RATING REPORT

Sheikhupura Textile Mills Limited

REPORT DATE:
July 12, 2023

RATING ANALYSTS:
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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	*Jul 12, 2023*		*June 30th, 2022*	

COMPANY INFORMATION	
Incorporated in 1989	**External Auditors:** Munaf Yousaf & Co.
Public Limited (unquoted) Company	**Chairperson of the Board/CEO:** Mr. Mohammad Asif
Key Shareholders (More than 5%):	
Mr. Asad Shafi– 33.9%	
Mr. Mohd. Asif– 33.0%	
Mr. Umar Shafi – 30.8%	

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**

Sheikhupura Textile Mills Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

OVERVIEW OF THE INSTITUTION

Sheikhupura Textile Mills Limited (STML) is engaged in the business of manufacturing, selling, buying and dealing in all types of yarn including different counts of blended yarn. The company was listed on the stock exchanges in 1989.

Profile of the Chairman/CEO

Mian Muhammad Asif possesses 45 years of experience in the textile business. He has been associated with the company since inception.

Financial Snapshot

Total Equity: end-9MFY23: Rs. 1.72b; end-FY22: Rs. 1.69b; end-FY21: Rs. 1.54b

Assets: end-9MFY23: Rs. 4.4b; end-FY22: Rs. 3.9b; end-FY21: Rs. 3.3b

Profit After Tax: 9MFY23: Rs. 35m; FY22: Rs. 141m; FY21: Rs.115m

RATING RATIONALE

Rating Rationale

Sheikhupura Textile Mills Limited (STML) is engaged in the business of manufacturing, selling, buying and dealing in all types of yarn including different counts of blended yarn. In line with revenue diversification, the Company also sells Women Fashion Cloth under the brand name of 'Cross Stitch'. STML began operations in 1989 and is one of the leading textile spinning companies in the Country. Currently, the Company operates its spinning division with 28,656 spindles along with Cross Stitch Production capacity of 150,000 Meters per month.

STML belongs to the Ayesha Group, which entered the spinning industry with the establishment of Ayesha Spinning Mills Ltd. in 1972. Since then, the group has grown into four spinning units, with a combined capacity of more than 120,000 spindles, a leather tannery, a leather shoe factory, a shoe retail chain under the brand name of 'EPCOT', socks factory and an embroidery factory.

Sheikhupura Textile Mills Limited has two manufacturing units namely the Spinning unit and the Cross Stitch Factory located in District Kasur, Punjab. Cross Stitch has 25 outlets all over Pakistan. Head office of STML is located in Gulberg area, Lahore. Production facility is located at District Kasur, Punjab. Power requirement of 3.2MW is met through two sources; national grid and two gas-based generators. The sanctioned loan from WAPDA is 3.2MW while the SNGPL connection provides load of 3.0MW.

The ownership of the company is shared majorly shared among four members of the sponsoring family while presently three are actively involved in business affairs.

Capacity Utilization

Spinning	FY21	FY22
Total number of spindles installed	28,656	28,656
Production capacity after conversion into 20/s counts (Kgs)	8,500,000	8,300,000
Actual Production (Kgs)	7,138,122	7,281,686
Actual production of yarn after conversion into 20/s counts (Kgs)	12,374,797	11,724,350
No. of shifts worked per day	3	3
Total number of working days	360	360
Capacity Utilization on conversion (%)	146%	141%
Cross Stitch	**FY21**	**FY22**
Number of embroidery/ stitching machines	120	122
Production Capacity	390,000	410,000
Actual Production	373,410	396,810
Total number of working days	275	275
No. of shifts worked per day	1	1
Capacity Utilization on conversion (%)	96%	97%

- Capacity utilization level of the Spinning and stitching division remain on the higher side, although some dip in productivity levels were observed in the review period due to stressed demand and raw material constraints As per management, cotton crops were affected due to flooding and import restrictions remained most part of the outgoing year.

- On the Stitching front, installed capacity increased from 390k Meters to 410k Meters as additional stitching machineries were employed during the review period.
- In order to cater the favorable demand in the retail segment and enhance the export portfolio, STML plans to add more embroidery and stitching machines over the rating horizon. The same will be funded through a mix of debt financing and internal reserves. Management intends to bring embroidery operations of Cross Stitch in-house over the next few years.
- Further, to rationalize fuel cost the company has also planned for install solar plant having 200 KWH capacity at Cross Stich factory with total capex estimated at Rs. 25-30m. Company's own cash resources will fund the same. Solar plant is expected to come online by end-FY24.

Key Rating Drivers

Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally broke the threshold, coming in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr. Barring seasonal and cyclical fluctuations, textiles sector has maintained an average share of about 60% in national exports.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
Pakistan Total Exports	22,536	25,639	32,450		23,706	21,088
Textile Exports	12,851	14,492	18,525		13,577	12,992
PKR/USD Average rate	158.0	160.0	177.5		171.5	235.5

Source: SBP

Export revenues from textile sector have noted sizeable growth over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports. As evident from the table above, overall export contraction is witnessed in 9MFY23 due to challenging global and local macroeconomic environment.

