



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
28-Sep-2019	BBB	A3	Stable	Maintain	-
30-Mar-2019	BBB	A3	Stable	Maintain	-
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 has also diversified into power and food sectors. Spinning industry has recently suffered as lower demand for cotton yarn from China owing to trade war with USA has lead to lower exports volume. Consequently, Salfi Textile's margins and, in turn, profitability have deteriorated, as the Company incurred losses. The financial risk profile of the Company is characterized by moderately leveraged capital structure and weak coverages. The cash flows came under pressure while interest cost remains high. Long association of experienced and professional management team adds comfort. Any further deterioration in margins or sustained losses will affect the ratings negatively. 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 improving margins while maintaining adequate coverages. Meanwhile, prudent management of short term liquidity would be essential. Going forward, materialization of successful merger of all three textile entities would be significant for ratings.

Disclosure

Name of Rated Entity	Salfi Textile Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study Spinning(Sep-19)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Salfi Textile Mills limited ('The Company' or 'Salfi Textile') 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 Textile Mills Limited, in the early 90s, along with already established Island Textile Mills Limited.

Operations The primary business of the Company is manufacturing and sale of different varieties of yarn. Functioning with two manufacturing units, the total number of spindles installed are 36,708, which operate in 3 shifts per day. Majority of the yarn produced by Salfi Textile 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 an 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 the succession plan has not been formalized 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. Tata Family has decades of textile related experience, 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 nonexecutive and one independent director on the board.

Members' Profile Board members have diversified experience, and relatively long association with the Company. Mr. Anwar Ahmad Tata – Chairman of the board – has over five 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 FY19, 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 financial statements for the half year ended December 31, 2018. The auditors fall in the Category - "A" of the SBP's Panel of Auditors. Audit for the Company's financial statements for the year ended June 30, 2019.

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 business 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 FY19, exports stagnated despite major segments including cotton cloth, knitwear, garments and bedwear displayed strong quantitative growth, industry players needed to share the benefit of the currency depreciation with their buyers which resulted in a unit price dip across all major categories, curbing overall growth. This, coupled with cotton yarn displaying double-digit quantitative decline on account of the US-China trade war as well as strong domestic demand for yarn, resulted in overall increase in exports of only -0.1% YoY. Going forward, withdrawal of textile's zero rated status will impact industry's overall liquidity and margins.

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 During 9MFY19, the Company's top-line clocked in at PKR 4,855mln (9MFY18: ~PKR 4,331mln), up by 12% YoY. Increase in top-line was mainly due to 15% increase in local yarn sales, whereas the sales revenue from exports increased by 8%. Sales mix remained in favor of local sales, which constituted 57% of total sales.

Margins During 9MFY19, the cost of goods sold increased to PKR 4,502mln (9MFY18: PKR 3,915mln), showing an increase of 15% YoY because of increase in the price of raw cotton. Increase in cost of raw material brought gross margin of the Company down to 7.3% (9MFY18: 9.6%) and consequently, operating profit margin to 3.9% (9MFY18: 6.5%). Finance cost of the Company rose by 29% (9MFY19: PKR 224mln, 9MFY18: PKR 174mln) on the back of higher borrowings and increase in interest rate, consequently, net loss after interest and tax during 9MFY19 clocked in at PKR 74mln (9MFY18: PKR 83mln).

Sustainability During 9MFY19, Salfi Textile maintained full capacity utilization. No further expansion is envisaged in near future. Going forward, the management is working to increase the turnover and productivity of the Company, while reducing the cost of production.

Financial Risk

Working Capital During 9MFY19, Salfi Textile's net working capital cycle slightly improved and clocked in at 116days (FY18: 128days, 9MFY18: 115days) as inventory held days decreased to 90days (FY18: 102days; 9MFY18: 94days) due to resumed yarn exports to China during the period. Short term borrowings increased to 2,762mln (FY18: PKR 1,951mln; 9MFY18: PKR 2,251mln) because the Company procured higher amounts of raw cotton. The Company's net trade assets stood at PKR 2,620 and short term borrowings at PKR 2,762, resulting in a negative room to borrow of -5% and creating an asset-liability mismatch.

Coverages During 9MFY19, the Company's free cash flows from operations decreased on a YoY basis to PKR 265mln (FY18: PKR 639mln, 9MFY18: 403mln) owing to worsened profitability (Net loss of PKR 74mln), resulting in decline in both interest coverage ratio (9MFY19: 1.9x, FY18: 3x) and debt coverage ratio (9MFY19: 0.4x, FY18: 10x).

Capitalization Salfi Textile has a moderately leveraged capital structure (9MFY19: 49.5%, FY18: 43.8%, 9MFY18: 57.7%). Out of the total debt only 11% of the debt comprises of long-term borrowings whereas the remaining 89% is obtained through short-term borrowings. Going forward, in absence of any major capacity expansion, and with the gradual payments of long-term loans, the leveraging is expected to reduce over time.



