The Pakistan Credit Rating Agency Limited

Rating Report

H. Sheikh Noor-ud-Din & Sons (Private) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
18-Jan-2021	BBB	A2	Negative	Maintain	YES
31-Jan-2020	BBB	A2	Negative	Downgrade	YES
01-Aug-2019	A-	A2	Developing	Maintain	YES
31-Jan-2019	A-	A2	Developing	Maintain	YES
02-Aug-2018	A-	A2	Stable	Maintain	-
29-Jan-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

H. Sheikh Noor-ud-Din & Sons (Private) Limited (The Company) is the manufacturing arm of NRS International which is primarily engaged in manufacturing of relief and health items for international donor agencies. In FY20, due to ongoing ownership related changes, the Company did not bid for new contracts with international relief agencies, which along with Covid-19 disruption led to a decrease in revenue and overall profitability. The Company's sales of Long Lasting Insecticidal Nets (LLIN) – Major revenue contributor– reluctantly suffered as production facility remained closed for more than a year, which has started again during 2QFY21. Loss of revenue and higher total borrowings pressured the Company's financial profile. The Company has converted its major short-term borrowings to SBP's export refinance scheme to save interest expense. The pressure on business profile is expected to persist in near future. The ratings incorporate the Company's long term association with international donor agencies such as UNHCR, UNICEF, Red Cross and others as a qualified vendor. Strong support from sponsors and other group businesses remains a key rating factor. The ownership structure of the Company has been reorganized after the sponsors reached an agreement. The process is expected to be completed within few months. PACRA has maintained "Rating Watch" and "Negative Outlook" on the ratings on account of observed decline in sales, issues relating to ongoing resolution of ownership and production from LLIN of the Company. PACRA will continue to closely monitor these developments. A rating action may be taken accordingly.

Successful transition and implementation of new ownership structure, improvement in sales volumes through resumption of production of netting business and prudent working capital management remain critical for ratings. Meanwhile, adequate coverages and improvement in governance practices are important. Further reduction in sales and/or deterioration in coverages will impact the ratings negatively.

Disclosure

Name of Rated Entity	H. Sheikh Noor-ud-Din & Sons (Private) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Relief(Jan-20)
Rating Analysts	Sohail Ahmed Qureshi | sohail.ahmed@pacra.com | +92-42-35869504

Profile

Legal Structure H. Sheikh Noor-ud-Din & Sons Pvt. Ltd. ('The Company') was incorporated in 1979 as a Private Limited Company.

Background In 1966, Sheikh Muhammad Sarwar, founder and Chairman of the Company, opened a local shop to sell canvas. A pivotal event in the Company was when it began to supply tents to the United Nations during the Iran-Iraq War in 1980.

Operations Principal operations of the Company comprise production and sale of humanitarian relief items, multi-purpose tents, insecticidal nets and solar solutions. The Company operates as the production arm of NRS Group.

Ownership

Ownership Structure The group is a family business owned and managed by Sarwar family via equal individual shareholdings of four brothers Farhan Sarwar, Farhaj Sarwar, Ahmar Sarwar and Furqan Sarwar. However, Sarwar family has decided to alter the ownership structure. In the new structure, Mr. Farhan will sell his shareholding in the Company and the remaining three brothers; Mr.Farhaj Sarwar, Mr.Ahmar Sarwar and Mr.Furqan Sarwar will split the shareholding equally.

Stability The Company recently went through the process of re-designing its ownership structure. Sponsors of the Company reached an asset division agreement, which resulted in one of the four brothers exiting the Company. The agreement also clearly lays out a road map for any future division of the Company assets in case of a split between the remaining three brothers. The transition in ownership structure has affected stability.

Business Acumen Sponsors have strong knowledge of the industry with extensive experience in the relevant fields. This facilitates smooth and effective running of the Company.

Financial Strength Financial Strength of the entity is considered strong. Apart from relief industry, the sponsors are also involved in other businesses like; oil extraction, real-estate and dairy products.

Governance

Board Structure The board is dominated by the sponsors. Currently, all four brothers are on the board but the composition will soon reduce to three brothers after the departure of Mr. Farhan Sarwar from the Company. All directors are executive directors.

Members' Profile Board members have significant industry experience and have a long association with the Company. During FY19, Mr. Farhaj Sarwar replaced Mr. Farhan Sarwar as the CEO and Chairman of the Company.

Board Effectiveness As a private limited company, the board does not have any formal committees. Being executive directors, all directors are actively involved in the day to day operations of the Company. There is room for improvement in governance framework.

