

Sapphire Textile Mills Limited

Chairman: Mr. Mohammad Abdullah & CEO: Mr. Nadeem Abdullah

Rating Rationale

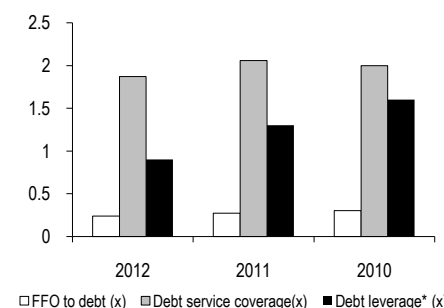
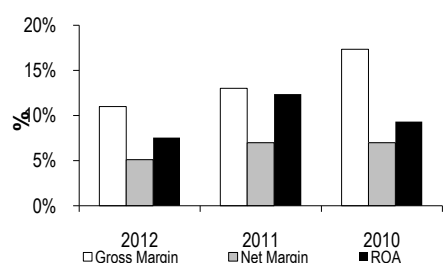
April 05, 2013

Analysts: Hina Saleem Mesiya, CFA
M. Omar Hussain

| Category | Latest | Previous |
|----------|------------|-------------|
| Entity | A+/A-1 | A/A-2 |
| | Apr 01 '13 | Feb 01, '12 |

| Outlook | Stable | Stable |
|---------|------------|-------------|
| | Apr 01 '13 | Feb 01, '12 |

Key Financial Trends



| (Rs. in Million) | 2012 | 2011 | 2010 |
|--|----------|----------|----------|
| Net Sales** | 21,069.5 | 22,451.3 | 14,145.7 |
| Gross Margin** | 11.2% | 13.4% | 17.3% |
| Net Profit | 1,073.7 | 1,607.4 | 1,015.5 |
| Equity (ex. Reval surplus) | 6,991.4 | 6,046.9 | 4,903.6 |
| Total Debt | 4,158.8 | 5,331.6 | 4,296 |
| Long term debt (inc. Current Maturity) | 1,308.1 | 1,148.6 | 817.9 |
| Gearing* | 0.63 | 0.92 | 0.99 |
| FFO | 985.4 | 1,430.4 | 1,286.8 |
| FFO/Total Debt | 0.24 | 0.27 | 0.30 |
| ROAE | 16.5% | 29.4% | 23% |
| ROAA | 7.5% | 12.4% | 9.3% |

Sapphire Textile Mills Limited (STML) has maintained a conservative capital structure over the years. Even though, capital expenditure in the past two years has been sizeable, retained profits have facilitated the company in funding capital expenditure partially through internally generated cash and maintain leverage indicators within prudent limits. At end-Jun'12, leverage* and gearing* were both below 1x. Additional long-term loans are planned to be obtained in FY13; the same are not expected to have a material impact on the capital structure of the company. FFO to total debt of the company was comfortable at 0.24x at end-Jun'12. Ability to service debt has remained sound with debt servicing coverage ratio at 1.9x (FY11: 2.1x).

Broadly, sales mix of STML comprises yarn, fabric and home-textiles. While yarn continues to comprise a significant proportion of sales at 60.2% (FY11: 67.7%), over time, share of fabric and home-textiles has improved to 26.4% (FY11: 19.8%) and 10.8% (FY11: 9.2%), respectively. Going forward, the company plans to increase sales of fabric and home-textiles through capacity expansion, along with some growth in yarn capacity. The company launched Sapphire Lawn fabric in 2013. Moreover, forward integration into finishing is planned and capacity for finishing will be utilized for lawn fabric and home-textiles. This will provide greater control to the company in managing lead time between different processes which is essential at higher sales volumes.

Around 81.8% of total sales of the company represent exports (including indirect exports). In yarn and fabric, local sales comprise at least 17% of totals sales of the segment. However, home-textiles sales are primarily export-based and marketed by STML directly and also sold through a company set up in Denmark, in which STML is a JV partner.

Sales** for the year were lower at Rs. 21b (FY11: Rs. 22.4b) owing to decline in cotton prices which translated into lower selling price of goods sold; rupee depreciation of around 9.7% in FY12 had some favorable impact on export sales. Gross margin of STML for FY12 was also lower at 11.2%** (FY11: 13.4%**). Reduction in sales value in FY12 compared to FY11 has been noted in other larger textile composite mills also, along with decline in gross margins. With improvement in selling price of yarn since the past few quarters on account of strong demand from China, gross margins of spinning units have witnessed an uptick in FY13. In 1QFY13, gross margin of the company was 12.1%. Given that recent trends in demand and price of yarn are largely driven by a single player China, STML's gross margins may continue to depict variability; greater diversification in value-added sector may have a positive impact on overall gross margin.

STML is part of Sapphire Group; the Group has interests in various textiles related concerns, power generation and dairy. Sizeable investments of STML in group companies include, Sapphire Dairies (Pvt) Limited (SDL), Sapphire Power Generation Limited, Sapphire Electric Company Limited.. Future funding requirements can arise in the case of SDL to the tune of Rs. 150m; the equity injection has been already approved by STML's Board. The investment portfolio of STML also comprises holdings in listed blue chip stocks with healthy dividend yields, which provides additional liquidity cushion.

*Equity has been adjusted for unlisted strategic investments for calculating gearing and leverage

**Net sales of the company have been adjusted for export development surcharge, insurance and commission.

Overview of the Institution

STML was incorporated as a public limited company in Pakistan in 1969 and its shares are listed on the Karachi stock exchange. The principal activities of STML are manufacturing and sale of yarn, fabrics and home textile products. The financial statements for FY12 have been audited by Mushtaq & Company, Chartered Accountants [JCR-VIS]