RATING REPORT

Sohail Textile Mills Limited

REPORT DATE:

October 19, 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	BBB-	A-2
Rating Date	October 19, 2022		August 09, 2021	
Rating Action	Reaffirmed		Initial	
Rating Outlook	Stable		Stable	

COMPANY INFORMATION	
Incorporated in 1981	External auditors: Munaf Yusuf & Co. Chartered Accountants.
Public Limited (Unlisted) Company	Chief Executive Officer/Chairman: Mr. Najib Usman
Key Shareholders (with stake 5% or more):	
Mr. Najib Usman – 59.75% Mr. Tayyab Najib – 40.04%	

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

Sohail Textile Mills Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Sohail Textile Mills Limited (SOT) was incorporated in 1981 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017).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-FY22: Rs. 551.0m; FY21: Rs. 420.3m; end-FY20: Rs. 320.9m.

Assets: end-FY22: Rs. 2.6b; end-FY21: Rs. 2.2b; end-FY20: Rs. 1.5b.

Profit After Tax: FY22: Rs. 116.6m; FY21: Rs. 90.3m; FY20: 10.0m.

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 of the sponsoring family, spanning nearly half a century and established relations with customers. The ratings incorporate notable growth in sales during the outgoing year driven by higher average yarn prices in line with covid led growth in textile industry of Pakistan. Gross margins decreased slightly while net margins were largely sustained owing to rationalized operating and other expenses. Liquidity position is underpinned by adequate cash flow coverages. Leverage indicators have remained high amidst high borrowings and small equity base. The ratings are constrained by small scale of operations, inherent cyclicality of spinning sector and volatility in cotton prices. Additionally, in the aftermath of recent floods in the country leading to cotton shortage, weakening demand of non-essential items in the local and international markets amid looming recession may negatively impact the outlook of textile industry. The continuance of favorable regulatory regime for textile industry is imperative for the assigned ratings. The ratings will remain sensitive to improvement in gearing, sales and profitability profile and maintenance of adequate debt service coverages.

Key Rating Drivers

Cotton production expected to decline owing to recent floods: According to Federal Commission on Agriculture, targeted area for cotton crop was 2.53m hectares (2020-21: 2.32m Hectares) with production target of 11.03m bales (2020-21: 10.5m bales). Meanwhile, actual area sown in 2022-23 is reported at 2.065m hectares (2020-21: 1.935m hectares) which is 6.5% higher than the preceding year. (Source: Provincial Agriculture Extension & Crop Reporting Service Departments). However, the recent floods have brought devastation for the agriculture and livestock sector of the country. Cotton and rice crop belts remain the most affected, besides fresh vegetables. As per news reports, major cotton producing areas impacted primarily include Sanghar, Khairpur, Naushahro Feroz etc. regions in Sindh and Rahim Yar Khan, Dera Ghazi Khan, Rajanpur etc. in South Punjab. As per estimate, affected area of cotton sowing destroyed by floods stands at 32% which could lead to a decline ~2.5m bales.

Due to demand and supply gap, Pakistan textile industry has to rely on imported cotton to meet country's demand. According to provisional numbers by Pakistan Bureau of Statistics (PBS), around 4.57m bales of cotton were imported during FY22 vis-à-vis 5.04m bales in FY21 while in terms of value, the imported cotton cloaked at Rs. 3.29b as compared to Rs. 2.35b in the preceding year; an increase of ~40%, primarily on account of surge in cotton prices due to demand supply dynamics and rupee depreciation. Cotton prices dropped by over 20% globally to six months low by end-June, 2022 and exhibited range bound variation afterwards owing to slowdown in demand amidst recession in global markets. With recent destruction of cotton crop, imports are expected to increase which will further stress the country's forex reserves.