Salfi Textile Mills Limited Textile	Mar-19 9M	Jun-18 12M	Mar-18 9M	Jun-17 12M	Jun-16 12M
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A BALANCE SHEET

1 Non-Current Assets	4,140	4,224	3,286	3,390	3,458
2 Investments	0	25	1	25	28
3 Related Party Exposure	-	-	-	-	-
4 Current Assets	3,046	2,150	2,457	2,212	1,489
<i>a Inventories</i>	2,074	1,111	1,602	1,376	731
<i>b Trade Receivables</i>	491	604	362	418	299
5 Total Assets	7,186	6,399	5,744	5,628	4,975
6 Current Liabilities	684	404	538	382	708
<i>a Trade Payables</i>	115	57	78	46	41
7 Borrowings	3,119	2,539	2,849	2,981	2,047
8 Related Party Exposure	-	-	-	-	-
9 Non-Current Liabilities	205	196	89	79	71
10 Net Assets	3,179	3,261	2,268	2,186	2,149
11 Shareholders' Equity	3,179	3,260	2,268	2,185	2,148

B INCOME STATEMENT

1 Sales	4,855	5,958	4,331	5,284	4,976
<i>a Cost of Good Sold</i>	(4,502)	(5,285)	(3,915)	(4,892)	(4,957)
2 Gross Profit	353	673	416	392	18
<i>a Operating Expenses</i>	(161)	(211)	(136)	(207)	(237)
3 Operating Profit	192	462	281	185	(219)
<i>a Non Operating Income</i>	6	108	25	87	8
4 Profit or (Loss) before Interest and Tax	197	570	306	272	(211)
<i>a Total Finance Cost</i>	(224)	(228)	(174)	(176)	(169)
<i>b Taxation</i>	(47)	(63)	(49)	(59)	(4)
6 Net Income Or (Loss)	(74)	279	83	37	(384)

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	265	639	403	366	(123)
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	41	428	241	205	(311)
<i>c Changes in Working Capital</i>	(589)	39	(116)	(1,092)	477
1 Net Cash provided by Operating Activities	(548)	467	125	(886)	166
2 Net Cash (Used in) or Available From Investing Activities	(30)	(32)	(4)	(76)	(241)
3 Net Cash (Used in) or Available From Financing Activities	--	(442)	(386)	934	80
4 Net Cash generated or (Used) during the period	--	(8)	(266)	(29)	5

D RATIO ANALYSIS

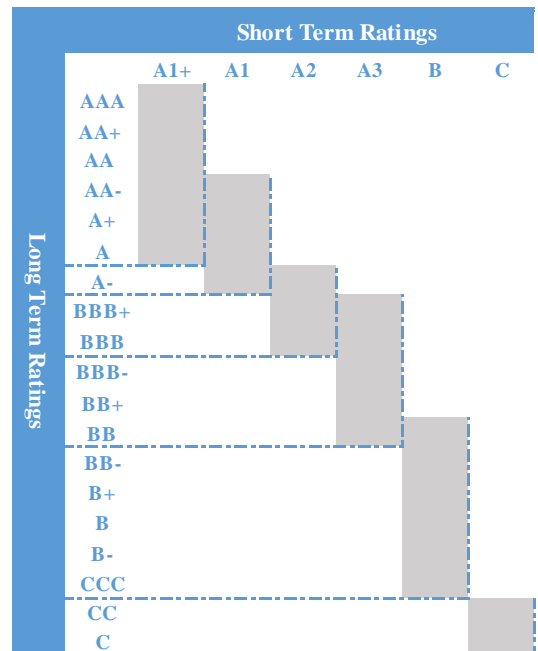
1 Performance					
<i>a Sales Growth (for the period)</i>	8.6%	12.8%	9.3%	6.2%	--
<i>b Gross Profit Margin</i>	7.3%	11.3%	9.6%	7.4%	0.4%
<i>c Net Profit Margin</i>	-1.5%	4.7%	1.9%	0.7%	-7.7%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	7.0%	11.9%	10.2%	8.5%	-0.7%
<i>e Return on Equity (ROE)</i>	-3.1%	10.2%	5.0%	1.7%	-16.4%
2 Working Capital Management					
<i>a Gross Working Capital (Average Days)</i>	121	107	119	98	101
<i>b Net Working Capital (Average Days)</i>	116	104	115	95	97
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	4.5	5.3	4.6	5.8	2.1
3 Coverages					
<i>a EBITDA / Finance Cost</i>	1.6	3.4	2.8	2.5	-0.2
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	0.4	1.0	0.7	0.5	-0.2
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	9.8	1.8	2.9	5.9	-4.2
4 Capital Structure (Total Debt/Total Debt+Equity)					
<i>a Total Borrowings / Total Borrowings+Equity</i>	49.5%	43.8%	55.7%	57.7%	48.8%
<i>b Short-Term Borrowings / Total Borrowings</i>	0.9	0.8	0.8	0.7	0.5
<i>c Average Borrowing Rate</i>	9.7%	7.6%	7.4%	7.0%	8.4%

#	Notes
D5	The line includes Advances from Customers, amounting to PKR 2.5bln [FY17: PKR 2.2bln]
-	-
-	-
-	-
-	-

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.

Disclaimer: PACRA’s ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA’s opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security’s market price or suitability for a particular investor.

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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.
- (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)

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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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