



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
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 strong profile in jute industry emanating from robust market share, adequate margins. Pakistan's jute industry depends 100% on raw jute imports from Bangladesh. The prices of raw jute fluctuate in the international market and have been on a rising trend lately. This, coupled with devaluation of rupee and higher finance cost, has increased costs for the industry. The Company was able to pass on these increased costs to consumers. However, the higher jute product prices, imposition of sales tax and CNIC requirement on buyers from July 01, 2019, has impacted demand in 1HFY20. The top-line of the Company declined by ~28% and is expected to remain subdued in FY20. Provincial Government has imposed lock down due to Corona Virus outbreak recently. However, the Company remains exempt from this due to its products being used for food storage. Extended lock down will put pressure on sales, nevertheless. The Company's profitability came under pressure due to lower sales and higher finance costs. The recent 225bps cut in interest rate is expected to provide some relief, going forward. The capital structure of the Company is moderately leveraged comprising short-term borrowings only. The Company reduced its borrowings during 1HFY20. The Company manages its working capital adequately with cushion at trade level available with strong coverages. The ratings incorporate financial strength and proven track record of the sponsoring family.

The ratings are dependent on the company's ability to maintain its revenues and margins. Substantial decrease in margins leading to lower profitability and/or deterioration in coverages will have implications on the ratings. At the same time, continuation of production activity during Corona Virus outbreak is critical.

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-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Jute(Dec-19)
Rating Analysts	Ateeb Riaz ateeb.riaz@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 had twelve textile mills, one jute mill and one sugar mill. Later on, the operations of Sargodha Jute were handed over to Mian Parvez Alsam son of Mian Muhammad Aslam. The Company started with annual production capacity of 5,000 metric tons in 1984 and has increased it to ~30,500 metric tons over the years.

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, sacking bags and twines.

Ownership

Ownership Structure Mr. Parvez Aslam and his family members collectively own majority (~85%) 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 associate company Shahzad Textile Mills Limited. Shahzad Textile's net assets are worth ~PKR 2bln. Moreover, 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 is ~PKR 1bln. 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 27 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 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, 2019. 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 general manager commercial from Head Office and mill managers all report to 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 customer's complaints and offer prompt solutions.

Business Risk

Industry Dynamics During 1HFY20, total quantity of jute imported in Pakistan was ~17000MT (1HFY19: ~41,500MT). The imported volumes decreased as due to higher prices of jute due to Rupee devaluation and increased finance cost. Industry players reverted to carrying raw material inventory to ~2-3 months instead of ~6 months, previously.

Relative Position There are only a handful of companies operating in jute industry. Sargodha Jute enjoys strong market share (~40%) and is the second largest player. Thal Jute Mills is the other main player and holds ~40% market share, with installed capacity of 33,800 MT. The remaining 20% is divided between White Pearl Jute Mills, Indus Jute and Madina Jute.

Revenues The Company's revenue in 1HFY20 declined by ~28% and clocked in at ~PKR 744mln (1HFY19: ~PKR 1,038mln). The decline was due to significant drop in local sales (~48%) as imposition of CNIC provision on buyers, lower buying by the Government and rising prices of jute products affected revenues. This was compensated to an extent by surging exports (110% higher YoY) as the Company recorded exports of ~PKR 258mln. Export sales improved due to enhanced competitiveness of finished jute products compared to other regional players on the back of Rupee devaluation.

Margins During 1HFY20, gross margin increased to ~19% (1HFY19: ~17%) as the Company was able to pass on the higher raw material cost to customers. The admin. and selling expenses remained intact in 1HFY20 and clocked in at ~PKR 78mln (1HFY19: 66mln). However, operating margin came down (1HFY20: 8.4%, 1HFY19: 10.5%). The Company's profitability suffered as it recorded net profit of PKR 13mln in 1HFY20 (1HFY19: PKR 40mln) due to trickle down effect of lower sales.

Sustainability Corona Virus is posing as serious challenge across the country. Provincial Governments have imposed lockdown of 2-3 weeks. As the Company is affiliated with food industry, it has received exemption from lockdown. The Company's revenues are expected to improve as Government starts procurement for wheat season. Moreover, the recent reduction of 225bps in interest rates is expected to supplement profitability, going forward.

