



The Pakistan Credit Rating Agency Limited

Rating Report

Saif Textile Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Jun-2019	A-	A2	Stable	Maintain	-
28-Dec-2018	A-	A2	Stable	Maintain	-
27-Jun-2018	A-	A2	Stable	Maintain	-
29-Dec-2017	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Saif textile mills limited (Saif Textile), a prominent textile venture of Saif Group, is involved in manufacturing and marketing of various varieties of cotton yarn including, melange yarn, dyed yarn, man-made yarn and raw white yarn. Despite challenging environment, Saif Textile has managed to maintain its optimal capacity while upgrading its machinery in order to ensure operational efficiencies and eventually higher production volumes. Recent devaluation has considerably eroded the Company's profitability as its debt includes a portion of dollar based borrowing. This coupled with hiked interest rates has further squeezed the Company's profitability. Additionally, the financial profile of the Company remains constrained by debt driven BMR thus resulting in highly leveraged capital structure with stretched coverages. Going forward, with better efficiency and specialized product profile, the management expects Saif Textile's margins to improve and become comparable with peers. The assigned ratings incorporates experienced management team, strong financial muscle of the Sponsors and their willingness to support the Entity. As demonstrated historically in the form of subordinated loans.

The ratings are dependent on managing financial obligations while improving business margins. Any further accumulation of debt and/or shift from current business strategy, impacting the risk profile of the entity, may negatively affect the ratings. Going forward, Saif group's support to the entity would remain critical.

Disclosure

Name of Rated Entity	Saif Textile Mills 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(Jun-18)
Related Research	Sector Study Textile(Oct-18)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Saif Textile Mills Limited (Saif Textile), was incorporated in 1989 as a Public Limited Company.

Background Saif Textile is associated with Saif Group since its inception. The Group has presence in spinning sector through Kohat Textile and Maditerranean Textile. The Company's production facilities are located in Gadoon Industrial Estate, KPK.

Operations The Company's current operational capacity comprises 100,968 Spindles. The total energy requirement of the Company is ~10MW which is wholly met through gas fired captive plant. Furthermore, the Company has NTDC connection as alternative source.

Ownership

Ownership Structure Saif Group holds majority of the shareholding of Saif Textile's through its holding company – Saif Holdings. It exercises its control over the Company's board by virtue of its ~50% shareholding in the Company, followed by NIT and State life with 7% and 4% stake respectively. The Company has a large free float dispersed among general public.

Stability The Group has a holding company in place, with equal shareholding of all Saif brothers, portraying structured line of succession. However, the transfer of ownership to next generation is not documented yet.

Business Acumen Saif Group is one of the oldest medium-sized business conglomerate in Pakistan with considerable interests in textile. The sponsors have a presence of five decades in local Spinning industry, eventually developing expertise. However, the Group's growth in textile sector was limited but it sustained through the volatility experienced by local textile industry.

Financial Strength Saif Group is one of the leading industrial and services conglomerates in Pakistan. The Group's interests lies in oil and gas exploration, power generation, textiles manufacturing, real estate development and health care services, through 7 subsidiaries and 4 associated companies across different sectors. The strong financial muscles of the Group portrays ability to support Saif Textile in time of need, as demonstrated in the past.

Governance

Board Structure Saif Textile's board comprises seven members, including the Chairman - Mr. Osman Saifullah. The board include five non-executive directors, one executive director, while one director is independent.

Members' Profile Mr. Osman Saifullah – Chairman – holds a post graduate degree in engineering from University of Oxford and post graduate degree in business administration from University of Stanford. Mr. Osman has overall experience of over two decades and he is also a senator. The board members have vast knowledge and expertise of textile industry, though diversity in experiences exists as well, ensuring a requisite skill mix for strategic planning.

Board Effectiveness Two committees: Audit and Human Resource & Remuneration, are in place to assist the board in relevant matters and it ensures proper oversight. Attendance of board members in meetings remains adequate and meeting minutes were formally documented. Meanwhile, overall strategy of the Company is discussed in bi-annual meeting of Saif Group, whereas, operational matters are discussed in board meetings.

Financial Transparency M/s Shinewing Hameed Chaudhri & Co., Chartered Accountants are the external auditors of the Company. They have expressed unqualified opinion on the financial statements of the Company for the periods ended June 30, 2018 and December 31, 2018.

Management

Organizational Structure The management team is headed by Mr. Zaheer ud Din (CEO), with defined reporting line to ensure smooth operations and efficiency. Meanwhile, the Company has nine functional departments, while all HOD's reports directly to CEO.

Management Team Mr. Zaheer ud Din - a Chartered Accountant - has been serving as the CEO for four years. He is supported by a team of seasoned professionals, most of them have been associated with the Company for a reasonably long period of time.

Effectiveness There is no formal management committee, however the Company maintains an adequate IT infrastructure and related controls. Additionally, delegation of power by sponsors to management is considered positive for management effectiveness.

MIS Saif Textile has in place Microsoft Dynamics based ERP system that provides comprehensive MIS reporting.

Control Environment The Company is compliant with following quality assurance standards; OEKA TEX 100, ISO 9001:2008, ISO 14001, Global Organic Textile Standards and Supima.

Business Risk

Industry Dynamics Pakistan's textile exports stagnated in 9MFY19 (~0.1% growth YoY). Even though major segments including cotton cloth, knitwear, garments and bed-wear displayed strong volumetric growth, a unit price dip resulting from sharing currency devaluation benefits with export clientele, curbed overall growth. Cotton yarn also displayed double-digit volumetric decline on account of the US-China trade war. Going forward, the withdrawal of zero-rated sales tax status from textile sector coupled with the increase in interest rate may impact liquidity and profitability of Pakistan's textile industry.

