RATING REPORT

Chiniot Textile Mills Limited

REPORT DATE:
July 12, 2023

RATING ANALYST:
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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 Date	*July 12, 2023*		*June 06, 2022*	
Rating Outlook	Stable		Stable	

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%	

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

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Chiniot Textile Mills Limited is a public un-listed company incorporated in Pakistan, under the repealed Companies Ordinance, 1984 (now Companies Act, 2017).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 ~31K spindles at end-Dec'23. 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

	FY21	FY22	6MFY23
Installed Spindles	24,648	31,272	31,272
Actual Capacity (Kgs)	7.7m	10.0m	5.0m
Production (Kgs)	14.8m	12.2m	2.5m
Capacity Utilization (%)	192%	122%	50%

During FY22, the Company enhanced yarn capacity through addition of spindles which were financed through Temporary Economic Relief Facility (TERF). Capacity utilization levels have dipped over the review period due to pressure overall demand dynamics in the textile industry. With ongoing international inflation along with war in Europe, exports witnessed a decline. However, stable demand in home textile provided cushion to the yarn producers.

<u>Key Rating Drivers</u>

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, demand slowdown, high interest rate situation, inflationary pressures and recent floods adversely affecting cotton crop while ongoing energy crisis in the country pose a challenge to 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 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 35% during FY22 driven by higher average selling prices

- Net sales of the Company witnessed a sizeable jump of 35% and were reported at Rs.3.4b (FY21: Rs. 2.5b; FY20: Rs. 1.9b) in FY22 driven by 38% increase in prices.
- Sales mix predominantly comprised yarn which accounted for 98% (FY21: 93%) of net sales during FY22. Product mix also consists a small proportion (2%) of polyester, fabric and waste material sold.
- Net sales of CTML comprises local sales only with customers based in Karachi and Faisalabad regions.
- Customer concentration has increased over the review period and is on a medium to high scale with top 10 customers accounting for 31% of total sales during 1HFY23 (FY22: 39%; FY21: 21%). However, as per management, 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.2.3b. Going forward, management expects revenue base to gradually increase due to consistent demand of the product which can be easily catered through the incremental available capacity. Expected ease in LC constraints will also contribute positively to the upward trend in the top line.

Margins under pressure due to currency devaluation and higher input & financial costs

- Gross margins of the Company followed a downward trend in the review period with the same reported at 6.6% (FY22: 8.6%; FY21: 10.6%) in 9MFY23 on account of increase in prices of imported raw material led by currency devaluation, higher local cotton prices and elevated fuel expense.
- In value terms, ~83% of raw materials including cotton and polyester are procured locally due to favorable pricing while the remaining proportion is imported. Ratings take comfort in high proportion of local procurement thereby limiting risk of raw material availability.
- Administrative expenses increased primarily due to higher remuneration & benefits allocated and elevated maintenance expenses during the year. Finance charges were reported higher at Rs. 67.9m (FY21: Rs. 38.9m; FY20: Rs. 43.6m) in FY22 mainly due to higher benchmark rates and elevated total borrowing levels in FY22 to finance costly working capital needs.
- Due to the aforementioned, net margins of the Company also weakened to 0.03% (FY22: 2.2%, FY21: 3.6%; FY20: 0.5%) in 9MFY23.
- Given uncertain macroeconomic environment, improving margins will be important from a ratings perspective.

Room for improvement in liquidity profile

- Funds from Operation (FFO) of the Company decreased to Rs. 151.2m (FY21: Rs.165.3m; FY20: Rs. 45.8m) in FY22 being a function of decrease in quantum of profits in absolute terms. In line with the low profitability profile and elevated quantum of debt, cash flow coverages against outstanding obligations have also witnessed weakening in the review period.

- FFO to Total Debt and FFO to Long-Term Debt declined to 20% (FY21: 45%; FY20: 17%) and 42% (FY21: 76%; FY20: 46%) respectively during FY22. The same furthered deteriorated significantly to 11% and 25% respectively during 9MFY23.
- Similarly, Debt Servicing ratio (DSCR) also reduced to 1.07x (FY22: 1.57x; FY21: 3.81x) during 9MFY23.
- As per management, more than 70% of sales are on cash basis while credit terms extend up to 60 days.
- Current ratio as of end-Mar'23 stood at 1.05x, which is around the minimum threshold level. Short-term borrowing coverage is deemed adequate at 162% at end-Mar'23.
- Aging profile of trade debts is considered fair with 77% of outstanding trade receivables due within three months.
- Ratings remain dependent on improvement of the liquidity indicators as per the benchmarks for the assigned ratings.

