

RATING REPORT

Sapphire Textile Mills Limited

REPORT DATE:

July 04, 2022

RATING ANALYSTS:

Syeda Batool Zehra Zaidi
batool.zaidi@vis.com.pk

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	July 04, 2022		June 21, 2021	
Rating Outlook	Stable		Stable	
Outlook	Reaffirmed		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 – 11.6%	
Mr. Yousuf Abdullah – 7.4%	

APPLICABLE METHODOLOGY (IES)

Applicable Rating Criteria: Industrial Corporates (August 2021)

<https://docs.vis.com.pk/docs/CorporateMethodology202108.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 FY21 were audited by EY Ford Rhodes Chartered Accountants.

Pattern of shareholding at end-FY21 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. STML is a vertically integrated entity incorporating spinning, weaving and yarn dyeing, printing, processing, and stitching units located in Kotri, Nooriabad, District Kasur, Sheikhpura, and Lahore. The Company also has a sizable investment portfolio which continues to support the Company's bottom-line.

Rating Drivers

Overall demand for textile products remained robust during the year, Pakistan's exports remained undisrupted relative to other countries in the international market leading to a shift in demand to the county. Supply chain crises and raw material price volatility also remained a challenge during FY21, however, the textile industry benefitted from favorable raw material and inventory procurement at lower prices leading to inventory gains later on. While cotton crop yields are seemingly favorable in the coming half, ratings will remain constrained due to size of cotton crop and resultant volatility in commodity prices. Uncertainty around local economic situation as well fears of a global recession will continue to weigh in on the long-term demand prospects for the industry.

Topline registered growth during FY21 & the ongoing fiscal year on the back of volumetric increase and higher average selling price. Profitability to remain strong in FY22.

During FY21, the Company's turnover increased by 13% to Rs 38.5b (FY20 Rs. 34.0b) on the back of increase in average selling price of the products and overall increase in volumes sold. Topline was also supported by increase in demand for textile products both in the international and domestic market. Net turnover registered further growth with the same pace closing at Rs. 43.1b end-9MFY22.

Local sales increased by 15% while export sales increased by 16% during FY21. Gross and net margins witnessed significant improvement during the year post ease in COVID-19 pandemic led slowdown in the market. Improvement in margins is primarily attributable to inventory gains, exchange gain on account of rupee devaluation and capacity enhancement. Gross margins improved to 16.5% (FY20 14.2%) and net margins to 8.5% during FY21 (FY20 3.5%).

Sales mix

Sales mix comprises of yarn, fabric, clothing items and home textile products. Yarn sales dominate the mix comprising 51% of the total sales in FY21. Fabric comprises of 30%, while home textile accounts for 13% of total sales. In FY21, highest growth was recorded in yarn sales of 33%, while fabric sales increased by 6%. Homes textiles on the other hand registered a 5% decline year over year.

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 yarn.

Investments continue to support bottom-line on timeline basis

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 Triconboston Consulting Corporation (Private) Limited (TBCL), Sapphire Retail Limited (SRL), Sapphire Wind Power Company Limited (SWPCL) and Sapphire International APS.

During FY21, other income was reported to be Rs. 1.1b (FY20 Rs. 721m) which mainly emanates from dividends from investment in associates, listed companies and subsidiaries. In 9MFY22, other income was recorded at Rs. 818m.

Capacity expansion continues to support topline and increased operational efficiency

Over a duration of six years, the Company has consistently invested in extensive balancing, modernization and replacement of its ring, looms, and dyeing machinery in order to further increase share in its value added products. During the year, an additional 529 spindles had been installed in the spinning segment which subsequently increased overall spinning capacity to 142,105 spindles. Capacity utilization for yarn segment (FY21: 90%; FY20: 83%) in FY21 remained higher than historic average on account of strong demand. Dyeing capacity also recorded an uptick of up to 83% (FY20 66%) due to increased volume of dyed fabric with Carrington Textiles. In the ongoing year, expansion continued with focus on enhancing the finishing capacities. Additions of Rs 5-6b are planned for FY22, while capacities will become online by FY23.

Liquidity metrics stand improved in FY21, however may depict some pressure going forward.

