The Pakistan Credit Rating Agency Limited

Rating Report

Ali Embroidery Mills (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-May-2020	BBB	A2	Stable	Maintain	YES
29-Nov-2019	BBB	A2	Stable	Maintain	-
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 Schiffli and Multi-Heads embroidery. The Company derives 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 modest, albeit growing, revenues on the back of stable demand for embroidered fabric as well as recent venture into retail market through its brand “The Embroidery Company”. Margins remain strong, though displaying stagnation over recent years. Since COVID-19 outbreak and subsequent lockdown, the Company performance is expected to suffer as the closure of retail shops impacted the demand and off take of the Company's products. However, 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. The ratings further reflect the Company's association with well-established Sefam Group as well as sponsor's willingness to provide support when required, as demonstrated in the past.

The 'Rating Watch' signifies the prevailing uncertainty due to the outbreak of COVID-19 pandemic. This has impacted the entire textile chain as demand contracted due to shutdown in domestic and global markets and tough economic conditions. SBP measures have provided some respite in this regard. The Company’s production facilities have been shut down since March in line with the provincial Government’s directive of lockdown, though reopened recently. Similarly, gradual reopening of retail shops is considered beneficial but attaining historical revenue levels remains to be seen. PACRA is closely monitoring the situation and will take rating action accordingly.

The ratings are dependent on sustaining business performance amidst prevailing tough conditions. Full resumption of operations and maintaining strong financial profile amidst lower revenues is critical. Meanwhile, the Company’s overall governance structure and financial transparency need improvement.

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-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Composite(Nov-19)
Rating Analysts	Bakhtawar Abid | bakhtawar.abid@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 34 Schiffli machines and 72 Multi-Heads embroidery machines. The Company also operates its retail brand "The Embroidery Company", launched in 2017, through three 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 a 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 the 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. The auditor has given an unqualified opinion on the financial statements for the year ended June 2019.

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 9MFY20, textile exports increased by 5% period on period. Currency devaluation and US-China trade war earlier in the year helped the country to increase its exports in value-added segments. Despite a decrease in per-unit prices, a factor of sharing currency devaluation benefits with buyers, exports of value-added segments increased by ~6%. Though the COVID-19 outbreak in early 2020 has affected the entire textile chain. Export orders have been postponed or cancelled as major export destinations remain in lockdown to contain the virus. Several domestic players have shut down production or are partially operational. Recent government initiatives are expected to provide some relief. Ease in lockdown from 11 May will help to retrieve some of the lost sales for local brands but overall brands will struggle in already a fiercely competed textile local market of Pakistan.

Relative Position Ali Embroidery is the largest embroidery player in Pakistan in terms of Schiffli embroidery capacity. Considering 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's, Sefam, main brands "Bareeze" and "Kayseria" 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 ~16% YoY in 1HFY20, with revenue clocking in at ~PKR 565mln (1HFY19: PKR 486mln), led by a volumetric increase owing to strong demand from Sefam as well as the addition of embroidery machines over the year.

Margins Ali Embroidery's gross margins largely remain at the same level (1HFY20: 22.7%, 1HFY19: 23.4%) as the Company has predetermined 'per stitch' embroidery charges with its related parties. This mechanism of agreed 'per stitch' embroidery charges brings stability to overall gross margins of the Company. Due to the increase in Administrative expenses, the Company's operating margins decreased. Resultant of lower operating profit and higher finance cost (1HFY20: 30mln, 1HFY19:20mln) the Company's net profit decreased in 1HFY20 to ~PKR 15mln (1HFY19: ~PKR 30mln) while net margin clocked in at ~8.7% (1HFY19: ~11.6%).

Sustainability Ali Embroidery had to shut down its operations due to lockdown. Ease of lockdown from 11th May has lead to reopening of operations of the Company. However, the complete lockdown on weekends and closure of malls (a major contributor to sales) will significantly impact revenues and performance of the Company as the Company sells its product to Brands and lower brands' sales will ultimately impact the performance of the Company.

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. Working capital management remains strong with net cash cycle remaining stagnant YoY at ~24 days. Meanwhile, the Company's reliance on short term borrowing further declined and borrowing dropped to zero.

