RATING REPORT

Sapphire Textile Mills Limited

REPORT DATE:
September 13, 2023

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 Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	
Rating Date	*Sept 13, 2023*		*July 04, 2022*	

COMPANY INFORMATION	
Incorporated in 1969	**External Auditors:** Shinewing Hameed Chaudhri & Co Chartered Accountants
Public Listed Company	**Chairman of the board:** Mr. Mohammad Abdullah
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Nadeem Abdullah
ATMZ Company (Private) Limited ~5.86%	
Channel Holdings (Private) Limited ~5.86%	
Resource Corporation (Private) Limited ~5.86%	
Synergy Holdings (Private) Limited ~5.86%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (May 2023) *https://docs.vis.com.pk/docs/CorporateMethodology.pdf*

APPLICABLE RATING SCALE(S)
VIS Issue/Issuer Rating Scale: *https://docs.vis.com.pk/docs/VISRatingScales.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 FY22 were audited by EY Ford Rhodes Chartered Accountants.

Profile of the Chairman:
Mian Mohammad Abdullah, a leading and experienced industrialist of Pakistan is the chairman and founder of Sapphire Group of Companies. He has significant experience of working in different business environments and possesses wide experience of business establishment. Mian Abdullah is an active philanthropist and has served on Board of various philanthropic organizations. He has twice been bestowed with Pakistan's top civilian award, Sitara-e-Imtiaz in recognition of his contribution towards business.

Profile of the CEO:
Mr. Nadeem Abdullah has been the Chief Executive Officer of Sapphire Textile Mills Limited for the last 18 years and is also a director in other group companies. He graduated from McGill University Canada. He is serving as Chief Executive Officer of company's

RATING RATIONALE

Corporate Profile
Established in 1969 as a modest spinning venture, Sapphire Textile Mills Limited (STML) has since evolved to become among Pakistan's top vertically integrated textile players and exporters. Involved in yarn, fabric, and home textile production, STML's operations cover spinning, weaving, dyeing, printing, processing, and stitching. Boasting various international certifications and export standards, the company has a global footprint with marketing offices, affiliate entities, and key business partnerships. Production infrastructure is based in Sindh and Punjab, backed by a workforce of 9,000+ employees.

Group Profile
Initiated by Mr. Mohammad Abdullah, the Sapphire Group began its journey in Calcutta (now in India) before relocating to Pakistan. Today, it stands out in the composite textile industry, exporting to 35+ global destinations and employing 35,000+ individuals. Beyond textiles, the group has ventures in power, dairy, retail, and investment sectors. Presently, the group has an annual turnover exceeding $1350m, supported by an asset base of over $500m.

Environment, Social & Governance (ESG) Initiatives
The company clinches second place in the 'Large National Enterprise' category at the UN Global Compact Sustainability Summit & Awards 2021, reaffirming its commitment to the UN Sustainable Development Goals (SDGs). Operating under the vision of the UN's 2030 Agenda for Sustainable Development, the company actively integrates global SDGs into its practices. Notable initiatives include utilizing 11.2MW of solar energy, implementing waste heat recovery at the facility, waste water treatment, effluent and hazardous waste treatment, and waste management processes in place, and partnering with WWF for organic cotton.

Strategic Investment Portfolio
STML boasts a diverse investment portfolio, including stakes in subsidiaries, associates, and listed entities as listed below:

Table: Investment Portfolio (% shareholding)

	Entities	Ownership
Associates	Creadore A/S Denmark - Foreign Company	***49.0%***
	Sapphire Power Generation Limited	***26.4%***
	Sapphire Dairies (Private) Limited	***13.0%***
	Reliance Cotton Spinning Mills Limited	***3.0%***
	Sapphire Electric Company Limited	***1.4%***
	Sapphire Holding Limited	***0.1%***
Wholly-owned Subsidiaries	Sapphire Retail Limited	***100.0%***
	Sapphire International APS	
	Sapphire Real Estate (Private) Limited	
	Sapphire Chemicals (Private) Limited	
	Designtex SMC-Private Limited	
	Sapphire Green Energy (Private) Limited	
Other subsidiaries	Sapphire Wind Power Company Limited	***70.0%***
	Triconboston Consulting Corporation (Private) Limited	***57.1%***
	Creek Properties (Private) Limited	***65.0%***

subsidiaries in the renewable energy segment.

