RATING REPORT

Sitara Textile Industries Limited (STIL)

REPORT DATE:
February 01, 2024

RATING ANALYSTS:
M. Amin Hamdani
amin.hamdani@vis.com.pk
Muhammad Meeran Siddique
meeran.siddiqui@vis.com.pk

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	Negative		Stable	
Rating Action	Maintained		Reaffirmed	
Rating Date	*February 01, 2024*		*December 31, 2021*	

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 *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*

Sitara Textile Industries Limited

OVERVIEW OF THE INSTITUTION

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Textile Industries Limited (STIL) is a public limited unlisted company incorporated in Pakistan in 1985 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017).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.

During the review period Mr. Muti-ur-Rasool was appointed as the new Group CFO in place of Mr, Salahuddin Aliani who last held the position for 6 years.

Profile of the 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.*

RATING RATIONALE

Corporate Profile

Sitara Textile Industries Limited (STIL), is principally involved in processing and exports of home textiles. Having more than three decades of operational history. STIL is wholly owned and managed by the sponsoring family. The Board comprises of four members including a female director. The organization structure is essentially clustered around two separate function, namely, processing and marketing, while the finance department is directly look after by the CEO.

Group Profile

STIL is part of the Mian Anees Group which came into existence following division of the Sitara Group, well known for Sitara Chemicals, into four independent groups. Other group companies include Sitara Hamza (Pvt) Ltd and Sitara Studios (Pvt) Ltd. Sitara Hamza sells processed fabrics while Sitara Studios is a retail outlet chain for fashion garments.

Operational Performance

The registered office and mills are located at Sarghodha Road, Faisalabad. Sitara Textile Industries Ltd. is an export oriented processing unit with more than 80% of revenues realized from exports while the remaining comes from commercial processing for Sitara Hamza (Pvt) Ltd. and other third parties. Exports of Sitara Textile Industries include home textile fabric and home textile made ups including bedding, table clothing kitchen coordinates and curtains/valances. STIL exports are mostly made to order, which include procurement of yarn of required quality and then have it weaved through third party weaving mills. The weaved cloth is then processed in STIL own facility. The entire process is usually completed in 4-5 months.

Production figures have shown a consistent decrease during the last 2 financial years, as reflected by the falling capacity utilization levels, with management attributing this trend to reduced demand for export-oriented orders.

Table 1: Capacity & Production Data (Units in millions)

Capacity	FY21	FY22	FY23
Installed Capacity (meters)	42.0	42.0	42.0
Actual Production (meters)	35.3	29.3	20.3
Capacity Utilization %	*84.1%*	*69.7%*	48.3%

In FY22, the company acquired a 12-acre land for Rs. 20m at FIEDMC Faisalabad, with future plans to develop a spinning and processing unit on this site in the long term.

<u>Key Rating Drivers</u>

Business risk remain elevated amid weak macroeconomic environment, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand. All these factors pose a challenge to the sector in terms of margins sustainability and future growth.

Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports broke the threshold, clocking in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and provides employment to about 40% of the industrial labor force[1]. Contributing around 8.5% to the country's gross domestic product (GDP), with an estimated market size of around Rs. 4.0tr, textile sector has maintained an average share of about 60% in national exports over the years.

Table 2: Pakistan Export Statistics (USD in Millions)

	FY20	FY21	FY22	FY23
PAKISTAN TOTAL EXPORTS	22,536	25,639	32,450	27,911
TEXTILE EXPORTS	12,851	14,492	18,525	16,710
PKR/USD AVERAGE RATE	158.0	160.0	177.5	248.0

Source: SBP

The lingering effects of Covid-19 pandemic continue to shape the Pakistan's textile industry. Initially, as lockdowns lifted, the industry capitalized on opportunities, securing production contracts with western countries. This redirection of substantial volumes to Pakistan, was complemented by government import tax reductions and subsidized covid-related financing programs such Temporary Economic Refinance Facility (TERF), spurred robust export growth during FY22. However, a subsequent phase presented new challenges. Global interest rate hikes aimed at curbing post-pandemic inflation, coupled with geopolitical unrest such as the Ukraine conflict, led to supply chain disruptions and energy crisis. These factors led to a global demand slowdown in major textile economies, reflected in a 10% year-on-year decline in Pakistan's textile exports in FY23, totaling USD 16.7b (FY22: USD 18.5b). As per the data from Pakistan Bureau of Statistics (PBS), High Value-Added Segments made up over 82.2% (FY22: 80.7%) of the total textile exports in FY23.

