RATING REPORT

Arshad Textile Mills Limited (ATML)

REPORT DATE:
August 29, 2022

RATING ANALYSTS:

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RATING DETAILS				
	Latest Ratings		Previous Ratings	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	BBB-	A-2	BB+	A-3
Rating Date	August 29, 2022		August 27, 2021	
Rating Action	Upgrade		Maintained	
Rating Outlook	Stable		Positive	

COMPANY INFORMATION	
Incorporated in 1984	**External auditors:** Riaz Ahmed & Company. Chartered Accountants.
Public Limited Company – Unquoted	**Chairman:** Mr. Muhammad Arshad Sheikh
	CEO: Mr. 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 (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Arshad Textile Mills Limited (ATML)

OVERVIEW OF THE INSTITUTION

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

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 largely vested with the sponsoring family, who are actively involved in the day-to-day operations of the company. The company has recently executed capacity enhancement plan entailing addition of nine ring frames and 720 rotors, which are expected to become fully operational by end-1QFY23. Around two-third of the required capital expenditure has been funded through subsidized bank borrowings while the rest has been arranged through own sources.

The ratings incorporate sound growth in revenues and profitability during FY21 and FY22 driven by covid led expansion in local textile industry. The liquidity position is underpinned by maintenance of adequate debt service coverage on a timeline basis. Net operating cycle has remained fairly manageable relative to industry amid working capital support from associated company and advances from customers. Leverage indicators have remained on a higher side due to overall increase in debt levels despite equity expansion. Meanwhile, capitalization is supported by profit retention and continued sponsors support in form of interest free unsecured loan, which is payable on discretion of the company. Moreover, the sponsors have decided to inject additional equity by way of right shares issuance during the ongoing year. Going forward, the growth in topline is projected to be primarily driven by enhanced production capacity. Whilst the ratings factor in high cyclicality and competitive intensity for spinning industry along with volatility in cotton prices, overall business risk profile of the textile industry is supported by stable demand and favorable regulatory regime. However, ongoing economic uncertainties in the domestic and international markets may impact growth in the textile segment. The ratings, therefore, will remain sensitive to achieving projected growth in revenues and profitability while improving leverage indicators and liquidity profile, going forward.

Key Rating Drivers:

Financial Snapshot

Tier 1 Equity: end-FY22*: Rs. 1,520m; end-FY21: Rs. 945m; end-FY20: Rs. 737m.

Assets: end-FY22*: Rs. 5.9b; end-FY21: Rs. 3.8b; end-FY20: Rs. 3.5b.

Profit After Tax: FY22*: Rs. 298m; FY21: Rs. 150m; FY20: Rs. 93m.

*Unaudited

Update on production and capacity enhancement: ATML is in final stages of executing its expansion plan which entails addition of 12,500 spindles (9 ring frames) and 720 rotors; total number of spindles will increase to 37,500 (FY21 and FY20: 25,000). Resultantly, the production capacity from ring spinning will increase to 11.6m Kgs (FY21 and FY20: 7.4m Kgs), while production capacity of 2.12m Kgs has been added through autocoro (open-end spinning) unit. Total project cost of Rs. 1.8b (previously estimated: Rs. 1.5b) has been arranged through bank financing of Rs. 1.2b for imported machinery, while local expenditure of around 600m related to building, import duties, installation cost, taxes and transportation cost etc. has been arranged though own sources. The project cost increased due to local currency depreciation, increase in sales tax to 17% from previous rate of 10% and inflationary pressure. The rotors have started commercial operations from March 1, 2022 while out of nine ring frames, six have been installed recently, while three ring frames will be installed by end-Aug'22. The company has been operating at a nearly full capacity utilization over the years. The snapshot of installed production capacities and actual production is presented below:

	FY20			FY21			9MFY22		
Spinning	**Installed Capacity (KG)**	**Prod. Output (KG)**	**Capacity Utilized**	**Installed Capacity (KG)**	**Prod. Output (KG)**	**Capacity Utilized**	**Installed Capacity (KG)**	**Prod. Output (KG)**	**Capacity Utilized**
Production Efficiency (20s) Ring Frames	7,429,386	7,117,272	95.8%	7,429,386	7,348,989	98.9%	5,500,000	5,389,000	98.0%
Production Efficiency (20s) Autocoro	-	-	-	-	-	-	91,000	89,744	98.6%

At present, power requirements of ATML have been met through gas generators having cumulative capacity of

3 MW and sanctioned load of 2.1 MW from national grid. In addition, the company has power backup arrangements with Arshad Energy Limited (AEL) (An associated concern). As the power requirements have increased due to capacity enhancement, coming online by end-1QFY23, the company has arranged 1.8 MW load from national grid along with installation of gas generators with rated capacity of 2.8 MW.

