RATING REPORT

Sheikhupura Textile Mills Limited

REPORT DATE:
July 24, 2024

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 / Rating Watch	Positive		Stable	
Rating Action	*Maintained*		*Reaffirmed*	
Rating Date	*July 24, 2024*		*July 12, 2023*	

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:
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

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 over 4 decades of experience in the textile business. He has been associated with the company since inception.

RATING RATIONALE

Company Profile

Sheikhupura Textile Mills Limited ('STML' or 'the Company') was incorporated in Pakistan and commenced its operations in 1989. The Company 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 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.

The head office of STML is located in Gulberg area, Lahore while manufacturing facilities are located at Ferozepur Road, Lahore and District Kasur, Punjab.

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

Operational Profile

Sheikhupura Textile Mills Limited has two manufacturing units, namely the Spinning unit with 28,656 spindles installed along with the Cross Stitch factory with the production capacity of 41,000 meters per month. Operational data of the Company is illustrated below:

Spinning	FY21	FY22	FY23
Total number of spindles installed	28,656	28,656	28,656
Production capacity after conversion into 20/s counts (Kgs)	8,500,000	8,300,000	8,300,000
Actual Production (Kgs)	7,138,122	7,281,686	5,279,042
Actual production of yarn after conversion into 20/s counts (Kgs)	12,374,797	11,724,350	8,087,148
No. of shifts worked per day	3	3	2
Total number of working days	360	360	350
Capacity Utilization on conversion (%)	146%	141%	97%

Cross Stitch	FY21	FY22	FY23
Number of embroidery/ stitching machines	120	122	122
Production Capacity	390,000	410,000	492,800
Actual Production	373,410	396,810	473,080
Total number of working days	275	275	275
No. of shifts worked per day	1	1	1
Capacity Utilization on conversion (%)	96%	97%	96%

In FY23, against the backdrop of depressed demand in a midst of challenges on the macroeconomic front, the production in the spinning unit saw a drop, resulting in the reduction in the capacity utilization to ~97% in the spinning unit. However, production in the cross-stitch unit saw an uptick. Capacity utilization varies according to the pattern of production adopted and the complexity of the final product.

Key Rating Drivers

Business risk profile constrained by cyclicality, and high competition in the sector.

The business risk profile of the spinning sector in Pakistan is characterized by high level of exposure to economic cyclicality 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 many players producing relatively homogenous products.

During FY23, Pakistan's yarn production registered a substantial decline, primarily due to reduced availability of cotton, because 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 persistent inflationary pressures. These factors are likely to result in continued sluggish performance for the spinning sector in FY24.

Topline growth was supported by increase in retail sales while sales from yarn observed a decline

During FY23, despite prevalent economic challenges, the Company managed to achieve a topline growth of approximately 9%. This growth was mostly driven by price increases during the year; however, support was drawn from a 56% increase in retail sales while yarn sales posted a decline of 16%.

Gross margins depicted improvement in 6MFY24 while operating and net margins remained strained by inflationary pressure and higher finance costs.

The Company's gross margins reported improvement on account of inventory gains as well as increased contribution from the higher margin retail segment of STML. Contribution to the topline from the retail segment increased to ~49% (FY22: ~34%) of total gross sales. During FY23, the Company reported gross margins of 20.07% (FY22: 17.43%). This trend continued in the subsequent period whereby gross margins further improved to 21.40%. On the other hand, operating margins were constrained by higher expenses from heightened inflationary during the period. Operating margins contracted to 5.68% (FY22: 6.53%), and to 5.15% in 6MFY24.

This decrease in operating margins coupled with higher finance charges suppressed net margins to 1.03% (FY22: 2.46%) in FY23. Net margins remained at similar levels in 6MFY24 despite a decrease in financial charges during the period.

Capitalization profile considered manageable

In FY23, the Company's gearing improved to 1.20x (FY22: 1.38x) as debt levels remained stable while equity increased in line with reported profitability. However, the leverage ratio remained similar to the previous year at 2.79x (FY22: 2.80x), as the Company met its working capital requirements through the management of non-debt liabilities. In 9MFY24, with an increase in operational activities, the Company expanded its short-term debt drawdown to address the widening working capital gap, resulting in gearing and leverage ratios rising to 1.28x and 3.08x, respectively. Given a small equity base, the Company's capitalization profile remains sensitive to changes in debt levels.

Coverage profile remains adequate despite slight weakening in FY23

In FY23, funds from operations (FFO) decreased due to lower operational cash flows. As a result, FFO to total debt declined to approximately 24.2% (FY22: ~30.4%). This ratio slightly improved to 25.4% in 9MFY24, attributed to higher FFO from increased cash flow from operations despite a reduction in operational margins. The debt service coverage ratio weakened in FY23, falling to 1.31x (FY22: 1.57x), before improving to 1.43x in 6MFY24. Additionally, the short-term debt coverage remained healthy, recorded at 2.28x in 6MFY24 (FY23: 2.29x, FY22: 2.09x).

Liquidity Profile is considered adequate

The current ratio of the Company remains at sensitive levels, yet adequate, at 1.03x in 9MFY24 (FY23: 1.00x, FY22: 1.01x). Meanwhile, the cash conversion cycle (CCC) has shown a trend of weakening over time but remains within an adequate range at 24.65 days in 9MFY24 (FY23: 18.20 days, FY22: 13.37 days).

Considerations for Future Reviews

Going forward, the assigned ratings will be influenced by key business risk indicators, including ongoing challenges in the spinning sector such as high interest rates, energy costs, and inflationary pressures. Moreover, the Company's performance remains dependent on improvements in key ratios and operational efficiencies.

REGULATORY DISCLOSURES						Appendix I
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 Watch**	**Rating Action**	
	RATING TYPE: ENTITY					
	24-07-2024	BBB	A-2	Positive	Maintained	
	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.					
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**		
	1	Mr. Salman Haider	CFO	July 19, 2024		