The Pakistan Credit Rating Agency Limited

Rating Report

Khaadi Pakistan (SMC-Pvt) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
01-Jun-2023	A	A1	Stable	Upgrade	-
14-Dec-2022	A-	A2	Positive	Maintain	-
14-Dec-2021	A-	A2	Stable	Maintain	-
14-Dec-2020	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Khaadi Pakistan (SMC-Pvt) Limited (Khaadi or The Company) is a distinct player in the retail fashion industry. Having been in the business for over two decades, Khaadi has been able to deliver growth and expansion resulting in a large customer base and strong brand equity. It has become synonymous with innovation and quality while ensuring affordability for its target customer base. The basket of the products offered includes Unstitched Fabric, Ready to Wear (Eastern and Western), Catalog, Accessories, Fragrances, Home, and many more. The business model of Khaadi, as envisioned by its founder and CEO, has been the self-propelling force for the expansion of the entity. The retail network has reached half a million square foot physical presence. The brand has outreached outside Pakistan as well. Khaadi designs its outlets to give walk-in customers more than a shopping experience. After the successful launching of its first Experience Hub store in Karachi, the Company established four more Experience Hub stores, 2 in Karachi and 2 in Lahore, where the customers are envisaging in shopping experience better than any other retail outlet in Pakistan. Re-branding of the logo is the leverage of distinct plans of the Company which will further unfold in the upcoming years. IFC invested $25mln in Khaadi Corporation, and the first tranche of $15mln is already received in Oct22. The equity injection is being utilized to support its strategic vision of expansion across Pakistan and Internationally to give Khaadi a strategic depth that will be instrumental in its exceptional growth in the future. The entity has a strong management structure in place, with professionals leading their respective roles. The reported numbers for 9MFY23 reflect the stable position of the Company. Sales mix represents a major contribution in Fabric (FY22: 66% of total revenue (FY21: 67%). The upward revision in ratings reflects the commencement of the expansion plans to increase market share by opening new stores in strategic locations and at the same time conversion of existing store design to Experience Hub philosophy, a strategy which has worked extremely well since it was implemented.

The ratings are dependent on the recovery in the business performance and relative position of the entity. The financial profile is also expected to improve as anticipated. Governance of the Company is expected to take positive support from the initiatives undertaken by the sponsor shareholder including creation of a new five members' Board of Directors of the holding company which consists of three renowned Pakistan's business personalities as independent directors and one IFC's female nominee director from Turkey.

Disclosure

Name of Rated Entity	Khaadi Pakistan (SMC-Pvt) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Composite and Garments(Dec-22)
Rating Analysts	Iram Shahzadi | iram.shahzadi@pacra.com | +92-42-35869504

Profile

Legal Structure Khaadi Pakistan (SMC Pvt.) Limited ('Khaadi' or The Company), was incorporated on July 15, 2015, as a single-member company under repealed Companies Ordinance 1984 (now Companies Act, 2017). Previously, Khaadi which commenced operations in 1998, products were sold by sole proprietorship managed by a single member.

Background Khaadi is one of Pakistan's leading fashion retail brands which offers home and clothing, shoes and accessories, fragrances, skin, and hair care solutions for women and kids. The Company is a Single Member Company (SMC) and has a history of 23 years.

Operations The Company has an exceptional retail network, with over 54 stores in Pakistan, and the related party, Texmark (Private) Limited export the products to UAE, Qatar, UK and Kindom of Bahrain under the brand name of "Khaadi".

Ownership

Ownership Structure The Company is a wholly owned subsidiary of Khaadi Corporation Limited. IFC invested $25mln Khaadi Corporation. IFC has inducted as a minority shareholder up to 20% in Khaadi Corp.

Stability The presence of a Group holding company, Khaadi Corporation (Pvt.) Limited, as well as formal documentation capturing the family ownership structure bodes well for the stability of Khaadi.

Business Acumen Extensive growth has been seen in the business where expansion into different segments multiplied growth volumes. Hence, the business acumen of sponsors is considered strong.

Financial Strength Over the years, Khaadi has grown into a big retail brand with total assets of PKR 10bln, and equity of PKR 1bln. Total leveraging for the Group remains fairly aggressive with total annual revenues of PKR 15.1bln.

Governance

Board Structure Currently, the company has an SMC status where it has a one-member board. In Khaadi Corporation has a five-member on the board, including the CEO, Mr. Shamoon. There are three independent members and one from the IFC.

Members' Profile Mr. Shamoon Sultan is the sole owner, founder, and director of Khaadi. He is the man at the last mile and the driving force behind the success and growth of Khaadi. The Company was established as a leading women's fashion brand in four countries based on his vision.

Board Effectiveness No committees have been formed to assist the Board. The Company, does, however, have an internal audit function in place.

Financial Transparency AF Ferguson & Co Company (PwC) is the external auditor of the Company. The auditors have expressed an unqualified opinion on the financial reports for the periods ended 30th June 2022. The Company also has an in-house internal audit department that monitors the internal controls within a Company.

