

RATING REPORT

Sohail Textile Mills Limited

REPORT DATE:

December 04, 2023

RATING ANALYSTS:

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Rating Category	Latest Ratings		Previous Ratings	
	Long-term	Short-term	Long-term	Short-term
Entity	BBB-	A-2	BBB-	A-2
Rating Date	December 04, 2023		October 19, 2022	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	

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)

Applicable Rating Criteria: Corporates (May 2023):

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

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Sohail Textile Mills Limited (SOT) was incorporated in 1981 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017).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 Sheikhpura, Sargodha Road, and head office is located at 45-50 Industrial Area, Gulberg III Lahore.

RATING RATIONALE

Company Profile

Sohail Textile Mills Limited (“SOT” or ‘the Company’) is a public unlisted company with its main business activity in manufacturing and marketing of yarn. The Company’s registered office is situated on the 2nd floor, Plot No. 21/C, Lane-6 Zamzama Commercial, Phase-V, DHA, Karachi while its head office is situated at 45-50, Industrial Area, Gulberg III, Lahore. SOT’s manufacturing facility is located at 09-KM Sheikhpura, Sargodha Road, District Sheikhpura, Punjab.

Key Rating Drivers

Ratings consider constrained business risk profile by cyclicity, and high competition in the sector.

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

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

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

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

While the global outlook for cotton production is expected to rebound, local challenges persist. These challenges include high interest rates, increasing energy costs, and difficulties with obtaining letters of credit (LCs). These factors are likely to result in continued sluggish performance for the spinning sector in FY24.

Ratings incorporate topline and margin compression on account of volatility in economic environment.

Topline of the Company has come under pressure, demonstrating a decline of ~11% to Rs.3.2b (FY22: Rs.4.8b). The decline can be primarily attributed to the recessionary trend observed in the export market which has dampened the demand from export-based clients. The decline in sales volumes along with increased raw material costs and high inflationary pressure resulted in a reduction in gross and operating margins. Gross and operating margins were reported at 6.3% (FY22: 9.9%) and 3.7% (FY22: 6.8%), respectively.

Moreover, net margins of the Company also contracted to 0.02% (FY22: 2.5%) in FY23, primarily due to a surge in the finance cost from higher interest rates, despite reduction in short-term borrowings.

Going forward, as per management, uncertainty still looms regarding the outlook for export sector. As such, the Company's ability to improve its topline and margins in line with its assigned ratings remain key rating considerations.

Ratings account for improvement in capitalization profile on the back of a reduction in short-term borrowings.

In FY23 the Company's capitalization saw an improvement, gearing and leverage ratios were reported at 0.7x (FY22: 1.2x) and 1.8x (FY22: 2.1x) in FY23, respectively. This was on account of a decline in the short-term borrowing owing to lower working capital requirements due to reduced operations. While the equity base without revaluation surplus of the Company stood at Rs.538m (FY22: 524m) in FY23.

Going forward, management plans to limit its utilization of short-term borrowings by way of maintaining its cash conversion cycle. Moreover, the Company has planned to install a small stitching unit, the cost of which will be fully financed through internal cash generation.

Therefore, the Company's ability to successfully manage Capex requirements through internal sources will be a key consideration for future ratings. Moreover, maintenance of the capitalization profile in line with assigned ratings will remain a key sensitivity, going forward.

Ratings incorporate stress on the coverage profile; However, liquidity profile remains adequate with assigned ratings. Improvement will be key for ratings going forward.

SOT's liquidity profile has remained adequate, with current ratio reported at 1.0x (FY22: 1.0x). Additionally, reduction in short-term borrowings has translated into an improvement in the Company's short-term debt coverage, with a cover of 2.5x (FY22: 1.1x) in FY23.

However, lower profitability has exerted pressure on the coverage profile, with FFO to total debt declining to 15.8% (FY22: 27.0%) and FFO to long term debt decreasing to 26.8% (FY22: 61.9%) in FY22. Moreover, with the decline in FFO coupled with the surge in finance costs, the DSCR has also narrowed, falling below 1.0x to report at 0.9x (FY22:1.7x).

Going forward, management expects support from their directors in case of any further deterioration. Consequently, ratings will remain sensitive to the support from directors, along with improvement in the coverage and liquidity profile commensurate of assigned ratings.

Sohail Textile Mills Limited
Annexure I

FINANCIAL SUMMARY (PKR Millions)				
<u>BALANCE SHEET</u>	FY20A	FY21A	FY22A	FY23M*
Property, plant and equipment	1,104.5	1,659.2	1,965.9	1,907.3
Stock-in-trade	270.4	300.6	361.1	283.6
Trade debts	17.8	25.9	75.8	82.8
Cash & Bank Balances	37.2	86.2	58.8	15.6
Total Assets	1,513.6	2,230.7	2,555.3	2,427.1
Trade and Other Payables	120.7	113.0	123.5	275.0
Long-term Debt (incl. current portion and lease liability)	72.8	210.8	279.5	210.9
Short-term Borrowings	206.9	245.5	361.6	145.5
Total Debt	279.7	456.2	641.1	356.4
Total Liabilities	627.5	883.2	1,117.4	988.6
Paid up Capital	69.0	69.0	69.0	69.0
Equity (excl. Revaluation Surplus)	320.9	420.3	524.6	538.7
<u>INCOME STATEMENT</u>	FY20A	FY21A	FY22A	FY23M*
Net Sales	2,008.4	2,511.4	3,541.3	3,152.6
Gross Profit	172.4	284.0	348.9	197.9
Operating Profit	92.8	174.2	241.3	117.4
Finance Costs	53.2	45.7	79.0	68.1
Profit Before Tax	41.7	130.9	163.6	51.3
Profit After Tax	10.0	90.3	90.3	0.6
<u>RATIO ANALYSIS</u>	FY20A	FY21A	FY22A	FY23M*
Gross Margin (%)	8.6%	11.3%	9.9%	6.3%
Net Margin (%)	0.5%	3.6%	2.5%	0.0%
Funds from Operation (FFO)	38.0	131.0	173.1	56.5
FFO to Total Debt (%)	13.6%	28.7%	27.0%	15.8%
FFO to Long Term Debt (%)	52.3%	62.2%	61.9%	26.8%
Gearing (x)	0.87	1.09	1.22	0.66
Leverage (x)	1.96	2.10	2.13	1.84
Debt Servicing Coverage Ratio (x)	1.61	1.73	1.73	0.92
Current Ratio (x)	1.12	1.33	1.01	1.03
(Stock in trade + trade debts) / STD (x)	1.39	1.33	1.21	2.52
Return on Average Assets (%)	1.3%	4.8%	3.8%	0.0%
Return on Average Equity (%)	2.3%	8.1%	6.5%	0.0%

*Management Accounts

REGULATORY DISCLOSURES		Annexure II			
Name of Rated Entity	Sohail Textile Mills Limited				
Sector	Textile				
Type of Relationship	Solicited				
Purpose of Rating	Entity Ratings				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	<u>RATING TYPE: ENTITY</u>				
	Dec-04-23	BBB-	A-2	Stable	Reaffirmed
	Oct-19-22	BBB-	A-2	Stable	Reaffirmed
	Aug-09-21	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.				
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Due Diligence Meetings Conducted	Name	Designation	Date		
	Mr. Salman Haider	Group CFO	November 15 2023		