# RATING REPORT

# Sohail Textile Mills Limited

**REPORT DATE:**
August 9, 2021

**RATING ANALYSTS:**

Tayyaba Ijaz
tayyaba.ijaz@vis.com.pk

| RATING DETAILS | | |
|---|---|---|
| **Rating Category** | **Initial Rating** | |
| | **Long-term** | **Short-term** |
| **Entity** | BBB- | A-2 |
| **Rating Outlook** | *Stable* | |
| **Rating Action** | Initial | |
| **Rating Date** | *August 9, 2021* | |

## COMPANY INFORMATION

| | |
|---|---|
| Incorporated in 1981 | External auditors: Munaf Yusuf & Co. Chartered Accountants. |
| Public Limited (Unlisted) Company | Chairman: Mr. Muhammad Nasir<br>Chief Executive Officer: Mr. Najib Usman |
| **Key Shareholders (with stake 5% or more):** | |
| Rizmar International (Pvt.) Limited – 11.91%<br>S&R Associates (Pvt.) Limited – 11.91%<br>Ahmed Rahim Associates (Pvt.) Limited – 11.65%<br>Mr. Najib Usman – 9.70%<br>Mr. Saqib Ellahi – 9.66%<br>Mr. Javed Usman – 9.63%<br>Mr. Shahid Usman – 9.56%<br>Mr. Muhammad Nasir – 9.42%<br>Mr. Muhammad Asif – 9.42% | |

## APPLICABLE METHODOLOGY(IES)

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

# Sohail Textile Mills Limited

## OVERVIEW OF THE INSTITUTION

Sohail Textile Mills Limited (SOT) was incorporated in 1981 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). The company is engaged in manufacturing and sale of yarn. The spinning unit is located at 9-KM Sheikhupura, Sargodha Road, and head office is located at 45-50 Industrial Area, Gulberg III Lahore.

**Financial Snapshot**

**Tier-1 Equity:** end-9MFY21: Rs. 363.9m; end-FY20: Rs. 320.9m; end-FY19: Rs. 303.5m.

**Assets:** end-9MFY21: Rs. 1.7b; end-FY20: Rs. 1.5b; end-FY19: Rs. 1.4b.

**Profit After Tax**: 9MFY21: Rs. 43.0m; FY20: 10.0m; FY19: Rs. 23.6m.

## RATING RATIONALE

Sohail Textile Mills Limited (SOT) is a part of Ayesha Group, which is one of the renowned players in yarn spinning industry of Pakistan. The assigned ratings take into account extensive experience, spanning nearly half a century, of the sponsoring family, and established relations with customers. The ratings incorporate some growth in sales and improvement in gross margins in the ongoing year in tandem with growth in textile sector. Liquidity is considered adequate in terms of coverages. Given modest growth in equity base due to limited profitability and increase in borrowings, leverage indicators have remained high. The ratings are constrained by small scale of operations and vulnerability of spinning sector to raw material prices. The ratings will remain sensitive to any further increase in gearing, maintenance of adequate coverages and sustained improvement in net margins.

**Group Introduction**

Ayesha Group entered the spinning industry with the establishment of Ayesha Spinning Mills Ltd. in 1972. Since then, the group has grown into four spinning units, with a combined capacity of more than 120,000 spindles, a leather tannery, a leather shoe factory, a shoe retail chain under the brand name of 'EPCOT', socks factory, an embroidery factory and a fashion retail chain under the brand name of 'Cross Stitch'. Total turnover of the group amounted to Rs. 14.9b and net income to Rs. 297.3m in FY20.

Ayesha Group is owned by six families, with each family having one-sixth shareholding in each group company individually and via four shell companies namely Rizmar International (Pvt.) Limited, S&R Associates (Pvt.) Limited, Ahmed Rahim Associates (Pvt.) Limited and UNA Associates (Pvt.) Limited. Six members of the family are the board members of each individual company and is headed by Mr. Muhammad Nasir. Moreover, a representative of each family is appointed as the chief executive officer.

**Key Rating Drivers**

**Company Overview**

Presently, the company has installed capacity of 27,972 spindles to manufacture blended polyester-cotton (PC) and chief-value-cotton (CVC) yarn of counts ranging from 10/s to 36/s. SOT uses a mix of local and imported raw material where imported constitutes around 15% of the total mix. Local cotton required for the entire year is procured between September and December; whereas polyester from local market can be purchased throughout the year with maintenance of 15 days' buffer stock. Procurement of raw material is primarily done on advance or cash basis from local market.

