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
23-Jan-2024	BBB	A2	Stable	Maintain	-
23-Jan-2023	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings of Ali Embroidery Mills (Private) Limited (Ali Embroidery) reflect its sustained business profile. The Company is a family-owned private limited company that operates with 30 Schiffli and 108 Multi-head embroidery machines. The embroidery industry consists of several players operating on a small scale with informal structures. However, Ali Embroidery has a tiered organizational structure with good operating capacity. The ratings mirror the company's enduring business profile, showcasing consistent enhancements in its revenues, equity, and asset base throughout the years. During FY23, the company's topline reflected growth to PKR 1.5bln (FY22: PKR 1.2bln). The company has witnessed an increasing trend of customer sales, the majority of the revenues are generated from related parties, while the rest of the customer base has also contributed over the years. Throughout this period, there has been a slight decrease in both gross profit and operating profit margin, whereas the net profit margin has demonstrated improvement. Ratings also incorporate adequate financial risk manifested by suitable working capital management and coverages. During FY23 the country's textile exports decreased to $16.5bln, reflecting a 15% YoY decline. This decline was attributed to factors such as high energy costs, cotton shortages, and foreign exchange rate uncertainties. Value-added products like knitwear, bedwear, towels, and readymade garments witnessed a 13% YoY decline, while basic textiles, including raw cotton, cotton yarn, and cotton cloth, experienced a 21% YoY decrease. Notably, in June 2023, there was a 7% MoM increase in cotton yarn exports, and value-added exports depicted a volumetric increase of 16% on an MoM basis. Knitwear and readymade garments witnessed an 18% and 19% increase, respectively.

The ratings are dependent on the management’s ability to uphold the entity’s performance trend. Meanwhile, maintaining strong margins and coverages to fulfill financial obligations will remain critical. Improvement in the governance framework is considered 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 Rating(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Composite and Garments(Dec-23)
Rating Analysts	Uswa Sikandar | uswa.sikandar@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. The Company is principally engaged in the manufacturing and retailing of embroidered cloth.

Background The Company is part of the Sefam Group of Industries headquartered in Lahore, Pakistan. The group takes pride in claiming themselves as the pioneers of introducing the concept of brands in Pakistan. Ali Embroidery was set up by Mr. J.A Zaman (late) and later became the launching pad for Sefam (Private) Limited and Sarena Textile Industries. Today, Ali Embroidery is among the largest embroidery companies in Pakistan with the highest number of Schiffli machines.

Operations The Company's production facility comprises two units, located on Sheikhupura Road, Lahore while the Company's head office is located on Waris Road, Lahore. Presently, the Company operates with ~30 Schiffli embroidery machines and ~108 Multi-Heads embroidery machines. The Company also operates its retail brand "The Embroidery Company" through three outlets in Lahore.

Ownership

Ownership Structure Ownership of the Company is shared by the children of the 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 planned in the upcoming years.

Business Acumen Mr. Hamid Zaman has been working since 1972 with his father, J.A Zaman, in Ali Embroidery Mills (Private) Limited. He is the co-founder and main partner, together with Ms. Seema Aziz, in the Sefam and Sarena group of companies. While Mr. Tariq Zaman the CEO of the company oversees the strategic aspect of the business and possesses vast experience in the textile sector.

Financial Strength Over the years, the Group has grown its presence in Pakistan by operating different fashion brands, each specialized to cater to different segments of the market. Ali Embroidery has grown into the market and contributed to the manufacturing and retailing of embroidered cloth.

Governance

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

Members' Profile All Directors, with the exception of Ms. Ambreen Zaman, possess rich experience in the textile sector and are engaged in the management of different Group companies. Each member has 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 development, depending on their availability. There are no sub-committees in place to assist the Board.

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, 2023.

Management

Organizational Structure The organizational structure of the Company is divided into broad functional departments, namely Production, Marketing, Finance, Purchase, Admin, Store, Mechanical, Electrical, HR, and Checking.

Management Team Mr. Tariq Zaman, the CEO of the Company, possesses extensive experience in the textile sector. While Mr. Hafiz Umair Nadeem, is the CFO of the company. Designing and sales fall under the purview of the General Manager of Marketing while the remaining production and administrative functions are overseen by General Manager Factories, Mr. Mubashir Abdali. Management of the group comprises experienced individuals with a wide range of skills and relevant experience.

