The Pakistan Credit Rating Agency Limited

Rating Report

Diamond Fabrics Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
14-Jul-2023	A-	A2	Stable	Maintain	-
15-Jul-2022	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings of Diamond Fabrics Limited reflect the company’s strong business profile emanating from its presence in the broader value chain in the international market; enabling the company to fare better against volatility. The company’s ownership rests with the Sapphire Group. The company is vertically integrated with four divisions (i) Spinning, (ii) Weaving iii) Denim, and iv) Apparel. Over the last two years, the company's revenue base recorded a healthy increase. During FY22, the company’s top line witnessed a sizeable improvement to stand at PKR 24.1bln (FY21: PKR 19.2bln) where the sales mix remained skewed towards the export market. Net profitability recorded growth whilst the margins and coverages remained good. Management of receivables is essential. The customer concentration has remained high during FY22. The financial matrix reveals largely the same leveraging despite an increase in short-term borrowings. The enhanced equity base bodes well for the enhanced risk absorption capacity. During 9MFY23, the company’s revenue base further increased to PKR 24.7bln (9MFY22: PKR 17.9bln). The margins and coverages remained in a comfortable range. The total borrowings remain largely the same. During 9MFY23, the textile exports were valued at $12.47bln compared to $14.24bln, reflecting a 12% decline YoY - the declining trend has been recorded in the last two quarters. The Country’s textile exports for the month of March clocked in at US$1.26bln, up 7% MoM. The decline in the previous overall exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand in international markets is also a challenge. During the month of March, value-added textile exports increased by 6% MoM to US$863mln mainly due to Readymade Garments and Knitwear increasing by 8% and 12% MoM respectively while towels decreased by 6% MoM. Basic textiles witnessed an increase of 8% MoM to US$230mln in Mar-23. In volume terms, Knitwear, Readymade Garments, Bedwear, and Towels increased by 18%, 13%, 5%, and 2% MoM respectively. The demand pattern is expected to improve in the upcoming quarters.

The ratings are dependent on sustaining the business profile of the company by maintaining profitability and margins achieved from core textile operations. The sustainability of non-core income and prudent management of surplus funds will be ratings critical.

Disclosure

Name of Rated Entity	Diamond Fabrics 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-22)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure The company was incorporated as a private limited company in Pakistan on February 10, 1988, and later on converted into a public unlisted company on October 8, 1988.

Background The company is a vertically integrated composite textile unit, manufacturing cotton yarn, fabric, and garments. The Company is associated with Sapphire Group.

Operations Diamond Fabric is engaged in the business of manufacturing and selling yarn, cloth, and garments. The Company is producing 100% Cotton, Polycotton, Greige, Bleached, Dyed, and Printed Fabrics in different widths and constructions. Currently, the Company has installed 23,280 spindles and 346 looms with all backup process machinery for weaving. In the apparel unit, the company has 734 stitching machines. The geographical location of major business units including mills /plants of the Company is as Karachi: registered office, Lahore: head office, and Shiekhupura: production plant.

Ownership

Ownership Structure The company is a public limited company where the majority shareholding vests with Sapphire Holding Limited (38.28%) and SFL (30.69%). The remaining shareholding (31.03%) is divided among different family members of the Sapphire family.

Stability The ownership structure is expected to stay the same in the foreseeable future.

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 textile setups in Pakistan, employing over 18,000 people and having more than 30 production units ranging from spinning, Denim weaving, finishing, home textiles, power plants, dairy, and some others. 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 the ability to support the Company if the need arises.

Governance

Board Structure The company has a seven-member board including the CEO, Mr. Amer Abdullah. The board also included the group CFO of Sapphire Group, Mr. Abdul Sattar. All other board members belong to the sponsoring family.

Members' Profile The CEO, Mr. Amer Abdullah has been associated with the Sapphire Group since 1980. Being a director of various companies of Sapphire Group, he has actively participated in planning for the new projects and served ably for expansion and development.

Board Effectiveness Since the board is dominated by Sapphire Group, independent oversight is lacking, though the same is compensated, through the non-executive role of three (out of five) family members to some extent.

Financial Transparency M/s. Shinewing Hameed Chaudhri & Company, Chartered Accountants, gave an unqualified opinion on the company's financial statements for the year ending June 30, 2022.

