

RATING REPORT

Sapphire Textile Mills Limited

REPORT DATE:

January 30, 2018

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A+	A-1	A+	A-1
Rating Date	Jan 30, 2018		Oct 25, 2016	
Rating Outlook	Positive		Positive	
Outlook Date	Jan 30, 2018		Oct 25, 2016	

COMPANY INFORMATION

Incorporated in 1969	External auditors: M/s Mushtaq & Company, Chartered Accountants
Public Limited Company	Chairman of the Board: Mr. Mohammad Abdullah
Key Shareholders (with stake 5% or more):	Chief Executive Officer: Mr. Nadeem Abdullah
Sapphire Agencies (Pvt.) Limited – 11.6%	
Mr. Yousuf Abdullah – 10.6%	
Mr. Amer Abdullah – 8.5%	
Mrs. Shireen Shahid – 8.0%	
Mr. Nadeem Abdullah - 5.7%	
Amer Tex (Pvt.) Limited – 5.6%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) <http://www.jcrvis.com.pk/kc-meth.aspx>

Sapphire Textile Mills Limited

OVERVIEW OF THE INSTITUTION

Sapphire Textile Mills Limited (STML) was incorporated in 1969 as a public limited company. Financial Statements of the company for FY17 were audited by Mushtaq & Co., Chartered Accountants.

Pattern of shareholding largely remain unchanged over FY17 with the Abdullah family holding 58.72% of the shares. Associated companies constitute 30.95% of the stake holding. Remaining shares are allocated to insurance companies, financial institutions and general public.

RATING RATIONALE

Sapphire Textile Mills Limited (STML) is a part of Sapphire Group of Companies (SGC) which has presence in textile, power, dairy sectors and listed equities. Diversification in the real estate sector is also planned. STML, a vertically integrated firm, operates in the textile sector. The company's core business operations include production and distribution of yarn, fabric, home textile and ready-to-wear garments.

STML's portfolio is relatively diversified, given the split in assets between textile, power and listed securities. Investments (long-term and short-term investments) represented around half of the total asset base and amounted to Rs. 21.5b (FY16: Rs. 13.5b) as at year end-FY17. Three-fifth of the company's investment portfolio comprises exposure to listed equities while investment in the power sector comprising 36% of total investments. Given the higher investment in the equity market, the company is exposed to significant market risk.

Sapphire Wind Power Company Limited (SWPCL)

SWPCL operates as a 52.8MW wind power station at Jhimpir, Sindh. The total cost of the project was \$128m financed through a Debt: Equity mix of 75:25. Equity proportion of the investment was financed by STML and Bank Alfalah Limited (BAFL) with a holding of 70:30 respectively. Debt financing of \$95m was obtained from Overseas Private Investment Corporation at a markup rate of LIBOR+3.7%. The company commenced its operations in November 2015 and posted a profit of Rs. 808m in FY17.

Tricon Boston Consulting Corporation (Private) Limited (TBCCL)

TBCCL is in the process of setting 3 x 50 MW Wind Energy Projects in Jhimpir Sindh. The project company achieved Financial Close on May 10, 2017 and has awarded the EPC contracts. The total cost of the project is \$316m which has been financed through a debt: equity mix of 75:25. Around 57% of the equity portion is financed by STML with the remaining share provided by Sapphire Fibers, Diamond Fabrics, Sapphire Finishing, and BAFL. Debt portion shall be financed by International Finance Corporation, Islamic Development Bank, Asian Development Bank and DEG (German Development Finance Institution). Project is expected to commence operations by end-2018.

Key Rating Drivers

Industry Dynamics

After remaining flat during FY17, textile exports have showed healthy growth of 8% during 5MFY18. Increase in exports has been driven by value added segment where readymade, knit and bed wear segment has depicted a growth of 15%, 12% and 7%, respectively during 5MFY18. Growth in value added exports has been driven by incentives under the textile package: 1) increased rebates on total FOB exports value of fiber (5%), home textiles (6%), and garments (7%); 2) removal of sales tax on imports of cotton and textile machinery; and 3) elimination of custom duty on man-made fiber. However, exports of cotton yarn and cotton cloth remained constant during 5MFY18 after declining in FY17. Increase in exports of cotton yarn and cotton cloth has remained limited due to weaker demand from China. Clearing rising quantum of receivables due from GoP is also considered important from a liquidity perspective.

Going forward, recent rupee depreciation and full year impact of textile package is expected to bode well for competitiveness of textile exports. With significant increase in cotton prices (17% FYTD), margins are expected to come under pressure, timing and quantum of which will depend on average price and quantity carried by different players.

Capacity Utilization

Spinning: During FY17, the number of spindles increased marginally to 130,407 (FY16: 129,652)

thereby growing installed capacity to 109.8m lbs (FY16: 108m lbs). Yarn production demonstrated nominal growth of 2% during FY17 reporting utilization level at 91% (FY16: 90%).

Weaving: STML produced 127.4m mtrs (FY16: 108.6m mtrs) of fabric during FY17, an increase of 17% owing to heightened demand for the same. During FY17, capacity utilization for the segment was reported at 104% (FY16: 85%).

Finishing: Since inauguration of the finishing plant in FY15, productivity from this segment has continued to grow on a timeline basis reporting utilization levels of 92% (FY16: 78%) during FY17. In the outgoing year, the company incurred capex of Rs. 2.27b for expansion of its finishing plant raising annual capacity from 28.8m mtrs to 36m mtrs due to the company's focus towards value addition.

