RATING REPORT

Sapphire Textile Mills Limited

REPORT DATE:
June 21, 2021

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A+	A-1	A+	A-1
Rating Date	*June 21, 2021*		*April 22, 2020*	
Rating Outlook	Stable		Rating Watch-Developing	
Outlook	*Maintained*		*Maintained*	

COMPANY INFORMATION	
Incorporated in 1969	**External auditors:** EY Ford Rhodes 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 – 7.4%	
Mr. Yousuf Abdullah – 11.6%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (April 2019)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Sapphire Textile Mills Limited

OVERVIEW OF THE INSTITUTION

Sapphire Textile Mills Limited (STML) was incorporated in 1969 as a listed company. Financial Statements of the company for FY20 were audited by EY Ford Rhodes Chartered Accountants.

Pattern of shareholding at end-FY20 depicts major shareholding of Directors, CEO, their spouse and children comprising 40.35% followed by associated companies and related parties' undertakings shareholding of 30.96%. Remaining shares are allocated to insurance companies, other companies and general public.

RATING RATIONALE

Corporate Profile: Incorporated as a public limited company in 1969, Sapphire Textile Mills Limited is primarily engaged in the manufacturing and distribution of yarn, fabrics, and home textile products. The company also has a sizable investment portfolio representing 37% of the total asset base in FY20; representing investments mainly in power sector through subsidiaries/associated concerns and listed equities.

On the operational front; STML is a vertically integrated entity incorporating spinning, weaving and yarn dyeing, printing, processing, and stitching units located in Kotri, Nooriabad, District Kasur, Sheikhupura, and Lahore. The company is among the leading textile exporters of Pakistan and has a diversified customer base across Europe, Asia, and the United States. Sales are primarily export dominated; however an increase in the proportion of local sales is being witnessed on a timeline basis.

Sales Proportion	FY18	FY19	FY20	9M'FY20	9M'FY21
Export Sales	75%	86%	79%	77%	70%
Local Sales	25%	14%	21%	23%	30%

Rating Drivers

Recovery in industry wide exports post ease in COVID-19 lockdown measures support business risk profile of the company.

With the objective of enhancing exports to support the economy, the Government of Pakistan (GoP), has provided incentives in the form of subsidized utility tariffs, low interest rates (Export Finance Scheme (EFS), Long Term Financing Facility (LTFF) and Temporary Economic Relief facility (TERF) and sales tax refund to the textile industry. The textile policy 2020-25 has laid emphasis on fixed electricity and gas tariff for the next 5 years till 2025 at US cents 7.5 per KWh and USD 6.5 per MMBTU, respectively. Moreover, Pakistan was able to benefit from diversion of orders from other regions that remained closed due to higher severity of pandemic. In the ongoing fiscal year, textile exports have started to post recovery. Even though exports remained sluggish in USD terms, at least in Q1'FY21, the recovery has particularly started to materialize in Q2'FY21, when export proceeds were 4% higher than SPLY. Going forward, most of the textile players indicate a strong order book; however the outcome of vaccination drive and opening up of export markets remains a risk factor.

Investments continue to support bottom-line

The company holds a diversified investment portfolio comprising of investments in subsidiaries, associates, and listed companies; contributing healthy dividend income and share of profits to the bottom-line. STML has three associated companies-Creadore A/S, Sapphire Power Generation Limited, Sapphire Dairies (Private) Limited; and four subsidiaries which are briefly described below.

Triconboston Consulting Corporation (Private) Limited (TBCL): Having a shareholding of 57.125% in the company; Triconboston Consulting Corporation (Private) Limited operates three projects with the capacity of 50MW each in Jhimpir Sindh. All the projects are successfully operating since September 2018.

Sapphire Retail Limited (SRL): A wholly owned subsidiary of Sapphire Textile Mills Limited; the principal business of the company is to operate the "Sapphire" brand outlets through twenty-five retail outlets across the country for the sale of textile and other products. It is principally engaged in the manufacturing and processing of textile goods through outside manufacturing facilities; and operating local brick-and-mortar retail outlets and online stores.

Furthermore, Designtex SMC-Private Limited was incorporated during FY20 as a wholly owned subsidiary of Sapphire Retail Limited; with the principal business of textile and ancillary products manufacturing.

