The Pakistan Credit Rating Agency Limited

Rating Report

H.A.R Fibres (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Mar-2023	BBB-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

H.A.R Fibres (Pvt) Limited reflects the adequate positioning of the company in the textile spinning industry. The company deals in the manufacturing of carded yarn of three blends: Cotton, Polyester cotton & Viscose (Coarse (1s –20s). The Company imports 70% of its cotton from the United States, Brazil, and Africa, with the remaining 30% coming from Punjab and Sindh. The efficiency parameters reflect room for improvement. The ratings incorporate the Company’s moderate yet improving business profile where revenue emanates from a single segment. Further improvement in the control environment remains vital. Management meetings are held regularly with follow-up points to resolve or proactively address operational issues, eventually ensuring a smooth flow of operations. The liquidity profile is underpinned by adequate cash flow coverages in relation to outstanding obligations. The ratings also incorporate a low-leveraged capital structure. The Company’s capital needs emanate from financing inventories and trade receivables for which the Company relies on short-term borrowings (STBs). Going Forward, the Company is planning to start a BMR, which will add 1,000 rotors to the existing capacity which will enhance the total capacity to 30,232 spindles. The total cost of CAPEX is estimated to be PKR 100mln, which will entirely be funded from equity. BMR is expected to bring in efficiency gains, lowering cost per spindle, and will consequently improve margins.
During 7MFY23, the textile exports were valued at $10.08bln compared to $10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand for yarn in international markets is also a challenge. The analysis of 5MFY23 reveals that among value-added items, bedwear has witnessed the largest decline of 19% (on an MoM basis), down to $217 million. Knitwear remained on the downward path in October 2022 and declined by 10% to $392 million. Among non-value-added items, cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is prevailing in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries. The demand pattern is expected to improve post-Jun-23.

The ratings are dependent upon the management’s ability to improve margins, profitability, and financial profile of the Company. This includes keeping the debt levels manageable and improving the business profile of the company in upcoming quarters. Sponsor’s support and business acumen remain important for the ratings.

Disclosure	
Name of Rated Entity	H.A.R Fibres (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Spinning(Sep-22)
Rating Analysts	Iram Shahzadi | iram.shahzadi@pacra.com | +92-42-35869504

Profile

Legal Structure H.A.R Fibres (Pvt) Limited ('H.A.R Fibres' 'The Company') was established in 2018. The Company is a part of H.A.R Group, with H.A.R Textile Mills (Pvt.) Limited is the other group company, which is operational since 1958.

Background The Company is a venture of the "Shahid Family", a well-respected family of yarn trading in Faisalabad. The Company is engaged in the manufacture and sale yarn.

Operations The Company operates a single spinning unit with 20,232 spindles. The Company's head office located in C39H+4JW, Clock Tower, Faisalabad, Punjab. While the production facility is located in Mohalla Mughalpura, Naya Lahore, Toba Tek Singh District, Punjab, on a 14 acres facility. The Company utilizes in house production as well as WAPDA connections.

Ownership

Ownership Structure Mr Shahid Mehmood Sheikh owns 40% shareholding of the Company. While the remaining is divided between his sons Mr Haroon Shahid, Mr Faizan Shahid & Mr Adan Shahid.

Stability The Company was set up to engage and transfer over the technical and business skills of the first generation to the second generation of the Shahid family. The Company encompasses the advice and expertise of first-generation and leadership of the new generation. Although, no official succession plan has been announced till date.

Business Acumen H.A.R Fibres is a family-owned Private Company. Apart from H.A.R Fibres, sponsoring family is engaged is involved in real estate. The sponsors have vast experience and knowledge of various aspects of the textile value chain. Mr Shahid Mehmood Sheikh has been in the yarn trading business for the last 45 years and is enjoy a good reputation in the business community.

Financial Strength The sponsor family is engaged in multiple businesses with over more than 20 years. The holding group is currently engaged in real estate. This indicates sponsors' ability to provide support if the need arises.

Governance

Board Structure The overall control of the Company vests in the four-member board of directors. All members of the broad are representatives of the sponsors. Despite being a private limited company, Sponsor domination on the board undermines the board's effectiveness. Mr Shahid Mehmood Sheikh is the Chairman & CEO.