Operating Performance
Headquartered in Karachi, STML has its production facilities spread out in Kotri, Nooriabad, District Kasur, Sheikhupura, and Lahore. In the past 21 months, total capital expenditure reached over Rs. 11b. Management indicates no upcoming significant capex projects, emphasizing instead a refined approach to streamline existing operations to improve overall efficiency.

Spinning: At present, there are four operational spinning units, and with the addition of close to 22K spindles in the past two fiscal years, capacity rose by ~16%. Despite this, utilization stays above 90% on account of consistent growth in yarn production levels.

Weaving & Yarn Dyeing: Barring stitching, all other operational activities are centralized in a single unit. In the last two fiscal years, weaving capacity surged by ~39%, driven by the addition of 77 new looms and the upgradation of several existing ones to more efficient latest models. Yet, a global demand dip in FY23 impacted production volumes, leading to reduced utilization levels. Similarly, while yarn dyeing capacity expanded by 1.6x, it also followed this trend.

Finishing & Printing: Management highlighted a notable expansion in the finishing segment. The integration of a new production line elevated monthly capacity from 3m to 7m square meters, an initiative of Rs. 3.4b funded by a 64:36 debt-to-equity split. The debt portion comprised an equal share of LTFF and KBOR-based loans. The project commenced operations in July'23. The utilization ratio of the segment recouped in FY23 after a dip in the preceding fiscal year, aligning with production trends.

Table: Capacity & Production Data (Units in millions)

	FY21	FY22	FY23
Spinning			
No. of spindles	142,105	157,464	164,072
Installed capacity – (lbs)	110.8	115.4	128.7
Actual production – (lbs)	100.0	103.7	118.9
Capacity Utilization	***90%***	***90%***	***92%***
Weaving			
No. of looms	357	430	434
Installed capacity – (mtr sq)	155.8	206.0	216.7
Actual production – (mtr sq)	136.2	171.6	169.1
Capacity Utilization	***87%***	***83%***	***78%***
Yarn Dyeing			
Installed capacity – (kgs)	1.1	2.9	2.9
Actual production – (kgs)	0.9	2.3	2.1
Capacity Utilization	***83%***	***80%***	***72%***
Finishing & Printing			
Installed Capacity – (mtr)	43.2	45.6	53.6
Actual Production – (mtr)	38.1	36.7	48.1
Capacity Utilization	***88%***	***81%***	***89%***
Power Generation			
Installed capacity – (MWh)	0.6	0.6	0.6
Actual production – (MWh)	0.5	0.7	0.5
Capacity Utilization	***90%***	***111%***	***75%***

About half of the yarn produced is used in-house for fabric creation, with 30-40% of this fabric further crafted into home textile items. External local suppliers meet the remaining yarn and fabric requirements. These proportions might shift due to market fluctuations and cost considerations. Management leans towards in-house production of specialized yarn/fabric, emphasizing maximum integration.

Key Rating Drivers

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand. All these factors pose a challenge to the sector over the medium term in terms of margins sustainability and future growth.

Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports broke the threshold, clocking in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and provides employment to about 40% of the industrial labor force. Contributing around 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr, textile sector has maintained an average share of about 60% in national exports over the years.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22	FY23
Pakistan Total Exports	22,536	25,639	32,450	27,911
Textile Exports	12,851	14,492	18,525	16,710
PKR/USD Average rate	158.0	160.0	177.5	248.0

Source: SBP

The lingering effects of Covid-19 pandemic continue to shape the Pakistan's textile industry. Initially, as lockdowns lifted, the industry capitalized on opportunities, securing production contracts with Western countries. This redirection of substantial volumes to Pakistan, complemented by government import tax reductions and subsidized covid-related financing programs such TERF, spurred robust export growth during FY20-22. However, a subsequent phase presented new challenges. Global interest rate hikes aimed at curbing post-pandemic inflation, coupled with geopolitical unrest such as the Ukraine conflict, led to supply chain disruptions and energy crisis. These factors led to a global demand slowdown in major textile economies, reflected in a ~15% year-on-year decline in Pakistan's textile exports in FY23, totaling USD 16.5b (FY22: USD 19.3b). Knitwear, Readymade, and Bed wear segments remain key contributors, making up over 60% of the textile exports.