Financial Transparency RSM Avais Hyder Liaquat Nauman Chartered Accountants are the external auditors of the Company. The auditor has given an unqualified opinion on the financial statements for the year ended June 30, 2020.

Management

Organizational Structure The Company has a broad organizational structure. It is mainly divided into four divisions. Three divisions operate in Pakistan whereas sales and marketing division is based in Dubai. The four divisions are 1) Finance 2) Sales & Marketing Services, 3) Supply Chain Services and 4) Production.

Management Team Mr. Farhaj Sarwar looks after the sales and marketing division of the group in Dubai and Mr. Furqan Sarwar overseas production division. Whereas, Mr. Ahmar Sarwar heads finance function, as well as, administrative responsibilities discharged by Mr. Farhan Sarwar. Mr. Farhaj Sarwar recently replaced Mr. Farhan Sarwar as the CEO of the Company.

Effectiveness The Company maintains good IT infrastructure and related controls. The Company recently changed its Enterprise Resource Planning Software from SAP to Oracle EBS 12.27 and Qlik Sense in its facilities. Four new management committees were formed during the year which are i). Contingency Committee, ii). Legal Affairs Committee, iii). Taxation Committee & iv). HR Committee.

MIS The Company maintains a comprehensive MIS reporting system for the management to keep track of activities. The Company's MIS comprises a range of reports including cash position, receivable position, payable position, production, inventory status reports, and segment wise profit & loss statement.

Control Environment The Company has a well-trained quality control department, which is responsible for ensuring strict product quality. The Company's compliance with internationally acclaimed quality standards help it meet customer specification. The Company is ISO 9001, ISO – 14000 and SA 8000 certified.

Business Risk

Industry Dynamics Sales of the industry are majorly made to relief organizations worldwide to help people in areas affected by natural calamities or areas which are more prone to diseases caused by mosquitoes. Relief items are mainly provided in parts of Africa, parts of Middle East, Western Asia which are affected by war, floods or other calamities.

Relative Position The Company is Pakistan's leading manufacturer of core relief items and long-lasting insecticidal nets for humanitarian aid and public health sectors. The Company also has a a moderate presence in international market in netting.

Revenues During FY20, revenue of the Company decreased by ~49.5% to PKR 6,015mln (FY19: PKR 11,904mln) due to delay in bidding for new contracts with internal relief organizations amid ownership division in the Company, delay in shipment of existing orders and low demand due to Covid-19 led disruption. This resulted in production halts and affected top-line. The Company's sales mix was dominated by Tent and Tarpaulin.

Margins The Company's gross margin increased to ~27.8% in FY20 (FY19: 26.8%) and operating margin to 19% (FY19: 18.1%) due to decrease in raw material cost, as the Company booked some of its existing inventory before the drop in PKR. Decrease in raw material costs coupled with lower sales resulted in cost of sales decreasing by 50.1% to PKR 4,345mln (FY19: PKR 8,716mln). Significant decrease in energy, distribution and administrative costs were other contributing factors to improvement in margins. The net profit margin, however, decreased to 4.7% (FY19: 7.6%) on account of finance cost (FY20: PKR 820mln FY19: PKR 1085mln). Although finance cost in absolute has decreased by 25%, however as proportion of sales it remained high at 13.3% as compared to 8.8% in FY19. Net profit stood at PKR 282mln in FY20 (FY19: PKR 909mln).

Sustainability In recent times, the Company's business suffered due to internal ownership changes and Covid-19 led lockdowns. However, deferment of interest payment for one year provided much needed support to the Company's liquidity position in the short term.

Financial Risk

Working Capital During FY20, the Company's net working capital cycle increased significantly to 396 days (FY19: 185 days) due to higher inventory retention as a result of lower sales and increase in average receivable days. Short term borrowings slightly decreased to PKR 8,186mln (FY19: PKR 8,269mln). Short term borrowings were required to meet the financing gap due to higher inventory retention and lower receivable realization. The Company short-term trade leverage improved to 0.2% in FY20 (FY19: -6.1%) due to decrease in short term borrowings and increase in net trade assets (FY20: PKR 8,203mln, FY19: PKR 7,756mln).

Coverages During FY20, Free Cashflow from Operations (FCFO) decreased by ~35% and clocked in at PKR 1,570mln (FY19: PKR 2,407mln) mainly due to lower profitability during the year. Impact of decrease in finance cost was offset by decrease in FCFO, which led to lower interest coverage ratio of 2.0x (FY19: 2.3x). However, debt coverage ratio remained stagnant at 1.8x (FY19: 1.8x).