Textile industry in Pakistan plays a significant role in supporting economy in terms of industrial growth, employment opportunities, and most importantly in improving current account deficit. Pakistan exported USD 19.33b worth textile products during FY22, exhibiting an increase of 25.5% as compared to USD 15.4b in the preceding year (PBS). The textile exports contributed ~61% to the total exports of USD 31.8b during the outgoing year. Local currency devaluation against USD has been giving a competitive advantage to textile exporters in the international markets in terms of pricing. The Govt. set the target to achieve USD 25b exports during FY23, however, domestic and global challenges may dampen the outlook of local textile industry. In addition, rising energy prices, inflationary pressure and recent increase in food inflation arising from flood has suppressed the purchasing power of local customers which may hamper the demand of textile products.

Change in shareholding and Board structure: 'Ayesha Group' is owned by six families. Previously, shareholding structure comprised one-sixth equity stake held by each family in each group company individually, and via four shell companies. During FY22, the ownership structure of the entire group has been changed. Presently, each family holds a single company while four shell companies have been dissolved. Shareholding of SOT is held by Mr. Najib Usman' family, including, Mr. Tayyab Najib and Mrs. Asma Najib who are also directors of the board. Mr. Najib Usman continues to be the CEO of the company. The long-term investments of SOT worth Rs. 2.7m, representing 1.96% equity stake in Chiniot Textile Mills Limited and 1.18% stake in Sheikhupura Textile Mills Limited, have therefore been dissolved accordingly with change in shareholding structure.

Production update: The company installed eleven ring frames comprising 6,372 spindles during the outgoing year which became fully operational in January 2022. Subsequently, the number of installed spindles has increased to 33,384 (FY21: 27,012). The ring frames and other related machinery costed Rs. 243.1m. Actual production while converted into 20s count has remained high as the company generally manufactures higher count yarn. In addition, the production capacity also varies depending on spindles speed, twists per inch and raw material used etc.

	FY20			FY21			FY22		
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**
Installed Spindles	27,012			27,012			33,384		
Production Efficiency (20s) Ring Frames	8,263,200	10,461,717	127%	8,263,200	11,113,368	134%	9,862,000	11,113,358	113%

Other additions in plant and machinery worth Rs. 164.5m pertained to a gas generator, new air conditioning plant along construction of building hall, godown and air conditioning station. The aforementioned expenditure has been financed through bank borrowings amounting Rs. 213m and through own sources. Property, plant and equipment stood higher at Rs. 2.0b (FY21: Rs.1 .6b) in line with aforementioned addition.

SOT has cumulative power requirement of 3 MW (operating at full capacity) that is being met through sanctioned load from national grid and gas generators of 2.5 MW capacity. During the outgoing year, the company remained primarily dependent on national grid owing to gas supply constraint and relatively higher cost per unit on captive power. However, the company do utilize 28% subsidized gas quota from Government to run generators.

Revenue growth led by higher average selling prices: Topline grew by ~40% to Rs. 3.5b (FY21: Rs. 2.5b) in FY22 on account of higher average selling prices despite some decrease in volumetric sales. Sales mix of the company largely comprised PC yarn of 30s count for home textile, export-oriented units. Breakdown of sales into volume and average prices for the last two years is tabulated below:

Rs. /Unit	**FY21**			**FY22**		
	Volume	**Average Price**	**Value (m. Rs.)**	**Volume**	**Average Price**	**Value (m Rs.)**
PC Yarn (Bags)	151,413	Rs. 16,483/Bag	2,495.7	151,161	Rs. 22,985/Bag	3,474.5
Waste (Kgs)	576,834	27.2/Kg	15.7	641,263	Rs. 38.8/Kg	24.8
Raw Material Sale (Kgs)	-	-	-	124,578	Rs. 337.1/Kg	42.0
Net Sales	Rs. 2,511.4m			Rs. 3,541.3m		

Sales concentration has remained largely unchanged as top ten customers accounted for 45% of the total sales. However, the risk is manageable due to longstanding relationship with clients underpinned by quality and pricing. Top ten clients of the company with respective contributions to the net sales during FY22 are presented below:

Top 10 Clients	**FY22 (m Rs.)**	**%**
Haroon Fabrics (Pvt. Ltd.	352.3	10%
J.K Spinning Mills Ltd.	299.3	8%
Kamal Limited	191.0	5%

