RATING REPORT

Sapphire Textile Mills Limited

REPORT DATE:
December 9th, 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-1	A+	A-1
Rating Date	*Dec 5, 2019*		*Dec 19, 2018*	
Rating Outlook	Positive		Positive	
Outlook Date	*Dec 5, 2019*		*Dec 19, 2018*	

COMPANY INFORMATION

Incorporated in 1969	**External auditors:** EY Ford Rhodes Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Mohammad Abdullah
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Nadeem Abdullah
Sapphire Agencies (Pvt.) Limited – 11.6%	
Mr. Yousuf Abdullah – 10.6%	
Mr. Amer Abdullah – 8.5%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) ***http://www.vis.com.pk/kc-meth.aspx***

Sapphire Textile Mills Limited

OVERVIEW OF THE INSTITUTION

Sapphire Textile Mills Limited (STML) was incorporated in 1969 as a public limited company. Financial Statements of the company for FY19 were audited by EY Ford Rhodes Chartered Accountants.

Pattern of shareholding at end-FY19 depicts major shareholding of Directors, CEO and Spouse comprising 49.5% followed by associated undertakings of a shareholding of 30.95%. Remaining shares are allocated to insurance companies, financial institutions and general public.

RATING RATIONALE

Sapphire Textile Mills Limited (STML) is a part of Sapphire Group of Companies which has presence in textile, power, dairy sectors and also has sizeable investment in listed equities. Within textile sector, sapphire group is amongst the leading textile exporters in the country and has presence across the broader value chain. The group after venturing in the retail segment has successfully diversified in the denim segment.

STML's core business operations include production and distribution of yarn, fabric, home textile and ready-to-wear garments while the company has diversified operations through investments in the power sector and listed equities. STML's investment portfolio (short-term and long-term) represented around 41% of the total asset base at end-FY19 reflecting diversified operations and low business risk profile. Around 44% (FY18: 52%) of the investment portfolio relates to exposure in listed equities while investment in the power sector comprises 43% (FY18: 41%) to the total investments at end-June 2019. Remaining investments are in related party group companies.

Sapphire Wind Power Company Limited (SWPCL)

SWPCL operates as a 52.8MW wind power station at Jhimpir, Sindh. The total cost of the project was $128m financed through a Debt: Equity mix of 75:25. Equity proportion of the investment was financed by STML and Bank Alfalah Limited (BAFL) with a holding of 70:30 respectively. Debt financing of $95m was obtained from Overseas Private Investment Corporation at a markup rate of LIBOR+3.7%. The company commenced its operations in November 2015 and posted a profit of Rs. 1.3b (FY18: Rs. 1.1b) during FY19. With improving profitability and satisfactory operations for the first two years, the company distributed a dividend of Rs. 400m, out of which Rs. 280m was received by STML. However, debt carried on balance sheet has increased given sizeable rupee devaluation.

Tricon Boston Consulting Corporation (Private) Limited (TBCCL)

TBCCL operates 3 x 50 MW Wind Energy Projects in Jhimpir Sindh, and commenced operations in September 2018. The total cost of the project was around $315m which has been financed through a debt: equity mix of 75:25. STML owns 57% shareholding in TBCCL with the remaining stake held by Sapphire Fibers, Diamond Fabrics, Sapphire Finishing, and BAFL. Debt portion has been financed by International Finance Corporation, Islamic Development Bank, Asian Development Bank and DEG (German Development Finance Institution). Operating performance of the plant has remained satisfactory since operations. TBCCL posted a profit after tax of Rs. 2.1b during the first nine months of operations.

Listed Equity Portfolio

Listed equity investment portfolio (long and short term) amounted to Rs. 8.1b (FY18: Rs. 9.8b) at end-FY19. Decline in investment portfolio is primarily on account of reduction in benchmark index. Given the recent sharp increase in benchmark index, value of equity investment portfolio has recovered. The investment portfolio comprises exposure in commercial banks (HBL, MCB, BAFL and BAHL), cement companies (LUCK, DGKC), a conglomerate (ENGRO) diversified in fertilizer, FMCG, power & chemical sectors. The management has pursued a passive investment strategy with dividend yield (based on average investments during the period) on the portfolio amounting to 4.4% during FY19.

Key Rating Drivers

Favorable government policies for enhancing exports and improving country's perception and law & order situation bode well for the textile sector. Key risk factor include rising cost of doing business (increasing electricity and gas tariff and rising local cotton prices).