Sales Mix

Net sales of the company increased by 11% during FY17 and amounted to Rs. 25.6b (FY16: Rs. 23.1b). Shift in sales mix has been noted with proportion of local sales increasing from 19% during FY15 to 30% during FY17. Over the last two years, yarn sales have witnessed a decline while revenues from fabric and home textile segment have depicted growth. However, yarn continues to be the largest contributor in sales mix (FY17: 46%; FY16: 51%; FY15: 55%) followed by fabric (FY17: 34%; FY16: 31%; FY15: 30%) and home textile (FY17: 14%; FY16: 14%; FY15: 13%). Going forward, value added export segment (particularly finished fabric) will continue to remain the main focus area of the management. Concentration risk is on the higher side in home textile and fabric segment while the same is on the lower side in the yarn segment.

Profitability

While profitability from textile operations declined in the outgoing year, profit before tax of the company increased by 71% during FY17 and amounted to Rs. 2.97b (FY16: Rs. 1.74b) due to gain on sale of investments. Decline in income from textile operations is a function of lower gross margins due to higher average cotton procurement cost and increase in administrative expenses. Sizeable dividend income from listed investment portfolio (Rs. 720.6m) and higher capital gain (FY17: Rs. 2.1b; FY16: Rs. 557.7m) on sale of equities have resulted in improved overall profitability. During 1QFY18, profitability was supported by other income against technical services rendered to TBCCL. Income from the same represented 70% of profit before tax for the 1QFY18. While lower dividend income from listed investment portfolio is expected to act as a constraint to profitability, management expects dividend income from wind power project to be received in 2018 to more than offset the impact of the same.

Liquidity

Adjusted funds flow from operations (FFO) (including recurring dividend income) increased to Rs. 1.85b (FY16: Rs. 1.18b) on account of lower taxes paid. However with increase in debt levels, adjusted FFO/total debt remained stable at 9% (FY16: 9%) and is on the lower side vis-à-vis peers and benchmark for the assigned ratings. Liquidity profile is supported by sizeable liquid investments carried on the balance sheet which amounted to Rs. 10.2b at end-September'2017. While FFO/long-term debt is on the lower side at 13%, liquid investments (sensitizing for market risk) carried on the balance sheet provide coverage of 75% of the outstanding long-term debt. Current ratio of the company has ranged between 1.1x and 1.2x over the last three years. Debt servicing coverage ratio was reported at 1.09x (FY16: 1.5x) for FY17.

Capitalization and Funding

Equity base of the company has grown at a 3 year CAGR of 8% on account of profit retention; equity amounted to Rs. 17b (FY16: Rs. 15b) at end-FY17. Total debt carried on balance sheet amounted to Rs. 21b; around two-third of the total debt is long-term in nature. Increase in long-term debt is to fund investment in TBCCL and expansion of the finishing plant. Resultantly, gearing and leverage indicators have trended upwards to 1.26x (FY16: 0.87x) and 1.50x (FY16: 1.13x) respectively at end-FY17. Given the sizeable debt funded expansion, gearing levels have increased by around 3(x) over the last three years.

Sapphire Textile Mills Limited**Appendix I**

FINANCIAL SUMMARY <i>(amounts in PKR millions)</i>			
<u>BALANCE SHEET</u>	FY15	FY16	FY17
Fixed Assets	8,751	9,523	10,575
Long Term Investments	9,823	10,523	17,513
Stock-in-Trade	3,969	4,281	5,327
Trade Debts	1,298	1,474	1,724
Cash & Bank Balances	50	100	72
Total Assets	28,088	31,801	42,532
Trade and Other Payables	2,317	2,526	3,224
Long Term Debt	5,502	8,358	13,883
Short Term Debt	4,718	4,657	7,464
Total Debt	10,221	13,015	21,347
Total Equity	14,370	14,904	16,995
<u>INCOME STATEMENT</u>			
Net Sales	23,315	23,111	25,584
Gross Profit	2,608	2,563	2,678
Operating Profit	1,848	2,610	3,944
Profit After Tax	1,034	1,448	2,722
<u>RATIO ANALYSIS</u>			
Gross Margin (%)	11.2%	11.1%	10.5%
Net Working Capital	1,406	1,907	2,224
FFO to Total Debt (%)*	11%	9%	9%
FFO to Long Term Debt (%)*	21%	14%	13%
Debt Servicing Coverage Ratio (x)*	1.74	1.50	1.09
ROAA (%)	4%	5%	7%
ROAE (%)	7%	10%	17%

*FFO adjusted for recurring dividend income

ISSUE/ISSUER RATING SCALE & DEFINITION

Appendix II

Medium to Long-Term

AAA

Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-

High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-

Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-

Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-

Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-

Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC

A high default risk

C

A very high default risk

D

Defaulted obligations

Short-Term

A-1+

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C

Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities

and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

JCR-VIS Credit Rating Company Limited

Technical Partner – IIRA, Bahrain | JV Partner – CRISL, Bangladesh

REGULATORY DISCLOSURES				Appendix III	
Name of Rated Entity	Sapphire Textile Mills Limited				
Sector	Textile				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	<u>RATING TYPE: ENTITY</u>				
	01/30/2018	A+	A-1	Positive	Reaffirmed
	10/25/2016	A+	A-1	Positive	Reaffirmed
	6/1/2015	A+	A-1	Positive	Reaffirmed
	3/5/2014	A+	A-1	Positive	Maintained
	4/1/2013	A+	A-1	Stable	Upgrade
	2/1/2012	A	A-2	Stable	Reaffirmed
	10/12/2010	A	A-2	Stable	Reaffirmed
Instrument Structure	N/A				
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
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