



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-2023	A-	A2	Stable	Maintain	-
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 has a wholly-owned subsidiary Designtex (SMC-Private) Limited and is principally engaged in manufacturing, stitching, and trading of textiles and ancillary products. The Company operates a complete range of clothing brands targeting various segments (unstitched, stitched, accessories, etc) of the retail market. With a policy aimed at increasing market share, the company is opening new stores and has a network of 45 stores currently. Apart from the physical stores, the online store is also generating huge traffic. The expanded retail footprint to support growth is expected to contribute towards margin improvement through economies of scale. The Company employs experienced professionals, aided by comprehensive reporting, who look after the operations of the Company with complete autonomy. With higher brand recognition developed over the years, sales have exhibited significant growth of 44% YoY in FY23 and were recorded at PKR 21.4 billion (FY22: PKR 14.9 billion). The rise in marketing and administrative expenses appears to be concomitant with the prevailing inflationary trends as well as the company's policy to enhance its market share. The company has been able to withhold the cost pressures and was able to pass it on, by the inflationary pressures. Hence, margins were intact. The company is focused on only retailing, thus avoiding the need to rely on short-term borrowings for working capital requirements. Notably, the uptick in financial charges is a result of elevated benchmark interest rates, offsetting any increase in profitability at the net level. The financial risk profile indicates good working capital management and moderately leveraged capital structure. 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 FY23, textile exports were valued at \$16.5 billion as against \$19.33 billion, reflecting a 15% year-on-year decline – a downward trend seen since the beginning of FY23. Exports declined due to higher energy prices, cotton shortages, and uncertainty in foreign exchange rates. Taming the demand represented by export routes was also a challenge.

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(Jul-23),Methodology Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology Rating Modifiers(Apr-23)
Related Research	Sector Study Composite and Garments(Dec-22)
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 45 stores in Pakistan.

Ownership

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

Stability Sapphire Retail Limited gains stability from the strong financial standing of Sapphire Textile Mills Limited as the latter supports it in backward integrated functions such as procurement of greige fabric and managing processing on its behalf.

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 72.8bln in FY23 and the net profit stood at PKR 3.3bln.

Governance

Board Structure Sapphire Retail has a five-member Board chaired by Mr. Nadeem Abdullah. Overall, the Board comprises from sponsoring family members, raising concern over its independent oversight function.

Members' Profile Mr. Nadeem Abdullah - the Chairman - has also been the CEO of Sapphire Textile Mills Limited for the last 16 years and is also a director in other group companies. He graduated from McGill University Canada. He is serving as Chief Executive Officer of company's subsidiaries in the renewable energy segment. 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 PWC, are the external auditors of the company and are 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, 2023.

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 FY23, textile exports were valued at \$16.5 billion as against \$19.33 billion, reflecting a 15% year-on-year decline – a downward trend seen since the beginning of FY23. Exports declined due to higher energy prices, cotton shortages, and uncertainty in foreign exchange rates. Taming the demand represented by export routes was also a challenge. During FY23, value-added products such as knitwear, bedwear, towels, and ready-made garments saw an annual decline of 13 percent. Basic textiles, including raw cotton, cotton yarn, and cotton fabrics, declined by 21 percent year-on-year. During the month of June 2023, cotton yarn exports increased by 7% MoM. Value-added exports reported volume growth of 16 percent on a month-on-month basis.

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 Breeze.

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 44% and stood at PKR 21.4bln in FY23 as compared to PKR 14.9bln in FY22. The rise in distribution costs and administrative expenses appears to be concomitant with the prevailing inflationary trends. Notably, the uptick in financial charges clocked at PKR 995mln (FY22: PKR 533mln). Consequently, the profitability of the Company declined and stood at PKR 611mln (FY22: PKR 769mln).

Margins Gross margins inched down in recent years and clocked at 28.5% (FY22: 29.2%). Similarly, operating expenses inclined but due to the massive increase in sales, operating margins inched up and stood at 10.5% (FY21: 9.3%). Net margins stood at 2.9% in FY23 as compared to 5.2% in FY22.

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 15% in FY23 and recorded at PKR 1,240mln (FY22: PKR 1,080mln). During FY23, the net-working capital of the Company increased and stood at 62 days (FY22: 56 days). The inventory and receivable days stood at 67 days (FY22: 69 days) and 02 days (FY22: 03 days) respectively.

