The Pakistan Credit Rating Agency Limited

Rating Report

Sapphire Fibres Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
13-Nov-2024	A+	A1	Stable	Maintain	-
13-Nov-2023	A+	A1	Stable	Maintain	-
23-Nov-2022	A+	A1	Stable	Maintain	-
23-Nov-2021	A+	A1	Stable	Maintain	-
23-Nov-2020	A+	A1	Stable	Maintain	-
23-Nov-2019	A+	A1	Stable	Maintain	-
24-May-2019	A+	A1	Stable	Maintain	-
23-Nov-2018	A+	A1	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The assigned ratings of Sapphire Fibres Limited ("SFL" or "the Company") reflect the prominent profile of its sponsoring group, the Sapphire Group, a renowned textile conglomerate in Pakistan. The group has appreciable business diversity in multiple industry segments including; power generation, dairy, and retail. SFL is considered one of the group's leading ventures in the competitive textile landscape. The Company operates as a vertically integrated unit, utilizing advanced production technologies to deliver high-quality products across its spinning, denim fabrics, knitted fabrics, and garment divisions. Over time, SFL has diversified its income streams beyond the textile business to manage concentration risk, entering the power sector through core strategic investments and building an equity investment portfolio. As part of SFL's business diversification strategy, the Company is in the process of acquiring a 50% share in UCH Power (Private) Limited and UCH–II Power (Private) Limited. A substantial portion of the Company's revenue comes from the export market, contributing approximately 81% of the total turnover, amounting to PKR 38.5bln. During FY24, the Company experienced a slight increase in revenue growth, reaching PKR 47.4bln (FY23: PKR 46.4bln), mainly attributable to a modest improvement in product pricing. Spinning is the top-performing segment in revenue generation, contributing PKR 28.6bln to the Company's top line, followed by PKR 12.3bln from Denim and PKR 6.4bln from Knits. The knitting segment encountered a substantial downturn during the year, primarily due to subdued product demand in international markets resulting from recessionary trends. However, the segment is showing signs of recovery with a recent increase in order volumes, and management anticipates improved performance in the coming quarters. SFL's clientele consists of established entities across various export destinations worldwide, primarily in Asia and European markets. During FY24, the dilution of gross margins was primarily attributable to the strategic procurement of imported raw cotton to elevate product quality and optimize the supply chain matrix. Concurrently, escalating energy costs, driven by increased electricity and gas tariffs, and elevated labour expenses, necessitated by inflationary pressures, coupled with the surge in finance costs are the prime challenges specific to the textile industry. The funding matrix of the Company revolves around short-term equity investments, which supplement the liquidity profile and augment the profitability matrix of the Company through the inflow of dividend income. The Company maintains a low-leverage capital structure. The Company's well-managed working capital supplements the financial risk profile. The cashflows and coverages of the Company are considered adequate owing to magnified finance costs.

The ratings depend on an improvement in profitability while venturing into diversified business segments. The prudent management of the investment portfolio remains important. The sustainability of coverages and stable generation of cashflows from core consolidated operations remain critical for assigned ratings.

Disclosure

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

Profile

Legal Structure Sapphire Fibres Limited ("SFL" or "the Company") was incorporated in Pakistan on June 05, 1979, as a Public Company under the Companies Act, 1913 (now the Companies Act, 2017), and its shares are quoted on the PSX.

Background SFL is the flagship Company of the Sapphire Group. Mr. Mian Mohammad Abdullah, the group's chairman, founded Sapphire Group in 1969, and the transition from a yarn manufacturer to one of the largest textile conglomerates reflects his vision. The group gradually expanded its footprint into multiple sectors, including power generation, dairy, and retail.

Operations SFL is a vertically integrated composite textile unit engaged in producing yarn, denim fabric, and knitted fabrics and garments. The Company currently operates with 104,256 spindles, 164 looms, 102 knitting machines, and 16 stitching machines across eight manufacturing facilities.

Ownership

Ownership Structure The sponsoring family holds a majority stake in the Company (68.2%) through group companies (53.8%) and individual holdings (14.4%), while the remaining shares are held by the general public (25.3%) and others (6.5%), including a 3.0% stake held by NIT and ICP.

Stability The group was succeeded by Mr. Mian Mohammad Abdullah's four sons: Mr. Shahid Abdullah, Mr. Nadeem Abdullah, Mr. Amer Abdullah, and Mr. Yousaf Abdullah. No changes in the ownership structure are anticipated in the foreseeable future.

Business Acumen The Abdullah family possesses a wealth of experience spanning ~05 decades in the textile industry. Their intimate knowledge of textile mill operations, coupled with their exceptional skills in strategic planning and policy formulation, positions them as one of the prominent industry leaders.

Financial Strength Sapphire Electric Company Limited (SECL), a subsidiary of SFL, owns and operates a combined-cycle power plant, contributing PKR 20.1bln to the Company's consolidated topline of PKR 67.5bln as of FY24. The Sapphire Group has an annual turnover of USD 1.35bln, with USD 1.15bln generated from the textile division.

