The Pakistan Credit Rating Agency Limited

Rating Report

Ahmed Fine Textile Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Aug-2019	A-	A2	Stable	Maintain	-
28-Feb-2019	A-	A2	Stable	Maintain	-
29-Aug-2018	A-	A2	Stable	Upgrade	-
28-Feb-2018	BBB+	A2	Stable	Maintain	-
26-Jan-2017	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Ahmed Fine Textile Mills (Ahmed Fine) association with renowned business groups of Pakistan – jointly owned by Fazal Group and Hussain Group. The Company is primarily engaged in the spinning business and also has presence in weaving segment through a wholly owned subsidiary – Fazal Rehman Fabrics Limited. The ratings incorporate improved business performance of the Company on the back of prudent inventory procurement, resulting in notably higher margins in first two quarters, eventually resulting in better margins for FY19. Meanwhile, significant rupee devaluation and subsidized utilities for textile industry has made the local textile industry cost competitive. Ahmed Fine's financial profile is considered strong reflected by (i) efficient working capital cycle, (ii) strong coverages, and (iii) moderately leveraged capital structure. Additionally, the Company is in possess of enhancing its capacity, which will increase its leveraging. However, the loan will be availed on SBP's concessional rate. Going forward, high interest rate environment, coupled with withdrawal of zero rating status and restriction on sales to unorganized sector will have a restraining impact on local textile industry.

The ratings are dependent on sustaining business margins while maintaining a sound financial profile with strong coverages and manageable leveraging. The Company’s ability to generate ensuing cash flows to fulfill its financial obligations will remain critical for the ratings.

Disclosure

Name of Rated Entity	Ahmed Fine Textile Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Textile(Oct-18)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure Ahmed Fine Textile Mills Limited (Ahmed Fine), a public unlisted company, was incorporated in 1989.

Background The Company is engaged in the manufacturing and marketing of different varieties of yarn. Historically, the Company was involved in manufacturing of fabric. However, in July 2014 the weaving segment of the Company was demerged into a separate entity, Ahmed Fine Textile Mills Limited retained the name and spinning segment.

Operations Ahmed Fine operates with a single spinning unit having a capacity of 45,888 spindles - manufacturing coarser count yarn. The Company caters its power needs via in-house production (6MW), as well as MEPCO's connection.

Ownership

Ownership Structure The Company is jointly owned by Fazal Group and Hussain Group (~50% each). Both groups belong to the same family descending from late Mr. Fazal-ur-Rehman.

Stability The clear shareholding pattern of the Company along with mutual consent of both Groups over its controls, portrays structured line of succession. However, transfer of ownership to the next generation is yet to be seen.

Business Acumen The sponsoring Groups have over five decades of presence in Pakistan's textile industry, developing expertise to sustain through the industry's volatility. Mr. Rehman Naseem – a textile veteran, primarily manages the Company's operations with sufficient acumen in order to sustain and flourish in competitive textile industry.

Financial Strength Fazal and Hussain Groups maintain dominant position in Multan's textile industry. Fazal Group, in particular, is one of the most resourceful group with strong financial health. Strategic investment in fertilizers and textile provide ample room for financial support to Ahmed Fine, if needed.

Governance

Board Structure The Company's seven member Board consists of four Fazal Group's representatives, including the Chairman and the CEO. The remaining three members are representatives of Hussain Group.

Members' Profile The board comprises experienced professionals and have reasonably long association with the Company. Mr. Sheikh Naseem is the Chairman of board. He carries with him over five decades of experience in textile industry.

Board Effectiveness The Board has Audit Committee in place to assist the board on relevant matters. Additionally, attendance of board members in meetings remained strong and meeting minutes are appropriately documented.

Financial Transparency M/s Deloitte Yousuf Adil & Co., Chartered Accountants are the external auditor of the Company. The auditors have expressed unqualified opinion on the financial reports for FY18. The audit report for the period FY19 is still under process.

Management

Organizational Structure The management control of the Company vests with Fazal Group, with Mr. Rehman Naseem as CEO of the Company. The organizational structure of the Company is divided into five functional departments.

