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
21-Nov-2019	A-	A2	Stable	Maintain	-
22-May-2019	A-	A2	Stable	Maintain	-
20-Nov-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Sefam (Pvt.) Limited’s reputable image as one of the leading players in the 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. The 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 managed to sustain growth in revenues and profitability based on strong branding, despite sluggish trend in the overall retail market amid economic slowdown and lower consumer spending. Withdrawal of zero-rated status of the textile sector has led the Company to increase its prices to pass on higher costs to its customers, capitalizing on its strong brand presence in the elite niche. Consequently, margins continued to maintain an upward trend owing to increase in prices and efficient operations. Ratings draw strength from the Company’s strong financial profile, recently augmented by the declaration of previously undeclared inventory under the amnesty scheme in FY19. Capital structure remains low leveraged while coverages stand robust along with efficient management of working capital. Meanwhile, declaration of inventory is likely to reflect in higher revenues and profitability, going forward.

The ratings are dependent on the Company’s ability to improve governance framework by hiring better financial auditors. 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-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Composite(Nov-19)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure Sefam (Private) Limited (Sefam) was incorporated in Pakistan in January, 1989, as a private limited Company.

Background Sefam was co-founded by Mr. Hamid Zaman and Ms. Seema Aziz and is an associated concern of Sarena and Ali Group of Industries. Sefam started out with its flagship brand, Bareezé, 30 years ago. It has now expanded to a family of 10 brands. Well-known brands owned by the Company include Bareezé, Minnie Minors, Leisure Club, Bareezé Home Expressions, Chinyere, Kayseria, among others, as well as a franchise of 'The Entertainer', which is the UK's largest independent toy retailer.

Operations The Company currently operates with 12 stitching units spread across Lahore and and a total of 308 shops spread across the country. Only a couple of brands (Bareezé and Chinyere) have dedicated stitching and warehouse units, whereas, majority of the units are shared between brands. Additionally, the Company operates 6 Entertainer branches across Pakistan.

Ownership

Ownership Structure Sefam is wholly owned by the 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 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 through various director loans.

Governance

Board Structure Sefam's Board of Directors comprises six members, four from the sponsoring family and two independent members. The Company effectively has two boards in place, one is a 'family board' which only comprises members of the sponsor family while the other is the 'extended board', which includes the external members. The family board discusses matters pertaining to operations and future strategy, whereas, the extended board meets for strategic planning.

Members' Profile Representatives from the sponsor family include Mr. Hamid Zaman and Ms. Seema Aziz, and their sons, Mr. Mustafa Zaman and Mr. Ali Zain all of whom have been part of the Company for a significant period of time. The external members are seasoned professionals with experience in diversified sectors.

Board Effectiveness Frequency of board meetings vary across both the Boards. However, there is no fixed number of meetings that are to be held in a year. Meetings are conducted when deemed fit without documentation of minutes.

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. Audit of the financial statements of the Company for the year ended June 30, 2019, is still in process.

Management

Organizational Structure The organizational structure of the Company is well-defined and is based on different brands. Management of the brands is split between three individuals, namely, Mr. Hamid Zaman, Ms. Seema Aziz and, Mr. Ali Zain. All individuals report to the Board of Directors. Brands have independent and dedicated teams which are divided into various departments reporting to the relevant head.

Management Team Both Mr. Hamid Zaman and Ms. Seema Aziz are Managing Directors of the Company. While Mr. Hamid Zaman looks more after the strategic aspect of the business, Ms. Seema Aziz is actively involved in managing some of the brands that the group owns. They are assisted by a professional management team.

Effectiveness The Company does not have any formal management committees in place. Meetings among management are called when deemed fit and are participated in by relevant department heads without documentation of minutes.

MIS The Company relies on a combination of in-house developed, external and ready to use softwares for MIS. Sefam deploys SAP ECC 6 as its Enterprise Resource and Planning (ERP) system with three modules currently implemented. A major portion of the modules deployed have been developed in-house and are regularly updated.

