



The Pakistan Credit Rating Agency Limited

ENTITY RATINGS REPORT

FAZAL CLOTH MILLS LIMITED

ENTITY	RATING	OUTLOOK	ACTION	DATE
Fazal Cloth Mills Limited	Long Term: A- Short Term: A2	Stable	Maintain	13-Jan-18

RATING RATIONALE

Fazal cloth enjoys a strong business profile in otherwise volatile textile industry. This primarily emanates from its large size – yielding economies of scale – established relationships with a diverse customer base- -export and local - and diversity of operations – spinning and weaving. This has helped the entity to sustain its position despite suppressed textile dynamics exerting pressure on prices. With focused marketing efforts, the company has been able to capitalize on additional capacities thereby generating incremental volumes, mainly in spinning segment. The management expects improved margins on account of (i) saving in power cost given regular supply of RLNG to industry players, and (ii) export – led relief provided by GoP. The management is contemplating a gradual entry into value-added segment - dyeing and finishing; once implemented, it is likely to further strengthen business risk profile of the entity. Fazal Cloth's financial risk assessment encompasses irrevocable and unconditional inter-corporate debt guarantee provided to wholly owned subsidiary - Fazal Weaving Mills Limited - with fall back on Fazal Cloth's cash flows. Nevertheless, overall financial profile is considered adequate. Although coverages are low, the company's designed financial strategy keeps sizeable cushion in short-term borrowing lines to meet shortfalls in operational cash flows in servicing debt obligations; this provides flexibility in management of financial affairs.

The rating are dependent on the company's ability to yield improvement in margins. Meanwhile, management of debt (current and planned), thereby impacting coverages, is considered important. Improvement in business and financial profile along with effective changes in governance framework would be rating positive.

Report Contents

1. Rating Analyses
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FAZAL CLOTH MILLS LIMITED	
Incorporated	1966
Major business lines	<ul style="list-style-type: none"> Specializes in the entire process of manufacturing yarn and fabric.
Legal status	Listed

INDUSTRY SNAPSHOT
<ul style="list-style-type: none"> During FY17, total textile exports stood at USD ~ 12,453mln. Cotton yarn contributes (10%), cotton cloth (17%), home textile (29%), while garments contributes (38%). Pakistan's weaving sector continues to witness suppressed margins. High cost of doing business as compared to other countries like Bangladesh, India and Vietnam.

OWNERSHIP	GOOD
<ul style="list-style-type: none"> Fazal Cloth, a listed concern incorporated in 1966, is engaged in the manufacturing and marketing of yarn and fabric. The company operates with 197,556 spindles, 224 air jet looms, and 2,220 open-end rotors with auto 384 MVS spindles; doubling machines to 106 Majority owned by Fazal Group and Fatima Group (~45% each) 	

GOVERNANCE	GOOD
<ul style="list-style-type: none"> The BoD comprises seven members with equal representation from both the shareholding groups, along with an independent director Representation of two families provides adequate challenge to management decisions 	

MANAGEMENT	GOOD
<ul style="list-style-type: none"> Management control vests with Fazal Group. Involvement of Sheikh Naseem – the CEO, is limited as Mr. Rehman Naseem – the Chairman – primarily manages the company's affairs Management team comprises long associated and experienced individuals Oracle based ERP; comprehensive MIS reporting International certifications; few prominent certification includes ISO 9001, Lycra assured, Fair Trade and Organic exchange Captive power generation (~39MW) to meet energy requirements (~35MW) 	

PERFORMANCE	GOOD
<ul style="list-style-type: none"> Topline pre-dominated by spinning sales; During FY17 topline increase by ~29% (Jun17: 26bln, Jun16 20bln), revenues tilted towards local sales. Top ten customers' revenue concentration is considered moderate. However, the growth couldn't translate into improved gross profit due to squeeze in margins During 1QFY18, revenues increased – a factor of higher sales volume in both spinning and weaving segment. Margins slightly improved owing to inventory gain Dividend income increased by ~18% Finance cost marginally decline despite higher average outstanding debt during the period due to better rates. Resultantly, profit before taxation increased to FY17: PKR 591mln (FY16: PKR 456mln). Operating expense of company increased mainly because of selling and marketing expenses (Jun-17 PKR 691mln; Jun-16 PKR 623mln). Investment book, constituting ~42% of its equity base at end-Jun17, comprises equity investments and interest bearing debt to group companies. This is increasing with new investments in a proposed power project. Fazal Cloth plans to diversify into value-added segment by setting up dyeing and finishing plant (capacity: 2.5mln meters per month). However, related timeline would depend on sustainability in operating and demand dynamics. Going forward, margins are expected to improve on account of better expected industry fundamentals i.e. crop size and continued RLNG supply 	

