RATING REPORT

Arshad Textile Mills Limited

REPORT DATE:

March 06, 2024

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Ratings		Previous Ratings	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	BBB-	A-2	BBB-	A-2
Rating Date	March 06, 2024		August 29, 2022	
Rating Action	Reaffirmed		Upgrade	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION

Incorporated in 1984	**External auditors:** Riaz Ahmed & Company. Chartered Accountants.
Public Limited Company – Unquoted	**Chairman/CEO:** Mr. Muhammad Arshad Sheikh
Key Shareholders (with stake 10% or more):	
Mr. Shehryar Arshad – 49.0%	
Mr. Muhammad Arshad Sheikh - 16.0%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Corporates:
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

Arshad Textile Mills Limited

RATING RATIONALE

Company Profile

Arshad Textile Mills Limited ('ATML' or 'the Company') is a public unlisted company incorporated in Pakistan in 1984. Its registered office is situated in Gulberg-II, Lahore. The Company is engaged in the business of manufacturing and sale of cotton-blended yarn, along with the sale of fabric after outside conversion/processing.

Operational Performance

The manufacturing plant of the Company is situated in Tehsil Jaranwala, Faisalabad, Punjab. In FY23, ATML experienced a significant decline in plant capacity utilization due to higher raw material prices and reduced demand for finished goods. Unit-I recorded the lowest utilization during the review period at 41%. Production was suspended between September 2022 and May 2023 due to the aforementioned factors. Additionally, the Company added a new unit, Unit-III, with a reported total capacity of 2,461,320 KGs of yarn. This new unit commenced production in January 2023 and achieved a capacity utilization rate of 81% by the year end.

Capacity and Utilization	FY20	FY21	FY22	FY23
Installed Capacity (KGs)	7,215,371.0	7,765,447.0	7,772,575.0	9,004,157.0
Production (KGs)	7,117,272.0	7,348,989.0	7,262,068.0	6,352,878.0
Utilization	99%	94%	93%	71%

Key Rating Drivers

Business risk profile constrained by cyclicality, and high competition in the sector.

The business risk profile of the spinning sector in Pakistan is characterized by high level of exposure to economic cyclicality and intense competition. This sector's performance is significantly influenced by the broader economic conditions in the country, making it inherently vulnerable to fluctuations in demand driven by economic factors.

In FY23, the spinning sector faced challenges due to various economic and environmental circumstances. These included damage to the cotton crop resulting from flooding in 1HFY23, escalating inflation, and diminishing foreign exchange reserves.

The spinning sector in Pakistan comprises ~407 spinning mills, which include both composite units and spinning units. This industry exhibits a competitive market structure with many players producing relatively homogenous products.

During FY23, Pakistan's yarn production registered a substantial decline, primarily due to reduced availability of cotton, because of crop damage and import restrictions. The sector's profitability was constrained by factors such as higher production costs, increased raw material costs, and rising energy expenses, all of which constrained the sector's profit margin. The industry's performance is closely intertwined with the outlook of the cotton and textile industries, both of which were affected in FY23. Global economic slowdown and contractionary economic policies led to a decrease in demand for textile products and, consequently, cotton yarn.

While the global outlook for cotton production is expected to rebound, local challenges persist. These challenges include high interest rates, increasing energy costs, and persistent inflationary pressures. These

factors are likely to result in continued sluggish performance for the spinning sector in FY24.

Sponsor support provides support to assigned ratings.

Ratings derive comfort from the sponsor support extended to the Company. This support is evident from the contributions made historically. This helped the Company sustain operations despite deteriorations in profitability and stress on the coverage profile.

Profitability profile constrained by deterioration of the topline and margins due to a challenging economic environment.

The Company's topline declined ~35% in FY23, as volumetric sales faced pressure from reduced demand amid a constrained economic environment. However, gross margins contracted due to rising input costs attributed to high inflation, currency exchange volatility, increased energy costs, and heightened raw material expenses. During the year, the Company faced constraints in procuring local cotton owing to a lack of availability, primarily due to floods that inundated the major crops of the country and increased import restrictions by the SBP. Consequently, ATML's operations were disrupted and faced challenges in passing these cost pressures on to customers in FY23. Gross margins were reported at 11.4% (FY22: 14.2%) in FY23. In 1HFY24, gross margins remained intact at 11.7%.

Going forward, management expects gross margins to normalize as higher cotton crop production and eased letter of credit restrictions will lead to lower costs and improved operations in FY24.

Net margins came under further pressure from escalation in finance cost. This is attributed to an 825-bps increase in domestic policy rates during the period. Net margins reported at 0.5% (FY22: 5.7%) in FY23.

Sustained improvement in the capitalization profile on account of equity expansion, with support from sponsors.

