The Pakistan Credit Rating Agency Limited

Rating Report

Siddiqsons Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
22-Jun-2024	A-	A1	Stable	Maintain	-
23-Jun-2023	A-	A1	Stable	Maintain	-
24-Jun-2022	A-	A1	Stable	Maintain	-
24-Jun-2021	A-	A1	Stable	Maintain	Yes
24-Jun-2020	A-	A1	Stable	Maintain	Yes
27-Dec-2019	A-	A1	Stable	Maintain	-
28-Jun-2019	A-	A1	Stable	Maintain	-
04-Jan-2019	A-	A1	Stable	Maintain	-
04-Jul-2018	A-	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Siddiqsons Limited ("Siddiqsons" or "the Company") is the flagship company of the Siddiqsons group and is considered a pioneer of the denim industry in Pakistan. The revenue base of the Company emanates from the five textile business divisions, including Denim Fabric, Home Textiles, Spinning, Garments & Knits. The export segment mainly contributes to the company's top line, with the USA and Europe being their prime export avenues. During 9MFY24, sales of the Company have shown growth of 29.7% YoY mainly contributed by price hikes in international markets. The business strategy of the Company vests in sustainable top-line growth while generating a green bottom line. Over the last few years, the business profile has strengthened manifold. Over the years Siddiqsons has executed CAPEX for BMR to improve manufacturing facility efficiency resulting in an increase of operating fixed assets to PKR 8.3bln. The denim industry enjoys relatively better margins reflected in the Company's profitability. The gross margins of the Company have shown improvement depicting an efficient price transferability matrix and maintaining the cost of production at an optimal level. However, escalated finance costs and tax burdens have impacted the net margins of the Company. The Company has maintained an investment portfolio in real estate and blue-chip companies in the stock exchange to generate steady investment income, mainly in dividends and rental income, to augment their liquidity profile and supplement the Company's bottom line. The Company is diversifying its product slate to enhance outreach to export avenues. The financial risk profile of the Company is considered moderate with a stretched working capital cycle depicting the industry norm. The working capital requirement of the Company is met through a mix of internally generated cashflows and short-term borrowings. The Company has maintained a leveraged capital structure with moderate coverages and cashflows. The ratings incorporate the financial strength and the proven track record of the sponsoring family. The size of the textile industry in Pakistan is estimated to be PKR 2.62Trn in LSM (Large Scale Manufacturing) ~3.0% of the total GDP as of FY23. The composite & garment segment in the textile sector has a contribution of ~ PKR 1.6Trn mainly dominated by knitwear, readymade garments, bedwear, and towels followed by PKR 775bln from spinning and PKR 637bln from weaving. The escalation in energy tariffs & finance costs, PKR devaluation, and ensuring the availability of optimum quality raw materials are prime challenges specific to the industry to assess the international market and stay price-wise competitive.

The ratings are dependent on the Company's ability to sustain its operations in prevailing conditions. The prudent working capital management and generating sufficient cash flows from core operations while maintaining comfortable coverages remain critical. The adherence to debt matrix at an optimal level is a prerequisite for assigned ratings

Disclosure

Name of Rated Entity	Siddiqsons Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-24),Methodology | Corporate Rating(Jul-23)
Related Research	Sector Study | Composite and Garments(Dec-23)
Rating Analysts	Muhammad Harris Ghaffar | harris.ghaffar@pacra.com | +92-42-35869504

Profile

Legal Structure Siddiqsons Limited (Siddiqsons or 'the Company') is a Public unlisted company incorporated in 1987.

Background Siddiqsons is the pioneer of the denim industry in Pakistan. The Company is engaged in spinning, weaving, dyeing, finishing, and stitching of denim, making it a composite textile unit.

Operations The Company operates 26,832 spindles and 265 looms. The weaving unit has the capacity to produce 31 million meters of denim every year. The Company regularly undertakes BMR activities, with the underlying objective of enhancing the efficiency of production processes. The Company is self-sufficient in terms of energy production and meets its energy requirements through captive power generation.