Members' Profile All the board members are qualified in different disciplines and carry ample experience in textile as well as other industries. Mr Shahid Mehmood Sheikh has been in the yarn trading business for the last 45 years.

Board Effectiveness Being a private Company, H.A.R Fibres does not comply with code of corporate governance and there is no independent director on the board. There is no system to record the board minutes and the overall governance structure needs improvement.

Financial Transparency External auditors of the company "Zahid Jamil & Co" are listed under category "B" by SBP. The auditors issued an unqualified opinion on the Company's financial statements for FY22.

Management

Organizational Structure The organizational structure of the Company is divided into three main departments namely, i) Finance, Admin & Marketing, ii) Purchase, and iii) Production. The finance, admin and Purchase department report directly to Mr Haroon Shahid. While marketing departments report to Mr Faizan.

Management Team Mr Haroon Shahid has completed his qualification of Master of Business Administration from the United State of America and dealing in Textile Manufacturing Industry for the last ten years and has yarn trading business experience for the last 20 years. Mr. Faizan Shahid has completed his qualification of Master of Business Administration from United Kingdom (UK) and dealing in Textile Manufacturing Industry for the last ten years and has yarn trading business experience for the last 15 years.

Effectiveness The Company has no management committees. The Sponsor's close involvement in day to day affairs of the business bodes well with the effectiveness of the Company.

MIS The Company has built an in-house oracle to cater for the business needs. The senior management monitors the business performance through certain Key MIS reports.

Control Environment Production is completely order driven, there is a rigorous quality check done on the end product by the QC department. The Company has obtained ISO 9001 certification.

Business Risk

Industry Dynamics During 7MFY23, the textile exports were valued at $10.08bln compared to $10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand for yarn in international markets is also a challenge. The analysis of 5MFY23 reveals that among value-added items, bedwear has witnessed the largest decline of 19% (on an MoM basis), down to $217 million. Knitwear remained on the downward path in October 2022 and declined by 10% to $392 million. Among non-value-added items, cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is prevailing in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries. The demand pattern is expected to improve post-Jun-23.

Relative Position With 20,232 operational Spindles, H.A.R Fibres Mills' position in Pakistan's Spindle capacity is considered small.

Revenues The Company does not have a brand-based clientele and sells all of its output locally in Faisalabad through sales brokers. The analysis of the last three years reveals that the revenue of H.A.R Fibres is reflected improvement. The revenue is clocked at PKR 1,438mln (FY21: PKR 994mln; FY20: PKR 508mln); an uptick of 45% due to better yarn prices in the local market. The Company's revenues wholly comprise local yarn sales with adequate customer concentration. In 1HFY23, the Company topline stood at PKR 676mln.

Margins The expenses increased in line with the growth in sales revenue. During FY22, the Company's cost of goods sold increased to PKR 1,318mln (FY21: PKR 910mln; FY20: PKR 470mln), mainly driven by a hike in raw material and energy costs YoY. Operating expenses also increased by 26% and stood at PKR 44mln (FY21: 35mln; FY20: PKR 16mln). The impact of the increase in the cost of goods sold and operating expenses was overshadowed by the increase in revenue and consequently, the gross profit margin remains in line with 8.4% (FY21: 8.5%; FY20: 7.3%) and the operating profit margin to 5.3% (FY21: 5.0%; FY20: 4.1%). While in 1HFY23, the gross margin stood at 7.2% and the operating margin was reported at 4.1%.

Sustainability In line with the improving business environment, the Company is planning to start a BMR, which will add 1,000 rotors to existing capacity. The total cost of CAPEX is estimated to be PKR 100mln, which will entirely be funded from equity. BMR is expected to bring in efficiency gains, lowering cost per spindle, and will consequently improve margins.

Financial Risk

Working Capital The Company's working capital needs are driven by its inventory requirements of cotton, polyester, and viscose through a mix of internal generation and short-term borrowings. During FY22, the Company's working capital requirement increased to 72days (FY21: 51days) because of inventory days (FY22: 91days, FY21: 68days). On the other hand, the Company's room to borrow displayed a slight attrition and stood at 48% (FY21: 50%) as its trade assets stood at PKR 742mln and short-term borrowings at PKR 22mln. While the short-term trade leverage declined and stood at 49% (FY21: 56%).

