RATING REPORT

Sitara Textile Industries Limited (STIL)

REPORT DATE:

December 31, 2021

RATING ANALYST:

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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	BBB+	A-2	BBB+	A-2
Rating Outlook	Stable		Stable	
Rating Date	*December 31, 2021*		*October 02, 2020*	

COMPANY INFORMATION	
Incorporated in 1985	**External Auditors:** RSM Avais Hyder Liaquat Nauman, Chartered Accountants
Unlisted Public Limited Company	**Chairman/C.E.O.:** Mr. Mian Muhammad Anees
Key Shareholders (with stake 5% or more):	
Mian Muhammad Anees – 86.96%	
Mrs. Naila Anees – 12.81%	

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

Sitara Textile Industries Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Sitara Textile Industries Limited (STIL) is a public limited unlisted company incorporated in Pakistan in 1985 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). The principal activity of the company is processing and export of value-added cloth and made-ups. The registered office is located at 6 Km Sargodha Road, Faisalabad.

Profile of Chairman/C.E.O.

Mian Muhammad Anees serves as the Chairman of the Board and CEO of STIL and two other group companies (Sitara Hamza (Pvt.) Limited and Sitara Studios (Pvt.) Limited). Mr. Anees has done MSc in International Fashion Retailing from University of Manchester, UK. He is a seasoned industrialist having more than two decades of experience.

Financial Snapshot

***Tier-1 Equity:** end-FY21: Rs. 1.6b; end-FY20: Rs. 1.5b; end-FY19: Rs. 1.4b*

***Assets:** end-FY21: Rs. 7.5b; end-FY20: Rs. 5.4b; end-FY19: Rs. 5.2b*

***Profit After Tax:** FY21: Rs. 87m; FY20: Rs. 69m; FY19: 51m*

Corporate Profile: Incorporated in 1985, Sitara Textile Industries Limited (STIL) operates as a textile processing unit and is principally involved in exports of home textiles which contributes approximately 80% of total sales. STIL is wholly owned and managed by the sponsoring family. The registered office and mills are located at Sarghodha Road, District Faisalabad. The company plans to shift its facilities to Faisalabad Industrial State going forward for which 13 acres of land has been already purchased.

Exports are mainly concentrated in Europe while local sales includes commercial processing of lawn cloth for wholly owned subsidiary company, Sitara Hamza (Pvt.) Ltd (SHL). Incorporated in 2004, SHL sells its products through the company's owned retail chain, Sitara Studios (Pvt.) Limited (SSL), as well as through wholesalers and retailers in major cities of Pakistan. There are thirteen retails outlets of SSL located in Faisalabad and Rawalpindi/Islamabad. As at end-FY21, total investment in SHL stood at Rs. 186.9m. In addition, STIL has extended loan to its subsidiary concern amounting to Rs. 356m (FY20: Rs. 300m). The loan has partially been repaid in FY22 while a portion will be further repaid by end-FY22. Remaining amount of the loan is expected to be converted into share capital of SHL, whereby increasing the total investment stake.

Rating Drivers

Positive momentum in exports of value-added segment of the textile industry

Outlook of the textile industry remains positive on account of recovery in international markets and export-oriented policies of the government. 4M'FY22 posted 27% upsurge in textile exports vis-à-vis SPLY primarily on account of strong growth in home textiles, towels, knitwear, and ready-made textile products. On the other hand, cotton and cotton cloth represented a lower portion in the overall textile exports thus indicating growth in the value added segment. Going forward, prospects remain strong on account of gradual establishment of international customer base alongside favorable incentives offered by the government. However, federal government's consideration to revise gas tariff for textile export units to $9 per mmbtu from $6.5 from November 15 2021 to March 31, 2022 remains a key risk which would detrimentally impact cost of sales. Nonetheless, undergoing rupee devaluation is likely to offset possible increase in gas tariff.

BMR initiatives expected to improve operational efficiencies

During FY21*, the company incurred capex of Rs. 208m funded through debt for BMR projects and additions in printing machinery. Furthermore, STIL undertook initiatives to automate stitching department and reduce bottlenecks in production lines. Going forward, management plans to replace existing rotaries with digital rotaries which is expected to further boost operational efficiencies, however limited scale of operations and lack of business integration remains a rating constraint.

Modest profitability despite topline growth

Sales revenue increased to Rs. 4.8b (FY20: Rs. 3.4b) in FY21*, registering 40% growth on a YOY basis, driven by higher export volumes of home textiles. Sales mix remained at similar levels in FY21, whereby exports of home textile and fabrics constituted 73% (FY20: 74%) and 9% (FY20: 10%) of total sales, respectively. Remaining 16% (FY20: 14%) constituted local cloth processing. Main geographical markets remained focused in European countries, particularly Netherland, Belgium, Germany, and Denmark, however, going forward, the company plans to diversify into the United States, Latin America, and Canada. Client concentration reduced in FY21 with top ten clients constituting approximately 58% (FY20: 70%) of the total sales, albeit remaining on the higher side.