Effectiveness MIS reports are compiled and reviewed by senior management at varying intervals. While financial position and shop sales reports are submitted to the CEO daily, production efficiency reports (of Multi-Heads machines) are compiled on real time basis. Going forward, Schiffli machine production reports will also be shifted to real time FPS software.

MIS The Company implemented Sidat Hyder (GL Mode) as the financial accounting MIS solution in Dec-17, provided by D-Biz Solutions (Pvt.) Ltd. The Company has also deployed several in-house software solutions. These include FPS (Factory Production System) which is used for billing management and monitoring the flow of plain and processed fabric for Multi-Heads embroidery machines.

Control Environment The Company places great importance on ensuring premium quality products for its customers. It allows its main customer, Sefam, to prepare its quality report to allow for an accurate and unbiased assessment.

Business Risk

Industry Dynamics During FY23, textile exports were valued at $16.5 billion compared to $19.33 billion, reflecting a dip of 15% YoY – the declining trend has been witnessed by the start of FY23. The exports tumbled attributable to high energy costs, shortage of cotton, and uncertainty in the foreign exchange rate. The suppressed demand pattern exhibited by export avenues was also a challenge. During FY23, value-added products such as knitwear, bedwear, towels, and ready-made garments witnessed a decline of 13% YoY. The basic textiles including raw cotton, cotton yarn, and cotton cloth posted a drop of 21% YoY. During June 2023, cotton yarn exports increased by 7% MoM. The value-added exports reported a volumetric increase of 16% on a MoM basis. Knitwear and readymade garments witnessed an incline at 18% and 19% respectively. During the month of July 2023, textile exports were valued at $2 billion compared to $2.3 billion, reflecting a slump of 12.6% on a MoM basis. Further analysis reveals an overall decline of 8.6% YoY.

Relative Position Ali Embroidery is a relatively small company in the value-added textile segment with only a local presence, operating with ~30 Schiffli embroidery machines and ~108 Multi-Heads embroidery machines.

Revenues Ali Embroidery has experienced a surge in revenues over the recent years, primarily generated through embroidery charges applied to fabrics supplied by its sister concern, Sefam. These fabrics are utilized for the production of the "Bareeze" brand, as well as a portion of "Bareeze Man" and "Bareeze Home Expressions." In FY23, the company achieved a total revenue of PKR 1,580mln, marking a notable 27% increase compared to the previous year (FY22), where revenue stood at PKR 1,242mln.

Margins Ali Embroidery observed a marginal reduction in its gross profit margin, which was reported at 18.6% in FY23, down from 19.9% in FY22. Similarly, the operating margin experienced a slight decline, registering at 7.9% in FY23 compared to 8.1% in the previous fiscal year. Despite an increase in the company's finance cost, there was a slight improvement in the bottom-line, reaching 3% in FY23, as opposed to 2.9% in FY22.

Sustainability To cater to demand for its retail brand as well as continually increasing demand from Sefam. The company is in the process of expanding its capacity by adding multi-heads machines. Further, it plans to add 15 to 20 embroidery machines to its capacity annually.

Financial Risk

Working Capital In FY23, total borrowings rose to PKR 1,120mln from PKR 1,021mln in FY22, with short-term borrowings at PKR 39mln. Working capital challenges emerged, leading to an increase in gross and net working capital days to 195 and 180 days, respectively, compared to FY22 figures of 166 and 133 days.

Coverages In FY23, FCFO reached PKR 192mln, progressing from FY22 (PKR 178mln) and FY21 (PKR 170mln), driven by strong operational performance and increased profitability. However, the EBITDA/Finance Cost ratio declined to 2.3x in FY23 from 2.9x in FY22. Additionally, the Debt Payback ratio increased to 11.2x in FY23, up from 9.7x in FY22, continuing a three-year trend of rising Debt Payback.

Capitalization In FY23, Ali Embroidery maintained a consistent high leverage level of approximately 68%, similar to the previous year. The significant portion of this leverage, around PKR 957mln, stemmed from long-term borrowings, primarily loans from directors with an annual interest rate of 7%. Equity base of the company improved to PKR 529mln in FY23 (FY22: PKR 480mln).