Historically, leverage indicators have been on the higher side, due to elevated debt levels. Nevertheless, ongoing equity expansion, supported by sponsors, through interest-free loans, and profit retention, has led to sustained improvements in capitalization indicators in recent years. In FY23, gearing and leverage improved to 1.2x (FY23: 1.3x, FY22: 1.5x, FY21: 1.7x) and 2.0x (FY23: 2.3x, FY22: 2.5x, FY21: 3.3x), respectively.

Debt service coverage reports strain on account of higher financial burden and stress on profitability, however, comfort derived from continued sponsor support. While liquidity profile remains adequate with assigned ratings.

The Company has historically sustained an adequate coverage profile over the years, with a 5-Year average debt service coverage (DSCR) and short-term debt coverage ratios of 1.4x each, respectively. However, owing to significant stress on the Company's profitability and higher finance costs the DSCR contracted to 0.7x (FY22: 1.3x) in FY23. The Company managed to slightly recover its DSCR to 0.9x in 1HFY24 albeit still under pressure. Comfort is derived from a longstanding history of active sponsor support to the Company. Despite sustained elevated short-term debt utilization, ATML's short-term debt coverage remained sufficient at 1.2x, unchanged between FY22 and 1HFY24. Meanwhile the liquidity profile has remained mostly stable with a current ratio of 1.0x throughout the years. However, there was slight deterioration in FY23 to 0.9x before recovering in 1HFY24 back to 1.0x. Nevertheless, the liquidity profile of the Company remains adequate with assigned ratings.

Consideration for future reviews

Going forward, ratings are underpinned by continued sponsor support with further improvement in the capitalization profile, to be commensurate with assigned ratings. Moreover, the Company's ability to enhance its profitability, coverage and liquidity profiles will also remain important considerations for future reviews.

Arshad Textile Mills Limited　　　　　　　　　　　　　　　　　　　　**Annexure I**

FINANCIAL SUMMARY				*(PKR Millions)*
Balance Sheet	**FY21A**	**FY22A**	**FY23A**	**6MFY24A**
Property, plant and equipment	1,772.0	3,466.1	3,816.1	3,747.9
Stock-in-trade	929.4	644.3	1,407.2	1,478.1
Trade debts	513.0	765.7	168.5	433.9
Cash & Bank Balances	16.2	25.9	20.4	9.5
Total Assets	3,836.4	5,992.1	6,709.6	7,102.6
Trade and Other Payables	1,080.8	1,014.3	1,448.0	1,307.9
Long-term Debt	556.8	1,178.1	1,090.3	1,087.7
Short-Term Borrowings	851.6	1,200.7	1,280.0	1,533.5
Total Debt	1,408.4	2,378.9	2,370.3	2,621.2
Total Liabilities	2,675.2	3,866.1	4,300.9	4,365.4
Paid up Capital	100.0	100.0	100.0	100.0
Equity (excl. Revaluation Surplus)	814.1	1,554.8	1,845.7	2,178.2
Income Statement	**FY21A**	**FY22A**	**FY23A**	**6MFY24A**
Net Sales	3,781.5	6,022.2	3,913.2	2,404.0
Gross Profit	540.3	856.9	445.4	280.2
Operating Profit	345.5	548.8	276.1	226.7
Finance Costs	133.4	231.4	301.8	143.3
Profit Before Tax	231.2	385.2	80.5	83.5
Profit After Tax	149.5	342.4	19.5	53.4
Ratio Analysis	**FY21A**	**FY22A**	**FY23A**	**6MFY24A**
Gross Margin (%)	14.3%	14.2%	11.4%	11.7%
Net Margin (%)	4.0%	5.7%	0.5%	2.2%
Funds from Operation (FFO)	277.7	355.8	201.4	106.2
FFO to Total Debt* (%)	19.7%	15.0%	8.5%	8.1%
FFO to Long Term Debt* (%)	49.9%	30.2%	18.5%	19.5%
Gearing (x)	1.7	1.5	1.3	1.2
Leverage (x)	3.3	2.5	2.3	2.0
Debt Servicing Coverage Ratio* (x)	1.5	1.3	0.7	0.9
Current Ratio (x)	1.0	1.0	0.9	1.0
(Stock in trade + trade debts) / STD (x)	1.7	1.2	1.2	1.2
Return on Average Assets* (%)	4.1%	7.0%	0.3%	1.5%
Return on Average Equity* (%)	20.6%	28.9%	1.1%	5.3%

Annualized, if required

REGULATORY DISCLOSURES					Annexure II
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				
	Mar - 06 - 2024	BBB-	A-2	Stable	Reaffirmed
	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.				
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Due Diligence Meetings Conducted	Name	Designation		Date	
	Mr. Amjad Iqbal	CFO		February 28, 2024	