



## The Pakistan Credit Rating Agency Limited

### Rating Report

#### Fazal Weaving Mills Limited

#### Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Nov-2019	A-	A2	Developing	Maintain	YES
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	-
07-Sep-2016	A-	A2	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings of Fazal Weaving Mills Limited (Fazal Weaving) primarily reflect irrevocable and unconditional guarantee on all financial obligations by Fazal Cloth Mills Limited (Fazal Cloth) - the parent company. Over the years, the Company sustained its profitability despite challenging environment. Lately, textile industry suffered from low international commodity prices due to global economic slowdown. However, the impact was largely mitigated by rupee devaluation in FY19 and higher domestic prices of yarn. The Company managed to sustain its export volumes which has yielded notable exchange gains in FY19 supporting margins and profitability. The Company has a stretched financial profile, characterized by significantly leveraged capital structure, high working capital cycle and modest coverages. Support from Fazal Cloth in the form of subordinated loans and guarantees provides comfort to the assigned ratings. Meanwhile, the Company is in final stages of merger with and into Fazal Cloth. Post-merger, all assets and liabilities of the Company will be transferred to Fazal Cloth. The merger is expected to conclude by end-Dec 2019. The rating watch "Developing" signifies ongoing merger activities.

The ratings are dependent upon continuation of irrevocable and unconditional guarantee on financial obligation by the parent company till completion of its merger. Meanwhile, improvement in margins, in turns, sufficient cash generation to fulfill its financial obligations amid high interest rates will remain critical.

#### Disclosure

<b>Name of Rated Entity</b>	Fazal Weaving Mills Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Ratings(Jun-19),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria   Rating Modifier(Jun-19)
<b>Related Research</b>	Sector Study   Spinning(Sep-19)
<b>Rating Analysts</b>	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 public unlisted 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 installed capacity is 39,600 spindles. The power requirements of the Company stands at ~5.6MW which is met through mix of in-house power generation (capacity: ~7.3MW) and MEPCO's connection, whichever is more feasible.

## Ownership

**Ownership Structure** Fazal Weaving is a wholly owned subsidiary of Fazal Cloth. Fazal Cloth is majorly owned by Fazal Group and Fatima Group (~45% each). Herein "Group means members of family without reference to any law of Pakistan".

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

**Business Acumen** The sponsoring Groups have over seven decades of presence in local textile industry, developing credential expertise of textile industry. Mr. Rehman Naseem, a textile veteran, primarily manage the Company's operations and has the requisite acumen.

**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 muscle of sponsoring Group's to support Fazal Weaving, if needed arises.

## 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 industry. Moreover, the board members have extensive expertise of the textile value chain which benefits 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 FY19.

## 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 – has a graduation degree and carries over five decades of experience in textile industry. Mr. Muhammad Azam – CFO – is a fellow chartered accountant and 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 these meetings to resolve bottlenecks, eventually ensuring smooth flow of operations.

**MIS** The Company has in place Oracle based ERP software 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 Company's plants are regularly inspected.

## Business Risk

**Industry Dynamics** The export performance of Pakistan's textile industry remained stagnated during FY19, despite ~34% currency devaluation and incentives introduced by the government to promote exports. Even though leading textile categories including ready-made garments, bed ware, knitwear and cotton cloth displayed double-digit volumetric growth, the hit to unit prices on account of exporters having to share the benefit of the currency depreciation with buyers in extremely competitive international market, curbed overall growth. Cotton crop for the year is expected to be lower than last year due to crop diseases, despite higher Cotton sowing area. This will decidedly result in the need to import 4-5mln bales, making for much costlier input, given the current duty structure of imported cotton. Meanwhile, withdrawal of zero rating status has pressurized the overall liquidity of textile industry. These factors are likely to impact margins of textile companies, going forward.

**Relative Position** Fazal Weaving is a wholly owned subsidiary of Fazal Cloth. Fazal Cloth is one of the largest composite textile unit in Pakistan, with significant spinning capacity, when compared to peers. Post-merger, the spinning capacity of Fazal Cloth will increase, in turn, considerable revenue growth. At group level, Fazal Group has a considerable presence in local textile industry, especially spinning with notable share in Pakistan's yarn exports. However, on standalone basis Fazal Weaving has a minimal share in local spinning industry.

