The Pakistan Credit Rating Agency Limited

Rating Report

Sapphire Finishing Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
22-Nov-2024	A	A1	Stable	Maintain	-
23-Nov-2023	A	A1	Stable	Maintain	-
25-Nov-2022	A	A1	Stable	Maintain	-
26-Nov-2021	A	A1	Stable	Maintain	-
27-Nov-2020	A	A1	Stable	Maintain	-
28-Nov-2019	A	A1	Stable	Maintain	-
29-May-2019	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings of Sapphire Finishing Mills Limited ("SFML" or "the Company") emanate from the established and robust business profile of the sponsors. Sapphire Group is considered one of Pakistan's largest manufacturers and exporters of textile products. Over the years, the group has evolved from a spinning business into a textile powerhouse, strategically diversifying its business portfolio with expansions into the energy, dairy, and real estate sectors. SFML, a prominent business venture of Sapphire Group, is engaged in fabric dyeing, processing, finishing and garments stitching. The Company is equipped with state-of-the-art production facilities and cutting-edge processes to manufacture premium products that meet the high-quality standards of the top international clientage. The Company offers a broad range of products in the garments segment, including casual wear and work wear. A predominant portion of SFML's top line is generated from export sales which represent ~95% of the total revenue. In terms of segment-wise revenue contribution, garments account for the largest share at ~57.6% followed by fabric. During FY24, the Company's top line demonstrated a modest growth of 4.0%, reaching PKR 44.0bln (FY23: PKR 42.3bln) mainly driven by an increase in local fabric sales volume and higher monetary value generation in garments. The dilution in gross margins is mainly attributable to a bearish trend in the international market, which has impacted product pricing in dollar terms coupled with expensive raw material procurement and an uptick in salaries and wages concomitant with inflationary trends. The Company has optimized its energy cost expense through its steam turbines. The surge in operating expenses and increased finance costs impacted the Company's net profitability, resulting in a loss after tax of PKR 714.4mln compared to a profit after tax of PKR 3.9bln in FY23. However, the income stream from the strategic allocation of funds in group companies and quoted equity instruments has supplemented the profitability matrix. The Company mainly fuels its working capital requirements through short-term borrowings (STB) followed by internally generated cash flows. The financial risk profile of the Company is considered adequate with a stretched working capital cycle and dilution in the coverages. The Company has maintained a leveraged capital structure. The management is mindful of the current challenges and expects to gain momentum by the end of FY25. Looking ahead, the management plans to enhance its operational efficiency through cost-reduction production processes, and therefore, created a BMR and capacity expansion reserve of approximately PKR 10bln. Further, any retained profits in the upcoming years will be reinvested with no dividend payout to the shareholders. The anticipated low cotton yield in FY25, which heightens the need for imported cotton, along with rising energy costs due to increased electricity and gas tariffs, are key challenges faced by the industry.

The ratings are dependent on the intact business operations under the current economic conditions. The improvement in the Company's profitability from core operations and maintenance of coverages at a comfortable range remains essential. Adherence to the debt matrix at an optimal level is a prerequisite for assigned ratings.

Disclosure

Name of Rated Entity	Sapphire Finishing Mills 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	Tasveeb Idrees | Tasveeb.Idrees@pacra.com | +92-42-35869504

Profile

Legal Structure Sapphire Finishing Mills Limited ("SFML" or "the Company") is an unlisted public limited Company incorporated in July 2000.

Background SFML, one of the leading ventures of the Sapphire Group, commenced commercial operations in November 2003 with state-of-the-art production facilities. The Company, as part of a group expansion strategy, was initially established to cater to the apparel-dyed fabric market. Over time, SFML gradually transitioned into manufacturing work wear and casual wear apparel.

Operations The Company specializes in fabric processing, dyeing, and finishing, as well as garment stitching for work wear and casual wear apparel. It operates with three production facilities. Unit 1 is dedicated to fabric dyeing and finishing, producing ~38mln meters of fabric annually, while Units 2 and 3 focus on garment stitching, with production capacities of ~2.8mln and 4.5mln pieces per annum respectively. The Company has a captive power generation boiler with a capacity of ~5.5 megawatts.

Ownership

Ownership Structure SFML's entire stake is owned by the Sapphire Group, holding approximately 92% of its shares through group companies: Sapphire Holdings (Pvt.) Limited (~32%), SFL Limited (~28%), and others (~32%). The remaining 8% stake is directly owned by members of the Abdullah family.

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 Since its inception in 1970, the Sapphire Group has gone through multiple economic cycles but the growth remained intact. With more than five decades of extensive experience in the textile, energy, retail, and dairy industries, the sponsors possess exceptional business acumen and strategic insight. Their diverse expertise underscores their capability to drive growth and innovation within the organization.

