RATING REPORT

Sadaqat Limited

REPORT DATE:
July 19, 2019

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-2	A	A-2
Rating Date	*18 Jul'19*		*23 Feb'18*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	

COMPANY INFORMATION

Incorporated in 1987	**External auditors:** EY Ford Rhodes Chartered Accountants
Public Limited Company	**Chairman:** Mr. Mukhtar Ahmed **Chief Executive Officer:** Mr. Khurram Mukhtar
Key Shareholders (with stake 5% or more):	
Mr. Khurram Mukhtar- 24.6%	
Mr. Hamid Mukhtar- 24.6%	
Mr. Awais Mukhtar- 24.6%	
Mr. Shoaib Mukhtar- 24.6%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (May 2019)
http://www.vis.com.pk/kc-meth.aspx

Sadaqat Limited

OVERVIEW OF THE INSTITUTION

Sadaqat Limited was incorporated in 1987 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017) as a private limited company. It was subsequently converted into public limited company in 2008. SL is an export-oriented textile unit, involved in manufacturing and sale of home textile products.

Profile of Chairman

Sheikh Mukhtar Ahmed is the Chairman of SL. He has almost 47 years of experience in the field of textile.

Profile of CEO

Mr. Khurram Mukhtar holds the position of CEO and is responsible for supervision of all divisions of the company.

Financial Snapshot

Tier-1 Equity: end-1HFY19: Rs. 6.4b; end-FY18: Rs. 5.7b; end-FY17: Rs. 4.6b.

Assets: end-1HFY19: Rs. 19.8b; end-FY18: Rs. 17.0b; end-FY17: Rs. 14.8b.

Profit After Tax: end-1HFY19: Rs. 0.70b; end-FY18: Rs. 1.1b; end-FY17: Rs. 0.47b.

RATING RATIONALE

Sadaqat Limited (SL) is one of the well-known value-added textile units operating from Faisalabad. SL is mainly involved in manufacturing and export of a wide range of home textile products and holds nearly 5% - 7% market share of annual bed ware exports. The assigned ratings take into experience of sponsoring family in the textile industry, growth in sales and profits, and further enhancement in production capabilities. Being primarily an export oriented company, recent rupee devaluation also bodes well for the profitability. The ratings also take into account adequate debt service coverage and liquidity profile as well as maintenance of gearing and debt leverage indicators.

Key Rating Drivers

Strengthening of corporate governance framework

The shareholding structure remained the same during FY18, though the sponsors intend to offload 12.5% - 15% equity stake through an IPO by end of FY20 to support the expansion plan. Mr. Mukhtar Ahmed is the Chairman of the Board of Directors (BoD) of seven members while Mr. Khurram Mukhtar serves as the CEO. The composition has changed as Mr. Muhammad Ijaz and Mr. Imran Noormohmed Kovariwala resigned from the BoD, whereas Ms. Maleeha Bangash and Mr. Syed Ahmad Ashraf joined as the Independent Directors. The BoD maintains its oversight through four BoD committees, namely Audit Committee, Human Resource & Remuneration Committee, Risk Management Committee and Nomination Committee.

The Audit Committee comprises 3 members. During FY18, four meetings were held and the members deliberated on the audit plan, internal audit reports, effectiveness of internal control environment, and business risk and mitigation strategies. The Human Resource & Remuneration Committee comprises 3 members who met on a quarterly basis during FY18 to approve the departmental strength and employees training programs. The committee also reviewed employee appraisals, pay grades and succession planning system. During FY18, none of the directors attended any training program from institutes approved by the Securities & Exchange Commission of Pakistan (SECP), however, the company has planned to conduct in-house SECP's Directors' training program during FY20.

SL plans to continue expansion strategy

SL's operations are sub-divided into processing, stitching, quilting, wadding and embroidery. During FY18, the company further enhanced production capacity by adding bleaching range, stenter machines and steam boiler. Resultantly, overall processing capacity of the company increased to 78m meters per annum (FY17: 72m; FY16: 72m). With the higher production during FY18, the capacity utilization of processing segment improved to 94% (FY17: 90%; FY16: 90%). The capex in automation of processing unit is expected to yield cost efficiencies, going forward.

The hemming units are not only equipped with high-speed precision stitching machines but also supported by Smart MRT Hanger system that helps manage workflow on a real-time basis. In addition, the company has automatic cut to sew TEXPA machines as a part of its cut & sew facility. SL made further capex in automatic cutting, stitching and folding machines to enhance production and cost efficiencies of stitching segment. Thereby, overall production capacity of stitching segment, including manual TEXPA machines, increased to 7.5m meters per month (FY17: 4.9m pieces per month; FY16: 4.0m pieces per month). The actual capacity utilization of stitching segment ranged between 80% and 90% during FY18.