Table: Textile Export Details (in USD millions)

	FY20	FY21	FY22	FY23	YoY FY23
High Value-Added Segment	**9,669**	**12,427**	**15,611**	**13,576**	**-13%**
- Knitwear	2,794	3,815	5,121	4,437	-13%
- Readymade Garments	2,552	3,033	3,905	3,492	-11%
- Bed wear	2,151	2,772	3,293	2,692	-18%
- Towels	711	938	1,111	1,000	-10%
- Made-up Articles	591	756	849	693	-18%
- Art, Silk & Synthetic Textile	315	370	460	412	-10%
- Others	555	743	872	851	-2%
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,719**	**2,926**	**-21%**
- Cotton Cloth	1,830	1,921	2,438	2,022	-17%
- Cotton Yarn	984	1,017	1,207	844	-30%
- Others	43	34	74	60	-20%
Total	**12,527**	**15,399**	**19,330**	**16,502**	**-15%**

Source: PBS

Flash floods in Sindh and Southern Punjab from last year's monsoon wreaked havoc on the cotton crop, washing away roughly 45% worth over USD 2.5b. This catastrophe led to a historic low yield of 4 million bales in 2022, compared to a 12 million bales annual demand. Local cotton prices subsequently reached a 12-year high of over Rs. 22,000 per 40kg during the year, and imports rose by ~20% in USD terms for FY22, vis-à-vis preceding year. This situation heightened working capital needs, adversely affecting profit margins and liquidity profile for textile entities, particularly spinners, weavers, and dyeing companies. On a positive note, the production target for the current season is set at 12.7 million bales, supported by favorable weather and timely government intervention.

Table: Cotton Prices Trend (In Rs.)

	June'19	June'20	June'21	June'22	June'23
Per Maund	8,770	8,860	13,000	17,380	17,735
YoY % Change	*26%*	*1%*	*32%*	*34%*	*2%*

The industry faces medium-term risks due to the current weak macroeconomic environment both globally and locally, high-interest rates, inflationary pressures, rising raw material costs, ongoing energy crisis in the country, and a global slump in demand, primarily from North America and Europe. Additionally, the potential expiration of Pakistan's GSP plus status in December 2023 could be impactful. This status, allowing duty-free access to the EU for over 6,300 tariff lines, fosters beneficial trade. Its loss could lead to reduced trade revenues and create market uncertainties.

Previously, the sector also enjoyed incentives provided by the government through a five-year textile policy (2020-25), including preferential energy rates, low-interest financing schemes, and timely payments of various refunds, easing liquidity constraints for local players. However, the prevailing economic instability led to the reduction or withdrawal of many of these supports. This along with contractionary monetary policy and political uncertainties in the country are the key present business risk factors. In the long run, improvement in value addition, investment in technology and optimization of energy cost would define the future prospects of textile exports.

Ratings continue to drive strength from strong market position as a prominent exporter.

STML, with a rich operating history spanning over five decades, stands as one of the leading manufacturers and exporters of yarn, fabric, and home textile products. In FY23, it secured the 16th spot among Pakistan's top twenty exporters.

Despite falling export volumes, revenue growth continues, supported by consistent rupee depreciation and higher local sales contribution. Geographic and client wise sales mix feature adequate concentration risk.