Flash floods in Sindh and Southern Punjab monsoon wreaked havoc on the cotton crop last year. This catastrophe led to a historic low production level of 4 million bales of cotton in 2022, compared to a 12 million bales annual demand. Consequently, local cotton prices reached 12-year high of over Rs. 22,000 per 40kg during the year as well as import of raw cotton rose by ~20% in USD terms during FY22, as compare to the preceding year. This situation led to higher working capital requirements, adversely affecting profit margins and liquidity profile of textile entities, particularly spinners, weavers, and dyeing companies. Supported by favorable weather and timely government intervention, cotton production in the country is estimated to increase to 12.7 million bales during the current season (FY24). 4.0 million bales have already been produced during Q1FY24, marking an impressive 80.0% increase compared to the same period last year.

The industry is facing business risk due to weak macroeconomic environment both globally and locally, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand, primarily from North America and Europe.

Previously, the sector also enjoyed incentives provided by the government through a five-year textile policy (2020-25), including preferential energy rates, low-interest financing schemes, and timely payments of various refunds, easing liquidity constraints for local players. However, the prevailing economic instability along with advisory from the IMF led to the reduction or withdrawal of many of these fiscal supports. This along with

[1] https://www.brecorder.com/news/40179021

contractionary monetary policy and political uncertainties in the country are the key business risk factors facing by the industry. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future prospects of textile exports.

Topline decreased significantly during FY23 primarily due to lower demand orders
Net sales fell by ~25% Y/Y, reaching Rs. 3.7b mark in FY23 (FY22: Rs. 5.0b) against a rising trend in the period FY20-FY22. According to the management this dip is primarily attributed to the economic downturn in major world economies, leading to reduced demand and lower export volumes. Going forward, due to improving volumes in Pakistan's textile export, the management projects that net sales will surpass Rs. 4.5b in FY24.

Majority of the sales are generated through exports, and a small portion is achieved through local sales. Geographical regions for export are predominantly focused in European countries, primarily Denmark, the Netherlands, Germany, Poland, and Belgium. Additionally, other significant destinations include Malaysia, Chile, and South Africa. The concentration of top-ten clients is considered moderate accounting for ~55% of the total sales revenue. However, client concentration risk is mitigated by the long-standing relationship with major clients.

Higher margins were achieved on the back of rupee depreciation with limited reliance on imports. Net margins deteriorated over time mainly due to elevated finance costs.
Gross margin increased to historic highs of 17.0% (FY22: 12.6%, FY21: 11.1%) while operating margins rose to 9.3% (FY22: 3.6%, FY21: 5.3%) in FY23. This is mainly due to the rupee devaluation impact, and reduction in usage of imported raw materials. Going forward management plans to move towards backward integration by installation of a spinning unit which they expect to further improve gross margins.

The Company's net margin showed a declining trend from 1.6% in FY21 to 0.7% in FY22 and stood at 0.8% in FY23. This is attributable to the substantial rise in financial costs in line with elevated benchmark interest rates. Improvement in margins is an important rating consideration.

Cash flow coverage indicators leave room for improvement while long term debt repayment servicing is below 1.0x. Liquidity profile remains adequate.
Funds flow from operations (FFO) grew to Rs. 126.9m (FY22: Rs. 66.6m, FY21: 112.6m) in FY23. In FY22, FFO was lower due to one-time write offs and repayments of deferred grant. However, cashflow coverage indicators remained short with FFO to total debt stood at 0.06x (FY22: 0.03x, FY21: 0.06x). Debt Service Coverage Ratio which defines as FFO to Current Debt Service Requirement, is clocked in at 0.91x in FY23 (FY22: 0.57x), which is marginally lower than 1x. Ratings take note of the same while improvement in DSCR is important for future sustainability of rating.

The liquidity profile considered adequate with current ratio remaining above 1. Moreover, the net cash conversion cycle has exhibited notable increase during the review period, driven by higher inventory holding and receivable days.

Equity growth remained subdued, gearing and leverage ratio remain elevated
Equity base (excluding revaluation surplus) experienced modest growth over time and increased slightly amounting to Rs. 1,640.1m as at Jun'23. Debt profile includes long-term

and short-term borrowings with total interest bearing liabilities remaining intact at Rs. 2b over time. Given no major change in the capital structure, leverage ratio marginally increased to 2.45x (FY22: 2.39x) in FY23, while the gearing inched down to 1.21x (FY22: 1.28) in FY23.