Ownership

Ownership Structure Ownership of Siddiqsons lies with the Tariq family. Mr. Tariq Rafi owns the majority stake with 62% shares, followed by his wife Mrs. Nighat Tariq, who owns 15% shares, and his son Mr. Abdur Rahim Tariq owns 12% shares. The remaining shares are owned by family friends

Stability There is no formal succession plan. However, the ownership of shares and business roles are divided to maintain stability. Formation of a group holding company or documented succession plan would bode well, going forward.

Business Acumen The Company's founder, Mr. Tariq Rafi, has been associated with the textile business since 1959 and carries vast knowledge and experience of the industry.

Financial Strength Siddiqsons is the flagship company of the Siddiqsons group. The group has invested in several other successful businesses in the banking, energy, real estate, and metal industries. The sponsors have the capacity and provide timely financial support to the Company when needed.

Governance

Board Structure The overall control of the board vests with the 4 member board of directors. There are no independent or non-executive directors on the board reflecting room for improvement. Mr. Tariq Rafi is the Chairman and CEO while Mr. Abdul Rahim is the COO of the Company.

Members' Profile Mr. Tariq Rafi has been awarded the Sitara-e-Imtiaz for services in commerce and industry. He is also the honorary consul general of Pakistan to Serbia. Mr. Abdur Rahim, the only son of Mr Tariq Rafi, is the Chief Operating Officer of the Company. He has been a member of the board since 2007. He has vast experience in Denim fabric and garments and extensively traveled to different regions of the world for sales and marketing of Siddiqsons group.

Board Effectiveness The effectiveness of the board is being compromised due to the small size of the board and lack of independent directors. There are no board committees and no formal structure to record broad meeting minutes, which does not reflect well for the board's effectiveness.

Financial Transparency The Company's auditors are Yousuf Adil & Co., Chartered Accountants. The auditor issued a qualified opinion on the financials for FY23 due to the limitation of scope on certain matters. This reflects negatively on the financial transparency of the Company. The reason for the qualified opinion is that the company has not recognized the gas infrastructure development cess (GIDC) liability amounting to PKR 533.28mln from 2016 to 2020.

Management

Organizational Structure The Company has a well-defined organizational structure with a clear segregation of responsibilities. The corporate office has three departments namely, i) Finance, ii) Admin & HR, and iii) Imports & Exports. Manufacturing segment has six departments namely, i) Marketing & Merchandising, ii) Operations, iii) Quality Control, iv) Finance, v) HR, and vi) Compliance. Each of these departments is headed by a GM who reports directly to the COO with the exception of Finance GM, who reports directly to the CEO.

Management Team The Company employs a senior management team that is qualified and experienced. However, the decision making is concentrated with the CEO.

Effectiveness The Company has a designated internal audit department to ensure all the business operations remain transparent. Timely completion of financial reporting has consistently been delayed, which does not bode well.

MIS The Company has installed SAP to streamline the flow of information within the Company. However, the Company faced challenges during SAP implementation. Most of these issues have now been resolved and it is expected that the flow of information will improve, going forward

Control Environment The Company implements customized controls at various levels for SAP. In addition, rigorous quality checks are conducted at the manufacturing units. The denim unit has a dedicated Quality Control lab that ensures quality at all stages of production. The Company is accredited with several international certifications including Better Cotton Initiative, Sedex Global Recycle Standard, etc, reflecting well on control environment

Business Risk

Industry Dynamics The size of the textile industry in Pakistan is estimated to be PKR 2.62Trn in LSM (Large Scale Manufacturing) ~3.0% of the total GDP as of FY23. The composite & garment segment in the textile sector has a contribution of ~ PKR 1.6Trn mainly dominated by knitwear, readymade garments, bedwear and towels followed by PKR 775bln from spinning and PKR 637bln from weaving. The escalation in energy tariffs & finance costs, PKR devaluation, and ensuring the availability of optimum quality raw materials are prime challenges specific to the industry to assess the international market and stay price-wise competitive.