Management

Organizational Structure The Company's overall operations are segregated into six broad divisions, namely: (i) Designing, (ii) Commercial operations, (iii) Branding and Marketing, (iv) Human Resource, (v) Finance, and (vi) Product strategy (vii) Supply Chain, (viii) Strategy and E-Commerce. Each of the departments is led by an experienced individual ensuring smooth operations in the Company. A large number of senior executives report directly to the CEO.

Management Team Mr. Shamoon Sultan – the CEO – primarily manages the Company's affairs, supported by a team of seasoned professionals. After Mr. Shamoon, his wife Miss. Saira Shamoon is the Chief Design Officer of the Company. Mr. Adnan Samdani is the CFO of the Company. He became CFO in 2016 and before that, he served as a Chief Commercial E-Commerce Officer, Chief Commercial Officer MESA & NA, and Chief Supply Chain Officer in Khaadi.

Effectiveness Management has formed six committees, namely, i) Steering Committee ii) Board and Product Committee iii) Commercial committee iv) CAPEX committee v) Management committee vi) Marketing committee headed by the CEO and other committee members.

MIS MIS primarily includes Microsoft, Adobe, Tubatech, and Oracle HRM Cloud. The MIS reports are updated on a real-time basis to be available to senior management all the time. The reports are shared and discussed with the CEO regularly so that the information is conveyed promptly to the CEO and higher management.

Control Environment Since Khaadi is not a manufacturing company, ISO certification does not apply. However, the Company maintains criteria for strong internal controls within the Company and follows the SOP's required for effective operation within the organization.

Business Risk

Industry Dynamics During 9MFY23, the textile exports were valued at $12.47bln compared to $14.24bln, reflecting a 12% decline YoY - the declining trend has been recorded in the last two quarters. The Country's textile exports for the month of March clocked in at US$1.26bln, up 7% MoM. The decline in the previous overall exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand in international markets is also a challenge. During the month of March, value-added textile exports increased by 6% MoM to US$863mln mainly due to Readymade Garments and Knitwear increasing by 8% and 12% MoM respectively while towels decreased by 6% MoM. Basic textiles witnessed an increase of 8% MoM to US$230mln in Mar-23. In volume terms, Knitwear, Readymade Garments, Bedwear, and Towels increased by 18%, 13%, 5%, and 2% MoM respectively. Moreover, a slowdown is prevailing in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries. The demand pattern is expected to improve in the upcoming quarters.

Relative Position Khaadi enjoys a healthy position among its competitors. Some of the competitors of Khaadi are Ideas by Gul Ahmed, Outfitters, J., and Bareeze. Among these competitors, Khaadi enjoys a healthy market share of 6.3% in the apparel division. It is followed by Ideas (5.2%), Outfitters (4.2%), J. (3.5%), and Bareeze (2.8%). The compound growth rate for Khaadi in the industry is 28% as compared to 12% of the retail industry.

Revenues The revenue of Khaadi showed a witnessed growth of 25% and stood at PKR 22.7bln in FY22 as compared to PKR 18.1bln in FY21. Retail sales make up 97% of the company's revenue, and e-commerce makes up 3%. Product-wise analysis reveals that unstitched clothes generate a major chunk of revenues. The cost of sales went up in line with higher revenue. The overall net profit of the company also indicated an upward momentum. Gross profit enhanced to PKR 6.97bln (FY21: PKR 4.80bln). Hence, the net profitability clocked in at PKR 855mln (FY21: loss of PKR 130mln). While in 1HFY23, the topline stood at PKR 12.7bln, and net profit clocked at PKR 175mln. Furthermore, the topline was recorded at PKR 19.1bln, and the net profit clocked at PKR 427mln during 9MFY23.

Margins Gross margins remained stagnant in recent years and clocked at 31.7% (FY21: 31.7%). Similarly, operating expenses inclined, but due to the massive increase in sales, operating margins were up by 6.9% (FY21: -2.4%). Net margins also improved and stood at 3.9% in FY22 as compared to -0.9% in FY21. While in 1HFY23, the gross margin stood at 29.6% and the operating margin was recorded at 6.5%. Furthermore, during 9MFY23 the gross margin stood at 28.9% and the operating margin was recorded at 7.1%.

Sustainability Khaadi plans to target the audience of Lahore, Islamabad, and Karachi is using the digital medium. It is also the second most visited website in Pakistan after Daraz. To ensure the sustainability of growth that Khaadi is expecting, the Company plans to recruit new customers in Tier-II cities by creating awareness among the mass media. The Company will also launch the Hub expericences shop in Lahore in which the customer came about not just to create a shopping space, but a space where experiences can be had while connecting with the product ranges through a journey of engaging storytelling.

Financial Risk

Working Capital The Company meets its working capital requirements through a mix of internal generation and short-term borrowings (STBs). Short-term borrowing of the Company was up by double digits and was recorded at PKR 1.1bln in FY22 (1HFY23: PKR 1.3bln; FY21: PKR 574mln). During FY22, the net-working capital of the Company inched down and stood at -96 days (9MFY23: -104 days; 1HFY23: -105 days; FY21: -111 days). The inventory and receivable days stood at 60 days (9MFY23: -93 days; 1HFY23: 90 days; FY21: 65 days) and 07 days (9MFY23: 7 days; 1HFY23: 7 days; FY21: 21 days) respectively.

