The Pakistan Credit Rating Agency Limited

Rating Report

Fazal Weaving Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Nov-2020	A-	A2	Developing	Maintain	YES
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

Fazal Weaving Mills Limited (Fazal Weaving), incorporated in 2014, is an unlisted public company, and a wholly owned subsidiary of Fazal Cloth Mills Limited; a group concern of one of the oldest textile groups in Pakistan – Fazal Group (herein; group means "members of family without reference to any law of Pakistan"). The ownership structure provides stability against unfavorable circumstances. During FY20, the Company's business risk profile was impacted by reduced sales and losses incurred. As per the management, pandemic induced lockdowns around the world led to deterioration in revenue as markets both; locally and internationally faced closures. Volumes, as well as, margins were impacted. High finance cost and significant exchange losses added to the downward pressure. The Company's financial risk profile witnessed squeeze in cash flows, negatively affecting the coverages in the wake of leveraged capital structure. Reduction in policy rates and the moratorium relief by SBP provided respite. The markets gradually opened in some parts of the world towards the end of 1QFY21. The management is of the view that Fazal Weaving will bounce back in FY21; expecting to close figures in profit. Furthermore, the Company is fully booked for the winter season as orders have poured in from local and international clients. Exports are picking up once again and improved results will be seen. Nevertheless, second wave of the pandemic has begun its course and lockdowns may be a cause of concern. However, business community is expected to continue operations under strict SOPs, both; locally and in most of the export destinations of the Company. Moreover, the ongoing merger with the parent Company – Fazal Cloth, is still underway as Court's final judgment is awaited.

The ratings are dependent upon continuation of irrevocable and unconditional guarantee by the parent company, on financial obligations till completion of the merger. The "Developing" outlook signifies ongoing merger activities. Whereas, the "rating watch" captures the performance deterioration and ramification of the ongoing pandemic. Meanwhile, improvement in margins, in turn, sufficient cash generation to fulfill its financial obligations will remain critical.

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-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Spinning(Sep-20)
Rating Analysts	Adil Kaleem | adil.kaleem@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, tentatively by Nov-end, 2020. 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 had expressed unqualified opinion on the financial reports for FY20.

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; a fellow cost & management accountant; and has been associated with Fazal Group for the past fourteen 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 Textile exports of the country increased by ~14% for 1MFY21 to stand at ~USD 1.3bln as compared to ~USD 1.1bln in 1MFY20. Although the demand for textile products internationally deteriorated on account of lock downs in major export destinations, the export market had under-performed in 1MFY20. Furthermore, economies around the world have been gradually reopening as businesses recommenced in the past month. Hence, the exports in 1MFY21, experienced an upward trend despite prior lockdowns. Going forward, uncertainty still prevails with regards to full resumption of businesses around the globe and a return to normality. Locally, textile sector has found comfort in relief measures introduced by State Bank of Pakistan such as, deferment of loan payments for one year, low interest rates and salary refinance scheme.

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 During FY20, the Company's revenue declined (FY20: PKR 6,934mln; FY19: PKR 9,240mln) on account of the pandemic induced lockdown. Furthermore, the pandemic also caused the demand to contract; consequently having an impact on the revenue. Sales mix of the Company remained unchanged; the exports' composition was stagnant at ~52% (FY19: ~52%).

Margins Contraction of demand due to the pandemic, led the yarn prices to dramatically dip; causing the gross margin to decline (FY20: 6.6%; FY19: 7.4%) This further translated in to reduced operating margins (FY20: 5.2%; FY19: 6.6%). Coupled with high finance cost (FY20: PKR 459mln; FY19: PKR 496mln), this led to net loss of PKR 294mln; registering a net loss margin -4.2% (FY9: 1.5%).

Sustainability Going forward, the Company is under process of merging with its parent company i.e. Fazal Cloth Mills Limited. The merger has been approved but final court orders are awaited. The delay is partly because the Court is exploring the tax implications and other charges such a merger will incur. Moreover, pandemic has been another delaying factor. Since the Company is merging with Fazal Cloth, no expansion or BMR is currently planned. Any such activity will take place only after the merger, if required.

Financial Risk

Working Capital Fazal Weaving fulfills its working capital needs through a mixture of ST borrowing and internal cash flows. During FY20, the net working capital cycle of the Company increased significantly (FY20: 149 days; FY19: 108 days), on account of higher raw material levels (FY20: PKR 2,429mln; FY19: PKR 1,910mln), piled up due to the pandemic. However, the net trade assets were at a relatively similar level as in the comparative year (FY20: PKR 2,929mln; FY19: PKR 2,982mln) due to a corresponding decrease in trade receivables (FY20: PKR 351mln; FY19: PKR 785mln). This brought about only a minor expansion in room-to-borrow at the trade level (FY20: PKR 617mln; FY19: 592mln), which subsequently caused a slight increase in ST trade leverage adequacy (FY20: ~20%; FY19: 19%).