The company's yarn producing capacity, on conversion into 20/s count, remained at 8.26m Kgs (FY19 & FY18: 8.26m Kgs) at end-FY20. The production decreased to 6.0m (FY19: 6.9m Kgs; FY18: 6.7m Kgs) in FY20 and capacity utilization was recorded lower at 72% (FY19: 83%; FY19: 81%) as the mill remained closed for a month during lockdown. The company is in process of importing machinery, comprising six draw frames, six auto cones, two simplex, eleven ring frames, eight Reiter cards and two generators of 1.5 MW each. Subsequently, total number of spindles will increase to 33,472. The estimated capex is around Rs. 350m which is being funded mainly through long-term borrowings at subsidized rates. The new addition is expected to come online by end-Dec'21.

SOT has a total power requirement of 3 MW (operating at full capacity) that is being met through captive power generators. National grid is used as a backup source due to relatively high cost per unit; electricity from Water and Power Development Authority (WAPDA) currently costs around Rs. 14.50/unit vis-à-vis Rs. 11/unit from own generators.

The company also plans to add 50 shuttle less looms within factory premises for a capex of around Rs. 150m in FY23. A building of 20,000 sq ft will be constructed for this purpose. Each machine will be capable to produce 140-meter grey fabric per day.

**Increase in asset base mainly on account of higher raw material inventory:** Total assets of the company stood higher at Rs. 1.74b (FY20: Rs. 1.51b; FY19: Rs. 1.40b) by end-9MFY21. Property, plant and equipment (PP&E) remained at Rs. 1.1b. Long-term investment stood at Rs. 2.7m (FY20: Rs. 2.7m) at end-9MFY21, which represents 1.96% equity stake in Chiniot Textile Mills Limited and 1.18% stake in Sheikhupura Textile Mills Limited. Long-term security deposits of Rs. 13.5m (FY20: Rs. 13.5m; FY19: Rs. 12.3m) mainly comprised lease deposits.

Stock in trade increased to Rs. 466.4m (FY20: Rs. 270.4m; FY19: Rs. 188.9m) mainly due to higher material inventory of Rs. 425.0m (FY20: 247.3m; FY19: Rs. 170.4m) at end-9MFY21. Increase in raw material inventory by end-FY20 was primarily due to the impact of higher cotton prices and higher stock available at end-9MFY21. Local cotton prices have witnessed an increasing trend due to shortfall in local cotton production on a timeline basis. The company procured cotton at a higher average rate of Rs. 240 per kg (FY19: Rs. 225 per Kg; FY18: Rs. 181 per Kg) while average polyester rates were lower at Rs. 174/Kg (FY19: Rs. 184 per Kg; FY18: Rs. 144 per Kg) in FY20. Trade debts amounting Rs. 26.6m (FY20: Rs. 17.8m; FY19: Rs. 24.2m) were outstanding at end-9MFY21. More than 90% of the sales are made on a cash basis. Aging of outstanding receivables is considered satisfactory as all trade debts fall under 6 months' credit bracket.

**Growth in topline in the ongoing year:** Sales mix of the company largely comprised PC yarn of 30/s counts for home textile, export-oriented units. Topline was recorded lower at Rs. 2.0b (FY19: Rs. 2.2b; FY18: Rs. 1.76b) in FY20. Sales decreased mainly in the last quarter of FY20 owing to lower demand amidst first wave of Covid-19. The company sold 131,732 bags (FY19: 151,923 bags; FY18: 148,692 bags) with the average rate of yarn of Rs. 17,715 per bag (FY19: Rs. 14,344 per bag; FY18: Rs. 11,756 per bag) in FY20. Sales to top 10 customers accounted for 46% (FY19: 46%; FY18: 23%) of the total sales, suggesting high concentration. However, the associated risk is considered manageable given longstanding relationships with majority of these clients.