Gross margins of the company remained under pressure reducing to 11.55% (FY20: 12.70%) in FY21* owing to increase in yarn prices. Operating expenses during FY21 recorded a sizeable increase on account of upsurge in ocean and air freight expenses globally. Consequently, operating margins reduced to 5.61% (FY20: 6.78%) in FY21, which also trickled down into lower net margins. As such, profitability profile remained subdued posting modest increase to Rs. 86m in FY21* (FY20: Rs. 69m). Net margins stood at 1.83% (FY20: 2.04%) during the outgoing year. Improvement in profitability profile will be important for ratings, going forward.

Decline in cash flow coverage indicators during the outgoing year

Due to limited profitability in FY21 coupled with increase in debt levels, cash flow coverages witnessed a decline in FY21 with FFO to Long Term Debt reducing sharply to 45.98% (FY20: 7431.20%). Debt servicing however remains adequate at 1.66x (FY20: 1.94x) in FY21*, due to relatively smaller long term debt as a portion of total borrowings.

Liquidity profile also remained adequate with current ratio standing at 1.20x (FY20: 1.19x) in FY21*. Cash conversion cycle depicted improvement over last year as a result of decrease in receivable days outstanding. According to management, increase in the number of retail stores of Sitara Studios (Pvt.) Limited in FY21 resulted in reduction in receivable days outstanding for the processing division thereby contributing towards efficiencies in cash cycle.

Capitalization indicators remain elevated

Tier 1 capital increased to Rs. 1.6b (FY20: Rs. 1.5b) in FY21, thus recording modest growth on account of retention of profits. Surplus on revaluation of land rose to Rs. 2.4b (FY20: 1.2b) during the outgoing year. Capitalization indicators remain elevated; increasing further in FY21 on account of increase in long term debt for BMR funding. Debt profile, however, primarily includes short term borrowings. Elevated leverage and gearing levels at 2.22x (FY20: 1.82x) and 1.21x (FY20: 1.07x), respectively, continue to constrain ratings. Improvement in capitalization indicators supported by higher profitability will be important for ratings, going forward.

**Management Accounts*

Sitara Textile Industries Limited Appendix I

FINANCIAL SUMMARY (all amounts in PKR millions				
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21***
Property, Plant, & Equipment	2,190.19	2,080.88	2,065.45	3,430.28
Investment in Subsidiary	186.88	186.88	186.88	186.88
Store, Spares, and Loose Tools	156.81	166.39	189.65	198.05
Stock-in-Trade	1,244.47	1,342.81	1,385.18	1,527.59
Trade Debts	671.00	737.36	761.11	957.43
Advances, Deposits, & Prepayments	367.26	386.30	368.59	619.16
Tax Refunds Due from Government	137.73	157.58	263.03	347.24
Cash & Cash Balances	48.59	30.99	118.53	86.79
Total Assets	5,084.77	5,196.87	5,438.82	7,510.28
Trade and Other Payables	580.92	723.42	947.31	1,394.03
Long Term Debt (including current maturity)	40.55	14.11	1.98	298.65
Short Term Debt	1,797.65	1,721.83	1,617.63	1,640.52
Total Debt	1,838.20	1,735.94	1,619.60	1,939.17
Total Liabilities	2,552.23	2,616.00	2,757.35	3,542.75
Tier-1 Equity	1,362.69	1,411.01	1,511.62	1,598.57
Total Equity	2,532.55	2,580.87	2,681.48	3,967.53
Paid-up-Capital	150.00	150.00	150.00	150.00
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**FY21***
Net Sales	3,140.32	3,099.60	3,395.66	4,755.08
Gross Profit	404.57	391.36	431.37	549.36
Profit Before Tax	94.77	90.37	101.39	140.21
Profit After Tax	60.64	50.85	69.21	86.96
Funds from Operations	110.65	107.15	146.77	137.33
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**FY21***
Gross Margins (%)	12.88%	12.63%	12.70%	11.55%
Operating Margins (%)	7.12%	7.09%	6.78%	5.61%
Net Margins (%)	1.93%	1.64%	2.04%	1.83%
Current Ratio (x)	1.10	1.13	1.19	1.20
Net Working Capital	241.69	334.39	496.71	623.49
FFO to Total Debt (%)	6%	6%	9%	7.08%
FFO to Long Term Debt (%)	273%	759%	7431%	45.98%
Debt Leverage (x)	1.87	1.85	1.82	2.22
Gearing (x)	1.35	1.23	1.07	1.21
DSCR (x)	1.56	1.55	1.94	1.66
ROAA (%)	1.25%	0.99%	1.30%	1.34%
ROAE (%)	4.54%	3.67%	4.74%	5.59%
(Stock in Trade+Trade Debt) to Short-Term Borrowing Ratio (x)	1.07	1.21	1.33	1.51

**Management Accounts*

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	Sitara Textile Industries Limited				
Sector	Textiles				
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				
	31/12/2021	BBB+	A-2	Stable	Reaffirmed
	02/10/2020	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**		
	Mr. Salahuddin Aliani	Chief Financial Officer	Nov 26, 2021		