



The Pakistan Credit Rating Agency Limited

Rating Report

Siddiqsons Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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, the flagship company of Siddiqsons group, is the pioneer of the denim industry in Pakistan. The company has managed to increase its top line, mainly from growth in local sales. The company's top line is driven mainly by exports, with Bangladesh as the prime export location. However, the share of exports in top line is declining over the years due to high competition in the international market. The gross margins of the company remain under pressure, due to higher raw material prices. However other costs stayed under control as the company sustained its operating margins. The Pak rupee devaluation in the recent period is expected to have a positive impact on the exports front as it will increase the export competitiveness compared to regional peers. The withdrawal of zero-rated status of textile industry in Finance Bill 2020 coupled with increasing interest rates may put pressure on margins and liquidity across the industry. Ratings draw comfort from income generated from the sizable strategic investments made by the company in banking, energy, real-estate, construction and metal industries. The company's high inventory needs during cotton procurement season gave rise to increased working capital requirements. However, the company's financial profile remains strong with low leveraged capital structure and strong coverages. Ratings reflect sponsors ability to provide support when required, as demonstrated in the past.

The ratings are dependent upon the management's ability to capitalize on growth opportunities in a competitive landscape while also improving the margins. Sustainability of investment income remains important. Meanwhile, excessive borrowing, leading to higher leverage, and/or deterioration in coverages can impact the ratings negatively. A strong governance framework will be important, going forward.

Disclosure

Name of Rated Entity	Siddiqsons Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Textile(Oct-18)
Rating Analysts	Ateeb Riaz ateeb.riaz@pacra.com +92-42-35869504

Profile

Legal Structure Siddiqsons Limited (Siddiqsons) is an un-listed public entity, incorporated in 1987.

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

Operations The Company has 26,256 spindles and 265 looms which allow the Company to produce ~21mln kgs yarn per year, 2.6mln meters of denim fabric and 1mln pieces of garments per month. The Company regularly spends on BMR of its production facilities, with the underlying objective of enhancing production processes efficiency. The Company is self-sufficient in terms of energy production and is capable of producing 28MW out of which 23.5MW are from gas based (RLNG) generators while remaining are furnace oil based.

Ownership

Ownership Structure Ownership of Siddiqsons lies with the Tariq family. Mr Tariq owns the majority stake (62%) followed by his wife Mrs Nighat Tariq (15%) and son Mr Abdur Raheem Tariq (12%), rest is owned by the friends of the family.

Stability Although there is no formal succession plan but the ownership of shares and business roles are equally divided. Formation of a group holding company or documented succession plan would do well to secure the future of the Company.

Business Acumen The Company 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 Limited is the flagship company of the Siddiqsons group. The group has invested in several other successful businesses including banking, energy, real-estate and metal industries. Sponsors can provide timely support to the entity in time of need.

Governance

Board Structure The overall control of the board vests in 4 member board of directors. There are no independent or non-executive directors on the board. Mr Tariq Rafi is the Chairman and CEO, while his son Mr Abdur Rahim is the COO of the Company. However, Mr Tariq Rafi remains the key person.

Members' Profile Mr Tariq Rafi has been awarded 25 trophies and Sitara-e-Intiaz 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 and is the Chief Operating Officer of Siddiqsons. He has been a member of the board since 2007. He has vast experience in Denim fabric and garments and has extensively travelled to different regions of the world for sales and marketing of Siddiqsons group.

Board Effectiveness There are no board committees and no formal structure to record broad meetings and minutes. The overall governance structure of the Company needs improvement.

Financial Transparency The Company's auditors are Deloitte M. Yousuf Adil Saleem & Co., Chartered Accountants. The auditor has expressed an unqualified opinion on the financial statements of the Company for the year ended June 30, 2018.

Management

Organizational Structure The Company has a well-defined organizational structure with clear segregation of responsibilities. 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 are headed by a GM who reports directly to the COO with the exception of finance, which reports directly to the Chairman. All GM's are qualified and experienced individuals.

Management Team The Company has employed experienced management staff who can well handle the business operations. The garments units has a total of six departments, namely i) Marketing & Merchandising, Operations, Quality, HR, Finance & Compliance. All of these department heads report to the Chairman via the COO.

Effectiveness The Company has a designated department of internal audit, to make sure that all the business operations remain transparent. Timely completion of financial reporting has consistently been delayed which reflects management inefficiency.

MIS The Company has installed SAP ERP, which has improved the flow of information within the Company.

Control Environment The Company's operating environment depends upon an IT Infrastructure supported by one of the best ERP's available (SAP). The system has been implemented by ABACUS consulting. In addition, there is rigorous quality checking after the completion of each of the steps from spinning to the fabric. The Company has accredited with several international certifications including Better Cotton Initiative, Sedex and Global Recycle Standard etc.

Business Risk

Industry Dynamics The global denim market is estimated to grow from ~USD 57bln to ~USD 75bln in 2021, driven by westernization in developing countries, especially India and China. Pakistan's denim sector market size hovers around 10-15% of total textile exports of Pakistan, with major markets for fabric exports including Bangladesh, Turkey and Egypt while prime markets for denim garments comprise US and Europe. The Pakistan has not been able to capitalize on devaluation of rupee in the recent periods as exports figures have not picked up. However, it is expected that the export competitiveness of Pakistan will increase and it will have a positive impact on textile industry. The withdrawal of zero-rated status of textile industry in Finance Bill 2020 coupled with increasing interest rates may put pressure on margins and liquidity across the industry.

Relative Position The Company has an adequate position on standalone basis and is considered a middle-tier player in Pakistan's denim industry.