Table: Textile Export Details (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**		**11,482**	**10,318**
- Knitwear	2,794	3,815	5,121		3,730	3,390
- Readymade Garments	2,552	3,033	3,905		2,864	2,657
- Bed wear	2,151	2,772	3,293		2,449	2,032
- Towels	711	938	1,111		820	745
- Made-up Articles	591	756	849		627	535
- Art, Silk & Synthetic Textile	315	370	460		344	309
- Others	555	743	866		650	650
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**		**2,760**	**2,158**
- Cotton Cloth	1,830	1,921	2,438		1,795	1,538
- Cotton Yarn	984	1,017	1,207		908	573
- Others	43	34	72		56	47

Total	**12,527**	**15,399**	**19,332**		**14,243**	**12,476**

Source: PBS

Cotton prices rose to a new 12-year high of ~Rs. 22,935/maund as of Sept'22, driven by the scarcity of cotton resulting from the recent floods that impacted the local cotton production. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Table: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	9M'FY23
Per Maund	8,770	8,860	13,000	17,380	18,935
YoY % Change	26%	1%	32%	34%	*n/a*

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than $2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dying companies.

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

High cyclicality and competitiveness in the spinning sector translate into high business risk profile.

Movement in cotton prices and cotton crop levels drives performance of spinning players in Pakistan. Given sizeable deficit in local cotton production compared to demand in recent years, cotton prices remained high. However, availability of imported yarn kept yarn prices competitive in the current fiscal year and thus resulting in weakening of profitability profile for spinning players.

Topline of the company grew by 43% during FY22 largely driven by higher average selling prices

- Net sales of the Company witnessed a sizeable jump of 43% and were reported at Rs.5.7b (FY21: Rs. 4.0b; FY20: Rs. 2.9b) in FY22 driven by higher average selling prices of yarn and fabric.
- Sales mix predominantly comprised yarn which accounted for 74% (FY21: 77%) of net sales during FY22. Remaining proportion of 26% includes a major proportion of retail sales followed by export and waste material. Yarn sales increased to Rs.4.3b (FY21: Rs. 3.1b) in FY22 on account of higher average selling prices during the year. Retail sales were reported higher at Rs. 2.3b (FY21: Rs. 1.6b) in FY22 on account of higher volumetric output.
- During FY22, STML began export operations of the retail segment (of around Rs. 50.2m; equivalent to 2.5% of total retail sales) to countries including USA, UK and Canada. Spinning division only caters to local market.
- Customer concentration of the spinning segment is on a medium to low scale with top 10 customers accounting for 28% of total net sales during 1HFY23 (FY22: 33%; FY21:

30%). In addition, client concentration risk is partially eliminated due to long-term association with the existing clientele.

- During 9MFY23, revenue of the Company was recorded at Rs. 4.4b. Going forward, management expects revenue base to increase due to ongoing capacity enhancement plans in the stitching segment to cater rising demand of the retail and export segment. Management expects, gradual ease in LC constraints will also contribute positively to the upward trend in the top line going forward.

Margins under pressure due to higher input costs, greater penetration costs related to Cross Stitch and uptick in financial costs

- In absolute terms, gross profit of the Company increased to Rs. 1,001.9m (FY21: 798.5m; FY20: Rs. 531.0m) in FY22. However, gross margins reduced to 17.4% (FY21: 19.8%; FY20: 18.3%) in the same period on account of increase in prices of raw material and elevated fuel & remuneration expense.
- The same was reported higher at 21.2% in 9MFY23 due to inventory gains.
- Ratings take comfort in the fact that around 88% of raw materials including cotton and polyester are procured locally due to favorable pricing while the remaining proportion is imported.
- Finance charges were reported higher at Rs. 150.2m (FY21: Rs. 109.5m; FY20: Rs. 115.5m) in FY22 mainly due to higher benchmark rates on higher borrowing levels in FY22.
- Net margins of the Company plunged to 0.9% in 9MFY23 (FY22: 2.5%, FY21: 2.9%) on account of higher distribution expense, inclined tax costs and increased financial charges. Increased focus on penetration of the retail brand led to higher marketing & selling expense during the review period.
- However, as per management the increase in scale of operations of higher margin generating segment along with other ongoing cost rationalization initiatives will provide support to the bottom-line, going forward.
- Amidst a challenging macroeconomic environment, improving margins will be important from a ratings perspective.

Sufficient Liquidity profile

- Funds from Operation (FFO) of the Company increased on a timeline basis to Rs. 317.7m (FY21: Rs.288.5m; FY20: Rs. 126.3m) in FY22 being a function of increase in quantum of profits in absolute terms. However, with greater incline in quantum of debt as compared to improvement in profitability, cash flow coverages against outstanding obligations have reduced in the review period.
- Although remaining adequate, FFO to Total Debt and FFO to Long-Term Debt declined to 21% (FY22: 30%; FY21: 31%) and 40% (FY22: 46%; FY21: 45%) respectively during 9MFY23.
- Similarly, Debt Servicing ratio (DSCR) was reported at 1.32x (FY22: 1.43x; FY21: 2.22x) during 9MFY23.
- Current ratio as of 9MFY23 end stood at 1.0x, which is the minimum threshold level. Short-term borrowing coverage is deemed adequate at 220% at end-Mar'23.
- Aging profile of trade debts is considered sound with 99% of outstanding trade receivables due within two months.