Financial Strength SFML's financial strength emerges from its association with Sapphire Group, which boasts an annual revenue of ~1.35bln USD. Among this, ~1.15bln USD is generated from the textile division, indicative of the sponsor's ample capacity to support the Company if needed.

Governance

Board Structure The seven-member board, chaired by Mr. Mohammad Abdullah, comprises five non-executive directors and two executive directors (the Chairman and CEO) from the Sapphire Group. The inclusion of independent oversight would further enhance the corporate governance framework.

Members' Profile Mr. Mian Mohammad Abdullah, the Chairman of Sapphire Group possesses an extensive experience of over 50 years in the local industry. He has been bestowed with Pakistan's top civilian award, the Sitara-e-Imtiaz twice. Mr. Shahid Abdullah, the CEO of Sapphire Fibres Limited and Sapphire Electric Company Limited, holds a bachelor's degree in commerce from the University of Karachi. Mr. Nadeem Abdullah earned his degree from McGill University in Canada and serves as the CEO of Sapphire Textile Mills Limited. Mr. Amer Abdullah is a key decision-maker in Diamond Fabrics Limited and Sapphire Dairies (Pvt). Limited. He holds a Master's degree in Business Administration from the United States. Mr. Ismael Abdullah graduated from the University of Pennsylvania and has been associated with SFML for over 3 years.

Board Effectiveness BOD meetings are held regularly to review the Company's performance and track progress toward targets. The BOD members ensure their availability, as shown by their strong attendance in meetings, where all relevant information is provided to them in advance for discussion.

Financial Transparency M/s. Shinewing Hameed Chaudhri & Co., the external auditors of SFML, are classified in category 'B' by the SBP panel of auditors. They issued an unqualified opinion on the Company's financial statements for the year ended June 30, 2024.

Management

Organizational Structure The Company has a well-structured organizational framework; the operations are categorized into eight functional departments, each further divided into specialized sub-divisions to optimize workflow. This structure ensures efficient management, with many senior executives reporting directly to the CEO.

Management Team Mr. Yousuf Abdullah, the CEO, is an accomplished leader with over 25 years of experience in the textile industry. He is a graduate of the Wharton Business School at the University of Pennsylvania and holds an MBA degree from Cambridge University. He is supported by a team of qualified and experienced professionals, most of whom have been associated with the Sapphire Group for a reasonable time period.

Effectiveness To facilitate a smooth flow of operations, two formal management committees are in place. MIS reports related to daily operations are generated and submitted to senior management for regular discussions, along with need-based meetings to address any arising issues.

MIS To ensure timely decision-making and adherence to high standards of operational efficiency, the Company implemented an Oracle-based ERP solution in 2006: the Oracle E-Business Suite version 12.1.3. The system aids in the integrating business processes by optimizing resource use through synchronization and planning.

Control Environment The Company's monthly MIS includes comprehensive performance reports that are frequently reviewed by senior management. As the Company performs chemical treatments on cloth for its products, it outsources testing to international labs to ensure quality control. Additionally, the Company holds several certifications namely GOTS, BCI, Higg Index and others supporting the adherence to high-quality standards throughout the production process. The Company maintains a ten-member, risk-based internal audit function that reports directly to the CEO.

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 matrix of export-oriented units, with a 29% tax on profits and a super tax of up to 10%.

Relative Position The Company operates in a highly fragmented market and sustains its relative position. This can also be depicted by SFML's inclusion in the top 15 textile exporters of Pakistan.

Revenues The Company's top line demonstrated a remarkable 3-year CAGR of 28.3% from FY22 to FY24, with a 4.1% (FY24: PKR 44.0bln; FY23: PKR 42.3bln) YoY revenue growth mainly driven by an increase in local fabric sales volume and higher monetary value generation in garments. Export sales comprise around 95.1% of the total revenue. The Company's top ten client concentration remained at ~57%, accompanied by long-term association with top international brands like Weenas, Swedol, Helly Hansen, and others exhibit optimal risk diversification.

Margins During FY24, the gross profit margin declined to 9.0% (FY23: 21.1%) mainly attributable to a bearish trend in the international market, which has impacted product pricing in dollar terms coupled with expensive raw material procurement and an uptick in salaries and wages concomitant with inflationary trends. The Company received a dividend income of PKR 425mln (FY23: PKR 165mln) from Tricon Boston Consulting (Pvt). Limited. The Company's finance cost-to-sales ratio inched up to 5.7% (FY23: 4.1%). The Company booked a loss after tax of PKR 714mln (FY23: PAT PKR 3.9bln).

