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
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 prominent profile in jute industry emanating from considerable market share, adequate margins. 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 on a rising trend. This, coupled with rupee devaluation and escalating logistic costs has asserted pressure on industry. However, the Company was able to pass these costs to its customers. Despite the higher jute product prices and imposition of sales tax from July 01, 2019, demand has shown growth during FY21 and 1HFY22. The top-line of the Company inclined to ~20% on annualized basis during 1HFY22 and grew by ~ 57% on YoY basis in FY21. The company's profitability remained stable. During FY 21, exports of the Company increased by ~102% on YoY basis. Going forward, the Company is focusing to further enhance its export sales. Ownership structure of the Company is solely represented by sponsoring family members. Financial risk profile of the Company is considered adequate with comfortable coverages and cashflows. Capital structure is leveraged, where borrowings are mainly comprising of short term to cater working capital requirements.

The ratings are dependent on the company's ability to maintain its organic growth in revenues and sustainability of its margins. Substantial increase in prices of raw material and inability to transfer associated inflationary effect to end customers leading towards lower profitability, margins and/or deterioration in coverages will have 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 Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Jute(Oct-21)
Rating Analysts	Sohail Ahmed Qureshi | sohail.ahmed@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 started with annual production capacity of 5,000 metric tons in 1984 and has increased it to ~30,500 metric tons over the years. The actual production of the Company reached at ~ 20,155 metric tons during June-2021.

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 ~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 Textile's net assets are worth ~PKR 3bln. Moreover, on personal level, he is an active investor in real estate, stock market and foreign exchange market. 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, 2021. 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 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 FY21, total quantity of jute imported in Pakistan was ~62,614MT (PKR: 11,437mln) (FY20: ~49,638MT, PKR: 4,852mln). 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 97.6% in 6MFY22 and clocked in at ~PKR 2,743mln (6MFY21: ~PKR 1,388mln). The increase was due to significant rise in local sales (~151%) as more buying by the Government and upward trend in purchase of local jute products on back of resuming operations and business activity post- COVID-19. During FY21, the Company has recorded an increase in export sales of jute and clocked in at ~PKR 727mln (FY20: ~PKR 346mln). Export sales improved due to enhanced competitiveness of finished jute products compared to other regional players on the back of Rupee devaluation.

Margins During FY21, gross margin of the company remained the same at ~13% owing to increase in the cost of raw materials consumed including the imported Raw material. The admin. and selling expenses increased by 21% in FY21 (FY21: PKR 149mln, FY20: PKR 123mln). However, PKR 149 million in admin and selling expenses included donation of PKR 20 million as well. Operating margin of the company improved to 8.9% (FY20: 7.4%). Resultantly company's net profitability before tax has improved significantly to PKR 414mln(FY21) from PKR 149mln(FY20) on the back of surplus in value of investments and decline in finance cost.

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 increase in population of the country. 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 FY21, the Company's gross working capital days improved to 94 days (FY20: 156 days) (6MFY22: 116days, 6MFY21: 156 days). This was mainly induced by better inventory management. Trade receivable days decreased to 36 days (FY20: 55) as a result of timely payments received from customers. The net working capital has improved as finished goods inventory diluted on Government buying. This reflects considerable improvement in Company's cash conversion cycle. The Company has adequate cushion to borrow against working capital, if needed.

Coverages During FY21, free cash flows from operations increased to ~PKR 365mln (FY20: ~PKR 212mln) (6MFY22: PKR 205mln). Interest coverage and debt coverage ratios improved due to increase in FCFO and reduction in Finance cost. Portfolio of investments is beef up with TDRs (FY21: PKR 313mln, FY20: PKR 126mln) , which going forward will further supplement their bottom line with positive cash flows.

Capitalization The Company's has more leveraged capital structure during 6MFY22 at ~43%. Total borrowings of the Company increased to ~PKR 1,882mln (6MFY21: PKR 1,235mln). Increase in short term borrowing and stability of KIBOR at lower level, led to higher leveraging on YoY basis. Short term borrowings constitute 96% of total borrowings. During 6MFY22, Company has no long term financing.

