The Pakistan Credit Rating Agency Limited

Rating Report

Sargodha Jute Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Mar-2023	A-	A2	Stable	Maintain	-
31-Mar-2022	A-	A2	Stable	Maintain	-
31-Mar-2021	A-	A2	Stable	Maintain	-
03-Apr-2020	A-	A2	Stable	Maintain	-
30-Oct-2019	A-	A2	Stable	Maintain	-
30-Apr-2019	A-	A2	Stable	Maintain	-
20-Dec-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Sargodha Jute Mills Limited's ("the Company" or "SJML") prominent business profile in the jute industry of Pakistan emanating from considerable market share and wide-ranging final product utility. The core strength of the Company lies in two segments (i) Usage of Jute bags for the storage of essential food items at a large scale and (ii) Predominately exports of Jute value-added products. Pakistan's jute industry imports 100% of its raw jute from Bangladesh. The prices of raw jute fluctuate in the international market and have been observing a downward sloping trend mainly on the back of demand squeeze in European markets as the global recession triggers. This price benefit is offset by the following factors (i)massive PKR devaluation over the year, (ii) a hike in the policy rate, (iii) a higher tax burden and (iv) consistent escalation in oil, gas and electricity prices have impacted the cost of production and exerted pressures on the margins. However, the Company was able to pass on a major portion of these costs to its customers. The rating takes comfort as despite these obstructive macroeconomic indicators the Company expects to sustain its top-line growth due to the nature of its product. The SJML have faced import restriction at a moderate level as ~40.0% of local sales are attributed to government departments and their final product utility classify under SBP circular No. 20 essential items- Imports related to essential sectors. The top line of the Company has observed a growth of 42% YoY basis mainly supplemented by 17% volumetric growth and remaining supply side inflation impact. The SJML export segment has shown an impressive growth of 53.3% YoY basis by exploring new export avenues and dispensing some hedge with respect to PKR devaluation. Going forward, the Company is focusing to induce further growth in its export segment. The ownership and the board structure are comprised of sponsoring family members. All members possess extensive industry-specific exposure and expertise. The financial risk profile of the Company is considered adequate with comfortable coverages, cashflows and a slightly stretched working capital cycle. Capital structure is leveraged, where borrowings are comprised of only short term to meet their working capital requirements. The Company's topline performance is aligned with SJML management's earlier shared financial projections which provides comfort to the rating sustainability.

The ratings are dependent on sustainable profits and market share while retaining sufficient cashflows and coverages. However, adherence to maintaining its debt metrics at an adequate level is a prerequisite.

Disclosure

Name of Rated Entity	Sargodha Jute Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Jute(Oct-22)
Rating Analysts	Muhammad Harris Ghaffar | harris.ghaffar@pacra.com | +92-42-35869504

Profile

Legal Structure Sargodha Jute Mills Limited (Sargodha Jute or the Company) was incorporated in Pakistan on February 10, 1981, as an unlisted Public Limited Company under the repealed Companies Act, 1913 (now the Companies Act, 2017).

Background The Company was established in 1981 by Mian Muhammad Aslam (late). The group has one jute mill and one textile mill. Later on, the operations of Sargodha Jute were handed over to Mian Parvez Aslam son of Mian Muhammad Aslam. The Company has a ~30,500 metric tons production capacity. The actual production of the Company reached at ~ 23,540 metric tons during June-2022.

Operations The principal activity of the Company is manufacturing, selling and dealing in jute products. The product portfolio of the Company includes yarn, hessian cloth, hessian bags, sacking cloth, sacking bags and twine.

Ownership

Ownership Structure Mr. Parvez Aslam and his family members collectively own majority ~75% shares of the Company. Mr. Irfan Aslam and Mr. Imran Aslam, sons of Mr. Parvez Aslam, own ~28% shares each. Shahzad Textile Mills Limited, an associated Company, hold 25% stake.

Stability There is no formal succession plan but the ownership of shares and business roles are equally divided between the two brothers, sons of Mr. Parvez Aslam (Mr. Imran Aslam and Mr. Irfan Aslam). Mr. Irfan Aslam is the CEO of Sargodha Jute Mills Limited and Mr. Imran Aslam is the CEO of Shahzad Textile Mills Limited. Documentation of succession planning or formation of a holding company will bode well for the Company's stability.

Business Acumen Mr. Irfan Aslam is the CEO of Sargodha Jute and is looking after the Company’s operations for more than two decades. His ability to take strategic decisions and seize opportunities on the right time has kept the entity on the right track.

Financial Strength Mr. Irfan Aslam has 25% shareholding in his associated company Shahzad Textile Mills Limited. Shahzad textiles mills limited has an assets base worth ~PKR 5.3bln as of December-22. Moreover, on personal level, he is an active investor in real estate, stock market and foreign exchange markets. The Company is expected to get timely support from its sponsors, if needed.