Property, plant and equipment stood higher at Rs. 2.8b (FY21: 1.8b; FY20: Rs. 1.6b) at end-9MFY22 due to capital work in progress related to plant and machinery amounting Rs. 1.1b (FY21; Rs. 85.6m) and Rs. 206.7m related to civil work on building pertaining to aforementioned capex.

Growth in topline during FY21 and the ongoing year along with improvement in profit margins: During FY21, net sales were recorded higher at Rs. 3.8b (FY20: Rs. 3.1b) mainly on account of increase in volumetric sales of yarn whereas average selling prices were lower vis-à-vis preceding year due to variation in count mix. Local sales comprising yarn, fabric sales, doubling and conversion income and waste sales, were recorded higher at Rs. 3.3b (FY20: Rs. 2.6b) while export sales of Rs. 434.3m (FY20: Rs. 532.7m) entirely comprised fabric sales. Around 72% of the net revenue (FY20: 70%) emanated from yarn sales. 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. Contribution of fabric sales (both local & export) in gross sales mix decreased to 19% (FY21: 22%). The proportion of revenue from conversion of fabric through ACL and doubling income remained at around 8%. During 9MFY22, net sales were reported higher at Rs. 4.5b mainly on account of considerable increase in average selling prices as a result of covid led growth in local textile industry. Net revenues are reported at Rs. 5.6b in full year (*provisional*), with a YoY growth of around 48%.

Rs. /Unit	**FY20**		**FY21**		**9MFY22**	
	Volume	**Average Price**	**Volume**	**Average Price**	**Volume**	**Average Price**
Local Sales:						
Yarn (Bags)	144,262	16,891	170,943	15,871	138,451	22,225
Fabric sales/Tender (pieces)	389,183	650	304,512	780	137,000	2,050
Doubling Income (Bags)	9,640	2,658	3,902	1,697.3	8,690	23.9
Conversion (Bags)	30,453	9,649	42,688	2,001	18,499	64.4
Waste (Kgs)	825,140	40	816.650	36	642,160	31
Export Sales:						
Fabric (Meters)	2,213,013	241	1,773,719	244.9	2,916,175	321

During FY21, gross profits were recorded higher at Rs. 540.3m (FY20: Rs. 491.9m) while gross margins decreased to 14.3% (FY20: 15.7%) mainly due to increase in sales of lower count yarn as compared to preceding year. Administrative expenses were recorded at Rs. 95.6m (FY20: Rs. 108.7m) and distribution cost amounted to Rs. 64.4m (FY20: Rs. 64.7m). Other expenses of Rs. 34.8m (FY20: Rs. 10.2m) largely included contribution to employees related fund contributions, allowance for expected credit losses and loss on sale of PP&E. Other income of Rs. 13.7m (FY20: Rs. 3.7m) mainly included dividend income form stocks held as short-term investments, markup on advances to Arshad Enterprises (Pvt.) Ltd. (AEPL - a related party) and profit on long-term investments. Finance cost was recorded lower at Rs. 133.4m (FY20: Rs. 178.4m) in line with decrease in average markup rates despite slightly higher average borrowings. Accounting for taxation, net profit was reported higher at Rs. 149.5m (FY20: Rs. 93.4m) with increase in net margin to 4.0% (FY20: 3.0%) largely in line with higher gross profits, rationalized operating costs and decrease in finance cost.

During 9MFY22, gross margins were reported higher at Rs. 714.5m with increase in gross margins to 16.0%, primarily on account of favorable yarn rates. Bottomline was recorded higher at Rs. 269.9m with net margins of 6.1%. Going forward, growth in topline will be driven by incremental sales from additional capacity. Net sales are projected to increase by ~63% on YoY basis in FY23, whereas gross margins are expected to decrease due to rationalization of yarn prices, going forward. Meanwhile, the impact of recent crash in cotton rates on the profitability profile of spinning industry is yet to been seen.

Adequate debt service coverage: Funds from operation (FFO) was recorded higher at Rs. 379.0m (FY21: Rs. 277.8m; FY20: Rs. 196.7m) in line with higher profitability during 9MFY22. However, with significant increase in overall debt levels due to capital expenditure and higher working capital requirements, annualized FFO to total debt and FFO to long-term debt decreased to 0.18x (FY21: 0.22x; FY20: 0.14x) and 0.39x (FY21: 0.65x; FY20: 0.50x), respectively. Nonetheless, debt service coverage has improved to 2.65x (FY21: 2.13x;

FY20: 1.62x) and has remained adequate on a timeline basis.

