

RATING REPORT

Sapphire Textile Mills Limited

REPORT DATE:

October 07, 2024

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/ Rating Watch	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	
Rating Date	Oct 07, 2024		Sept 13, 2023	

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
<i>ATMZ Company (Private) Limited ~5.86%</i>	
<i>Channel Holdings (Private) Limited ~5.86%</i>	
<i>Resource Corporation (Private) Limited ~5.86%</i>	
<i>Synergy Holdings (Private) Limited ~5.86%</i>	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Industrial Corporates
<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

RATING RATIONALE

Sapphire Textile Mills Limited (STML) was incorporated in 1969 as a listed company. Financial Statements of the Company for FY23 were audited by Shinewing Hameed Chaudhry and Co. 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

Corporate Profile

Established in 1969 as a modest spinning venture, Sapphire Textile Mills Limited ('STML' or 'the Company') 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 affiliate entities and key business partnerships. Production infrastructure is based in Sindh and Punjab, backed by a workforce of 10,000+ 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 42,000+ individuals. Beyond textiles, the group has ventures in power, dairy, retail, and investment sectors. Presently, the group has an annual turnover exceeding \$1,250 m, supported by an asset base of over \$ 1,400 m.

Corporate Governance

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 Executive Directors, four Non-Executive Directors, and three independent directors. During the FY23, Six Board Meetings were held. A new independent director Mirza Saleem Baig was elected during the election of directors on 15th June 2023.. To ensure transparency and governance, there are dedicated audit and HR & remuneration committees, alongside internal audits that cover both operations and other departments.

Long-Term Investment Portfolio

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

Table: Investment Portfolio (% shareholding)

	Entities	FY22 Rupees in Millions	FY23 Rupees in Millions	FY23 Ownership
Associates	Creadore A/S Denmark - Foreign Company	58.71	58.71	49.0%
	Sapphire Power Generation Limited	113.71	113.71	26.4%
	Sapphire Dairies (Private) Limited	235	235	13.0%
	Reliance Cotton Spinning Mills Limited	8.46	8.46	3.0%

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 20 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 subsidiaries in the renewable energy segment.

	Sapphire Electric Company Limited	60	60	1.4%
	Sapphire Holding Limited	0.1	0.1	0.1%
Wholly-owned Subsidiaries	Sapphire Retail Limited	2,000	2,000	100.0%
	Sapphire International APS	15.76	15.76	
	Sapphire Real Estate (Private) Limited	150	1,175	
	Sapphire Chemicals (Private) Limited	-	600	
	Sapphire Green Energy (Private) Limited	-	30	
Other subsidiaries	Sapphire Wind Power Company Limited	2,282	2,282	70.0%
	Triconboston Consulting Corporation (Private) Limited	5,224	5,224	57.1%
Other Equity Instruments	<i>Various Equity Investments (Quoted & unquoted)</i>	3,356	2,627	-
	Total	13,504	14,430	

At the end of FY23, the Company's long-term investments increased by 6.9%, rising to Rs. 14.43 billion from Rs. 13.50 billion at the end of FY22. This growth was primarily driven by a 17% rise in investments in subsidiary companies, with its value increasing from Rs. 9.67 billion in FY22 to Rs. 11.33 billion in FY23.

During FY23, the Company made several significant investments, including Rs. 1.18 billion in Sapphire Real Estate Private Limited, acquiring an additional 102.5 million shares. As a wholly owned subsidiary of Sapphire Textile Mills Limited, Sapphire Real Estate plays a key role in the Company's portfolio. The Company also directed Rs. 600 million to Sapphire Chemicals Private Limited and Rs. 30 million to Sapphire Green Energy Private Limited, both of which are wholly owned subsidiaries of Sapphire Textile Mills Limited.

Conversely, the Company's investments in other equity instruments declined by 20.9%, falling from Rs. 3.3 billion in FY22 to Rs. 2.6 billion in FY23. This decrease was majorly due to impairment in its investment in Jomo Technologies Private Limited amounting to Rs. 150 million which was deemed no longer recoverable.

Operational Update

The Company has a registered Office at Cotton Exchange Building, I.I Chundrigar Road, Karachi. The Company's Spinning units are located at Kotri, Nooriabad, District Kasur and Sheikhpura. The weaving, Yarn Dyeing, printing and Processing, Home Textile Unit is located at Sheikhpura. The Stitching Unit of the Company is located at Lahore.