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Financial Summary
PKR mln

Sargodha Jute Mills Limited	Dec-21	Jun-21	Jun-20	Jun-19
Jute	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	1,431	1,458	1,506	1,173
2 Investments	523	667	377	318
3 Related Party Exposure	-	-	1	1
4 Current Assets	3,136	1,711	1,630	1,739
a Inventories	*1,873*	*703*	*755*	*859*
b Trade Receivables	*468*	*439*	*471*	*408*
5 Total Assets	5,090	3,835	3,514	3,230
6 Current Liabilities	523	515	447	441
a Trade Payables	*27*	*27*	*25*	*29*
7 Borrowings	1,882	790	901	1,132
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	170	156	172	172
10 Net Assets	2,515	2,375	1,995	1,484
11 Shareholders' Equity	2,515	2,375	1,995	1,484
B INCOME STATEMENT				
1 Sales	2,743	4,575	2,916	3,061
a Cost of Good Sold	*(2,378)*	*(3,959)*	*(2,537)*	*(2,595)*
2 Gross Profit	364	616	379	465
a Operating Expenses	(98)	(209)	(162)	(144)
3 Operating Profit	266	406	217	321
a Non Operating Income or (Expense)	*(11)*	*94*	*69*	*(41)*
4 Profit or (Loss) before Interest and Tax	255	501	286	280
a Total Finance Cost	*(53)*	*(86)*	*(137)*	*(153)*
b Taxation	*(61)*	*(59)*	*(22)*	*(40)*
6 Net Income Or (Loss)	141	355	127	87
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*205*	*365*	*212*	*283*
b Net Cash from Operating Activities before Working Capital C	*132*	*203*	*82*	*148*
c Changes in Working Capital	*23*	*62*	*29*	*325*
1 Net Cash provided by Operating Activities	155	265	111	473
2 Net Cash (Used in) or Available From Investing Activities	(37)	(159)	9	(47)
3 Net Cash (Used in) or Available From Financing Activities	(85)	(113)	(229)	(414)
4 Net Cash generated or (Used) during the period	32	(6)	(109)	12
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	19.9%	56.9%	-4.7%	-19.5%
b Gross Profit Margin	13.3%	13.5%	13.0%	15.2%
c Net Profit Margin	5.1%	7.8%	4.4%	2.9%
d Cash Conversion Efficiency (FCFO adjusted for Working Ca	8.3%	9.3%	8.3%	19.9%
*e Return on Equity [Net Profit Margin * Asset Turnover * (To*	11.5%	16.3%	7.3%	6.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	116	94	156	170
b Net Working Capital (Average Days)	114	92	153	166
c Current Ratio (Current Assets / Current Liabilities)	6.0	3.3	3.7	3.9
3 Coverages				
a EBITDA / Finance Cost	4.9	5.8	2.2	2.5
b FCFO / Finance Cost+CMLTB+Excess STB	2.3	2.3	1.3	1.8
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fin	0.3	0.4	1.0	0.1
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	42.8%	25.0%	31.1%	43.3%
b Interest or Markup Payable (Days)	63.9	50.5	253.0	218.5
c Entity Average Borrowing Rate	7.9%	8.2%	13.2%	10.3%

Credit Rating

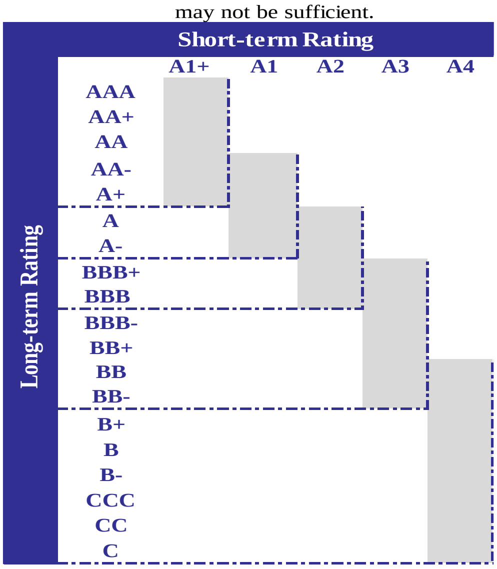
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

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

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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

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(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)

(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)

(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)

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

(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)

(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)

(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)

(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity

(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)

(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)

(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)

(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)

(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

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

(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)

(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)

(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

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