



The Pakistan Credit Rating Agency Limited

Rating Report

Sapphire Retail Limited

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Rating History

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

Rating Rationale and Key Rating Drivers

Sapphire is a leading and reputable brand, with a history of the last few decades, in the bigger textile space. The group has also built a formidable presence in the retail world under Sapphire Retail. The Company operates a complete range of clothing brands targeting various segments (unstitched, stitched, accessories, etc) of the retail market. Sapphire Retail has a network of over 42 stores in Pakistan. Apart from the physical stores, the online store is also generating huge traffic. The Company employs experienced professionals, aided by comprehensive reporting, who look after the operations of the Company with complete autonomy. Sales have exhibited significant growth, with higher brand recognition developed over the years. The Company possesses strong margins at the gross level, while net margins reflected meager improvement due to controlled operating expenses. The net profitability of the company improved to PKR 783mln (FY21: PKR 533mln). The Company implemented a new ERP platform, which is expected to improve inventory management. The Company has a wholly-owned subsidiary Designtex (SMC-Private) Limited and is principally engaged in manufacturing, stitching, and trading of textiles and ancillary products. The strong financial profile is characterized by strong coverages, moderately leveraged capital structure, and improving working capital management. The management is in process of expanding its retail footprints to support growth, which is expected to contribute towards margin improvement through economies of scale. Positive prospects for the retail clothing industry in view of our social demographics, an increase in internet penetration bodes well for the Company, however, in the backdrop of rising inflation and pressure on GDP growth, the sector remains vulnerable to possible demand overhang. 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. Moreover, a slowdown is expected in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries.

The ratings are dependent on sustaining the business profile of the Company by maintaining profitability and margins achieved from core textile operations. At the same time, the sustainability of non-core income and prudent management of surplus funds are important. The sustainability of coverages would remain critical to avoid any drag on the financial profile due to prolonged downturns in capital markets.

Disclosure

Name of Rated Entity	Sapphire Retail 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

Profile

Legal Structure Sapphire Retail Limited is an unlisted, public limited company, incorporated in June 2014.

Background The Company is one of Pakistan's leading fashion retail brands which offers home and clothing, shoes and accessories, fragrances, and skincare for women and kids. It is a part of the Sapphire Group, one of the leading textile groups in Pakistan.

Operations The Company is principally engaged in carrying out the manufacturing of textile products by processing the textile goods and operating retail outlets to sell the same in Pakistan and abroad through E-stores. Sapphire Retail has a retail network with over 42 stores in Pakistan.

Ownership

Ownership Structure Sapphire Retail is a wholly owned subsidiary of the Sapphire Textile Mills Limited.

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

Business Acumen Founded by Mr. Mohammad Abdullah in 1969, the Group has acquired expertise in composite textiles. It further has interests in diversified sectors including textile, power, dairy, and investment companies.

Financial Strength Sapphire Group is one of the largest vertically integrated textiles setups in Pakistan with Group has an annual turnover of over US \$800mln with an asset base of over US \$500mln. The Group has shown a willingness and ability to support the Company if the need arises. Sapphire Textile Mills Limited is primarily engaged in the manufacturing and distribution of yarn, fabrics, and home textile products. The revenue base of the Company is recorded at PKR 61.3bln in FY22 and the net profit stood at PKR 7.01bln.

Governance

Board Structure Sapphire Retail has a seven-member Board chaired by Mr. Mohammad Abdullah. Overall, the Board comprises five sponsoring family members and two associates of the Sapphire Group, raising concern over its independent oversight function.

Members' Profile Mr. Mohammad Abdullah has over five decades of textile experience and provides guidance to management from time to time. The other Board members also have good experience regarding textile and finance and have been associated with the Company for a reasonable period of time.

Board Effectiveness Attendance of directors in meetings remains satisfactory with all relevant information provided to them beforehand for informed decision-making. No committees have been formed to assist the Board. The Company, does, however, have an internal audit function in place.

Financial Transparency EY Ford Rodes, Chartered Accountants, ICAP QCR rated, is the external auditor of the company and is currently placed in the category "A" on a panel of auditors maintained by the State Bank of Pakistan. The auditor gave an unqualified opinion on the company's financial statements for the year ending June 30th, 2022.

Management

Organizational Structure The Company's overall operations are segregated into eight broad divisions, namely: (i) Design Studio, (ii) IT, (iii) Operations & Marketing, (iv) Finance, (v) Planning & Merchandising, (vi) Purchases, (vii) Human Resources, and (viii) Internal Audit. Every department is categorized into various sub-divisions to ensure a smooth flow of operations.

Management Team Mr. Nabeel Abdullah – CEO – has over 20 years of experience in the textile sector with expertise in dyeing, knitting, and finishing. He is supported by a team of qualified and experienced professionals, most of whom have been associated with the Sapphire Group for a reasonably long time but are relatively new to the Company's management team.

Effectiveness MIS reports relating to daily operations are generated and submitted to senior management for discussion on regular basis along with need-based meetings for discussion of issues.

MIS The Company implemented a new ERP platform, which is expected to improve inventory management. The system aids the integration of business processes and aids the management in timely decision-making.

Control Environment The Company's monthly MIS comprises comprehensive performance reports which are reviewed frequently by senior management. Since the company performs chemical treatment of cloth for its products, it outsources testing to international labs to ensure quality control. Furthermore, the company also has several certifications. These factors aid adherence to quality standards throughout the production process.

