RATING REPORT

Siara Textile Mills (Pvt.) Limited (STML)

REPORT DATE:
November 10, 2022

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	BBB	A-2
Rating Date	*10th Nov, 2022*	
Rating Outlook	Stable	

COMPANY INFORMATION	
Incorporated in 2004	External Auditors: Arshad Raheem & Co. Chartered Accountants
Private Limited Company	Chairman of the Board: Choudhry Mussarat Ali Chief Executive Officer: Mr. Akhtar Ali Choudhry
Key Shareholders (with stake 5% or more):	
Ch. Mussarat Ali – 44%	
Akhtar Ali Chaudhary – 19%	
Mr. Imran Akhtar – 10%	
Mr. Sufiyan Akhtar – 10%	
Mr. Wajid Ali – 10%	

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

Siara Textile Mills (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Siara Textile Mills (Pvt.) Limited (STML) was incorporated in 2004 and commenced commercial operations in 2007. The principal business activity of the company is manufacturing and sale of yarn in the local and international market. STML is ISO 9001 certified.

Profile of the Chairman

Choudhry Mussarat Ali is the Chairman of Board of Director at STML. He is also Chairman of Lal Qila Group in Manchester, UK.

Profile of CEO

Akhtar Ali Choudhry is the CEO of the company. He is a graduate and has over twenty-five years of experience in the textile sector. He has also served as Chairman Union Council from 1983-1991 and is an active member of Lahore, Gujrat and Sheikhupura Chamber of Commerce and Industry as well as the All Pakistan Textile Mills Association.

Financial Snapshot

Core Equity: end-FY22: Rs. 1.1b; end-FY21: Rs. 880.1m; end-FY20: Rs. 745.0m

Assets: end-FY22: Rs. 2.8b; end-FY21: Rs 2.0b; end-FY20: Rs. 2.7b

Profit After Tax: FY22: Rs. 155.6m; FY21: Rs. 113.2; FY20: Rs. 19.2m

RATING RATIONALE

Siara Textile Mills (Pvt.) Limited (STML) is a small-sized spinning unit, with shareholding vested with the sponsoring family who is actively involved in day-to-day operations of the company. The assigned ratings factor in high cyclicality and competitive intensity for spinning segment along with volatility in cotton prices which translate into moderate to high business risk profile. The rising cost of doing business, inflationary pressures coupled with increasing commodity prices and onset of monetary tightening regime is likely to impact profitability across the entire textile sector, going forward. Moreover, the business risk is further heightened on account of cotton crop being the most adversely impacted in wake of recent floods. The ratings draw comfort from growth in scale of operations, improvement in profitability indicators and gradual enhancement of equity in the past two years resulting in increased financial flexibility. On the other hand, leverage indicators have increased on account of higher borrowings to fund capital expenditure and increasing working capital requirements. The ratings also incorporate management's focus on expanding the scale of operations with the setup of additional 10,000 spindles expected to come online by end-Oct'22. Going forward, sales are projected to escalate on account of adequate orders in pipeline along with expansion. However, the ratings remain sensitive to any adverse changes in regulatory duties, lack of revenue diversification and limited scale of operations. The ratings are dependent on sustenance of margins, realization of projected targets, incremental cash flow generation from recent capital expenditure and maintenance of leverage indicators coupled with evolution of sector dynamics.

Textile and clothing exports have registered a sizeable growth given the surge in demand on account of rerouting of orders to Pakistan and favorable sector policies. However, the outlook is not favorable going forward in wake of competing countries operating at full potential post covid-lockdowns coupled with recent floods expected to have drastically impacted cotton crop.

The textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of Rs. 3.8tr (FY20: Rs. 3.3tr) in FY21. Barring seasonal and cyclical fluctuations, textiles products have maintained an average share of about 60% in national exports. Given post pandemic sustained economic recovery and diversion of export orders to Pakistan, export revenues from textile segment (as per PBS) stood at USD 15.4b (FY20: USD 12.5b; FY19: USD 13.6b) in FY21, registering a sizeable year-on-year growth of ~23%. The similar growth trend has been noted in the ongoing year with exports reaching at USD 9.4b during 6M'FY22, up by 26% vis-à-vis SPLY. Readymade and Bed wear segments continued to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While primarily a volumetric driven growth, the exports also received a boost from higher prices (excluding Knitwear). During the year, while average volumes increased by around 20-30% in various segments as compared to the lock down period, average prices increased by 8-10%.