Governance

Board Structure The board of the Company consists of only three members, out of which two are from the sponsoring family. Mr. Irfan (CEO) and Mr. Ahsan (COO) are executive directors, whereas Mr. Imran (Chairman) is the non-executive director.

Members’ Profile Mr. Irfan Aslam has more than two decades of experience in jute business and is a foreign university graduate. Mr. Imran Aslam is in textile business and is CEO of Shahzad Textile Mills Limited. Ahsan Ahmad Khan - COO Sargodha Jute Mills - has 29 years of working experience with Sargodha group.

Board Effectiveness The effectiveness of the board is being compromised due to its small size and domination by the sponsoring family. Secondly, board meetings are done on "as and when needed" basis. Absence of independent directors and board committees does not bodes well for board's effectiveness.

Financial Transparency The external auditors of the Company are Crowe Hussain Chaudhry & Co., Chartered Accountants. They expressed an unqualified opinion on the Company’s annual financial statements for the year ended June 30, 2022. SBP has classified them in “Category-A” on its panel of auditors.

Management

Organizational Structure The organizational structure of the Company is currently divided into two main divisions, Head Office and Mills. The CFO reports to the CEO while the purchase manager and manager commercial from Head Office and mill managers all report to the COO of the Company Mr. Ahsan Khan.

Management Team Mr. Irfan Aslam (CEO) holds the authority to take strategic decisions. He is supported by the COO, Mr Ahsan Khan, who has vast experience in jute business and is responsible for day-to-day operations

Effectiveness The Company has an adequate IT infrastructure and related controls. The Company maintains a comprehensive MIS reporting system to keep track of activities including a range of reports on cash position, receivable position, payable position, production, inventory status reports and segment-wise profit & loss.

MIS Sargodha Jute Mills uses oracle based ERP system by the name of Wizmen. Regular reporting of sales figures, raw materials positions, payables, receivables and income statement on monthly basis is shared with the top management.

Control Environment The Company is ISO 9001-2015 certified and has established a quality control department to ensure quality of its products. In addition, the Company has devised a system for actively attending to customers’ complaints and offering prompt solutions.

Business Risk

Industry Dynamics The market size of the jute industry is estimated at PKR~31,650mln (Qty 59,260MT) in FY22 as compared to PKR~27,826mln (Qty: 53,275MT) in FY21, up ~14% YoY. The imported volumes increased as overall demand increased and industry imports 100% of its jute from Bangladesh. Jute is a Kharif crop. Pakistan’s jute industry is relatively small with 5 players in the country. Out of these 5 players, the market is dominated by 2 players, Sargodha Jute Mills Limited and Thal Limited, which occupy a combined market share of ~60% in terms of production capacity.

Relative Position There are only a handful of companies operating in jute industry. Sargodha Jute enjoys strong market share (~ 30%) and is the second largest player. Thal Jute Mills is the other main player and holds ~30% market share, with installed capacity of 33,800 MT. The remaining market share is divided between White Pearl Jute Mills, Indus Jute and Madina Jute.

Revenues The Company reported sales growth of 42.4% in FY22 and clocked in at ~PKR 6,366mln (FY21: ~PKR 4,558mln). The increase was due to rise in local sales (~42%) as more buying by the Government and an upward trend in the purchase of local jute products on the back of flooding in Pakistan destroyed the local crops of wheat, rice etc which trigger the import demand of these commodities. During FY21, the Company recorded an increase in export sales of jute and clocked in at ~PKR 1,115mln (FY21: ~PKR 727 mln). Export sales improved due to the enhanced competitiveness of finished jute products(value-added products)compared to other regional players on the back of the Rupee devaluation.

Margins During FY22, gross margin of the company remained the same at ~13% owing to an increase in the cost of raw materials consumed including the imported Raw material. The admin. and selling expenses increased by 19.6% in FY22 (FY21: PKR 209mln, FY22: PKR 250mln). Operating margin of the company improved slightly to 9.2% (FY21: 8.9%) mainly on the back of optimization in operating expenses with respect to total sales. As resultantly the company's net profit before tax has improved to PKR 461mln(FY22) from PKR 414mln(FY21).

Sustainability The company's topline has increased YoY in both; monetary and quantitative terms. The Company's revenues are further expected to improve as Government starts procurement for wheat season. The demand of jute bags is also ever-increasing with the increase in population of the country and recent drastic flooding situation in Pakistan. Furthermore, jute bags is main component for sale as they are environment friendly and bio-degradable, and with more social awareness it will become the preferred product.

Financial Risk

Working Capital During FY22, the Company’s gross working capital days improved slightly to 91 days (FY21: 94 days) . The net working capital has improved as finished goods inventory is diluted on Government buying in comparison to two years back in June-20 (153 days) . This reflects considerable improvement in Company's cash conversion cycle. The Company has an adequate cushion to borrow against working capital if needed.

