



The Pakistan Credit Rating Agency Limited

Rating Report

Salfi Textile Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
03-Dec-2018	BBB	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Salfi Textile Mills Limited – a public listed company, primarily engaged in the manufacturing and sale of different varieties of yarn is majorly owned by Mr. Anwar Tata Family. Tata group currently owns three textile mills i.e. Island, Salfi and Tata Textile Mills Limited. The Group is also diversified into power and food sectors. Due to higher demand in local market recently the group has shifted its focus from export sales which led to increasing its footprints in the local market. Textile industry in general and spinning industry in particular has benefitted from recent devaluation of currency despite higher cotton prices. However, on standalone basis prudent cotton procurement lead to improvement in Salfi's margins and in turn profitability. The ratings of Salfi incorporate its working capital cycle which remain stretched despite improvement in profitability. The financial risk profile of the company is characterized by well maintained leveraged capital structure, however coverages remain under pressure due to relatively small size of cashflows. Amidst rising interest rates coverages may stretch further. Long association of experienced and professional management team adds comfort. Going forward, management is planning to merge all three textile entities in order to benefit from the economies of scale.

The ratings are dependent on sustaining business margins while improving its financial risk via improved core coverages. Meanwhile, prudent management of short term liquidity would be rating essential. Going forward, materialization of successful merger of all three textile entities would be significant to rating.

Disclosure

Name of Rated Entity	Salfi 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 Salfi Textile Mills limited was incorporated in 1968 and got listed on Pakistan Stock Exchange in April, 1970. It is engaged in the manufacture and sale of different varieties of yarn.

Background TATA Pakistan, in 1981, took over the ownership and management of Salfi Textile Mills Limited. It later established Tata Textiles Mills Limited, in the early 90s, along with already established Island Textile Mills Limited.

Operations The primary business of the company is manufacture and sale of different varieties of yarn. Functioning with two manufacturing units, the total number of spindles installed is 36,708 spindles which operate in 3 shifts per day. Majority of the yarn produced by Salfi is used in denim wear and towel sector.

Ownership

Ownership Structure The director Mr. Shahid Anwar Tata and his son Mr. Adeel Shahid Tata (CEO) along with other family members and associated company (Island Textile) collectively own majority (91%) shares of the company. The remaining shareholding of the company is held by mutual funds (3%) and general public (6%).

Stability TATA group is one of the oldest and renowned groups of Pakistan. Third generation of TATA family has entered into the business. Although there is no formal succession plan but roles among Adeel Shahid Tata and Bilal Shahid Tata are clearly defined. Proper definition of roles give TATA group long-term stability.

Business Acumen Mr. Anwar Tata - founder of Tata group has more than ~50 years of work experience, possessing strong business acumen of the Industry. Tata Family has decades of textile related business which remains key in day to day operations of the group.

Financial Strength Apart from Textile companies, Tata group also has interests in power and food sector. Overall financial strength of the sponsors is considered strong.

Governance

Board Structure The control of the company vests in seven members including Mr. Anwar Ahmad Tata as the chairman of the board. There are two executive, four non-executive and one independent director in the board.

Members' Profile Board members have diversified experience, and relatively long association with the company. Chairman - Mr. Anwar Ahmad Tata has over 5 decades of experience.

Board Effectiveness For effective results the board has formed two committees (Audit and HR) to assist the board on relevant matters. During the year four board meetings were held with strong attendance.

Financial Transparency The External Auditors of the Company are M/s. Deloitte Yousuf Adil, Chartered Accountants. They expressed an unqualified opinion on the company's annual financial statements for the year ended June 30, 2018.

Management

Organizational Structure Management control vests with Tata Group. Shahid Anwar Tata primarily manages the company's affairs, supported by a team of professionals.

Management Team Management team comprises long associated and experienced individuals. Adeel Shahid Tata - CEO - under the guidance of his father Shahid Anwar continues to handle the business affairs professionally.

Effectiveness At Salfi Textile all deliberations are held at meetings conducted by department heads on "as and when needed" basis. Though there is no formal process but daily and weekly meetings are done to manage affairs.

MIS Salfi Textile deploys Oracle based Enterprise Resource Planning (ERP) system. The Company's MIS can be classified into two categories on the basis of periodicity – daily and monthly. The daily and weekly reports generated for top management mainly scrutinize production and liquidity position whereas company's P&L is discussed on need basis in the meetings.

Control Environment Salfi Textile's plant is connected with head office through VPN, thereby reporting on real time basis. Moreover, All associated companies of Tata Pakistan group are ISO-9001 compliant, whereas Salfi Textile is also awarded with OEKO Tex Standard 100 Certifications, Cotton USA License and is a member of International Cotton Association.

