



The Pakistan Credit Rating Agency Limited

## Rating Report

### Sarena Textile Industries (Pvt.) Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jul-2020	A-	A2	Positive	Maintain	-
01-Aug-2019	A-	A2	Positive	Maintain	-
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 finishes and has created a niche where it processes and produces specialized cloth for fire resistant and other uniforms. It is the only licensee for PROBAN® in Pakistan. The Company employs experienced professionals, aided by comprehensive reporting, who look after operations of the Company with complete autonomy. The Company has established its presence in the overseas market and also considered a strong player in local market as the revenue is balanced almost equally between the local and export market. Captive clientele in shape of group companies, provide an advantage in local sale. The Company managed to sustain its revenues despite adverse impact of COVID-19, although it was unable to generate higher revenues as planned. The Company has a strong financial profile characterized by robust coverages and improving working capital management reflected by an adequate borrowing cushion. Almost all of the borrowings of the Company are on SBP concessional rates, insulating it from interest rate movement. The Company has availed principal deferment of loans under the SBP scheme providing relief to cashflows. The COVID-19 outbreak has created uncertainty, which impacted the entire textile chain. The demand is gradually improving as lockdown in domestic and global markets eases. However, this recovery is still at nascent stage and could be derailed due to subdued macroeconomic factors and/or second wave of COVID pandemic.

The ratings are dependent on the management's ability to sustain its operations and margins amidst tough prevailing conditions in Pakistan and internationally. Maintaining prudent working capital management practices and strong coverages is important. Adverse movement in margins and/or coverages will impact the ratings.

#### Disclosure

<b>Name of Rated Entity</b>	Sarena Textile Industries (Pvt.) Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Ratings(Jun-20),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria   Rating Modifier(Jun-20)
<b>Related Research</b>	Sector Study   Composite(Nov-19)
<b>Rating Analysts</b>	Bakhtawar Abid   bakhtawar.abid@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, headquartered in Lahore, Pakistan. The Group is vertically integrated in the textile industry and has expanded its operations over the years. It owns many well known retail brands including Bareezé, Leisure Club, Minnie Minors, Chinyere and Kayseria etc.

**Operations** The Company is engaged in the manufacture and sale of fabrics and garments 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 the capacity to produce 10.5 MW/H through own sources and an additional 4.7 MW/H through lines from LESCO while its power requirement adds up to an average of ~4 MW/H.

## 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** While no written agreement between the sponsors currently exists, the Group is moving towards consolidation and formalization of Group structure in line with the current management structure.

**Business Acumen** The sponsor Group holds extensive experience and expertise in the textile and retail industry. They are viewed as the pioneers of introducing the concept of brands in Pakistan. Apart from the textile industry, the Group has also diversified into corporate farming, energy etc, through small scale ventures.

**Financial Strength** The net worth of the Group is considered strong and the sponsors have shown willingness and ability to support the Company in the past.

## 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 the 'family board' which comprises only sponsor family members and discusses matters pertaining to operations and future strategy, while the other is the 'extended board', which includes the independent members and oversees 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 well qualified and have been associated with the Company for a reasonable 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 while minutes are not documented formally

**Financial Transparency** The Company has appointed EY Ford Rhodes & Co. as its external auditor, listed in the "A" category on the State Bank of Pakistan's panel of auditors. The quality of the auditor reflects well on the governance framework of the Company.

## Management

**Organizational Structure** Mr. Asif Masood is the CEO of Sarena Textile. He looks after all day to day operations and all departments report to him. Mr. Asif reports to Mr. Hamid Zaman, who is the Managing Director of the Company, involved in key strategic decision making

**Management Team** The 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 to aid informed and timely decision making

**Control Environment** Sarena Textile has an ISO17025 accredited Quality Assurance Lab and is the only Licensee in Pakistan for PROBANO®, a quality controlled technological process that gives cotton and cotton rich woven and knitted textiles flame retardant properties. During FY19, the Company engaged KPMG Taseer Hadi & Co. as its internal auditor, adding quality to its transparency and control environment.

## Business Risk

**Industry Dynamics** Textile exports of the country dropped by ~6% for FY20 to stand at ~USD 12.5bln as compared to ~USD 13.3bln in FY19 due to slowdown in demand for textile products internationally, instigated by Covid-19 led lockdowns in major export destinations. Going forward, prevailing uncertainty in the dynamics of textile sector due to Covid-19 outbreak globally, lifting of lockdowns in most countries, contraction in local and international demand is expected to affect the entire textile value chain. Locally, textile sector will find comfort in relief measures introduced by State Bank of Pakistan such as, deferment of loan payments for one year, low interest rates and salary refinance scheme.

**Relative Position** Sarena Textile is an established name in Pakistan's textile industry. The Company enjoys higher margins in comparison to local competitors mainly due to its penetration into the niche of work-wear, leading to a higher value-added product mix.

**Revenues** Sarena Textile has a fairly balanced sales mix (Exports: ~53%, Local: ~47%). The bulk of the Company's revenue is derived from the sale of processed cloth (~64%), followed by weaving (~23%), stitching (~13%) and Yarn (~0.07%). The Company's topline witnessed a growth of ~9% YoY in 9MFY20, amounting to ~PKR 10.6bln (9MFY19: PKR 9.8bln).

