



The Pakistan Credit Rating Agency Limited

Rating Report

Sarena Industries & Embroidery Mills (Pvt.) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jul-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Sarena Industries and Embroidery Mills (Private) Limited specializes in weaving, dyeing, printing, finishing and stitching. The company offers a variety of special finishes and is the only licensee for PROBAN® in Pakistan. The company employs experienced professionals, aided by comprehensive reporting who look after operations with autonomy. The company has a balanced sales mix and the greater part of the sales revenue comes from processing sales. Recent devaluation of the rupee enabled the company to capitalize on positive dynamics and was able to grow its revenue and margins in line with industry trends. The company has a strong financial profile categorized by a moderately leveraged capital structure and a relatively stretched working capital due to high net working capital days. A significant increase in Cashflows resulted in strong coverages for the company.

The ratings are dependent on the management's ability to improve governance framework. Additionally, working capital management and ensuing borrowings should be monitored closely. Adverse movement in margins and/or coverages will negatively impact the ratings.

Disclosure

Name of Rated Entity	Sarena Industries & Embroidery Mills (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale Jun18(Jun-18)
Related Research	Sector Study Textile(Oct-17)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

The Pakistan Credit Rating Agency Limited
SARENA INDUSTRIES & EMBROIDERY MILLS (PRIVATE) LIMITED – PROFILE

Incorporated	1998
Major business lines	Dyeing, Printing & Finishing
Capacity	6mln mtrs. / month
Head office	21-Waris Road, Lahore
Plant Locations	22-KM Sheikhpura Road
Legal status	Private Limited

INDUSTRY SNAPSHOT

- During 9MFY18, total textile exports of Pakistan stood at USD ~ 12bln, a 13% YoY growth. Cotton yarn contributes 31% to exports in volume terms.
- High cost of doing business as compared to other countries like Bangladesh, India and Vietnam.
- Re-imposition of custom duty & sales tax on cotton imports in FY 19 budget, coupled with exclusion of tax rebate on yarn and greig fabric may put pressure on the industry margins, if not modified.
- Recent devaluation of Rupee is expected to boost otherwise diminishing exports of textile.

OWNERSHIP

- Sarena Industries & Embroidery Mills (Private) Limited is part of the Sefam and Ali Group of Industries. It is vertically integrated in the textile industry and specializes in weaving, dyeing, printing, finishing and stitching.
- Ownership of the company lies with the four children of late Mr. J.A Zaman. Mr. Zaman founded Ali Embroidery Mills (Private) Limited in 1972, which later became the launching pad for Sefam (Private) Limited and Sarena Industries. Ms. Seema Aziz and Mr. Hamid Zamman, hold 42% of the company each, while Mr. Tariq Zaman and Ms. Ambreen Zaman, hold the remaining 16% equally.
- The sponsors have strong business acumen and are considered the pioneers of brand building in Pakistan.

GOVERNANCE

- The company's board of directors comprises six members, four from the sponsor family and two independent directors. Both the independent directors are qualified individuals, having significant experience between them. Mr. Wasif M. Khan is the Professor of Entrepreneurship at Forman Christian College, Lahore and Mr. Arif Ijaz is a seasoned professional, who is an advisor to Maple Leaf Cement in addition to being on the board of various companies.
- The company has two boards in place, one is a 'family board' which only comprises members of the sponsor family and the other is an 'extended board', which includes external members. The family board meets frequently and discusses matters pertaining to operations and future strategy. The extended board meets less frequently for strategic planning, in addition to settling family disputes, if any.
- The company has systems in place for the induction and progress of family members in the business. Additionally, plans are in place for the development of a family office in the near future reflecting positively on governance.
- M/s Arshad Raheem & Co. Chartered Accountants, who are not rated by the SBP but have a satisfactory QCR rating by ICAP, are the external auditors of the company. They have expressed an unqualified opinion on the financial statements of the company for the year ended June 30, 2017.

MANAGEMENT

- Mr. Asif Masood is the CEO of the company. He has been associated with the company for ~20 years and is responsible for running the day to day operations, with complete independence. He is aided by the CFO and Mustafa Zaman (Mr. Hamid Zaman's son), who works as an advisor to the CEO.
- Mr. Hamid Zaman and Ms. Seema Aziz act as Managing Directors and take part in making key strategic decisions.
- The top management is supported by a team of professionals working under various sub-divisions to ensure smooth reporting.
- The company deploys SAP ECC6 as their primary ERP solution, in addition to having Oracle (modified in-house) and S-Track, which is an in-house developed software. The company has a comprehensive MIS in place and has plans to shift all its reporting to SAP in the next year. Various reports are generated regarding inventory management, sales, and accounts, among others.