Relative Position The Company's association with Saif Group strengthen its position in local spinning industry. However, on standalone basis the Company's share in local spinning industry is minimal.

Revenues During 9MFY19, the Company's top-line clocked in at ~PKR 6,247mln (9MFY18: PKR 5,644mln), posting a growth of ~11% on YoY basis. This is attributable to consistent BMR activities coupled with better pricing in local market, favoring the domestic oriented nature of the Company. Sale mix has remained tilted toward local market with ~92% share of total revenues.

Margins The Company's gross margin has improved (9MFY19: 11.4%, 9MFY18: 10.5%), a factor of lower than proportionate increase in cost of sales. This is attributable to constant BMR activities in previous years resulting in cost efficiency. Higher gross profit and cost control at operating level led to better operating margin (9MFY19: 7.0%, 9MFY18: 6.0%). The Company is not booking GIDC in energy cost, over time it has surged to PKR 1.3bln. Finance cost has increased considerably because of higher long term borrowing coupled with increased interest rates. Meanwhile, rupee devaluation has resulted in an exchange loss of ~PKR 95mln on dollar based subordinated loan (\$ 5mln). Consequently, the Company reported a loss of ~PKR 75mln (9MFY19).

Sustainability The Company has incurred BMR of PKR 1.35bln in recent years, comprising induction of energy efficient machinery and partial replacement of old spindles with energy efficient spindles. This will ensure wider range of products with higher margins, in turn, better profitability. Going forward, adverse verdict in GIDC may significantly impact the profitability of the Company.

Financial Risk

Working Capital The Company's reliance on STB has increased in 9MFY19, on the back of higher working capital needs. Meanwhile, the Company has no further room to borrow at trade assets level (9MFY19: 0%, 9MFY18: -15%); though it has improved considerably over the year. The Company's receivable days have increased (9MFY19: 61days, 9MFY18: 52days). Meanwhile, inventory days have declined (9MFY19: 88days, 9MFY18: 97days), owing to lower raw material inventory. Resultantly, gross working capital days has remained the same (9MFY19: 149days, 9MFY18: 149days). However, working capital cycle is considered stretched when compared with peers.

Coverages During 9MFY19, the Company's operating cash flows stood at ~PKR 569mln, posting a growth of ~23%. However, higher than proportionate increase in finance cost has resulted slightly lower interest coverage (9MFY19: 1.5x, 9MFY18: 1.6x). The Company's debt coverage is weak, though it has improved over the year (9MFY19: 0.7x, 9MFY18: 0.6x), owing to declined uncovered short term borrowing at trade assets level.

Capitalization Saif textile has an aggressively leveraged capital structure ~73% (9MFY19). Total debt stood at PKR 6,191mln, mainly comprising current debt ~67%.



Saif Textile Mills Limited

Listed Public Limited

A BALANCE SHEET	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
1 Non-Current Assets	5,156	5,023	4,521	4,630
2 Investments	4	5	6	6
a Equity Instruments	4	5	6	6
c Others (including loans and advances)	-	-	-	-
3 Current Assets	4,582	3,967	4,108	3,392
a Inventory	2,191	1,836	2,029	1,766
b Trade Receivables	1,516	1,268	1,018	759
c Others	875	863	1,061	868
4 Total Assets	9,751	9,005	8,639	8,029
5 Borrowings	6,191	5,472	5,319	4,679
a Short-Term	3,787	3,299	3,430	2,768
b Long-Term (Incl. CMLTB)	2,404	2,173	1,889	1,912
6 Other Short-Term Liabilities	1,037	903	786	848
7 Other Long-Term Liabilities	216	227	261	261
8 Shareholder's Equity	2,307	2,402	2,273	2,241
9 Total Liabilities & Equity	9,751	9,005	8,639	8,029
B INCOME STATEMENT				
1 Sales	6,247	7,852	7,586	6,698
2 Gross Profit	712	855	763	622
3 Non Operating Income/Expense	(87)	(78)	28	3
4 Total Finance Cost	(411)	(385)	(315)	(324)
5 Net Income	(75)	47	23	(49)
C CASH FLOW STATEMENT				
1 Free Cash Flow from Operations (FCFO)	569	668	641	449
2 Net Cash changes in Working Capital	(545)	204	(814)	(257)
4 Net Cash from Operating Activities	(275)	550	(435)	(68)
5 Net Cash from Investing Activities	(325)	(602)	(214)	(469)
6 Net Cash from Financing Activities	604	44	639	539
7 Net Cash generated during the period	4	(8)	(10)	1
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	11%	4%	13%	-16%
b Gross Profit Margin	11%	11%	10%	9%
c Net Profit Margin	-1%	1%	0%	-1%
d Return of Equity	-4%	2%	1%	-3%
2 Working Capital Management				
a Gross Working Capital (Inventory Days + Receivable Days)	149.2	143.0	134.0	165.4
b Net Working Capital (Inventory Days + Receivable Days - Payable Days)	135.6	131.5	122.0	148.6
3 Coverages				
a Debt Service Coverage (FCFO / Finance Cost+CMLTB+Excess STB)	0.7	0.7	0.7	0.5
b Interest Coverage (FCFO / Finance Cost)	1.5	1.8	2.0	1.4
c Total Operating Coverage (TCF / Finance Cost+CMLTB+Excess STB)	3.0	2.5	2.6	2.9
d Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	11.2	8.0	6.1	17.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Capital Structure (Current Borrowings / Total Borrowings)	67%	66%	74%	68%
b Capital Structure (Total Borrowings / Total Borrowings+Equity)	73%	69%	70%	68%

Jun-19

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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(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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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.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
- (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)

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- (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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