



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
17-Dec-2021	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Sapphire is a leading and reputable brand in the bigger textile space. Over the year, the group has expanded both horizontally and vertically. The group has built a formidable presence in the retail world as well, as 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 retail network with over 32 stores in Pakistan. Apart from the physical stores Sapphire Retail online store is also generating huge traffic and is the second most visited website in Pakistan. The Company enjoys a strong presence in Tier I cities whereas expansion in Tier-II cities is also underway. The Company employs experienced professionals, aided by comprehensive reporting, who look after operations of the Company with complete autonomy. Its established business profile emanating from strong presence in the broader value-chain; enabling the company to manage volatility in the textile industry. In FY21, revenues depicted an increase along with strengthened operating profit. The decline in finance cost is also supplementing the profitability. The Company has wholly-owned subsidiary Designtex (SMC-Private) Limited. The Company took the SBP facility of deferment of the principal amount of the long-term loan. The Company has a strong financial profile characterized by strong coverages, moderately leveraged capital structure and improving working capital management. Textile exports of the country recorded a double-digit increase of ~23% for FY21 to stand at USD 15.4bln as compared to USD 12.5bln in FY20. The same trend continued and exports recorded 27% growth to stand at USD 4.4bln in the first-quarter ending September 2021. The growth is attributable to an increase in demand for textile products internationally, led by good recovery around the globe post-pandemic. Going forward, the textile sector's outlook is expected to stay stable in the medium term where the demand for textile products is expected to increase.

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, sustainability of income and prudent management of the surplus funds are important.

Disclosure

Name of Rated Entity	Sapphire Retail Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating(Jun-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Rating Modifiers(Jun-21)
Related Research	Sector Study Composite and Garments(Dec-21)
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Profile

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

Background Sapphire Retail 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 manufacturing of textile products by processing the textile goods in outside manufacturing facilities and to operate retail outlets to sell the same in Pakistan and abroad through E-store. Sapphire Retail has a retail network with over 32 stores in Pakistan.

Ownership

Ownership Structure Sapphire Textile's holds 100% shareholding of Sapphire Retail.

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 textile. 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 \$800 million with an asset base of over US \$500 million. The Group has shown a willingness and ability to support the Company if the need arises.

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 the management from time to time. The other Board members also have significant 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 discussion. 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 panel of auditors maintained by State Bank of Pakistan. The auditor gave an unqualified opinion on the company's financial statements for the year ended June 30th, 2021.

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 CEO – Mr. Nabeel Abdullah – 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 whom 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 has implemented an Oracle based ERP solution – Oracle E business suite. Initially implemented in 2006, the system aids 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 Textile exports of the country recorded an increase of 28.6% to stand at USD 2.9bln as compared to USD 2.3bln from July 21 to Aug 21 due to an increase in demand for textile products internationally, led by a good recovery around the globe post-pandemic. Going forward, the textile sector's outlook is expected to stay stable in the medium term where the demand for textile products is expected to increase. In the local market, the textile sector has recorded strong performance. The relief measures introduced by the State Bank of Pakistan such as deferment of loan payments for one year, low-interest rates, and salary refinance scheme also provided comfort to the sector in the last year. Many players have also availed the TERF scheme announced by the Central Bank. This will lead to overall leveraging of the sector to increase; however, on relaxed financing rates. The sustainability of demand pattern for the current higher orders from Europe and USA etc) textile sector remains essential for the feasible utilization of added capacity by textile players.

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

Revenues Despite continued challenging conditions brought forward by subsequent waves of COVID-19, the revenue of Sapphire Retail's showed the witnessed growth of 46.5% and stood at PKR 9.5bln in FY21 as compared to PKR 6.5bln in FY20. The revenue is primarily derived from local sales 95% and the rest is from the export sales.

Margins Sapphire Retail's gross margin dropped in recent years due to increasing the company's primary raw material and recorded at 30.0% (FY20: 34.1%). Similarly, operating expenses increase but due to the increase in sales operating margins improved and stood at 9.2% (FY20: 7.8%). The finance cost of the Company decreased to PKR 395mln as compared to PKR 506mln in the previous years. As a result, the Company posted a net profit of PKR 533mln in FY21 as compared to FY20 (PKR 74mln). Net margins also inclined to 5.6% in FY21 as compared to 1.1% in FY20.

Sustainability The Company enjoys a strong presence in Tier I cities whereas expansion in Tier-II cities is also underway.