SL also has single and multi-needle quilting lines, wadding plant, precision controlled and high-speed quilt & pillow fillings, and computerized as well as hand-guided setups for embroidery. The production capacity of single and multi-needle quilting stood at 65,000 pieces per month and 18,000 meters per month (FY17: 130,000 pieces per month and 36,000 meters per month; FY16: 200,000 pieces per month and 50,000 meters per month) respectively. Similarly, the production capacity of computerized embroidery segment maintained to 5.6m stitches per day (FY17: 5.6m; FY16: 13.0m).

SL is executing a plan of incurring a capital expenditure of Rs. 1.9b during FY19 (FY20: Rs. 1.1b) to enhance the scale of operations, out of which Rs. 505m has been incurred during 1HFY19. The major portion of the said capex has been allocated for setting up garments manufacturing and knitting segments. The first phase of garment segment having production capacity of 10,000 pieces per day is expected to be completed by end-FY19. Upon completion of second phase during FY20, the production capacity of garment segment will reach 25,000 pieces per day. The cost of completion of both phases is estimated at Rs. 1.6b. The knitting segment will be completed in a single phase at an estimated cost of Rs. 638m and will have production capacity of Rs. 10,000 kg per day. In addition, SL will also enhance the production capacity of wadding, quilting and stitching segments and will invest in solar power facility of 1MW during FY20.

Increasing share of current assets in overall asset mix

SL augmented its assets base to Rs. 19.8b by end-1HFY19 (FY18: Rs. 17.0b; FY16: Rs. 14.8b). Fixed assets amounted to Rs. 9.1b (FY18: Rs. 8.7b; FY17: Rs. 8.4b) as the company made capex of Rs. 100m on building, Rs. 144m in garment & processing machines, Rs. 112m in stitching machines, and Rs. 97m in vehicles during 1HFY19. During FY18, SL enhanced its processing and stitching capabilities by making a capex Rs. 0.38b in plant & machinery (FY17: 1.3b; FY16: 0.93b), and Rs. 0.46b in building to enhance the scale of operations. The proportion of fixed assets in overall asset mix decreased to 46% by end-1HFY19 (FY18: 51%; FY17: 57%) owing to considerable increase in current assets.

In line with the growing scale of operations, stock in trade was recorded higher at Rs. 3.6b at end-1HFY19 (FY18: Rs. 3.1b; FY17: Rs. 2.9b). Stock in trade as a percentage of annualized net sales remained largely stable at 18.9% at end-1HFY19 (FY18: 20.4%; FY17: 26.4%) while its share in overall asset mix increased slightly to 18.1% (FY18: 18.0%; FY17: 19.4%). In line with the growing scale of operations, trade debts stood higher at Rs. 4.2b at end-1HFY19 (FY18: Rs. 2.6b; FY17: Rs. 1.6b). Trade debts as a percentage of annualized net sales increased to 21.9% by end-1HFY19 (FY18: 17.0%; FY17: 14.7%) partially due to rupee devaluation. Loans and advances, which mainly comprised loan to associated undertaking and advances to executives and employees, decreased to Rs. 267m by end-1HFY19 (FY18: Rs. 602m; FY17: Rs. 469m) mainly on account of reduction in advances to suppliers. The balance with the statutory authorities accumulated to Rs. 1.3b (FY18: Rs. 1.1b; FY17: Rs. 0.45b) mainly on account of increase in drawback of local taxes and levies (DLTL) due to lower claims lodged during 1HFY19. Similarly, tax refund due from the government comprising income and sales tax amounted to Rs. 519m (FY18: Rs. 402m; FY17: Rs. 606m). Cash & bank balance increased to Rs. 248m (FY18: Rs. 198m; FY17: Rs. 108m) by end-1HFY19.

Sizeable growth in sales and profitability on the back of volumetric growth and favorable pricing

Gross sales of the company for FY18 increased to Rs. 15.2b (FY17: Rs. 11.1b; FY16: Rs. 11.6b) mainly on account of higher exports of Rs. 15.0b (FY17: Rs. 11.0b; FY16: Rs. 11.4b). Local sales were also reported modest at Rs. 170m (FY17: Rs. 129m; FY16: Rs. 169m). The increase in exports is attributable to higher article sales of Rs. 27.6m during FY18 (FY17: Rs. 20.4m; FY16: 21.2m) and average selling price of Rs. 544 per article (FY17: Rs. 539 and FY16: Rs. 548). Customer concentration was recorded on the higher side as top-10 customers accounted for 83% (FY17: 79%) of export sales during FY18. The regional sales mix changed slightly and the share of Europe in total exports increased to 59% (FY17: 52%), whereas the proportion of the U.S., Asia and Africa decreased to 24%, 6% and 2% (FY17: 26%; 9% and 4%) respectively. Net sales amounted to Rs. 15.0b (FY17: Rs. 10.9b; FY16: Rs. 11.4b).

