



The Pakistan Credit Rating Agency Limited

## Rating Report

### Sapphire Fibres Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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	-
29-May-2018	A+	A1	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect Sapphire Fibres Limited's (Sapphire Fibres) established business profile emanating from a strong presence in the broader value-chain; enabling the Company to manage volatility in the textile industry. To one side from producing a range of finer quality yarn, the Company is also engaged in dyeing, knitting, stitching, and manufacturing of denim fabric. The business profile has improved on the back of the established denim weaving segment. Continuous BMR activities have led to significant growth in operations in recent years. During FY21, Company's gross and net margins both improved on the back of enhanced core income and dividend. A sizable investment book (PKR 11.5bln, 60.8% of equity) built over the years by deploying surplus funds augments the Company's profile. During CY21, escalated domestic demand and rising exports resulted in improved revenues. The demand for exports has surged after Dec'20 and the Company capitalized on it. The exports increased by PKR 3.6bln YoY to clock in at PKR 22.2bln. Strong core operations have led to continued improvement in profitability. Dividend income comprises 46.4% of the Company's bottom-line in FY21. The financial risk of the Company has recently improved due to higher cashflows and low finance cost. Company bounced back in FY21 and the coverages improved due to a reduction in finance cost. Free cashflows have shown significant improvement due to better performance in core operations, reflected in improved coverages in FY21 after being stagnant in FY20. Core coverage only improved marginally attributable to higher quantum of CMLTD. The expected continuity of the dividend stream from Sapphire Electric will further supplement the bottom-line and coverages. Ratings incorporate association of the company with well-established Sapphire Group which enjoys distinguishing presence in several sectors.

The ratings are dependent on sustaining the business profile of the Company by maintaining profitability and margins achieved from core textile operations. At the same time, the sustainability of non-core income and prudent management of the surplus funds are important. Sustainability of coverages would remain critical to avoid any drag on financial profile due to a prolonged downturn in capital markets.

#### Disclosure

<b>Name of Rated Entity</b>	Sapphire Fibres Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Rating(Jun-21),Criteria   Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria   Rating Modifiers(Jun-21)
<b>Related Research</b>	Sector Study   Composite(Nov-20)
<b>Rating Analysts</b>	Muhammad Fahad Iqbal   fahad.iqbal@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Sapphire Fibres Limited (Sapphire Fibres) is a listed, public limited concern established in 1979.

**Background** Sapphire Fibres is the flagship Company of Sapphire Group. Mr. Mohammad Abdullah, Chairman of the Group, founded Sapphire Group in 1969 and is succeeded by his sons, Mr. Shahid Abdullah, Mr. Nadeem Abdullah, Mr. Amer Abdullah, and Mr. Yousaf Abdullah.

**Operations** Sapphire Fibres is a vertically integrated composite textile unit engaged in the production of yarn, knitwear, and denim fabric. The Company has eight manufacturing facilities in and around Lahore as well as captive power plants. The Company currently operates with 102,336 spindles.

## Ownership

**Ownership Structure** Sapphire Group collectively continues to own the majority (~85%) shares of the Company directly through individuals (~33%) and group companies (~52%). The remaining (~15%) stake is well spread among financial institutions, companies, and the general public.

**Stability** The presence of a Group holding company, Sapphire Holdings (Pvt.) Limited, as well as formal documentation capturing the family ownership structure bodes well for the stability of Sapphire Fibres.

**Business Acumen** The Abdullah family has more than 50 years of experience in the textile industry with full knowledge of the internal working of textile mills as well as a special knack in the formulation of policies and strategic planning.

**Financial Strength** The Sapphire Group has one of the largest vertically integrated textile set-ups in Pakistan with more than 30 production units. It also has interests in diversified sectors including power, dairy, cement, and investment companies with the Group's collective revenue exceeding ~PKR 100bln in FY21.

## Governance

**Board Structure** Overall control vests in an eight-member board of directors chaired by Mr. Amer Abdullah. The Board is dominated by Sapphire Group with six members. However, the non-executive role of some family members and the presence of two independent directors makes the overall governance structure strong.

**Members' Profile** Mr. Amer Abdullah has ceased to be the Chairman of the Board as of September 23rd, 2021, and Mr. Yousaf Abdullah has been appointed as a chairman of the board.

**Board Effectiveness** Attendance of members in Board meetings remains strong while meeting minutes are well documented. Two committees – Audit, and Human Resource & Remuneration – are in place to assist the Board on relevant matters. Both committees are chaired by independent directors.

