RATING REPORT

Sadaqat Limited

REPORT DATE:
June 22, 2022

RATING ANALYST:

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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-2	A	A-2
TFC	A		A	
Rating Outlook	*Stable*		*Positive*	
Rating Date	*23, May'22*		*24, Jun'21*	
Rating Action	*Maintain*		*Maintain*	

COMPANY INFORMATION	
Incorporated in 1987	**External auditors:** Kreston Hyder Bhimji & Co Chartered Accountants
Public Unlisted Company	**Chairman:** Sheikh Mukhtar Ahmed
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Khurram Mukhtar
Mr. Hamid Mukhtar ~ 24.6%	
Mr. Awais Mukhtar ~ 24.6%	
Mr. Shoaib Mukhtar ~ 24.6%	
Mr. Khurram Mukhtar ~ 14.6%	
Mr. Hamza Mukhtar ~ 10.0%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (August 2021)*
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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Sadaqat Limited was incorporated in 1987 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017) as a private limited company.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 and woven & knitted apparels.

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.

RATING RATIONALE

Sadaqat Limited (SL) is one of the well-known value-added textile units operating in the country's textile hub, Faisalabad for more than three decades. At present, the company's textile operations encompass processing (bleaching, dyeing, and printing), knitting, and stitching and export of majorly home-textile products followed by knitted apparels and denim and non-denim woven garments. Major products of the Company include bedsheets, fitted sheets, duvet set, duvet cover, quilt covers, pillow cases, comforters, cushions, curtains, kitchenware and towels. SL is an export oriented company with export sales contribution of around 98%.

Power requirement of 13.2MW is met through four sources; national grid (FESCO), 9 Gen-Sets, 2 diesel backed generators and has lately installed 1MW solar power plant. The efficient energy mix provides a competitive edge to Company.

Historically, the Company has been operating at high capacity utilization levels and the trend continues barring FY20 due to covid-19 induced slowdown.

Key Rating Drivers:

Positive industry outlook provides support to the business risk profile of the Company. However, the onset of monetary tightening regime and increasing cost of doing business is expected to impact, specifically, the leveraged textile players operating profits.

The growth momentum in textile led exports continued in the ongoing year, with textile exports registering a growth of 26% during 8MFY22 to stand at USD12.6b. Key export driver has been increase in value-added exports where knitwear segment contributed the most, followed by ready-made garments and Bed wear. Favorable Government policies for enhancing exports bode well for the sector. The margins of textile operators have broadly depicted improvement despite the uptick in raw material, given, that the same was offset by exchange rate movements. Nevertheless, higher raw material cost has increased the working capital requirements for textile operators and the increase in finance cost via rising interest rates is likely to weigh on the liquidity of the textile players. VIS expects the order book for the industry to remain strong in the on-going year along with transfer of orders from neighboring countries. Furthermore, the continuation of GSP+ status will continue to provide support as well. In addition, given the increase in textile demand, the industry is currently operating at high capacity and going through expansion and up-gradation to cater for additional demand.

USDmn	8MFY22	YoY
Cotton Cloth	1,584	28%
Other basic	865	38%
Basic Textile	**2,449**	**31%**
Knitwear	3,302	34%
Bed wear	2,186	20%
Towels	716	17%

Ready Garments	2,517	25%
Value-added	8,721	26%
Other Textile	1,437	17%
Total Textile Exports	**12,607**	**26%**

Source: Pakistan Bureau of Statistics

Undergoing business integration project to contribute towards operational efficiencies. Planned IPO during FY23 is expected to provide some support to financing requirements.

The Company has rolled out a CAPEX plan to expand business backwards into spinning and weaving segment to enhance operational efficiencies. SL is in the process of installing 29,184 spindles ring frame & 480 spindles MVS in spinning and 132 Air jet looms in weaving segment. Previously, the Company undertook capex of Rs. 2.1b in FY20 to expand knitting facility.

The total estimated project cost for backward integration is Rs. 8.2b with debt to equity ratio of 60:40. The debt funding majorly encompasses borrowings on concessionary rate through TERF/LTFF facility. Weaving operations entail cost of around Rs. 3.04b and is expected to commence operations with the onset of FY23 and fulfill 17% of the in-house requirement. Spinning operations, entailing cost of Rs. 5.2b, is expected to commence operations from mid-FY23 and would meet around one-fifth of the in-house requirement for yarn. The remaining project cost, after availing debt, is around Rs. 3.46b and will be arranged through internal cash flows, equity injection from sponsors and expected IPO proceeds. The materialization of expected IPO is considered important to avert any liquidity pressure on the Company.

In the long run, margins are expected to improve on account of reduced cost of production with reduced dependency upon outsourced suppliers with the commencement of spinning and weaving segment.

Significant uptick in revenues on account of volumetric growth.

