The Pakistan Credit Rating Agency Limited

Rating Report

Sarena Textile Industries (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
01-Aug-2019	A-	A2	Positive	Maintain	-
30-Jan-2019	A-	A2	Stable	Maintain	-
30-Jul-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Sarena Textile Industries (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 greater part of revenue is generated from processing sales followed by weaving. Revenue is balanced between the local and export market. The devaluation of the rupee has enabled the company to capitalize on positive dynamics and grow its revenue while penetration into the niche of work-wear gives it a competitive advantage over local peers, in terms of margins. The Company has a strong financial profile characterized by strong coverages and improving working capital management reflected in an adequate borrowing cushion. Financing at concessionary rates by the SBP shields the Company's moderately leveraged capital structure against the recent interest rate hikes. Planned expansion into value-added weaving is expected to further enhance the Company's performance, going forward.

The ratings are dependent on the management’s ability to sustain its working capital management and margins. Adverse movement in margins and/or coverages will negatively impact the ratings.

Disclosure

Name of Rated Entity	Sarena Textile Industries (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Textile(Oct-18)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure Sarena Textile Industries (Private) Limited (Sarena Textile) is a private limited company incorporated in 2001.

Background Sarena Textile is part of the Sefam and Ali Group of Industries, head quartered in Lahore, Pakistan. The Group is vertically integrated in the textile industry and has expanded its operations over the years. It owns many well known retail brands including Bareezé, Leisure Club, Minnie Minors, Chinyere, Home Expressions and Kayseria.

Operations The Company is engaged in the manufacture and sale of fabrics and garments used for fashion and work-wear with production operations divided into three main units: weaving, processing and stitching/apparel. The Company is self-sufficient in power generation with capacity to produce 7.9 MW/H through own sources and an additional 4.7 MW/H through lines from LESCO while its power requirement adds up to an average of ~4 MW/H.

Ownership

Ownership Structure Shareholding of Sarena Textile lies with the children of late Mr. J.A Zaman, founder of Ali Embroidery Mills (Private) Limited. Ms. Seema Aziz and Mr. Hamid Zaman each hold 42% of the Company while Mr. Tariq Zaman and Ms. Ambreen Zaman hold the remaining 16%, equally.

Stability While no written agreement between the sponsors currently exists, the Group is moving towards consolidation and formalization of Group structure in line with the current management structure.

Business Acumen The sponsor Group holds extensive experience and expertise in the textile and retail industry. They are viewed as the pioneers of introducing the concept of brands in Pakistan. Apart from the textile industry, the Group has also diversified into corporate farming, energy etc, through small scale ventures.

Financial Strength The net worth of the Group is considered strong and the sponsors have shown willingness and ability to support the Company in the past through various director loans.

Governance

Board Structure Sarena Textile’s Board comprises six members, four from the sponsor family and two independent members. The Board operates in two parts: one is the ‘family board’ which comprises only sponsor family members and discusses matters pertaining to operations and future strategy, while the other is the ‘extended board’, which includes the independent members and oversees strategic planning.

Members’ Profile Mr. Hamid and Ms. Seema both possess quality education from prestigious universities as well as significant experience in the textile industry. Ms. Seema also manages C.A.R.E foundation which she co-founded with Mr. Hamid. Other Board members are also well qualified and have been associated with the Company for a reasonable period of time.

Board Effectiveness Frequency of board meetings vary across both Boards. The family board meets more frequently; however, there is no fixed number of meetings that are to be held in a year. Meetings are conducted when deemed fit while minutes are not documented formally.

Financial Transparency The Company has appointed EY Ford Rhodes & Co. as its external auditor for FY, listed in the "A" category on the State Bank of Pakistan's panel of auditors. The quality of the auditor reflects well on the governance framework of the Company.

Management

Organizational Structure Mr. Asif Masood is the CEO of Sarena Textile. He looks after all day to day operations and all departments report to him. Mr. Asif reports to Mr. Hamid Zaman, who is the Managing Director of the Company, involved in key strategic decision making.

Management Team The management of the Company comprises qualified and experienced professionals with a wide range of skills and relevant experience. Most of the senior management has been associated with the Company for an adequate amount of time.

Effectiveness The Company does not have any formal management committees in place. Meetings among management are held only on need-basis and attended by the relevant management personnel. Formal meeting minutes are not documented.

