



The Pakistan Credit Rating Agency Limited

Rating Report

Khaadi Pakistan (SMC-Pvt) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
14-Dec-2022	A-	A2	Positive	Maintain	-
14-Dec-2021	A-	A2	Stable	Maintain	-
14-Dec-2020	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Khaadi Pakistan (SMC-Pvt) Limited (Khaadi or The Company) is a distinct player in the retail fashion industry. With over two decades of history, reflecting growth and expansion, Khaadi has built strong brand equity. It has become synonymous with innovation and quality while ensuring affordability for its target customer base. The basket of the products offered (Ready to Wear (Eastern and Western), Fabrics, Khaadi Khaas, Accessories, Fragrances, Home, and many more). The topline size and growth supplement this assertion. The business model of Khaadi, as envisioned by its founder and CEO, has been the self-propelling force for the expansion of the entity. The retail network has reached half a million square foot physical presence. The brand has outreached outside Pakistan as well. Khaadi designs its outlets to give walk-in customers more than a shopping experience. The Experience Hub launched in December 2021 in Dolmen, Karachi, with a square footage of 32,000 came about not just to create a shopping space, but where experiences can be had while connecting with the product ranges. Khaadi also plans to target the audience of Lahore and Islamabad. The Company will also launch the Hub experience shop in Lahore. Re-branding of the logo is the leverage of distinct plans of the Company which will further unfold in the upcoming years. Recently a IFC invested \$ 25mln in Khaadi Corporation. The equity injection will be utilized in expanding the presence and product lines across Pakistan and abroad. The entity has a strong management structure in place, with professionals leading their respective roles. The Company takes pride in its design team which is considered the brain behind the brand. The reported numbers for FY22 reflect the stable position of the Company. Sales mix represents a major contribution in Fabric (FY22: 66% of total revenue (FY21: 67%).

The ratings are dependent on the recovery in the business performance and relative position of the entity. The financial profile is also expected to improve as anticipated. Governance of the Company is expected to take positive support from the initiatives undertaken by the sponsor shareholder.

Disclosure

Name of Rated Entity	Khaadi Pakistan (SMC-Pvt) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating(Jun-22),Methodology Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology Rating Modifiers(Jun-22)
Related Research	Sector Study Composite and Garments(Dec-21)
Rating Analysts	Iram Shahzadi iram.shahzadi@pacra.com +92-42-35869504



Composite and Garments

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Profile

Legal Structure Khaadi Pakistan (SMC Pvt.) Limited ('Khaadi' or The Company), was incorporated on July 15, 2015, as a single-member company under repealed Companies Ordinance 1984 (now Companies Act, 2017). Previously, Khaadi which commenced operations in 1998, products were sold by sole proprietorship managed by a single member.

Background Khaadi is one of Pakistan's leading fashion retail brands which offers home and clothing, shoes and accessories, fragrances, skin, and hair care solutions for women and kids. The Company is a Single Member Company (SMC) and has a history of 23 years.

Operations The Company has an exceptional retail network, with over 54 stores in Pakistan, and the related party, Texmark (Private) Limited export the products to UAE, Qatar, UK and Kingdom of Bahrain under the brand name of "Khaadi".

Ownership

Ownership Structure The Company is a wholly owned subsidiary of Khaadi Corporation Limited. Last year, IFC invested \$25mln in Khaadi Corporation. IFC has been inducted as a minority shareholder of up to 20% in Khaadi Corp.

Stability The presence of a Group holding company, Khaadi Corporation (Pvt.) Limited, as well as formal documentation capturing the family ownership structure bodes well for the stability of Khaadi.

Business Acumen Extensive growth has been seen in the business where expansion into different segments multiplied growth volumes. Hence, the business acumen of sponsors is considered strong.

Financial Strength Over the years, Khaadi has grown into a big retail brand with total assets of PKR 10bln, and equity of PKR 1bln. Total leveraging for the Group remains fairly aggressive with total annual revenues of PKR 15.1bln.

Governance

Board Structure Currently, the company has an SMC status where it has a one-member board. Khaadi Corporation has a five-member board, including the CEO, Mr. Shamoon as well as three independent members and one representative from the IFC.

Members' Profile Mr. Shamoon Sultan is the sole owner, founder, and director of Khaadi. He is the man at the last mile and the driving force behind the success and growth of the brand. The Company was established as a leading women's fashion brand in four countries based on his vision.

