



The Pakistan Credit Rating Agency Limited

Rating Report

Khaadi Pakistan (SMC-Pvt) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
03-Jun-2024	A	A1	Stable	Maintain	-
01-Jun-2023	A	A1	Stable	Upgrade	-
14-Dec-2022	A-	A2	Positive	Maintain	-
14-Dec-2021	A-	A2	Stable	Maintain	-
14-Dec-2020	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the appreciable presence of Khaadi Pakistan (SMC-Pvt). Limited (“Khaadi” or “the Company”) in the competitive retail fashion industry of Pakistan. The Company primarily operates under the umbrella of the Khaadi Corporation Limited (KCL) - a Holding Company. The rating takes comfort from the ownership transition of a 20% stake to IFC (International Financial Corporation) through a series of phase-wise investments up to USD 25mln in KCL. The Khaadi has shown endurance through a gradual strategic shift from go-wide (expanding brand presence geographically by opening numerous stores across multiple locations.) to go-deep (consolidating the number of stores to give a better customer experience) to penetrate the B2C category and elevate the customer experience. This transition has benefitted the Company by augmenting the average store time of walk-in customers. In the future, the company plans to progressively convert "normal category stores" into "experience hub stores" as part of its strategy to ameliorate the point-of-purchase display for its prime product categories, including Unstitched Fabric (UF), Ready-to-Wear (RTW), and Emerging Concepts (EC). The majority of the Company sales are carried out by retail outlets and remaining through online platform-e-commerce driven by customer preference trends. The Company's product slate divests into UF, RTW, EC, and Specialized Hand-woven fabric under the brand name, “Chapter II”. In business-wise product contribution, the foremost product is Unstitched fabric in the local market and Ready to Wear in the international market. The Company's top suppliers are well-established and stable entities providing comfort to the business sustainability. During 6MFY24, the Company generated a topline of PKR 13.1bln (FY23: PKR 27bln) amidst macroeconomic and industry-specific challenges. The margins dipped minutely depicting the industry norm. The financial risk profile of the Company is considered moderate with improved coverages. The working capital requirements of the Company are met through internally generated cashflows and short-term borrowings. The Company has maintained a moderately leveraged capital structure. The size of the textile industry in Pakistan is estimated to be PKR 2.62Trn ~3.0% of the total GDP as of FY23. The composite & garment segment in the textile sector has a contribution of ~ PKR 1.6Trn mainly dominated by knitwear, readymade garments, bedwear, and towels followed by PKR 775bln from spinning and PKR 637bln from weaving. The escalation in energy tariffs & finance costs, PKR devaluation, and ensuring the availability of optimum quality raw materials are prime challenges specific to the industry to assess the international market and stay price-wise competitive.

The ratings are dependent on the Company's ability to sustain its business profile while maintaining its profitability matrix at an optimal level. The sustainability of margins and improvement in coverages while expanding business volumes remain critical. The sufficient generation of cashflows to meet working capital requirements while retaining the debt matrix at a moderate level is a prerequisite. The sponsor's commitment to providing support gives comfort to the ratings.

Disclosure

Name of Rated Entity	Khaadi Pakistan (SMC-Pvt) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating(Jul-23),Methodology Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology Rating Modifiers(Apr-24)
Related Research	Sector Study Composite and Garments(Dec-23)
Rating Analysts	Muhammad Harris Ghaffar harris.ghaffar@pacra.com +92-42-35869504

Profile

Legal Structure Khaadi Pakistan (SMC Pvt.) Limited ('Khaadi' or The Company) was incorporated on July 15, 2015, as a single-member company under repealed Companies Ordinance 1984 (now Companies Act, 2017). Khaadi commenced operations in 1998 where the products were sold by the sole proprietorship managed by a single member.

Background Khaadi is one of Pakistan's leading fashion retail brands which offers Home and Clothing, Shoes and Accessories, Fragrances, Skin, and Haircare solutions for women and kids. It is a Single Member Company (SMC) with a history of 23 years.

Operations The Company has an exceptional retail network of 41 retail stores in Pakistan, and the related party, Weaves Exports (SMC Pvt.) Limited exports the products to USA, UAE and UK under the brand name "Khaadi".

Ownership

Ownership Structure The Company is a wholly owned subsidiary of Khaadi Corporation Limited. International Finance Corporation (IFC) holds a 20% stake in Khaadi Corporation Limited through an equity injection of \$25mln.

Stability The presence of a Group holding company, Khaadi Corporation Limited, as well as formal documentation capturing the family ownership structure bodes well for the stability of Khaadi.

Business Acumen Extensive growth has been witnessed in the business where expansion into different segments has multiplied the growth in volumes. Hence, the business acumen of sponsors is considered strong.