Kamal Industries	152.3	4%
Elahi Enterprises	142.1	4%
Furqan Textile	134.5	4%
A.B Exports (Pvt.) Ltd	105.0	3%
Elahi Impex	86.2	2%
Zafar Fabrics (Pvt.) Ltd.	80.5	2%
K.B Enterprises	53.0	1%
Total	1,596.3	45%

The company generated Rs. 364.8m (FY21: Rs. 284.0m) in gross profits during FY22. Gross margins, however, decreased slightly to 10.3% (FY21: 11.3%) despite ~39% increase in average selling prices, primarily owing to relatively higher cost of raw materials. The company procured local and imported cotton at around 57% higher average rate of Rs. 417.4/Kg as compared to Rs. 266.3/Kg in the preceding year while average polyester rates increased by 63% to Rs. 292/Kg (FY21: Rs. 179.1/Kg). Imported raw material, including cotton and polyester, constituted around 15% of the raw material mix while proportion of these remained at 60:40. Administrative and distribution expenses were recorded at Rs. 90.6m (FY21: Rs. 77.9m) and Rs. 11.5m (FY21: Rs. 7.5m), respectively. Other income remained limited and largely included profit on bank deposit accounts. Financial charges were recorded higher at Rs. 78.4m (FY21: 45.7m) in line with higher average markup rates and borrowings during FY22. Accounting for taxation, the company reported net profit of Rs. 116.6m (FY21: 86.0m) with largely sustained net margins of 3.3% (FY21: 3.6%).

The management projected the revenues to grow at a CAGR of 18% over three years period led by combined impact of higher volumes emanating from incremental production from new spindles and some increase in selling prices. Rising cost of sales amidst raw material availability constraints, inflationary pressure, depreciating local currency along with weakening of demand due to slower economic growth may put some pressure on achieving expected revenue growth and profitability profile for the company.

Adequate coverages: Funds from operations (FFO) amounted to Rs. 144.1m (FY21: Rs. 131.0m) in FY22. FFO to total debt and long-term debt albeit decreased to 0.25x (FY21: 0.32x) and 0.49x (FY21: 0.58x), respectively, on account of overall increase in borrowings, have remained at adequate level. Debt service coverage has also remained adequate at 2.14x (FY21: 3.0x); some decrease was due to increase in long-term repayments and finance cost paid during FY22.

Stock in trade stood lower at Rs. 362.2m (FY21: 300.6m), with raw material inventory including material in transit amounted to Rs. 298.5m (FY21: Rs. 274.9m) by end-FY22. Trade debts amounted to Rs. 75.6m (FY21: RS. 25.9m) and as percentage of net sales have remained minimal at 2% (FY21: 1%). Sales are normally executed on cash basis where credit sales have remained at around 10%. Aging profile of trade receivables is also considered satisfactory as almost entire receivables were due for less than 90 days. Advances, deposits and other receivables decreased to Rs. 52.8m (FY21: Rs. 122.1m) in line with decrease in outstanding letters of credit against import of raw material. Cash and bank balances amounted to Rs. 58.8m (FY21: Rs. 86.2m) at end-FY22. Trade and other payables increased to Rs. 155.3m (FY21: 113m) by end-FY22 owing to higher accrued expenses and other liabilities; however, in proportion to cost of sales remained at 5% (FY21: 5%). Accordingly, current ratio was reported slightly lower at 1.0x (FY21: 1.33x). Coverage of short-term borrowings via trade debts and stock in trade remained adequate at 1.21x (FY21: 1.33x). Working capital management drives strength from relatively shorter net operating cycle (FY22: 33 days; FY21: 34 days) as compared to industry median, on a timeline basis, due to higher receivables and inventory turnover.