Control Environment The Company invests heavily in research and development to come up with innovative designs and prints to capture the market. Quality is maintained through strict control measures in place. Additionally, the Company has in place in-house developed softwares which track production, customer feedback/complaints and worker efficiency.

Business Risk

Industry Dynamics Overall textile exports showed lackluster performance in FY19, displaying negative YoY growth of ~1% in dollar terms while the same improved by ~1% in 3MFY20. Meanwhile, the local textile retail industry remains under pressure due to fierce competition between retail brands while operating costs remain high. Withdrawal of zero-rated status of the textile sector has increased working capital needs and poses a threat to liquidity of textile players, leading to costly short-term borrowing in account of spike in interest rates.

Relative Position Sefam is among the pioneers of textile retailing brands in Pakistan and is among the top retailing companies in the country, particularly in eastern ladies wear. The Company largely caters to the quality conscious female buyer and has little competition in this niche.

Revenues Major portion of the Company's revenue emanates from two brands: Bareezé and Minnie Minors which contribute ~57% towards total revenue. The Company sells its product locally and only exports a small portion of its products (~1%). Strong growth in revenues was witnessed in FY19, amounting to ~PKR 15.5bln, a growth of ~21% YoY. The growth in sales was a product of volumetric and price increase as the Company opened up 27 new shops across the Country while it also passed on higher costs to customers by increasing prices.

Margins Gross margin showed YoY improvement (FY19: ~46%, FY18: ~42%) as the Company increased prices across all brands. This translated into higher operating margin of ~14% (FY18: ~8%) wherein selling and marketing expenses constitute the bulk of its operating expenses, a trait inherent to the retail industry. The same growth could not be reflected in net margin, however, due to higher tax expense owing to declaration of inventory under the amnesty scheme as well as higher finance cost due to spike in interest rates. Net profit and net margin showed strong YoY growth to stand at ~PKR 1,070mln (FY18: ~PKR 589mln) and ~7% (FY18: ~5%) respectively.

Sustainability The Company is focused on expanding its presence through addition of retail outlets while no major expansion is envisioned in the near future. Profitability is expected to improve once the impact of the inventory declaration materializes and is reflected in revenues. Moreover, with respect to the Group, an effort is being made to formalize the Group ownership structure which is expected to be completed during FY20.

Financial Risk

Working Capital Sefam's working capital needs mainly emanate from the need to maintain a high stocks of finished inventory in order to meet consumer demand at its shops. Finished inventory amounted to ~PKR 8bln in FY19 after declaring finished inventory of ~PKR 5.5bln. This led to a surge in net cash cycle (FY19: 183 days, FY18: 126 days) which amounted to 53 days previously. This is expected to normalize once the inventory is recognized in revenues. The Company maintains a strong borrowing cushion at trade assets level.

Coverages Sefam maintained robust coverages in FY19 due to a twofold increase in cash flows on the back of strong operations, amounting to ~PKR 1.7bln. While interest coverage showed slight deterioration YoY (FY19: 10.1x, FY18: 10.4x) on account of the increase in finance cost, core coverage ratio improved to 7.3x (FY18: 6.3x), depicting strong ability to meet financial obligations.

Capitalization Sefam has a low leveraged capital structure with total debt of ~PKR 1.8bln in FY19, comprising almost exclusively of short-term financing (~93%) to meet working capital needs. The Company's leveraging ratio currently stands at ~18% (~34%, prior to stock declaration). The Company also declared a cash dividend of ~PKR 1.5 per share for FY19.