BUSINESS RISK

- The company generates its revenue from three segments: i) Weaving, ii) Processing and iii) Stitching. Sarena Industries has a fairly balanced sales mix, slightly inclined towards local sales (52%). Major share of the revenue emanates from processing, which constitutes 77% of total sales, followed by weaving (22%). During FY17, the company grew its top line by ~21%, mainly owing to increased quantity and higher prices fetched in the international market, with respect to processing and weaving. In the international market, top 10 customers for processing, account for 61% of total export sales and 32% of total sales, indicating relative concentration.
- Raw materials consumed account for 74% of the Cost of Goods Sold and increased by 45% in FY17, mainly owing to increased yarn prices. The company posted higher gross profits, but margins remained constant due to proportionate increases in cost of sales. Higher administrative and distribution costs led to a slightly lower operating margin (8%) in FY17 (FY16: 9%)
- Through 10MFY18, Sarena Industries increased its sales revenue by 27%, YoY, owing to surge in local sales and better pricing. The company posted a healthy gross margin of 19%. Marginal increases in administrative and distribution costs helped the company post an operating margin of 11% (10MFY17: 6%)
- Going forward, the management is looking to expand its weaving operations by 66 looms financed through LTFF to cater to increasing demand. This is expected to bring efficiencies through economies of scale. The company also intends to focus on specialized fabric that yield better margins.

FINANCIAL RISK

- Majority of the working capital needs emanate from trade receivables and inventories. Through 10MFY18, working capital needs for the company decreased by 20%, YoY. The company finances its working capital needs through short-term borrowings.
- Working capital remained stretched for the company with lower creditor days resulting in Net Working Capital Days of 111. The company maintains a cushion in the form of utilized credit lines to meet unexpected financial needs. However, this cushion remains stretched as the company engaged in higher borrowings as compared to its current assets.
- The company posted strong coverages on the back of better cashflows. Interest coverage ratio stood at 5.8x, while debt pay back stood at 2.1x during 10MFY18.
- Sarena has a leveraged capital structure (60%) and a strong financial profile. During 10MFY18 total debt taken up by the company stood at ~PKR 3,968mln. Majority of this debt is in the form of short-term borrowings, which represent 81% of total debt.



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Sarena Industries & Embroidery Mills Limited

BALANCE SHEET	30-Apr-18 10M	30-Jun-17 FY	30-Jun-16 FY	30-Jun-15 FY
Non-Current Assets	3,537	3,064	2,725	2,515
Investments (incl. Associates)	-	-	-	-
Equity	-	-	-	-
Current Assets	4,270	3,973	3,175	2,680
Inventory	1,336	1,186	1,111	1,014
Trade Receivables	1,847	1,746	1,199	834
Others	1,086	1,041	865	833
Total Assets	7,806	7,037	5,900	5,196
Debt	3,968	3,780	3,217	2,818
Short-term	2,865	2,845	2,246	1,787
Long-term (incl. Current Maturity of Long-Term debt)	1,103	935	971	1,031
Other Short-term Liabilities	1,000	967	634	690
Other Long-term Liabilities	197	200	213	173
Shareholder's Equity	2,641	2,091	1,836	1,515
Total Liabilities & Equity	7,806	7,037	5,900	5,196
INCOME STATEMENT				
Turnover	7,703	7,420	6,154	4,832
Gross Profit	1,467	1,229	1,057	885
Other Income	(21)	(15)	(34)	(32)
Financial Charges	(157)	(170)	(162)	(110)
Net Income	626	330	321	282
Cashflow Statement				
Free Cashflow from Operations (FCFO)	912	663	670	468
Net Cash changes in Working Capital	(241)	(426)	(524)	(700)
Net Cash from Operating Activities	502	73	(20)	(312)
Net Cash from Investing Activities	(637)	(412)	(354)	(1,355)
Net Cash from Financing Activities	69	399	291	1,696
Net Cash generated during the period	(67)	60	(84)	28
Ratio Analysis				
Performance				
Turnover Growth	27.1%	20.6%	27.4%	N/A
Gross Margin	19.0%	16.6%	17.2%	18.3%
Net Margin	8.1%	4.5%	5.2%	5.8%
ROE	28.4%	15.8%	17.5%	7.7%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	2.1	1.5	1.6	2.2
Interest Coverage (x) (FCFO/Gross Interest)	5.8	3.9	4.1	4.2
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	1.2	1.9	1.9	2.9
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	85	91	98	107
Capital Structure (Total Debt/Total Debt+Equity)	60.0%	64.4%	63.7%	65.0%

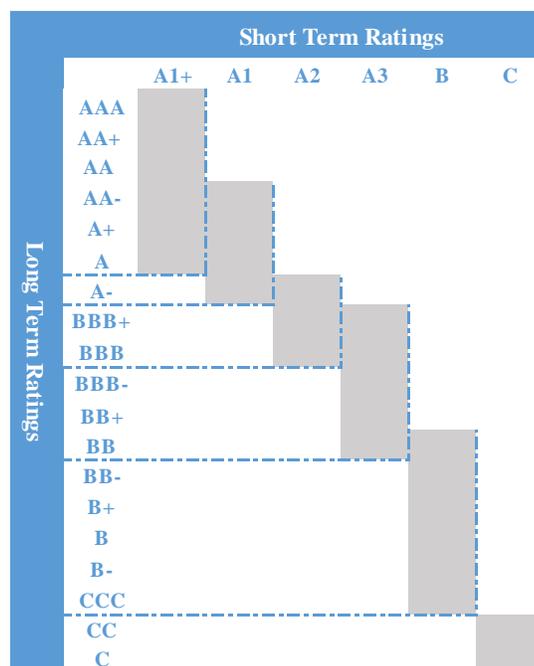
Sarena Industries & Embroidery Mills (Private) Limited

Jul-18

Credit Rating Scale & Definitions

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 Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

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

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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)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- 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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- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (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.
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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)
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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)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

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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