MIS Sarena Textile 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 with regular generation of reports to aid informed and timely decision making.

Control Environment Sarena Textile has an ISO17025 accredited Quality Assurance Lab and is the only Licensee in Pakistan for PROBAN®, a quality controlled technological process that gives cotton and cotton rich woven and knitted textiles flame retardant properties. During FY19, the Company engaged KPMG Taseer Hadi & Co. as its internal auditor, adding quality to its transparency and control environment.

Business Risk

Industry Dynamics Pakistan's textile sector exports displayed negative YoY growth of ~1% in dollar terms. Even though leading textile categories including ready-made garments, knitwear and cotton cloth displayed double-digit volumetric growth, the hit to unit prices on account of exporters having to share the benefit of the currency depreciation with buyers, curbed overall growth. Meanwhile, cotton yarn exports fell by ~18% YoY, mainly driven by volumetric decline owing to the US-China trade war. Amidst rising interest rate environment, the recent removal of zero-rated status of the textile sector in the FY19-20 budget may pose a challenge to the liquidity of exporters if refunds are not timely disbursed by the government.

Relative Position Sarena Textile is an established name in Pakistan’s textile industry. On a standalone basis, the Company enjoys higher margins in comparison to local competitors mainly due to its penetration into the niche of work-wear, leading to a higher value-added product mix.

Revenues Sarena Textile has a fairly balanced sales mix (Exports: ~52%, Local: ~48%). The bulk of the Company’s revenue is derived from the sale of processed cloth (~69%), followed by weaving (~25%) and stitching (~6%). During 9MFY19, the Company grew its top line by ~27%, a factor of volumetric increase owing to the currency devaluation as well as improved prices fetched in the international market, with respect to processing and weaving. Top 10 customer concentration remains on the higher side, but the customer base comprises established, well known brands, partially mitigating the risk.

Margins For 9MFY19, the Company’s gross margin amounted to ~18%, displaying a slight YoY dip (9MFY18: ~19%) due to rising energy costs and higher cost of importing dyes and chemicals for processing department. Operating margin was sustained at ~11% while net margin showed YoY increase (9MFY19: ~10%, 9MFY18: ~8%), on account of exchange gain due to higher exports. Net profit for the period amounted to ~PKR 970mln, up by ~56% YoY, mainly driven by the high revenue growth.

Sustainability In addition to regular BMR in 9MFY19, the Company also expanded its stitching capacity to increase its presence in the international market. The Company is placing focus on increasing its margins through further penetration into value-added exports. For this purpose, it recently ventured into yarn dyeing and further plans to expand its value-added weaving operations by the addition of ~35 looms for the manufacturing of work-wear fabric. The project is to be financed through LTFF while the timeline is yet uncertain.

Financial Risk

Working Capital The Company’s working capital needs emanate from financing its inventory needs and trade receivables. During 9MFY19, net cash cycle showed minimal change (9MFY19: ~84 days, 9MFY18: ~82 days), though remains stretched, mainly on account of high receivable days. Improved cash flows in 9MFY19 have improved the Company's borrowing cushion against trade assets, depicting improved working capital management.

Coverages During 9MFY19, the Company managed to increase its free cashflows by ~23% (9MFY19: ~PKR 1,126mln) on the back of higher profitability. The Company's exposure in the current rising interest rate environment is quite low, due to borrowing at concessionary SBP rates. Thus, despite higher short-term borrowing during the period, the interest coverage for the period increase to ~7.8x (9MFY18: ~7.4x) while core debt coverage amounted to ~2.6x (9MFY18: ~2.4x).

Capitalization In 9MFY19, Sarena Textile's leveraging stood at ~59% (9MFY18: ~61%). Majority of the Company’s borrowings comprise short-term finance (~77%), mainly constituting Export Refinance, while long-term borrowing predominantly comprises LTFF. Short-term borrowing witnessed a significant YoY rise of ~38% in 9MFY19 due to an increase in working capital requirements. Going forward, taking on additional debt to finance upcoming projects may increase leveraging.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

