



The Pakistan Credit Rating Agency Limited

Rating Report

Sarena Textile Industries (Pvt.) Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jan-2019	A-	A2	Stable	Maintain	-
30-Jul-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Sarena Textile Industries (Private) Limited specializes in weaving, dyeing, printing, finishing and stitching. The company offers a variety of special finishes and is the only licensee for PROBAN® in Pakistan. The company employs experienced professionals, aided by comprehensive reporting who look after operations with autonomy. The greater part of revenue is generated from processing sales followed by weaving. Recent devaluation of the rupee enabled the company to capitalize on positive dynamics and grow its revenue and margins in line with industry trends. The company has a strong financial profile categorized by a moderately leveraged capital structure and improving working capital management due to reduced net working capital days. A significant increase in cash flows driven by revenue growth resulted in strong coverages for the company.

The ratings are dependent on the management's ability to improve corporate governance framework. Additionally, sustainability of working capital management and margins is critical. Adverse movement in margins and/or coverages will negatively impact the ratings.

Disclosure

Name of Rated Entity	Sarena Textile Industries (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Textile(Oct-18)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Sarena Textile Industries (Private) Limited (Sarena Textile) is a private limited company incorporated in 2001.

Background Sarena Textile is part of the Sefam and Ali Group of Industries, head quartered in Lahore, Pakistan. The Group is vertically integrated in the textile industry and specializes in weaving, dyeing, finishing, printing and manufacturing woven apparel. The group has expanded its operations over the years and owns many well-known retail brands including Bareezé, Leisure Club, Minnie Minors, Chinyere, Home Expressions and Kayseria.

Operations The company is engaged in the manufacture and sale of fabrics used for fashion and work-wear with production operations divided into three main units: weaving, processing and stitching/apparel. The company is self-sufficient in power generation with capacity to produce 7.9 MW/H through own sources and an additional 4.7 MW/H through lines from LESCO and SNGPL. Power requirement for the company adds up to be ~4 MW/H, on average.

Ownership

Ownership Structure Shareholding of Sarena Textile lies with the children of late Mr. J.A Zaman, founder of Ali Embroidery Mills (Private) Limited. Ms. Seema Aziz and Mr. Hamid Zaman each hold 42% of the company while Mr. Tariq Zaman and Ms. Ambreen Zaman hold the remaining 16%, equally.

Stability The Company aims to set up a family office which will help facilitate effective wealth management, reflecting positively on the company. Moreover, ownership structure of the Company is seen as stable as no ownership changes are expected in the coming years.

Business Acumen Sponsors of the Company hold significant experience in the textile and retail industry. They are seen as the pioneers of introducing the concept of brands in Pakistan.

Financial Strength The sponsors have shown ability to support the business in the shape of director loans. Moreover, net worth of the group is considered strong.

Governance

Board Structure Sarena Textile's Board comprises six members, four from the sponsor family and two independent members. The Board operates in two parts. One is a 'family board' comprising only sponsor family members discusses matters pertaining to operations and future strategy while the other is the 'extended board', which includes the external members which conducts strategic planning.

Members' Profile Mr. Hamid and Ms. Seema both possess quality education from prestigious universities as well as significant experience in the textile industry. Ms. Seema also manages C.A.R.E foundation which she co-founded with Mr. Hamid. Other Board members are also qualified and have been associated with the company for a reasonably long period of time.

Board Effectiveness Frequency of board meetings vary across both Boards. The family board meets more frequently; however, there is no fixed number of meetings that are to be held in a year. Meetings are conducted when deemed fit and minutes are not captured formally.

Financial Transparency EY Ford Rhodes are the external auditors of the company, listed in the "A" category on the State Bank of Pakistan's panel of auditors. The auditor has expressed an unqualified opinion on the financial statements of the company for the year ended June 30, 2018.

Management

Organizational Structure Asif Mehmood is the CEO of the company. He looks after all day to day operations and all departments report to him. Mr. Asif reports to Ms. Seema Aziz and Mr. Hamid Zaman, both of whom are the Managing Directors of the company and take part in making key strategic decisions.

Management Team Management of the company comprises qualified and experienced professionals with a wide range of skills and relevant experience. Most of the senior management has been associated with the company for an adequate amount of time.

Effectiveness The company does not have any formal management committees in place. Meetings among management are held only on need-basis and attended by the relevant management personnel. Formal meeting minutes are not documented.

MIS Sarena Textile deploys SAP ECC6 as their primary ERP solution, in addition to having Oracle (modified in-house) and S-Track, which is an in-house developed software. The company has a comprehensive MIS in place with regular generation of reports including inventory management, production, receivables and payables etc.

Control Environment The company invests heavily in R&D and quality control. Sarena Textile has an ISO17025 accredited Quality Assurance Lab and is the only Licensee in Pakistan for PROBAN®, a quality controlled technological process that gives cotton and cotton rich woven and knitted textiles flame retardant properties.

Business Risk

Industry Dynamics Textile exports of the country grew by ~9% in FY18, backed by devaluation of the rupee, bailout package from the government and GSP Plus Scheme of the EU. However, rising cost of utilities and the issue of outstanding refunds have kept industry liquidity strained. Going forward, exports are expected to remain strong on account of devalued currency while the recently announced relief in gas prices and electricity tariffs announced for textile players is expected to boost exports, going forward.

Relative Position The company faces tough competition from established brands in the international market. In Pakistan, Sarena Textile enjoys higher margins compared to competitors despite being smaller in size, primarily due to its relationship with PROBAN.

