The Pakistan Credit Rating Agency Limited

Rating Report

Saif Textile Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Dec-2019	A-	A2	Stable	Maintain	-
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 utilization while upgrading its machinery in order to ensure operational efficiencies and eventually higher production volumes. The top line of the Company has shown a healthy growth that translated in to better margins in FY19. Moreover, the dollar-based subordinated loan was waived off in FY19, helping the Company to post a one-time gain. Higher interest rates and increased short term borrowing squeezed the net margin in 1QFY20 resulting in a net loss. 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.

The ratings are dependent on managing financial obligations effectively 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 and prudent debt management 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-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Spinning(Sep-19)
Rating Analysts	Adil Kaleem | Adil.kaleem@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 freefloat 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 four non-executive directors, while two directors are 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. Zaheen 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. Zaheen 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 During 4MFY20, textile exports increased by 4.1% YoY in comparison to 3.81% overall growth in exports. The balance of trade within the textile group appreciated by 13% in 4MFY20. Furthermore, US-China trade war has a disrupting impact on the cotton prices across the globe. Considering that China accounts for more than 50% of Pakistan's cotton yarn exports, lesser demand from China have negatively impacted the spinning industry. Additionally; the withdrawal of zero-rated sales tax status from textile sector coupled with the high interest rates, has impacted liquidity and profitability.

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 FY19, the Company recorded a growth of 14.3% in Revenues, registering at PKR 8,976mln (FY8: PKR 7,852); owing to better production planning as well as better pricing. Majority of the sales were concentrated in the local market (FY19: 92%). For 1QFY20, the revenue stood at PKR 1,926mln (FY18: PKR 1,888mln).

Margins In FY19, the gross margin of the Company had an upward trend; and was clocked at 11.6% (FY18: 10.9%) on the back of effective cost structure changes and better pricing. This was also translated in to the operating margin of the company, which ended up at 7.6% in FY19, as compared to 6.5% in FY18. During FY19, the subordinated loan, along with accrued interest, was waived off. Consequently, the company booked on time gain of PKR 896mln which increased its net margin to 9.3%, nullifying the impact of higher finance cost (FY19: PKR 595mln; FY18: PKR 385mln). However, despite better gross margin (1QFY20 : 15.5%), higher finance cost lead the company to post a loss of PKR 40mln.

Sustainability The Company is investing in alternative energy sources for conservation and is in the process of installing solar panels for power generation. Going forward, the withdrawal of zero rated status will negatively impact the Company as some unregistered customers stopped purchase of yarn; consequently, the Company's profitability may deteriorate.

Financial Risk

Working Capital Saif Textile meets its working capital requirement through short term borrowing. During of FY19, the Company's inventory cycle largely remained the same (FY19: 85 days; FY18: 85 days) due to prudent inventory management and higher revenue. Furthermore, the room-to-borrow was further squeezed in FY19 at the trade level, magnified by 21% when compared to FY18 owing to the working capital needs. In 1QFY20, the Company saw a further increase of PKR 447mln in the short-term borrowing with a corresponding increasing in the net trade assets of ~18% since the end of last financial year.

Coverages For FY19, there was a decline in the interest coverage to 1.6x from 2.0x in FY18. This resulted from the high finance cost incurred by the Company in FY19 of PKR. 565mln. The total debt coverage remained unchanged at 0.7x in FY19 despite the increase in finance cost; owing to the higher profits generated. In 1QFY20, the interest coverage (0.7x) and the total debt coverage (0.6x) contracted; a consequence of a sharp increment in the finance cost.

Capitalization Saif Textile has slightly reduced its leverage to 63.9% in FY19 (FY18: 69.5%), owing to the waiving off of subordinated loan. The borrowing has increased to PKR 5,664mln in FY19, from PKR 5,472mln in FY18; the increase mainly registered by the STBs (to PKR. 3,780mln in FY19, from PKR 3,299mln in FY18). In 1QFY20, the total debt increased to PKR 6,106mln, mainly due to an increment in the STB.