Net Sales of the Company grew significantly by 61.8% to stand at Rs. 32.9b (FY20: Rs. 20.3b) on account of volumetric growth coupled with increased sales from expansion within knitting facility. Product mix exhibits home textile made ups contributing around 90% of the sales, followed by knitted apparel (7%) and garments (3%). Margins vary from product to product and from customer to customer as well, with the Company tailoring its product specifications according to the selling prices offered by its clients. Gross margins depicted improvement to clock in at 20.0% (FY20: 17.9%; FY19: 14.1%; FY18: 18.2%) due to enhanced efficiency, automation and processing ability coupled with higher utilization level. It is also pertinent to note that the decline in margins during past two fiscal years (FY19 and FY20) was majorly contributed by cost associated with sizable capex incurred. SL has set up an e-commerce entity in UK by the name Sadaqat global to enable sales within European market. Operating expenses jumped drastically on account of higher selling and distribution expense, coupled with exchange loss faced by the Company. Overall, the volumetric growth in sales boosted the profitability to Rs. 1.4b (FY20: Rs. 512m) in FY21.

Growth trend in revenue continued during 1H'FY22 with sales increasing to Rs. 18.6b. The positive momentum in sales is attributable to increase in volumes amid higher demand for home textile made-up given Covid-19 times necessitates high maintenance of hygiene and frequent use of home textile accessories. While Gross margins reduced to 17.5% incorporating impact of reduction in duty drawback along with rising coal prices leading to higher energy charges and transportation cost. The Company recorded Net Profit of Rs. 751.4m in H'FY22. Going forward, sales revenue is targeted to reach Rs. 38b by the year-end FY22 on the back of healthy orders booked for the ongoing fiscal year and growth in profitability is expected to be a function of volumetric increase in sales.

Of total exports, around two-fourth is concentrated in UK followed by Germany, Belgium, Italy/Spain, USA and Australia. In addition, client wise concentration is also at higher side, with top ten clients constituting more than three-fifth of the export sales. Nonetheless, SL has established strong business relations with the leading international retailers which ensures repeat business. Some of the prominent names include Primark, B&M, Next, Target Australia and Zara Home, Asda, K-Mart, Matalan.

Higher debt utilization levels to exert pressure on liquidity and capitalization indicators.

Overall liquidity profile of the Company is considered adequate in view of sufficient cash flows in relation to outstanding obligations. Current ratio has remained close to 1x over the years. Stock in trade and Trade Debts provide adequate coverage in relation to short term borrowing (HFY22: 107%: FY21: 116%). Cash conversion cycle of the company remains comfortable at 72 days during FY21, albeit increasing to 84 days during HFY22.

In absolute terms, Funds from Operations (FFO) has increased due to higher profitability (HFY22: Rs. 1.5b; FY21: Rs. 3.1b; FY20: Rs. 1b). However, increased borrowings is likely to reduce the debt servicing coverage which currently stands at comfortable level of 3.1x in FY21. FFO to long term debt stood at 67.6% during FY21 and is also likely to contract given higher projected borrowings. Hence, managing projected pressure on cash flow coverage in relation to elevated borrowings is considered important.

Given the company operating in full scale capex mode, total debt stood higher at Rs. 17.6b (FY21: 15.1b; FY20: Rs. 10.6b). Short term debt comprises 70% of the total borrowings; out of which around two-fourth constitutes export refinance facilities. Short term debt has witnessed an increasing trend due to capex related working capital requirement (H'FY22: Rs. 12.2b; FY21: Rs. 10.5b; FY20: Rs. 8b). Long Term debt (including current maturity) has also grown to support capex financing (H''FY22: Rs. 5.4b; FY21: Rs. 4.6b; FY20: Rs. 2.6b). Additional loan of Rs. 753m was acquired at end Dec'21 and further debt drawdown in the range of Rs. 3 to 3.5b is expected to be mobilized. In addition, the management aims to collect funds of around Rs. 2.5b during the expected IPO proceeds. While equity base has also increased on a timeline basis due to profit retention and the same was reported at Rs. 16.3b (FY21: Rs. 15.6b; FY20: Rs. 14.1b) at end Dec'21. However, as the increase in debt was greater than the increase in equity, both leverage and gearing indicators stood higher at 2.16x (FY21: 2.19x) and 1.71x (FY21: 1.62x) at end Dec'21.

Going forward, given plans of further debt drawdown , leverage indicators are expected to remain elevated on similar levels supported by higher profit retention. Maintaining leverage indicators at adequate levels will remain an important rating consideration.

Enhanced governance structure to align itself with Public Limited Company status amid IPO plans

Given the management's plan to change the legal status of the company from 'Public Unlisted Company' to 'Public listed Company' during FY23, the Company has added two independent directors heading the Audit and Human Resource and Remuneration Committee, respectively. With addition of two new board members, board of directors is now composed of seven directors.