Coverages The Company's cash flows from operations – a factor of its increase in EBITDA – witnessed an increase and clocked in at PKR 79mln (FY21: PKR 56mln). Hence, the coverage of the Company is very strong.

Capitalization During FY22, the Company's leverage exhibited an increase to 37.6% (FY21: 25.9%) due to the increase in borrowings, which came up to PKR 231mln (FY21: 119mln). Short-term borrowings make up 9% of the total borrowings.

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Financial Summary
PKR mln

H.A.R Fibres (Pvt.) Limited	Dec-22	Jun-22	Jun-21	Jun-20
Spinning	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	319	211	225	52
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	673	825	492	254
a Inventories	*295*	*469*	*251*	*118*
b Trade Receivables	*160*	*170*	*141*	*79*
5 Total Assets	992	1,036	717	306
6 Current Liabilities	226	410	245	156
a Trade Payables	*126*	*280*	*187*	*126*
7 Borrowings	356	231	119	-
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	12	12	13	-
10 Net Assets	398	383	340	150
11 Shareholders' Equity	397	383	340	150
B INCOME STATEMENT				
1 Sales	676	1,438	994	508
a Cost of Good Sold	*(628)*	*(1,318)*	*(910)*	*(470)*
2 Gross Profit	48	120	84	37
a Operating Expenses	(21)	(44)	(35)	(16)
3 Operating Profit	28	77	50	21
a Non Operating Income or (Expense)	*0*	*(14)*	*50*	*(1)*
4 Profit or (Loss) before Interest and Tax	28	63	100	19
a Total Finance Cost	*(4)*	*(2)*	*(1)*	*(1)*
b Taxation	*(8)*	*(17)*	*(30)*	*(7)*
6 Net Income Or (Loss)	15	43	70	11
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*34*	*79*	*56*	*12*
b Net Cash from Operating Activities before Working Capital Changes	*34*	*77*	*55*	*11*
c Changes in Working Capital	*76*	*(136)*	*(144)*	*(39)*
1 Net Cash provided by Operating Activities	109	(59)	(89)	(27)
2 Net Cash (Used in) or Available From Investing Activities	(118)	(7)	(17)	(17)
3 Net Cash (Used in) or Available From Financing Activities	(12)	102	121	39
4 Net Cash generated or (Used) during the period	(20)	36	14	(5)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-6.0%	44.6%	95.9%	-48.9%
b Gross Profit Margin	7.2%	8.4%	8.5%	7.3%
c Net Profit Margin	2.3%	3.0%	7.0%	2.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	16.2%	-4.0%	-8.9%	-5.3%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	7.9%	12.0%	28.4%	8.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	148	131	108	129
b Net Working Capital (Average Days)	93	72	51	55
c Current Ratio (Current Assets / Current Liabilities)	3.0	2.0	2.0	1.6
3 Coverages				
a EBITDA / Finance Cost	174.7	1012.4	N/A	N/A
b FCFO / Finance Cost+CMLTB+Excess STB	1.4	2.4	N/A	N/A
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.2	2.6	2.1	0.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	47.2%	37.6%	25.9%	0.0%
b Interest or Markup Payable (Days)	0.0	0.0	N/A	N/A
c Entity Average Borrowing Rate	0.1%	0.1%	0.0%	0.0%

Credit Rating

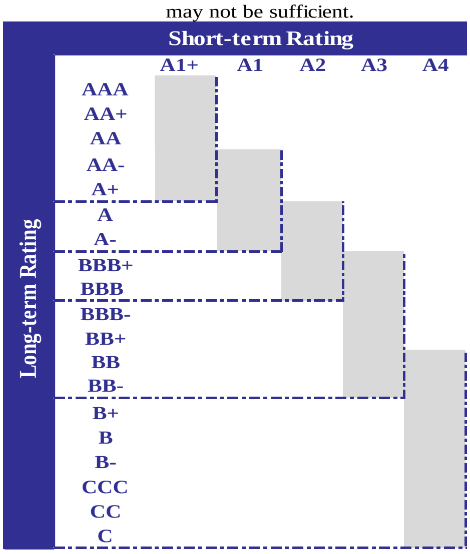
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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 | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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