



The Pakistan Credit Rating Agency Limited

Rating Report

Ali Embroidery Mills (Pvt.) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
31-May-2019	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Ali Embroidery Mills (Private) Limited, part of the Sefam Group, specializes in Schiffl and Multi-Heads embroidery. The Company derives the bulk of its revenue from embroidery services for its sister concern, Sefam (Private) Limited's associated brands "Bareeze" and "Kayseria". The ratings reflect the Company's adequate business profile characterized by growing revenues on the back of stable demand for embroidered fabric as well as recent venture into retail through its brand "The Embroidery Company". Margins remain strong, though displaying stagnation over recent years. This is expected to improve with further expansion into retail. The Company's bottom line has remained steady over the years, though remains relatively small with limited cushion against any adverse situation. Conservative financial structure with minimal dependence on short-term borrowing bodes well for the financial risk profile. This is supported by prudent working capital management and strong coverages. Ratings further reflect association with the well-established Sefam Group as well as sponsors willingness to provide support when required, as demonstrated in the past. Meanwhile, the Company's overall governance structure and financial transparency need improvement.

The ratings are dependent on anticipated growth in topline resulting from recent penetration into retail. Additionally, sustainability of working capital management and coverages is critical. Improvement in corporate governance framework will be important.

Disclosure

Name of Rated Entity	Ali Embroidery Mills (Pvt.) 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 Textile(Oct-18)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Ali Embroidery Mills (Private) Limited (Ali Embroidery) was incorporated in Pakistan in 1972 as a private limited company.

Background Ali Embroidery is part of the Sefam Group, head quartered in Lahore, Pakistan. The Company was set up by Mr. J.A Zaman (late) and later became the launching pad for Sefam (Private) Limited and Sarena Textile Industries. The Company started out in Schiffli embroidery, which remains its specialty, and later entered into Multi-Heads embroidery in 2012.

Operations The Company's production facility is located on Sheikhupura Road, Lahore, while its head office is located on Waris Road. Its present capacity comprises 32 Schiffli machines and 62 Multi-Heads embroidery machines. The Company also operates its retail brand "The Embroidery Company", launched in 2017, through four outlets in Lahore. Further, it has invested in the construction of a mall adjacent to its factory premises over ~3.5 kanals, which is under construction. The total power requirement of the Company is met through a line from LESCO with diesel generators serving as backup.

Ownership

Ownership Structure Ownership of the Company is shared by the children of late Mr. J.A Zaman. Mr. Tariq Zaman, Mr. Hamid Zaman, Ms. Seema Aziz and Ms. Ambreen Zaman hold ~24.5% stake in the Company while Mr. Ali Zaman holds ~2%.

Stability While no documented agreement exists between the family members, the shareholding structure is well defined, and no ownership change is envisaged in the coming years.

Business Acumen All sponsors have a solid background in the textile industry, backed with quality education from prestigious universities. In addition to textile, the sponsors also possess experience in diversified industries including agriculture, transportation and energy.

Financial Strength Over the years, the Group has grown its presence in Pakistan through diversified ventures. The sponsors of the business have shown willingness and ability to support the Company through various long-term loans in the past.

Governance

Board Structure Ali Embroidery's Board of Directors comprises four members, all sponsors. Absence of independent members undermines the role of the Board as an independent oversight function. However, non-executive role of three sponsors compensates the same, to some extent.

Members' Profile The Board possess rich experience in the textile sector with each member involved in the management of different Group companies. Board members have been associated with the Company for over a decade.

Board Effectiveness No formal meetings are held between the Board members. Instead, members meet infrequently to discuss business developments, depending on availability. There are no sub-committees in place to assist the Board. Significant room for strengthening governance framework exists.

Financial Transparency M/s Arshad Raheem & Co. Chartered Accountants, who are not rated by the SBP but have a satisfactory QCR rating by ICAP, are the external auditors of the Company. They have expressed an unqualified opinion on the financial statements of the Company for the year ended June 30, 2018.

Management

Organizational Structure The Company has a lean organizational structure divided into broad functional departments, reporting to the CFO and two General Managers, who in turn report to the CEO.

Management Team The management team is led by Mr. Tariq Zaman, the CEO of the Company. Mr. Zaman possesses a diversified skill set comprising extensive experience in the textile sector along with managing other Group projects including JAZ Hatari Farms (Pvt.) Ltd, Manzil Ventures (Pvt.) Limited and Kazan Energy Solutions (Pvt.) Limited. He is currently an active member of several non-profit organizations including Civil Rights Groups and welfare societies. Most of the senior management team has been associated with the Group for a considerable time.

Effectiveness Mr. Zaman is actively involved in day-to-day business operations, meeting with the senior management daily to review financial performance and production reports.

MIS The Company utilizes a combination of various in-house MIS solutions for monitoring and reporting relating to finance, inventory, billing, production and shop sales.

Control Environment The Company has various quality controls in place to ensure premium quality products for its customers. Quality reports are compiled by its main customer daily to allow for an accurate and unbiased assessment.

Business Risk

Industry Dynamics During 9MFY19, Pakistan's textile exports stagnated (~0.1% growth YoY) due to a unit price dip across major categories, which set off the volumetric increase spurred by the currency devaluation. Meanwhile, the local textile retail industry remains under pressure due to fierce competition between retail brands struggling to compete through various discounts and sale offers, often at the expense of their own profitability.