On the other hand, cotton production in Pakistan was at its lowest level in decades for FY21. Cotton prices rose to a new 11-year high of around Rs. 13,000/maund, as a result of the production shortage. Given favorable weather conditions cotton production in Pakistan posted strong growth in FY22. Nevertheless, the upward momentum in cotton pricing continued in FY22. However, to the end of FY22, the cotton prices eased, falling in the range of Rs. 15.5-16k/maund. Going forward, challenges on the global economy will weigh on the business risk profile of textile operators; these include waning demand dynamics internationally, and external account crisis on the domestic front, which may affect provision of utilities to exporters at competitive pricing. In addition, on account of devastation caused by heavy rainfall and flash floods nationwide, Pakistan's cotton production has shrunk by 19% to 2.19 million bales till 15th Sep, 2022 in the current season. Prior to floods, Punjab was expected to produce 5.5 million bales and Sindh 3.5 million bales in the current season; however, in aggregate now Pakistan will produce around 5.5 million bales. As a result, the country is expected to import a similar quantity (5.5-6 million bales) to overcome the shortfall; the same is likely to impact the margins of the all textile players from upstream to downstream.

Five Year (2020-25) textile policy continues to support the industry: With the aim to double textile exports in five years, GoP through a five-year textile policy (2020-25) has provided incentives in form of preferential energy rates, low interest rates financing schemes (such as EFS, LTFF and TERF) and timely payments of DLTL, Income tax & Sales tax refund which would support liquidity constraints of local players. Initiatives are also being undertaken in order to increase production and yield of cotton to support the industry. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future of textile exports.

Addition of 10,000 spindles expected to be completed by end-Oct'22; the impact of the expansion will be seen in the ongoing year's results: STML incurred capex amounting to Rs. 778.8m on procurement of 10,000 spindles along with complete back process set up to expand the current spinning operations during FY22. Out of the total cost, Rs. 514.0m was financed through SBP's subsidized temporary economic relief scheme while the remaining expenditure was met through internal sources. The project is expected to come online by end-Oct'22 therefore the financial impact of capacity expansion will be evidenced in the ongoing year results. Under the existing setup, STML only manufactures carded coarse yarn of 10/s to 30/s counts depending on market demand. However, with the setup of additional spindles the company will add finer counts ranging from 40/s to 52/s to its product mix; the same as per the management will positively reflect in the margins of the company as finer counts entail higher margins as opposed to coarse counts. On the other hand, the total installed and operational spindles of STML along with capacity after conversion into 20/s count remained unchanged at 23,232 (FY21: 23,232) and 7.6 million Kgs (FY21: 7.6 million Kgs) at end-FY22. Further, mill has been running at nearly full capacity utilization (FY22: 99%; FY21: 96%) over the years.

Profitability underpinned by higher yarn prices: While volumetric sales of the company decreased by around 8% to 181,497 bags (FY21: 197,013 bags), topline increased sizably to Rs. 5.2b (FY21: Rs. 3.8b) on account of higher yarn prices in local and international markets during FY22. The company predominantly operates in the local market; volumetric increase in local sales to 181,497 bags (FY21: 155,613 bags) was witnessed as the share of export sales was taken up by local demand during FY22. There was no export sale made in FY22 as against export of 41,400 bags in the preceding year. Given the company largely is operating at full capacity, any sizable increase in quantum sales is not possible until recent capacity expansion gets underway. STML was able to reap higher average prices of yarn at Rs. 27,746/bag during FY22 as opposed to Rs. 19,257/kg in the previous year; however, the same did not reflect in the margins that were recorded slightly lower at 8.0% (FY21: 8.5%) during FY22. The dip in margins despite considerable increase in yarn prices was a combined function of increase in average cotton price to Rs. 389.1/kg (FY21: Rs. 270.1/kg) coupled with higher employee related expenses in line with increased minimum wage levels by the government and significant jump in fuel, power & vehicle running expenses in the cost of sales on account of recent petrol price hike and general inflation. Customer concentration, as measured in terms of sales to top 10 customers as a proportion of total sales, has remained high at 64% (FY21: 60%) during FY22. However, in order to mitigate client attrition risk, the company has developed long-term relationship with customers over the years along with production of higher quality carded yarn that makes supplier switching difficult.

