RATING REPORT

Sapphire Textile Mills Limited

REPORT DATE:
December 19, 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	*Dec 19, 2018*		*Jan 30, 2018*	
Rating Outlook	Positive		Positive	
Outlook Date	*Dec 19, 2018*		*Jan 30, 2018*	

COMPANY INFORMATION

Incorporated in 1969	**External auditors:** M/s Mushtaq & Company, Chartered Accountants (2018)
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%	
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 FY18 were audited by Mushtaq & Co., Chartered Accountants.

Pattern of shareholding largely remain unchanged over FY18 with the Abdullah family holding 54.2% 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 which has presence in textile, power, dairy sectors and listed equities. The company's core business operations include production and distribution of yarn, fabric, home textile and ready-to-wear garments.

STML's investment portfolio (short-term and long-term) represented around 45% of the total asset base at end-FY18. Around 52% (FY17: 60%) of the investment portfolio relates to exposure in listed equities while investment in the power sector contributes 41% (FY17: 36%) to the total investments at end-June'2018. Given higher exposure in the equity market, the company is exposed to market risk. Remaining investments are in related party group companies.

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. 1.1b (FY17: Rs. 808m) during FY18. With improving profitability and satisfactory operations for the first two years, the company disbursed a dividend of Rs. 330m, out of which Rs. 231m was distributed to STML. Going forward, quantum of future dividend receipts from SWPCL is expected to increase.

Tricon Boston Consulting Corporation (Private) Limited (TBCCL)
TBCCL operates 3 x 50 MW Wind Energy Projects in Jhimpir Sindh, and commenced operations in September'2018. The total cost of the project was around $315m 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 has been financed by International Finance Corporation, Islamic Development Bank, Asian Development Bank and DEG (German Development Finance Institution). TBCCL achieved commercial operations in 1QFY19 and the management expects dividend flows from the same to materialize after one year of successful operations.

Listed Equity Portfolio
Listed equity investment portfolio (long term and short term) amounts to Rs. 9.8b (FY17: Rs. 12.8b) at end-FY18. Decline in liquid investment portfolio is primarily on account of significant reduction in market value of investments. The investment portfolio comprises exposure in commercial banks (HBL, MCB, BAFL and BAHL), cement companies (LUCK, DGKC), a conglomerate (ENGRO) diversified in fertilizer, FMCG, power & chemical sectors.

Key Rating Drivers

Industry Dynamics
Textile exports depicted healthy growth of 14% during FY18 driven by increase in value added segment exports with knit and bed wear segment reporting growth of 21% and 11%, respectively. Growth in value added exports has been driven by incentives under the textile package: 1) increased rebates on total FOB exports value of processed fabric (5%) 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. Moreover, cotton cloth and cotton yarn exports also depicted growth of 8% and 15%, respectively. However, imposition of duties ranging from 10-25% on Chinese textile exports to USA is expected to impact yarn exports from Pakistan to China. Going forward, recent rupee depreciation and increased focus of the government on enhancing exports (through reducing cost of doing business and commitment for timely release of refunds and rebates) bodes well for competitiveness of textile exports. Conversely, reduction in rebate rates and increase in cotton prices may impact margins; timing and quantum of which will depend on average price and quantity carried by different players.

Capacity Utilization
Spinning: Utilization levels of the segment decreased during FY18 to 81% from 91% in the corresponding period last year. Decline is attributable to temporary non-operation of one of the unit in FY18.

Weaving: During FY18, the company enhanced its capacity by 10% to 134.7m meters (FY17: 122.9m meters) during FY18. Capacity utilization level for the segment was recorded on the higher side at 99% (FY17: 104%).

Finishing: This segment remains the key focus area for the management. With increasing focus towards the finishing segment, productivity and capacity utilization levels have improved on a timeline basis. During FY18, STML completed expansion in its new finishing unit which has enhanced segment's capacity to 38.4m meters (FY17: 36m meters). Capacity utilization level for the segment stood at 94% (FY17: 92%, FY16: 78%) during FY18.

