



The Pakistan Credit Rating Agency Limited

Rating Report

Fazal Weaving Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
08-May-2019	A-	A2	Developing	Maintain	YES
24-Jan-2019	A-	A2	Stable	Maintain	-
24-Jul-2018	A-	A2	Stable	Maintain	-
22-Jan-2018	A-	A2	Stable	Maintain	-
29-Jun-2017	A-	A2	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The board of directors of Fazal Weaving Mills Limited (Fazal Weaving) and Fazal Cloth Mills Limited (Fazal Cloth) – the parent company – have agreed upon the merger of Fazal Weaving with and into Fazal Cloth. Fazal weaving is a wholly owned (100%) subsidiary of Fazal Cloth. Currently, the transaction is in process of completion. Most of the approvals have already been acquired and the process is in final stage. Post merger, all assets and liabilities of the Company will be transferred to Fazal Cloth. The merger is expected to conclude by end-Jun 2019.

Considering these developments, PACRA has placed the entity ratings of Fazal Weaving on 'Rating Watch - Developing'.

Disclosure

Name of Rated Entity	Fazal Weaving Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Textile(Oct-18)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Fazal Weaving Mills Limited (Fazal Weaving) was incorporated in April, 2014 as a private limited company.

Background Fazal Weaving is a wholly owned subsidiary of Fazal Cloth - the flagship Company of Fazal Group. During FY14, Fazal Weaving commenced its operation with 26,400 spindles, later on in Feb16, the Company expanded its capacity by adding 13,200 spindles.

Operations Fazal Weaving's current operational capacity comprises 39,600 spindles, with a total energy requirement of 5.6MW, which is met through captive power generation (gas: 6.3MW, diesel: 1MW). Meanwhile, MEPCO connection is used as back-up.

Ownership

Ownership Structure Fazal Weaving is a wholly owned subsidiary of Fazal Cloth - a listed concern. Fazal Cloth is majorly owned by Fazal Group and Fatima Group (~45% each).

Stability Fazal Weaving is scheduled to be merged into Fazal Cloth – parent company – by end Jun-19. Fazal Cloth has a structured line of succession, portraying requisite stability. However, the transfer of ownership to the next generation is not documented.

Business Acumen The sponsoring Groups have over seven decades of presence in Pakistan's textile industry, developing expertise to sustain through the volatile textile industry. Mr. Rehman Naseem – a textile veteran primarily manage the Company's operations, providing business acumen in order to sustain and flourish in competitive textile industry.

Financial Strength The sponsoring Groups have a prominent position in Pakistan's corporate sector, with interests in textile, fertilizer, energy and trading. This portrays strong financial health and room of financial support to Fazal Weaving, if needed.

Governance

Board Structure The Company's board of directors comprises seven members, including the Chief Executive Officer (CEO). The board has four representatives from Fazal Group and three representatives from Fatima Group.

Members' Profile Mr. Rehman Naseem – the Chairman, is a Columbia University graduate and carries over two decades of experience in the textile sector. Moreover, the board members have vast knowledge and extensive experience of the textile value chain. The directors' expertise in textile industry benefits the board in efficient decision making.

Board Effectiveness Two committees: Audit and Human Resource & Remuneration, are in place to assist the board in relevant matters and ensures proper oversight. Attendance of board members in meetings remained strong, however documentation of meeting minutes needs improvement.

Financial Transparency M/s. KPMG Taseer Hadi & Co., Chartered Accountants is the external auditor of the company. The auditors have expressed unqualified opinion on the financial reports for the year ended 30th June, 2018.

Management

Organizational Structure The management control of the Company vests with Fazal family. There is a well-defined organizational structure with clear segregation of responsibilities. Moreover, Mr. Rehman Naseem (Chairman) primarily manages the Company's affairs. The organizational structure of the Company is divided into various functional departments: i) Production, ii) Finance & Accounts, iii) Marketing, iv) Admin, v) HR, and vi) Internal audit.

Management Team Mr. Sheikh Naseem Ahmad – the CEO – is a graduate and carries over five decades of experience in textile industry. Mr. Muhammad Azam is a fellow chartered accountant, serving in the capacity of CFO. He has been associated with the Company for thirteen years.

Effectiveness The Company has formed three-member management committee – Executive Committee – headed by the CFO. Routine financial and compliance issues are discussed in the executive committee meeting to resolve bottlenecks, ensuring smooth flow of operations.