Management Team Mr Rehman Naseem – the – CEO is a Columbia University graduate and carries over two decades of experience in the textile sector. Moreover, Ahmed Fine employs long associated professionals, which bodes well for the Company's sustainable growth. Mr. Naveed Amer is serving in the capacity of CFO, carrying almost three decades of experience.

Effectiveness The management meetings are held on a periodic basis with formal recording of meeting minutes, followed by need based meetings to resolve bottlenecks and to ensure smooth operations.

MIS Ahmed Fine has deployed Oracle based Enterprise Resource Planning (ERP) system that provides comprehensive MIS reporting.

Control Environment Ahmed Fine is accredited with various International certifications for compliance. The Company is following latest Quality Assurance Standards for yarn and fabric production. Few of the prominent certification includes ISO 9001, Lycra assured and Fair Trade.

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 in exports. While the current deficit has shown improvement, overall exports showed lackluster performance with the textile sector displaying negative YoY growth of ~1% in dollar terms. Even though leading textile categories including ready-made garments, 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 the extremely competitive international market, curbed overall growth. Meanwhile, cotton yarn exports fell by ~18% YoY. This decline was driven by falling yarn prices due to decreasing trend in international cotton prices during the year, as well as volumetric decline owing to the US-China trade war. The withdrawal of zero rating status may cause liquidity crunch for the companies with majority exports. This, along with restriction on sales to unregistered person has resulted in a slowdown in textile's operations, in local market.

Relative Position Ahmed Fine is associated with Fazal Group. The Group has a leading position in Pakistan's spinning sector, consequently, strengthening Ahmed Fine's market position. However, on standalone basis Ahmed Fine's share in spinning industry is minimal

Revenues The Company's revenues clocked in at PKR 4,882mln, posting a growth of 22.4%. This is mainly attributable to rupee devaluation, which has pushed PC yarn (polyester cotton yarn) prices in local market. In FY18, GoP had incentivized local textile industry with 4% rebate on yarn exports, so the Company pushed for higher exports. However in FY19, unavailability of export rebate and more attractive prices in local market led to declined exports ~19% (FY18: 27%) of the Company. Going forward, local sales may come under pressure with imposition of sales tax on yarn sales.

Margins The gross margin has posted a notable growth (FY19: 13.8%, FY18: 11.9%) on account of inventory gains in first half of the financial year. This was followed by higher then proportionate increase in operating margins (FY19: 11.6%, FY18: 8.9%) due to lower distribution cost, a factor of declined exports. The Company's finance cost increased by 40% on YoY basis. Despite this, the Company's bottom line reported at PKR 321mln in FY19, posting 85% YoY growth.

Sustainability The Company has a wholly owned subsidiary, Fazal Rehman Fabrics Limited. Despite generating profits, Fazal Rehman has yet not paid dividend. In future, dividend from Fazal Rehman will supplement the cash generation of the Company. Meanwhile, the Company is planning expansion of 50,000 spindles. In first phase, 32,000 spindles will be installed at an estimated cost of PKR 4bln and will be operational by the end-FY20. This will ensure wider product range and cost efficiency, eventually adding to Company's margins.

Financial Risk

Working Capital Working capital requirements, a function of inventory and receivables, are historically met through a mix of internal cash generation and short-term borrowing. In the last two years, the Company has minimal reliance on STB and most of the working capital needs are met through internal cash flows. In border terms, overall quantum of working capital needs of the Company has largely remained the same. However, growth in revenues has yielded lower inventory days (FY19: 49days, FY18: 57days). This, coupled with considerable decline in trade debtor days led to improved gross working capital days (FY19: 98days, FY18: 122days). Meanwhile, the Company has significant room to borrow at trade assets level.

Coverages During FY19, the Company's operating cash flows (FCFO) posted a YoY growth of 62% and stood at PKR 699mln on the back of higher profitability. The increase in finance cost of the Company was in lower proportion to FCFO which has translated into better coverages (FY19: 4.7x, FY18: 4.3x). Likewise, the debt coverage of the Company has shown improvement (FY19: 1.6x, FY18: 1.4X).

Capitalization Ahmed Fine has intermediately leveraged capital structure ~42.4% in FY19 (FY17: 45.7%). The total debt stood at PKR 1.39bln, wholly constituting log-term borrowing. Going forward, the leveraging of the Company is expected to increase on account of expansion.

