RATING REPORT

Qadri Textile Mills Limited

REPORT DATE:

January 17, 2022

RATING ANALYSTS:

Maham Qasim

maham.qasim@vis.com.pk

RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	BBB-	A-2
Rating Date	*10th Jan 2022*	
Rating Outlook	Stable	

COMPANY INFORMATION	
Incorporated in 1973	External Auditors: Sarwar Awan & Co.
Public (Unquoted) Listed Company	Chairperson of the Board: Ch. Muhammad Aamir
Key Shareholders (More than 5%):	Chief Executive Officer: Ch. Muhammad Aamir
Ch. Muhamad Aamir– 86%	
Ch. Muhammad Nasir Ali – 7%	

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

Qadri Textile Mills Limited

OVERVIEW OF THE INSTITUTION

Qadri Textile Mills Limited (QTML) is engaged in the business of manufacturing, selling, buying and dealing in all types of yarn including different counts of blended yarn.

Financial Snapshot

Total Equity: end-FY21: Rs. 711.4; end-FY20: Rs. 722.2m; end-FY19: Rs. 711.3m

Assets: end-FY21: Rs. 1.6b; end-FY20: Rs. 1.4b; end-FY19: Rs. 1.4b

Profit After Tax: FY21: Rs. 26.3m; FY20: Rs. 19.4m; FY19: Rs. 0.65m

RATING RATIONALE

Rating Rationale

Qadri Textile Mills Limited (QTML) is a spinning company with main shareholding vested with the sponsoring family. The assigned ratings factor in high cyclicality and competitive intensity for spinning segment along with volatility in cotton prices which translate into moderate to high business risk profile. On the other hand, holistically business risk profile of the textile industry is supported by stable and growing demand. Ratings also incorporate financial risk profile marked by stagnant revenues, thin gross and net margins and nominal core equity. The ratings incorporate sound liquidity profile underpinned by sizable coverages. However, current ratio needs improvement in line with rating benchmarks. The company has a conservative capital structure with no reliance on long-term borrowings; moreover, the utilization of short-term funding was also largely tapered off during the review period owing to advances from customers largely funding the working capital requirements; as a result, gearing has improved significantly while the debt leverage was recorded higher during the review period. Further, owing to reduction in benchmark rates, a trend which has now reversed, the financing cost for the company had reduced, reflecting positively on the bottom line in the outgoing period. However, the ratings remain sensitive to lack of revenue diversification and limited scale of operations. The management's focus on improving the quality of yarn with procurement of three drawing frames during the rating horizon is likely to positive reflect in the company's margins. Nevertheless, on account of nominal funding to be procured for the capex, gearing is expected to remain on a lower side. The ratings remain dependent on improvement of business margins through operational efficiencies, prudent management of working capital cycle and maintenance of leverage indicators at around current levels. The ratings are based on management accounts for the outgoing year.

QTML is a medium size spinning unit with 45,000 spindles; the shareholding of the company is vested with the sponsoring family. The primarily business of the company is production and sale of different counts of yarn ranging from 30 to 52. The capacity utilization for FY21 was recorded lower at 28.5% (FY20: 44.4%) owing to stoppage for normal maintenance, supply and demand situation in the market and interruption of electrical supply. The plant capacity and actual production is tabulated below:

	FY20	FY21
Installed Capacity after conversion into 20s count	11,430,720	11,430,720
Actual Production of yarn after conversion into 20s count	5,058,608	3,261,946
Capacity Utilization	44.4%	28.5%

Local Spinning Segment during COVID-19: The coronavirus pandemic led to 3% drop in global trade volumes in the 1QFY20 according to United Nations conference on Trade and Development forecasts. Given most of the textile companies in Pakistan are heavily reliant on local cotton produce; the supply side risk was largely curtailed. However, due to the heavy rainfall and pest attack, cotton crop was badly damaged and the same was reported at a multi-year low. Subsequently, reduction in local cotton production pushed the cotton prices to 11 year high in Feb'21. Movement in cotton prices and cotton crop levels drives performance of spinning sector players; the same have depicted seasonality historically. The increase in global demand for value-added textile products coupled with diversion of orders to Pakistan from competing neighboring countries on account of more severe pandemic situation prevalent supports the business risk environment for local spinning units.