Liquidity profile of the Company improved during FY21 with current ratio reported at 1.40x (FY20 1.26x) and inventory and receivable coverage to borrowings improving to 2.02x (FY20 1.44x)

However, with greater reliance on short-term borrowings to fund capex requirements, we expect some liquidity pressure to develop in the near term. Moreover, higher working capital requirements led by higher commodity prices as well as inflationary pressures is also expected to build up short-term liquidity pressure. Working capital cycle depicts an increase on account inventory buildup on supply chain disruptions and volatile commodity prices.

Funds flow from operations (FFO) improved to Rs.3.7b in FY21 on the back of higher profitability and recurring dividend income. Profitability momentum continued in 9MFY22. The Company's debt servicing profile also witnessed improvement; DSCR increased to 2.2x in FY21 from 1.06x however, future debt servicing may come under pressure on account of increase in debt utilization going forward.

Capitalization indicators depict increase but are expected to remain manageable

During FY21, the Company's equity base grew to Rs. 21.0b from Rs. 16.5b on the back of higher profitability. Equity base registered further growth by the end of 9MFY22 as profitability profile further improved. Gearing and leverage indicators, however, reflect an increase at the end of 9MFY22 primarily on account of higher working capital requirements. Increased inventory levels as well as capital expenditures have been funded through increase

in short term borrowings, which has elevated the gearing and leverage levels. However, we expect that higher projected profitability is expected to keep gearing and leverage within manageable levels, going forward.

Corporate governance framework:

In line with best practices, the Company's board comprises of ten members including independent representation as well. The Company also has audit and human resources committees both chaired by independent members. There has been no major change in the Company's management profile during the year.

Sapphire Textile Mills Limited

FINANCIAL SUMMARY <i>(amounts in millions)</i>						Appendix I
<u>BALANCE SHEET</u>	FY17	FY18	FY19	FY20	FY21	9MFY22
Fixed Assets	10,575	11,415	12,595	13,119	14,714	18,653
<u>Long term Investments</u>	17,513	14,927	14,257	13,613	14,273	14,095
Stock-in-Trade	5,327	5,472	7,482	8,911	12,885	22,522
Trade Debts	1,724	2,947	2,198	2,783	2,634	4,630
Cash & Bank Balances	72	55	97	68	76	93
Total Assets	42,532	42,330	43,563	44,446	51,798	69,622
Trade and Other Payables	3,224	3,869	3,443	3,899	3,910	5,666
Long Term Debt	13,883	13,997	14,258	14,509	17,605	18,474
Short Term Debt	7,464	7,302	7,798	8,071	7,679	18,006
Total Debt	21,347	21,300	22,056	22,580	25,284	36,480
Paid Up Capital	201	201	201	217	217	217
Total Equity	16,995	16,022	16,382	16,477	21,019	25,376
INCOME STATEMENT						
Net Sales	25,584	28,896	34,253	34,030	38,471	43,120
<u>Gross Profit</u>	2,678	3,536	5,406	4,835	6,350	9,295
Operating Profit	3,944	3,340	5,031	3,866	5,342	7,430
Profit Before Tax	2,975	1,949	2,946	1,309	3,759	5,674
Profit After Tax	2,722	1,595	2,559	1,179	3,263	5,154
RATIO ANALYSIS						
Gross Margin (%)	10.5%	12.2%	15.8%	14.2%	16.5%	21.6%
<u>Net Working Capital</u>	2,224	2,376	2,041	3,583	6,470	7,787
Adjusted FFO	1,850	2,723	3,672	2,282	3,679	4,352
FFO to Total Debt (%)	9%	13%	17%	10%	15%	16%
FFO to Long Term Debt (%)	13%	19%	26%	16%	21%	31%
Debt Servicing Coverage Ratio (x)	1.09	2.12	1.82	1.06	2.20	1.47
Gearing (x)	1.26	1.33	1.35	1.37	1.20	1.44
Leverage (x)	1.50	1.64	1.66	1.70	1.46	1.74
Current Ratio (x)	1.19	1.18	1.14	1.26	1.40	1.27
STD Coverage	94%	115%	124%	145%	202%	151%
ROAA (%)	7%	4%	6%	3%	7%	11%
ROAE (%)	17%	10%	16%	7%	17%	30%
*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	
	<u>RATING TYPE: ENTITY</u>					
	07/04/2022	A+	A-1	Stable	Reaffirmed	
	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		16 th May 2022		
	Mr. Abdul Sattar	CFO				