Relative Position Ali Embroidery is the largest embroidery player in Pakistan in terms of Schiffli embroidery capacity. In terms of overall revenues and profitability, on a standalone basis, it is a relatively small company operating in the value-added textile segment with only local presence.

Revenues Ali Embroidery's revenues are derived predominantly from embroidery charges for its sister concern, Sefam's, main brands "Bareeze" and "Kayseria" (FY18: ~86%, FY17: ~95%) followed by walk-in customers at the Company's retail outlets. Presently, it is catering to ~70% and ~50% embroidery work of "Bareeze" and "Kayseria", respectively. The Company's sales depicted an increase of ~4% in FY17 while growth spiked to ~31% in FY18, with sales clocking in at ~PKR 681mln, led by volumetric increase due to the addition of some embroidery machines during the year as well as the launch of its retail network. During 9MFY19, revenues amounted to ~PKR 636mln and the Company projects its revenues to clock in at ~PKR 900mln for FY19.

Margins Ali Embroidery enjoys strong gross margins that have stayed above 20% over the past few years (FY18: ~22%, FY17: ~22%) and witnessed a slight uptick in 9MFY19 (~23%) due to better prices fetched through retail. Finance cost on sponsors loan is high and has shown an increasing trend over recent years. Thus, the Company's net profit remains relatively small, showing growth in 9MFY19 to stand at ~PKR 33mln (FY18: ~PKR 26mln, FY17: ~PKR 24mln) while net margin clocked in at ~5% (FY18: ~4%, FY17: ~5%).

Sustainability The Company has identified the retail market as an opportunity for business expansion and plans to expand its retail network. It also plans to expand its embroidery capacity to cater to demand for its retail brand as well as continually increasing demand from Sefam. It is also investing in the construction of a mall adjacent to its factory in Sheikhupura, which will include "The Embroidery Company's" factory outlet as well as factory outlets of other brands, within and outside the Sefam Group. The mall is expected to become operational in August, 2019.

Financial Risk

Working Capital The Company's working capital needs emanate from financing its inventory of plain fabric from Sarena Textile Industries (sister concern) and importing embroidery yarn while offering relaxed credit terms to its customer, Sefam. Rise in inventory needs in 9MFY19 due to strong demand for its retail brand led the Company's net cash cycle to increase to ~59 days (FY18: ~47 days, FY17: ~40 days). Minimal use of short-term borrowing for working capital needs reflects well on the Company's working capital management.

Coverages Ali Embroidery's free cash flows FCFO clocked in at ~PKR 105mln in 9MFY19 (FY18: ~PKR 100mln, FY17: ~PKR 82mn) owing to strong operations and improved profitability. The same resulted in improved debt-service and core coverages which clocked in at 3.5x and 1.6x respectively (FY18:3.2x and 1.4x respectively). Going forward, since the Company does not plan on taking on any significant amount of debt, coverages are expected to remain strong.

Capitalization Ali Embroidery is moderately leveraged (~48%) and the Company has maintained the same level over recent years. Borrowings largely comprise loans obtained from directors at varying interest rates to finance capacity expansion in the past. Going forward, no major borrowing has been planned and the same capital structure is expected to sustain.



**Ali Embroidery Mills Limited
Private Limited**

BALANCE SHEET	Mar-19	Jun-18	Jun-17	Jun-16
	9M	12M	12M	12M
a Non-Current Assets	530	449	436	397
b Investments (Incl. Associates)	5	27	7	4
Equity Instruments	5	27	7	4
Debt Instruments	-	-	-	-
Investment Property	-	-	-	-
c Current Assets	318	356	276	192
Inventory	90	142	73	23
Trade Receivables	113	72	68	54
Others	114	142	135	116
d Total Assets	853	832	719	594
e Debt/Borrowings	369	331	281	258
Short-Term	13	-	-	-
Long-Term (Incl. Current Maturity of Long-Term Debt)	356	331	281	258
Other Short-Term Liabilities	105	156	119	41
Other Long-Term Liabilities	-	-	-	-
f Shareholder's Equity	379	346	319	295
g Total Liabilities & Equity	853	832	719	594

INCOME STATEMENT

a Turnover	636	681	521	503
b Gross Profit	143	149	113	107
c Net Other Income	4	5	9	7
d Financial Charges	(30)	(32)	(18)	(15)
e Net Income	33	26	24	24

CASH FLOW STATEMENT

a Free Cash Flow from Operations (FCFO)	105	101	82	75
b Total Cashflows (TCF)	105	101	82	75
c Net Cash changes in Working Capital	(37)	(58)	1	(12)
d Net Cash from Operating Activities	37	11	65	48
e Net Cash from Investing Activities	(88)	21	(5)	(21)
f Net Cash from Financing Activities	4	(47)	(52)	(32)
g Net Cash generated during the period	(46)	(15)	9	(5)

RATIO ANALYSIS

a Performance				
Turnover Growth	24%	31%	4%	-
Gross Margin	23%	22%	22%	21%
Net Margin	5%	4%	5%	5%
ROE	12%	8%	8%	8%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.6	1.4	1.3	1.2
Interest Coverage (X) (FCFO/Gross Interest)	3.5	3.2	4.7	4.9
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	3.6	4.7	4.4	4.3
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	59	47	40	40
d Capital Structure (Total Debt/Total Debt+Equity)	49%	49%	47%	47%

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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- (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.
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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)
- (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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