Cost of sales also increased to Rs. 12.3b (FY17: Rs. 9.2b; FY16: Rs. 9.4b) on the back of higher production activity and input costs. Cost of raw materials consumed was recorded higher at Rs. 8.0b (FY17: Rs. 6.7b) mainly on account of increase in production levels and slightly higher grey fabric purchase price of Rs. 117 per meter (FY17: Rs. 115 per meter). Similarly, cost of store & spares consumed amounted to Rs. 2.2b during FY18 (FY17: Rs. 1.7b) as the average purchase price of dyes & chemicals increased to Rs. 161 per kg (FY17: Rs. 132 per kg). With the increase in average number of employees to 5,574 (FY17: 5,128) and inflationary pressure, the expense against salaries, wages & benefits was recorded higher at Rs. 1.2b during FY18 (FY17: Rs. 0.94b). Fuel & power and conversion & processing charges amounted higher at Rs. 560m and 431m (FY17: 457m and 298m), respectively. Gross profits were recorded higher at Rs. 2.7b during FY18 (FY17: Rs. 1.7b; FY16: Rs. 2.0b) on the back of higher sales and improved gross margins of 18.2% (FY17: 15.5%; FY16: 17.5%).

The selling & distribution expenses increased to Rs. 489m during FY18 (FY17: Rs. 338m; FY17: Rs. 346m), with increase mainly emanating from higher clearing & forwarding and sales promotion expenses. Similarly, administration expenses amounted higher at Rs. 757m (FY17: Rs. 502m; FY16: Rs. 477m) owing to sizeable increase in staff salaries & benefits, utilities and vehicle running & maintenance expenses. Other income stood at Rs. 250m (FY17: Rs. 150m; FY16: Rs. 167m) as the company recorded unrealized gain on derivative financial instruments of Rs. 41m (FY17: nil) and net exchange gain of Rs. 196m (FY17: Rs. 102m). Meanwhile, the increase in finance cost of Rs. 441m (FY17: Rs. 396m; FY16: Rs. 459m) was mainly due to higher utilization of short-term borrowings during FY18. Accounting for tax expense of Rs. 144m, SL recorded profit after tax of Rs. 1.1b during FY18 (FY17: Rs. 0.47b; FY16: Rs. 0.76b) with improved net margins of 7.2% (FY17: 4.3%; FY16: 6.7%). Resultantly, the ROAA and ROAE were recorded higher at 6.8% and 21.0% (FY17: 3.6% and 10.9%; FY16: 7.3% and 20.9%), respectively.

SL reported net sales of Rs. 9.6b during 1HFY19 against the full-year target of Rs. 19.4b. Gross and net profits amounted to Rs. 1.4b and Rs. 0.70b with lower margins of 15.0% and 7.3%, respectively. Going forward, the company is projecting its sales to grow at a CAGR of 23% through FY21. Despite slight weakness in gross margins, bottom-line of the company is expected to augment on the back of sizeable growth in sales.

Adequate liquidity and improving cash flows generation

SL generated Rs. 1.4b in funds from operations (FFO) (FY17: Rs. 1.1b; FY16: Rs. 1.0b) mainly on the back of notable increase in profits during FY18. The improved cash flows generation underpinned the company's capacity to timely meet its financial obligations, as depicted by slightly higher FFO to long-term debt and FFO to total debt ratios of 1.18x and 0.21x (FY17: 0.69x and 0.17x), respectively. Similarly, the debt service coverage ratio (DSCR) improved to 2.13x in FY18 (FY17: Rs. 1.79x; FY16: 2.20x). Going forward, the coverages are projected to improve further on account of expected uptrend in FFO generation.

Trade debts of the company increased to Rs. 2.6b by end-FY18 (FY17: Rs. 1.6b; FY16: Rs. 1.9b), of which 97.7% were due from the foreign customers and 2.3% from the local customers. The secured foreign receivables stood higher at Rs. 2.2b at end-FY18 (FY17: Rs. 57m), whereas unsecured decreased to Rs. 295m (FY17: Rs. 1.5b). The aging analysis shows that only 2.9% of total receivables were past due 3 months, as of June 30, 2018. The current ratio was recorded at 0.99x at end-FY18 (FY17: 0.92x; FY16: 1.04x) as the impact of increase in short-term borrowings and trade & other payables was offset by higher stock in trade, receivables and balance with the statutory authorities. Similarly, the stock in trade plus receivables to short-term borrowings ratio remained largely stable at 0.99x at end-FY18 (FY17: 0.97x; FY16: 1.05x), which is in line with the company's working capital management strategy. During FY18, the cash conversion cycle of the company improved to 95 days, mainly on account of lower inventory days.