Exports					
Product (Rs. in m)	FY15	FY16	FY17	FY18	FY19
Total Exports	**2,397,513**	**2,166,846**	**2,140,852**	**2,555,043**	**3,131,425**
Raw Cotton	14,933	7,948	4,484	6,184	2,708
Cotton Yarn	187,376	131,700	130,192	151,063	152,725
Cotton Cloth	248,431	230,757	221,989	242,373	285,554
Cotton Carded or Combed	644	15	25	1	36
Yarn other than Cotton	4,343	3,413	2,549	3,683	4,645
Knitwear	243,719	246,267	247,299	298,374	394,568
Bed Wear	213,018	210,543	223,421	248,538	307,297
Towels	80,778	83,681	82,357	87,633	107,043
Tents, Canvas, and Tarpaulin	12,835	8,886	14,014	9,338	11,201

Readymade Garments	212,210	228,861	242,588	283,495	362,577
Art, Silk and Synthetic Text	33,485	30,005	21,386	34,069	40,539
Made-up Articles	66,359	65,518	67,500	75,239	92,322
Other Textile Materials	44,773	49,663	45,953	46,958	52,297
Total Textile Exports	**1,362,904**	**1,297,257**	**1,303,757**	**1,486,948**	**1,813,512**
Textile Exports share in Total Exports	*57%*	*60%*	*61%*	*58%*	*58%*

Textile exports depicted growth of 22% during FY19 driven largely by sizeable currency devaluation in the outgoing year. In USD terms, growth rate was limited to 2%. Overall growth emanated from knitwear, bed wear, and ready-made garments reporting increase of 32%, 24%, and 28% respectively. Favorable government policies for enhancing exports and improving country's perception and law & order situation bode well for the textile sector. Conversely, increasing cost of doing business and reduction in rebate rates may impact margins for select players.

Strong operating performance with capacity utilization of all segments remaining high. Focus remains on value addition and increasing proportion of finished segment in the sales mix.
Spinning: Utilization levels of the segment increased during FY19 to 83% from 81% in the corresponding period last year. Increase is attributable to higher requirement emanating from the weaving division.

Weaving: During FY18, the company enhanced its capacity by 8% to 145.98m meters (FY18: 134.7m meters) during FY19. Capacity utilization level for the segment was recorded on the higher side at 98% (FY18: 99%).

Finishing: This segment remains the key focus area for the management. With increasing focus towards the finishing segment, productivity and capacity utilization levels have improved on a timeline basis. During FY19, STML completed expansion in its finishing unit which has enhanced segment's capacity to 43.2m meters (FY18: 38.4m meters). Capacity utilization level for the segment stood at 90% (FY18: 94%) during FY19.

Double digit growth in sales during FY19. Exports were the major growth driver. Growth in momentum in sales is expected to continue in FY20 given healthy order pipeline.
Net sales of the company increased by 19% to Rs. 34.2b (FY18: Rs. 28.9b) during FY19 led by higher exports sales. More than four-fifth of the total sales comprises exports during FY19. Export sales increased significantly by 38% to Rs. 29.5b (FY18: Rs. 21.3b) whereas local sales declined by 34% to Rs. 4.6b (FY18: Rs. 7.1b) during FY19. While declining on a timeline basis, Yarn continues to be the largest contributor in total sales revenue of the company (FY19: 43%, FY18: 45%, FY17: 46%). Fabric is the second largest contributor to revenues (FY19: 33%, FY18: 32%, FY17: 34%) followed by home textile segment (FY19: 16%, FY18: 16%, FY17: 14%). Going forward, proportion of finishing segment (finished fabric and home textile) in revenues will increase given the completion of recent expansion in the segment.

Despite significant jump in finance cost, growth in revenues, improvement in gross margins and dividend income from subsidiary & listed equity portfolio translated into 51% growth in profit before tax. Going forward, organic growth from core operations and increase in dividend income from wind power projects is expected to support profitability growth.
Gross margins of the company have been improving on a timeline basis and stood at 15.8% (FY18: 12.2%) during FY19 on account of higher sales volume and average selling prices. Profitability from the textile operations witnessed significant improvement with operating profit excluding other income being reported at Rs. 3.5b (FY18: Rs. 1.9b) in FY19. Consequently overall profitability (before accounting for finance cost and taxes) increased to Rs. 5b (FY18: Rs. 3.3b) supported by dividend inflow from subsidiary company- SWPCL and non-recurring technical services fee from TBCCL. While dividend receipts from listed exposure declined during the outgoing year, overall dividend income was supported by dividend receipt from SWPCL. Finance costs increased during the outgoing year on account of sizeable increase in benchmark rates. With higher revenues, improving margins and support of other income, profit after tax increased to Rs. 2.6b (FY18: Rs. 1.6b) during FY19. Gross margins improved to 17.1% in 1QFY19 on the back of utilization of lower priced cotton inventory and higher sales in value-added segment. Going forward, organic growth from core operations and increase in dividend income from wind power projects is expected to support profitability growth.