Management

Organizational Structure The company's overall operations are segregated into four divisions namely 1) Spinning Division, 2) Weaving Division 3) Denim Division 4) Apparel Division. All four divisions are headed by a co-managing director and managing director, who are directly reporting to the CEO, Mr. Amer Abdullah.

Management Team The CEO is supported by a team of qualified and experienced professionals. Most of the senior management has been associated with Diamond Fabric for a reasonably long time.

Effectiveness While there are no formal management committees, 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 Given the large scale of operations spread at various locations and divided into various segments and processes, the need for quality information systems is paramount to control and maintain the efficiency of operations. The company has implemented SAP with operational modules including (i) Financial Accounting, (ii) Financial Assets Management, (iii) Production Planning, (iv) Materials Management, (v) Plant Maintenance & Services Management, (vi) Quality Management, (vii) Sales & Distribution, (viii) HRM and (ix) Business Information warehouse.

Control Environment The company's products are Oeko-Tex certified and meet the human-ecological requirements of the standards presently established for products with direct contact with the skin. The certified goods fulfill requirements of reach (including the use of azo-dyes, nickel, etc.) as well as the American requirement exception of accessories made from glass.

Business Risk

Industry Dynamics During 9MFY23, the textile exports were valued at $12.47bln compared to $14.24bln, reflecting a 12% decline YoY - the declining trend has been recorded in the last two quarters. The country's textile exports for the month of March clocked in at US$1.26bln, up 7% MoM. The decline in the previous overall exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand in international markets is also a challenge.

Relative Position The company is a vertically integrated composite textile unit, manufacturing cotton yarn, fabric, and garments recording good growth in the last few years. The capacity has been growing with the recent addition planned in the apparel unit.

Revenues The company generates a major portion of its revenue from export sales. The export sale comprises the sale of yarn, fabric, and garments. Exports displayed a sizeable increase YoY clocking at PKR 20.7bln (FY21: PKR 15.8bln) constituting 86% of the top line. During the last two years, the highest concentration of exports vested with Germany and the USA. The company's revenue base reflected a healthy increase of 25% on a YoY basis to stand at PKR 24.1bln (FY21: PKR 19.2bln). During 9MCY23, the company's top line further increased to PKR 24.7bln; a major contribution from exports.

Margins During FY22, the gross profit margin increased to 22.1% (FY21: 13.7%) owing to a sizeable increase in the revenue base and favorable pricing from esteemed international brands. The operating expenses grew by 58% and clocked at PKR 2.7bln (FY21: PKR 1.7bln). The finance cost increased to PKR 919mln (FY21: PKR 708mln). Despite this increase, the company's bottom line increased manifold recorded at PKR 1.5bln (FY21: PKR 323mln). Hence, the net profit margin improved YoY to stand at 6.3% (FY21: 1.7%). During 9MCY23, the company's gross margin remains unchanged at 22.1%. The net profit margin inched down to 5.8% due to the higher finance cost.

Sustainability The company is continuously enhancing its production units for the past three to four years and is still working to enhance its capacity to meet the emerging demand of the international market.

Financial Risk

Working Capital The company's net cash cycle days increased to 104 days at end-Jun'22 (end-Jun'21: 97 days). The short-term trade leverage sizably improved to 17.2% (end-Jun'21: 4.7%) due to strengthened trade assets. At end-Mar'23, the net cash cycle days remain unchanged at 104 days whereas the inventory days were recorded at 98 days.

Coverages At the end-Jun'22, the free cash flows from operations witnessed improvement to stand at PKR 1.5bln (end-Jun'21: PKR 1.1bln). The company's debt payback was reduced to 12.9 years (end-Jun'21: PKR 19.3 years). At end-Mar'23, the free cash flows from operations increased manifold to stand at PKR 3.4bln. Hence, the interest coverage strengthened to 3.2x. The core debt coverage also recorded uptick to 1.5x.

Capitalization At the end-Jun'22, the leveraging of the company inched down to 76.7% (end-Jun'21: 78.9%). The equity base enhanced to PKR 5.4bln (end-Jun'21: PKR 4bln). At end-Mar'23, the equity base further increased to stand at PKR 6.7bln. The total borrowings increased to PKR 18bln. Out of which short-term borrowings constitute 50.8% standing at PKR 9.1bln. The Company's major short-term and long-term loan is on subsidized rates. Hence, debt burden is managed.