MIS The Company has in place fully integrated ERP software from Oracle Corporation with version E Business Suite R -12.1.1, with following modules; Payables, Receivable, Fixed Asset, Cash Management etc.

Control Environment Fazal Weaving is accredited with various International certifications for compliance and quality assurance standards. In order to ensure better productivity and compliance with relevant certifications the plants are regularly inspected.

Business Risk

Industry Dynamics During 1HFY19, textile exports stagnated despite ~15% rupee devaluation during the period. Knitwear showed a relatively stronger performance ensuring that textile exports' growth stayed in positive territory. Falling cotton production, rising cotton prices and issue of outstanding refunds continue to be major hindrances for the textile sector. The devalued currency, recently announced relief in gas and electricity tariffs for zero-rated sectors and removal of duties on imported cotton are expected to boost overall exports, going forward. On the other hand exports of spinning industry are largely dependent on China and any material positive development among USA and China regarding tariffs will be beneficial for spinning industry.

Relative Position The Company is associated with Fazal Group, through its parent company Fazal Cloth. Fazal Group maintains considerable position in Pakistan's spinning and weaving sector, consequently strengthening Fazal Weaving's market position. However, on standalone basis the Company's share in local spinning industry is minimal.

Revenues Fazal Weaving's revenues posted a limited growth in FY18 and reported at ~PKR 6,249mln. This was largely attributable to considerable decline in exports share, as Fazal Weaving's sales to its parent company significantly increased during the period under review. Resultantly, the Company's sales mix has significantly changed, as the local sales dominated ~90% (FY17: 48%) its revenues. With regard to export revenues, Asian region remained the key market. In the domestic market, top ten customer concentration is high ~83% (FY17: ~41%). Whereas during 1HFY19, the Company's revenues increased by ~34% on half yearly basis and landed at ~PKR 4,161mln, owing to robust export sales and better yarn prices when compared with same period last year.

Margins The Company's gross margins slightly improved during the year (FY18: 7.7%, FY17: 7.1%), owing to lower than proportionate increase in cost of sales. The Company's operating margins improved (FY18: 7.0%, FY17: 5.7%), due to rationalization of distribution cost, a factor of declined export sales. The finance costs increased by ~25%, as a result of higher short term borrowing. Despite that increase, the Company posted a profit of ~PKR 117mln (FY17: ~PKR 91mln), on account of tax credits. The Company's margins further improved in 1HFY19 (gross: 8.9%, operating: 8.2%). Meanwhile, despite the significant increase in finance cost, the Company's net profit increased ~PKR 113mln (1HFY18: PKR 73mln) on half yearly basis.

Sustainability Fazal Cloth has provided corporate guarantee on all financial obligation of Fazal Weaving. Post merger, owing to strong business profile of Fazal Cloth, the sustainability of Fazal Cloth will remain same.

Financial Risk

Working Capital In FY18, the Company's reliance on STB increased significantly (FY18: PKR 2,776mln, FY17: PKR 1,425mln), owing to seasonal inventory procurement, which led to increase in inventory days (FY18: 83days, FY17, 46days), eventually higher working capital cycle (gross - FY18: 124days, FY17, 84days, net - FY18: 121days, FY17 82days); though remain in line with industry. The working capital cycle further increased in 1HFY19, reflected from higher working capital days (gross - 1HFY19: 178days, net - 1HFY19: 175days), on the back of seasonal raw material procurement and higher receivables.

Coverages During FY18, the Company's operating cash flows (FCFO) increased by ~16%. The increase in finance cost in higher proportion, coupled with higher CMLTD has resulted in lower interest and debt coverages (FY18: 1.9x, FY17: 2.1x) and (FY18: 0.6x, FY17: 1.0x), respectively. Whereas, coverages improved in 1HFY19 (interest - 1HFY19: 2.2x, debt - 1HFY19: 1.1x), owing to better profitability. Furthermore, the parent company has provided irrevocable and unconditional corporate guarantee on all financial obligations of Fazal Weaving.

Capitalization Fazal Weaving has a significantly leveraged capital structure (FY18: 82.9%, FY17: 86%). However, the Company has a balanced debt mix; comprising short term (50%) and long term (50%) debt. During FY18, the Company has revalued its fixed assets and eventually reported revaluation gains, in turn, higher equity level. In 1HFY19, the Company's leveraging increased to ~84% because of higher STB.



