RATING REPORT

Chiniot Textile Mills Limited

REPORT DATE:
June 06, 2022

RATING ANALYST:
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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	BBB	A-2
Rating Outlook	Stable	
Rating Date	*June 06, 2022*	

COMPANY INFORMATION	
Incorporated in 1989	**External Auditors:** Munaf Yusuf & Co, Chartered Accountants
Public Unlisted Company	**Chairman/CEO:** Mr. Saqib Ellahi
Key Shareholding (more than 5%)	
Saqib Ellahi ~31.98%	
Rabia Saqib ~47.34%	
Shams Ellahi ~18.71%	
Ismail Ellahi ~1.96%	

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

Chiniot Textile Mills Limited

OVERVIEW OF THE INSTITUTION

Chiniot Textile Mills Limited is a public un-listed company incorporated in Pakistan, under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). Principal business activity is manufacturing and sale of yarn. Head office of the company is located in Lahore.

Profile of Chairman/CEO:
Mr. Saqib Ellahi is a seasoned professional with extensive experience of over 23 years in textile industry. He holds a Master degree in business from University of Salford, UK.

RATING RATIONALE

Corporate Profile

Headquartered in Lahore, Chiniot Textile Mills Limited (CTML) is primarily engaged in the production and sale of yarn with total installed capacity of ~26K spindles while further addition of around 6-8K new spindles is planned over the rating horizon. The ownership of the company is shared among four members of the sponsoring family while presently three are actively involved in business affairs. Production facility is located at District Kasur, Punjab. Power requirement of 5.6MW is met through two sources; national grid and two gas-based generators.

Table: Production Data

	FY19	FY20	FY21	9M'FY22
Installed Spindles	24,648	25,992	25,992	25,992
Actual Capacity (Kgs)	6.3m	7.2m	7.2m	7.2m
Production (Kgs)	5.4m	5.7m	6.9m	5.2m
Capacity Utilization (%)	95%	78%	95%	94%

Capacity utilization levels have witnessed a strong recovery from the pandemic slump on account of sizeable jump in demand in textile sector particularly on the export front. Yarn production has increased by ~22% in FY21 and the growth trend is continued in the ongoing year.

<u>Key Rating Drivers</u>

Textile and clothing exports have registered a sizeable growth given the surge in demand on account of rerouting of orders to Pakistan and favorable sector policies. Outlook is favorable going forward.

The 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 Rs. 3.8tr (FY20: Rs. 3.3tr) in FY21. Barring seasonal and cyclical fluctuations, textiles products have maintained an average share of about 60% in national exports. Given post pandemic sustained economic recovery and diversion of export orders to Pakistan, export revenues from textile segment (as per PBS) stood at USD 15.4b (FY20: USD 12.5b; FY19: USD 13.6b) in FY21, registering a sizeable year-on-year growth of ~23%. The similar growth trend has been noted in the ongoing year with exports reaching at USD 9.4b during 6M'FY22, up by 26% vis-à-vis SPLY. Knitwear, Readymade and Bed wear segments continued to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While primarily a volumetric driven growth, the exports also received a boost from higher prices (excluding Knitwear). During the year, while average volumes increased by around 20-30% in various segments as compared to the lock down period, average prices increased by 8-10%.

Figure: Textile Exports (as per PBS)

Segments	Value (US$ millions)		YoY(Δ)
	FY20	FY21	
Knitwear products	2,785	3,816	*37%*
Readymade Garments	2,549	3,033	*19%*
Bed wear	2,149	2,772	*29%*

Cotton Cloth	1,830	1,921	*5%*
Cotton Yarn	987	1,017	*3%*
Towels	711	938	*32%*
Made-up Articles	591	756	*28%*
Art, silk and synthetic textile	314	370	*18%*
Tents, canvas and tarpaulin	98	110	*12%*
Others	487	667	*37%*

Going forward, sector dynamics are favorable as Pakistan continues to receive export orders from global economies as competing regional countries remains hampered by the pandemic. Given the surge in demand, the industry is currently operating at full capacity and going through expansion and up-gradation to cater for additional demand.

5-Year (2020-25) textile policy continues to support the industry.

With the aim to double textile exports in five years, GoP through a five-year textile policy (2020-25) has provided incentives in form of preferential energy rates, low interest rates financing schemes (such as EFS, LTFF and TERF) and timely payments of DLTL, Income tax & Sales tax refund which would support liquidity constraints of local players. Initiatives are also being undertaken in order to increase production and yield of cotton to support the industry. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future of textile exports.

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 vis-à-vis demand in the recent years, cotton prices have remained elevated due to which inventory loss risk is considered limited. As with other domestic spinning players, reliance on China as major export market translates into high country concentration risk. However, business risk is supported by favorable government policies and healthy demand outlook.

Sizeable uptick in volumetric sales along with over time increase in average yarn prices has led to healthy growth trend in revenues.

Sales revenue of the company grew by ~32% in FY21 and a similar growth trend has been noted in the ongoing fiscal year. In absolute terms, topline amounted to Rs. 2.6b (FY21: Rs. 2.5b; FY20: Rs. 1.9b) during 9M'FY22. The growth is mainly attributable to sizeable upsurge in volumetric demand driven by diversion of export orders to Pakistan along with over time increase in average sale prices of yarn. The management is projecting sales revenue to cross Rs. 3.0b mark in FY22 while the sales target for next year FY23 is Rs. 4.2b.