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Financial Summary
PKR mln

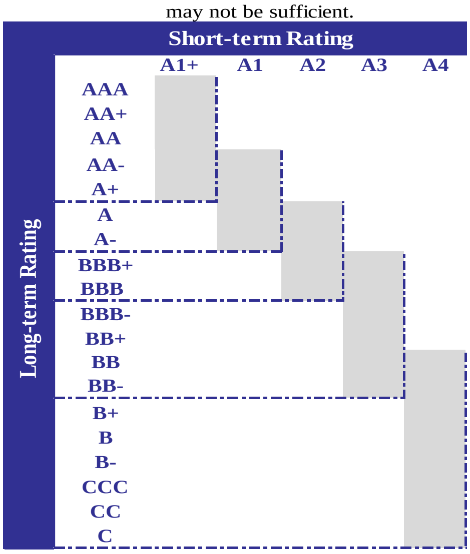
Diamond Fabrics Limited	Mar-23	Jun-22	Jun-21	Jun-20
Textile	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	12,731	12,335	10,391	10,255
2 Investments	438	532	654	558
3 Related Party Exposure	1,723	1,723	1,723	1,160
4 Current Assets	14,497	13,538	9,313	9,584
a Inventories	*8,925*	*8,830*	*5,726*	*6,298*
b Trade Receivables	*2,579*	*2,060*	*1,484*	*1,515*
5 Total Assets	29,390	28,129	22,081	21,557
6 Current Liabilities	4,389	4,648	2,743	2,896
a Trade Payables	*1,553*	*2,052*	*2,366*	*2,478*
7 Borrowings	18,066	17,889	15,142	14,922
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	172	167	159	147
10 Net Assets	6,763	5,424	4,038	3,592
11 Shareholders' Equity	6,763	5,424	4,038	3,592
B INCOME STATEMENT				
1 Sales	24,765	24,100	19,226	16,224
a Cost of Good Sold	*(19,286)*	*(18,783)*	*(16,592)*	*(13,368)*
2 Gross Profit	5,479	5,317	2,635	2,856
a Operating Expenses	(2,720)	(2,778)	(1,757)	(1,639)
3 Operating Profit	2,759	2,540	877	1,217
a Non Operating Income or (Expense)	*181*	*269*	*383*	*54*
4 Profit or (Loss) before Interest and Tax	2,940	2,808	1,260	1,270
a Total Finance Cost	*(1,213)*	*(919)*	*(708)*	*(1,203)*
b Taxation	*(295)*	*(381)*	*(229)*	*(184)*
6 Net Income Or (Loss)	1,433	1,508	323	(117)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*3,450*	*1,557*	*1,135*	*716*
b Net Cash from Operating Activities before Working Capital Changes	*2,386*	*703*	*357*	*(544)*
c Changes in Working Capital	*(1,662)*	*(36)*	*819*	*(945)*
1 Net Cash provided by Operating Activities	724	667	1,176	(1,489)
2 Net Cash (Used in) or Available From Investing Activities	(1,019)	(2,555)	(1,182)	(889)
3 Net Cash (Used in) or Available From Financing Activities	176	2,751	(45)	1,207
4 Net Cash generated or (Used) during the period	(119)	863	(51)	(1,171)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	37.0%	25.4%	18.5%	1.6%
b Gross Profit Margin	22.1%	22.1%	13.7%	17.6%
c Net Profit Margin	5.8%	6.3%	1.7%	-0.7%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	7.2%	6.3%	10.2%	-1.4%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	31.3%	31.9%	8.5%	-3.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	124	137	143	163
b Net Working Capital (Average Days)	104	104	97	115
c Current Ratio (Current Assets / Current Liabilities)	3.3	2.9	3.4	3.3
3 Coverages				
a EBITDA / Finance Cost	3.4	2.2	1.7	0.8
b FCFO / Finance Cost+CMLTB+Excess STB	1.5	0.6	0.4	0.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.8	12.9	19.3	-22.1
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	72.8%	76.7%	78.9%	80.6%
b Interest or Markup Payable (Days)	85.4	83.9	0.0	0.0
c Entity Average Borrowing Rate	7.9%	5.0%	4.2%	7.6%

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.

Long-term Rating	
Scale	**Definition**
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating	
Scale	**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
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 surveill 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

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)

ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)

iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

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

(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)

(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)

(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | 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)

Independence & Conflict of interest

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity

(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)

(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)

(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)

(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)

(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)

(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)

(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)

(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

Proprietary Information