Gross profit was recorded slightly higher at Rs. 172.4m (FY19: Rs. 168.3m; FY18: Rs. 118.5m) in FY20. Gross margin increased to 8.6% (FY19: 7.7%; FY18: 6.7%) mainly on back of higher average yarn prices. Cost of sales was recorded lower at Rs. 1.84b (FY19: Rs. 2.02b; FY18: Rs. 1.64b) in line with decrease in sales. Raw material consumed as proportion of cost of goods manufactured also decreased to 74% in FY20 from 77% in the preceding year. Salaries, wages and amenities increased in line with annual salary adjustments along with increase in fuel cost due to inflationary pressure. Administrative expenses were recorded higher at Rs. 69.5m (FY19: 60.4m; FY18: Rs. 53.7m). Selling and distribution expenses have remained largely stable at Rs. 7.1m (FY19: Rs. 7.2m; FY18: Rs. 7.4m). Financial charges increased slightly to Rs. 53.2m (FY19: Rs. 50m; FY18: Rs. 23m). Other income amounted to Rs. 2.1m (FY19: Rs. 0.8m; FY18: Rs. 0.5m). Other expenses of Rs. 3.0m (FY19: Rs. 3.6m; FY19: Rs. 2.4m) pertained to employees related expenses. Net profit stood lower at Rs. 10.0m (FY19: Rs. 23.6m; FY18: Rs. 86.1m) in FY20 mainly on account of lower sales, higher operating expenses, and higher effective tax. The company is liable to pay minimum tax on turnover under section 113 of Income Tax Ordinance, 2001.

Sales during 9MFY21 amounted to Rs. 1.8b. The company managed to sell 120,302 bags in 9MFY21 at an average rate of Rs. 17,325/bag. Waste sales amounted to Rs. 16.9m (FY19: Rs. 11.6m; FY18: Rs. 12.3m). Gross profit was recorded at Rs. 164.9m with higher gross margin of 9.1%; an outcome of higher average yarn rates. Administrative expenses were largely rationalized. Selling and distribution expenses increased in 9MFY21 due to higher packing cost which will be adjusted in stores consumed under cost of goods sold in full year accounts. Finance cost has decreased on an annualized basis owing to lower average markup rates. Accounting for taxation, net profit amounted to Rs. 43m. The company expects net revenues of Rs. 2.5b in FY21 on back of higher volumetric sales and yarn prices.

**Adequate coverages:** Funds from operations (FFO) increased to Rs. 60.7m (FY20: Rs. 38.0m; FY19: Rs. 72.2m) in line with higher profitability in 9MFY21. FFO decreased in FY20 mainly due to higher tax paid, lower difference between paid and incurred finance cost and lower profit before taxation. Annualized FFO to long-term debt and total debt increased to 0.51x (FY20: 0.23x; FY19: 0.44x) and 0.14x (FY20: 0.10x; FY19: 0.23x), respectively in 9MFY21. In addition, debt service coverage ratio (DSCR) remained adequate at 2.4x (FY20: 1.5x; FY19: 2.1x). Coverage of short-term borrowings via trade debts and stock in trade is also considered adequate at 1.23x (FY20: 1.39x; FY19: 1.45x) at end-9MFY21. Current ratio has remained largely stable at 1.19x (FY20: 1.12x; FY19: 1.12x) on timeline basis. With higher profitability, cash flow coverages are projected to improve, going forward.

**High leverage amid relatively small equity base:** Tier-1 equity increased to Rs. 363.9m (FY20: Rs. 320.9m; FY19: Rs. 303.5m) by end-9MFY21 on the back of profit retention. Total equity amounted to Rs. 929.1m (FY20: Rs. 886.1m; FY19: Rs. 876.1m) including revaluation surplus on fixed assets. Total liabilities witnessed an increase on a timeline basis to Rs. 811.1m (FY20: Rs. 627.5m; FY19: Rs. 524.1m) mainly on account of increase in short-term borrowings. Trade and other payables stood at Rs. 116.5m (FY20: Rs. 120.7m; FY19: Rs. 78.0m) at end-9MFY21; increase in trade and other payables in FY20 was mainly due to higher advances from customers coupled with some increase in outstanding creditors.

The debt profile of the company comprises a mix of short-term borrowings from commercials banks, subordinated long-term loan from directors, and finance lease. Short-term borrowings stood higher at Rs. 399.4m (FY20: Rs. 206.9m; FY19: Rs. 146.7m) at end-9MFY20 in line with working capital requirements. Subordinated long-term loan from the directors amounted to Rs. 87.3m (FY20: Rs. 89.1m; FY19: Rs. 89.1m). The directors have entered into a subordinated agreement with a commercial bank against this loan which carries markup at rate of 3M KIBOR plus 1.5%. Finance lease obligations, inclusive of current maturity, amounted to Rs. 72.2m (FY20: Rs. 72.8m; FY19: Rs. 73.4m) at end-9MFY21. The company rescheduled principal amount payable under these lease financing facilities for one year under SBP relief for Covid-19, out of which Rs. 56.5m are outstanding as of now. Gearing and leverage increased to 1.54x (FY20: 1.15x; FY19: 1.02x) and 2.23x (FY20: 1.96x; FY19: 1.73x), respectively, mainly on account of higher short-term borrowings.