Leverage indicators are elevated due to small equity base

- Tier-I Equity base of the company accumulated to Rs. 515.7m (FY22: 514.9m; FY21: Rs. 424.1m) by end-Mar'23 through profit retention.
- The debt profile comprises a mix of long-term (45%) and short-term borrowings (55%) at end-Mar'23.
- Growth in long-term debt during FY22 was to fund expansion of additional spindles.
- Short-term borrowings increased to Rs. 759.4m (FY21: Rs. 367.4m) at end-FY22 to meet higher working capital requirements in lieu of growth rising raw materials costs.
- With increase quantum of debt (FY22: Rs. 759.4m; FY21: Rs. 367.4m) being greater than profit retention in the review period due to increased cash conversion cycle, gearing and debt leverage ratios have depicted an uptick on a timeline basis.
- Gearing and leverage indicators were reported at 1.36x (FY22: 1.47x; FY21: 0.87x) and 2.63x (FY22: 2.40x; FY21: 1.84x) respectively, at end-9MFY23.
- Given no plans for expansion, and gradual improvement in profit generation, management expects similar capitalization levels over the rating horizon.
- Maintaining the same as planned will be critical.

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.
- IT infrastructure in place commensurate with the scale of operations. Moreover, as per management, there are plans to deploy integrated ERP system going forward.
- Room for improvement exists in terms of increasing board size and setting up an independent internal audit function.

Chiniot Textile Mills Limited Appendix I

FINANCIAL SUMMARY			*(amounts in PKR millions)*		
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**	**9MFY23**
Non-Current Assets	809.3	1,306.5	1,356.5	1,700.4	1,663.9
Stores, Spares. And Loose Tools	26.7	33.5	26.8	27.3	36.0
Stock-in-Trade	171.7	228.7	196.5	397.8	507.0
Trade Debts	60.8	72.7	127.1	141.4	125.0
Advances, Deposits and Other	44.0	43.9	62.0	110.8	172.1
Cash and Bank Balance	27.9	21.6	101.4	19.3	15.1
Total Assets	**1,140.3**	**1,706.8**	**1,870.3**	**2,396.8**	**2,519.1**
Trade and Other Payables	110.6	167.1	142.9	161.1	331.3
Long-Term Borrowings *(Inc. current*	58.1	98.5	216.7	363.8	313.5
Short-Term Borrowings	172.7	177.2	150.7	395.6	390.1
Total Liabilities	**505.5**	**710.9**	**782.4**	**1,235.5**	**1,357.0**
Paid-up Capital	96.8	96.8	96.8	96.8	96.8
Tier-1 Equity	**295.4**	**313.9**	**424.1**	**514.9**	**515.7**
Total Equity *(Inc. revaluation surplus)*	634.9	996.0	1,088.0	1,161.3	1,162.1
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**	**9MFY23**
Net Sales	1,927.6	1,906.8	2,524.2	3,403.2	2,311.1
Gross Profit	123.3	150.9	266.6	291.4	151.9
Operating Profit	74.5	91.1	168.6	187.8	100.3
Profit Before Tax	42.5	47.5	129.7	119.9	29.8
Profit After Tax	19.4	10.3	92.0	73.3	0.8
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**FY22**	**9MFY23**
Gross Margin (%)	6.39%	7.92%	10.56%	8.56%	6.57%
Net Margin (%)	1.00%	0.54%	3.65%	2.15%	0.03%
Net Working Capital	21.8	36.5	136.9	51.7	38.6
Current Ratio	1.07	1.10	1.36	1.08	1.05
FFO to Long-Term Debt	85%	46%	76%	42%	25%
FFO to Total Debt	21%	17%	45%	20%	11%
DSCR (x)	1.75	1.49	3.81	1.57	1.07
Gearing (x)	0.78	0.88	0.87	1.47	1.36
Debt Leverage (x)	1.71	2.26	1.84	2.40	2.63
Inventory + Receivable/Short-term Borrowings (x)	135%	170%	215%	136%	162%

REGULATORY DISCLOSURES					Appendix II
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				
	12/07/2023	BBB	A-2	Stable	Reaffirmed
	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.				
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Due Diligence Meeting Conducted	**Name**	**Designation**	**Date**		
	Mr. Salman Haider	Chief Financial Officer	May 30, 2023		