The Pakistan Credit Rating Agency Limited

Rating Report

Sefam (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
20-Nov-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Ratings reflect Sefam (Private) Limited’s (the Company) reputable image as one of the leading players in clothing/home textile retail industry, with several established brands. The Company operates a complete range of clothing brands targeting all segments of the retail market. Major portion of the Company's raw material is sourced from group companies, which allows it to maintain profitability while ensuring quality. The Company has witnessed growth over the years amid positive industry dynamics and higher consumer spending. Margins continued to maintain an upward trend indicating efficient operations and improved profitability. Ratings draw strength from the Company’s strong financial profile, characterized by a low leveraged capital structure, strong coverages and efficient management of working capital.

The ratings are dependent on the Company’s ability to improve governance framework. Additionally, working capital management and ensuing borrowings should be monitored closely. Adverse movement in margins and/or coverages would be critical for the ratings.

Disclosure	
Name of Rated Entity	Sefam (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 Sefam (Private) Limited (The Company) was incorporated in 1989 as a Private Limited Company.

Background The Company is associated with Sarena and Ali Group of Industries. The Company started out with its flagship brand, Bareezé, 30 years ago. It has now expanded to a family of 10 brands, each of which caters to different segments of the market.

Operations The Company has a total of 279 shops spread across the country, majority of which are rented. Additionally, the Company has 12 stitching units spread across Lahore and uses a mix of Chinese and Japanese machinery. High end brands (Giorgio Armani & Ralph Lauren) are also sold by the Company through its wholly owned subsidiary, S-Luxe (Private) Limited. Moreover, the Company operates 6 'The Entertainer' (UK based toy retailer) branches spread across Karachi, Lahore and Islamabad.

Ownership

Ownership Structure Ownership of the Company is split between the four children of late Mr. J.A Zaman. Ms. Seema Aziz and Mr. Hamid Zaman hold 42% of the Company, each, 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 Sefam's board comprises six members, four from the sponsor family and two independent members. Presence of independent members bodes well for the Company.

Members' Profile Board comprises members who specialize in the textile industry, with independent members specializing in strategic and succession planning.

Board Effectiveness The Company effectively has two boards in place, one is a 'family board' which only comprises members of the sponsor family and the other is the 'extended board', which includes the external members. Frequency of board meetings vary across both Boards. The family board meets more frequently as compared to the extended board. However, there is no fixed number of meetings that are to be held in a year and are conducted when deemed fit.

Financial Transparency M/s Arshad Raheem & Co. Chartered Accountants, who are not rated by the SBP but are QCR rated by ICAP, are the external auditors of the Company. They have expressed an unqualified opinion on the Company's financial statements for the year ended June 2017. However, audit for June 2018 is under process.

Management

Organizational Structure The Company's organizational structure is based on different brands and is spilt between five individuals, namely, Mr. Hamid Zaman, Ms. Seema Aziz, Mr. Ali Zain Aziz, Mr. Bilal Ahmed Khan and Mr. Raza Rehman. Brands have independent and dedicated teams which are divided into various departments.

Management Team The Company employs experienced professionals who have years of experience in their respective fields. Mr. Raza Rehman, the Chief Operating Officer, holds an MBA and has been associated with the Company since 2002. Similarly, Mr. Bilal Ahmed Khan holds an MBA from LUMS and has been associated with the Company since 2010.

Effectiveness The Company does not have any formal management committees in place. Meetings among management are called when deemed fit and are participated by relevant department heads. Formal meeting minutes are not captured by the Company.

MIS The Company has deployed SAP ECC 6 as its Enterprise Resource and Planning system, however, only three modules are implemented by the Company. Sefam relies on a combination of in-house developed, external and ready to use softwares for MIS.

Control Environment The Company invests heavily in research and development and sources most of its raw material from associated companies to maintain quality. Moreover, the internal audit function of the Company ensures compliance and proper reporting.

Business Risk

Industry Dynamics Devaluation of the rupee, bailout package from the government and GSP plus scheme of the EU led to YoY growth in the country's textile exports of ~9% during FY18 when total textile exports were recorded at ~$13.5 bln. This growth was mainly led by value added segment including knitwear, home textile and ready-made garments. Recent re-imposition of custom duty & sales tax on cotton imports in FY19 budget, coupled with exclusion of tax rebate on yarn and greige fabric may put pressure on industry margins.

Relative Position The Company has been operating in the industry for a considerable amount of time and operates a network of 10 brands, many of which are household names. Due to its quality products and customer service, the Company is one of the top players in the domestic market.

Revenues Major source of the Company's revenue emanates from two brands (Bareeze & Minnie Minors) which contribute 55% towards total revenue. Products are mainly sold locally and only a small portion is exported. The Company has witnessed strong growth in sales and posted a revenue of ~PKR 12,846mln in FY18, increasing by ~17% as compared to the preceding year. Increased revenue can be seen as an effect of strong performance by the Company's leading brands, namely, Bareeze, Minnie Minors and Kayseria.