The distribution cost decreased to negligible Rs. 0.5m (FY21: Rs. 20.7m) majorly due to decrease in ocean freight & inland freight on export; the decrease is in sync with discontinuation of export sales altogether during FY22. On the other hand, administrative expenses stood higher at Rs. 77.0m (FY21: Rs. 60.0m) during FY22 mainly as a result of increase in employee related expenses in line with annual salary increments coupled with high vehicle running expenses on account of sharp increase in prices of petrol and related products. Increase in administrative expenses is largely aligned with higher sales value and general inflation. The other expenses increased to Rs. 18.5m (FY21: Rs. 12.1m) owing to increased contribution to workers welfare fund on account higher profit booked during FY22. Moreover, the finance cost also increased to Rs. 83.6m (FY21: Rs. 76.1m) during FY22 due to procurement of long-term borrowing to fund capex expenditure along with higher utilization of commercial short-term credit to meet increased day to day working capital requirements. However, despite sizable increase in long-term borrowings coupled with market interest rates being at the higher end of the spectrum, the financial expense recorded is still not exorbitant given long-term borrowing are primarily procured under subsidized SBP facility. As a result of positive trajectory of revenues, STML reported higher profit of Rs. 155.6m (FY21: Rs. 113.2m) during FY22, the topline and bottom line of the company for the outgoing year are the highest ever recorded.

Going forward, the management projects to close FY23 with a topline of Rs. 7.8b; VIS expects that the target is realistic and achievable given incremental revenue generation is expected from additional 10,000 spindles coming online in Nov'22. Moreover, the margins are also projected to improve slightly to 9.0% for FY23 on account of production of fine count yarn entailing higher margins along with any price increase in raw material to be transferred to customers.

Liquidity position exhibited improvement stemming from enhanced scale of operations: Liquidity profile of the company has exhibited positive trajectory with improvement during the ongoing year in line with growth in revenues and profitability indicators. Funds from Operations (FFO) were recorded higher at Rs. 251.6 (FY21: Rs. 190.9m) during FY22 owing to growth in scale of operations. However, given significant procurement of long-term debt to fund capex coupled with higher utilization of short-term borrowings in line with increased scale of operations, FFO to total debt and FFO to long-term debt reduced to 0.23x (FY21: 0.38x) and 0.48x (FY21: 2.41x) respectively at end-FY22. Prior to FY22, STML had limited reliance on long-term funding therefore FFO to long-term debt was significantly huge. On the other hand, the debt service coverage improved to 1.41x (FY21: 1.03x) in line with growth in FFO along with the fact that the long-term repayments of the recently obtained debt will begin in the ongoing year; the same depicts that the company is comfortably placed to meet its contractual obligations due in one year.

Stock in trade subsided on a timeline to Rs. 550.5b (end-FY21: Rs. 532.5m; end-FY20: Rs. 1.2b) by end-FY22 owing to offloading of inventory that was retained on company's books during covid. Despite increase in scale of operations, the management has rationalized inventory levels to avoid unnecessary carrying costs. Further, given the company deals largely in cash, trade debts as a proportional of revenue are less than 5%. Moreover, the aging of receivables is also sound as all receivables pertaining to the last three financial years were recorded in the less than three months bracket.

Advances ad prepayments reduced to Rs. 202.9m (FY21: Rs. 316.4m) primarily owing to lower letters of credit open for import of goods at end-FY22. The cotton procurement mix for the company constituted 70% reliance on local cotton; however, after the anticipation that recent floods have destroyed sizable cotton crop STML has proactively changed its procurement strategy with two-thirds dependence on imports. Further, liquidity of the company is impacted due to sizable tax refunds amounting to Rs. 110.1m (end-FY21: Rs. 57.7m) due from government at end-FY22; the company is unable to rectify the situation given it is an exogenous factor and inherent in the local textile industry.

On the other hand, trade and other payables were recorded higher on a timeline at Rs. 224.9(end-FY21: Rs. 223.0m; FY20: Rs. 178.7m) at end-FY22 with majority pertaining to trade creditors; the increase in trade creditors is a function of higher inventory kept to meet demand of growing business operations. Further, international suppliers of raw material are paid through LC on sight and international suppliers of stores & spares are paid in advance. Therefore, working capital cycle necessitates utilization of short-term financing to fund inventory levels. Current ratio of the company stands comfortably over 1.0x. Stock levels are manageable while trade debts and stock in trade are more than sufficient to cover short-term borrowings. As per the management, the liquidity profile will improve in line with enhancement of scale of operations, sustained margins and capacity enhancement initiatives being undertaken. Going forward, maintenance of liquidity indicators is considered crucial from a rating perspective.

