The Pakistan Credit Rating Agency Limited

Rating Report

H. Sadar Ali Akhtar Ali (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
31-May-2024	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

H. Sadar Ali Akhtar Ali (Pvt.) Limited (hereafter referred to as "HSA") boasts a long-standing legacy in the leather industry, primarily focusing on the manufacturing and export of high-quality leather. HSA's extensive range comprises finished leather. The production capabilities encompass a diverse array of leather types, including burnished, waxed, and pull-up leather, as well as oily and nubuck leather, among others. Over the years the company developed expertise and started manufacturing value-added finished leather products, such as leather jackets, and gloves, although its impact on revenue is currently modest. HSA is one of the few leather manufacturers in the country having the highest “Gold-Rated” certification by LWG (Leather Working Group). HSA has an advanced and state-of-the-art tanning facility designed to meet the needs of prominent global clientele. Pakistan’s leather industry comprises five different segments i.e. Leather Gloves (31.7%), followed by Leather Apparel & Clothing (31.6%), Tanned Leather (18.9%), Leather footwear (16%), and other leather goods & accessories (1.7%). The tanned leather industry in Pakistan has experienced a downward trend for the past couple of years, with export volumes plummeting from 26 million SQM in FY18 to just 11 million SQM in FY23. This worrisome trend poses a significant business risk for the industry players. However, value-added leather export segments such as apparel & clothing, and footwear registered a humble volumetric growth. Total leather exports of the country also posted a decline of ~7% and recorded at $887mln as compared to $954mln SPLY due to shrinking in global demand caused by high inflation and geographical tensions etc. To address this challenge, HSA undertook product diversification by entering the textile sector, specifically focusing on manufacturing and exporting ready-made denim and non-denim garments. This strategic decision has led to the new division contributing around 40% of the total export revenue. The sponsors have a clear vision for further expansion within this segment to increase market share. The company's governance structure indicates potential for enhancement, notably through the establishment of a formal board structure, board committees, and an independent oversight function. The Company is striving to strengthen its internal control system and recently established internal audit function. The financial risk profile of the company is demonstrated by comfortable coverages, cashflows, and working capital cycle. The capital structure is moderately leveraged, primarily utilizing short-term borrowings to fulfill working capital requirements, further supported by SBP concessionary rates.

The ratings are dependent on HSA's ability to maintain its position in its specific business niches and sustain growth in the face of challenging industry dynamics. Essential factors include bolstering share capital, achieving consistent revenue growth, enhancing margins, and maintaining prudent financial performance in accordance with projections.

Disclosure

Name of Rated Entity	H. Sadar Ali Akhtar Ali (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 | Leather(Apr-24)
Rating Analysts	Kanwal Ejaz | kanwal.ejaz@pacra.com | +92-42-35869504

Profile

Legal Structure H. Sadar Ali Akhtar Ali Pvt. Ltd (hereinafter referred to as 'HSA' or 'the Company') was incorporated in Pakistan on 11th August 1985, under the repealed Companies Ordinance 1984 (Now Companies Act, 2017). The company's registered office is located at 14- G.T Road, Hide Market, Lahore, the tannery is located at Mauza Halloki, Lahore. The Company has another manufacturing unit located at Niaz Nagar Kasur and a branch office located at Din Garh Kasur.

Background The family started leather business in 1941. Over the years, HSA transitioned into a state-of-the-art leather processing and production facility. Currently, the company now classified among top finished leather manufacturers and exporters of the country.

Operations The principal activity of the Company is to manufacture and sell tanned, finished leather, leather products, and ready-made garments. The company manufactures all types of finished leather such as Cow, Sheep, Goat, and Buffalo. HSA has another division of Denim which was established in 2017 and it is an export-oriented unit. There are ~450 machines installed in factory and all jeggings including of ladies, gents, and kids are manufactured and exported.

Ownership

Ownership Structure H. Sadar Ali Akhtar Ali Pvt. Ltd is a family-owned company with ownership distributed among family members. The CEO, Mr. Mian Naeem Akhtar, holds a direct stake of approximately 3.0%. While his sons, Mian Ahsan Ali, Mian Mohsin Ali, and Mian Hassan Ali, respectively hold stakes of ~26%, ~25%, and ~25%. Additionally, Mr. Mian Saleem Akhtar (Director), who is the brother of the CEO, owns ~ 21% of the company's shares.

Stability The company has emerged as an industry leader by cultivating an ethical and responsible corporate culture. Through a commitment to enhancing both the quality and diversity of leather products, and anticipate bolstering the stability of HSA. Upholding these established standards is poised to solidify HSA's position in the export market, further supported by a Gold rating certification from the globally recognized Leather Working Group (LWG).

Business Acumen The company's sponsor possesses a profound understanding of business, backed by decades of experience. Over time, HSA has diversified its revenue streams by entering various value-added segments, including the production of leather jackets, denim garments, and twill garments.

Financial Strength The Company maintains an adequate financial profile with a substantial equity base. This indicates the Sponsors' ability to provide support, if needed.