Spinning: In FY23, STML saw a notable improvement in its spinning operations due to an increase in installed capacity. Specifically, the installed capacity grew by 11%, which in turn boosted actual production by 15% and raised capacity utilization to 92%.

Weaving: In FY23, although the installed capacity for weaving increased by 5%, this did not translate into higher production or better capacity utilization. Actual production fell by 1% despite the capacity expansion, and capacity utilization decreased from 83% in FY22 to 78% in FY23—a decline of 5%.

Finishing & Printing: In FY23, the installed capacity for Finishing and Printing saw a significant 19% increase, which positively impacted both actual production and capacity utilization. This expansion led to a 31% rise in actual production and an 8% improvement in capacity utilization, which increased from 81% in FY22 to 89% in FY23.

Yarn Dyeing: In FY23, the installed capacity for Yarn Dyeing remained unchanged. However, there was a decrease in actual production, which fell by 6%. Additionally, capacity utilization declined by 4%, dropping from 80% in FY22 to 76% in FY23.

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	435
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	2.2
Capacity Utilization	83%	80%	76%
Finishing & Printing			
Installed Capacity – (mtr)	43.2	45.6	54.2
Actual Production – (mtr)	38.1	36.7	48.1
Capacity Utilization	88%	81%	89%

Sector Update

The business risk profile of the textile sector in Pakistan is characterized by a high level of exposure to economic cyclicality and intense competition. This sector's performance is significantly influenced by the broader economic conditions in the country, making it inherently vulnerable to fluctuations in demand driven by economic factors.

In FY23, the textile sector faced challenges due to various economic and environmental factors. These included damage to the cotton crop resulting from flooding in 1HFY23, escalating inflation, and import restrictions due to diminishing foreign exchange reserves.

During FY23, Pakistan's yarn production registered a substantial decline, primarily due to reduced availability of cotton, as a result of crop damage and import restrictions. The sector's profitability was constrained by factors such as higher production costs, increased raw material costs, and rising energy expenses, all of which constrained the sector's profit margin. The industry's performance is closely intertwined with the outlook of the cotton and textile industries, both of which were affected in FY23. Reduction in cotton supply, coupled with global economic slowdown and contractionary economic policies, led to a decrease in demand for textile products and, consequently, cotton yarn.

While the global outlook for cotton production is expected to rebound, local challenges persist. These challenges include high interest rates, increasing energy costs and inflationary pressures. Additionally, the sector's vulnerability to global market dynamics and the domestic economic landscape further contribute to its high business risk profile. The worrying trend has continued during the first quarter of FY25 as the cotton production has declined by 48% during the first 15 days of FY25. Several factors have contributed to this downturn. Climate change has altered

weather patterns, resulting in irregular rainfall and increased temperatures that have negatively affected crop yields. Additionally, pest infestations, especially by the pink bollworm, have devastated cotton fields. Rising costs of inputs such as fertilizers, pesticides, electricity, and quality seeds have made cotton cultivation less profitable.

Addressing the decline in cotton production requires a multifaceted approach. Improved pest management practices, such as integrated pest management (IPM), can help control infestations more effectively. Education and training for farmers on IPM techniques are crucial. They need access to the latest research and pest-resistant cotton varieties. Investment in agricultural research and development is also essential. Developing drought-resistant and high-yield cotton varieties can mitigate the impacts of climate change.

MONTH-WISE EXPORT DATA FOR TEXTILE SECTOR

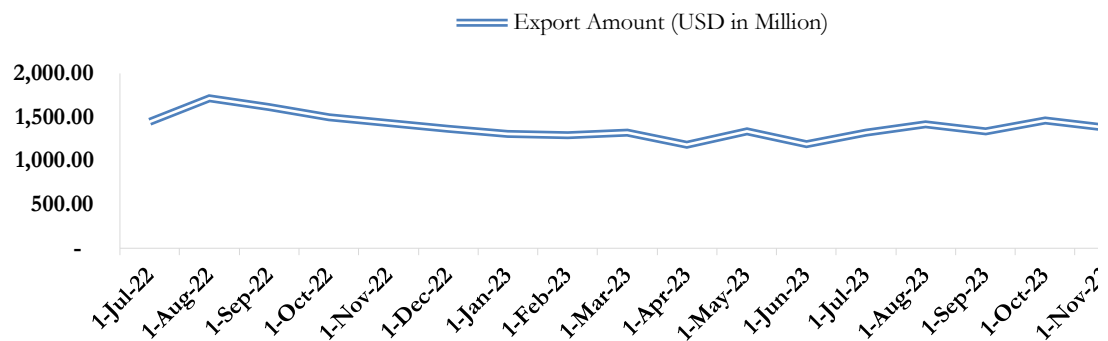


Figure 1: MoM Textile Exports (In USD' millions)
Source: SBP

Key Rating Drivers:

Ratings continue to drive strength from strong market position as a prominent exporter. STML has over five decades of operating history and is a leading manufacturer and exporter of yarn, fabric, and home textile products. In 2024, the Company elevated its ranking to 14th among Pakistan's top exporters, up from 16th in 2023.