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Ahmed Fine Textile Mills Limited Spinning	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET			
1 Non-Current Assets	1,729	1,510	1,604
2 Investments	-	-	-
3 Related Party Exposure	355	355	355
4 Current Assets	2,084	1,861	1,625
a Inventories	*628*	*674*	*563*
b Trade Receivables	*655*	*662*	*767*
5 Total Assets	4,168	3,726	3,584
6 Current Liabilities	599	539	483
a Trade Payables	*32*	*26*	*29*
7 Borrowings	1,453	1,392	1,508
8 Related Party Exposure	-	-	-
9 Non-Current Liabilities	140	141	112
10 Net Assets	1,976	1,655	1,482
11 Shareholders' Equity	1,976	1,655	1,483
B INCOME STATEMENT			
1 Sales	4,882	3,987	3,209
a Cost of Good Sold	*(4,210)*	*(3,514)*	*(2,894)*
2 Gross Profit	671	473	315
a Operating Expenses	(107)	(118)	(98)
3 Operating Profit	564	354	217
a Non Operating Income	*(31)*	*(40)*	*(15)*
4 Profit or (Loss) before Interest and Tax	533	315	202
a Total Finance Cost	*(153)*	*(109)*	*(71)*
b Taxation	*(59)*	*(32)*	*(32)*
6 Net Income Or (Loss)	321	174	99
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*669*	*430*	*316*
b Net Cash from Operating Activities before Working Capital Changes	*523*	*315*	*246*
c Changes in Working Capital	*(32)*	*(15)*	*(656)*
1 Net Cash provided by Operating Activities	491	301	(410)
2 Net Cash (Used in) or Available From Investing Activities	(368)	(71)	(309)
3 Net Cash (Used in) or Available From Financing Activities	61	(116)	724
4 Net Cash generated or (Used) during the period	185	114	6
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	22.4%	24.3%	5.6%
b Gross Profit Margin	13.8%	11.9%	9.8%
c Net Profit Margin	6.6%	4.4%	3.1%
d Cash Conversion Efficiency (EBITDA/Sales)	14.3%	12.4%	11.3%
e Return on Equity (ROE)	17.7%	11.1%	6.9%
2 Working Capital Management			
a Gross Working Capital (Average Days)	98	122	114
b Net Working Capital (Average Days)	96	119	111
c Current Ratio (Total Current Assets/Total Current Liabilities)	3.5	3.4	3.4
3 Coverages			
a FCFO / Finance Cost	4.7	4.3	5.0
b FCFO / Finance Cost+CMLTB+Excess STB	1.6	1.4	1.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.8	4.2	4.3
4 Capital Structure (Total Debt/Total Debt+Equity)			
a Total Borrowings / Total Borrowings+Equity	42.4%	45.7%	50.4%
b Short-Term Borrowings / Total Borrowings	0.0	0.0	0.3
c Average Borrowing Rate	10.1%	6.8%	5.6%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

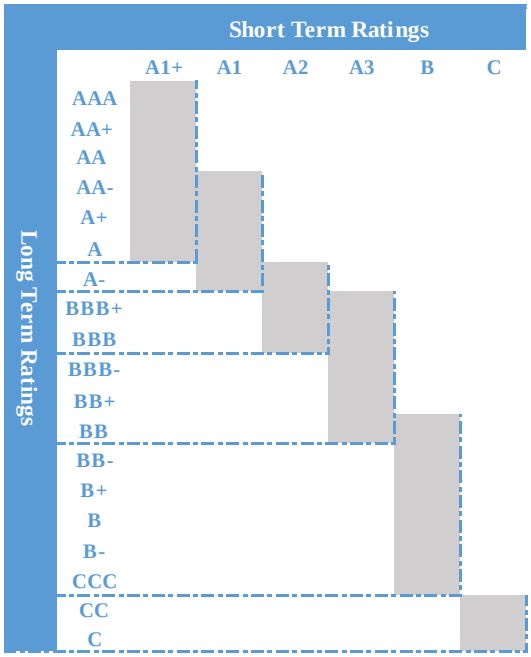
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

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 Ratings

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 conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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 surveill the opinion due to lack of requisite information.

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

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