Governance

Board Structure Board comprises five members, including CEO – Mr. Mian Naeem Akhtar. There are no independent directors on the board and it is dominated by the sponsoring family, thus depicts further room for improvement.

Members' Profile Mr. Mian Naeem Akhtar – CEO has more than five decades of relevant industry experience while Mr. Mian Saleem Akhtar –Director also has more than four decades of experience. Both have been associated with the Company since the times of their ancestors. The board comprises vast knowledge and experience of tannery, though diversity in experiences exists as well.

Board Effectiveness The Board of Directors convenes quarterly in accordance with regulatory requirements, ensuring full attendance and enhancing board effectiveness. Additionally, meticulous records of minutes are maintained, although opportunities for further enhancement persist.

Financial Transparency M/S. Muniff Ziauddin & Co. is the external auditor of the Company. Auditors are QCR rated also appears on the SBP panel in A category. The auditors have expressed an unqualified audit opinion on the financial statements for the year ended June 30th, 2023. Company has recently established an Internal audit department as well.

Management

Organizational Structure A well-designed organizational structure exists in the Company. In the first tier, operations are segregated into 7 broad departments: (i) Leather Wing, (ii) Accounts & Taxation, (iii) HR, (iv) MIS & IT, (v) Internal Audit, (vi) Administration, and (vii) HSA Apparel (Denim). Clear lines of responsibility are defined for each department.

Management Team Overall management control is in the hands of board of directors. Mr. Wajih ud din, serving as CFO, brings over 36 years of seasoned expertise to the role. Mr. Ahsan oversees finance and denim operations, Mr. Mohsin manages the technical aspects of leather production, and Mr. Hassan is responsible for the company's marketing endeavors.

Effectiveness With the support of qualified and experienced team of professionals, the Company is successfully building up its strengths and increasing foot print within and outside Pakistan. Functions of the management are clear and well-defined to achieve its underlying goals and objectives.

MIS Currently, the Company is using an ERP solution SHerp _ with version 17.12. Sherpa ERP is a cloud-based business management software built for small and medium-sized businesses (SMBs). Sherpa automates manual processes and brings customer, sales, inventory, and financial data into one platform

Control Environment The Company follows a balanced & environment-friendly growth strategy in all their operations and adopted sustainable growth principles that emphasize diminishing the environmental harm to a minimum. The Company has installed an imported state-of-the-art Waste Water Treatment Plant, and also complies with ISO: 45001 : 2018.

Business Risk

Industry Dynamics Pakistan's leather industry is segregated into 5 major divisions including: i). Tanned Leather, ii). Apparel & clothing, iii). Gloves, iv). Footwear and v). other products. In terms of sector share, apparel & clothing of leather contributed (32%) in total export market, accompanied by leather gloves (32%), tanned leather (19%), leather footwear (16%), & other leather products (2%). Pakistan's leather industry shows a declining trend in tanned leather and in ready made garments, however, footwear segment showed a positive growth in FY23. Of total leather production in the country, ~80-95% is exported annually. In7MFY24, leather production clocked in at ~8.1mlnsq.ft, registering~(3.6%) growth YoY.

Relative Position HSA maintained its position as one of the largest Leather Exporters in Pakistan. It has sustained growth in its revenue at a consistently increasing pace. Company broadened its horizons and ventured into new areas over the years.

Revenues During IHFY24, Company's topline clocked at PKR ~4,184mln (FY23: PKR ~7,091mln, FY22: ~5,590mln) registering growth of ~18% (FY23: ~27%, FY22: 64%). Export sales are ~85% of total figure while ~15% are local sales which is also counted as an indirect exports.

Margins During IHFY24, the Company's gross margin recorded at ~18.1% (FY23: ~18.9%, FY22: ~17.4%). Gross margins remained almost stagnant on back of proportionate increase in the prices of finished leather sold. Operating profit margin sustained ~6.6% in IHFY24 (FY23: ~6.7%, FY22: ~4.7%). Net profit margin stood at ~3.6% in IHFY24 (FY23: ~3.5% , FY22: ~3.0%).

Sustainability HSA management envisage sustainable footing in the local and international markets by investing in new technology and machines to enhance and facilitate its production lines. HSA has planned to install solar power project of ~1100KWT that will generate enough energy to meet the needs of whole manufacturing facility. The managemnet also periodicaly reviews the business performance with projections and forecasts.

Financial Risk

Working Capital During IHFY24, the Company's gross working capital days has reached to ~156 days (FY23: ~165days, FY22: ~165 days). Average inventory days has almost remained at same level during last three years and stood in the bracket of ~120 days to ~122 days. Whereas, average receivable days reached to ~36 days (FY23: ~ 45 days, FY22: ~43 days). However, the net working capital cycle also increased to ~84 days as at IHFY24 (FY23: ~76 days, FY22: ~74 days).