Coverages During FY22, Khaadi's cashflows (FCFO) increased (FY22: PKR 1,746mln, FY21: PKR 1,654mln). consequently, the coverage of the Company witnessed improved. Interest coverage inclined (FY22: 8.5x, FY21: 1.5x). Similarly, debt coverage also reflected an upward trend and was recorded at 0.9x (FY21: 0.5x).

Capitalization Khaadi has a highly leveraged capital structure of 55.7% in FY22 (9MFY23: 46.0%; 1HFY23: 42.7%; FY21: 74.2%). IFC invested $ 25mln in a minority stake in Khaadi Corporation.

The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

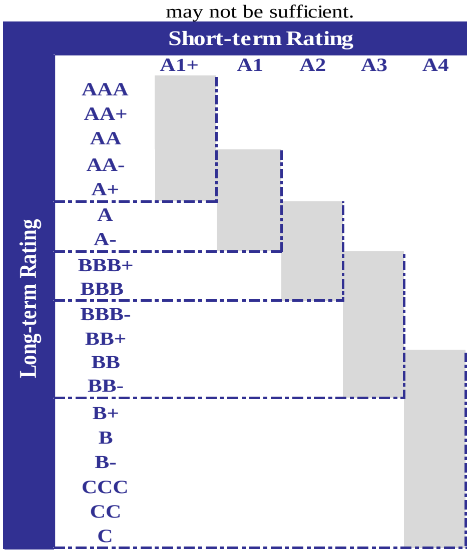
Khaadi Pakistan (SMC-Pvt) Limited	Mar-23	Jun-22	Jun-21	Jun-20
Retail	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	7,020	5,714	5,200	11,476
2 Investments	54	63	74	85
3 Related Party Exposure	-	824	213	88
4 Current Assets	12,421	7,070	4,890	5,341
a Inventories	*8,548*	*4,437*	*2,759*	*2,650*
b Trade Receivables	*579*	*420*	*402*	*1,312*
5 Total Assets	19,495	13,671	10,377	16,990
6 Current Liabilities	9,137	6,968	5,895	5,688
a Trade Payables	*8,786*	*6,736*	*5,701*	*5,264*
7 Borrowings	3,489	2,750	2,870	3,954
8 Related Party Exposure	1,279	981	451	-
9 Non-Current Liabilities	-	-	3	6,060
10 Net Assets	5,590	2,972	1,158	1,288
11 Shareholders' Equity	5,594	2,972	1,158	1,288
B INCOME STATEMENT				
1 Sales	19,131	22,037	15,167	15,678
a Cost of Good Sold	*(13,609)*	*(15,058)*	*(10,364)*	*(10,751)*
2 Gross Profit	5,522	6,979	4,803	4,927
a Operating Expenses	(4,168)	(5,462)	(5,168)	(5,803)
3 Operating Profit	1,354	1,518	(365)	(876)
a Non Operating Income or (Expense)	-	*(102)*	*1,369*	*177*
4 Profit or (Loss) before Interest and Tax	1,354	1,416	1,004	(699)
a Total Finance Cost	*(954)*	*(423)*	*(1,223)*	*(1,438)*
b Taxation	*(201)*	*(138)*	*88*	*595*
6 Net Income Or (Loss)	199	855	(130)	(1,541)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*627*	*1,746*	*1,654*	*913*
b Net Cash from Operating Activities before Working Capital Changes	*627*	*1,243*	*398*	*(494)*
c Changes in Working Capital	-	*(1,140)*	*1,082*	*(885)*
1 Net Cash provided by Operating Activities	627	103	1,480	(1,379)
2 Net Cash (Used in) or Available From Investing Activities	-	(850)	(676)	(1,135)
3 Net Cash (Used in) or Available From Financing Activities	-	833	(865)	2,242
4 Net Cash generated or (Used) during the period	627	86	(61)	(272)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	15.7%	45.3%	-3.3%	-19.6%
b Gross Profit Margin	28.9%	31.7%	31.7%	31.4%
c Net Profit Margin	1.0%	3.9%	-0.9%	-9.8%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	3.3%	2.7%	18.0%	0.2%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	6.2%	41.4%	-10.6%	-74.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	7	7	21	30
b Net Working Capital (Average Days)	-104	-96	-111	-73
c Current Ratio (Current Assets / Current Liabilities)	1.4	1.0	0.8	0.9
3 Coverages				
a EBITDA / Finance Cost	1.3	9.5	1.6	0.7
b FCFO / Finance Cost+CMLTB+Excess STB	1.3	0.9	0.5	0.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	11.0	2.4	7.9	-11.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	46.0%	55.7%	74.2%	75.4%
b Interest or Markup Payable (Days)	59.7	71.9	9.1	17.5
c Entity Average Borrowing Rate	15.1%	5.4%	30.9%	54.3%

Credit Rating

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating	
Scale	**Definition**
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating	
Scale	**Definition**
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
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iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
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(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
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Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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