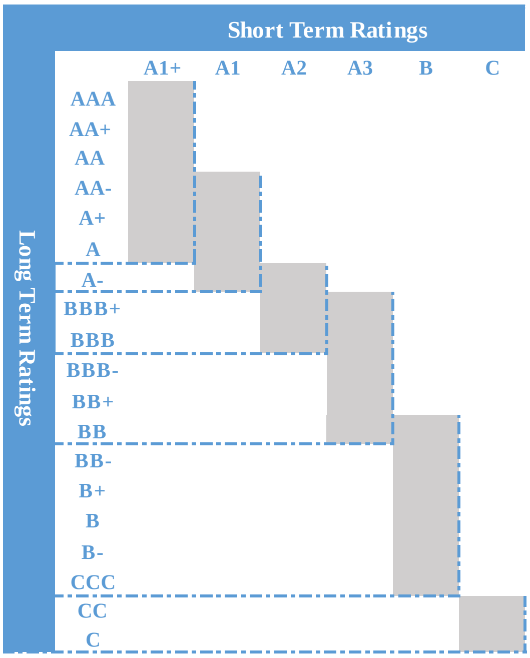
Sarena Textile Industries (Pvt.) Limited Textile Composite	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
A BALANCE SHEET				
1 Non-Current Assets	3,898	3,529	3,064	2,725
2 Investments	-	-	-	-
3 Related Party Exposure	139	161	149	116
4 Current Assets	6,299	5,228	3,824	3,059
a Inventories	*2,057*	*1,394*	*1,186*	*1,111*
b Trade Receivables	*2,493*	*1,978*	*1,746*	*1,199*
5 Total Assets	10,336	8,918	7,037	5,900
6 Current Liabilities	1,527	1,912	915	626
a Trade Payables	*1,234*	*695*	*696*	*414*
7 Borrowings	4,978	4,044	3,756	3,156
8 Related Party Exposure	173	184	181	197
9 Non-Current Liabilities	123	123	94	85
10 Net Assets	3,535	2,655	2,091	1,836
11 Shareholders' Equity	3,535	2,655	2,091	1,836
B INCOME STATEMENT				
1 Sales	9,777	9,412	7,420	6,154
a Cost of Good Sold	*(7,988)*	*(7,655)*	*(6,190)*	*(5,097)*
2 Gross Profit	1,788	1,757	1,229	1,057
a Operating Expenses	(676)	(782)	(657)	(520)
3 Operating Profit	1,113	975	572	537
a Non Operating Income	*143*	*(57)*	*(15)*	*(34)*
4 Profit or (Loss) before Interest and Tax	1,256	918	558	502
a Total Finance Cost	*(189)*	*(188)*	*(170)*	*(162)*
b Taxation	*(97)*	*(90)*	*(57)*	*(19)*
6 Net Income Or (Loss)	970	640	330	321
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,126*	*1,046*	*663*	*670*
b Net Cash from Operating Activities before Working Capital Changes	*941*	*869*	*499*	*504*
c Changes in Working Capital	*(2,367)*	*517*	*(426)*	*(524)*
1 Net Cash provided by Operating Activities	(1,426)	1,386	73	(20)
2 Net Cash (Used in) or Available From Investing Activities	(369)	(552)	(412)	(354)
3 Net Cash (Used in) or Available From Financing Activities	887	63	359	358
4 Net Cash generated or (Used) during the period	(908)	897	20	(16)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	38.5%	26.9%	20.6%	--
b Gross Profit Margin	18.3%	18.7%	16.6%	17.2%
c Net Profit Margin	9.9%	6.8%	4.5%	5.2%
d Cash Conversion Efficiency (EBITDA/Sales)	12.8%	12.5%	10.2%	12.3%
e Return on Equity (ROE)	41.8%	27.0%	16.8%	18.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	111	122	129	140
b Net Working Capital (Average Days)	84	95	102	116
c Current Ratio (Total Current Assets/Total Current Liabilities)	4.1	2.7	4.2	4.9
3 Coverages				
a EBITDA / Finance Cost	8.7	7.4	5.6	5.8
b FCFO / Finance Cost+CMLTB+Excess STB	2.6	2.0	1.4	1.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.9	1.3	2.1	2.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	59.3%	61.4%	65.3%	64.6%
b Short-Term Borrowings / Total Borrowings	77%	73%	72%	67%
c Average Borrowing Rate	4.1%	3.9%	3.7%	4.2%

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)
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

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(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)
Proprietary Information