Coverages During IHFY24, the Company's free cash flows from operations (FCFO) marked at PKR ~286mln (FY23: PKR 596mln, FY22: ~442mln). Interest coverage ratio of the Company stood at 2.7x in IHFY24 (FY23: 3.7x, FY22: 6.5x) whereas core-debt coverage ratio remained at 0.4x (FY23: 0.3x, FY22: 0.4x).

Capitalization In IHFY24 , the Company has a modest leveraged capital structure with a leveraging ratio of ~25% (FY23: ~27%, FY22: ~26%). Leveraging remained almost stagnant from the last three years. Majority portion of the Company's debt is comprised of short-term borrowings as at IHFY24 ~90.2% (FY23: ~90.4%, FY22: ~86%). Major portion of Company's' long term debt and short term borrowings have obtained at concessionary SBP rates.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

H. SADAR ALI AKHTAR ALI PVT. LTD	Dec-23	Jun-23	Jun-22	Jun-21
Tanneries / Leather	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	3,095	3,144	2,499	2,470
2 Investments	-	-	-	-
3 Related Party Exposure	59	94	94	94
4 Current Assets	4,748	5,269	3,826	3,281
a Inventories	*2,804*	*2,692*	*1,962*	*1,768*
b Trade Receivables	*777*	*895*	*857*	*465*
5 Total Assets	7,902	8,507	6,419	5,846
6 Current Liabilities	1,572	2,204	1,695	1,420
a Trade Payables	*1,384*	*1,947*	*1,505*	*1,287*
7 Borrowings	1,525	1,691	1,201	1,093
8 Related Party Exposure	98	62	2	-
9 Non-Current Liabilities	80	74	58	37
10 Net Assets	4,629	4,476	3,464	3,296
11 Shareholders' Equity	4,629	4,476	3,464	3,296
B INCOME STATEMENT				
1 Sales	4,184	7,091	5,590	3,414
a Cost of Good Sold	*(3,427)*	*(5,752)*	*(4,616)*	*(2,889)*
2 Gross Profit	757	1,340	974	525
a Operating Expenses	(481)	(867)	(709)	(404)
3 Operating Profit	276	473	265	121
a Non Operating Income or (Expense)	*3*	*1*	*43*	*(4)*
4 Profit or (Loss) before Interest and Tax	279	473	309	117
a Total Finance Cost	*(85)*	*(151)*	*(87)*	*(42)*
b Taxation	*(41)*	*(71)*	*(56)*	*(34)*
6 Net Income Or (Loss)	152	252	166	41
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*286*	*596*	*442*	*158*
b Net Cash from Operating Activities before Working Capital Changes	*246*	*495*	*362*	*118*
c Changes in Working Capital	*(314)*	*(854)*	*(529)*	*(224)*
1 Net Cash provided by Operating Activities	(68)	(359)	(167)	(106)
2 Net Cash (Used in) or Available From Investing Activities	(44)	(44)	(206)	(113)
3 Net Cash (Used in) or Available From Financing Activities	(7)	496	121	562
4 Net Cash generated or (Used) during the period	(119)	94	(252)	342
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	18.0%	26.9%	63.7%	--
b Gross Profit Margin	18.1%	18.9%	17.4%	15.4%
c Net Profit Margin	3.6%	3.5%	3.0%	1.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-0.7%	-3.6%	-1.6%	-1.9%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	6.7%	6.3%	4.9%	1.2%
2 Working Capital Management				
a Gross Working Capital (Average Days)	156	165	165	239
b Net Working Capital (Average Days)	84	76	74	101
c Current Ratio (Current Assets / Current Liabilities)	3.0	2.4	2.3	2.3
3 Coverages				
a EBITDA / Finance Cost	3.8	5.5	11.0	10.8
b FCFO / Finance Cost+CMLTB+Excess STB	2.7	3.7	6.5	5.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.4	0.3	0.4	0.6
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	24.8%	27.4%	25.7%	24.9%
b Interest or Markup Payable (Days)	69.7	133.8	46.8	97.1
c Entity Average Borrowing Rate	10.6%	8.3%	3.9%	1.7%

Credit Rating

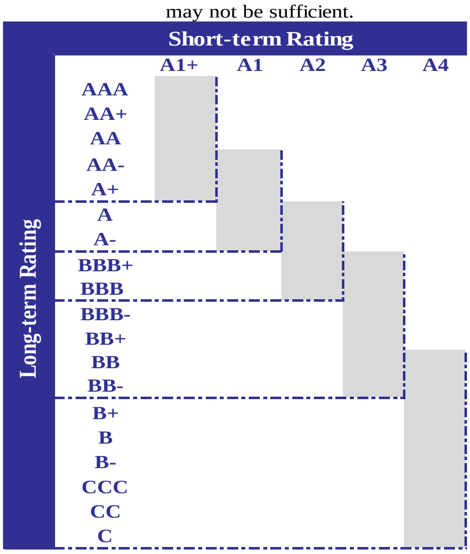
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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)

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 | 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)

Proprietary Information