Financial Strength Over the years, Khaadi has grown into a big retail brand in the local industry with a Total Assets of ~PKR 29.0bln, and an Equity base of PKR ~8.6bln.

Governance

Board Structure Currently, the company has an SMC status where it has a one-member board. Khaadi Corp has a five-member board, including the CEO, Mr. Shamoon. The presence of three independent members reflect the strong governance framework.

Members' Profile Mr. Shamoon Sultan is the sole owner, founder, and director of Khaadi. He is the man at the last mile and the driving force behind the success and growth of Khaadi. The Company was established as a leading women's fashion brand in four countries based on his vision.

Board Effectiveness No committees have been formed to assist the Board. However, the Company has an internal audit function in place to assist the board. The in-house internal audit department monitors the internal controls within the Company.

Financial Transparency A.F. Ferguson & Co. Chartered Accountants are the external auditors of the Company. The auditors have expressed an unqualified opinion on the financial reports for the period ended June 30th, 2023 and December 31st, 2023. The financial year end of the Company has been changed from June 30th to December 31st in pursuance of a change in the financial year end of Khaadi Corp, the Parent Company.

Management

Organizational Structure The Company's overall operations are segregated into six broad divisions, namely: (i) Designing, (ii) Commercial operations, (iii) Branding and Marketing, (iv) Human Resource, (v) Finance, and (vi) Product strategy (vii) Supply Chain, (viii) Strategy and E-Commerce. Each of the departments is led by an experienced individual ensuring a smooth flow of operations. A large number of senior executives report directly to the CEO.

Management Team Mr. Shamoon Sultan – the CEO – primarily manages the Company's affairs, supported by a team of seasoned professionals. After Mr. Shamoon, his wife Miss. Saira Shamoon is the Chief Design Officer of the Company. Mr. Tahir Iqbal, the Group CFO is responsible for shaping the overall financial strategy of Khaadi.

Effectiveness Management has formed six committees, namely, i) Steering Committee ii) Board and Product Committee iii) Commercial Committee iv) CAPEX Committee v) Management Committee vi) Marketing Committee headed by the CEO and other committee members.

MIS MIS primarily includes Microsoft, Adobe, Tubatech, and Oracle HRM Cloud. The MIS reports are updated on a real-time basis to be available to senior management. The reports are shared and discussed with the CEO regularly so that the information is conveyed promptly to the CEO and higher management.

Control Environment Since, Khaadi Pakistan is not a manufacturing company, ISO certification does not apply. However, the Company maintains criteria for strong internal controls within the Company and follows the SOPs required for effective operations within the organization.

Business Risk

Industry Dynamics The size of the textile industry in Pakistan is estimated to be PKR 2.62Trn ~3.0% of the total GDP as of FY23. The composite & garment segment in the textile sector has a contribution of ~ PKR 1.6Trn mainly dominated by knitwear, readymade garments, bedwear, and towels followed by PKR 775bln from spinning and PKR 637bln from weaving. The escalation in energy tariffs & finance costs, PKR devaluation, and ensuring the availability of optimum quality raw materials are prime challenges specific to the industry to assess the international market and stay price-wise competitive.

Relative Position Khaadi has grabbed a healthy market share of 14.40% in the respective local industry on a standalone basis. The competitors of Khaadi are Sapphire, Ideas by Gul Ahmed, Outfitters, J., and Bareeze, etc.

Revenues During 1HFY24, the Company's topline exhibited a marginal increase of 3.5% and stood at PKR 13.1bln (1HFY3: PKR 12.6bln). Retail sales make up 86% of the Company's revenue base while E-commerce makes up 14%. The product-wise analysis reflected that Unstitched fabric generates a major chunk of total revenue. The cost of sales went up in line with higher revenue. The finance cost posted an upward trend (1HFY24: PKR 746mln; 1HFY23: PKR 554mln) due to the higher policy rate. The net profitability of the Company clocked at PKR 410mln (1HFY23: PKR 175mln).

Margins During 1HFY24, the Company's gross profit margin inched down to 27.1% (1HFY23: 29.6%) aligning with the industry trend. The operating expenses remained largely the same and clocked at PKR 2.8bln (1HFY23: PKR 2.9bln). The Company's operating margin went down to 5.8% (1HFY23: 6.5%). The Company's net profit margin improved to 3.1% (1HFY23: 1.4%).

Sustainability The Company has changed its strategy with a keen focus on exceptional customer service. Aligning with this strategy, the Company has converted its Normal category stores to "Experience Hub Stores". Khaadi Group is also operating in the international domain with its three subsidiaries in UK, USA and UAE.

