RATING REPORT

Arshad Corporation (Pvt.) Limited

REPORT DATE:

December 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	A-	A-2	A-	A-2
Rating Date	December 29, 2022		September 27, 2021	
Rating Action	Reaffirmed		Upgrade	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION	
Incorporated in 1973	External auditors: Zahid Jamil & Co. Chartered Accountants.
Private Limited Company	Chairman/CEO: Mr. Muhammad Arshad Sheikh
Key Shareholders (with stake 5% or more):	
Mr. Muhammad Arshad Sheikh – 27.50%	
Mr. Shahzad Ahmed Sheikh – 26.0%	
Mr. Nisar Ahmed Sheikh – 24.0%	
Mr. Sharhyar Arshad – 5.0%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates (August, 2021) https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Arshad Corporation (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Arshad Corporation (Pvt.) Limited was incorporated in 1973 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017). The company is principally engaged in manufacturing of sale of fabric and made-ups

Profile of the Chairman/CEO

Mr. Muhammad Arshad Sheikh is the Chairman of the Board and Chief Executive Officer (CEO). Mr. Arshad is a graduate and has over 50 years of textile industry experience.

Financial Snapshot

Tier-1 Equity: end-FY22: Rs. 5.3b; end-FY21: Rs. 4.1b; end-FY20: Rs. 3.5b

Assets:

end-FY22: Rs.20.5b; end-FY21: Rs. 15.8b; end-FY20: Rs 13.2b.

Profit After Tax:

FY22: Rs. 722m; FY21: Rs. 531m; FY20: Rs. 542m.

RATING RATIONALE

Arshad Corporation (Pvt.) Limited (ACL) is an export-oriented composite textile unit and primarily operates four business segments, including grey and processed fabric, made-ups and garments. The U.S. and Europe are the primary target markets, which account for nearly three-fourth of total sales. Shareholding of the company is held by the sponsoring family, who have been in the industry since 1954. The assigned ratings take into account notable growth in revenues primarily led by higher average product prices. Gross margins remained healthy while net margins were maintained despite increase in financial charges. Debt service coverage has remained adequate on a timeline basis. The company has recently carried out expansion of its weaving operations which became operational in August'22. In addition, the company has also executed BMR to enhance operational efficiencies in its processing and garments units during FY22. Despite notable increase in borrowings to support capex and meet elevated working capital requirements, gearing has remained intact due to augmentation in equity base. The capitalization is supported by profit retention and considerable support by sponsors over the years in form of provision of interest free loan, payable on discretion of the company.

During 1Q'23 the company reported slight improvement in gross margins on the back of favorable product prices. As per management, apart from some slowdown in the month of Sep'22, the company has been receiving steady export orders. The management also projects largely sustained topline and gross margins in full year while higher finance cost will put some pressure on the bottomline. Gearing is projected to improve on the back of scheduled repayment of long-term loans and strengthening equity base, going forward. Meanwhile, the ratings also factor in the political and economic uncertainty prevailing in Pakistan which may impact the business risk profile of the company. Slowdown in demand from international clients amid looming recession in global markets may lead to diseconomies of scale pushing gross and net profitability downward. Thus, the ratings will remain sensitive to achieving projected revenues and profitability while maintaining liquidity and capitalization profile within acceptable range.

Overall improvement in capacity utilization in the outgoing year while new weaving unit started commercial operations in Aug'22: The overall production capacities have remained optimal on the back of timely Balancing, Modernization and Replacement (BMR) over the years while variations in production capacities are largely driven by demand dynamics. During FY22, ACL weaved 50.9K meters/days of grey fabric (FY21: 42.6K meters) with increase in capacity utilization to 99% (FY21: 83%). Fabric processing unit of the company processed 79.3K meters of fabric per day (FY21: 82K meter) with slightly lower capacity utilization of 88% (FY21: 91%) in FY22. Installed capacity of printing operations increased from 115K meters per day to 125K meters per day while capacity utilization remained high at 90% (FY21: 86%). The capacity utilization of stitching unit-I increased to 91% (FY21: 76%) while stitching unit-II, which is used for quilting, reported decrease in capacity utilization to 62% (FY21: 91%). Installed and actual production per day along with capacity utilization of product segments are tabulated below:

	Installed Capacity per Day			Actual Production per Day			Capacity Utilization		
Unit Name	**FY20**	**FY21**	**FY22**	**FY20**	**FY21**	**FY22**	**FY20**	**FY21**	**FY22**
Weaving – Meters	51,600	51,600	51,600	41,354	42,630	50,958	80%	83%	99%
Processing – Meters	90,000	90,000	90,000	77,000	82,066	79,259	86%	91%	88%

