RATING REPORT

Sadaqat Limited

REPORT DATE:
February 03, 2020

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
TFC (Preliminary)	A		-	
Rating Outlook	*Stable*		*Stable*	
Rating Date	*29 Jan'20*		*18 Jul'19*	

COMPANY INFORMATION	
Incorporated in 1987	**External auditors:** EY Ford Rhodes Chartered Accountants
Public Limited (Unlisted) Company	**Chairman:** Sheikh 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Sadaqat Limited was incorporated in 1987 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017) as a private limited company.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 textiles.

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-1QFY20: Rs. 7.1b; end-FY19: Rs. 7b; end-FY18: Rs. 5.7b.

Assets: end-1QFY20: Rs. 22b; end-FY19: Rs. 21.5b; end-FY18: Rs. 17b.

Profit After Tax: end-1QFY20: Rs. 397m; end-FY19: Rs. 1.3b; end-FY18: Rs. 1.1b.

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 account experience of sponsoring family in the textile industry, healthy growth in sales and profits on account of higher demand for existing made-ups and addition of new garments and knitting capacities. Being primarily an export oriented company, rupee devaluation has positively impacted profitability. The ratings also take into account adequate debt service coverage and liquidity profile, however, debt leverage has increased due to higher trade & other payables and increased utilization of debt for working capital and capex requirements despite enhanced equity base.

Key Rating Drivers

Growth in assets continue to emanate from addition of new production capacities and capabilities
SL has doubled its asset base in the past four years by adding new production capacities. Total assets increased to Rs. 22b by end-1QFY20 (FY19: Rs. 21.5b; FY18: Rs. 17b), of which 47% were fixed assets (FY19: 46%; FY18: 51%). Property, plant and equipment amounted to Rs. 10.2b (FY19: Rs. 9.5b; FY18: Rs. 8.5b) as the company made capex including work in progress of Rs. 652m during 1QFY20 (FY19: Rs. 1.6b; FY18: Rs. 839m). During FY19, construction of building was partially completed and Rs. 674m were transferred from work-in-progress. The said building is being used for circular knitting and dying unit for the manufacturing of knitted fabric.

During FY19, capex on plant and machinery amounted to Rs. 872m and mainly pertained to woven (denim/non-denim) and knitted garment manufacturing units, having production capacity of 10,000 pieces per day and 10 tons per day, respectively. The company has recently increased garments capacity to 15,000 pieces per day and circular kitting capacity to 15 tons per day. New land has also been purchased alongside the existing land for further expansion plan. Long-term advances amounting Rs. 251m at end-FY19 (FY18: Rs. 123m) pertained to purchase of land and work-in-progress. Intangible and long-term deposits amounted to Rs. 30m (FY19: Rs. 45m; FY18: Rs. 27m) and Rs. 21m (FY19: Rs. 25m; FY18: Rs. 23m) respectively.

Stores, spare and loose tools decreased to Rs. 327m (FY19: Rs. 389m; FY18: Rs. 212m). The increase in stores, spares, and loose tools during FY19 was due to civil work on building and garments and knitting unit. In line with the growing scale of operations, stock in trade increased to Rs. 4.5b by end-1QFY20 (FY19: Rs. 4.1b; FY18: Rs. 3b), while stock in trade as a percentage of annualized sales stood at 18% (FY19: 20.8%; FY18: 20.4%). Raw material amounted to Rs. 1.6b (FY18: Rs. 1b), work in progress was Rs. 1.5b (FY18: Rs. 1b), finished goods were Rs. 966m (FY18: Rs. 976m), and waste material was Rs. 33m (FY18: 45m) at end-FY19. Trade debts stood at Rs. 4.9b at end-1QFY20 (FY19: Rs. 4.9b; FY18: 2.6b), as increase was mainly due to devaluation of rupee. Trade debts to annualized sales ratio stood at 19.7% at end-1QFY20 (FY19: 25.1%; FY18: 17%). The ratio increased during FY19 as the company deliberately accumulated receivables from customers to benefit from rupee devaluation. Loans and advances were recorded lower at Rs. 202m (FY19: Rs. 226m; FY18: Rs. 602m) on account of decrease in advances to suppliers and loan received from an associated concern.

Balance with the statutory authorities related to taxes & duty drawback and rebates was Rs. 1.2b (FY19: Rs. 1.2b; FY18: Rs. 1.1b). During FY19, the company received Rs. 503m (FY18: Rs. 282m) against duty drawback on taxes and Rs. 126m (FY18: Rs. 64m) against drawback of customs-duty. Fresh claims filed for duty drawback on taxes amounted to Rs. 626m during FY19 (FY18: Rs. 895m) and drawback on customs-duty of Rs. 173m (FY18: Rs. 100m). Sales and income tax refundable from government remained at Rs. 421m at end-1QFY20 (FY19: Rs. 423m; FY18: Rs. 402m). Short-term investment stood lower at Rs. 50m (FY19: Rs. 140m; FY18: Rs. 50m) owing to encashment of government bond – refund payment order of Rs. 90m. Cash and bank balance amounted to Rs. 135m at end-1QFY20 (FY19: Rs. 131m; FY18: Rs. 198m).