Board Effectiveness No committees have been formed to assist the Board. The Company, does, however, have an internal audit function in place.

Financial Transparency AF Ferguson & Co Company (PwC) is the external auditor of the Company. The auditors have expressed an unqualified opinion on the financial reports for the period ending 30th June 2022. The Company also has an in-house internal audit department that monitors the internal controls within a Company.

Management

Organizational Structure The Company's overall operations are segregated into six broad divisions, namely: (i) Designing, (ii) Commercial operations, (iii) Branding and Marketing, (iv) Human Resource, (v) Finance, and (vi) Product strategy (vii) Supply Chain, (viii) Strategy and E-Commerce. Each of the departments is led by an experienced individual ensuring smooth operations in the Company. A large number of senior executives report directly to the CEO.

Management Team Mr. Shamoon Sultan, the CEO, primarily manages the Company's affairs, supported by a team of seasoned professionals. After Mr. Shamoon, his wife Ms. Saira Shamoon is the Chief Design Officer of the Company. Mr. Tahir Iqbal is the Group CFO. The Company has an experienced management team spearheading its departments.

Effectiveness Management has formed six committees, namely, i) Steering Committee ii) Board and Product Committee iii) Commercial committee iv) CAPEX committee v) Management committee vi) Marketing committee headed by the CEO and other committee members.

MIS MIS primarily includes Microsoft, Adobe, Tubatech, and Oracle HRM Cloud. The MIS reports are updated on a real-time basis to be available to senior management all the time. The reports are shared and discussed with the CEO regularly so that the information is conveyed promptly to the CEO and higher management.

Control Environment Since Khaadi is not a manufacturing company, ISO certification does not apply. However, the Company maintains criteria for strong internal controls within the Company and follows the SOP's required for effective operation within the organization.

Business Risk

Industry Dynamics During 5MFY23, textile exports were valued at \$7.44bln compared to \$7.76bln, reflecting a 4% dip YoY – the declining trend recorded in the last two months. The fall in export value has mainly come from volumetric decline as prices of almost all categories have either increased or stayed flat. This has taken a fiscal year to date exports into negative with a 1.4% decline in the first four months (July – October) FY23. Among value-added items, bedwear has witnessed the largest decline of 19% (on an MoM basis), down to \$217 million. Knitwear remained on the downward path in October 2022 and declined by 10% to \$392 million. Among non-value-added items, cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is expected in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries.

Relative Position Khaadi enjoys a healthy position among its competitors. Some of the competitors of Khaadi are Ideas by Gul Ahmed, Outfitters, J., and Bareeze. Among these competitors, Khaadi enjoys a healthy market share.

Revenues The revenue of Khaadi reflected a growth of 25% and stood at PKR 22.7bln in FY22 as compared to PKR 18.1bln in FY21. Retail sales make up 97% of the company's revenue, and e-commerce makes up 3%. Product-wise analysis reveals that unstitched clothes generate a major chunk of revenues. The cost of sales went up in line with higher revenue. The overall net profit of the company also indicated an upward momentum. Gross profit enhanced to PKR 6.97bln (FY21: PKR 4.80bln). Hence, the net profitability clocked in at PKR 855mln (FY21: loss of PKR 130mln).

Margins Gross margins remained stagnant in recent years and clocked at 31.7% (FY21: 31.7%). Similarly, operating expenses inclined, but due to the massive increase in sales, operating margins were up by 6.9% (FY21: -2.4%). Net margins also improved and stood at 3.9% in FY22 as compared to -0.9% in FY21.

Sustainability Khaadi plans to target the audience of Lahore, Islamabad, and Karachi by using digital media. To ensure the sustainability of growth that Khaadi is expecting, the Company plans to tap new customers in Tier-II cities by creating awareness among the mass media. The Company will also launch the 'Experience Hub' shop in Lahore at two distinct locations in the upcoming year. The Experience Hub gives more than just a shopping space but offers customers with distinct experience while connecting with the product ranges.

Financial Risk

Working Capital The Company meets its working capital requirements through a mix of internal generation and short-term borrowings (STBs). Short-term borrowing of the Company up by double digit and was recorded PKR 1.1bln in FY22 (FY21: PKR 574mln). During FY22, the net-working capital of the Company inched down and stood at -36 days (FY21: -46 days). The inventory and receivable days stood at 60 days (FY21: 65 days) and 07 days (FY21: 21 days) respectively.