**Revenues** In FY19, the Company's top-line clocked in at PKR 9,240mln (FY18: PKR 6,249mln) up by ~47% YoY. Increase in top-line was driven by; i) upsurge in local yarn's prices and, ii) yarn trading amounting to PKR 2.35bln, as Fazal Cloth - parent company - has channeled its exports sales through Fazal Weaving. This has inflated the Company's exports to ~48% (FY18: 11%) of total revenues. The Company local sales largely rests with organized sector, mitigating the sales risk. Arised, on account of withdrawal of zero rating regime which restricts sales to unregistered customers. Whereas during 1QFY20, the Company's revenues posted YoY growth of ~6.6% on and reported at ~PKR 1,708mln.

**Margins** The Company's gross margins remained subdued during the year (FY19: 7.4%, FY18: 7.9%), owing to lower than proportionate increase in cost of sales. Similarly, operating margins marginally declined (FY19: 6.6%, FY18: 7.0%) due to higher distribution cost, a factor of increased exports. Despite declined exports the Company's finance cost increased twofold due to higher interest rates. The Company booked significant exchange gain of ~PKR 192mln. However, this has been largely offsetted by reporting of notable Group taxation in Fazal Weaving's books, eventually limiting the Company's net margins (FY19: 1.5%, FY18: 1.9%) and its profit reported at PKR 137mln, posting growth of 16%. The Company's gross margins improved in 1QFY20 (1QFY20: 15.3%, 1QFY19: 14.8%). Likewise, operating margins were better (1QFY20: 14.1%, 1QFY19: 13.5%). Significant increase (~48%) in finance cost along with declined non-operating income have resulted in lower profitability (1QFY20: PKR 63mln, 1QFY19: PKR 111mln).

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

## Financial Risk

**Working Capital** In FY19, the Company's short term trade leverage improved (FY19: 15%, FY18: -1%) as it received interest free loan (PKR 484mln) for working capital which has lowered its reliance on STB. The Company's inventory days increased (FY19: 115days, FY18: 99days). Similarly, the receivable days were notably higher (FY19: 33days, FY18: 25days). Collectively, these factors led to higher gross working capital days (FY19: 148days, FY18: 124days). Furthermore, gross working capital cycle improved in 1QFY20 (1QFY20: 125days, 1QFY19: 170days).

**Coverages** The Company's operating cash flows (FCFO's) increased by ~70% in FY19. However, higher than proportionate increase in finance cost led to marginally declined debt coverages (FY19: 1.8x, FY18: 2.0x). On the contrary, debt coverages improved (FY19: 1.0x, FY18: 0.6x) on account of higher quantum of FCFO. In 1QFY20, the Company's interest (3.5x) and debt (2.1x) coverages improved on the back of better profit generation. 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 (FY19: 73.2%, FY18: 80.3%) with balanced debt mix; comprising short term (51.5%). In 1QFY20, the Company's leveraging further declined to ~87.3% due to declined STB.