The business environment for textile spinning improved considerably in 2HFY21 due to resurgence in demand following easing of COVID-19 related lockdowns globally. Raw material prices along with many other commodities increased from the low levels seen last year, which in turn increased yarn prices. With higher international demand for Pakistani Textiles along with favorable government policies, large capacity enhancement projects in the downstream textile industry are expected, which will further strengthen demand for yarn. Going forward, the improvement in margins for the spinning segment will remain contingent on investment in technology and capital expansion to reap economies of scale.

Topline remained stagnant during the outgoing year: Sales of the company remained stagnant at Rs.1.3b (FY20: Rs. 1.3b) during FY21 owing to decline in quantity of yarn sold to 3.43m kgs of yarn during FY21 as opposed 3.75m kgs in the preceding year. Although the company was able to reap higher average prices of yarn at Rs. 376.2/kg (FY20: Rs. 346.2/kg) during FY21, the same did not translate into higher topline owing to reduction in volumetric sales. Moreover, despite increase in better yarn prices fetched during the outgoing year the gross margins dipped to 5.4% (FY20: 6.1%) owing to higher fuel & power expenses incurred during FY21; although the absolute increase to Rs. 383.7m (FY20: Rs. 296.1m) does not seem profound; however, the increase in relation to sales revenue and reduced production during FY21 is substantial. On the other hand, the average procurement price of cotton was reported lower at Rs. 197.9/kg during FY21 as compared to Rs. 204.3m in the previous year. The operating expenses including administrative and selling & distribution expenses were recorded slightly higher at Rs. 18.8m during FY21 vis-à-vis Rs. 16.5m in FY20 on account of increase in employee related cost in line with annual salary increments coupled with higher average headcount of 266 (FY20: 252) during the outgoing year. On the other hand, the finance cost reduced to Rs. 12.3m (FY20: Rs. 30.9m) during FY21 in the line with benchmark rates being at the very bottom end of the spectrum coupled with reduced utilization of short-term borrowings during the period under review. There was no other income booked during FY21. Despite stagnant timeline and slash in margins, QTML reported higher profit after tax amounting to 26.3m (FY20: Rs.19.4m) during FY21 on account of reductional of financial expense. Going forward, the management projects to close FY22 with a topline of Rs. 1.8b; VIS expects that the target is realistic and achievable given Rs. 900.0m revenue was booked in HY22.

Liquidity position exhibited slight improvement: Liquidity profile of the company has exhibited positive trajectory with nominal improvement of Funds from Operations (FFO) to Rs. 53.6m (FY20: Rs. 43.4m) during FY21 owing to higher profitability metrics coupled with reduced financial and taxation expense paid during the outgoing year. As a result of the same coupled with reduced utilization of short-term borrowings, FFO to total debt was recorded significantly higher at 0.63x (FY20: 0.24x) at end-FY21. On the other hand, the company has long-term debt free balance sheet therefore FFO to long-term debt was not calculated. In addition, given there was no long-term repayment made during FY21 in comparison to long-term borrowing of Rs. 13.1m returned during the preceding year, the debt service coverage improved and was sizable at 4.10x (FY20: 1.68x); the same depicts that the company is comfortably placed to meet its contractual obligations due in one year. Stock in trade increased to Rs. 170.0b (end-FY20: Rs. 129.8m) at end-FY21on account of sizable raw material inventory held to meet forecasted demand; the same is linked with projected growth in scale of business operations. Further, trade debts also increased during the outgoing year owing to relaxed terms extended to customers to improve market penetration. Although, trade debts are considered good by the management with expected recovery of 99% of receivables; however, due to 10% of receivables being overdue for more than three years VIS believes that stringent checks on receivable recovery coupled with stricter credit policy should be placed to avoid credit losses in the future. Loans and advances increased to Rs. 27.7m

(FY20: Rs. 10.6m) during FY21 primarily owing to higher advances extended to suppliers; the amounts are non-adjustable and are refundable after the contract with the supplier is concluded. In addition, trade deposits and prepayments were also recorded higher at Rs. 9.2m (FY20: Rs. 0.4m) on account of higher value LCs open amounting to Rs. 8.7m (FY20: nil) pertaining to increased quantum of cotton import. Further, liquidity of the company is impacted due to sizable tax refunds amounting to Rs. 49.1m (FY20: Rs. 37.4m) due from government at end-FY21; the company is unable to rectify the situation given it is an exogenous factor and inherent in the local textile industry. On the other hand, trade payables of the company also increased sizably to Rs. 593.7m (FY20: Rs. 224.1m) in line with substantial advances amounting to Rs. 316.8m (FY20: Rs. 13.5m) procured from customers; the same will get adjusted against sale of goods. Moreover, no payable is overdue for more than one-year. As a result of exponential growth in trade payables, current ratio was recorded lower at 1.08x (FY20: 2.21x) at end-FY21.