Financial Risk

Working Capital Sapphire Retail meets its working capital requirements through a mix of internal generation and short-term borrowings (STBs). During FY21, the net working capital of the Company decreased and stood at 53days (FY20: 90days) due to the decrease in payables days and inventory days (FY21: 87days and 34days) respectively. Sapphire retail has no receivables because the Company has made all sales on cash. Additionally, Sapphire Retail borrowed short-term loans for fulfilling its working capital needs and to provide working capital finance to its subsidiaries. The low-cost borrowing benefits in keeping the overall Group's finance cost low. STBs clocked in more than total net current assets which resulted in negative short-term trade leverage at 52.6% in FY21 (FY20: 43.4%).

Coverages During FY21, Sapphire Retail's cashflows (FCFO) significantly increased (FY21: PKR 1,565mln, FY20: PKR 984mln). Consequently, Interest coverage inclined (FY21: 4.4x, FY20: 2.2x) due to a decrease in finance cost. Similarly, debt coverages also showed an upward trend and were recorded at 1.8x (FY20: 1.4x) because of the decrease in STB. Coverages continued to show improvement in FY21, a factor of strong cash flows due to significantly higher profitability

Capitalization Sapphire Retail has improved the leveraged capital structure and clocked at 39% in FY21 (FY20: 61%) due to the decrease of 32% in borrowings. The Company's non-current lease liabilities are PKR 2.3bln due to the adaption of IFRS16. Sapphire Retail availed PKR 198mln long-term facility from ABL for deferment.



The Pakistan Credit Rating Agency Limited

Sapphire Retail Limited Retail	Jun-21 12M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET			
1 Non-Current Assets	3,961	3,530	1,715
2 Investments	-	-	-
3 Related Party Exposure	200	34	-
4 Current Assets	2,277	2,902	2,491
<i>a Inventories</i>	1,957	2,568	2,244
<i>b Trade Receivables</i>	-	-	-
5 Total Assets	6,438	6,466	4,205
6 Current Liabilities	1,238	1,335	762
<i>a Trade Payables</i>	760	1,020	583
7 Borrowings	813	1,205	1,546
8 Related Party Exposure	299	731	736
9 Non-Current Liabilities	2,330	1,970	11
10 Net Assets	1,758	1,225	1,151
11 Shareholders' Equity	1,758	1,225	1,151
B INCOME STATEMENT			
1 Sales	9,529	6,503	8,145
<i>a Cost of Good Sold</i>	(6,675)	(4,285)	(5,869)
2 Gross Profit	2,854	2,218	2,277
<i>a Operating Expenses</i>	(1,976)	(1,711)	(1,985)
3 Operating Profit	878	508	292
<i>a Non Operating Income or (Expense)</i>	160	71	(35)
4 Profit or (Loss) before Interest and Tax	1,038	579	257
<i>a Total Finance Cost</i>	(395)	(506)	(214)
<i>b Taxation</i>	(110)	0	(20)
6 Net Income Or (Loss)	533	74	23
C CASH FLOW STATEMENT			
<i>a Free Cash Flows from Operations (FCFO)</i>	1,565	984	366
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	1,206	460	169
<i>c Changes in Working Capital</i>	(61)	(33)	(370)
1 Net Cash provided by Operating Activities	1,145	427	(202)
2 Net Cash (Used in) or Available From Investing Activities	(393)	(37)	(362)
3 Net Cash (Used in) or Available From Financing Activities	(773)	687	1,410
4 Net Cash generated or (Used) during the period	(21)	1,077	847
D RATIO ANALYSIS			
1 Performance			
<i>a Sales Growth (for the period)</i>	46.5%	-20.2%	--
<i>b Gross Profit Margin</i>	30.0%	34.1%	28.0%
<i>c Net Profit Margin</i>	5.6%	1.1%	0.3%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	15.8%	14.6%	-0.1%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]</i>	35.7%	6.2%	2.0%
2 Working Capital Management			
<i>a Gross Working Capital (Average Days)</i>	87	135	101
<i>b Net Working Capital (Average Days)</i>	53	90	74
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	1.8	2.2	3.3
3 Coverages			
<i>a EBITDA / Finance Cost</i>	22.2	6.6	6.3
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	5.3	4.2	1.8
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.6	1.8	4.1
4 Capital Structure			
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	38.8%	61.3%	66.5%
<i>b Interest or Markup Payable (Days)</i>	0.0	0.0	0.0
<i>c Entity Average Borrowing Rate</i>	4.9%	7.3%	2.9%

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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(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)

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- 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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- (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.
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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)
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- (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)
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- (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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