FINANCIAL RISK	GOOD
<ul style="list-style-type: none"> Working capital requirements, a function of its receivables and inventory, are met through a mix of internal generation and short term borrowings Inventory and receivables as a percentage of sales increased slightly. Resultantly, net working capital days remained almost same (FY17 : 135days, FY16: 133days) Interest coverage is modest (end-Jun17: 1.6x, end-Jun16: 1.9x) Capital structure leverages further to fund increased nominal working capital needs and ongoing capital expenditure (end-Jun17; ~60%) Fazal Cloth has provided unconditional and irrevocable corporate debt guarantee on all long term loans of its subsidiary – Fazal Weaving. Incorporating subsidiary's financial liabilities, the financial risk profile largely remain intact 	



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Fazal Cloth Mills Limited

BALANCE SHEET	30-Sep-17	30-Jun-17	30-Jun-16	30-Jun-15
	Annual	Annual	Annual	Annual
Non-Current Assets	18,192	17,988	16,814	17,489
Investments (Incl. associates)	5,338	5,012	5,890	5,546
Equity	4,561	4,044	4,075	4,653
Debt	778	969	1,815	894
Current Assets	12,232	13,219	8,319	9,670
Inventory	6,106	6,420	5,113	4,446
Trade Receivables	4,041	4,243	1,903	3,805
Others	2,084	2,556	1,303	1,419
Total Assets	35,762	36,220	31,024	32,705
Debt	15,503	16,213	11,335	12,912
Short-term	6,848	7,516	3,886	5,742
Long-term (Incl. Current Maturity of long-term debt)	8,655	8,697	7,449	7,171
Other shortterm liabilities	2,177	2,098	2,193	2,112
Other Longterm Liabilities	2,400	2,379	2,279	2,163
Shareholder's Equity	15,682	15,529	15,217	15,518
Total Liabilities & Equity	35,762	36,220	31,024	32,705
INCOME STATEMENT				
Turnover	7,574	26,555	20,616	25,419
Gross Profit	661	1,782	1,754	2,409
Financial Charges	(253)	(879)	(917)	(1,275)
Net Income	150	388	150	511
Cashflow Statement				
Free Cashflow from Operations (FCFO)	634	1,563	1,700	2,352
Net Cash changes in Working Capital	858	(3,681)	367	(92)
Net Cash from Operating Activities	1,248	(2,755)	1,442	1,172
Net Cash from Investing Activities	(401)	(2,021)	200	(1,232)
Net Cash from Financing Activities	(710)	4,808	(1,726)	(116)
Ratio Analysis				
Performance				
Turnover Growth	13.1%	28.8%	-18.9%	6.9%
Gross Margin	8.7%	6.7%	8.5%	9.5%
Net Margin	2.0%	1.5%	0.7%	2.0%
ROE	1.0%	2.7%	1.0%	3.6%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.6	0.6	0.6	0.9
Interest Coverage (x) (FCFO/Gross Interest)	2.5	1.8	1.9	1.8
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) /FCFO - Gross Inter	3.4	54.0	9.5	6.7
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	122	122	133	124
Capital Structure (Total Debt/Total Debt+Equity)	50%	51%	43%	45%

Fazal Cloth Mills Limited (Fazal Cloth)

January 2017



Name of Rated Entity
Sector
Type of Relationship

Fazal Cloth Mills Ltd
 Textile
 Solicited

Purpose of the Rating

Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
13-Jan-17	A-	A2	Stable	Maintain
29-Jun-17	A-	A2	Stable	Maintain
07-Sep-16	A-	A2	Stable	Maintain
09-Oct-15	A-	A2	Stable	Maintain
10-Oct-14	A-	A2	Stable	Maintain
22-Oct-13	A-	A2	Stable	Maintain
19-Nov-12	A-	A2	Positive	Maintain

Related Criteria and Research

Rating Methodology
 Sector Research

Corporate Rating Methodology
 Textile Sector - Viewpoint | Sep-17

Rating Analysts

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[Rating Team Statement](#)

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[Probability of Default \(PD\)](#)

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