Revenue growth continues, supported by consistent rupee depreciation and volumetric growth

The Company's net sales increased by 18.7% in FY23, reaching Rs. 72.8 billion, up from Rs. 61.4 billion in FY22, largely due to rupee depreciation. Approximately 82% of these sales were generated from exports, while the remainder came from local markets. Gross margins fell to 14.2% in FY23, down from 19.33%, driven by rising energy costs and increased salaries and wages. Operating expenses rose in line with overall inflation. Other income decreased by 18%, totaling Rs. 2.5 billion in FY23 compared to Rs. 3.0 billion in FY22 due to reduced dividend income from associated companies. Consequently, the Company's operating profit margin dropped to 12.9% (down from 18.1% in FY22). Additionally, finance costs increased from 4% to 6% of net sales due to the high interest rate environment. As a result, net margins declined to 4.5%, down from 11.4%.

During the 9M FY24 period, the Company's net sales reached Rs. 61.7 billion. In terms of product-wise sales, yarn represented the largest share at 44%, followed by fabric at 31%, and home textile products at 17%. Geographically, over 50% of sales were made in Denmark and the United Kingdom. Client concentration remained moderate, with one-third of net sales generated from the top 10 clients. Gross Margins and Net Margins of the Company have remained intact with 9M FY24 Margins at 14.8% and 4.9% respectively.

Looking ahead, the Company anticipates its revenue will rise to Rs. 92 billion in FY25, driven by a recovery in product demand, with margins expected to remain intact.

FFO Coverage and liquidity indicators remain at adequate levels

As of FY23, the Company's FFO decreased by 42% to Rs. 2.64 billion (FY22: Rs. 4.55 billion), due to reduced profitability and a decline in cash flow before working capital changes. Consequently, FFO coverage ratios weakened, with FFO to total debt, FFO to long-term debt, and FFO to short-term debt declining to 0.07x, 0.13x, and 0.17x, respectively (FY22: 0.13x, 0.26x, and 0.27x). Moreover, DSCR of the Company has also declined to 1.18x from 1.69x due to reduced FFO. The Company maintained a satisfactory liquidity profile with a current ratio of 1.3x (FY22:1.3x) during FY23.

In 9MFY24, FFO rebounded to Rs. 4.59 billion, primarily due to tax refunds. This improvement led to a recovery in FFO coverage metrics, with FFO to long-term debt at 0.25x, FFO to short-term debt at 0.27x, and FFO to total debt at 0.13x. Correspondingly, the Company's DSCR also improved to 1.39x. Additionally, short-term borrowings were adequately covered by inventory and receivables, resulting in a short-term coverage ratio of 1.7x at the end of 9MFY24 (FY22: 1.43x; FY23: 1.51x).

Capitalization Indicators Show Improvement Driven by Strong Profit Retention

The Company's equity increased by 8.2% as of end-Jun'23, reaching Rs. 28.2 billion (FY22: Rs. 26.1 billion), primarily due to profit retention. At the same time, total debt rose slightly from Rs. 34.2 billion to Rs. 35.8 billion, driven by higher long-term borrowings during the period. As a result, the gearing ratio improved marginally from 1.31x to 1.27x, reflecting the growth in equity and a slight decline in short term debt levels. The Company's debt structure comprises 45% short-term debt and 55% long-term debt. Additionally, the leverage position showed slight improvement, decreasing from 1.71x to 1.68x.

As of Mar'24, the Company's equity further grew by 20%, reaching Rs. 33.8 billion, amid strong profit retention. Meanwhile, total debt remained stable at Rs. 35.5 billion, allowing the gearing ratio to improve to 1.05x. The leverage metric also enhanced to 1.45x by the end of Mar'24.