In FY22, sales revenue surged by ~60% to an all-time high of Rs. 61.4 (FY21: Rs. 38.5b), fueled by higher volumes, rising per unit dollar prices, and rupee devaluation impact. Currently, sales are distributed as 45% yarn, 33% fabric, and 15% home textiles (primarily bedsheets, quilts, and table covers), with the rest from the sale of raw materials, waste disposal, and processing income. Growth was noted in all segments during the review period. While exports dominate, the overall export-to-local sales ratio shifted from 80:20 to 75:25 this year. Product-wise, the ratios are 60:40 for yarn, 90:10 for fabric, and a stark 2:98 for home textiles.

Geographically, the bulk export – over 50% – is channeled towards Denmark and the UK, with Italy, South Korea, Japan, Germany and Bangladesh trailing behind. Additionally, the company has established strategic alliances via joint venture partnerships with clients based in Denmark and the UK. As for client concentration, the top ten clients consistently generate more than one-third of total sales; comfort is drawn from long-standing relationships with these customers. Management ensures that no single client exceeds a 10% concentration to mitigate risk. Key revenue contributors include Beirholms Vaeveriers, Sapphire Finishing Mills Limited, US Denim Mills, Nishat Mills, Sapphire International Aps, Style Textiles, and others.

Despite a worldwide economic slump impacting export volumes, FY23 revenue reached nearly Rs. 73b, driven by a rise in the local sales ratio and consistent rupee depreciation. Going forward, management foresees export growth due to anticipated global demand recovery and expanded finishing segment capacity. Projected top-line revenue for FY24 stands at Rs. 84b, with a 6% targeted net margin.

After peaking in FY22, profitability margins have returned to historic levels; dividend income continue to support the bottom-line.
Profitability margins hit a peak in FY22, fueled by healthy demand, timely cotton purchases, cost efficiencies, and rupee devaluation benefits. However, this year witnessed a return to historic levels, influenced by a significant drop in yarn and home textile margins, combined with global recession impacts and rising raw material costs. Management anticipates these margin levels to persist in FY24.

In the past 21 months, raw material costs have spiked by ~71%. Currently, half of the overall raw materials are imported, but management is keen on reducing this dependence. Notably, ~70% of cotton is imported, while yarn and fabric are primarily sourced locally. The rise in administrative and distribution costs correlates with inflation, elevated freight charges from global supply chain issues, and sales growth trend. Increased financial charges stem from higher benchmark rates and growing working capital needs, yet profitability remains buoyed by dividends from subsidiaries and associates.

Debt service coverage ratio lags behind industry peers and high inventory holding days have led to elevated cash conversion cycle.
In the past two fiscal years, strong revenue and dividend upticks spurred a growth in funds flow from operations (FFO). However, during 9M'FY23, divergent cash flow patterns led to a notable dip in cash-flow coverages. The debt service coverage ratio (DSCR) also dipped below 1.5x, lagging behind peers. While the current ratio of over 1.25x mirrors industry standards, an extended cash conversion cycle, due to higher inventory holding days, amplifies reliance on short-term finance. The aging profile of trade debts remains sound, with over 95% of receivables settled within 90 days.

Strong bottom-line performance and limited payouts fueled equity growth while steady leverage ratios aligned with industry peers.
Equity base grew by ~34% in the last 21 months, hitting Rs. 28.1b at end-9M'FY23, primarily driven by robust bottom-line results. After retaining all profits in FY21, a dividend of Rs. 325m was disbursed in FY22, marking a payout ratio of ~5% — significantly below the usual rate. Debt profile is a blend of short-term and long-term debt, with total interest-bearing liabilities increasing to Rs. 38.3b (FY22: Rs. 35.2b; FY21: Rs. 25.3b) at end-9M'FY23, ~47% constituted short-term debt while aggregated running finance lines stand at Rs. 26.3b. Leverage ratios remained at similar levels since the last review, aligning with industry peers.

	Sound corporate governance framework anchored by a well-structured organizational layout and experienced management team. STML has a structured organizational layout with distinct departments for core functions, each with its own management team. With sponsors well-versed in the textile sector and senior management of industry experts, the governance is robust. The 10-member board includes three independent directors and a female representative. To ensure transparency and governance, there are dedicated audit and HR & remuneration committees, alongside internal audits that cover both operations and departments. The 2022 audit report highlighted key audit matters concerning inventory and capital expenditure.