Long-term debt-free capital structure: Tier-1 equity of the company reduced to Rs. 711.4m (FY20: Rs. 722.2m) at end-FY21 owing to reduction in revaluation surplus on fixed assets. On the other hand, tier-1 equity despite withdrawal of Rs. 40.0m sponsor loan increased to Rs. 255.0m (FY20: Rs. 249.1m) during FY21 owing to internal capital generation. The company has zero reliance on long-term debt therefore debt profile of the company only comprises short-term borrowings. With payables largely financing debt receivables, short-term borrowings of the company decreased sizably to 85.0m (FY20: Rs. 180.4m) by end-FY21. These facilities primarily include cash finance (CF) and LC sight facilities aggregating to Rs. 173.7m and are secured against pledge/hypothecation of ginned cotton, cotton/polyester bales, yarn stock, mortgage on property and personal guarantees of directors of the company. The facilities are locked in at a markup arrangement ranging from of 6M-KIBOR+ 4.5% and 1M-KIBOR+ 5.5%. In line with sizable decrease in short-term funding obtained, gearing improved to 0.33x (FY20: 0.72x) by end-FY21. However, on the other hand debt leverage exhibited an increasing trend with the same recorded higher at 3.62x (FY20: 2.65x) in line with significant increase in trade receivables owing to advances procured from customers; the same is likely to self-correct once the advances are adjusted against sale of goods. Furthermore, the company has plan to obtain long-term debt amounting to Rs. 23.0m during FY23 for expected capital expenditure on procurement of three drawing frames; the shipment is projected to be received by end-Novc'23 while the equipment will begin operation by end-HY23. The aforementioned capex will not increase the production capacity; however, improve the quality of output by adding more strength to yarn produced; the same is expected to provide positive impetus to margins. The leverage indicators are expected to remain around current levels as the increase in borrowings is expected to be off-set by retained earnings of FY22 and FY23.

Qadri Textile Mills Limited *(Rs. in million)* Annexure I

BALANCE SHEET	June 30, 2019	June 30, 2020	June 30, 2021
Non-Current Assets	918.8	884.6	871.5
Stock-in-Trade	63.7	129.8	170.0
Trade Debts	126.5	284.2	419.2
Loans & Advances	14.5	10.6	27.7
Trade Deposits & Prepayments	0.4	0.4	9.2
Tax Refunds from Government	22.7	37.4	49.2
Cash & Bank Balances	206.5	7.8	37.2
Total Assets	**1,364.9**	**1,381.4**	**1,634.4**
Trade and Other Payables	181.0	224.1	593.7
Short Term Borrowings	198.6	180.4	85.0
Long Term Borrowings	13.1	-	-
Total Borrowings	211.6	180.4	85.0
Total Liabilities	653.5	659.2	923.0
Paid Up Capital	79.4	79.4	79.4
Core Equity	220.5	249.1	255.0
Total Equity	711.3	722.2	711.4
INCOME STATEMENT	June 30, 2019	June 30, 2020	June 30, 2021
Net Sales	1,449.7	1,229.0	1,293.0
Gross Profit	55.0	79.8	70.5
Operating Profit	41.4	63.2	51.7
Profit Before Tax	13.8	39.4	32.3
Profit After Tax	0.65	19.4	26.3
FFO	47.9	43.4	53.6
RATIO ANALYSIS	June 30, 2019	June 30, 2020	June 30, 2021
Gross Margin (%)	3.8	6.1	5.4
Net Margin (%)	1.3	1.5	2.0
Current Ratio (x)	1.87	2.21	1.08
FFO to Total Debt (x)	0.23	0.24	0.63
FFO to Long Term Debt (x)	3.66	-	-
Debt Service Coverage Ratio (x)	1.96	1.68	4.10
ROAA (%)	1.4	1.4	1.7
ROAE (%)	8.8	8.3	10.4
Gearing (x)	0.96	0.72	0.33
Debt Leverage (x)	2.96	2.65	3.62
Stock+ Trade debts/ Short-term Borrowings (x)	0.96	2.29	6.93

(*) FY21 are unaudited 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	Qadri Textile Mills Limited
Sector	Textile
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		
10-01-2022	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
	1	Haji Basheer	Finance Manager	07-Jan-2022