The company has mobilized a loan of Rs. 30.5m under SBP refinance for payment of salaries and wages at subsidized rate of 3% per annum in the ongoing year. The company has also availed financing under Temporary Economic Refinance Facility (TERF) carrying markup at rate of 5% per annum to the tune of Rs. 211.5m for the intended capex in the last quarter of FY21. With the said additional borrowings, leverage is expected to remain high despite projected increase in equity base, going forward.

## Sohail Textile Mills Limited — Annexure I

| FINANCIAL SUMMARY *(amounts in PKR millions)* | | | | |
|---|---|---|---|---|
| **BALANCE SHEET** | **FY18** | **FY19** | **FY20** | **9MFY21** |
| **Non-Current Assets** | 1,111.6 | 1,109.2 | 1,120.8 | 1,101.6 |
| **Stores, Spares and Loose Tools** | 15.6 | 15.3 | 22.6 | 21.0 |
| **Stock-in-Trade** | 160.6 | 188.9 | 270.4 | 466.4 |
| **Trade Debts** | 13.8 | 24.2 | 17.8 | 26.6 |
| **Advances, Deposits and Other Receivables** | 36.4 | 45.8 | 44.8 | 59.2 |
| **Cash and Bank Balance** | 19.2 | 16.7 | 37.2 | 65.5 |
| **Total Assets** | **1,357.2** | **1,400.1** | **1,513.6** | **1,740.2** |
| **Trade and Other Payables** | 51.0 | 78.0 | 120.7 | 116.5 |
| **Short-Term Borrowings** | 148.0 | 146.7 | 206.9 | 399.4 |
| **Long-Term Borrowings *(including current maturity)*** | 174.8 | 162.5 | 161.8 | 159.5 |
| **Deferred Liabilities** | 160.2 | 116.1 | 117.6 | 117.6 |
| **Other Liabilities** | 6.6 | 20.8 | 20.5 | 18.1 |
| **Total Liabilities** | 540.5 | 524.1 | 627.5 | 811.1 |
| **Tier-1 Equity** | **277.9** | **303.5** | **320.9** | **363.9** |
| **Total Equity** | 816.7 | 876.1 | 886.1 | 929.1 |
| **Paid-up Capital** | 69.0 | 69.0 | 69.0 | 69.0 |
| | | | | |
| **INCOME STATEMENT** | **FY18** | **FY19** | **FY20** | **9MFY21** |
| **Net Sales** | 1,760.3 | 2,190.8 | 2,008.4 | 1,807.1 |
| **Gross Profit** | 118.5 | 168.3 | 172.4 | 164.9 |
| **Operating Profit** | 57.3 | 100.7 | 95.8 | 107.2 |
| **Profit/(Loss) Before Tax** | 32.4 | 47.9 | 41.7 | 70.1 |
| **Profit After Tax** | 86.1 | 23.6 | 10.0 | 43.0 |
| **FFO** | 42.9 | 72.2 | 38.0 | 60.7 |
| | | | | |
| **RATIO ANALYSIS** | **FY18** | **FY19** | **FY20** | **9MFY21** |
| **Gross Margin (%)** | 6.7 | 7.7 | 8.6 | 9.1 |
| **Net Margin (%)** | 4.9 | 1.1 | 0.5 | 2.4 |
| **FFO to Long-Term Debt (x)** | 0.25 | 0.44 | 0.23 | 0.51* |
| **FFO to Total Debt (x)** | 0.13 | 0.23 | 0.10 | 0.14* |
| **Debt Servicing Coverage Ratio (x)** | 3.0 | 2.1 | 1.5 | 2.4 |
| **Gearing (x)** | 1.16 | 1.02 | 1.15 | 1.54 |
| **Debt Leverage (x)** | 1.94 | 1.73 | 1.96 | 2.23 |
| **Current Ratio** | 1.12 | 1.12 | 1.12 | 1.19 |
| **Inventory Plus Receivables / Short-term Borrowings** | 1.18 | 1.45 | 1.39 | 1.23 |

***** *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** | Sohail Textile Mills 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. |
| **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. Copyright 2019 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS. |
| **Due Diligence Meetings Conducted** | see table below |

**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| **9/08/2021** | BBB- | A-2 | Stable | Initial |

**Due Diligence Meetings Conducted**

| Name | Designation | Date |
|---|---|---|
| **Mr. Salman Haider** | Group CFO | June 24, 2021 |