Printing – Meters	115,000	115,000	125,000	101,065	98,670	112,091	88%	86%	90%
Stitching Unit I– Meters	65,000	70,000	70,000	43,240	53,038	63,580	67%	76%	91%
Stitching Unit II- Kgs	1,000	1,000	1,000	600	912	620	60%	91%	62%
Garments – Pieces	2,700	5,572	5,572	1,641	4,179	3,588	61%	75%	64%

Property, plant and equipment (PP&E) increased to Rs. 4.4b (FY21: Rs. 2.9b) at end-FY22. There were additions in plant & machinery amounting Rs. 269.7m, which were related to 2 straight Kaj machine, 2 Bottom machine, 1 Auto Hole machine at Garments unit. Capital work in progress amounting Rs. 1.2b mainly pertained to setting up of a new weaving unit. As per management the weaving unit was completely installed by end-June'22 while it started commercial operations in August'22 after running pilot tests. The weaving unit comprised 70 Airjet looms with a production capacity of 14.4m meters. A complete Karl Mayer Sizing machine, Jenbacher Gas Generator and air compressors have also been installed to support expansion. Previously the company used to meet around one-third of its fabric requirement through in-house production, whereas with new weaving unit coming online, the company will now be able to meet about 80% of fabric requirements itself.

Imported plant and machinery have been financed through bank borrowings under Long Term Financing Facility (LTFF) by SBP at a subsidized markup rate of 5%, while local components, installation cost and civil work related expenses amounting Rs. 355.2m were financed by sponsors through interest free loan. The company has sufficient capacity to meet its power requirements through a combination of gas generators, coal powered plant and national grid. The preferred mix is utilized by assessing per unit cost of each source.

Growth in sales mainly led by increase in average selling price: During FY22, the company posted a YoY growth of ~40% in topline; net sales were recorded higher at Rs. 18.3b (FY21: Rs. 13.2b) with around 88% comprising export sales. Increase in topline was largely driven by notably higher average selling prices of all products while volumetric sales of key products remained largely subdued except for garments and kitchen items. The overall demand compression was led by slowdown in global markets amidst inflation, especially in United States and Major European economies. The quantity sold in bedding segments declined substantially due to demand dynamics whereas average selling prices were recorded notably higher primarily as the company switched to producing premium articles. Accordingly, its percentage share in the product mix decreased to 31% (FY21: 43%). On the other hand, albeit quantity sold of processed fabric decreased by ~30%, the average selling prices more than doubled, leading to increase in its contribution to 38% (FY21: 28%) in the sales mix. The proportion of garments and kitchen items increased slightly. Local sales amounting Rs. 2.3b (FY21: Rs. 1.7b) comprised proceeds from fabric processing which makes 12% (FY21: 13%) of the total sales. The increase in local sales was in line with higher average prices along with largely stable quantity sold. Segment-wise breakdown of volumetric sales and average prices are tabulated below:

	Quantity Sold (Million)		Average Price Rs. /Unit		Total Sales (Millions)		% of Total Sales	
	FY21	**FY22**	**FY21**	**FY22**	**FY21**	**FY22**	**FY21**	**FY22**
Export Sales:								
Beddings	11.50	1.88	505.00	3,186.00	5,807.50	5,974.87	43%	31%
Garments	3.60	5.23	420.00	431.00	1,512.00	2,255.68	11%	12%
Kitchen Items	1.50	2.45	370.00	491.00	555.00	1,203.90	4%	6%
Kids Items	0.50	0.02	435.00	796.00	217.50	16.80	2%	0%

Processed Fabric	18.30	12.95	210.00	557.55	3,843.00	7,218.37	28%	38%
Local Sales:								
Fabric Processing	42.90	42.80	40.00	54.00	1,716.00	2,312.59	13%	12%

During FY22, gross profits were recorded significantly higher at Rs. 3.1b (FY21: Rs. 2.1b). Gross margins increased to 17.0% (FY21: 15.8%) mainly on account of increase in average selling prices of all products which more than offset the impact of cost of sales. Cost of sales was recorded higher at Rs. 15.2b (FY21: Rs. 11.1b), where the increase was mainly manifested in cost of raw material consumed amounting to Rs. 10.1b (FY21 Rs. 6.1b) along with increase in its contribution in cost of goods manufactured to 66% (FY21: 55%). The proportion of fabric purchased during the year decreased to 38% (FY21: 49%) of the total procurement as the company upscaled its weaving production. Accordingly, cotton/polyester yarn purchased contributed 42% (FY21: 30%) to the raw material mix. Other cost components also increased primarily due to inflationary pressure. Average price/mtr (Kgs) of all the raw materials is briefly tabulated below:

