher average short-term borrowings in FY20. Despite higher gross profit, net profit for FY20 decreased to Rs. 93.2m (FY19: Rs. 111.8m) mainly owing to higher finance cost and taxation expense.

Net sales during 9MFY21 amounted to Rs. 2.6b. Gross yarn sales were recorded at Rs. 2.5b. The company managed to sell 130,160 bags of yarn at an average rate of Rs. 19,136. Fabric sales in local market continued to remain low at Rs. 53.2m in 9MFY21 due to no tender sales while fabric sales for men's suiting and home textile products under company's own brands, namely, 'Shahsawar' and 'Araish', respectively, also decreased due to lower demand. ATML sold 197K meters of fabric at an average rate of Rs. 270 per meter; average selling rate varies with the type of fabric sold. Conversion income amounted to Rs. 239.9m, with volumetric sales of 33K bags and an average rate of Rs. 7,268 per bag. Waste sales amounted to Rs. 23m. Export sales were recorded at Rs. 213.8m, with 763.5K meters of fabric sold at an average rate of Rs. 280m. Gross profit was recorded at Rs. 385.3m with some decrease in gross margin to 14.7%. Administrative expenses and distribution cost were largely rationalized. Finance cost has decreased mainly due to lower average markup rates. Accounting for taxation, net profit was recorded at Rs. 120.1m.

The company expects net revenue of Rs. 4.1b in FY21 mainly on account of higher yarn sales. Local fabric sales are also expected to increase as the company has been able to secure tender sales order of Rs. 900m, out of which Rs. 300m will be recorded in 4QFY21. Sales are projected to grow by around 50% mainly due to additional capacity coming online in Dec'21. Increase in average cotton prices along with higher cost of polyester and fabric is expected to put pressure on gross margins, going forward.

Adequate coverages: Funds from operations (FFO) amounted to Rs. 170.5m (FY20: Rs. 196.7; FY19: Rs. 148.6m) in 9MFY21; recorded higher on annualized basis in line with higher profitability. FFO increased in FY20 mainly on account of lower income tax paid and higher non-cash adjustments, as compared to the preceding year. Annualized FFO to total debt and FFO to long-term debt increased to 0.20x (FY20: 0.14x; FY19: 0.14x) and 0.54x (FY20: 0.50x; FY19: 0.39x), respectively in 9MFY21. Debt service coverage also improved to 2.52x (FY20: 1.62x; FY19: 1.38x).

The increase in stock in trade during FY20 was mainly manifested in finished goods inventory of yarn worth Rs. 314.1m (FY19: Rs. 97.8m). Stock in trade stood lower at Rs. 765.7m (FY20: Rs. 938.9m; FY19: Rs. 526.4m) by end-9MFY21. The raw material inventory stood at Rs. 316.4m, work in progress amounted to Rs. 212.2m and finished goods stood at Rs. 232.3m at end-9MFY21. Stock in trade stood at Rs. 770.2m at end-June, 2021. Trade debts stood higher at Rs. 643.5m (FY20: Rs. 431.5m; FY19: Rs. 495m) by end-9MFY21. Aging profile of receivables is considered satisfactory given around 83% of trade debts fall under 6 months credit bracket while 17% of trade debts were in 6-9 months credit bracket. Local yarn customers normally take a credit period of 25– 40 days while foreign customers make payments on cash against documents (CAD) terms. Payments against tender sales and from other clothing retailers generally take up to four months to settle completely. Trade receivables of Rs. 576.9m were outstanding at end-FY21 out of which Rs. 69.1m pertained to tender sales. Trade receivables remained at 14% (FY20: 13.7%) of net sales at end-FY21. Loans and advances decreased to Rs. 26.4m (FY20: Rs. 82.7m; FY19: Rs. 106.1m) due to lower advance to suppliers, settlement of advance to related party and no advance tax paid in 9MFY21. Other receivables amounted to Rs. 241.3m (FY20: Rs. 299.1m; FY19: Rs. 286.9m) mainly comprising income tax refundable and sales tax refundable. Short-term investment stood higher at Rs. 47.3m (FY20: Rs. 0.6m; FY19: Nil) comprising equity investment in listed companies. Current ratio stood at 1.06x (FY20: 0.96x; FY19: 0.86x) at end-9MFY21. Coverage of short-term borrowings via trade debts and stock in trade is considered adequate at 2.04x (FY20: 1.32x; FY19: 1.43x). However, overall liquidity position is projected to remain adequate on the back of higher cash flows generation, going forward.

