



The Pakistan Credit Rating Agency Limited

Rating Report

Fazal Rehman Fabrics Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Feb-2018	BBB+	A2	Stable	Maintain	-
26-Jan-2017	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The rating reflects company's business risk profile which is characterized by sizeable revenue base, adequate profitability, and requisite return on equity. Depressed topline growth is the characteristic of decline in exports, an industry phenomenon. Strength of company's financial risk has provided requisite breather to the overall profile, emanating from efficient working capital management and healthy liquidity position. On standalone basis, debt service coverages are adequate. Fazal Rehman Fabrics has embarked upon expansion in its weaving capacities; adding 96 air jet looms - in two phases. First phase of expansion of 66 looms, with an estimated cost of PRK 1.1bln (debt: equity - 70:30) is expected soon. Therefore, further accumulation of debt has added to the standalone financial risk. Nevertheless, financial support and corporate guarantee against financial obligations from parent company provides comfort. Fazal Rehman has a leveraged capital structure and maintains short term lines which may be utilized in case the need arises.

The ratings are dependent on the management's ability to uphold the entity's risk profile. Meanwhile, prudent management of expansion-related debt, post-expansion cashflows, and parent company's support will be important to support the financial profile of the company.

Disclosure

Name of Rated Entity	Fazal Rehman Fabrics Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating Methodology(27-Jul-17), Methodology Correlation between long-term and short-term rating scale(30-Jun-17), Methodology Criteria Modifiers(30-Jun-17)
Related Research	Sector Study Textile(10-Oct-17)
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FAZAL REHMAN FABRICS LIMITED	
Incorporated	2004
Major business lines	<ul style="list-style-type: none"> Manufacturing and sale of greige fabric
Legal status	Public unlisted company

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

- Fazal Rehman is a wholly-owned subsidiary of Ahmed Fine Textile Mills Limited. Ahmed Fine is jointly owned by Fazal Group and Hussain Group (50% each). The company is involved in the manufacturing and marketing of yarn.
- Hussain Group, through its flagship entity (Hussain Mills Limited), is primarily engaged in spinning and weaving business.
- Production facility is located in Multan; operates with 341 air-jet looms
- Total power requirement of 6MW; met through captive sources

GOVERNANCE

- Fazal Rehman is a wholly-owned subsidiary of Ahmed Fine Textile Mills Limited. Ahmed Fine is jointly owned by Fazal Group and Hussain Group (50% each). The company is involved in the manufacturing and marketing of yarn.
- Hussain Group, through its flagship entity (Hussain Mills Limited), is primarily engaged in spinning and weaving business.
- Seven members BoD: Four directors represent Fazal Group (including Chairman) while three represent Hussain Group (including CEO)
- presence of two housewives on board weakens governance profile; lacks challenge to management decisions

MANAGEMENT

- Mr. Hussain Ahmed Fazal is the CEO; however, operational control vests with Mr. Rehman Naseem (Director). He carries with him over two decades of experience in textile sector; supported by seasoned management team
- Deployed European technology sizing and warping machines, while Japanese & European technology implemented for air-jet looms
- Oracle based ERP system implemented since 2008. Comprehensive MIS reports generated on daily and monthly basis
- Operational consolidation with subsidiary in near-term; operational synergies expected to flow gradually

PERFORMANCE

- In FY17 companies revenue declined by ~3 on YOY bases; on account of lower fabric prices in local and export markets
- Local sales revenues increased by 7% and export sales revenues decreased by 17% YoY despite surge in volumes; relatively balanced export: local sales mix.
- Margins slightly decline YoY (gross: FY17: 8.3, FY16: 8.4%, operating: FY17: 5.2%, FY16: 5.1%) due to high input costs
- In FY17, the company generated revenue amounting to PKR 5,459mln, with slightly decline in margins; gross margin: 8.3%, operating margin: 5%. Net profitability (PKR 152mln) was further supported by falling finance costs (PKR ~36mln)
- In 1QFY18 profitability marginally decline PKR 28mln, (1QFY17: PKR 50mln) on account of high finance cost
- Going forward, prudent management of expansion and related debt remains important

FINANCIAL RISK

- Company's working capital requirements are a function of inventory and receivables, for which the company relies on mix of internal generation and short term borrowings; room for borrowing exists, while being covered by trade and net current assets
- Adequate coverages in recent periods (end-Jun17: 1.3x, end-Jun16: 1.3x).
- Moderately leveraged capital structure (end-Jun17: 61%, end-Jun16: ~46%)
- Ahmed Fine has issued a cross-corporate guarantee on a short/medium-term financing facility of Fazal Rehman, enabling the former to directly provide financial support in time of need
- Overall standalone financial risk profile considered adequate, despite strong liquidity. Incremental cashflows from expansion, and parent company support remain important to keep the financial profile afloat



Fazal Rehman Fabrics Limited

BALANCE SHEET

	30-Sep-17	30-Jun-17	30-Jun-16	30-Jun-15
	Annual	Annual	Annual	Annual
Non-Current Assets	2,607	2,515	1,772	1,865
Investments (Incl. associates)	-	-	-	-
Equity	-	-	-	-
Mutual funds	-	-	-	-
Current Assets	2,900	2,630	1,468	1,718
Inventory	593	685	660	869
Trade Receivables	629	494	258	512
Others	1,678	1,451	550	337
Total Assets	5,507	3,240	3,240	3,583
Debt	2,426	2,423	1,168	1,749
Short-term	690	628	140	541
Long-term (Incl. Current Maturity of long-term debt)	1,736	1,795	1,028	1,208
Other shortterm liabilities	1,346	1,016	554	425
Other Longterm Liabilities	168	167	140	114
Shareholder's Equity	1,567	1,538	1,378	1,295
Total Liabilities & Equity	5,507	5,145	3,240	3,583

INCOME STATEMENT

Turnover	1,593	5,459	5,604	5,921
Gross Profit	158	454	472	458
Other Income	(18)	36	(11)	(7)
Financial Charges	(39)	(130)	(126)	(157)
Net Income	28	152	83	46

Cashflow Statement

Free Cashflow from Operations (FCFO)	128	459	430	428
Net Cash changes in Working Capital	278	(52)	383	16
Net Cash from Operating Activities	359	310	691	269
Net Cash from Investing Activities	(348)	(612)	(88)	(321)
Net Cash from Financing Activities	(4)	284	(581)	(36)
Net Cash generated during the period	7	(17)	22	(88)

Ratio Analysis

Performance				
Gross Margin	9.9%	8.3%	8.4%	9.9%
Net Margin	1.7%	2.8%	1.5%	1.7%
ROE	7.3%	11.2%	5.7%	7.3%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.3	1.3	1.3	1.3
Interest Coverage (x) (FCFO/Gross Interest)	3.3	3.5	3.4	3.3
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	4.9	5.4	3.4	4.9
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	33	75	65	33
Capital Structure (Total Debt/Total Debt+Equity)	60.8%	61.2%	45.9%	60.8%

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

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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.
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- (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)

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- (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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