Coverages During FY23, Sapphire Retail's cashflows (FCFO) increased (FY23: PKR 2,901mln, FY22: PKR 1,753mln). Interest coverage declined (FY23: 2.0x, FY22: 1.1x) due to an increase in finance costs. Similarly, debt coverage also reflected a downward trend and was recorded at 0.8x (FY22: 2.7x).

Capitalization The Company has a highly leveraged capital structure of 74.8% in FY23 (FY22: 70.6%). The Company's long-term loan remained stagnant at PKR 3.2bln in FY23 (FY22: PKR 3.3mln). Non-current lease liabilities are PKR 2.3bln due to the adoption of IFRS-16 in FY23 (FY22: PKR 2.6bln). The equity base has grown over the last few years to PKR 3.1bln (end-Jun22: PKR 2.5bln).



Sapphire Retail Limited Composite & Garments	Jun-23 12M	Jun-22 12M	Jun-21 12M
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A BALANCE SHEET

1 Non-Current Assets	4,765	4,830	3,961
2 Investments	-	-	-
3 Related Party Exposure	350	350	200
4 Current Assets	6,884	4,290	2,277
a Inventories	4,688	3,225	1,957
b Trade Receivables	101	124	-
5 Total Assets	11,999	9,470	6,438
6 Current Liabilities	932	840	965
a Trade Payables	305	502	760
7 Borrowings	5,093	4,835	3,414
8 Related Party Exposure	2,836	1,254	299
9 Non-Current Liabilities	-	-	1
10 Net Assets	3,137	2,541	1,758
11 Shareholders' Equity	3,137	2,541	1,758

B INCOME STATEMENT

1 Sales	21,412	14,875	9,529
a Cost of Good Sold	(15,311)	(10,525)	(6,675)
2 Gross Profit	6,101	4,349	2,854
a Operating Expenses	(3,862)	(2,969)	(1,976)
3 Operating Profit	2,239	1,380	878
a Non Operating Income or (Expense)	(339)	90	160
4 Profit or (Loss) before Interest and Tax	1,899	1,471	1,038
a Total Finance Cost	(995)	(533)	(395)
b Taxation	(294)	(169)	(110)
6 Net Income Or (Loss)	611	769	533

C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	2,901	1,753	1,565
b Net Cash from Operating Activities before Working Capital	2,443	1,306	1,206
c Changes in Working Capital	(1,210)	(1,206)	(61)
1 Net Cash provided by Operating Activities	1,232	101	1,145
2 Net Cash (Used in) or Available From Investing Activities	(580)	(1,010)	(393)
3 Net Cash (Used in) or Available From Financing Activities	(522)	28	(773)
4 Net Cash generated or (Used) during the period	130	(882)	(21)

D RATIO ANALYSIS

1 Performance			
a Sales Growth (for the period)	43.9%	56.1%	46.5%
b Gross Profit Margin	28.5%	29.2%	30.0%
c Net Profit Margin	2.9%	5.2%	5.6%
d Cash Conversion Efficiency (FCFO adjusted for Working C	7.9%	3.7%	15.8%
e Return on Equity [Net Profit Margin * Asset Turnover * (T	21.5%	35.8%	35.7%
2 Working Capital Management			
a Gross Working Capital (Average Days)	69	72	87
b Net Working Capital (Average Days)	62	56	53
c Current Ratio (Current Assets / Current Liabilities)	7.4	5.1	2.4
3 Coverages			
a EBITDA / Finance Cost	6.1	12.9	22.2
b FCFO / Finance Cost+CMLTB+Excess STB	2.5	2.7	2.8
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fi	2.8	3.1	2.3
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equit	71.6%	70.6%	67.9%
b Interest or Markup Payable (Days)	93.2	148.7	0.0
c Entity Average Borrowing Rate	7.1%	4.1%	1.9%

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+	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	
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	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.
CC	
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):
 a) Broker Entity Rating
 b) Corporate Rating
 c) Debt Instrument Rating
 d) Financial Institution Rating
 e) Holding Company Rating
 f) Independent Power Producer Rating
 g) Microfinance Institution Rating
 h) Non-Banking Finance Companies 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)
- (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)
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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 | 17-(a)
- (19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)

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