The Pakistan Credit Rating Agency Limited

		Jun-19	Jun-18	Jun-17
Sefam (Pvt.) Limited				
Textile Composite		12M	12M	12M
A BALANCE SHEET				
1	Non-Current Assets	2,105	1,975	1,765
2	Investments	-	-	-
3	Related Party Exposure	411	380	193
4	Current Assets	11,448	10,382	3,953
	a Inventories	*8,804*	*8,657*	*2,029*
	b Trade Receivables	*55*	*45*	*13*
5	**Total Assets**	13,964	12,738	5,912
6	Current Liabilities	1,776	1,504	1,328
	a Trade Payables	*986*	*966*	*902*
7	Borrowings	1,837	2,121	1,423
8	Related Party Exposure	320	60	46
9	Non-Current Liabilities	309	298	292
10	**Net Assets**	9,723	8,755	2,823
11	**Shareholders' Equity**	9,723	8,755	2,823
B INCOME STATEMENT				
1	**Sales**	15,539	12,846	10,955
	a Cost of Good Sold	*(8,458)*	*(7,435)*	*(6,453)*
2	**Gross Profit**	7,081	5,411	4,503
	a Operating Expenses	(4,974)	(4,430)	(3,796)
3	**Operating Profit**	2,107	980	706
	a Non Operating Income	*(93)*	*(33)*	*(6)*
4	**Profit or (Loss) before Interest and Tax**	2,014	948	701
	a Total Finance Cost	*(174)*	*(96)*	*(79)*
	b Taxation	*(770)*	*(263)*	*(206)*
6	**Net Income Or (Loss)**	1,070	589	416
C CASH FLOW STATEMENT				
	a Free Cash Flows from Operations (FCFO)	*1,683*	*901*	*800*
	b Net Cash from Operating Activities before Working Capital Changes	*1,521*	*816*	*713*
	c Changes in Working Capital	*(120)*	*(834)*	*(223)*
1	**Net Cash provided by Operating Activities**	1,401	(17)	490
2	**Net Cash (Used in) or Available From Investing Activities**	(389)	(316)	(233)
3	**Net Cash (Used in) or Available From Financing Activities**	(140)	427	(180)
4	**Net Cash generated or (Used) during the period**	872	93	77
D RATIO ANALYSIS				
1	**Performance**			
	a Sales Growth (for the period)	21.0%	17.3%	6.3%
	b Gross Profit Margin	45.6%	42.1%	41.1%
	c Net Profit Margin	6.9%	4.6%	3.8%
	d Cash Conversion Efficiency (EBITDA/Sales)	15.2%	9.3%	8.1%
	e Return on Equity (ROE)	11.6%	10.2%	15.9%
2	**Working Capital Management**			
	a Gross Working Capital (Average Days)	206	153	63
	b Net Working Capital (Average Days)	183	126	35
	c Current Ratio (Total Current Assets/Total Current Liabilities)	6.4	6.9	3.0
3	**Coverages**			
	a EBITDA / Finance Cost	14.2	13.8	12.5
	b FCFO / Finance Cost+CMLTB+Excess STB	7.3	6.3	6.0
	c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.3	0.2	0.2
4	**Capital Structure (Total Debt/Total Debt+Equity)**			
	a Total Borrowings / Total Borrowings+Equity	18.2%	19.9%	34.2%
	b Short-Term Borrowings / Total Borrowings	0.8	0.9	0.9
	c Average Borrowing Rate	7.7%	4.7%	4.6%

#	Notes
A-4/a	**Includes previously undeclared inventory (restated for FY18)**

Rating Scale | Corporate

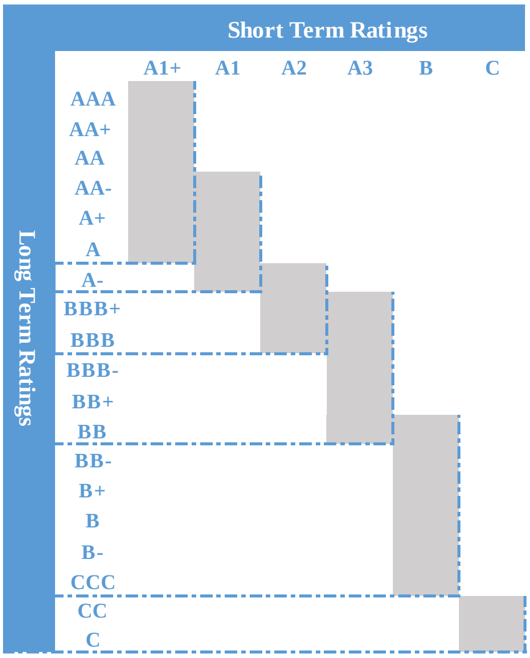
2019

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.

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.
(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)

Proprietary Information