Term Finance Certificates (TFCs) Issue

In July'20, SL raised Rs. 1.5b through a privately placed TFC issue in order to fund the expansion in knitted/woven garment segment by addition of new machinery. Tenor of the instrument is 5 years (including one year of grace period) with 8 equal semiannual principal installments commencing from Jan'2022. In addition, the instrument carries an interest rate of 3-month KIBOR plus a spread of 225 bps. Interest is payable quarterly in arrears. Security structure entails joint pari passu charge over current and fixed assets of Rs. 2b collectively.

Moreover, issuer has 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. Prepayment option will be subject to a) in multiples of Rs. 250m b) to be allowed on scheduled principal/profit payment dates and c) shall not attract any prepayment penalty.

Sadaqat Limited **Annexure I**

FINANCIAL SUMMARY (Rs. in millions)			Appendix I		
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**1H'FY22**
Property, plant and equipment	8,548.3	9,540.1	16,279.8	18,223.7	19,175.5
Stock-in-Trade	3,059.9	4,087.7	4,676.6	6,610.3	7,637.0
Trade Debts	2,557.3	4,932.8	2,991.7	5,613.9	5,497.2
Cash & Bank Balances	198.1	130.9	409.5	103.2	127.3
Total Assets	16,995.2	21,520.7	27,862.5	36,143.6	38,677.5
Trade and Other Payables	2,166.1	3,439.8	2,890.2	4,860.3	4,216.7
Long Term Debt (incl. current maturity)	1,222.8	1,573.7	2,603.5	4,649.4	5,392.2
Short Term Debt	5,677.7	7,264.3	8,003.2	10,532.1	12,254.1
Total Debt	6,900.5	8,838.0	10,606.7	15,181.5	17,646.3
Total Liabilities	9,200.3	12,513.2	13,705.2	20,556.0	22,338.4
Paid Up Capital	1,200.0	2,400.0	2,400.0	2,460.0	4,920.0
Total Equity (excluding surplus on reval)	5,732.1	7,015.3	7,538.1	9,386.5	10,329.6
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**FY21**	**1H'FY22**
Net Sales	15,022.6	19,617.6	20,375.2	32,969.0	18,660.9
Gross Profit	2,734.5	2,769.3	3,647.2	6,585.4	3,270.8
Operating Profit	1,416.8	1,016.4	1,843.0	2,545.5	1,455.1
Profit Before Tax	1,225.9	1,501.0	1,058.2	1,762.2	937.1
Profit After Tax	1,081.5	1,332.6	851.3	1,432.9	751.5
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**FY21**	**1H'FY22**
Gross Margin (%)	18.2%	14.1%	17.9%	20.0%	17.5%
Net Margin (%)	7.2%	6.8%	4.2%	4.3%	4.0%
Net Working Capital	(68.8)	350.6	(121.1)	846.2	1,310.3
Trade debts/Sales	17.0%	25.1%	14.7%	17.0%	29.5%
FFO	1,488.6	1,493.2	1,084.2	3,141.7	1,524.4
FFO to Total Debt (%)	21.6%	16.9%	10.2%	20.7%	8.6%
FFO to Long Term Debt (%)	121.7%	94.9%	41.6%	67.6%	28.3%
Current Ratio (x)	1.0	1.0	1.0	1.1	1.1
Debt Servicing Coverage Ratio (x)	2.2	2.0	1.4	3.1	2.1
Gearing (x)	1.20	1.26	1.41	1.62	1.71
Leverage (x)	1.6	1.8	1.8	2.2	2.2
(Stock in Trade+Trade Debts)/STD	98.9%	124.2%	95.8%	116.1%	107.2%
ROAA (%)		6.9%	3.4%	4.5%	4.0%
ROAE (%)		20.9%	11.7%	16.9%	15.2%

**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	Entity & Instrument Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	06/22/2022	A	A-2	Stable	Maintained
	06/24/2021	A	A-2	Positive	Maintained
	04/15/2020	A	A-2	Rating Watch - Negative	Maintained
	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
	04/23/2013	A-	A-2	Stable	Reaffirmed
	03/16/2012	A-	A-2	Stable	Reaffirmed
	RATING TYPE: Term Finance Certificates (TFC)				
	06/22/2022	A	A-2	Stable	Maintained
	06/14/2021	A	A-2	Positive	Maintained
	04/15/2020	A	A-2	Rating Watch - Negative	Maintained
	12/13/2019	A		Stable	Preliminary
Instrument Structure	SL raised Rs. 1.5b through a privately placed TFC issue. Tenor of the instrument is 5 years (including one year of grace period) with 8 equal semiannual principal installments commencing from Jan'2022. The instrument carries an interest rate of 3-month KIBOR plus a spread of 225 bps. Interest is payable quarterly in arrears. Security structure entails joint pari passu charge over current and fixed assets of Rs. 2b collectively. 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.				
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				

Due Diligence Meeting Conducted	Name	Designation	Date
	Mr. Hummayun Shahzad	CFO	April 13, 2022
	Mr. Bilal Ashfaq	Manager Finance	