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Financial Summary
PKR mln

00-Jan-00	Sep-19	Jun-19	Jun-18	Jun-17
##	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	5,401	5,439	5,023	4,525
2 Investments	31	6	5	6
3 Related Party Exposure	11	11	10	4
4 Current Assets	4,854	4,547	3,967	4,104
a Inventories	*2,400*	*2,340*	*1,836*	*2,029*
b Trade Receivables	*1,589*	*1,211*	*1,268*	*1,018*
5 Total Assets	10,297	10,003	9,005	8,639
6 Current Liabilities	804	911	903	786
a Trade Payables	*445*	*542*	*445*	*409*
7 Borrowings	6,106	5,664	5,472	5,319
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	228	229	227	261
10 Net Assets	3,159	3,198	2,402	2,273
11 Shareholders' Equity	3,159	3,198	2,402	2,273
B INCOME STATEMENT				
1 Sales	1,926	8,976	7,852	7,586
a Cost of Good Sold	*(1,627)*	*(7,938)*	*(6,997)*	*(6,823)*
2 Gross Profit	298	1,038	855	763
a Operating Expenses	(103)	(356)	(342)	(370)
3 Operating Profit	195	682	513	393
a Non Operating Income	*1*	*833*	*(78)*	*28*
4 Profit or (Loss) before Interest and Tax	196	1,515	435	421
a Total Finance Cost	*(207)*	*(595)*	*(385)*	*(315)*
b Taxation	*(28)*	*(89)*	*(4)*	*(84)*
6 Net Income Or (Loss)	(40)	830	46	23
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*210*	*796*	*668*	*641*
b Net Cash from Operating Activities before Working Capital Changes	*47*	*313*	*346*	*379*
c Changes in Working Capital	*(450)*	*(407)*	*204*	*(814)*
1 Net Cash provided by Operating Activities	(403)	(94)	550	(435)
2 Net Cash (Used in) or Available From Investing Activities	(54)	(676)	(602)	(214)
3 Net Cash (Used in) or Available From Financing Activities	442	781	44	639
4 Net Cash generated or (Used) during the period	(15)	11	(8)	(10)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-14.2%	14.3%	3.5%	#DIV/0!
b Gross Profit Margin	15.5%	11.6%	10.9%	10.1%
c Net Profit Margin	-2.1%	9.3%	0.6%	0.3%
d Cash Conversion Efficiency (EBITDA/Sales)	12.9%	10.2%	9.1%	9.2%
e Return on Equity (ROE)	-5.0%	29.7%	2.0%	1.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	179	135	143	113
b Net Working Capital (Average Days)	155	115	123	93
c Current Ratio (Total Current Assets/Total Current Liabilities)	6.0	5.0	4.4	5.2
3 Coverages				
a EBITDA / Finance Cost	1.3	1.6	2.0	2.4
b FCFO / Finance Cost+CMLTB+Excess STB	0.6	0.7	0.7	0.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	37.7	8.7	8.0	5.8
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	65.9%	63.9%	69.5%	70.1%
b Short-Term Borrowings / Total Borrowings	0.7	0.7	0.6	0.6
c Average Borrowing Rate	13.4%	10.1%	6.8%	5.5%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

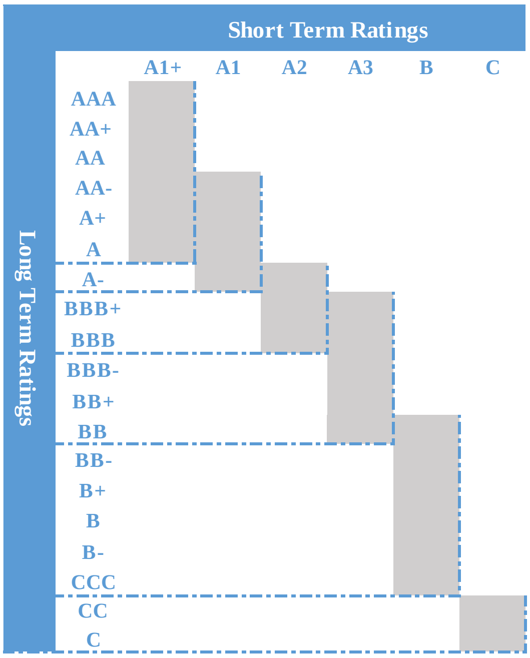
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

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 Ratings

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 conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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 surveill the opinion due to lack of requisite information.

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

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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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(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.
(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)
(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)

Independence & Conflict of interest
(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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