Environmental, Social & Governance (ESG) initiatives:
The company has adopted the following environmental and social governance relating measures to fulfill its social and corporate responsibilities:

1) Solar Energy:
The company has recently shifted its offices / admin block from Wapda electricity to Solar energy due to its green / renewable energy initiatives and being socially responsible, further has plan to convert all its manufacturing facility to solar in near future

2) Water Treatment Plant:
The company has installed waste water treatment plant to purify the contaminated water before its disposal to mitigate its hazardous effects to the environment.

3) Steam Boiler:
The company has installed steam producing boilers on burning gas for its energy requirements which along with producing energy for manufacturing process, also produce steam which reduce its harmful effects.

4) Wet Scrubbers:
The company has installed water scrubbers which converts black smoke to white to mitigate its hazardous effects to the environment.

5) Green areas and tree plantation policy and implementation status:
Two grassy lawn and several seasonal and evergreen plants are present in the factory which are maintained by a team of trained gardeners.

Sitara Textile Industries Limited Appendix I

FINANCIAL SUMMARY				(PKR Millions)
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**FY23***
Property, Plant, & Equipment	2,065.45	3,492.44	3,368.76	3,314.67
Investment in Subsidiary	186.88	286.88	286.88	286.88
Store, Spares, and Losse Tools	189.65	243.04	308.30	301.38
Stock-in-Trade	1,385.18	1,609.6	1,848.6	1,912.7
Trade Debts	761.11	831.57	858.74	847.33
Advances, Deposits, & Prepayments	368.59	531.34	460.08	677.23
Tax Refunds Due from Government	263.03	324.98	351.63	350.90
Cash & Cash Balances	118.53	66.71	39.86	24.80
Total Assets	5,438.82	7,449.42	7,688.89	7,882.03
Trade and Other Payables	947.31	1,495.35	1,565.11	1,762.56
Long Term Debt (including current maturity)	1.98	291.78	275.48	217.77
Short Term Debt	1,617.63	1,634.07	1,782.10	1,771.88
Total Debt	1,619.60	1,925.85	2,057.58	1,989.65
Total Liabilities	2,757.35	3,638.07	3,851.47	4,014.11
Tier-1 Equity	1,511.62	1,598.57	1,609.59	1,640.09
Total Equity	2,681.48	3,811.35	3,837.41	3,867.92
Paid-up-Capital	150.00	150.00	150.00	150.00
INCOME STATEMENT	**FY20**	**FY21**	**FY22**	**FY23***
Net Sales	3,395.66	4,787.24	5,012.77	3,735.73
Gross Profit	431.37	533.29	631.18	634.52
Profit Before Tax	101.39	128.03	85.95	66.63
Profit After Tax	69.21	75.00	32.95	30.51
Funds from Operations	146.77	112.58	66.57	126.87
RATIO ANALYSIS	**FY20**	**FY21**	**FY22**	**FY23***
Gross Margins (%)	12.70%	11.14%	12.59%	16.99%
Operating Margins (%)	6.78%	5.26%	3.63%	9.27%
Net Margins (%)	2.04%	1.57%	0.66%	0.82%
Current Ratio (x)	1.19	1.12	1.14	1.14
Net Working Capital	496.71	391.49	469.19	510.16
FFO to Total Debt (%)	9.06%	5.85%	3.24%	6.38%
FFO to Long Term Debt (%)	7431.20%	38.58%	24.17%	58.26%
Debt Leverage (x)	1.82	2.28	2.39	2.45
Gearing (x)	1.07	1.20	1.28	1.21
DSCR (x)	1.94	1.48	0.57	0.91
ROAA (%)	1.30%	1.16%	0.44%	0.39%
ROAE (%)	4.74%	4.82%	2.05%	1.88%
(Stock in Trade+Trade Debt) to STD Ratio (x)	1.33	1.49	1.52	1.56

**Un-audited financial statements*

REGULATORY DISCLOSURES — Appendix II

Name of Rated Entity	Sitara Textile Industries Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
01/02/2024	BBB+	A-2	Negative	Maintained
30/01/2023				Suspended
31/12/2021	BBB+	A-2	Stable	Reaffirmed
02/10/2020	BBB+	A-2	Stable	Initial

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Muti-ur-Rasool	Chief Financial Officer	November 15, 2023
Mr. Hafiz Nasir	Manager Accounts	