Sales Mix

Net sales of the company increased by 13% to Rs. 28.9b (FY17: Rs. 25.6b) during FY18. Around three-fourth of the total sales comprised exports. Export sales increased by 19% to Rs. 21.3b (FY17: Rs. 17.9b) whereas local sales declined by 6% to Rs. 7.1b (FY17: Rs. 7.5b) during FY18. While declining on a timeline basis, Yarn continues to be the largest contributor in total sales revenue of the company (FY18: 45%, FY17: 46%, FY16: 51%). Fabric is the second largest contributor to revenues (FY18: 32%, FY17: 34%, FY16: 31%) followed by home textile segment (FY18: 16%, FY17: 14%, FY16: 14%). Going forward, proportion of finishing segment (particularly finished fabric) in revenues will increase given the completion of recent expansion in the segment. Sales 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

Gross Margins of the company improved to 12.2% (FY17: 10.5%) during FY18 on account of higher sales volume, average selling prices and higher rebate. Profitability from the textile operations witnessed significant improvement with operating profit excluding other income being reported at Rs. 1.9b (FY17: Rs. 1b) in FY18. However, overall profitability (before accounting for finance cost and taxes) declined to Rs. 3.3b (FY17: Rs. 3.9b) due to sizeable decline in capital gains from listed investments (FY18: Rs. 45.9m, FY17: Rs. 2.1b) in FY18. While dividend receipts from listed exposure declined during the outgoing year, overall dividend income was supported by dividend inflow from subsidiary company- SWPCL. Finance costs increased during the outgoing year on account of increase in benchmark rates. Consequently, profit after tax declined to Rs. 1.6b (FY17: Rs. 2.7b) during FY18. Gross margins improved to 15.7% in 1QFY19 on the back of utilization of lower priced cotton inventory. Going forward, sizeable dividend income from wind power projects and listed equity portfolio will support profitability. Dividend income from listed portfolio and wind power projects is expected to contribute to over 40% of operating profit from 20% currently.

Liquidity

Adjusted funds flow from operations (FFO) (including recurring dividend income) increased to Rs. 2.7b (FY17: Rs. 1.8b) during FY18 primarily on account of improving profitability from textile operations. Consequently, liquidity profile of the company is considered adequate in view of sufficient cash flows in relation to outstanding obligations, satisfactory debt servicing ability and aging of trade debts which remain within manageable levels. Liquidity profile of the company is supported by sizeable liquid investments carried on the balance sheet amounting to Rs. 9.8b at end-FY18. Even after sensitizing for market risk, liquid investments provide coverage of 56% of the outstanding long-term debt at end-June'2018.

Capitalization and Funding

Equity base of the company has grown at a 4 year CAGR of 5% (FY14-FY18) on account of profit retention and amounted to Rs. 16b (FY17: Rs. 16.9b) at end-FY18. Total debt carried on balance sheet amounted to Rs. 21b at end-FY18; around two-third of the total debt is long-term in nature. With no change in debt position during FY18 and loss on revaluation of AFS investments, gearing and leverage indicators increased to 1.33x (FY17: 1.26x) and 1.64x (FY17: 1.50x). However, to fund raw material inventory, total debt increased to Rs. 23b at end-September'2018 consequently increasing gearing to 1.42x. With no major debt drawdown planned, and expected improvement in profitability, capitalization indicators are expected to improve going forward.

Sapphire Textile Mills Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY15**	**FY16**	**FY17**	**FY18**	**1QFY19***
Fixed Assets	8,751	9,523	10,575	11,415	11,687
Long term Investments	9,823	10,523	17,513	14,927	14,494
Stock-in-Trade	3,969	4,281	5,327	5,472	7,228
Trade Debts	1,298	1,474	1,724	2,947	2,839
Cash & Bank Balances	50	100	72	55	98
Total Assets	28,088	31,801	42,532	42,330	44,299
Trade and Other Payables	2,317	2,526	3,224	3,869	3,987
Long Term Debt	5,502	8,358	13,883	13,997	13,861
Short Term Debt	4,718	4,657	7,464	7,302	9,065
Total Debt	10,221	13,015	21,347	21,300	22,926
Total Equity	14,370	14,904	16,995	16,022	16,110
INCOME STATEMENT					
Net Sales	23,315	23,111	25,584	28,896	8,095
Gross Profit	2,608	2,563	2,678	3,536	1,272
Operating Profit	1,848	2,610	3,944	3,340	985
Profit After Tax	1,034	1,448	2,722	1,595	507
RATIO ANALYSIS					
Gross Margin (%)	11.2%	11.1%	10.5%	12.2%	15.7%
Net Working Capital	1,406	1,907	2,224	2,376	2,375
FFO to Total Debt (%)**	11%	9%	9%	13%	12%
FFO to Long Term Debt (%)**	21%	14%	13%	19%	20%
Debt Servicing Coverage Ratio (x)**	1.74	1.50	1.09	2.12	1.63
Gearing (x)	0.71	0.87	1.26	1.33	1.42
Leverage (x)	0.95	1.13	1.50	1.64	1.75
ROAA (%)	4%	5%	7%	4%	5%
ROAE (%)	7%	10%	17%	10%	13%

**Ratios Annualized*

*** FFO Adjusted for 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.

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
RATING TYPE: ENTITY				
12/19/2018	A+	A-1	Positive	Reaffirmed
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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