Relative Position Siddiqsons is the pioneer in the denim industry of Pakistan. The Company has enjoyed successful business operations in the past three decades. The Company has a spinning capacity of ~19.3mln kilograms per year, ~31.2mln meters of denim fabric, and ~5.4mln pieces of garments per year. It is one of the largest garment manufacturers in Pakistan. The company has also one of the most advanced manufacturing facilities in the country

Revenues During FY23, revenues increased to stand at PKR 2,378mln (FY22: PKR 23,428mln). The company's share of export sales to total revenue inched up to 92% (FY22: 90%) clocking in at PKR 22,354mln (FY22: PKR 21,091mln). The sales mix of the company is tilted toward export sales. As of Mar'24, the company's revenue base stood at PKR 22.5bln (Mar'23: PKR 17.3bln), an YoY increase of 30%.

Margins During FY23, the gross margin of the company improved to stand at 23.6% (FY22: 16.2%) on the back of better prices. This translated into an improved operating margin of 15.5% (FY22: 9.7%). However, the net margin declined to 7.8% (FY22: 8.5%. During 9MFY24, the gross and net margins of the company stood at 18.8% and 6.1% respectively.

Sustainability The group has adopted a relatively slower approach for expansion in textiles, along with launching projects in the real estate domain, and has made significant investments in the stock market to enjoy dividend income. Siddiqsons limited is planning to get into the towel industry

Financial Risk

Working Capital At end-Jun23, the net working capital cycle days inclined to 133 days (end-Jun22: 116 days) on account of higher inventory days at 110 days (endJun22: 106 days). The trade assets of the company decreased to PKR 13,927mln (end-Jun22: PKR 13,022mln) on account of an increased receivable level clocking in at PKR 5,062mln (end-Jun22: PKR 4,075mln) resulting in larger room-to borrow at PKR 3,723mln (end-Jun22: PKR 2,563mln). ST trade leverage adequacy inched up to 27% (end-Jun22: 20%). As of March '24, the company's net working capital cycle marginally increased to 135days

Coverages During FY23, the Company built up its free cash flows to stand at PKR 3,990mln (FY22: PKR 2,752mln) on the back of improved profitability. The increasing policy rate led to higher finance costs clocking in at PKR 1,374mln (FY22: PKR 806mln). The interest coverage of the company declined to 3.0x (FY22: 3.6x) due to a higher finance cost. Conversely, the debt coverage decreased to 2.2x (FY22: 1.9x). However, the debt repayment period of the company declined to 1.7 years (FY22: 2.6 years).