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Financial Summary
PKR mln

Ali Embroidery Mills Textile | Composite	Jun-23 12M	Jun-22 12M	Jun-21 12M	Jun-20 12M
A BALANCE SHEET				
1 Non-Current Assets	860	725	692	635
2 Investments	18	51	-	-
3 Related Party Exposure	-	-	20	-
4 Current Assets	1,050	960	576	376
a Inventories	*673*	*542*	*234*	*59*
b Trade Receivables	*214*	*256*	*100*	*158*
5 Total Assets	1,928	1,736	1,288	1,011
6 Current Liabilities	271	235	217	155
a Trade Payables	*36*	*88*	*138*	*55*
7 Borrowings	199	126	214	142
8 Related Party Exposure	921	895	411	294
9 Non-Current Liabilities	7	-	1	3
10 Net Assets	529	480	445	416
11 Shareholders' Equity	529	480	445	416
B INCOME STATEMENT				
1 Sales	1,580	1,242	959	874
a Cost of Good Sold	*(1,286)*	*(994)*	*(733)*	*(681)*
2 Gross Profit	294	248	226	192
a Operating Expenses	(169)	(147)	(155)	(125)
3 Operating Profit	125	101	71	68
a Non Operating Income or (Expense)	*38*	*18*	*15*	*8*
4 Profit or (Loss) before Interest and Tax	163	118	86	75
a Total Finance Cost	*(96)*	*(65)*	*(42)*	*(40)*
b Taxation	*(20)*	*(17)*	*(16)*	*(6)*
6 Net Income Or (Loss)	47	36	28	29
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*192*	*170*	*159*	*120*
b Net Cash from Operating Activities before Working Capital Changes	*164*	*154*	*93*	*102*
c Changes in Working Capital	*(106)*	*(544)*	*(62)*	*(17)*
1 Net Cash provided by Operating Activities	57	(390)	30	85
2 Net Cash (Used in) or Available From Investing Activities	(58)	(89)	(37)	21
3 Net Cash (Used in) or Available From Financing Activities	2	354	(105)	(181)
4 Net Cash generated or (Used) during the period	1	(125)	(112)	(75)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	27.2%	29.5%	9.8%	-5.1%
b Gross Profit Margin	18.6%	19.9%	23.6%	22.0%
c Net Profit Margin	3.0%	2.9%	2.9%	3.3%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	5.4%	-30.2%	10.1%	11.8%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareho*	9.3%	7.7%	6.5%	7.2%
2 Working Capital Management				
a Gross Working Capital (Average Days)	195	166	105	83
b Net Working Capital (Average Days)	180	133	68	59
c Current Ratio (Current Assets / Current Liabilities)	3.9	4.1	2.6	2.4
3 Coverages				
a EBITDA / Finance Cost	2.3	2.9	3.7	3.5
b FCFO / Finance Cost+CMLTB+Excess STB	0.9	1.2	1.0	1.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	11.2	9.7	5.3	5.5
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	67.9%	68.0%	58.4%	51.2%
b Interest or Markup Payable (Days)	597.1	530.7	388.4	628.6
c Entity Average Borrowing Rate	8.7%	7.9%	7.9%	9.0%

Credit Rating

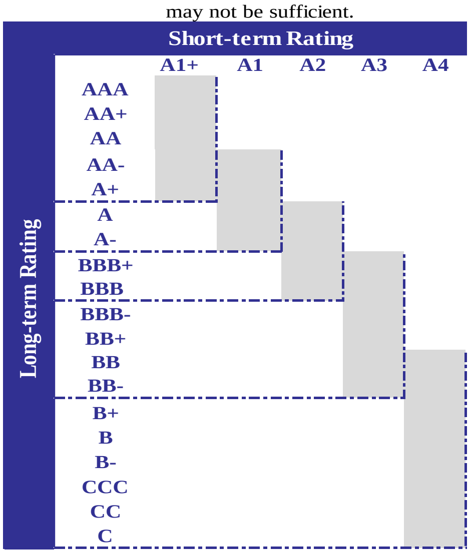
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

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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(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**
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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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(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).
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(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)
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(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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