Coverages In FY20, the Company's operating cashflow decreased (FY20: PKR 486; FY19: PKR 875mln) due to the loss made during the year. Consequently, coverages dropped during the year; with interest coverage at 1.1x (FY19: 1.8x) and debt coverage at 0.8x (FY19: 1.0x); despite reduced finance cost (FY20: PKR 459mln; FY19: PKR 496mln).

Capitalization Fazal Weaving has a highly leveraged capital structure. In FY20, the leverage increased to ~83% (FY19: 79%) on the back of a reduction in revenue reserves (FY20: PKR 195mln; FY19: PKR 465mln) caused by the loss in FY20, culminating in lower equity base (FY20: PKR 940mln; FY19: PKR 1,235mln). Whereas the total debt decreased in FY20 to PKR 3,236mln (FY19: PKR 3,540mln), out which ~51% were short term borrowings.

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Financial Summary
PKR mln

Fazal Weaving Mills Limited	Jun-20	Jun-19	Jun-18
Spinning	12M	12M	12M
A BALANCE SHEET			
1 Non-Current Assets	3,083	3,228	3,439
2 Investments	-	-	-
3 Related Party Exposure	-	-	-
4 Current Assets	3,228	3,247	3,103
a Inventories	*2,660*	*2,091*	*2,233*
b Trade Receivables	*351*	*785*	*478*
5 Total Assets	6,311	6,476	6,542
6 Current Liabilities	790	566	549
a Trade Payables	*127*	*94*	*40*
7 Borrowings	3,236	3,540	4,253
8 Related Party Exposure	1,299	1,099	609
9 Non-Current Liabilities	45	35	16
10 Net Assets	940	1,235	1,115
11 Shareholders' Equity	940	1,235	1,115
B INCOME STATEMENT			
1 Sales	6,934	9,240	6,249
a Cost of Good Sold	*(6,474)*	*(8,555)*	*(5,766)*
2 Gross Profit	460	684	483
a Operating Expenses	(97)	(71)	(47)
3 Operating Profit	362	614	437
a Non Operating Income or (Expense)	*(133)*	*176*	*(31)*
4 Profit or (Loss) before Interest and Tax	230	790	406
a Total Finance Cost	*(459)*	*(496)*	*(267)*
b Taxation	*(65)*	*(157)*	*(21)*
6 Net Income Or (Loss)	(294)	137	117
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*486*	*875*	*517*
b Net Cash from Operating Activities before Working Capital Changes	*90*	*379*	*306*
c Changes in Working Capital	*237*	*329*	*(1,394)*
1 Net Cash provided by Operating Activities	327	708	(1,088)
2 Net Cash (Used in) or Available From Investing Activities	(15)	(23)	(75)
3 Net Cash (Used in) or Available From Financing Activities	(301)	(713)	1,202
4 Net Cash generated or (Used) during the period	10	(27)	39
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	-25.0%	47.9%	0.5%
b Gross Profit Margin	6.6%	7.4%	7.7%
c Net Profit Margin	-4.2%	1.5%	1.9%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	10.4%	13.0%	-14.0%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	-30.9%	11.0%	11.9%
2 Working Capital Management			
a Gross Working Capital (Average Days)	155	110	138
b Net Working Capital (Average Days)	149	108	136
c Current Ratio (Current Assets / Current Liabilities)	4.1	5.7	5.7
3 Coverages			
a EBITDA / Finance Cost	0.9	2.0	2.2
b FCFO / Finance Cost+CMLTB+Excess STB	0.8	1.0	0.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	82.2	5.9	9.0
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	82.8%	79.0%	81.4%
b Interest or Markup Payable (Days)	134.8	78.0	149.3
c Entity Average Borrowing Rate	10.7%	9.5%	5.8%

Credit Rating

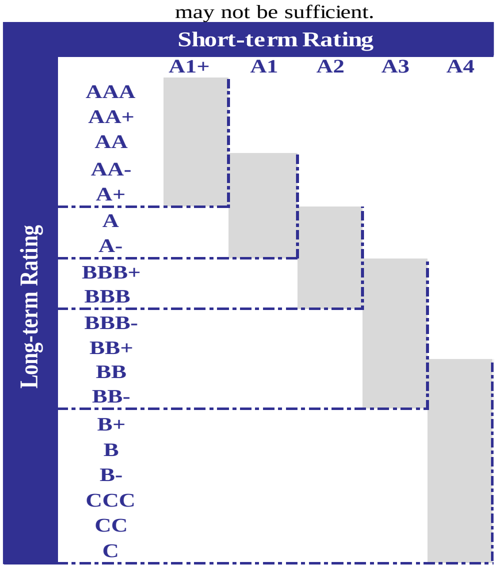
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

Entities
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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.
(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)
Proprietary Information