Coverages During FY22, free cash flows from operations increased to ~PKR 492mln (FY21: ~PKR 365mln). Interest coverage and debt coverage ratios are slightly under stress mainly on the back of a surge in finance costs. A portfolio of investments consists of PKR 206mln TDRs and PKR 336mln listed equity security investments.

Capitalization The Company has moderately leveraged capital structure during FY22 at ~32.3%. Total borrowings of the Company increased to ~PKR 1,260mln (FY21: PKR 790mln) for the purpose of meeting their working capital requirements as 100% of their borrowings consist of short-term borrowings. An increase in short-term borrowing and the upward sloping yield curve trend of KIBOR will lead to a surge in finance costs and leveraging of the Company in the future.

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Financial Summary
PKR mln

Sargodha Jute Mills Limited Jute	Dec-22 6M	Jun-22 12M	Jun-21 12M	Jun-20 12M
A BALANCE SHEET				
1 Non-Current Assets	1,399	1,423	1,458	1,506
2 Investments	542	545	667	377
3 Related Party Exposure	-	-	-	1
4 Current Assets	4,088	2,919	1,711	1,630
a Inventories	*2,476*	*1,342*	*703*	*755*
b Trade Receivables	*748*	*751*	*439*	*471*
5 Total Assets	6,030	4,888	3,835	3,514
6 Current Liabilities	722	827	515	447
a Trade Payables	*34*	*33*	*27*	*25*
7 Borrowings	2,348	1,260	790	901
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	184	162	156	172
10 Net Assets	2,775	2,639	2,375	1,995
11 Shareholders' Equity	2,775	2,639	2,375	1,995
B INCOME STATEMENT				
1 Sales	2,688	6,516	4,575	2,916
a Cost of Good Sold	*(2,204)*	*(5,669)*	*(3,959)*	*(2,537)*
2 Gross Profit	485	847	616	379
a Operating Expenses	(138)	(250)	(209)	(162)
3 Operating Profit	347	598	406	217
a Non Operating Income or (Expense)	*(3)*	*37*	*94*	*69*
4 Profit or (Loss) before Interest and Tax	343	634	501	286
a Total Finance Cost	*(143)*	*(173)*	*(86)*	*(137)*
b Taxation	*(64)*	*(163)*	*(59)*	*(22)*
6 Net Income Or (Loss)	136	298	355	127
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*196*	*492*	*365*	*212*
b Net Cash from Operating Activities before Working Capital Changes	*118*	*343*	*203*	*82*
c Changes in Working Capital	*(402)*	*(804)*	*62*	*29*
1 Net Cash provided by Operating Activities	(284)	(461)	265	111
2 Net Cash (Used in) or Available From Investing Activities	52	102	(159)	9
3 Net Cash (Used in) or Available From Financing Activities	102	470	(113)	(229)
4 Net Cash generated or (Used) during the period	(131)	111	(6)	(109)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-17.5%	42.4%	56.9%	-4.7%
b Gross Profit Margin	18.0%	13.0%	13.5%	13.0%
c Net Profit Margin	5.0%	4.6%	7.8%	4.4%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-7.7%	-4.8%	9.3%	8.3%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	10.0%	11.9%	16.3%	7.3%
2 Working Capital Management				
a Gross Working Capital (Average Days)	180	91	94	156
b Net Working Capital (Average Days)	178	89	92	153
c Current Ratio (Current Assets / Current Liabilities)	5.7	3.5	3.3	3.7
3 Coverages				
a EBITDA / Finance Cost	1.9	4.3	5.8	2.2
b FCFO / Finance Cost+CMLTB+Excess STB	1.4	2.4	2.3	1.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.1	0.4	1.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	45.8%	32.3%	25.0%	31.1%
b Interest or Markup Payable (Days)	109.8	67.4	50.5	253.0
c Entity Average Borrowing Rate	15.5%	15.8%	8.2%	13.2%

Credit Rating

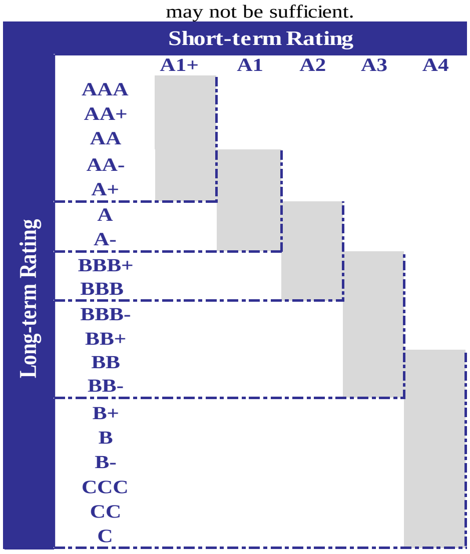
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	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
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 surveill 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):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 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