



The Pakistan Credit Rating Agency Limited

Rating Report

Sargodha Jute Mills Limited

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Rating History

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

Rating Rationale and Key Rating Drivers

The ratings reflect Sargodha Jute Mills Limited's strong business profile in harmonization with jute industry dynamics in recent times. Pakistan's jute industry depends 100% on raw jute imports from Bangladesh. Recent devaluation in currency has increased import cost of raw jute. The increase in cost is passed gradually, hence margins of the industry may be affected. The Company's revenues show steady growth in the last five years. In FY 18, sales revenue grew by ~14% and majority of the revenues come from sale of jute products to the Government and whole-sale dealers. Sargodha Jute Mills carry a strong financial profile depicted by strong coverages and moderate leveraging. Overall profitability of the company has showcased a healthy trend as the Company has ~40% market share and enjoys a strong repute in the jute industry of Pakistan.

The rating is dependent on the Company's ability to sustain its business profile and continue to hold its position in the jute industry. At the same time, diversification in revenues and products is critical. Substantial decrease of margins leading to lower profits and excessive leveraging will have its implications on the ratings.

Disclosure

Name of Rated Entity	Sargodha Jute Mills 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 Jute(Dec-18)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Sargodha Jute Mills Limited was incorporated in Pakistan on February 10, 1981 as an unquoted Public Limited Company under the repealed Companies Act, 1913 (now the Companies Act, 2017).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). Earlier, the group had twelve textile mills, one jute mill and one sugar mill. Later on the operations of the Sargodha Jute Mills were handed over to Mian Parvez Alsam, son of Mian Muhammad Aslam. Business started with annual production of 5,000 metric tons in 1984 and over a period with expansion and improvement in operating systems, the mill has been able to achieve annual production of 28,000 metric tons.

Operations The principal activity of the company is manufacturing, selling and dealing in jute products while using top of the line machinery. The jute product portfolio of Sargodha Jute Mills Limited includes yarn, hessian cloth, hessian bags, sacking bags and twines.

Ownership

Ownership Structure Mr. Parvez Aslam and the family members collectively own majority (~67.5%) shares of the company. The remaining shareholding of the company is held by associate company, Shahzad Textile Mills Limited (25%).

Stability Third generation of Mian Muhammad Aslam's family has entered into the business. Although there is no formal succession plan but the ownership of shares and business roles are equally divided between the two brothers (Imran Aslam and Irfan Aslam). Mr. Irfan Aslam is CEO of Sargodha Jute Mills Limited and Mr. Imran Aslam is CEO of Shahzad Textile Mills Limited. However, documentation of succession planning or formation of holding company will bode well with the company's stability.

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

Financial Strength Mr. Irfan Aslam has 25% shareholding in his associate company Shahzad Textile Mills Limited. Shahzad Textile's net assets are worth ~PKR 2bln. Other than that, on personal level he is an active investor in real estate, stock market and foreign exchange market. The net worth of assets in personal possession of Mr. Irfan Aslam are ~PKR 1bln. So the entity can get timely support from its sponsors in lean times.

Governance

Board Structure The board of the company consists of only four board members, out of which three members are from the sponsoring family. Mr. Irfan (CEO) and Mr. Ahsan (COO) are the two executive directors. Whereas, Mr. Imran (Chairman) and Mrs. Fakhra Parvez (mother of Mr. Irfan and Imran) are non-executive directors.

Members' Profile Mr. Irfan Aslam has more than two decades of experience in jute business and is a foreign university graduate. Mr. Imran, elder brother of Mr. Irfan, is in textile business and is CEO of Shahzad Textile Mills Limited. Ahsan Ahmad Khan - COO Sargodha Jute Mills - has 26 years of working experience with Sargodha group.

Board Effectiveness The effectiveness of the board is being compromised due to the size of the board 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 bode well with board's effectiveness.

Financial Transparency The external auditors of the company are M/s Horwath Hussain Chaudhry & Co., Chartered Accountants. They expressed an unqualified opinion on the company's annual financial statements for the year ended June 30, 2018. State Bank of Pakistan 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. CFO, purchase manager and general manager commercial from Head Office and mill managers from the mill all report to COO of the company i.e. Mr. Ahsan Ahmad Khan.

Management Team Mr. Irfan Aslam (CEO) has more than two decades of experience in jute business and is a foreign university graduate. He holds the authority to take strategic decision for the company. Second supporting hand of the company is Ahsan Ahmad Khan (COO). He has 26 years of working experience in Sargodha Jute Mill and has vast experience in jute business. The COO 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 for the management 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 top management.

Control Environment The company is ISO 9001-2008 certified. In the presence of quality management system, the company ensures that the quality products are being delivered to its customers. Currently, the company is in the process to obtain latest version of ISO 9001-2015 certificate.

Business Risk

Industry Dynamics Pakistan's jute industry depends 100% on the imported raw jute as the country is not self-sufficient in growing this rare commodity. In the last three years demand for jute has almost doubled. Total quantity of jute imported in FY18 was ~88,000 MT (FY17: ~67,000 MT and FY16: ~47,000 MT). Products that are mainly made from jute are sacking bags, hessian cloth and twines.

Relative Position There are only a few companies who are manufacturing jute and Sargodha Jute Mills has a high ranking in the industry with almost 40% market share. Another big slice of market share of ~40% is taken by Thal Jute Mills. The remaining 20% is shared between White Pearl Jute Mills, Indus Jute and Madina Jute. Installed capacity of the company is currently 29,500 MT whereas, installed capacity of Thal Jute is 33,800 MT.