Business Risk

Industry Dynamics During FY18, Sowing targets of FY19 has been missed by a significant amount so achieving cotton production target of 14.37 million bales is in doubt. Pakistan still expects to match its previous year's crop production of PKR ~11.5mln. On the other hand increased raw material prices in the international market and duties by the government of Pakistan can make the situation a little difficult for spinning textile industry despite currency devaluation.

Relative Position With 36,708 spindles Salfi Textile's position in Pakistan's spindle capacity is considered small. However at group level TATA group has a better position among industry players with 127,092 spindles.

Revenues Salfi Textile's revenues come from local and export sales. During FY18, the company's top line clocked in at PKR 5.958mln (FY17 PKR 5.284mln) posting a growth of ~13%. Currency devaluation supported Salfi Textile's revenue growth in FY18.

Margins The gross margins improved (FY18: 11.3%, FY17: 7.4%), followed by better operating margin (FY18: 7.8%, FY17: 3.5%). Moreover, the finance cost increased by ~30% on the back of stress on long-term borrowings. Whereas, Profit after tax significantly increased to PKR 234.4mln at end FY18 (FY17: PKR 36.7mln) mainly due to efficient buying of raw materials and currency depreciation affect.

Sustainability During FY18, Salfi Textile Mills limited achieved capacity utilization of 93.6% (FY17: 95.5%) and no further expansion is envisaged in near future. Going forward, management of Tata Pakistan is planning to merge all three entities i.e. Island Textile Mills Limited, Salfi Textile Mills Limited and Tata Textile Mills Limited.

Financial Risk

Working Capital During FY18, Salfi Textile's net working capital cycle has slightly deteriorated (end-Jun18: 104days, end-Jun17: 94 days), as inventory held days have increased (FY18: 76 days; FY17: 73 days). Short term borrowings in comparison to previous periods has decreased (FY18: PKR 1.951mln; FY17: PKR 2,185mln). However, there still mismatch between long term and short term exist on the financials.

Coverages During FY18, the company's free cash flows from operations increased on a YoY basis (FY18: ~640mln, FY17: ~370mln) owing to improved profitability, resulting in better interest coverage ratio (FY18: 2.8x; FY17: ~2.1x) and debt coverage ratio (FY18: 1.4x, FY17: 1.0x). Amidst rising interest rates, coverages will stretch in the future.

Capitalization Salfi Textile has well maintained capital structure (end-Jun18: ~45%, end-Jun17: ~58%). Out of the total debt only 23% of the debt comprises of long-term borrowings whereas the remaining ~77% is obtained through short-term borrowings.

Salfi Textile Mills Limited
BALANCE SHEET

	30-Jun-18	30-Jun-17	30-Jun-16
	FY18	FY17	FY16
Non-Current Assets	4,223	3,389	3,457
Investments (incl. Associates)	25	25	28
Equity	1	1	1
Debt Securities (incl. income funds)	25	25	28
Current Assets	2,150	2,212	1,489
Inventory	1,112	1,376	731
Trade Receivables	604	418	299
Others	434	418	459
Total Assets	6,398	5,627	4,974
Debt/Borrowings	2,539	2,981	2,047
Short-Term	1,951	2,185	1,080
Long-Term (incl. Current Maturity of Long-Term Debt)	588	796	967
Other Short-Term Liabilities	404	382	708
Other Long-Term Liabilities	196	79	71
Shareholder's Equity	3,260	2,185	2,148
Total Liabilities & Equity	6,398	5,627	4,974

INCOME STATEMENT

Turnover	5,958	5,284	4,976
Gross Profit	673	392	18
Other Income	64	87	8
Financial Charges	(228)	(176)	(169)
Net Income	234	37	(384)

Cash Flow Statement

Free Cash Flows from Operations (FCFO)	639	366	(123)
Net Cash changes in Working Capital	39	(1,092)	477
Net Cash from Operating Activities	467	(886)	166
Net Cash from Investing Activities	(32)	(76)	(241)
Net Cash from Financing Activities	(442)	934	80
Net Cash generated during the period	(8)	(29)	5

Ratio Analysis
Performance

Turnover Growth (v.s same period last year)	12.8%	6.2%	11.9%
Gross Margin	11.3%	7.4%	0.4%
Net Margin	3.9%	0.7%	-7.7%
ROE	8.6%	1.7%	-16.4%

Coverages

Debt Service Coverage (times) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.9	0.5	-0.2
Interest Coverage (times) (FCFO/Gross Interest)	2.8	2.1	-0.7
Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO - Gross Interest)	1.9	6.1	-4.3

Liquidity

Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	104	95	83
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Leveraging (Total Debt/Total Debt+Equity)	43.8%	57.7%	48.8%
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*Total Debt = Long-Term Debt + Short-Term Debt

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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- (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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- (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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