Revenues The Company's top-line clocked in PKR 9,680mln during 9MFY19 (FY18: PKR 11,479mln), portraying a growth of ~12%. The growth in Company's top line is mainly coming from local sales, hence the share of exports in the top line is declining over the years and stood at ~61% during 9MFY19 (FY18: ~71%). Going forward, the Company aims to carry on with its strategy of increasing exports and will further benefit from the recent rupee devaluation.

Margins The gross margins of the Company remained in-line with previous year and stood at ~14% in 9MFY19 (FY18: ~14%). However, the gross margins are declining over the years due to increasing cotton prices. Further, other costs remained under control as the Company maintained its operating margins at ~6%. The Company's bottom line is supported by a stable stream of income from strategic investments; though majority of the investments are yet to stream income. The net profit margins of the Company clocked in at ~5% during 9MFY19 (FY18: ~6.5%).

Sustainability In last three years the Company has invested ~PKR 3bln to expand its operations by regular BMR and investing in new technology in order to increase the production capacity to meet the increasing demand.

Financial Risk

Working Capital Working capital is a function of inventory and trade receivables and is financed partly via in house generated cash flows and mainly from short-term borrowings. The Company's reliance on short-term borrowings has increased during 9MFY19 and clocked in at ~PKR 4,939mln (FY18: PKR 3,592mln). Net trade assets of the Company stood at ~PKR 4,577mln during 9MFY19 (FY18: PKR 5137mln), showing excess borrowings of ~PKR 363mln (FY18: Room to borrow of PKR 5,137mln). Further, trade receivables have also declined to 59days during 9MFY19 (FY18: 68days), while trade payable days remain in-line with previous year.

Coverages The free cash flows of the Company has remained in-line with previous year and clocked in at ~PKR 1,055mln during 9MFY19 (FY18: PKR 1,553mln). The interest coverage ratio stood in-line with the previous year and clocked in at 5.9x (FY18: 6.1x). The debt coverage ratio improved to 5.9x during 9MFY19 (FY18: 3.6x).

Capitalization The Company has moderately leveraged capital structure. The leveraging stood at ~42% during 9MFY19 (FY18: ~32%). The increase in leveraging is attributable to increase in short-term borrowings. The leveraging of the Company is expected to remain at the same level in the coming years.



Siddiqsons Limited Textile & Allied	Mar-19	Jun-18	Jun-17	Jun-16
	9M	12M	12M	12M

A BALANCE SHEET

1 Non-Current Assets	5,937	5,493	4,383	4,635
2 Investments	3,712	3,708	3,702	3,316
3 Related Party Exposure	4,591	4,131	4,831	5,184
4 Current Assets	9,711	8,310	6,248	5,270
<i>a Inventories</i>	4,376	3,657	2,940	2,115
<i>b Trade Receivables</i>	1,402	2,737	1,526	1,390
5 Total Assets	23,951	21,641	19,164	18,405
6 Current Liabilities	1,829	2,371	1,782	1,473
<i>a Trade Payables</i>	1,796	1,505	1,275	843
7 Borrowings	7,169	5,360	4,240	4,098
8 Related Party Exposure	2,055	791	635	564
9 Non-Current Liabilities	169	235	229	211
10 Net Assets	12,730	12,883	12,278	12,059
11 Shareholders' Equity	12,730	12,883	12,278	12,059

B INCOME STATEMENT

1 Sales	9,680	11,479	9,171	9,017
<i>a Cost of Good Sold</i>	(8,342)	(9,912)	(7,826)	(7,555)
2 Gross Profit	1,338	1,567	1,346	1,462
<i>a Operating Expenses</i>	(766)	(916)	(769)	(647)
3 Operating Profit	572	651	576	815
<i>a Non Operating Income</i>	222	448	155	142
4 Profit or (Loss) before Interest and Tax	794	1,099	731	957
<i>a Total Finance Cost</i>	(231)	(338)	(307)	(254)
<i>b Taxation</i>	(77)	-	(135)	(80)
6 Net Income Or (Loss)	486	760	289	623

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	1,055	1,553	838	990
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	824	1,553	535	727
<i>c Changes in Working Capital</i>	(426)	(1,493)	(816)	157
1 Net Cash provided by Operating Activities	398	60	(281)	884
2 Net Cash (Used in) or Available From Investing Activities	(1,494)	(1,108)	(104)	(1,793)
3 Net Cash (Used in) or Available From Financing Activities	1,018	944	212	1,283
4 Net Cash generated or (Used) during the period	(78)	(104)	(173)	374

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	12.4%	25.2%	1.7%	-34.5%
<i>b Gross Profit Margin</i>	13.8%	13.7%	14.7%	16.2%
<i>c Net Profit Margin</i>	5.0%	6.6%	3.2%	6.9%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	11.7%	13.5%	9.4%	12.7%
<i>e Return on Equity (ROE)</i>	5.1%	6.0%	2.4%	7.4%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	172	173	159	204
<i>b Net Working Capital (Average Days)</i>	125	128	116	185
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	5.3	3.5	3.5	3.6
3 Coverages				
<i>a EBITDA / Finance Cost</i>	6.4	6.1	3.7	6.0
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	5.9	3.6	2.0	2.4
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	3.7	2.0	2.3	1.7
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Short-Term Borrowings / Total Borrowings</i>	42.0%	32.3%	28.4%	27.9%
<i>b Interest or Markup Payable (Days)</i>	0.5	0.6	0.7	0.7
<i>c Average Borrowing Rate</i>	3.1%	4.6%	4.9%	3.6%

Credit Rating Scale & Definitions

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 Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

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

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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

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- (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)
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Conduct of Business

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- (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.
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- (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)
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- (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)
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- (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)

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- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(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 | 18-(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 | 18-(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-(F-VII)

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