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 Sapphire Retail enjoys a healthy position among its competitors. Some of the competitors of Sapphire Retail are Ideas by Gul Ahmed, Khaadi, Outfitters, J., and Bareeze.

Revenues The revenue is primarily derived from local sales 95% and the rest is from export sales. Product-wise analysis reveals that unstitched clothes generate a major chunk of revenues. The revenue of Sapphire Retail witnessed a growth of 56% and stood at PKR 14.9bln in FY22 as compared to PKR 9.5bln in FY21. Distribution costs and administrative expenses went up in line with higher revenue. Other income also depicted a noticeable increase in FY22 mainly attributable to exchange gain earned during the year. Through cost-optimizing efforts in line with revenue growth, the overall net profit of the company also indicated an upward momentum. Gross profit enhanced to PKR 4.3bln (FY21: PKR 2.9bln). Hence, the net profitability clocked in at PKR 783mln (FY21: PKR 533mln).

Margins Gross margins inched down in recent years and clocked at 29% (FY21: 30%). Similarly, operating expenses inclined but due to the massive increase in sales, operating margins inched up and stood at 9.3% (FY21: 9.2%). Net margins remained largely same at 5.3% in FY22 as compared to 5.6% in FY21.

Sustainability The Company enjoys a strong presence in Tier I cities whereas expansion in Tier-II cities is also being done over the course.

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 was up by PKR 851mln in FY22 and recorded at PKR 1,080mln (FY21: PKR 229mln). During FY22, the net-working capital of the Company increased and stood at 56 days (FY21: 53 days). The inventory and receivable days stood at 69 days (FY21: 87 days) and 03 days (FY21: 00 days) respectively.

Coverages During FY22, Sapphire Retail's cashflows (FCFO) increased (FY22: PKR 1,753mln, FY21: PKR 1,565mln). Interest coverage declined (FY22: 11.1x, FY21: 20.7x) due to an increase in finance costs. Similarly, debt coverage reflected an upward trend and was recorded at 3.1x (FY21: 2.3x).

Capitalization The Company has a highly leveraged capital structure of 70.6% in FY22 (FY21: 68%). The Company's long-term loan stood at PKR 3.3bln in FY22 (FY21: PKR 2.7mln). Non-current lease liabilities are PKR 2.5bln due to the adaption of IFRS-16 in FY22 (FY21: PKR 2.3bln). The equity base has grown over the last few years to PKR 2.5bln (end-Jun21: PKR 1.7bln).



The Pakistan Credit Rating Agency Limited

Sapphire Retail Limited Composite & Garments	Jun-22 12M	Jun-21 12M	Jun-20 12M
A BALANCE SHEET			
1 Non-Current Assets	4,830	3,961	3,530
2 Investments	-	-	-
3 Related Party Exposure	350	200	34
4 Current Assets	4,290	2,277	2,902
a Inventories	3,225	1,957	2,568
b Trade Receivables	124	-	-
5 Total Assets	9,470	6,438	6,466
6 Current Liabilities	840	965	1,177
a Trade Payables	502	760	1,020
7 Borrowings	4,835	3,414	3,333
8 Related Party Exposure	1,254	299	731
9 Non-Current Liabilities	-	1	-
10 Net Assets	2,541	1,758	1,225
11 Shareholders' Equity	2,541	1,758	1,225
B INCOME STATEMENT			
1 Sales	14,875	9,529	6,503
a Cost of Good Sold	(10,525)	(6,675)	(4,285)
2 Gross Profit	4,349	2,854	2,218
a Operating Expenses	(2,971)	(1,976)	(1,711)
3 Operating Profit	1,378	878	508
a Non Operating Income or (Expense)	90	160	71
4 Profit or (Loss) before Interest and Tax	1,468	1,038	579
a Total Finance Cost	(516)	(395)	(506)
b Taxation	(169)	(110)	0
6 Net Income Or (Loss)	783	533	74
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	1,753	1,565	984
b Net Cash from Operating Activities before Working Capital Changes	1,306	1,206	460
c Changes in Working Capital	(1,146)	(61)	(33)
1 Net Cash provided by Operating Activities	160	1,145	427
2 Net Cash (Used in) or Available From Investing Activities	(1,010)	(393)	(37)
3 Net Cash (Used in) or Available From Financing Activities	878	(773)	687
4 Net Cash generated or (Used) during the period	28	(21)	1,077
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	56.1%	46.5%	-20.2%
b Gross Profit Margin	29.2%	30.0%	34.1%
c Net Profit Margin	5.3%	5.6%	1.1%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	4.1%	15.8%	14.6%
e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]	36.4%	35.7%	6.2%
2 Working Capital Management			
a Gross Working Capital (Average Days)	72	87	135
b Net Working Capital (Average Days)	56	53	90
c Current Ratio (Current Assets / Current Liabilities)	5.1	2.4	2.5
3 Coverages			
a EBITDA / Finance Cost	12.9	22.2	6.6
b FCFO / Finance Cost+CMLTB+Excess STB	2.7	2.8	2.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.1	2.3	4.4
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	70.6%	67.9%	76.8%
b Interest or Markup Payable (Days)	0.0	0.0	0.0
c Entity Average Borrowing Rate	4.1%	1.9%	4.9%

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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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 | Clause 11-(A)(p).

(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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