Leveraged indicators are projected to increase due to mobilization of long-term borrowings in 4QFY21: Tier-1 equity increased to Rs. 904.0m (FY20: Rs. 737.4m; FY19: Rs. 624.5m) by end-9MFY21 mainly on account of profit retention. In addition, interest free loan from sponsors increased to Rs. 244.1 (FY20: Rs. 197.7m; FY19: Rs. 190.2m) by end-9MFY21 and has continued to support equity on a timeline basis. Out of total sponsors' loan, Rs. 147.4m (FY20: Rs. 100.7m; FY19: Rs. 93.5m) pertained to interest free, unsecured loans obtained from directors/shareholders of the company which are repayable in one bullet installment on June 30, 2023, while the remaining amount is payable on discretion of the company. Total equity amounted to Rs. 1.3b (FY20: Rs. 1.1b; FY19: Rs. 1.0b), including revaluation surplus on property, plant and equipment. Total liabilities decreased to Rs. 2.1b (FY20: Rs. 2.4b; FY19: Rs. 2.1b) by end-9MFY21 mainly due to lower short-term borrowings. Trade and other payables stood at Rs. 883m (FY20: Rs. 828.4m; FY19: Rs. 888.7m) which largely includes trade creditors of Rs. 611.8m (FY20: Rs. 639m; FY19: Rs. 717.9m) and advances from customers amounted to Rs. 133.5m (FY20: Rs. 74.6m; FY19: Rs. 100.2m). Around 80% of trade creditors at end-9MFY21 were due to ACL (FY20: Rs. 587.0m; FY19: Rs. 658.6m). Payments to associated undertakings is generally made after 45 days while conversion payments to third parties are made within 30-60 days. Around 95% of local cotton is procured on a cash basis. Polyester procurement from the local market is an ongoing process, entirely based on cash payment. A credit period of 20 – 40 days is availed for payments to fabric suppliers.

Debt profile of the company comprises a mix of short-term and long-term borrowings from banks. Short-term borrowings stood lower at Rs. 690.8m (FY20: Rs. 1.0b; FY19: Rs. 712.6m). Long-term borrowings including current maturity amounted to Rs. 420.9m (FY20: 395.4m; FY19: Rs. 382.1m) at end-9MFY21. The company obtained term finance facility of Rs. 54.3m under SBP refinance scheme for salaries and wages in 9MFY21. In FY20, the company obtained loan under the same scheme to the tune of Rs. 25.3m. The company also mobilized a loan of Rs. 47.6m in FY20 charged at 6M KIBOR Plus 1.5% for BMR. ATML deferred long-term borrowings of Rs. 83.1m under Covid relief provided by SBP.

Debt leverage and gearing have decreased to 2.35x (FY20: 3.25x; FY19: 3.39x) and 1.23x (FY20: Rs. 1.95x; FY19: 1.75x) by end-9MFY21. However, given additional long-term borrowings of Rs. 1.2b in 4QFY21, resulted in higher debt leverage and gearing of 3.56x and 2.50x, respectively by end-FY21 *(as per projected financial statements)*. With scheduled repayments of long-terms borrowings, equity expansion on the back of profit retention and equity injection of Rs. 300m for ongoing capex *(not included in financial projection)*, capitalization indicators are projected to improve in FY22 and beyond.

Arshad Textile Mills Limited (ATML) Annexure I

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**FY19**	**FY20**	**9MFY21**
Non-Current Assets	1,589	1,613	1,555
Stores, Spares and Loose Tools	37	27	15
Stock-in-Trade	526	939	765
Trade Debts	495	432	644
Other Receivables	287	299	241
Other Current Assets	158	123	101
Cash & Bank Balances	18	68	67
Total Assets	**3,110**	**3,501**	**3,388**
Trade and Other Payables	889	828	883
Short Term Borrowings	713	1,041	691
Long-Term Borrowings *(Inc. current maturity)*	382	395	421
Other Liabilities	136	136	125
Total Borrowings	1,095	1,436	1,112
Total Liabilities	**2,120**	**2,400**	**2,120**
Tier-1 Equity	624	737	904
Total Equity	990	1,101	1,268
Paid Up Capital	100	100	100
INCOME STATEMENT	**FY19**	**FY20**	**9MFY21**
Net Sales	4,076	3,138	2,624
Gross Profit	443	492	385
Profit Before Tax	128	133	162
Profit After Tax	113	93	120
FFO	149	197	171
RATIO ANALYSIS	**FY19**	**FY20**	**9MFY21**
Gross Margin (%)	10.9	15.7	14.7
Net Margin (%)	2.8	3.0	4.6
FFO to Long-Term Debt	0.39	0.50	0.54*
FFO to Total Debt	0.14	0.14	0.20*
Debt Servicing Coverage Ratio (x)	1.38	1.62	2.52
Inventory + Receivable/Short-term Borrowings (x)	1.43	1.32	2.04
Gearing (x)	1.75	1.95	1.23
Debt Leverage (x)	3.39	3.25	2.35
Current Ratio (x)	0.86	0.96	1.06

**Annualized*

ISSUE/ISSUER RATING SCALE &DEFINITIONS — Annexure 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 — Annexure III

Name of Rated Entity	Arshad Textile 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				
August-27-2021	BB+	A-3	Positive	Maintained
April-28-2020	BB+	A-3	Rating Watch – Negative	Maintained
April-03-2019	BB+	A-3	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
Mr. Shafiq Ijaz	CFO	July 27, 2021