**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, 2021. Sapphire Fibres also has an Internal Audit function.

## Management

**Organizational Structure** The Company's overall operations are segregated into eight broad functional divisions which are further categorized into various sub-divisions to ensure a smooth flow of operations with a large number of senior executives reporting directly to the CEO.

**Management Team** The management team comprises qualified and experienced professionals, led by the CEO – Mr. Shahid Abdullah – who possesses rich textile industry experience and has been associated with the Company since its inception. He is assisted by the COO, Mr. Shayan Abdullah.

**Effectiveness** The management tier ensures effective delegation of functional responsibility across various departments, facilitating a smooth flow of operations while the implementation of IT systems covers the integration of business processes, optimizing resources using synchronization and planning.

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

**Control Environment** The Company's monthly MIS reports which comprise comprehensive segment and unit wise performance reports are reviewed formally by the CEO along with monthly accounts.

## Business Risk

**Industry Dynamics** Pakistan's textile and clothing exports declined by over 1% year-on-year in August 2020, from ~PKR 2.3bln in Aug last year to ~PKR 2.28bln. Textile exports of the country recorded an increase of 28.6% to stand at USD 2.9bln as compared to USD 2.3bln from July 21 to Aug 21 due to an increase in demand for textile products internationally, led by a good recovery around the globe post-pandemic. Going forward, the textile sector's outlook is expected to stay stable in the medium term where the demand for textile products is expected to increase. The probability of little attrition in demand remains on the horizon attributable to the outbreak of COVID-19 variants. In the local market, the textile sector has recorded strong performance. The relief measures introduced by the State Bank of Pakistan such as deferment of loan payments for one year, low-interest rates, and salary refinance scheme also provided comfort to the sector.

**Relative Position** During FY21, Sapphire Fibres contributes ~0.9% (FY21) share in the country's total textile exports. It is one of the largest specialized yarn manufacturing and marketing Company in Pakistan.

**Revenues** During FY21, the Company's topline rose by 22.4% on a YoY basis on account of improved export performance (volumetric) – despite the highly competitive international market. Export and local sales in terms of proportion during FY21 stood at i.e. Export: 80.7%; Local: 19.3%. During FY21, core business expenses increased by 19.9% on a YoY basis due to higher cotton, labor, and energy costs.

**Margins** The Company has established a stable stream of non-core income from the strategic book of investments. Dividend income comprises 46.4% of the Company's bottom-line in FY21; in magnitude (FY21: PKR 1,057mln, FY20: PKR 1,381mln) remained steady largely due to stable dividend stream from Sapphire Electric Company Limited - subsidiary. During FY21, Interest expense decreased (34.1% YoY) owing to increased borrowings. Profit before tax increased by 76.9% YoY to report at PKR 2,674mln during FY21 (FY20: 1,511mln). Margins during the year improved due to higher revenues (gross: FY21: 14.3%, FY20: 12.6%; operating: FY21: 9.1%, FY20: 7.3%) on a YoY basis. Net income of the Company clocked in at PKR 2,274mln in FY21 (FY20: PKR 1,125mln) and the net margin improved to 8.3% in FY21 (FY20: 5%).

**Sustainability** Regular Balancing, Modernization, and Replacement (BMR) in spinning and weaving segments in FY21 are likely to have a positive impact on productivity going forward. Furthermore, continuous BMR has resulted in improving the turnover and margins of the Company and the benefits are expected to sustain, going forward. Dividend income from the Company's trading portfolio continues to supplement the bottom line. Meanwhile, dividend stream from strategic investments has been a major determinant of profitability in the past and remains critical to the Company's performance amidst the outbreak of Covid-19.

## Financial Risk

**Working Capital** The net-working capital days end-June'21 were: 140days (end-June'20: 156days) However, in FY21, short-term borrowings are higher as an investment in raw material increased as compared to the same period last year to gain the advantage of rising cotton prices.

**Coverages** Due to an increase in cashflows (FY21: PKR 3,214mln, FY20: PKR 2,112mln) interest coverage improved and clocked in at 3.8x in FY21 (FY20: 1.6x) due to lower finance cost. Similarly, the debt coverage also improved (FY21: 1.7x FY20: 1.2x). The Company's TCF coverage also improved (FY21: 2.2x FY20: 2x).

**Capitalization** Sapphire Fibres maintains a moderately leveraged capital structure (FY21: 47.6%, FY20: 48.4%), with financing mainly comprising of short-term borrowing (63.7%).