Governance

Board Structure The board comprises nine members (eight male directors and one female director) including the Chairman and CEO. Five members act as non-executive directors, three independent directors, and one executive director. The inclusion of independent oversight has strengthened the governance matrix of the Company.

Members' Profile The chairman of the board, Mr. Yousuf Abdullah, holds an MBA from the UK. He is the CEO of Sapphire Finishing Mills Limited and has also served on the boards of other group businesses since 1995. SFL's CEO, Mr. Shahid Abdullah holds a bachelor's degree in Commerce and has been associated with the Sapphire Group since 1980. Mr. Nadeem Abdullah, CEO of Sapphire Textile Mills Limited possesses over 17 years of experience and graduated from McGill University Canada. Mr. Shayan Abdullah has a Bachelor of Science in Business Management from the USA and associated with the board since 2015. Mr. Amer Abdullah has been associated with the group since 1990 and holds an MBA from the USA. He is currently serving as the CEO of Diamond Fabrics Limited and Sapphire Dairies (Private) Limited.

Board Effectiveness SFL has established three board committees – Audit Committee, Human Resource & Remuneration Committee, and Risk Management Committee. During FY24, five meetings of the board of directors were held to evaluate the Company's overall performance towards its targets. The minutes of those meetings have been formally documented.

Financial Transparency M/s. Shinewing Hameed Chaudhri & Co. - in category "B" on the SBP panel of auditors - is the external auditor of the Company. The auditor gave an unqualified opinion on the Company's financial statements for the period ended June 30th, 2024.

Management

Organizational Structure The Company has a well-structured organizational layout, with overall operations divided into eight broad functional divisions, which are further categorized into various sub-divisions to ensure a smooth flow of operations. The heads of departments report primarily to the CEO and COO, while the COO reports directly to the CEO.

Management Team The management team comprises qualified and experienced professionals, led by the CEO. Mr. Shayan Abdullah serves in the position of director and oversees raw material procurement, accounts and marketing for the spinning divisions of SFL. Mr. Jawwad Faisal, Group CFO and COO of the Company, is a chartered accountant by profession and possesses ~25 years of experience.

Effectiveness The management tier ensures effective delegation of functional responsibilities across various departments, facilitating a smooth flow of operations. The system's implementation supports the integration of business processes and optimizes resources through synchronization and planning.

MIS The Company has implemented an Oracle-based ERP—Oracle E-business suite—to accommodate large-scale and diversified operations. Regular updates to the software aid management in timely decision-making.

Control Environment The Company's monthly MIS reports, which include comprehensive segment- and unit-wise performance reports, are formally reviewed by the CEO along with monthly accounts. The Company has a co-sourced internal audit function to ensure compliance, effective internal controls, and risk management, as well as to enhance operational efficiency.

Business Risk

Industry Dynamics Textile exports of the country reached USD 16.7bln in FY24, a slight increase from USD 16.5bln in the previous year, reflecting a growth of 0.93% YoY. The highest contribution came from the composite and garments segment at USD 9.1bln, followed by the weaving segment at USD 6.5bln, and the spinning segment at USD 1.0bln. In FY25, the transition from the final tax regime to the normal tax regime is set to impact the profitability of export-oriented units, with a 29% tax on profits and an additional super tax of up to 10%.

Relative Position The Company's relative position is considered strong, as SFL achieved approximately USD 97.4mln in exports during FY24 and ranked among the top 50 textile exporters in Pakistan as of FY24.

Revenues During FY24, the Company's topline marginally rose by 2.1% on a YoY basis and stood at PKR 47.4bln (FY23: 46.4bln; 3MFY25: PKR 13.1bln) mainly attributable to improved business volumes in the spinning segment. The proportion of export and local sales during FY24 was 81.2% for exports and 18.8% for local sales. Spinning segments hold the most concentration at 60.3% in the Company's top line, followed by Denim at 26.1% and Kits at 13.5%. (FY23: 25.4%). Sluggish demand in international markets has mainly impacted sales in the Knits segment.

Margins The gross margin showed a YoY decline (FY24: ~11.9%, FY23: ~19.2%) due to the procurement of imported cotton and a surge in energy costs, reflecting an adequate price transferability matrix. Consequently, PAT stood at PKR 3.4bln as of FY24 (FY23: PKR 5.1bln), impacted by an elevated interest burden. Dividend income of PKR 3.1bln from strategic investment and trading portfolio has supplemented the profitability.

Sustainability Looking ahead, the Company does not foresee any substantial capital expenditures in the textile segment. As part of its diversification strategy, SFL has entered into an agreement to acquire a 50% share in both UCH Power (Private) Limited and UCH-II Power (Private) Limited.

Financial Risk

Working Capital SFL meets its working capital requirements through a mix of internal generation and short-term borrowings (STBs). The net-working capital days end-June'24: 149 days (end-June'23: 147days). The Company's short-term trade leverage stood at 52.2% as of FY24, depicting sufficient room to borrow.