Revenues Sarena Textile's sales mix is equally divided between local and export sales. Major share of the revenue comes from processing, which accounts for 77% of total sales, followed by weaving (22%). During FY18, the company increased its revenue by ~27% YoY on the back of volumetric increase as well as currency devaluation. Sefam (Pvt.) Limited, a sister concern of Sarena Textile, is its largest customer, accounting for over 50% of its total sales. The company continued to increase its revenue in 3MFY19, which amounted to ~PKR 3.1bln.

Margins During FY18, the company witnessed an increase in gross margins (FY18:~18.7%, FY17:~16.6%) driven by high revenue growth. The company was able to double its YoY profitability and net profit for FY18 stood at ~PKR 640mln, compared to ~PKR 330mln in the preceding period. In 3MFY19, however, gross margin deteriorated due to an increase in cost of raw materials. Raw material cost for the period amounted to ~85% of total cost of sales, compared to 74% in FY17. Thus, company gross margins for 3MFY19 stood at ~16.5%

Sustainability In recent years, the company has been investing in BMR and capex for new machinery, resulting in increased efficiency. Going forward the company has plans to increase its weaving operations by adding 66 looms. Furthermore, it is forecasting growth in its PROBAN treated fabrics and has plans to extend its stitching operations and expand its presence in the international market.

Financial Risk

Working Capital Sarena Textile's working capital needs arise from financing of inventories and trade receivables. Trade receivables are slightly inclined towards receivables from foreign customers. During FY18, the company's net cash cycle increased marginally (FY18: 95 days, FY17: 92 days). Net cash cycle stood at 54 days in 3MFY19 due to high procurement of inventory to meet seasonal needs.

Coverages During FY18, coverages improved on the back of high profitability. While interest coverage stood at 5.6x (FY17: 3.9x), core coverage improved to 2.0x (FY17: 1.5x). In 3MFY19, high tax expense incurred by the company led to core coverage deteriorating to stand at 1.6x.

Capitalization Sarena Textile has a fairly leveraged capital structure (FY18: 60%, FY17: 64%). Majority of the company's borrowings are short-term and in the terms of export refinance. The company maintained its leveraging at ~61% in 3MFY19.



The Pakistan Credit Rating Agency Limited

Sarena Textile Industries (Pvt.) Limited

BALANCE SHEET

	30-Sep-18 3M	30-Jun-18 FY	30-Jun-17 FY	30-Jun-16 FY
Non-Current Assets	3,544	3,529	3,064	2,725
Investments (incl. Associates)	5	-	-	-
Equity	5	-	-	-
Current Assets	5,591	5,390	3,973	3,175
Inventory	1,711	1,394	1,186	1,111
Trade Receivables	2,326	1,978	1,746	1,199
Others	1,555	2,018	1,041	865
Total Assets	9,141	8,918	7,037	5,900
Debt	4,490	3,991	3,718	3,156
Short-term	3,461	3,081	2,845	2,246
Long-term (incl. Current Maturity of Long-Term debt)	1,029	910	873	909
Other Short-term Liabilities	1,467	1,985	967	634
Other Long-term Liabilities	185	185	156	147
Shareholder's Equity	2,999	2,758	2,196	1,964
Total Liabilities & Equity	9,141	8,918	7,037	5,900

INCOME STATEMENT

	3,109	9,412	7,420	6,154
Turnover	3,109	9,412	7,420	6,154
Gross Profit	512	1,757	1,229	1,057
Other Income	47	(57)	(15)	(34)
Financial Charges	(57)	(188)	(170)	(162)
Net Income	241	640	330	321

Cashflow Statement

Free Cashflow from Operations (FCFO)	287	1,046	663	670
Net Cash changes in Working Capital	(1,538)	517	(426)	(524)
Net Cash from Operating Activities	(1,305)	1,386	73	(20)
Net Cash from Investing Activities	(64)	(552)	(412)	(354)
Net Cash from Financing Activities	499	63	359	358
Net Cash generated during the period	(869)	897	20	(16)

Ratio Analysis

Performance		26.9%	20.6%	27.4%
Turnover Growth	-	26.9%	20.6%	27.4%
Gross Margin	16.5%	18.7%	16.6%	17.2%
Net Margin	7.8%	6.8%	4.5%	5.2%
ROE	32.2%	23.2%	15.0%	16.4%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	2.1	2.0	1.5	1.6
Interest Coverage (x) (FCFO/Gross Interest)	5.0	5.6	3.9	4.1
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	1.2	1.1	1.9	1.9
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	54	95	91	98
Capital Structure (Total Debt/Total Debt+Equity)	60.3%	59.5%	63.3%	62.1%

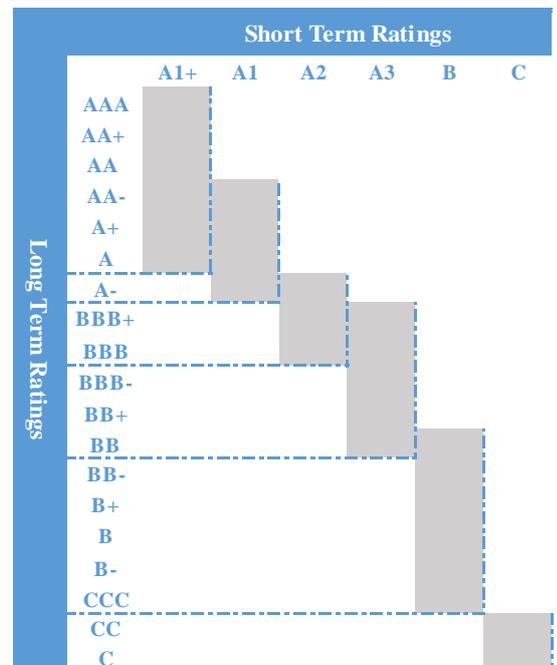
Sarena Textile Industries (Pvt.) Limited

Jan-19

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

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- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (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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