Sapphire Textile Mills Limited Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**9M'FY23**
Fixed Asset	13,119.3	14,714.2	19,921.3	23,016.6
Long term investments	13,613.0	14,273.2	13,504.3	14,096.8
Short-term investments	2,956.2	3,487.4	2,988.3	2,342.0
Stock-in-Trade	8,910.9	12,885.1	23,145.1	22,428.1
Trade Debts	2,782.8	2,633.8	5,656.2	6,883.6
Cash and Bank Balance	67.5	75.6	98.6	206.1
Total Assets	**44,446.3**	**51,798.4**	**70,642.6**	**75,381.7**
Trade and Other Payables	3,898.9	3,909.9	6,283.1	5,739.6
Long-Term Borrowings *(Incl. current maturity)*	14,509.3	16,702.4	17,208.0	19,124.5
Short-Term Borrowings	8,070.6	7,679.2	16,943.2	18,073.0
Total Debt	22,579.9	24,381.2	34,151.2	37,197.5
Total Liabilities	**27,969.7**	**30,779.8**	**44,533.0**	**47,246.6**
Paid-up Capital	216.9	216.9	216.9	216.9
Total Equity *(Incl. loan from directors)*	**16,476.5**	**21,018.6**	**26,109.7**	**28,135.2**
INCOME STATEMENT				
Net Sales	34,030.2	38,470.9	61,373.4	52,879.7
Gross Profit	4,834.7	6,350.0	11,859.1	7,666.5
Operating Profit	3,866.1	5,341.8	11,116.7	6,954.5
Profit Before Tax	**1,309.1**	**3,759.3**	**8,457.7**	**3,952.4**
Profit After Tax	**1,179.1**	**3,262.8**	**7,015.6**	**3,062.1**
RATIO ANALYSIS				
Gross Margin (%)	14.2%	16.5%	19.3%	14.5%
Net Margin (%)	3.5%	8.5%	11.4%	5.8%
Net Working Capital	3,582.9	6,469.7	8,133.0	8,125.6
Current Ratio (x)	1.26	1.40	1.28	1.27
Adjusted FFO	2,282.1	3,678.6	7,158.7	3,552.4
FFO to Long-Term Debt (%)	10.1%	15.1%	21.0%	12.7%*
FFO to Total Debt (%)	15.7%	22.0%	41.6%	24.8%*
DSCR (x)	1.06	2.20	1.84	1.39*
Gearing (x)	1.37	1.16	1.31	1.32
Debt Leverage (x)	1.70	1.46	1.71	1.68
Inventory + Receivable/Short-term Borrowings (x)	1.45	2.02	1.70	1.62
ROAA (%)	2.7%	6.8%	11.5%	5.6%*
ROAE (%)	7.2%	17.4%	29.8%	15.0%*

**Annualized*

REGULATORY DISCLOSURES					Appendix II
Name of Rated Entity	Sapphire Textile Mills Limited				
Sector	Textile				
Type of Relationship	Solicited				
Purpose of Rating	Entity Ratings				

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
Rating Type: Entity				
13/09/2023	A+	A-1	Stable	Reaffirmed
04/07/2022	A+	A-1	Stable	Reaffirmed
21/06/2021	A+	A-1	Stable	Maintained
22/04/2020	A+	A-1	Rating Watch-Developing	Maintained
05/12/2019	A+	A-1	Positive	Reaffirmed
19/12/2018	A+	A-1	Positive	Reaffirmed
30/01/2018	A+	A-1	Positive	Reaffirmed
25/10/2016	A+	A-1	Positive	Reaffirmed
1/6/2015	A+	A-1	Positive	Reaffirmed
5/3/2014	A+	A-1	Positive	Maintained
1/4/2013	A+	A-1	Stable	Upgrade
1/2/2012	A	A-2	Stable	Reaffirmed
12/10/2010	A	A-2	Stable	Initial

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.
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Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Muhammad Imran	Head of Accounts & Finance	Aug 03, 2023