Given the increase in funds generated from operations, cash flow coverage of outstanding debt increased. Liquidity profile of the company is supported by sizeable liquid investments carried on the balance sheet.
Adjusted funds flow from operations (FFO) (including recurring dividend income) increased to Rs. 3.7b (FY18: Rs. 2.7b) during FY19 primarily on account of improving profitability from textile operations. Consequently, cash flow coverage of outstanding debt improved while debt servicing ability remains satisfactory. Ageing profile of trade debts has remained within manageable levels. Liquidity profile of the company is supported by sizeable liquid investments carried on the balance sheet amounting to Rs. 8b at end-FY19. Even after sensitizing for market risk, liquid investments provide significant coverage of outstanding long-term debt at end-June 2019.

Coverage of short-term debt has also improved on a timeline basis with stock in trade and trade debts representing 127% (FY19: 124%; FY18: 115%) of short-term borrowings as at end-1QFY20.

Adjusted leverage indicators continue to remain within manageable levels
Equity base of the company was reported at Rs. 16.7b (FY18: Rs. 16b) at end-FY19. Total debt carried on balance sheet amounted to Rs. 22b at end-FY19; around two-third of the total debt is long-term in nature. Concessionary rate borrowing represents around two-third of total financing which partly limits impact of increase in interest rate Moreover, despite increase in revenues over the last years, short-term borrowings have witnessed limited increase during the period. Gearing and leverage indicators continue to be reported on the higher side in comparison to peers at 1.35x (FY18: 1.33x) and 1.70x (FY18: 1.64x), respectively. However, adjusted leverage indicators continue to remain within manageable levels. With no major debt drawdown planned, and expected improvement in profitability, capitalization indicators are expected to improve going forward.

Sapphire Textile Mills Limited — Appendix I

FINANCIAL SUMMARY (amounts in PKR millions)						
BALANCE SHEET	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**1QFY20***
Fixed Assets	8,751	9,523	10,575	11,415	12,680	12,559
Long term Investments	9,823	10,523	17,513	14,927	14,257	14,398
Stock-in-Trade	3,969	4,281	5,327	5,472	7,482	7,678
Trade Debts	1,298	1,474	1,724	2,947	2,198	2,705
Cash & Bank Balances	50	100	72	55	97	92
Total Assets	28,088	31,801	42,532	42,330	44,212	45,167
Trade and Other Payables	2,317	2,526	3,224	3,869	3,443	3,695
Long Term Debt	5,502	8,358	13,883	13,997	14,258	13,902
Short Term Debt	4,718	4,657	7,464	7,302	7,798	8,175
Total Debt	10,221	13,015	21,347	21,300	22,056	22,077
Paid Up Capital	201	201	201	201	201	201
Total Equity	14,370	14,904	16,995	16,022	16,382	16,751
INCOME STATEMENT						
Net Sales	23,315	23,111	25,584	28,896	34,253	9,092
Gross Profit	2,608	2,563	2,678	3,536	5,406	1,556
Operating Profit	1,848	2,610	3,944	3,340	5,031	1,280
Profit Before Tax	1,178	1,737	2,975	1,949	2,946	674
Profit After Tax	1,034	1,448	2,722	1,595	2,559	564
RATIO ANALYSIS						
Gross Margin (%)	11.2%	11.1%	10.5%	12.2%	15.8%	17.1%
Net Working Capital	1,406	1,907	2,224	2,376	2,041	1,786
Adjusted FFO	1,135	1,182	1,850	2,723	3,756	613
FFO to Total Debt (%)	11%	9%	9%	13%	17%	11%
FFO to Long Term Debt (%)	21%	14%	13%	19%	26%	18%
Debt Servicing Coverage Ratio (x)	1.74	1.50	1.09	2.12	1.85	1.10
Gearing (x)	0.71	0.87	1.26	1.33	1.35	1.32
Leverage (x)	0.95	1.13	1.50	1.64	1.70	1.70
Current Ratio (x)	1.18	1.20	1.19	1.18	1.14	1.11
STD Coverage	112%	124%	94%	115%	124%	127%
ROAA (%)	4%	5%	7%	4%	6%	5%
ROAE (%)	7%	10%	17%	10%	16%	14%

**Ratios Annualized*

*** FFO Adjusted for dividend income*

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix 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 — Appendix III

Name of Rated Entity	Sapphire Textile Mills Limited
Sector	Textile
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	(see below)
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
12/05/2019	A+	A-1	Positive	Reaffirmed
12/19/2018	A+	A-1	Positive	Reaffirmed
01/30/2018	A+	A-1	Positive	Reaffirmed
10/25/2016	A+	A-1	Positive	Reaffirmed
6/1/2015	A+	A-1	Positive	Reaffirmed
3/5/2014	A+	A-1	Positive	Maintained
4/1/2013	A+	A-1	Stable	Upgrade
2/1/2012	A	A-2	Stable	Reaffirmed
10/12/2010	A	A-2	Stable	Reaffirmed