Stock in trade stood at Rs. 1.1b (FY21: Rs. 929.4m; FY20: Rs. 938.9) at end-9MFY22. The company held raw material inventory worth Rs. 414.3m (FY21: Rs. 254.3m; FY20: Rs. 361.4m) while work in progress stood at Rs. 307.7m (FY21: 381.0m; FY20: 256.4m) and finished goods inventory stood at Rs. 361.8m (FY21: 279.0m; FY20: Rs. 314.1m). Cotton prices witnessed a hike globally during FY22 mainly due to higher demand and contraction in crop output. During 9MFY22, ATML procured local cotton at ~68% higher average rate as compared to previous year. Similarly, average polyester and fabric rates also remained higher compared to previous years. Breakdown of major raw material purchases with average rates and quantity is tabulated below:

		FY20			FY21			9MFY22		
	Unit	QTY	Avg. Price	Amount (m Rs.)	QTY	Avg. Price	Amount (m Rs.)	QTY	Avg. Price	Amount (m Rs.)
Local										
Cotton	Bales	35,209	34,475	1,213.8	17,400	36,697	638.5	25,300	60,393	1,527.9
Polyester	Bales	9,388	63,248	593.8	8,349	62,394	520.9	7,295	86,884	633.8
Fabric	m. Mtrs	2,423.8	251	608.0	1,794.9	227	407.4	2,949.0	203	598.8
Imported										
Cotton	Bales	440	61,834	27.2	12,675	60,204	763.1	2,120	85,330	180.9

Trade debts increased to Rs. 878m (FY21: 513m; FY20: 432m) by end-9MFY22 while as a percentage of net sales remained at 15% (FY21 & 20: 14%). 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. Credit terms have remained intact with local yarn sales being made at credit period of 25 to 40 days while export sales are made on cash against documents (CAD) terms. Payments against tender sales generally take up to four months to settle completely. Loans and advances increased to Rs. 139.0m (FY21: Rs. 93.8m; FY20: Rs. 59.8m) on account of increase in advances to suppliers/contractors and to AEL. Other receivables increased to Rs. 321.7m (FY21: Rs. 128.6m; FY20: Rs. 139.4m) mainly on account of higher sales tax refundable amounting Rs. 286.9m (FY21: Rs. 88.8m; FY20: Rs. Rs. 106.9m). Short-term deposits and prepayments amounted to Rs. 140.9m (FY21: Rs. 120.4m; FY20: Rs. 40.4m) due to increase in security deposits. Trade and other payables decreased to Rs. 828.2m (FY21: 1.1b; FY20: Rs. 821.3m) by end-9MFY22 mainly due to decrease in trade creditors (9MFY22: Rs. 393.0m; FY21: Rs. 514.5m; FY20: Rs. 639.0m) and advances from customers (9MFY22: Rs. 227.8m; FY21: Rs. 421.7m; FY20: Rs. 74.6m). Around 70% of outstanding trade creditors were due to ACL (FY21: Rs. 459.5m; FY20: Rs. 587.0m) at end-9MFY22. 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 and polyester procurement from the local market is entirely based on cash payment. Meanwhile, credit period of 20 to 40 days is availed for payments to fabric suppliers. Current ratio stood at 1.06x (FY21: 0.96x; FY20: 0.96x) while coverage of short-term borrowings via trade debts and stock in trade remained adequate at 1.30x (FY21: 1.69x; FY20: 1.32x). Net operating cycle has remained fairly manageable at 47 days (FY21: 44 days; FY20: 37 days), largely supported by higher days of payables. Liquidity position is projected to improve in terms of cash flow coverages on the back of higher profitability and decrease in overall debt levels, going forward.

Increase in gearing ratio by end-9MFY22 on account of mobilization of long-term loan while capitalization is supported by profit retention and continued sponsors support in form of interest free loan: Tier-1 equity augmented to Rs. 1.5b (FY21: Rs. 944.9m; FY20: 727.4m) on the back of profit retention and equity contribution by sponsors in form of interest free loan amounting Rs. 519.9m (FY21: Rs. 242.8m; FY20: Rs. 197.7m). Out of the total sponsor's loan, sum of Rs. 407.8m (FY21: Rs. 130.8m; FY20: Rs. 100.7m) was previously categorized as loan repayable in one bullet installment on June 30, 2023. However, in view of recent capital expenditure, the loan would be payable at the discretion of the company. Total equity amounted to Rs. 1.8b (FY21: 1.3b; FY20: Rs. 1.1b), including revaluation surplus on PP&E.