Looking ahead, Sapphire Chemicals Private Limited, a wholly owned subsidiary of Sapphire Textile Mills Limited, is planning to establish a soda ash manufacturing facility with a capacity of 220,000 tons per annum. The estimated cost of this facility is USD 160 million, to be financed through a combination of 60% debt and 40% equity. Going forward, maintenance of capitalization structure will remain important from the ratings perspective.

Sapphire Textile Mills Limited
Appendix I

FINANCIAL SUMMARY (amounts in PKR millions)						
BALANCE SHEET	FY19	FY20	FY21	FY22	FY23	9MFY24
Fixed Assets	12,595.2	13,119.3	14,714.2	19,921.3	23,645.0	25,295.7
Long term Investments	14,256.5	13,613.0	14,273.2	13,504.3	14,430.0	15,682.3
Short-term investments	4,030.7	2,956.2	3,487.4	2,988.3	1,365.0	3,334.5
Stock-in-Trade	7,482.0	8,910.9	12,885.1	23,145.1	23,034.0	26,430.8
Trade Debts	2,197.9	2,782.8	2,633.8	5,656.2	6,614.0	8,155.8
Cash & Bank Balances	96.8	67.5	75.6	98.6	413.0	198.3
Total Assets	43,562.9	44,446.3	51,798.4	70,642.6	75,715.8	82,642.2
No of Days in Inventory	82.0	102.5	123.8	132.8	134.9	128.9
No of Days Receivable	27.4	26.7	25.7	24.7	30.7	32.8
No of Days Payable	46.3	45.9	44.4	37.6	38.5	42.0
Net Operating Cycle	63.1	83.3	105.2	119.9	127.2	119.6
Trade and Other Payables	3,442.6	3,898.9	3,909.9	6,283.1	6,894.0	9,240.0
Long Term Debt	14,258.1	14,509.3	16,702.0	17,208.0	19,761.0	18,621.0
Short Term Debt	7,797.5	8,070.6	7,679.2	16,943.2	15,990.0	16,923.0
Total Debt	22,055.6	22,579.9	24,381.2	34,151.2	35,751.0	35,544.0
Paid Up Capital	200.8	216.9	216.9	216.9	216.9	217.0
Total Equity(Excluding Revaluation)	16,382.1	16,476.5	21,018.6	26,109.7	28,238.9	33,799.0
INCOME STATEMENT						
Net Sales	34,252.8	34,030.2	38,470.9	61,373.4	72,837.0	61,664.0
Gross Profit	5,405.7	4,834.7	6,350.0	11,859.1	10,369.0	9,120.0
Operating Profit	5,031.4	3,866.1	5,341.8	11,116.7	9,385.0	9,217.0
Profit Before Tax	2,946.0	1,309.1	3,759.3	8,457.7	4,701.0	4,393.0
Profit After Tax	2,559.4	1,179.1	3,262.8	7,015.6	3,291.0	3,003.0
RATIO ANALYSIS	FY19	FY20	FY21	FY22	FY23	9M'FY24
Gross Margin (%)	15.8%	14.2%	16.5%	19.3%	14.2%	14.8%
Net Margin (%)	7.5%	3.5%	8.5%	11.4%	4.5%	4.9%
Net Working Capital	2,040.9	3,582.9	6,469.7	8,133.0	7,840.2	9,146.9
FFO	2,955.7	1,666.7	2,852.6	4,546.6	2,642.0	4,594.0
FFO to Total Debt (%) *	13.4%	7.4%	11.7%	13.3%	7.4%	12.9%
FFO to Long Term Debt (%) *	20.7%	11.5%	17.1%	26.4%	13.4%	24.7%
Debt Servicing Coverage Ratio (x) *	1.82	1.06	2.20	1.69	1.18	1.39
Gearing (x)	1.35	1.37	1.16	1.31	1.27	1.05
Leverage (x)	1.66	1.70	1.46	1.71	1.68	1.45
Current Ratio (x)	1.14	1.26	1.40	1.28	1.27	1.28
STD Coverage (x)	0.99	1.33	1.42	1.43	1.51	1.66
ROAA (%) *	6.0%	2.7%	6.8%	11.5%	4.5%	5.0%
ROAE (%) *	15.8%	7.2%	17.4%	29.8%	12.1%	12.9%

*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					
	07/10/2024	A+	A-1	Stable	Reaffirmed	
	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.					
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 Meeting Conducted	Name	Designation			Date	
	Mr. Abdul Sattar	Chief Financial Officer			Aug 08, 2024	
	Mr. Muhammad Imran	Head of Accounts & Finance			Aug 08, 2024	