Administrative expenses increased to Rs. 542.8m (FY21: 432m) in FY22 and were largely rationalized. Distribution costs were recorded higher at Rs. 719.3m (FY21: Rs. 394.5m) primarily due to hike in freight charges. Other income amounting Rs. 9.1m (FY21: Rs. 1.5m) largely included profit realized on disposal of operating fixed asset. Finance cost increased to Rs. 826.3m (FY21: Rs. 541.1m) on account of higher average markup rates and overall increase in borrowings. Other expenses comprising employee profit participation and welfare fund amounted to Rs. 70.9m (FY21: Rs. 49.4 m). Accounting for taxation, net profit was recorded higher at Rs. 722.1m (FY21: Rs. 531.4m) while net margins remained at 4.0% (FY21: 4.0%) as result of inflationary impact on operating expenses and higher finance cost.

During 1Q'23, the company recorded Rs. 4.6b in net revenues. Gross margins also improved to 19.7% as rupee devaluation continued to support the exports. As per management, there was a slowdown in demand in the month of Sep'22, however, the sales picked up pace after that. In addition, raw material prices have trended downwards globally, and given competitiveness of exports in international markets ensuing from depreciating currency, the company expect to maintain its gross margins as well. Accordingly, the management has projected to sustain its topline and gross margins while net profitability is projected to decrease owing to higher finance cost in FY23.

Adequate debt service coverage: Funds from operations (FFO) increased to Rs. 1b (FY21: Rs. 695m; FY20: Rs. 399m) primarily due to higher profitability and positive difference between incurred and paid finance cost in FY22 vis-à-vis preceding year. However, FFO to total debt stood at 0.10x (FY21: 0.08) as a result of overall increase in debt levels. FFO to long-term debt, on the other hand remained adequate at 0.64x (FY21: 0.89x). Debt service coverage ratio albeit decreased to 1.61x (FY21: 1.78x) due to higher finance cost and principal repaid, has remained adequate.

Stock in trade stood higher at Rs. 7.6b (FY21: Rs. 6.6b) mainly on account of increase in finished goods inventory (FY22: Rs. 2.5b; FY21: Rs. 1.7b) by the end-FY22. Raw materials and work in progress inventories remained largely at prior year's level. Trade debts increased notably to Rs. 5.4b (FY21: Rs. 3.7b) whereas as a percentage of net sales stood at 30% (FY21: 28%). Aging profile of trade debts is considered satisfactory as around 56% of receivables were due for less than three months and 37% fall within 3-6 months credit bracket. The trade debts also included receivables amounting Rs. 607.7m (FY21: Rs. 511.8m) due from its associated undertakings, out of which about 80% were outstanding for less than six months. Local sales emanating from fabric processing services is majorly done on a cash basis with maximum credit period of 15 days while leftover fabric is entirely sold on a cash basis. Loans and advances amounted to Rs. 800.4m (FY21: Rs. 557.7m), mainly comprised advances paid to suppliers, and against letters of credit. Tax refunds due from government increased to Rs. 1.2b (FY2: Rs. 1b) due to higher sales tax refunds. As per management, after completion of filing process, tax refunds take around a month to get cleared by the government. In addition, other receivables have decreased to Rs. 211.7m (FY21: Rs. 478.8m) mainly due to a decrease in rebate/duty drawback. Cash and bank balances stood at Rs. 133.7m (FY21: Rs. 110.6m). Coverage of short-term borrowings via stock in trade and trade debts remained adequate at 1.42x (FY21: 1.37x). Current ratio has also been maintained at 1.15x (FY21: 1.14x). Net operating cycle has remained higher than the industry median mainly owing to slower inventory turnover. The liquidity profile is projected to remain largely intact, going forward.

Leverage indicators remained on a higher side: Tier-1 equity increased to Rs. 5.3b (FY21: Rs. 4.1b) on the back of internal capital generation during the outgoing year. The sponsors have continued to support the equity on a timeline basis through provision of interest free loan, repayable on discretion of the company. During the outgoing year, equity injection to the tune of Rs. 488m was made by the sponsors to support growth; total loan from directors amounted to Rs. 735.3m (FY21: Rs. 247.5m) at end-FY22. Total liabilities stood higher at Rs. 15.2b (FY21: Rs. 11.8b). Trade and other payables increased to Rs. 4.2b (FY21: Rs. 3.4b) mainly on account of higher trade creditors of Rs. 3.4b (FY21: Rs. 2.9b) and accrued charges amounting Rs. 502.7m (FY21: 330.9). ACL avails a credit period of 15-30 days for local yarn purchases, 12 – 60 days for local fabric purchases, and yarn imports on LC plus 90 days.