Financial Risk

Working Capital The company's working capital requirements are a function of its inventory and trade receivables for which the company relies on a mix of internal generation and short-term borrowings (STBs). At end-Dec23, the Company's gross working capital days remained the same clocking at 81 days whereas the inventory days were recorded at 72 days (end-Jun23: 74 days). The Company's current ratio portrayed an improvement (end-Dec23: 2.8; end-Jun23: 1.4).

Coverages At end-Dec23, the Company's free cash flows from operations were recorded at PKR 949mln (end-Jun23: PKR 2.6bln). The Company's interest coverage illustrated a sharp decline at 1.6x (end-Jun23: 6.7x) whereas the core operating coverage stood at 1.4x (end-Jun23: 2.6x). The Company's debt payback period was reduced to 0.7 years (end-Jun23: 1.2 years).

Capitalization The Company has a moderately leveraged capital structure. The Company's total leveraging has decreased (end-Dec23: 43.3%; end-Jun23: 46.3%). The Company's equity base was enhanced to PKR 7.5bln (end-Jun23: PKR 6.1bln) primarily due to an incline in Unappropriated profit (end-Dec23: PKR 961mln; end-Jun23: PKR 550mln).



The Pakistan Credit Rating Agency Limited

Khaadi Pakistan (SMC-Pvt) Limited Retail	Dec-23 6M	Jun-23 12M	Jun-22 12M	Jun-21 12M
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A BALANCE SHEET

1 Non-Current Assets	7,636	7,196	5,714	5,200
2 Investments	87	52	63	74
3 Related Party Exposure	344	1,482	778	213
4 Current Assets	8,185	9,872	7,116	4,890
a Inventories	3,917	6,441	4,437	2,759
b Trade Receivables	680	655	420	402
5 Total Assets	16,252	18,602	13,671	10,377
6 Current Liabilities	2,954	7,192	6,968	5,895
a Trade Payables	2,295	6,766	6,736	5,701
7 Borrowings	5,384	3,418	2,750	2,870
8 Related Party Exposure	376	1,867	981	451
9 Non-Current Liabilities	-	-	-	3
10 Net Assets	7,538	6,125	2,972	1,158
11 Shareholders' Equity	7,538	6,125	2,972	1,158

B INCOME STATEMENT

1 Sales	13,135	27,002	22,037	15,167
a Cost of Good Sold	(9,570)	(19,031)	(15,058)	(10,364)
2 Gross Profit	3,565	7,971	6,979	4,803
a Operating Expenses	(2,807)	(5,678)	(5,462)	(5,168)
3 Operating Profit	758	2,293	1,518	(365)
a Non Operating Income or (Expense)	(71)	144	(102)	1,369
4 Profit or (Loss) before Interest and Tax	687	2,437	1,416	1,004
a Total Finance Cost	(746)	(1,191)	(423)	(1,223)
b Taxation	469	(284)	(138)	88
6 Net Income Or (Loss)	410	962	855	(130)

C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	949	2,674	1,746	1,654
b Net Cash from Operating Activities before Working Capital Changes	344	1,571	1,243	396
c Changes in Working Capital	(1,703)	(2,586)	(1,140)	1,082
1 Net Cash provided by Operating Activities	(1,359)	(1,015)	103	1,478
2 Net Cash (Used in) or Available From Investing Activities	(302)	(1,792)	(850)	(673)
3 Net Cash (Used in) or Available From Financing Activities	2,969	2,858	833	(939)
4 Net Cash generated or (Used) during the period	1,309	50	86	(135)

D RATIO ANALYSIS

1 Performance				
a Sales Growth (for the period)	-2.7%	22.5%	45.3%	-3.3%
b Gross Profit Margin	27.1%	29.5%	31.7%	31.7%
c Net Profit Margin	3.1%	3.6%	3.9%	-0.9%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-5.7%	0.3%	2.7%	18.0%
e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh	12.0%	21.2%	41.4%	-10.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	81	81	7	21
b Net Working Capital (Average Days)	18	-10	-96	-111
c Current Ratio (Current Assets / Current Liabilities)	2.8	1.4	1.0	0.8
3 Coverages				
a EBITDA / Finance Cost	1.7	7.2	9.5	1.6
b FCFO / Finance Cost+CMLTB+Excess STB	1.4	2.6	0.9	0.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.7	1.2	2.3	7.9
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	43.3%	46.3%	55.7%	74.2%
b Interest or Markup Payable (Days)	81.0	117.1	71.9	9.1
c Entity Average Borrowing Rate	24.7%	9.1%	5.4%	30.9%

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB	
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	Very high credit risk. Substantial credit risk "CCC" Default is a real possibility.
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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):

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

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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

Restrictions

- (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 | Clause 11-(A)(p).
- (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)

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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)

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 | 17-(a)
- (19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)

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