Coverages During FY22, Khaadi's cashflows (FCFO) increased (FY22: PKR 1,746mln, FY21: PKR 1,654mln). Consequently, the coverage of the Company recorded improvement. Interest coverage inclined (FY22: 8.5x, FY21: 1.5x). Similarly, debt coverage also inched up and was recorded at 0.9x (FY21: 0.5x).

Capitalization Khaadi has a highly leveraged capital structure of 55.7% in FY22 (FY21: 74.2%) - which recorded improvement attributable to an increase in equity base. Recently, a foreign investor invested \$ 25mln as a minority stake in Khaadi Corporation (Parent Company).



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Khaadi Pakistan (SMC-Pvt) Limited Retail		Jun-22 12M	Jun-21 12M	Jun-20 12M
A BALANCE SHEET				
1 Non-Current Assets		5,714	5,200	11,476
2 Investments		63	74	85
3 Related Party Exposure		824	213	88
4 Current Assets		7,070	4,890	5,341
<i>a Inventories</i>		4,437	2,759	2,650
<i>b Trade Receivables</i>		420	402	1,312
5 Total Assets		13,671	10,377	16,990
6 Current Liabilities		6,968	5,895	5,688
<i>a Trade Payables</i>		6,736	5,701	5,264
7 Borrowings		2,750	2,870	3,954
8 Related Party Exposure		981	451	-
9 Non-Current Liabilities		-	3	6,060
10 Net Assets		2,972	1,158	1,288
11 Shareholders' Equity		2,972	1,158	1,288
B INCOME STATEMENT				
1 Sales		22,037	15,167	15,678
<i>a Cost of Good Sold</i>		(15,058)	(10,364)	(10,751)
2 Gross Profit		6,979	4,803	4,927
<i>a Operating Expenses</i>		(5,462)	(5,168)	(5,803)
3 Operating Profit		1,518	(365)	(876)
<i>a Non Operating Income or (Expense)</i>		(102)	1,369	177
4 Profit or (Loss) before Interest and Tax		1,416	1,004	(699)
<i>a Total Finance Cost</i>		(423)	(1,223)	(1,438)
<i>b Taxation</i>		(138)	88	595
6 Net Income Or (Loss)		855	(130)	(1,541)
C CASH FLOW STATEMENT				
<i>a Free Cash Flows from Operations (FCFO)</i>		1,746	1,654	913
<i>b Net Cash from Operating Activities before Working Capital Changes</i>		1,243	398	(494)
<i>c Changes in Working Capital</i>		(1,140)	1,082	(885)
1 Net Cash provided by Operating Activities		103	1,480	(1,379)
2 Net Cash (Used in) or Available From Investing Activities		(850)	(676)	(1,135)
3 Net Cash (Used in) or Available From Financing Activities		833	(865)	2,242
4 Net Cash generated or (Used) during the period		86	(61)	(272)
D RATIO ANALYSIS				
1 Performance				
<i>a Sales Growth (for the period)</i>		45.3%	-3.3%	-19.6%
<i>b Gross Profit Margin</i>		31.7%	31.7%	31.4%
<i>c Net Profit Margin</i>		3.9%	-0.9%	-9.8%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>		2.7%	18.0%	0.2%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]</i>		41.4%	-10.6%	-74.9%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>		66	86	73
<i>b Net Working Capital (Average Days)</i>		-37	-46	-30
<i>c Current Ratio (Current Assets / Current Liabilities)</i>		1.0	0.8	0.9
3 Coverages				
<i>a EBITDA / Finance Cost</i>		9.5	1.6	0.7
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>		0.9	0.5	0.3
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>		2.4	7.9	-11.0
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>		55.7%	74.2%	75.4%
<i>b Interest or Markup Payable (Days)</i>		71.9	9.1	17.5
<i>c Entity Average Borrowing Rate</i>		5.4%	30.9%	54.3%

Credit Rating

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
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.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



*The correlation shown is indicative and, in certain cases, may not hold.

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

<p>Entities</p> <ul style="list-style-type: none"> a) Broker Entity Rating b) Corporate Rating c) Financial Institution Rating d) Holding Company Rating e) Independent Power Producer Rating f) Microfinance Institution Rating g) Non-Banking Finance Companies (NBFCs) Rating 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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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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(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)

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(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 | Clause 11-(A)(p).

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(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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