Short-term borrowings increased to Rs. 9.1b (FY21: Rs. 7.5b) in line with working capital requirements. These majorly included export refinance arrangements with a sanctioned limit of 11.6b (FY21: Rs. 9.4b) and carry markup rate ranging from average 1 to 3 months KIBOR plus 1% to 2.5% p.a. and average 1% over SBP refinance rate. Long-term loans including current portion increased to Rs. 1.6b (FY21: Rs. 780.8m) by end-FY22. Long term financing obtained during the year totaled to Rs. 1.1b (FY21: 333.5m) while principal repayments amounted to Rs. 344.3m (FY21: Rs. 151.2m). The long-term facilities are subject to markup ranging from average 1 to 3 months KIBOR plus 2% p.a. and average 1.5% to 2.5% over SBP financing rate. These are repayable on various dates in quarterly and semi-annually installments and would be fully repaid by Jan, 2032. The long-term financing obtained for payment of salaries and wages under subsidized scheme by SBP will be fully settled by end-Dec'22. Lease liabilities amounted to Rs. 79.5m (FY21: Rs. 22.2m). Debt leverage and gearing remained largely unchanged at 2.88x (FY21: 2.90x) and 2.03x (FY21: 2.03x), respectively, by end-FY22. Gearing decreased to 1.66x by end-1Q'23. Leverage indicators are projected to improve steadily on account of scheduled repayments of long-term loans and strengthening equity base due to profit retention.

Arshad Corporation (Pvt.) Limited (ACL) Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**Q1'FY23**
Non-Current Assets	2,608	2,921	4,518	4,524
Stores, Spares. And Loose Tools	382	511	635	696
Stock-in-Trade	5,138	6,604	7,588	7,566
Trade Debts	3,393	3,688	5,465	5,479
Other Receivables	278	479	212	214
Tax Refund Due From Government	855	1,009	1,151	1,200
Other Current Assets	402	564	805	830
Cash and Bank Balances	102	111	134	121
Total Assets	**13,158**	**15,887**	**20,508**	**20,630**
Trade and Other Payables	2,427	3,409	4,229	4,273
Short-Term Borrowings	6,502	7,489	9,181	9,239
Long-Term Borrowings *(Inc. current maturity)*	595	781	1,621	1,460
Other Liabilities	102	137	196	61
Total Liabilities	**9,626**	**11,816**	**15,227**	**15,027**
Paid-Up Capital	500	500	500	500
Tier-1 Equity	3,533	4,071	5,281	5,554
Total Equity	**3,533**	**4,071**	**5,281**	**5,554**
INCOME STATEMENT	**FY20**	**FY21**	**FY22**	**Q1'FY23**
Net Sales	10,839	13,200	18,261	4,608
Gross Profit	1,771	2,085	3,107	909
Current Ratio	1.15	1.14	1.15	1.16
Finance Cost	657	541	826	284
Other Income	285	2	9	1
Profit Before Tax	652	670	957	333
Profit After Tax	542	531	722	273
FFO	399	695	1036	134
RATIO ANALYSIS	**FY20**	**FY21**	**FY22**	**Q1'FY23**
Gross Margin (%)	16.3	15.8	17.0	19.7
Net Margin (%)	5.0	4.0	4.0	5.9
Net Working Capital	1,386	1,562	2,044	2,196
FFO to Long-Term Debt	0.68	0.88	0.64	0.36*
FFO to Total Debt	0.06	0.08	0.10	0.05*
Debt Servicing Coverage Ratio (x)	1.33	1.78	1.61	1.09
ROAA (%)	4.5	3.6	4.0	5.3*
ROAE (%)	16.7	13.3	15.4	20.2*
Gearing (x)	2.01	2.03	2.03	1.66
Debt Leverage (x)	2.72	2.90	2.88	2.71
Inventory + Receivable/Short-term Borrowings (x)	1.31	1.37	1.42	1.41
Net Operating Cycle (Days)	220	200	186	210

*Annualized

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Annexure II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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 Corporation (Pvt.) Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see table below
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	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
29/12/2022	A-	A-2	Stable	Reaffirmed
27/9/2021	A-	A-2	Stable	Upgrade
23/04/2020	BBB+	A-2	Rating Watch-Negative	Maintained

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Irfan Shahzad	CFO	December 1, 2022