Capital expenditure plan to be funded through the mix of borrowings, internal capital generation and IPO proceeds, going forward

Core equity of the company augmented to Rs. 6.4b by end-1HFY19 (FY18: Rs. 5.7b; FY16: Rs. 4.6b) with the continued retention of profits, whereas revaluation surplus amounted to Rs. 2.0b (FY18: Rs. 2.1b; FY17: Rs. 2.1b). SL utilizes a mix of short-term and long-term borrowings to fund its working capital and capex requirements. The outstanding balance of short-term borrowings increased to Rs. 6.8b by end-1HFY19 (FY18: Rs. 5.7b; FY17: Rs. 4.6b) mainly on account of elevated working capital requirements due to growing operations and rupee devaluation. The long-term borrowings, including current portion, amounted to Rs. 1.3b at end-1HFY19 (FY18: Rs. 1.2b; FY17: Rs. 1.6b). With the increase in total borrowings to Rs. 8.2b (FY18: Rs. 6.9b; FY17: Rs. 6.2b) and total liabilities to Rs. 11.3b (FY18: Rs. 9.2b; FY17: Rs. 8.1b), the gearing and debt leverage indicators stood slightly higher at 1.27x and 1.77x at end-1HFY19 (FY18: 1.20x and 1.61x; FY17: 1.36x and 1.77x).

SL has a plan to invest Rs. 2.5 b to enhance its production capabilities during FY20 and FY21. As per the management, the investment in machinery will be funded by the SBP's Long Term Financing Facility (LTFF), while the acquisition of land, building and import incidental will be funded through internal capital generation and proceeds from the IPO amounting approx. Rs. 1.5b ~ 2b. The unutilized LTFF limit in hand at end 1HFY19 and further loan is expected to be mobilized during the ongoing year. Given the company's current funding plan and expected IPO timeline, the leverage indicators is likely to remain around current levels by end-FY19, before improving during FY20.

Sadaqat Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**1HFY19**
Non-Current Assets	5,878	8,435	8,722	9,092
Stores, Spares. And Loose Tools	283	193	212	428
Stock-in-Trade	2,044	2,879	3,060	3,588
Trade Debts	1,861	1,600	2,557	4,152
Balances With Statutory Authorities	149	446	1,094	1,343
Tax Refund Due From Government	663	606	402	519
Other Current Assets	369	653	948	647
Total Assets	**11,247**	**14,810**	**16,995**	**19,769**
Trade and Other Payables	974	1,758	2,166	2,925
Other Liabilities	74	139	133	255
Short-Term Borrowings	3,734	4,638	5,678	6,837
Long-Term Borrowings *(Inc. current matur)*	1,185	1,561	1,223	1,322
Total Liabilities	5,967	8,096	9,200	11,338
Tier-1 Equity	**4,053**	**4,571**	**5,732**	**6,405**
Revaluation Surplus	1,227	2,143	2,063	2,026
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**1HFY19**
Net Sales	11,420	10,893	15,023	9,499
Gross Profit	1,998	1,683	2,735	1,423
Operating Profit	1,125	765	1,417	628
Profit After Tax	763	469	1,081	696
FFO	1,034	1,076	1,448	554
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**1HFY19**
Gross Margin (%)	17.5	15.5	18.2	15.0
Net Working Capital	219	(547)	(69)	278
FFO to Long-Term Debt	0.87	0.69	1.18	0.84*
FFO to Total Debt	0.21	0.17	0.21	0.14*
Debt Servicing Coverage Ratio (x)	2.20	1.79	2.13	n.a
ROAA (%)	7.3	3.6	6.8	7.6
ROAE (%)	20.9	10.9	21.0	22.9
Gearing (x)	1.21	1.36	1.20	1.27
Debt Leverage (x)	1.47	1.77	1.61	1.77
Inventory + Receivable/Short-term Borrowings (x)	1.05	0.97	0.99	1.13

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure 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 — Annexure III

Name of Rated Entity	Sadaqat 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				
07/18/2019	A	A-2	Stable	Reaffirmed
02/23/2018	A	A-2	Stable	Reaffirmed
12/27/2016	A	A-2	Stable	Upgrade
12/31/2015	A-1	A-2	Stable	Reaffirmed
01/01/2015	A-1	A-2	Stable	Reaffirmed
04/23/2013	A-1	A-2	Stable	Reaffirmed
3/16/2012	A-1	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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