Sapphire Fibres Limited Textile Composite	Jun-21 12M	Jun-20 12M	Jun-19 12M	Jun-18 12M
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**A BALANCE SHEET**

1 Non-Current Assets	12,896	11,901	10,592	10,338
2 Investments	6,854	6,173	7,031	8,644
3 Related Party Exposure	4,682	4,492	4,318	4,033
4 Current Assets	16,427	11,751	12,961	9,641
<i>a Inventories</i>	11,352	7,538	6,831	4,796
<i>b Trade Receivables</i>	2,728	2,226	4,233	2,851
5 Total Assets	40,860	34,317	34,903	32,656
6 Current Liabilities	4,315	3,062	3,029	2,212
<i>a Trade Payables</i>	1,724	946	661	459
7 Borrowings	17,161	14,912	16,094	13,682
8 Related Party Exposure	-	-	124	-
9 Non-Current Liabilities	468	454	369	477
10 Net Assets	18,915	15,888	15,287	16,284
11 Shareholders' Equity	18,915	15,888	15,287	16,284

**B INCOME STATEMENT**

1 Sales	27,531	22,492	21,750	17,828
<i>a Cost of Good Sold</i>	(23,591)	(19,668)	(18,886)	(16,003)
2 Gross Profit	3,941	2,824	2,865	1,825
<i>a Operating Expenses</i>	(1,429)	(1,179)	(1,034)	(894)
3 Operating Profit	2,512	1,645	1,830	931
<i>a Non Operating Income or (Expense)</i>	1,125	1,329	448	1,250
4 Profit or (Loss) before Interest and Tax	3,637	2,974	2,278	2,181
<i>a Total Finance Cost</i>	(963)	(1,463)	(1,262)	(733)
<i>b Taxation</i>	(400)	(386)	(257)	(304)
6 Net Income Or (Loss)	2,274	1,125	759	1,145

**C CASH FLOW STATEMENT**

<i>a Free Cash Flows from Operations (FCFO)</i>	3,144	2,112	2,176	1,209
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	3,227	2,017	1,463	1,880
<i>c Changes in Working Capital</i>	(3,487)	1,034	(2,553)	(2,212)
1 Net Cash provided by Operating Activities	(260)	3,051	(1,091)	(332)
2 Net Cash (Used in) or Available From Investing Activities	(1,718)	(1,852)	(1,156)	(2,328)
3 Net Cash (Used in) or Available From Financing Activities	1,975	(1,207)	2,299	2,652
4 Net Cash generated or (Used) during the period	(4)	(8)	53	(7)

**D RATIO ANALYSIS**

1 Performance				
<i>a Sales Growth (for the period)</i>	22.4%	3.4%	22.0%	23.2%
<i>b Gross Profit Margin</i>	14.3%	12.6%	13.2%	10.2%
<i>c Net Profit Margin</i>	8.3%	5.0%	3.5%	6.4%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	-1.2%	14.0%	-1.7%	-5.6%
<i>e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Sh</i>	13.1%	7.0%	5.1%	7.2%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	158	169	157	134
<i>b Net Working Capital (Average Days)</i>	140	156	148	124
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	3.8	3.8	4.3	4.4
3 Coverages				
<i>a EBITDA / Finance Cost</i>	4.3	1.9	2.3	2.5
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.7	1.2	1.1	0.8
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	2.7	6.4	4.6	8.9
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	47.6%	48.4%	51.5%	45.7%
<i>b Interest or Markup Payable (Days)</i>	86.8	50.3	67.0	67.0
<i>c Entity Average Borrowing Rate</i>	5.0%	8.6%	7.3%	5.4%

**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.

Scale	Long-term Rating Definition
AAA	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	<b>Very high credit quality.</b> 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.
AA-	
A+	
A	<b>High credit quality.</b> 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.
A-	
BBB+	
BBB	<b>Good credit quality.</b> 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.
BBB-	
BB+	<b>Moderate risk.</b> 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.
BB	
BB-	
B+	
B	<b>High credit risk.</b> 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.
B-	
CCC	<b>Very high credit risk.</b> 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.
CC	
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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):

<p><b>Entities</b></p> <ul style="list-style-type: none"> <li>a) Broker Entity Rating</li> <li>b) Corporate Rating</li> <li>c) Financial Institution Rating</li> <li>d) Holding Company Rating</li> <li>e) Independent Power Producer Rating</li> <li>f) Microfinance Institution Rating</li> <li>g) Non-Banking Finance Companies (NBFCs) Rating</li> </ul>	<p><b>Instruments</b></p> <ul style="list-style-type: none"> <li>a) Basel III Compliant Debt Instrument Rating</li> <li>b) Debt Instrument Rating</li> <li>c) Sukuk Rating</li> </ul>
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- 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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- (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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- (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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- (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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