Entire revenue emanates from local sales while catering mainly to customers based in Karachi & Faisalabad regions. Given that majority of sales are directed towards institutions, sale concentration risk in terms of clients is medium to high, with top 10 clients constituting around ~34% of total sales revenue.

Earning profile has noted improvement.

Gross margins have exhibited a strong growth trend over the period of past four years (FY18-21); however, the same slightly declined in the ongoing year due to higher energy cost and significant increase in cotton prices given the present commodities super-cycle. In value terms, ~90% of raw materials including cotton and polyester are procured locally due to favorable pricing while the remaining proportion is imported. Going forward, the management expects gross margins to sustain at above 10%.

On the cost front, distribution expenses largely remained at similar levels while administrative overheads increased in line with inflation. Financial charges remain limited given that entire borrowings are on concessionary rates. Bottom-line along with net margins during the ongoing year depicted considerable improvement due to healthy growth in sale revenues.

Liquidity profile is sound with healthy cash flow generation.
Liquidity profile is considered sound with healthy cash flow generation in line with improving profitability. Funds from Operations (FFO) increased considerably to Rs. 165.3m (FY20: Rs. 45.8m) at end-FY21. The same has positively impacted debt coverage metrics as reflected by upward trend in DSCR. As per management, more than three-fifth of sales are on cash basis while credit terms extend up to 60 days. Hence, working capital cycle necessitates utilization of short-term financing to fund inventory levels.

Current ratio of the company stands at over 1.0x. Stock levels are elevated while trade debts and stock in trade are more than sufficient to cover short-term borrowings. Aging profile of trade debts remain within manageable levels with no receivable outstanding for more than 12 months. Going forward, maintenance of liquidity indicators is considered important from a rating perspective.

Limited size of equity base is a constraint on capitalization levels.
Equity base despite growth on a timeline basis has remained limited in terms of size. The company has not paid any dividends for the last five years. Debt profile comprises a mix of short-term and long-term debt with total interest bearing liabilities amounting to Rs. 613.6m (FY21: Rs. 367.4m; FY20: Rs. 275.7m) at end-6M'FY22; short-term debt (ERF) constituted ~70% of total debt. The increase in debt levels is attributable to higher utilization of running finance facility. Given limited equity base, leverage indicators are reported on the higher side. The same are expected to remain elevated given additional debt drawdown of Rs. 100m planned for installation of new spindles over the rating horizon.

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 experience while at present, total staff strength stands at 550+ employees. Board of Directors (BoD) comprises 2 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. Moreover, as per management, there are plans to deploy integrated ERP system going forward.

Chiniot Textile Mills Limited **Appendix I**

FINANCIAL SUMMARY					*(amounts in PKR millions)*
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**6M'FY22**
Non-Current Assets	781	809	1,306	1,357	1,374
Stores, Spares. And Loose Tools	27	27	33	27	26
Stock-in-Trade	125	172	229	197	554
Trade Debts	36	61	73	127	119
Advances, Deposits and Other Receivables	37	44	44	62	382
Cash and Bank Balance	19	28	22	101	64
Total Assets	**243**	**331**	**400**	**514**	**1,144**
Trade and Other Payables	88	111	167	143	472
Long-Term Borrowings *(Inc. current maturity)*	32	58	98	217	189
Short-Term Borrowings	130	173	177	151	424
Other Liabilities	167	164	268	261	263
Total Liabilities	**417**	**505**	**711**	**782**	**1,359**
Paid-up Capital	97	97	97	97	97
Tier-1 Equity	**267**	**295**	**314**	**424**	**495**
Total Equity *(Inc. revaluation surplus)*	340	339	682	664	664
INCOME STATEMENT					
Net Sales	1,616	1,928	1,907	2,524	1,639
Gross Profit	96	123	151	267	160
Operating Profit	52	74	91	169	117
Profit Before Tax	32	43	48	130	91
Profit After Tax	16	19	10	92	71
RATIO ANALYSIS					
Gross Margin (%)	5.9%	6.4%	7.9%	10.6%	9.8%
Net Margin (%)	1.0%	1.0%	0.5%	3.6%	4.3%
Net Working Capital	4	22	37	137	164
Current Ratio	1.02	1.07	1.10	1.36	1.17
FFO to Long-Term Debt	1.41	0.85	0.46	0.76	1.06
FFO to Total Debt	0.28	0.21	0.17	0.45	0.33
DSCR (x)	n/a	1.75	1.49	3.81	1.98
Gearing (x)	0.60	0.78	0.88	0.87	1.24
Debt Leverage (x)	1.56	1.71	2.26	1.84	2.75
Inventory + Receivable/Short-term Borrowings (x)	123%	135%	170%	215%	159%

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	Chiniot 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				
	06/06/2022	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 Meeting Conducted	Name	Designation	Date		
	Mr. Salman Haider	Chief Financial Officer	May 27, 2022		