Capitalization During FY20, the Company's leveraging improved and stood at 43.9% (FY19: 45.5%) on account of revaluation of fixed assets carried during the period under review which has increased by PKR 1,095mln from PKR 2,785mln in FY19 to PKR 3,880mln in FY20. Total borrowings increased by ~6.5% to PKR 9,714mln (FY19: PKR 9,123mln). Short-term borrowings made continues to be significant proportion of total borrowings (FY20: 84.3%, FY19: 90.3%).

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Financial Summary
PKR mln

H. Sheikh Noor-ud-Din & Sons Relief	Jun-20	Jun-19	Jun-18
	12M	12M	12M
A BALANCE SHEET			
1 Non-Current Assets	11,393	9,549	7,317
2 Investments	-	-	-
3 Related Party Exposure	1,451	1,385	341
4 Current Assets	9,991	10,247	9,574
a Inventories	*3,536*	*3,699*	*3,323*
b Trade Receivables	*3,375*	*3,500*	*3,002*
5 Total Assets	22,835	21,181	17,231
6 Current Liabilities	645	1,000	1,154
a Trade Payables	*405*	*655*	*805*
7 Borrowings	9,714	9,123	6,517
8 Related Party Exposure	-	29	-
9 Non-Current Liabilities	57	63	41
10 Net Assets	12,419	10,966	9,519
11 Shareholders' Equity	12,419	10,966	9,519
B INCOME STATEMENT			
1 Sales	6,015	11,904	19,596
a Cost of Good Sold	*(4,345)*	*(8,716)*	*(15,886)*
2 Gross Profit	1,670	3,188	3,710
a Operating Expenses	(525)	(1,031)	(1,251)
3 Operating Profit	1,145	2,157	2,458
a Non Operating Income or (Expense)	*22*	*(43)*	*(91)*
4 Profit or (Loss) before Interest and Tax	1,167	2,115	2,367
a Total Finance Cost	*(820)*	*(1,085)*	*(487)*
b Taxation	*(66)*	*(121)*	*(198)*
6 Net Income Or (Loss)	282	909	1,683
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*1,570*	*2,407*	*2,553*
b Net Cash from Operating Activities before Working Capital Changes	*659*	*1,528*	*2,037*
c Changes in Working Capital	*72*	*(2,197)*	*(1,190)*
1 Net Cash provided by Operating Activities	731	(669)	847
2 Net Cash (Used in) or Available From Investing Activities	(1,204)	(1,239)	(1,219)
3 Net Cash (Used in) or Available From Financing Activities	562	1,963	340
4 Net Cash generated or (Used) during the period	89	54	(33)
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	-49.5%	-39.3%	-1.2%
b Gross Profit Margin	27.8%	26.8%	18.9%
c Net Profit Margin	4.7%	7.6%	8.6%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	27.3%	1.8%	7.0%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	2.4%	9.1%	18.3%
2 Working Capital Management			
a Gross Working Capital (Average Days)	428	207	118
b Net Working Capital (Average Days)	396	185	104
c Current Ratio (Current Assets / Current Liabilities)	15.5	10.2	8.3
3 Coverages			
a EBITDA / Finance Cost	2.1	2.5	6.3
b FCFO / Finance Cost+CMLTB+Excess STB	1.8	1.8	4.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.0	0.6	0.1
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	43.9%	45.5%	40.6%
b Interest or Markup Payable (Days)	65.2	82.0	25.8
c Entity Average Borrowing Rate	8.6%	12.7%	7.0%

Credit Rating

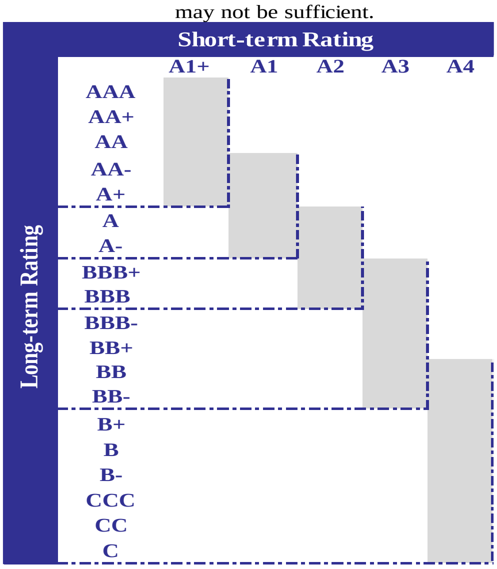
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

Entities

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

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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.
(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)

Proprietary Information