Sizeable growth in sales and profitability on the back of volumetric growth and favorable pricing
Net sales of the company increased by 31% to Rs. 19.6b during FY19 (FY18: Rs. 15b; FY17: Rs. 10.9b), driven by higher exports volumes of made-ups and selling price. Growth mainly emanated from Europe as made-ups exports to the U.K. increased to Rs. 11.7b (FY18: Rs. 8.7b), Spain Rs. 1.8b (FY18: Rs. 1.2b), and Germany Rs. 899m (FY18: Rs. 690m). Exports to Australia also increased to Rs. 1.1b during FY19 (FY18: Rs. 278m). SL reported slightly higher gross profit of Rs. 2.8b during FY19 (FY18: Rs. 2.7b; FY17: Rs. 1.7b). Exchange gain on sales amounting to Rs. 1.1b (FY18: Rs. 196m) was classified in other income, whereas exchange loss on imported raw material was classified in cost of sales, which resulted in lower gross margin of 14.1% during FY19 (FY18:

18.2%; FY17: 15.5%).

Selling and distribution expenses increased to Rs. 615m during FY19 (FY18: Rs. 489m; FY17: Rs. 338m) mainly on account of higher staff salaries, promotional spending, freight and clearing and forwarding charges. Administrative expenses also increased to Rs. 991m (FY18: Rs. 757m; FY17: Rs. 502m) mainly due to higher staff salaries and depreciation charge. Other operating expenses amounted to Rs. 147m (FY18: Rs. 72m; FY17: Rs. 78m) due to recognition of Rs. 16m in provision for expected credit losses, Rs. 14m in provision for doubtful recoveries, Rs. 18m in unrealized exchange loss as well as increase in provision of workers' participation fund to Rs. 80m (FY18: Rs. 65m). Therefore, operating income was recorded lower at Rs. 1b (FY18: Rs. 1.4b). The increase in finance cost to Rs. 639m (FY18: Rs. 441m; FY17: Rs. 396m) was due to higher interest rates and increase in average utilization of debt. Despite lower operating income and higher financial charges, the company registered increase in bottom line on the back of higher other income, which increased significantly to Rs. 1.1b (FY18: Rs. 250m; FY17: Rs. 150m) mainly due to exchange gain on rupee devaluation. SL reported net profit of Rs. 1.3b for FY19 (FY18: Rs. 1.1b; FY17: Rs. 469m), though net margin was slightly lower at 6.8% (FY18: 7.2%; FY17: 4.3%).

SL reported net sales of Rs. 6.2b during 1QFY20 on account of higher volumetric exports and improved selling price. Other income arising from exchange gain was Rs. 115m. Gross and net profits amounted to Rs. 1b and Rs. 0.4b as with gross and net margins of 17.1% and 6.4%, respectively.

Adequate liquidity position underpinned by stable cash flows generation

Liquidity profile of the company remained largely stable. Despite higher profit before tax, funds from operations (FFO) remained at Rs. 1.5b during FY19 (FY18: Rs. 1.5b; FY17: Rs. 1.1b) owing to relatively higher tax and WPPF payment. FFO to long-term debt and FFO to total debt ratio stood slightly lower at 0.95x (FY18: 1.22x; FY17: 0.69x) and 0.17x (FY18: 0.22x; FY17: 0.17x) at end-FY19 due to increase in debt. The debt service coverage ratio stood at 2.09x during FY19 (FY18: 2.18x; FY17: 1.79x), which depicts adequate capacity of the company to meet its financial obligations. Current ratio improved marginally to 1.03x (FY18: 0.99x; FY17: 0.92x) as net working capital turned positive to Rs. 351m. Cash conversion cycle increased marginally to 86 days (FY18: 80 days; FY17: 101 days) as the impact of reduction in inventory days 77 (FY18: 88 days; FY17: 98 days) due to supply chain and production efficiencies was offset by increase in sales days outstanding to 70 days (FY18: 51 days; FY17: 58 days).

Slight increase in leverage indicators despite growth in equity owing to continuation of expansion plan

Total liabilities increased to Rs. 12.9b by end-1QFY20 (FY19: Rs. 12.5b; FY18: Rs. 9.2b). Trade and other payables stood at Rs. 3.8b at end-1QFY20 (FY19: Rs. 3.4b; FY18: Rs. 2.2b) as a result of increase in production, some delayed payments to suppliers, higher accrued liabilities, and increased provision for bonus and provident fund payable. Accrued markup amounted to Rs. 115m (FY19: Rs. 123m; FY18: Rs. 63m). Outstanding balance of short-term borrowings stood at Rs. 7.3b at end-1QFY20 (FY19: Rs. 7.3b; FY18: Rs. 5.7b) due to elevated working capital needs of the company. Long-term debt amounted to Rs. 1.6b (FY19: Rs. 1.6b; FY18: Rs. 1.2b) as the company availed long-term finance facility (LTFF) to fund the capex. Tier-1 equity of the company augmented to Rs. 7.1b by end-1QFY20 (FY19: Rs. 7b; FY18: Rs. 5.7b) with the retention of profits. The company issued bonus shares worth Rs. 1.2b thereby increasing its paid-up capital while cash dividend amounting Rs. 120m was also paid during FY19. Revaluation surplus on fixed assets remained at Rs. 2b (FY19: Rs. 2b; FY18: Rs. 2b). With increase in borrowings, nominal increase was witnessed in gearing and debt leverage at 1.26x (FY19: 1.26x; FY18: 1.2x) and 1.83x (FY19: 1.78x; FY18: 1.61x) respectively, by end-1QFY20.