Margins The Company has been witnessing improving margins over the years on the back of strict cost controls and efficiency in operations. During FY18, the Company posted a gross profit margin of ~43% (FY17:41%). Similarly, operating margins also registered growth and stood at ~8% in FY18, improving from ~6% in FY17. A high gap between gross and operating margins is attributable to high selling and administration costs which are inherent to the retail industry.

Sustainability In an attempt to improve quality, the Company plans to source fabrics in-house by setting up a spinning unit going forward. In addition to maintaining quality, the Company would have the benefit of producing special fabrics at a lower cost. Moreover, an effort is being made to consolidate all group companies under one holding company.

Financial Risk

Working Capital The Company has been efficient in managing its working capital, with net working capital days standing at 36 days in FY18. The Company utilizes short-term borrowings to finance working capital needs and maintains a healthy cushion to borrow additional funds, if any situation arises.

Coverages During FY18 FCFO stood at PKR 1,104mln (FY17 800mln) and the Company was able to post strong coverages owing to a decline in finance costs. Interest coverage improved to 7.9x in FY18 (FY17: 5.7). Similarly, the Company was able to maintain a low debt payback period, which stood at 0.1 years in FY18.

Capitalization The Company maintains a low leveraged capital structure with a debt-to-equity ratio ~41% in FY18. Total borrowings for the Company stood at PKR 2,231mln, increasing by ~52% in FY18, as compared to FY17. Major portion of borrowings is short-term in nature, representing 92% of total debt. Going forward, leveraging for the Company is expected to increase as the Company looks to expand its operations.

PKR mln

Sefam (Private) Limited

BALANCE SHEET	30-Jun-18	30-Jun-17	30-Jun-16
	FY	FY	FY
Non-Current Assets	**1,974**	**1,827**	**1,674**
Investments (incl. Associates)	**179**	**118**	**118**
Equity	118	118	118
Current Assets	**5,133**	**3,967**	**3,615**
Inventory	3,006	2,029	1,751
Trade Receivables	15	13	15
Others	2,112	1,925	1,849
Total Assets	**7,286**	**5,912**	**5,407**
Debt	**2,231**	**1,469**	**1,627**
Short-term	2,056	1,313	1,459
Long-term (incl. Current Maturity of Long-Term debt)	174	156	168
Other Short-term Liabilities	1,475	1,328	1,130
Other Long-term Liabilities	297	292	243
Shareholder's Equity	**3,236**	**2,823**	**2,407**
Total Liabilities & Equity	**7,238**	**5,912**	**5,407**
INCOME STATEMENT			
Turnover	**12,846**	**10,955**	**10,307**
Gross Profit	5,458	4,503	3,895
Other Income	(39)	(6)	(2)
Financial Charges	(92)	(79)	(143)
Net Income	**611**	**416**	**285**
Cashflow Statement			
Free Cashflow from Operations (FCFO)	1,104	800	599
Net Cash changes in Working Capital	(936)	(223)	620
Net Cash from Operating Activities	75	490	1,065
Net Cash from InvestingActivities	(373)	(233)	(108)
Net Cash from Financing Activities	762	(162)	(489)
Net Cash generated during the period	463	95	468
Ratio Analysis			
Performance			
Turnover Growth	17.3%	6.3%	13.6%
Gross Margin	42.5%	41.1%	37.8%
Net Margin	4.8%	3.8%	2.8%
ROE	25.2%	14.7%	11.9%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	7.9	5.7	2.9
Interest Coverage (x) (FCFO/Gross Interest)	11.9	10.2	4.2
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	0.1	0.2	0.4
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	36	42	46
Capital Structure			
Leveraging (Total Debt/Total Debt+Equity)	40.8%	34.2%	40.3%

PACRA

Rating Scale

Credit Rating Scale & Definitions

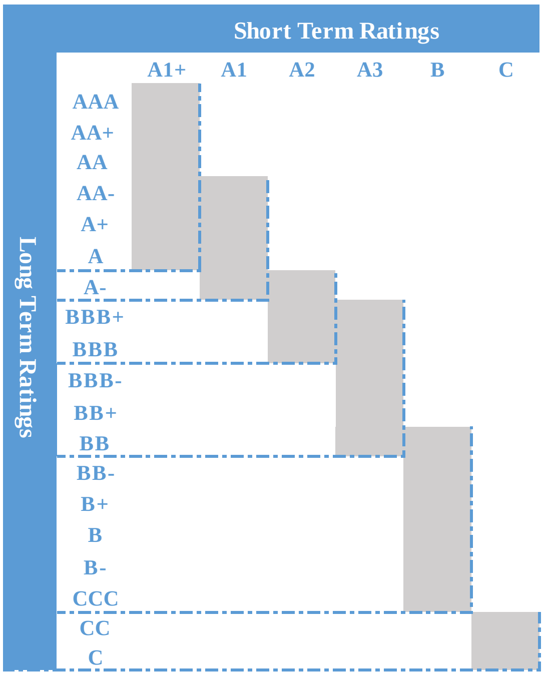
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

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.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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 surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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.
(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 | 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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