



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
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 Siddiqsons group and considered pioneer of the denim industry in Pakistan. The Company earns majority of its revenue through direct or indirect exports. The recent rupee devaluation increased the competitiveness of denim industry's exports in the international market. However, the Company was unable to translate this benefit into improved margins as currency devaluation increased the cost of imported raw materials such as cotton and dyes. However, the Company improved its operating and net margin through effective control of operating costs and lower finance costs. The bottom-line is supplemented by steady investment income, mainly in the form of dividends, providing cushion against industry challenges. The Company has a moderately leveraged capital structure, strong coverages and adequate working capital management. This is signified by limited room to borrow at trade asset level. The rating incorporates financial strength of the sponsors and likely support, if needed.

The ratings are dependent upon the management's ability to capitalize on growth opportunities in an increasingly competitive landscape while also improving margins. Sustainability of investment income remains important. Further, the elimination of asset liability mismatch in working capital is critical. 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-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Garments(Dec-19)
Rating Analysts	Ateeb Riaz ateeb.riaz@pacra.com +92-42-35869504

Profile

Legal Structure Siddiqsons Limited (Siddiqsons or 'the Company') was incorporated as an unlisted public entity in 1987.

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

Operations The Company has 26,800 spindles and 150 looms. The denim weaving unit has a production capacity of 60,000 meters per day. The Company regularly spends on BMR of its production facilities, 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 (15%), and son Mr. Abdur Rahim Tariq, (12%). 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 banking, energy, real-estate and metal industries. If required, the sponsors can provide timely financial support to the Company.

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. Mr. Tariq Rafi is the Chairman and CEO, while Mr. Abdur 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 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. The audit for FY19 is under progress.

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 is headed by a GM who reports directly to the COO with the exception of Finance GM, who reports directly to the Chairman.

Management Team The Company employs a senior management team that is qualified, experienced and capable of handling challenges that arise in business operations.

Effectiveness The Company has a designated department of internal audit to ensure all the business operations remain transparent. Timely completion of financial reporting has consistently been delayed, which reflects poorly on management efficiency.

MIS The Company has installed SAP, in order to streamline the flow of information within the Company. However, the Company faced challenges during SAP implementation. Most of these issues have been resolved and therefore, flow of information is likely to improve in future.

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 and Global Recycle Standard etc, reflecting well on control environment.

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 country's textile exports. Bangladesh, Turkey and Egypt are the major markets for fabric exports, while prime markets for denim garments comprise US and Europe. Pakistan's export competitiveness has increased due to the rupee devaluation and this has had a positive impact on textile industry. However, the players were unable to improve margins as some of the benefit was shared with the customers due to intense competition from other regional players. The withdrawal of zero-rated status of textile industry in Finance Bill 2020 has put pressure on 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 at PKR 12,238mln in FY19 (FY18: PKR 10,762mln), representing a growth of ~14%. Higher prices, in rupee terms due to currency devaluation, combined with increase in volumes contributed to the overall growth in top-line. Revenues are mostly derived from exports and a majority of local sales are also in the form of indirect exports.

Margins The Company's gross margin for FY19 stood at ~12% (FY18: ~14%). The expected positive impact of rupee devaluation was not observed in the margins as the Company had to share the benefit with its customers due to competition. Furthermore, the cost of imported raw material (cotton and dyes) also increased, resulting in a decline in the gross margin. In FY19, the operating margin improved to 6.5% (FY18: 5.1%) due to better control over operating costs. Markup incurred against LTFF was capitalized leading to reduced finance costs. Consequently, the Company's net profit margin increased to 5.6% in FY19 (FY18: 3.6%). The Company posted net profit of PKR 689mln in FY19 (FY18: PKR 390mln).

Sustainability The Company conducted BMR during the year, which included replacement of machinery in the spinning unit and addition of machinery in garment unit. The Company does not plan on increasing capacity in near future and instead will focus on higher capacity utilization and BMR.

Financial Risk

Working Capital Working capital is a function of inventory and trade receivables and is financed by the Company's cash flows and short term borrowings. The Company's gross working capital days decreased to 155 days in FY19 (FY18: 170 days) due to reduction in both inventory days (FY19: 104 days, FY18: 108 days) and trade receivable days (FY19: 52 days, FY18: 62 days). The Company's short term trade leverage turned negative and stood at -5%, showing no room for further borrowings to finance working capital.