SL is in process of issuing TFC in place of Sukuk as an instrument of redeemable capital of up to Rs. 1.5b for a tenor of 5 years from the issue date, inclusive of grace period of 1 year. The instrument will carry profit rate of 3-month KIBOR (Base Rate) plus a spread of 225 bps. The proceeds from the issue will be utilized for the company's expansion in garment and knitting segment by addition of new production facilities. The underlying issue will be secured by hypothecation charge on all present and future current and fixed assets (excluding land and building) of SL on an aggregate basis amounting Rs 2b. The ranking equitable mortgage over immovable properties of the company will be upgraded to pari passu charge within a period of 180 days of the issue, through a joint pari passu charge structure. The aforesaid securities will collectively have a margin of 25% over the issue amount. Although the TFC issuance will increase debt burden, the leverage indicators are projected to remain around current levels on the back of expanding equity base.

Sadaqat Limited — Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**1QFY20**
Property, Plant and Equipment	8,379	8,548	9,540	10,185
Long-term Advances	1	123	251	-
Other Fixed Assets	55	50	70	51
Stores, Spares. And Loose Tools	193	212	389	327
Stock-in-Trade	2,879	3,060	4,088	4,452
Trade Debts	1,600	2,557	4,933	4,850
Balances With Statutory Authorities	446	1,094	1,235	1,218
Tax Refund Due From Government	606	402	423	421
Loans and Advances	469	602	226	202
Short-term Investment	-	50	140	50
Cash and Bank Balance	108	198	131	135
Other Current Assets	74	98	95	70
Total Assets	**14,810**	**16,995**	**21,521**	**21,961**
Trade and Other Payables	1,758	2,166	3,440	3,772
Other Liabilities	139	133	235	204
Short-Term Borrowings	4,638	5,678	7,264	7,297
Long-Term Borrowings *(Inc. current matur)*	1,561	1,223	1,574	1,644
Total Liabilities	8,096	9,200	12,513	12,917
Tier-1 Equity	**4,571**	**5,732**	**7,015**	**7,074**
Revaluation Surplus	2,143	2,063	1,992	1,970
Paid-up Capital	1,200	1,200	2,400	2,400
INCOME STATEMENT	**FY17**	**FY18**	**FY19**	**1QFY20**
Net Sales	10,893	15,023	19,618	6,152
Gross Profit	1,683	2,735	2,769	5,103
Operating Profit	765	1,417	1,016	1,049
Profit Before Tax	518	1,226	1,501	453
Profit After Tax	469	1,081	1,333	397
FFO	1,076	1,489	1,493	281
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**	**1QFY20**
Gross Margin (%)	15.5	18.2	14.1	17.1
Net Margin (%)	4.3	7.2	6.8	6.4
Net Working Capital	(547)	(69)	351	166
FFO to Long-Term Debt	0.69	1.22	0.95	0.68*
FFO to Total Debt	0.17	0.22	0.17	0.13*
Debt Servicing Coverage Ratio (x)	1.79	2.18	2.09	n.a
Gearing (x)	1.36	1.20	1.26	1.26
Debt Leverage (x)	1.77	1.61	1.78	1.83
Current Ratio	0.92	0.99	1.03	1.01
Inventory + Receivable/Short-term Borrowings (x)	0.97	0.99	1.24	1.27

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITION 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	Instrument 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-	A-2	Stable	Reaffirmed
	01/01/2015	A-	A-2	Stable	Reaffirmed
			RATING TYPE: TFC		
	12/13/2019	A		Stable	Preliminary
Instrument Structure	The proposed TFC is of amount Rs. 1.5b. Tenor of TFC will be 5 years, including grace period of 1 year. TFC will be redeemed in 8 equal semiannual installments. The issuer would have an option to prepay the issue amount after the expiry of the grace period with thirty days prior written irrevocable notice to the trustee/issue agent in multiples of Rs. 250m. The instrument will carry profit rate of 3-month KIBOR (Base Rate) plus a spread of 225 bps. Profit will be payable quarterly in arrears. The underlying issue will be secured by hypothecation charge on all present and future current and fixed assets (excluding land and building) of SL on an aggregate basis amounting Rs 2b. The ranking equitable mortgage over immovable properties of the company will be upgraded to pari passu charge within a period of 180 days of the issue, through a joint pari passu charge structure. The aforesaid securities will collectively have a margin of 25% over the issue amount.				
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.				
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2020 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				
Due Diligence Meetings Conducted	**Name**	Designation	Date		
	Mr. Hmmayun Shahzad	CFO	24/01/2020		