Moderately leveraged capital structure: The equity base of STML exhibited gradual growth to Rs. 1.1b (FY21: Rs.880.1m; FY20: Rs. 745.0m) by end-FY22 on account of internal capital generation. The equity includes loans extended by related parties amounting to Rs. 160.5m (FY21: Rs. 160.5m; FY20: Rs. 160.5m) at end-FY22; these are unsecured interest-free loans from directors and associates. The management has the intention to convert the loan into equity, therefore the loan is already treated as capital given the debt is not to be repaid. On the other hand, long-term borrowings also increased significantly to Rs. 524.2m (FY21: Rs. 79.2m) at end-FY22 as STML procured additional debt amounting to Rs. 461.1m under SBP TERF facility to fund capex incurred on installation of spindles during the outgoing year. Majority of company's borrowings are under SBP subsidized facilities therefore the interest cost is on the lower side. There has been a shift in the debt matrix of the company as by end-FY21 the same was heavily dominated by short-term funding; however, with the procurement of long-term funds during FY22, short-term debt comprised 53% (FY21: 84%) of total debt at end-FY22. In line with increase in trade debts owing to growth in operational scale, the short-term borrowings also increased to Rs. 550.5m (FY21: Rs. 532.5m) by end-FY22. The company had un-availed short-term credit lines of around Rs. 2.0b from different financial institutions at end-FY22. As a result of increase in total borrowings despite augmentation of equity base, gearing and leverage trended upwards during the rating period and were recorded higher at 1.03x (FY21: 0.57x) and 1.41x (FY21: 1.03x) respectively at end-FY22. Given there are no expansion plans in perspective with only normal BMR to be carried out which is to be met from internally generated capital, the leverage indicators are projected to improve during the rating horizon.

The leverage indicators, both gearing and debt leverage, exhibited volatility during the rating review period with improvement in FY21 owing to considerable growth in equity base. However, both gearing and leverage increased from FY21's level to 1.28x (FY21: 0.93x; FY20: 1.72x) and 1.88x (FY21: 1.63x; FY20: Rs. 2.59x) respectively owing to procurement of long-term funding for capex requirements coupled with increased utilization of short-term credit to meet higher working capital requirements in line with increase in scale of operations. Moreover, for the setup and procurement of additional 6,000 spindles, the company plans to procure additional debt of Rs. 250m during FY22. Given the expansion plans in perspective, the gearing is projected to increase in the current year.

Siara Textile Mills (Pvt.) Limited **Appendix I**

BALANCE SHEET (PKR Millions)	FY19	FY20	FY21	FY22
Property, Plant & Equipment	973.1	904.6	883.8	1,566.7
Store, Spares and Loose Tools	18.1	22.9	30.5	33.2
Stock-in-Trade	664.7	1,184.8	532.5	550.5
Trade Debts	75.0	109.3	133.6	236.6
Advances, Deposits & Prepayments	230.5	341.1	316.4	202.9
Balances with Statutory Authorities	46.2	102.1	57.7	110.1
Cash & Bank Balances	21.3	3.5	64.5	50.6
Other Assets	29	10.9	17.5	34.0
Total Assets	**2,057.3**	**2,679.2**	**2,036.5**	**2,784.6**
Trade and Other Payables	105.6	178.7	223.0	224.9
Deferred Liabilities	183.0	172.2	165.4	168.3
Long Term Debt *(including current maturity)*	25.5	20.4	79.2	524.2
Short Term Debt	731.6	1,268.3	502.8	1,083.6
Total Debt	**757.1**	**1,288.7**	**467.3**	**640.1**
Total Liabilities	1,061.7	1,661.3	866.2	1,051.0
Tier-1 Equity	699.6	**745.0**	**880.1**	**1,054.4**
Total Equity *(including revaluation surplus)*	995.6	1,017.9	1,132.3	1,287.9
Paid-up Capital	300.0	300.0	300.0	300.0
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**
Net Sales	2,834.4	2,796.6	3,834.2	5,169.9
Gross Profit	189.3	219.1	326.5	413.4
Profit Before Tax	58.5	45.4	158.1	235.7
Profit After Tax	23.2	19.2	113.2	155.6
Funds from Operations	155.5	98.6	190.9	251.6
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**FY22**
Gross Margin (%)	6.7	7.8	8.5	8.0
Net Margins (%)	0.8	0.7	3.0	3.0
Current Ratio (x)	1.25	1.20	1.67	1.36
Net Working Capital	215.0	288.7	455.2	312.8
FFO to Total Debt (x)	0.21	0.08	0.38	0.23
FFO to Long Term Debt (x)	6.10	4.83	2.41	0.48
Debt Leverage (x)	1.52	2.23	0.98	1.00
Gearing (x)	1.08	1.73	0.57	1.03
DSCR (x)	2.87	1.88	2.50	3.59
ROAA (%)	1.2	0.8	4.8	6.5
ROAE (%)	3.4	2.6	13.9	16.1
(Stock in Trade+ Trade Debt) to Short-Term Borrowing Ratio (x)	1.01	1.02	1.57	1.41

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	Appendix III				
Name of Rated Entity	Siara Textile Mills (Pvt.) Limited				
Sector	Textile				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	10/11/2022	BBB	A-2	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	
	1	Mr. Muhammad Anwar	CFO	7th Sep,2022	