Leveraged capital structure amid relatively small equity base: The core equity of the company has increased steadily to Rs. 551.0m (FY21: Rs. 420.3m) on the back of profit retention. Total equity, including revaluation surplus, amounted to Rs. 1.5b (FY21: 1.3b). The debt profile of the company comprises a mix of short-term and long-term borrowings from commercial banks, finance lease and subordinated long-term loan from directors. Short-term borrowings have increased to Rs.361.6m (FY21: 245.5m) mainly to finance purchase of local machinery components. Long-Term borrowings including current portion stood higher at Rs. 376.3m (FY21: 299.9m). This includes subordinated long-term loan from the directors amounting Rs. 89.1m (FY21: 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%. SOT mobilized long-term loan under

Temporary Economic Relief Facility (TERF), priced at a flat rate of 5% for import of machinery during the last two years (FY22: Rs. 122.4m; FY21: Rs. 145.7m). In addition, lease liabilities amounted to Rs. 62.1m (FY21: Rs. 78.6m). Gearing and debt leverage were reported at 1.34x (FY21: 1.30x) and 2.00x (FY21: 2.10x), respectively, at end-FY22. The management does not intend to mobilize additional long-term borrowings in the medium term. Therefore, going forward, leverage indicators are projected to decrease primarily due to scheduled repayments of long-term loans to the banks and increase in equity base on account of internal capital generation.

Sohail Textile Mills Limited Annexure I

Financial Summary (in million PKR)

BALANCE SHEET	FY19	FY20	FY21	FY22 (Unaudited)
Property, Plant and Equipment	1,109.2	1,120.8	1,659.2	1,974.1
Stock-in-Trade	188.9	270.4	300.6	362.2
Trade Debts	24.2	17.8	25.9	75.8
Advances, Deposits and Other Receivables	45.8	44.8	122.1	52.8
Cash and Bank Balance	16.7	37.2	86.2	58.8
Other Assets	30.4	38.9	36.6	40.9
Total Assets	**1,400.1**	**1,513.6**	**2,230.7**	**2,564.5**
Trade and Other Payables	78.0	120.7	113.0	121.7
Short-Term Borrowings	146.7	206.9	245.5	361.6
Long-Term Borrowings *(including current maturity)*	162.5	161.8	299.9	376.3
Deferred Liabilities	116.1	117.6	200.8	209.8
Other Liabilities	20.8	20.5	24.0	31.0
Total Liabilities	**524.1**	**627.5**	**883.2**	**1,100.4**
Tier-1 Equity	**303.5**	**320.9**	**420.3**	**551.0**
Total Equity	876.1	886.1	1,347.6	1,464.2
Paid-up Capital	69.0	69.0	69.0	69.0

INCOME STATEMENT	FY19	FY20	FY21	FY22 (Unaudited)
Net Sales	2,190.8	2,008.4	2,511.4	3,541.3
Gross Profit	168.3	172.4	284.0	364.8
Operating Profit	100.7	95.8	198.6	264.0
Profit/(Loss) Before Tax	47.9	41.7	130.9	172.7
Profit After Tax	23.6	10.0	90.3	116.6
FFO	72.2	38.0	131.0	184.1

RATIO ANALYSIS	FY19	FY20	FY21	FY22 (Unaudited)
Gross Margin (%)	7.7	8.6	11.3	10.3
Net Margin (%)	1.1	0.5	3.6	3.3
FFO to Long-Term Debt (x)	0.44	0.23	0.58	0.49
FFO to Total Debt (x)	0.23	0.10	0.32	0.25
Debt Servicing Coverage Ratio (x)	2.1	1.5	3.0	2.14
Gearing (x)	1.02	1.15	1.30	1.34
Debt Leverage (x)	1.73	1.96	2.10	2.00
Current Ratio	1.12	1.12	1.33	1.00
Cash Conversion Cycle (days)	23	34	34	33
Inventory Plus Receivables / Short-term Borrowings (x)	1.45	1.39	1.33	1.21

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.
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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				
Oct-19-22	BBB-	A-2	Stable	Reaffirmed
Aug-09-21	BBB-	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Salman Haider	Group CFO	September 13, 2022