**Margins** For 9MFY20, the Company's gross margin amounted to ~14%, a significant YoY decline (9MFY19: ~18%). This was mainly due to the higher cost of importing dyes and chemicals following the currency devaluation and increase in energy cost. The impact could not be passed on to customers immediately which resulted in the decline in margins. This translated into a decline in operating margin (9MFY20: ~7%, 9MFY19: ~11%). Meanwhile, due to a ~28% YoY increase in finance cost on the back of rising interest rates, the Company's net margin also decreased YoY at ~5%. Consequently, net profit for 9MFY20 amounted to ~PKR 503mln (9MFY19: ~PKR 957mln).

**Sustainability** Due to COVID-19 outbreak and subsequent lockdown, the Company's operations remained shut for a month; however, capacity utilization resumed significantly afterwards. The Company being an export-oriented entity was impacted as its demand from export destinations have gone down. Furthermore, its sales to its related parties also significantly reduced due to closure of malls and markets. However, since reopening of malls and markets, demand has improved but it will take time to reach at pre-corona level. Recent SBP's measures will provide relief to the Company.

## Financial Risk

**Working Capital** The Company's working capital needs emanate from financing its inventory and trade receivables. During 9MFY20, net cash cycle showed an increasing trend (9MFY20: ~115 days, 9MFY19: ~84 days), mainly on account of high receivable days (9MFY20: 86 days, 9MFY19: 63 days). Meanwhile, borrowing cushion at current assets level remains low (9MFY20: ~6%, 9MFY19: ~13%).

**Coverages** During 9MFY20, the Company's free cashflows decreased by ~36% (9MFY20: ~PKR 671mln) on the back of lower profitability. Consequently, both interest coverage and core coverage dipped YoY, with interest coverage amounting to 3.5x (9MFY19: 6.1x) and core coverage at 1.3x (9MFY19: 2.6x) on account of higher finance cost incurred in line with higher short term borrowing for working capital needs. Reduced interest rates and SBP's moratorium relief availed by the Company will provide comfort to the cashflows and coverages in future.

**Capitalization** Sarena Textile's leveraging was maintained YoY at ~61%. Borrowing predominantly comprises short-term finance (~81%), constituting Export Refinance, while long-term borrowing predominantly comprises LTFF. Further, Company has avail PKR 265mln as lease facility for capex of 85 looms. Going forward, taking on additional debt to finance upcoming projects may increase leveraging.



Sarena Textile Industries (Private) Limited Composite	Mar-20 9M	Jun-19 12M	Jun-18 12M	Jun-17 12M
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#### A BALANCE SHEET

1 Non-Current Assets	4,465	4,104	3,529	3,064
2 Investments	-	69	-	-
3 Related Party Exposure	199	133	161	149
4 Current Assets	7,740	7,302	5,228	3,824
<i>a Inventories</i>	2,222	2,060	1,394	1,186
<i>b Trade Receivables</i>	3,094	3,573	1,978	1,746
5 Total Assets	12,405	11,609	8,918	7,037
6 Current Liabilities	2,639	2,691	1,912	915
<i>a Trade Payables</i>	1,021	1,046	695	696
7 Borrowings	5,621	5,264	4,044	3,756
8 Related Party Exposure	152	164	184	181
9 Non-Current Liabilities	70	70	123	94
10 Net Assets	3,924	3,421	2,655	2,091
11 Shareholders' Equity	3,924	3,421	2,655	2,091

#### B INCOME STATEMENT

1 Sales	10,614	13,068	9,412	7,420
<i>a Cost of Good Sold</i>	(9,081)	(11,346)	(7,655)	(6,190)
2 Gross Profit	1,533	1,722	1,757	1,229
<i>a Operating Expenses</i>	(741)	(815)	(782)	(657)
3 Operating Profit	792	907	975	572
<i>a Non Operating Income</i>	85	315	(57)	(15)
4 Profit or (Loss) before Interest and Tax	877	1,222	918	558
<i>a Total Finance Cost</i>	(234)	(256)	(188)	(170)
<i>b Taxation</i>	(135)	(92)	(90)	(57)
6 Net Income Or (Loss)	507	873	640	330

#### C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	675	1,224	1,046	663
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	644	977	869	499
<i>c Changes in Working Capital</i>	(226)	(1,800)	517	(426)
1 Net Cash provided by Operating Activities	418	(822)	1,386	73
2 Net Cash (Used in) or Available From Investing Activities	(538)	(821)	(552)	(412)
3 Net Cash (Used in) or Available From Financing Activities	373	783	63	359
4 Net Cash generated or (Used) during the period	253	(860)	897	20

#### D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	8.3%	38.8%	26.9%	20.6%
<i>b Gross Profit Margin</i>	14.4%	13.2%	18.7%	16.6%
<i>c Net Profit Margin</i>	4.8%	6.7%	6.8%	4.5%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	6.6%	11.1%	12.5%	10.2%
<i>e Return on Equity (ROE)</i>	18.4%	28.7%	27.0%	16.8%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	141	126	122	129
<i>b Net Working Capital (Average Days)</i>	115	101	95	102
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	2.9	2.7	2.7	4.2
3 Coverages				
<i>a EBITDA / Finance Cost</i>	3.7	7.2	7.4	5.6
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.4	1.9	2.0	1.4
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	1.7	1.2	1.3	2.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	59.5%	61.3%	61.4%	65.3%
<i>b Short-Term Borrowings / Total Borrowings</i>	0.8	0.8	0.7	0.7
<i>c Average Borrowing Rate</i>	4.5%	4.2%	3.9%	3.7%

**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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(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)

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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
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- (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)

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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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