Sapphire Wind Power Company Limited (SWPCL): STML owns 70% of the shareholding of SWPCL, and 30% stake lies with Bank Alfalah Limited. The company started commercial operations in November 2015 and runs a wind farm with a capacity of 52.80MW at Jhimpir Sindh. The company posted a profit of Rs. 1.8b during FY20 (FY19: Rs. 1.3b), thus contributing a profit share of Rs. 1.2b (FY19: 0.9b) for STML. The dividend paid by the company during FY20 amounted to Rs. 150m (FY19: Rs. 400m), out of which Rs. 105m (FY19: Rs. 280m) was received by STML.

Sapphire International APS: Incorporated in 2019 as a wholly owned subsidiary of STML; the company is a limited liability concern incorporated in Denmark to strengthen exports. Paid up capital is equivalent to $100,000.

Alongside the incorporation of Designtex SMC-Private Limited and Sapphire International APS during FY20; the holding company merged the non-functional wholly owned subsidiaries (Sapphire Solar (Private) Limited (SSPL), Sapphire Tech (Private) Limited (STPL) and Sapphire Renewables Limited (SRL)) with and into the company. The investments also include a diversified equity portfolio having exposure in commercial banks, a conglomerate involved in fertilizers, and a utility company. During FY20, total dividend received from investments amounted to Rs. 616m (FY19: 716m). Increasing return on investments will be an important factor going forward.

Joint Venture with Carrington Textile to boost retail sales going forward

Sapphire Textiles has agreed to form a Joint Venture with a longtime customer, Carrington Textile - a British company specializing in the manufacturing and sale of work wear fabrics globally. The JV will be formed in the United Kingdom with each company having 50% shareholding. This venture aims to provide dyed fabric to Carrington. STML foresees healthy volumes and margins from the project, and expects to increase exports of dyed fabric going forward.

Capital expenditure to contribute towards operational efficiencies and capacity enhancements

During FY20, the company undertook capex for modernization in the spinning unit amounting to Rs. 1.5b. Furthermore, the company plans to undertake a modernization program incorporating 85% replacement and 15% capacity addition in the spinning, weaving, and finishing divisions in FY21. The program involves streamlining of processes in the spinning division, replacement of looms in the weaving division, and capacity additions in the finishing department. The project has an estimated cost of Rs. 3b, to be financed primarily through TERF and will be fully drawn in 2021-22. The company is also planning to undertake sustainability initiative through production of yarn from pre and post-consumer waste.

Revenues sustained during FY20, however margins remained under pressure

Revenues were sustained at Rs. 34.0b during FY20 (FY19: 34.3b) after being impacted by pandemic in the last quarter of FY20 which eroded the growth recorded in the first three quarters. Export sales continue to dominate the sales mix however on a timeline basis their share has been on a declining trend. Yarn and fabric sales remained the primary revenue generators; contributing approximately 44% and 32% of the total gross sales respectively. During 9M'FY21, yarn sales have further picked up on the back of higher demand, recording 11% growth versus SPLY and constituting 47% of total gross sales.

Home textile sales however remained under pressure amid pandemic as demand from hospitality sector declined. While the company has strategically shifted the sales mix within the home textile segment towards the retail and health sector, competitive pressures continue to weigh in as reflected in 20% decline recorded in home textile sales at the end of 9M'FY21 versus SPLY.

To optimally operate during the pandemic, the company compromised on margins for volume gains. As such, gross margins were recorded at 14.2% during FY20 (FY19: 15.8%). Margins have started to recover in the current year on the back of higher yarn prices. During FY20, net margins dipped to 3.5% (FY19: 7.5%) on account of lower other income and higher financial charges. Previously, the company had booked technical services fee for development of wind farms of Triconboston Consulting Corporation (Private) Limited. Discontinuation of the same, together with lower dividend income and higher financial charges impacted margins negatively. Net margins are however tracking back in line with historical levels at the end of 9M'FY21.

Client concentration continued to remain on the higher side for all three segments, with top ten clients contributing more than one-half of the sales for the yarn and fabric segments, and more than four-fifth of the sales for the home textile segment.

Cash flow coverage indicators declined amid pandemic; however depict recovery during 9M'FY21. Liquidity profile is supported by sizable liquid investments.

Adjusted funds from operations (FFO) (including recurring dividend income) fell to Rs. 2.3b during FY20 (FY19: Rs. 3.8b) on account of lower profitability and dividend income. As a result, cash flow coverage indicators regressed as FFO/Total Debt and FFO/Long Term Debt fell to 10% (FY19: 17%) and 16% (FY19: 27%) respectively. Debt servicing also decreased to 1.04x during FY20 (FY19: 1.86x). Increase in debt utilization also contributed to the decline in cash flow coverage indicators. However, indicators show recovery during 9M'FY21 on the back of improving profitability.