Coverages Ali Embroidery's free cash flows FCFO clocked in at ~PKR 100mln in 1HFY20 YoY (1HFY19: ~PKR 81mln) owing to better operations. However, interest coverage decreased due to high finance cost (1HFY20: 3.3x,1HFY20: 4.1x) and debt coverage also decreased (1HFY20: 1.8x,1HFY19: 2.0x). 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 (~52%). However, leveraging has been rising over recent years (FY19: ~PKR 460mln, FY18: ~PKR 371mln) to finance expansion and investment into retail plans. Borrowings largely comprise loans obtained from directors at varying interest rates. Going forward, no further borrowing is planned and the same capital structure is expected to sustain.

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Financial Summary
PKR mln

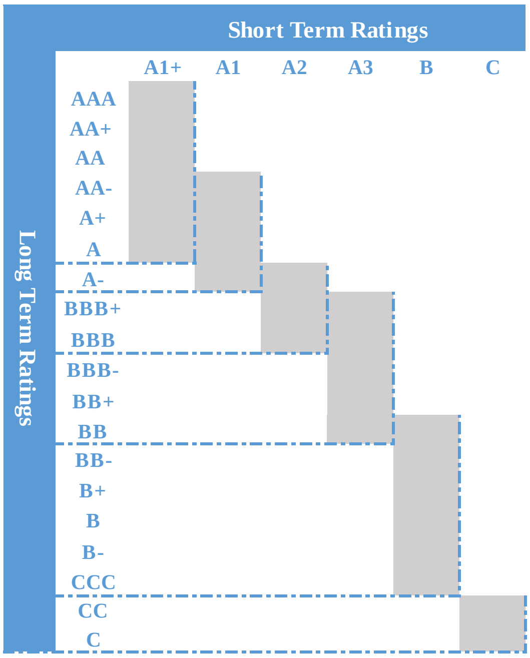
Ali Embroidery Mills (Private) Limited Textile Composite	Dec-19 6M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	603	597	449	436
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	27	7
4 Current Assets	378	340	356	276
a Inventories	*66*	*80*	*142*	*73*
b Trade Receivables	*135*	*101*	*72*	*68*
5 Total Assets	982	937	832	719
6 Current Liabilities	127	84	116	103
a Trade Payables	*90*	*58*	*99*	*82*
7 Borrowings	102	156	106	92
8 Related Party Exposure	347	304	265	204
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	406	393	346	319
11 Shareholders' Equity	406	393	346	319
B INCOME STATEMENT				
1 Sales	565	921	681	521
a Cost of Good Sold	*(436)*	*(707)*	*(533)*	*(408)*
2 Gross Profit	128	213	149	113
a Operating Expenses	(79)	(108)	(84)	(74)
3 Operating Profit	49	105	64	40
a Non Operating Income	*2*	*2*	*5*	*9*
4 Profit or (Loss) before Interest and Tax	51	108	69	48
a Total Finance Cost	*(31)*	*(41)*	*(32)*	*(18)*
b Taxation	*(6)*	*(20)*	*(10)*	*(6)*
6 Net Income Or (Loss)	15	47	26	24
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*100*	*147*	*101*	*82*
b Net Cash from Operating Activities before Working Capital Changes	*89*	*106*	*69*	*64*
c Changes in Working Capital	*25*	*(40)*	*(58)*	*1*
1 Net Cash provided by Operating Activities	114	66	11	65
2 Net Cash (Used in) or Available From Investing Activities	20	(150)	21	(5)
3 Net Cash (Used in) or Available From Financing Activities	(105)	13	(47)	(52)
4 Net Cash generated or (Used) during the period	29	(70)	(15)	9
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	22.7%	35.1%	30.7%	3.6%
b Gross Profit Margin	22.7%	23.2%	21.8%	21.7%
c Net Profit Margin	2.6%	5.1%	3.9%	4.6%
d Cash Conversion Efficiency (EBITDA/Sales)	19.1%	17.6%	16.8%	17.5%
e Return on Equity (ROE)	7.3%	12.7%	7.9%	7.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	62	78	95	78
b Net Working Capital (Average Days)	38	47	47	42
c Current Ratio (Total Current Assets/Total Current Liabilities)	3.0	4.1	3.1	2.7
3 Coverages				
a EBITDA / Finance Cost	3.5	4.1	3.6	5.3
b FCFO / Finance Cost+CMLTB+Excess STB	1.8	1.8	1.4	1.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.2	3.9	5.3	4.6
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	52.5%	54.0%	51.8%	48.2%
b Short-Term Borrowings / Total Borrowings	0.0	0.1	0.0	0.0
c Average Borrowing Rate	13.4%	9.4%	9.4%	6.3%

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	
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 Ratings	
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 conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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 surveill the opinion due to lack of requisite information.

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

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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