- As per the management, the liquidity profile will improve in line with enhancement of scale of retail operations, and planned efficiency improvement initiatives.
- Ratings remain dependent on maintaining liquidity coverages in line with the benchmarks for the assigned ratings.

Capitalisation profile of the Company is constrained by a small equity base

- Tier- I Equity base of the company gradually increased to Rs. 813.7m (FY22: 778.4m; FY21: Rs. 618.9m) at end-Mar'23 through profit retention.
- The debt profile comprises a mix of long-term (51%) and short-term borrowings (49%). The outstanding balance of long-term borrowings, inclusive of current maturity, increased to Rs. 690.4m (FY21: Rs. 642.5m) due to higher lease liabilities. The same was reported lower at Rs. 610.5 at end-9MFY23 on account of repayment of debt employed.
- Short-term borrowings increased to Rs.576.5 (FY22: Rs. 384.2m; FY21: Rs. 298.8m) at end-9MFY23 to meet higher working capital requirements in lieu of rising raw materials costs.
- With growth in quantum of debt (9MFY23: Rs. 1.2b; FY22: Rs. 1.1b; FY21: Rs. 0.9b) being greater than profit retention in the review period, gearing and debt leverage ratios have depicted an uptick at period ended-9MFY23. The same were reported at 1.46x (FY22: 1.38x; FY21: 1.52x) and 3.29x (FY22: 2.80x; FY21: 2.75x) respectively, at end-9MFY23.
- Given there are no sizable expansion plans in perspective with installations of small stitching machineries, the leverage indicators are projected to remain at similar levels during the rating horizon.
- However, given the challenging market dynamics and pressure on margins, maintaining financial risk profile over the rating horizon will remain critical for ratings.

Room for improvement exist in terms of corporate governance framework; IT infrastructure is adequate.

- The company has in place a qualified senior management team with extensive relevant experience.
- Board of Directors (BoD) comprises three members while informal meetings are held on ad-hoc basis with no documentation of minutes.
- Room for improvement exists in terms of increasing board size and setting up an independent internal audit function.
- IT infrastructure in place commensurate with the scale of operations. Under the IT function, Hardware including SAP B1 ERP system and MS Office were installed during the review period.

Sheikhupura Textile Mills Limited Appendix I

Sheikhupura Textile Mills Limited *(Rs. in million)*				Annexure I
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**9M23**
Non-Current Assets	2,104.4	2,301.5	2,506.5	2,463.8
Stock-in-Trade	600.9	635.5	841.9	1,098.2
Stores & Spares	50.9	57.3	103.7	121.7
Trade Debts	75.9	102.4	184.9	171.4
Cash & Bank Balances	39.4	98.9	104.9	365.7
Total Assets	2,965.0	3,249.4	3,864.5	4,398.9
Trade and Other Payables	382.0	456.5	786.5	1,167.7
Short Term Borrowings	486.3	298.8	384.1	576.5
Long Term Borrowings	366.6	642.5	690.4	610.5
Total Borrowings	852.9	941.3	1,074.6	1,187.0
Total Liabilities	1,534.1	1,703.3	2,177.0	2,676.0
Paid Up Capital	70.5	70.5	70.5	70.5
Tier-I Equity	481.5	618.9	778.4	813.7
Total Equity	1,430.8	1,546.1	1,687.5	1,722.9
INCOME STATEMENT	**FY20**	**FY21**	**FY22**	**9M23**
Net Sales	2,902.4	4,028.4	5,742.4	4,433.1
Gross Profit	531.0	798.5	1,000.9	938.2
Profit Before Tax	65.6	170.7	224.9	91.5
Profit After Tax	14.6	115.2	141.4	35.4
FFO	126.3	288.5	317.7	185.1
RATIO ANALYSIS	**FY20**	**FY21**	**FY22**	**9M23**
Gross Margin (%)	18.3%	19.8%	17.4%	21.2%
Net Margin (%)	0.5%	2.9%	2.5%	0.8%
Current Ratio (x)	0.90	1.00	1.01	1.00
FFO to Total Debt (%)	14.8%	30.7%	29.6%	20.7%
FFO to Long Term Debt (%)	34.5%	44.9%	46.0%	40.3%
Debt Service Coverage Ratio (x)	1.66	2.22	1.43	1.32
ROAA (%)	0.6%	3.7%	4.0%	1.1%
ROAE (%)	3.1%	20.9%	20.2%	5.9%
Gearing (x)	1.77	1.52	1.38	1.46
Debt Leverage (x)	3.19	2.75	2.80	3.29
Stock+ Trade debts/ Short-term Borrowings (%)	139.1%	246.9%	267.3%	220.2%

REGULATORY DISCLOSURES					Appendix IV
Name of Rated Entity	Sheikhupura 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				
	12-07-2023	**BBB**	**A-2**	**Stable**	**Reaffirmed**
	30-06-2022	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	Mr. Salman Haider	CFO	30-May-2023	