Fazal Weaving Mills Limited

Private Limited

BALANCE SHEET

	Dec-18	Jun-18	Jun-17	Jun-16
	6M	12M	12M	12M
a Non-Current Assets	3,340	3,439	3,137	3,230
b Investments (Incl. Associates)	-	-	-	-
Equity Instruments	-	-	-	-
Debt Instruments	-	-	-	-
c Current Assets	5,745	3,103	1,868	1,707
Inventory	3,953	2,233	1,160	1,106
Trade Receivables	1,449	478	376	237
Others	343	392	332	364
d Total Assets	9,085	6,542	5,005	4,937
e Debt/Borrowings	6,439	4,863	4,162	4,235
Short-Term	4,438	2,776	1,425	566
Long-Term (Incl. Current Maturity of Long-Term Debt)	2,001	2,087	2,737	3,669
Other Short-Term Liabilities	1,399	549	215	166
Other Long-Term Liabilities	19	16	10	9
f Shareholder's Equity	1,228	1,115	618	527
g Total Liabilities & Equity	9,085	6,542	5,005	4,937

INCOME STATEMENT

a Turnover	4,161	6,249	6,228	3,743
b Gross Profit	372	483	443	245
c Net Other Income	45	(30)	2	(0)
d Financial Charges	(202)	(267)	(214)	(218)
e Net Income	113	117	91	(3)

CASH FLOW STATEMENT

a Free Cash Flow from Operations (FCFO)	440	517	447	247
b Total Cashflows (TCF)	440	517	447	247
c Net Cash changes in Working Capital	(1,769)	(1,394)	(869)	774
d Net Cash from Operating Activities	(1,478)	(1,088)	(659)	746
e Net Cash from Investing Activities	(8)	(75)	(69)	(801)
f Net Cash from Financing Activities	1,453	1,202	631	171
g Net Cash generated during the period	(32)	39	(97)	117

RATIO ANALYSIS

a Performance				
Turnover Growth	33%	0%	66%	5%
Gross Margin	9%	8%	7%	7%
Net Margin	3%	2%	1%	0%
ROE	19%	14%	16%	0%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+U	1.1	0.6	1.0	0.6
Interest Coverage (X) (FCFO/Gross Interest)	2.2	2.0	2.2	1.2
Debt Payback (Years) (Total Debt (excluding Covered Short T	4.3	9.0	11.3	100.4
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable D	175	121	82	122
d Capital Structure (Total Debt/Total Debt+Equity)	84%	81%	87%	89%

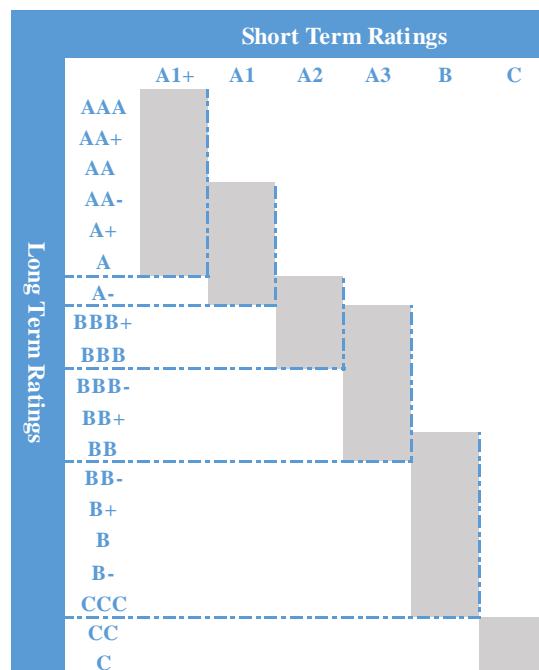
Fazal Weaving Mills Limited

Apr-19

Credit Rating Scale & Definitions

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 Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
AA		A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
AA-		A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
A		C	An inadequate capacity to ensure timely repayment.
A-			
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.		
BBB			
BBB-			
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.		
BB			
BB-			
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.		
B			
B-			
CCC	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.		
CC			
C			
D	Obligations are currently in default.		



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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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.
- (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)

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- (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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