Liquidity profile of the company remains sound, evident through the current ratio which stood at 1.26x during FY20 (FY19: 1.14x). Liquidity profile of the company is further supported by sizeable liquid investments carried on the balance sheet amounting to Rs. 6b at end-FY20, which adequately covers the outstanding debt. Also, trade debts and inventory continued to sufficiently cover short-term borrowings.

Capitalization indicators continue to remain within manageable levels

Despite issuance of right shares and profitability during FY20, equity base of the company remained stable at Rs. 16.5b during FY20 (FY19: Rs. 16.4b); primarily due to unrealized losses on revaluation of equity investments. Total debt utilization during the year was Rs. 22.6b (FY19: Rs. 22.1b); out of which approximately three-fifth is long-term. Long-term debt rose by 12% for financing capex; and short-term debt by 3.5% to fund working capital requirements. As a result, leverage and gearing indicators increased minimally to 1.70x (FY19: 1.66x) and 1.37x (FY19: 1.35x). Debt servicing coverage ratio also fell to 1.04x (FY19: 1,86x). Ratings will remain dependent upon improvement of the same over the rating horizon. Going forward, capitalization indicators are expected to remain under pressure on the back of capital expenditure plans; however profitability over the rating horizon will provide comfort.

Sapphire Textile Mills Limited Appendix I

FINANCIAL SUMMARY (amounts in PKR millions)						
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**FY20**	**9MFY20***	**9MFY21***
Fixed Assets	10,575	11,415	12,595	13,119	13,264	13,793
Long term Investments	17,513	14,927	14,257	13,613	13,749	14,226
Stock-in-Trade	5,327	5,472	7,482	8,911	10,505	12,888
Trade Debts	1,724	2,947	2,198	2,783	3,190	3,144
Cash & Bank Balances	72	55	97	68	131	118
Total Assets	42,532	42,330	43,563	44,446	48,252	51,026
Trade and Other Payables	3,224	3,869	3,443	3,899	3,986	3,519
Long Term Debt	13,883	13,997	14,258	14,509	14,140	16,797
Short Term Debt	7,464	7,302	7,798	8,071	11,296	9,615
Total Debt	21,347	21,300	22,056	22,580	25,436	26,412
Paid Up Capital	201	201	201	217	217	217
Total Equity	16,995	16,022	16,382	16,477	16,550	19,622
INCOME STATEMENT						
Net Sales	25,584	28,896	34,253	34,030	27,630	27,882
Gross Profit	2,678	3,536	5,406	4,835	4,563	4,287
Operating Profit	3,944	3,340	5,031	3,866	3,704	3,547
Profit Before Tax	2,975	1,949	2,946	1,309	1,649	2,380
Profit After Tax	2,722	1,595	2,559	1,179	1,413	2,031
RATIO ANALYSIS						
Gross Margin (%)	10.5%	12.2%	15.8%	14.2%	16.5%	15.4%
Operating Margin (%)	15.4%	11.6%	14.7%	11.4%	13.4%	12.7%
Net Profit Margin (%)	10.6%	5.5%	7.5%	3.5%	5.1%	7.3%
Net Working Capital	2,224	2,376	2,041	3,583	3,948	5,653
Adjusted FFO	1,844	2,719	3,794	2,268	1,821	2,410
FFO to Total Debt (%)	9%	13%	17%	10%	14%	18%
FFO to Long Term Debt (%)	13%	19%	27%	16%	26%	29%
Debt Servicing Coverage Ratio (x)	1.08	2.12	1.86	1.04	1.39	2.08
Gearing (x)	1.26	1.33	1.35	1.37	1.54	1.35
Leverage (x)	1.50	1.64	1.66	1.70	1.92	1.60
Current Ratio (x)	1.19	1.18	1.14	1.26	1.23	1.33
STD Coverage	94%	115%	124%	145%	121%	167%
ROAA (%)	7%	4%	6%	3%	6%	8%
ROAE (%)	17%	10%	16%	7%	16%	21%

**Ratios Annualized*

*** FFO Adjusted for dividend income*

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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		
06/21/2021	A+	A-1	Stable	Maintained
04/22/2020	A+	A-1	Rating Watch-Developing	Maintained
12/05/2019	A+	A-1	Positive	Reaffirmed
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	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.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meetings Conducted	

Name	Designation	Date
Mr. Muhammad Imran	Finance Manager	April 13, 2021
Mr. Abdul Sattar	CFO	