Coverages A dip in free cash flows from operations (FY24: PKR 3.8bln. FY23: PKR 6.9bln) has impacted the interest coverage ratio to 1.5x in FY24 (FY23: 3.9x). The EBITDA to Finance cost ratio declined to 1.9x (FY23:4.4x) on account of the surge in finance cost paid and dilution in gross profit. During 3MFY25, the Company's FCFO clocked at 698mln.

Capitalization The Company has a low-leveraged capital structure, with leverage decreasing to 27.8% during FY24 (FY23: 35%) and financing mainly comprising KIBOR-based short-term borrowings (61%). The Company's long-term borrowings stood at PKR 3.9bln, primarily consisting of subsidized borrowings (LTFF) from the SBP, while the equity base reached PKR 34.5bln during FY24.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

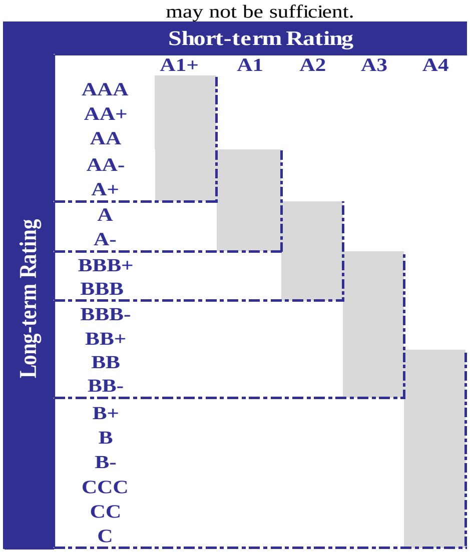
Sapphire Fibres Limited Composite and Garments	Sep-24 3M	Jun-24 12M	Jun-23 12M	Jun-22 12M
A BALANCE SHEET				
1 Non-Current Assets	16,850	16,448	15,215	14,695
2 Investments	8,352	8,208	4,303	5,298
3 Related Party Exposure	6,036	5,694	5,444	4,966
4 Current Assets	29,600	25,926	26,193	23,942
a Inventories	*15,951*	*14,891*	*14,503*	*14,344*
b Trade Receivables	*6,224*	*5,596*	*7,447*	*5,077*
5 Total Assets	60,837	56,276	51,156	48,900
6 Current Liabilities	10,258	7,676	7,879	7,329
a Trade Payables	*2,629*	*1,881*	*1,723*	*2,320*
7 Borrowings	14,262	13,322	14,926	17,685
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	762	717	642	517
10 Net Assets	35,556	34,560	27,709	23,369
11 Shareholders' Equity	35,556	34,560	27,709	23,369
B INCOME STATEMENT				
1 Sales	13,133	47,420	46,447	43,638
a Cost of Good Sold	*(11,742)*	*(41,755)*	*(37,530)*	*(33,350)*
2 Gross Profit	1,391	5,665	8,917	10,288
a Operating Expenses	(796)	(2,378)	(2,477)	(2,494)
3 Operating Profit	595	3,287	6,439	7,794
a Non Operating Income or (Expense)	*1,204*	*3,711*	*1,639*	*932*
4 Profit or (Loss) before Interest and Tax	1,799	6,997	8,079	8,726
a Total Finance Cost	*(477)*	*(2,784)*	*(1,984)*	*(1,672)*
b Taxation	*(468)*	*(841)*	*(974)*	*(838)*
6 Net Income Or (Loss)	855	3,373	5,121	6,215
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*698*	*3,871*	*6,971*	*8,091*
b Net Cash from Operating Activities before Working Capital	*196*	*936*	*5,109*	*6,490*
c Changes in Working Capital	*(1,084)*	*523*	*(2,295)*	*(5,452)*
1 Net Cash provided by Operating Activities	(888)	1,459	2,814	1,038
2 Net Cash (Used in) or Available From Investing Activities	215	657	475	(1,359)
3 Net Cash (Used in) or Available From Financing Activities	939	(1,814)	(2,975)	301
4 Net Cash generated or (Used) during the period	266	302	314	(19)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	10.8%	2.1%	6.4%	58.5%
b Gross Profit Margin	10.6%	11.9%	19.2%	23.6%
c Net Profit Margin	6.5%	7.1%	11.0%	14.2%
d Cash Conversion Efficiency (FCFO adjusted for Working C	-2.9%	9.3%	10.1%	6.0%
*e Return on Equity [Net Profit Margin * Asset Turnover * (T*	9.8%	10.8%	20.1%	29.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	148	163	163	140
b Net Working Capital (Average Days)	133	149	147	123
c Current Ratio (Current Assets / Current Liabilities)	2.9	3.4	3.3	3.3
3 Coverages				
a EBITDA / Finance Cost	2.2	1.9	4.4	6.0
b FCFO / Finance Cost+CMLTB+Excess STB	0.9	1.0	2.3	3.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fi	4.9	4.1	1.2	1.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equit	28.6%	27.8%	35.0%	43.1%
b Interest or Markup Payable (Days)	37.0	28.9	73.2	61.4
c Entity Average Borrowing Rate	11.0%	16.0%	10.5%	7.3%

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