Coverages In FY19, the Company's free cash flows increased to PKR 1,424mln (FY18: PKR 880mln) due to better profitability. Moreover, finance costs decreased to PKR 227mln (FY18: PKR 335mln). This resulted in a significant improvement in coverages. The interest coverage ratio increased to 8.9x (FY18: 3.8x) and the debt coverage ratio increased to 8.9x (FY18: 2.1x).

Capitalization The Company has moderately leveraged capital structure. In FY19, the leveraging stood at ~35% (FY18: ~34%). The Company's short term borrowings increased to PKR 4,158mln (FY18: PKR 3,804mln). Short term borrowings constitute ~58% of total borrowings. Leveraging is expected to remain stable as the Company does not have plans for capex in the near future.



The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Siddiqsons Limited Textile and Allied	Jun-19 12M	Jun-18 12M	Jun-17 12M
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A BALANCE SHEET

1 Non-Current Assets	6,292	5,475	4,383
2 Investments	3,302	3,708	3,702
3 Related Party Exposure	5,626	4,130	4,831
4 Current Assets	7,533	7,719	6,084
<i>a Inventories</i>	3,502	3,455	2,940
<i>b Trade Receivables</i>	1,360	2,103	1,526
5 Total Assets	22,754	21,032	19,000
6 Current Liabilities	2,439	2,053	1,782
<i>a Trade Payables</i>	1,395	1,167	1,275
7 Borrowings	5,771	5,572	4,240
8 Related Party Exposure	1,351	837	635
9 Non-Current Liabilities	69	189	229
10 Net Assets	13,124	12,382	12,114
11 Shareholders' Equity	13,124	12,382	12,114

B INCOME STATEMENT

1 Sales	12,238	10,762	9,171
<i>a Cost of Good Sold</i>	(10,801)	(9,269)	(7,990)
2 Gross Profit	1,437	1,493	1,181
<i>a Operating Expenses</i>	(637)	(944)	(769)
3 Operating Profit	800	549	412
<i>a Non Operating Income</i>	116	178	155
4 Profit or (Loss) before Interest and Tax	915	727	567
<i>a Total Finance Cost</i>	(227)	(335)	(307)
<i>b Taxation</i>	-	(1)	(135)
6 Net Income Or (Loss)	689	390	125

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	1,424	880	674
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	1,198	560	371
<i>c Changes in Working Capital</i>	1,381	(1,268)	(652)
1 Net Cash provided by Operating Activities	2,579	(708)	(281)
2 Net Cash (Used in) or Available From Investing Activities	(2,047)	(874)	(104)
3 Net Cash (Used in) or Available From Financing Activities	(500)	1,534	212
4 Net Cash generated or (Used) during the period	32	(48)	(173)

D RATIO ANALYSIS

1 Performance			
<i>a Sales Growth (for the period)</i>	13.7%	17.3%	1.7%
<i>b Gross Profit Margin</i>	11.7%	13.9%	12.9%
<i>c Net Profit Margin</i>	5.6%	3.6%	1.4%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	11.6%	10.7%	9.0%
<i>e Return on Equity (ROE)</i>	5.4%	3.2%	1.0%
2 Working Capital Management			
<i>a Gross Working Capital (Average Days)</i>	155	170	207
<i>b Net Working Capital (Average Days)</i>	117	129	165
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	3.1	3.8	3.4
3 Coverages			
<i>a EBITDA / Finance Cost</i>	8.9	4.9	3.6
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	8.9	2.1	1.6
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	2.3	4.0	3.1
4 Capital Structure (Total Debt/Total Debt+Equity)			
<i>a Total Borrowings / Total Borrowings+Equity</i>	35.2%	34.1%	28.7%
<i>b Short-Term Borrowings / Total Borrowings</i>	0.6	0.6	0.7
<i>c Average Borrowing Rate</i>	2.4%	4.2%	4.9%

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.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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.
- (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)

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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)
- (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 | 18-(a)
- (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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