Financial Risk

Working Capital During 1HFY20, the Company's gross working capital days improved to 302 days (1HFY19: 332 days). This was due to lower raw material days. Trade receivable days increased as a result of lenient credit terms to customers. The net working capital is expected to further improve when the finished goods inventory dilutes on Government buying. The Company has adequate cushion at trade level of ~17% in 1HFY20, showing room to borrow against working capital, if needed.

Coverages During 1HFY20, free cash flows from operations decreased to ~PKR 71mln (1HFY19: ~PKR 86mln) due to lower profitability. Even though the Company's total borrowings decreased significantly to PKR 991mln (1HFY19: PKR 1,679mln), and total finance costs declined (1HFY20: PKR 50mln, 1HFY19: PKR 63mln). Due to lower finance cost, the interest coverage and debt coverage ratios improved slightly to 1.5x (1HFY19: 1.4x) and 1.5x (1HFY19: 1.3x), respectively. Going forward, coverages of the Company are expected to improve due to lower benchmark rate. The Company has liquid investments to supplement coverages as well.

Capitalization The Company's capital structure is moderately leveraged at ~40% and leveraging. Total borrowings of the Company decreased to ~PKR 991mln (1HFY19: PKR 1,679mln) due to reduction in short term borrowing, leading to lower leveraging on YoY basis. Short term borrowings constitute 98.8% of total borrowings.



Sargodha Jute Mills Limited Jute	Dec-19 6M	Jun-19 12M	Jun-18 12M	Jun-17 12M
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A BALANCE SHEET

1 Non-Current Assets	1,146	1,173	1,158	1,060
2 Investments	293	318	359	335
3 Related Party Exposure	-	1	1	1
4 Current Assets	1,666	1,739	2,099	1,583
<i>a Inventories</i>	887	859	1,209	1,057
<i>b Trade Receivables</i>	309	408	370	151
5 Total Assets	3,104	3,230	3,616	2,979
6 Current Liabilities	404	441	474	433
<i>a Trade Payables</i>	31	29	34	48
7 Borrowings	991	1,132	1,546	962
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	210	172	175	184
10 Net Assets	1,500	1,484	1,421	1,400
11 Shareholders' Equity	1,500	1,484	1,421	1,400

B INCOME STATEMENT

1 Sales	744	3,061	3,803	3,333
<i>a Cost of Good Sold</i>	(604)	(2,595)	(3,304)	(3,176)
2 Gross Profit	141	465	499	157
<i>a Operating Expenses</i>	(78)	(144)	(161)	(146)
3 Operating Profit	62	321	338	11
<i>a Non Operating Income</i>	11	(41)	(72)	(2)
4 Profit or (Loss) before Interest and Tax	73	280	266	9
<i>a Total Finance Cost</i>	(50)	(153)	(92)	(107)
<i>b Taxation</i>	(10)	(40)	(59)	(37)
6 Net Income Or (Loss)	13	87	115	(135)

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	71	283	274	(29)
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	(6)	148	203	(79)
<i>c Changes in Working Capital</i>	82	325	(390)	(397)
1 Net Cash provided by Operating Activities	76	473	(187)	(475)
2 Net Cash (Used in) or Available From Investing Activities	53	(47)	(95)	(105)
3 Net Cash (Used in) or Available From Financing Activities	(132)	(414)	519	563
4 Net Cash generated or (Used) during the period	(3)	12	237	(18)

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	-51.4%	-19.5%	14.1%	--
<i>b Gross Profit Margin</i>	18.9%	15.2%	13.1%	4.7%
<i>c Net Profit Margin</i>	1.8%	2.9%	3.0%	-4.1%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	14.8%	12.4%	9.2%	0.8%
<i>e Return on Equity (ROE)</i>	1.8%	6.0%	8.1%	-9.6%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	302	170	134	104
<i>b Net Working Capital (Average Days)</i>	294	166	130	98
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	4.1	3.9	4.4	3.7
3 Coverages				
<i>a EBITDA / Finance Cost</i>	2.3	2.5	4.0	0.3
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.5	1.8	2.8	-0.3
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.3	0.1	0.5	0.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	39.8%	43.3%	52.1%	40.7%
<i>b Short-Term Borrowings / Total Borrowings</i>	1.0	1.0	0.9	1.0
<i>c Average Borrowing Rate</i>	9.2%	11.2%	7.0%	10.6%

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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(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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- (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

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- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
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- (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)
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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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