Revenues Sargodha Jute Mill's revenues come from three main product categories (sacking bags, hessian and twines) where sacking bags are the cash cows and have massive contribution of ~53% in revenues of the company. Followed by hessian 27% and then twines 12%. Top ten customers of Sargodha Jute Mills contribute 74% to the total sales value. Sargodha Jute sells its products to government and wholesale dealers who sell it to end consumers i.e. landlords and factories.

Margins The company's revenues this year clocked in at ~PKR 3,800m (FY17: ~PKR 3,333m) and recorded a growth rate of 14% on behalf of 23% increase in quantity sold of hessian & sacking bags. Cost of sales only increased by ~11%, mainly on account of prudent procurement of raw materials, as they contribute ~70% to the total cost of sales. Gross margins increased to 13% (FY17: 10.7%) whereas, operating margins increased to 9% (FY17: 6.3%). Distribution cost of the company increased massively on account of export sales expenses, which amounted to ~PKR 16.3m (FY17: 0.44m). As a result net profit of the company was recorded at PKR ~161m (FY17: ~PKR 148m).

Sustainability Sargodha Jute does not plan any further expansion in near future as Jute industry is already mature. However, to continue its BMR tradition in line with keeping its plant up to date, the company may spend on BMR.

Financial Risk

Working Capital In FY18, inventory increased by ~14% as the company purchased significant amount of inventory, foreseeing the rupee devaluation and anticipation of jute shortage in Bangladesh. As a result average inventory held days increased to 134 days (FY17: 130 days). On the other hand, amount of trade debtors more than doubled because on account of credit sales and delayed receipts from government owned entities and consequently increasing the net cash cycle to 165 days (FY17: 140 days, FY16: 112 days).

Coverages During FY18, operating cash flows increased to PKR 312m (FY17: PKR 205m). Resulting in stable debt and interest coverages despite increased finance cost (FY18: ~PKR 83m, FY17: ~PKR 58m). Debt service coverages remained above 3.0x. Going forward amidst rising interest rate, coverages may deteriorate though expected to remain in comfortable region in absence of any further debt procurement.

Capitalization The company's capital structure is moderately leveraged. Total debt of the company increased to PKR 1,207m (FY17: PKR 738m) mainly on account of increased short-term borrowings. As a result the leveraging this year has increased to 42.5% (FY17: 30.5%). Short term debt constitutes 93% to the total amount of debt. Going forward, in absence of any major capacity expansion, and with the gradual payments of long-term loans, the leveraging is expected to reduce over time.

Sargodha Jute Mills Limited

BALANCE SHEET	30-Jun-18	30-Jun-17	30-Jun-16
	FY18	FY17	FY16
Non-Current Assets	1,158	1,060	766
Investments (incl. Associates)	360	336	173
Equity	360	336	173
Debt Securities (incl. income funds)	-	-	-
Current Assets	2,099	1,583	1,109
Inventory	1,209	1,057	595
Trade Receivables	370	151	219
Others	519	376	296
Total Assets	3,616	2,979	2,048
Debt/Borrowings	1,292	738	478
Short-Term	1,207	738	417
Long-Term (incl. Current Maturity of Long-Term Debt)	85	-	61
Other Short-Term Liabilities	399	374	232
Other Long-Term Liabilities	175	184	131
Shareholder's Equity	1,750	1,684	1,208
Total Liabilities & Equity	3,616	2,979	2,048

INCOME STATEMENT

Turnover	3,803	3,333	2,751
Gross Profit	499	357	259
Operating Expenses	(161)	(146)	(104)
Operating Profit	338	211	155
Other Expenses/Income	(34)	32	4
Financial Charges	(83)	(58)	(61)
Net Income	161	148	70

Cash Flow Statement

Free Cash Flows from Operations (FCFO)	312	205	152
Net Cash changes in Working Capital	(390)	(397)	(126)
Net Cash from Operating Activities	(150)	(241)	(31)
Net Cash from Investing Activities	(95)	(105)	6
Net Cash from Financing Activities	482	328	7
Net Cash generated during the period	237	(18)	(18)

Ratio Analysis

Performance			
Turnover Growth (v.s same period last year)	14.1%	21.1%	-10.8%
Gross Margin	13.1%	10.7%	9.4%
Net Margin	4.2%	4.4%	2.5%
ROE	18.4%	10.2%	4.7%
Coverages			
Debt Service Coverage (times) (FCFO/Gross Interest+CMLTD+Uncovered STB)	3.1	3.5	2.5
Interest Coverage (times) (FCFO/Gross Interest)	3.7	3.5	2.5
Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO - Gross Interest)	0.4	0.0	0.7
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	165	140	112
Leveraging (Total Debt/Total Debt+Equity)			
	42.5%	30.5%	28.4%

Credit Rating Scale & Definitions

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

Long Term Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
AA+ AA AA-	Very high credit quality. Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	A1	A strong capacity for timely repayment.
A+ A A-	High credit quality. Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
BBB+ BBB BBB-	Good credit quality. Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
BB+ BB BB-	Moderate risk. Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
B+ B B-	High credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.	C	An inadequate capacity to ensure timely repayment.
CCC CC C	Very high credit risk. Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.		
D	Obligations are currently in default.		



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

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

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Rating Team Statements

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

2) Conflict of Interest

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

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- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

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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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