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Financial Summary

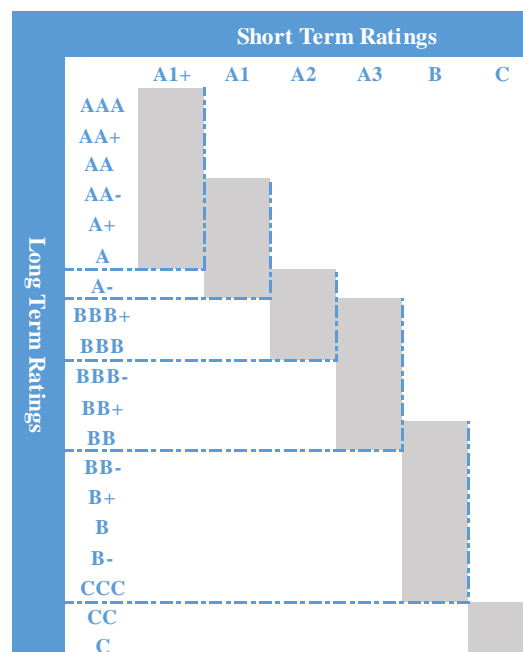
PKR mln

Fazal Weaving Mills Limited Spinning	Sep-19 3M	Jun-19 12M	Jun-18 12M	Jun-17 12M
<b>A BALANCE SHEET</b>				
1 Non-Current Assets	3,196	3,228	3,439	3,137
2 Investments	90	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	1,970	3,247	3,103	1,868
a Inventories	1,439	2,091	2,233	1,160
b Trade Receivables	351	785	478	376
5 Total Assets	5,256	6,476	6,542	5,005
6 Current Liabilities	374	566	549	321
a Trade Payables	52	94	40	50
7 Borrowings	2,705	3,540	4,253	3,051
8 Related Party Exposure	844	1,099	609	1,005
9 Non-Current Liabilities	34	35	16	10
10 Net Assets	1,299	1,235	1,115	618
11 Shareholders' Equity	1,299	1,235	1,115	618
<b>B INCOME STATEMENT</b>				
1 Sales	1,708	9,240	6,249	6,219
a Cost of Good Sold	(1,447)	(8,555)	(5,766)	(5,785)
2 Gross Profit	262	684	483	434
a Operating Expenses	(21)	(71)	(47)	(89)
3 Operating Profit	240	614	437	345
a Non Operating Income	(43)	176	(30)	10
4 Profit or (Loss) before Interest and Tax	198	790	406	355
a Total Finance Cost	(123)	(496)	(267)	(214)
b Taxation	(11)	(157)	(21)	(51)
6 Net Income Or (Loss)	63	137	118	90
<b>C CASH FLOW STATEMENT</b>				
a Free Cash Flows from Operations (FCFO)	432	875	517	447
b Net Cash from Operating Activities before Working Capital Changes	323	379	306	211
c Changes in Working Capital	737	329	(1,394)	(869)
1 Net Cash provided by Operating Activities	1,060	708	(1,088)	(659)
2 Net Cash (Used in) or Available From Investing Activities	(8)	(23)	(75)	(69)
3 Net Cash (Used in) or Available From Financing Activities	(832)	(713)	1,202	631
4 Net Cash generated or (Used) during the period	220	(27)	39	(97)
<b>D RATIO ANALYSIS</b>				
1 Performance				
a Sales Growth (for the period)	6.6%	47.9%	0.5%	66.2%
b Gross Profit Margin	15.3%	7.4%	7.7%	7.0%
c Net Profit Margin	3.7%	1.5%	1.9%	1.4%
d Cash Conversion Efficiency (EBITDA/Sales)	14.6%	10.6%	9.3%	8.5%
e Return on Equity (ROE)	20.0%	11.6%	13.6%	15.7%
2 Working Capital Management				
a Gross Working Capital (Average Days)	125	110	124	84
b Net Working Capital (Average Days)	121	108	121	82
c Current Ratio (Total Current Assets/Total Current Liabilities)	5.3	5.7	5.7	5.8
3 Coverages				
a EBITDA / Finance Cost	2.0	2.0	2.2	2.6
b FCFO / Finance Cost+CMLTB+Excess STB	2.1	1.0	0.6	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.5	5.9	9.0	10.8
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	73.2%	79.0%	81.4%	86.8%
b Short-Term Borrowings / Total Borrowings	0.5	0.5	0.6	0.4
c Average Borrowing Rate	12.0%	10.4%	5.8%	4.9%

## 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	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
AA+	<b>Very high credit quality.</b> 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+	<b>High credit quality.</b> 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+	<b>Good credit quality.</b> 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+	<b>Moderate risk.</b> 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+	<b>High credit risk.</b> 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	<b>Very high credit risk.</b> 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.		



<b>Outlook (Stable, Positive, Negative, Developing)</b> 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'.	<b>Rating Watch</b> 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.	<b>Suspension</b> 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.	<b>Withdrawn</b> 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.	<b>Harmonization</b> A change in rating due to revision in applicable methodology or underlying scale.
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