Sustainability The management is continuously upgrading machinery in existing production facilities to enhance operational efficiency and implement cost-reducing methods. However, given the prevailing economic conditions, no major capital expenditure (CAPEX) is anticipated for expansion in the near future.

Financial Risk

Working Capital The Company meets its working capital requirements through internally generated cash flows and short-term borrowings (STBs). The net working capital cycle was extended to 134 days (FY23: 124 days) primarily on the back of a stretched inventory cycle (FY24: 106 days; FY23: 98 days).

Coverages The dilution in PBT attributed to magnified finance cost led to a dip in the Company's free cash flows from operations (FCFO) reported at PKR 1.8bln during FY24 (FY23: PKR 7.2bln). Correspondingly, in FY24, the EBITDA/Finance cost and FCFO/Finance cost ratios dropped to 1.0x (FY23: 4.4x) and 0.7x (FY23: 4.1x) respectively.

Capitalization The equity base reflected a decline to PKR 14.9bln during FY24 (FY23: PKR 15.3bln) due to a loss after tax. The debt profile comprises long-term subsidized borrowings by SBP and conventional short-term borrowings (STBs). The STBs increased to PKR 18.8bln (FY23: PKR 15.7bln) due to intensive working capital requirements. Consequently, the Company maintained a leveraged capital structure, with leverage rising to 55.8% (FY23: 50.6%).

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Sapphire Finishing Mills Limited Composite & Garments	Jun-24 12M	Jun-23 12M	Jun-22 12M
A BALANCE SHEET			
1 Non-Current Assets	16,944	14,673	12,280
2 Investments	628	481	879
3 Related Party Exposure	1,058	1,041	600
4 Current Assets	23,096	21,452	20,228
a Inventories	*13,551*	*11,995*	*10,659*
b Trade Receivables	*3,772*	*2,934*	*3,125*
5 Total Assets	41,726	37,647	33,987
6 Current Liabilities	7,309	6,188	6,383
a Trade Payables	*3,260*	*1,642*	*2,449*
7 Borrowings	18,880	15,743	15,519
8 Related Party Exposure	551	336	600
9 Non-Current Liabilities	-	-	-
10 Net Assets	14,985	15,380	11,484
11 Shareholders' Equity	14,985	15,380	11,484
B INCOME STATEMENT			
1 Sales	44,077	42,348	34,253
a Cost of Good Sold	*(40,089)*	*(33,393)*	*(28,824)*
2 Gross Profit	3,988	8,955	5,429
a Operating Expenses	(2,946)	(2,428)	(2,024)
3 Operating Profit	1,042	6,527	3,405
a Non Operating Income or (Expense)	*1,010*	*17*	*280*
4 Profit or (Loss) before Interest and Tax	2,052	6,544	3,685
a Total Finance Cost	*(2,676)*	*(1,919)*	*(649)*
b Taxation	*(91)*	*(641)*	*(545)*
6 Net Income Or (Loss)	(714)	3,984	2,490
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*1,778*	*7,181*	*3,808*
b Net Cash from Operating Activities before Working Capital Changes	*(1,147)*	*5,706*	*3,292*
c Changes in Working Capital	*366*	*(2,807)*	*(5,389)*
1 Net Cash provided by Operating Activities	(781)	2,899	(2,096)
2 Net Cash (Used in) or Available From Investing Activities	(2,436)	(3,221)	(2,414)
3 Net Cash (Used in) or Available From Financing Activities	3,135	310	4,354
4 Net Cash generated or (Used) during the period	(82)	(12)	(156)
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	4.1%	23.6%	57.1%
b Gross Profit Margin	9.0%	21.1%	15.9%
c Net Profit Margin	-1.6%	9.4%	7.3%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	4.9%	10.3%	-4.6%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	-4.7%	29.7%	24.1%
2 Working Capital Management			
a Gross Working Capital (Average Days)	134	124	122
b Net Working Capital (Average Days)	113	106	98
c Current Ratio (Current Assets / Current Liabilities)	3.2	3.5	3.2
3 Coverages			
a EBITDA / Finance Cost	1.0	4.4	7.9
b FCFO / Finance Cost+CMLTB+Excess STB	0.5	2.8	2.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-9.4	1.1	1.8
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	55.8%	50.6%	57.5%
b Interest or Markup Payable (Days)	55.5	135.0	142.9
c Entity Average Borrowing Rate	14.2%	10.6%	4.1%

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
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.

Scale	Short-Term Rating
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.

Rating Modifiers | Rating Actions

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. Rating actions may include "maintain", "upgrade", or "downgrade".

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 Company

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