Total borrowings stood higher at Rs. 2.8b (FY21: Rs. 1.3b; FY20: 1.4b) at end-9MFY22 on account of increase in overall debt levels. Short-term borrowing increased to Rs. 1.5b (FY21: Rs. 851.6m; FY20: Rs. 1.0b) in line with working capital requirements. Long-term financing including current maturity stood higher at Rs. 1.3b (FY21: Rs. 426.0m; FY20: Rs. 395.4m) due to mobilization of loan amounting Rs. 932.9m (FY21: Rs. 104.7m) to fund capital expenditure during 9MFY22. The company obtained additional loan amounting Rs. 125m in last quarter FY22. Total required bank financing for capacity enhancement has been obtained under temporary economic finance facility (TERF) and long-term financing facility (LTFF), priced at flat rates of 5% and 10%, respectively. Leverage indicators have remained at a higher side due to increase in debt levels despite equity expansion. Gearing and debt leverage were reported at 1.88x (FY21: 1.35x; FY20: 1.95x) and 2.61x (FY21: 2.69x; FY20: 3.26x), respectively at end-9MFY22.

The sponsors have decided to extend additional equity contribution to the tune of Rs. 400m via issuance of right shares by the end-1QFY23, as a result of which paid-up capital of the company would increase from Rs. 100m to Rs. 500m. According to management, the same amount would be used to offset trade payables due to associated undertakings. As per projections, core equity will augment to Rs. 2.4b by end-FY23. Resultantly, debt leverage and gearing will improve to 1.55x and 1.19x, respectively on the back of equity expansion and scheduled repayments of long-term loans. In addition, higher cash flow generation is projected to support working capital leading to decrease in reliance on bank borrowings.

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	FY20	FY21	9MFY22	FY22 (Unaudited)
Property, Plant and Equipment	1,613	1,772	2,846	2,963
Stock-in-Trade	939	929	1,104	966
Trade Debts	432	513	878	1,066
Short-Term Deposit and Prepayments	40	120	141	141
Other Receivables	139	129	322	322
Other Current Assets	211	263	289	289
Cash & Bank Balances	68	16	14	9
Total Assets	**3,501**	**3,836**	**5,732**	**5,894**
Trade and Other Payables	821	1,081	828	828
Short Term Borrowings	1,041	852	1,527	1,630
Long-Term Borrowings *(Inc. current maturity)*	395	426	1,280	1,405
Total Borrowings	1,436	1,278	2,807	3,035
Total Liabilities	**2,401**	**2,544**	**3,893**	**4,027**
Tier-1 Equity	737	945	1,492	1,520
Total Equity	1,101	1,292	1,839	1,867
Paid Up Capital	100	100	100	100

INCOME STATEMENT	FY20	FY21	9MFY22	FY22 (Unaudited)
Net Sales	3,138	3,781	4,453	5,596
Gross Profit	492	540	715	814
Profit Before Tax	134	231	380	420
Profit After Tax	93	150	270	298
FFO	197	278	379	364

RATIO ANALYSIS	FY20	FY21	9MFY22	FY22 (Unaudited)
Gross Margin (%)	15.7	14.3	16.0	14.6
Net Margin (%)	3.0	4.0	6.1	5.3
FFO to Long-Term Debt	0.50	0.65	0.39*	0.26
FFO to Total Debt	0.14	0.22	0.18*	0.12
Debt Servicing Coverage Ratio (x)	1.62	2.13	2.65	1.85
Inventory + Receivable/Short-term Borrowings (x)	1.32	1.69	1.30	1.25
Gearing (x)	1.95	1.35	1.88	2.00
Debt Leverage (x)	3.26	2.69	2.61	2.65
Current Ratio (x)	0.96	0.96	1.06	1.08
Cash Conversion Cycle (days)	37	44	47	79
ROAA (%)	2.8	4.1	7.5*	5.1
ROAE	13.7	17.8	29.5*	19.8

**Annualized*

ISSUE/ISSUER RATING SCALE &DEFINITIONS 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 — Annexure IV

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				
Aug- 29-2022	BBB-	A-2	Stable	Upgrade
Aug- 27-2021	BB+	A-3	Positive	Maintained
Apr- 28-2020	BB+	A-3	Rating Watch – Negative	Maintained
Apr- 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.
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. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. 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
Mr. Shafiq Ijaz	CFO	July 7, 2022; August 12, 2022
Mr. Muhammad Arshad Sheikh	Chairman	August 12, 2022
Mr. Irfan Shahzad	Group CFO	August 12, 2022