Capitalization At end-Jun23, leveraging of the company decreased to 45.1% (end-Jun22: 47%) due to a decrease in the total borrowings of the company clocking in at PKR 12,488mln (end-Jun22: PKR 11,748mln). Whereas, the equity base of the company increased to PKR 15,181mln (end-Jun22: PKR 13,373mln). As of Mar'24, the leveraging of the company stood at 41.3% whereas the equity clocked at PKR 16.6bln.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Siddiqsons Limited Composite and Garments	Mar-24 9M	Jun-23 12M	Jun-22 12M	Jun-21 12M
A BALANCE SHEET				
1 Non-Current Assets	9,882	9,665	8,082	6,629
2 Investments	1,004	1,004	763	3,478
3 Related Party Exposure	4,369	4,764	5,377	3,354
4 Current Assets	16,175	15,746	15,958	10,784
a Inventories	*9,888*	*7,626*	*7,050*	*4,741*
b Trade Receivables	*3,897*	*5,062*	*4,075*	*2,134*
5 Total Assets	31,430	31,179	30,179	24,245
6 Current Liabilities	3,164	3,446	4,880	2,451
a Trade Payables	*2,055*	*2,258*	*3,769*	*1,394*
7 Borrowings	11,639	12,027	11,748	9,563
8 Related Party Exposure	-	461	114	-
9 Non-Current Liabilities	65	65	65	161
10 Net Assets	16,562	15,181	13,373	12,070
11 Shareholders' Equity	16,562	15,181	13,373	12,070
B INCOME STATEMENT				
1 Sales	22,459	24,378	20,249	13,835
a Cost of Good Sold	*(18,235)*	*(18,634)*	*(16,961)*	*(11,738)*
2 Gross Profit	4,224	5,744	3,288	2,097
a Operating Expenses	(1,944)	(1,963)	(1,314)	(851)
3 Operating Profit	2,281	3,781	1,974	1,247
a Non Operating Income or (Expense)	*863*	*130*	*946*	*311*
4 Profit or (Loss) before Interest and Tax	3,144	3,911	2,920	1,558
a Total Finance Cost	*(1,414)*	*(1,562)*	*(887)*	*(480)*
b Taxation	*(354)*	*(437)*	*(311)*	*(174)*
6 Net Income Or (Loss)	1,376	1,911	1,722	904
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,376*	*3,990*	*2,752*	*1,602*
b Net Cash from Operating Activities before Working Capital	*(38)*	*2,616*	*1,946*	*1,183*
c Changes in Working Capital	*(1,300)*	*(3,699)*	*(1,910)*	*(2,947)*
1 Net Cash provided by Operating Activities	(1,338)	(1,083)	36	(1,764)
2 Net Cash (Used in) or Available From Investing Activities	803	(329)	(1,348)	(91)
3 Net Cash (Used in) or Available From Financing Activities	100	2,651	3,192	(853)
4 Net Cash generated or (Used) during the period	(435)	1,239	1,880	(2,708)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	22.8%	20.4%	46.4%	20.4%
b Gross Profit Margin	18.8%	23.6%	16.2%	15.2%
c Net Profit Margin	6.1%	7.8%	8.5%	6.5%
d Cash Conversion Efficiency (FCFO adjusted for Working C	0.3%	1.2%	4.2%	-9.7%
*e Return on Equity [Net Profit Margin * Asset Turnover * (T*	11.6%	13.4%	13.5%	7.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	161	178	162	173
b Net Working Capital (Average Days)	135	133	116	134
c Current Ratio (Current Assets / Current Liabilities)	5.1	4.6	3.3	4.4
3 Coverages				
a EBITDA / Finance Cost	1.5	3.2	3.9	4.6
b FCFO / Finance Cost+CMLTB+Excess STB	1.2	2.2	1.9	2.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fi	15.1	1.7	2.6	3.4
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equit	41.3%	45.1%	47.0%	44.2%
b Interest or Markup Payable (Days)	88.9	109.0	97.7	116.7
c Entity Average Borrowing Rate	13.5%	11.1%	7.0%	5.2%

Credit Rating

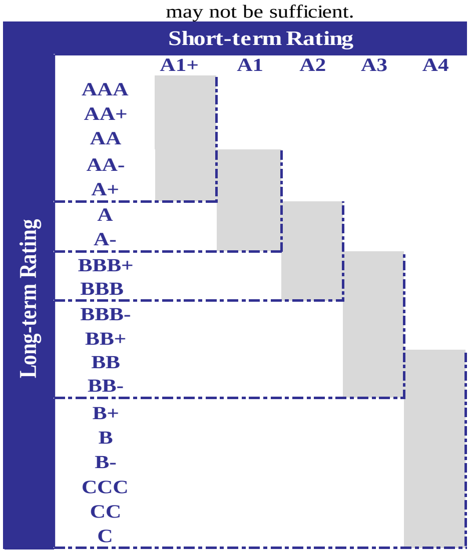
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 17-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument;| Chapter III | 17-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past; | Chapter III | 14-3(f)(vii)
Proprietary Information