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
28-Aug-2020	A-	A2	Stable	Maintain	-
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. 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 the Company's adequate business operations plus its strong financial profile reflected by reasonable working capital cycle; healthy coverages; and moderately leveraged capital structure. Additionally, Ahmed Fine is planning on enhancing its capacity by 50,000 spindles, thereby improving its business profile to boost revenues. The operations of the Company suffered on account of the COVID-19 outbreak as the entire textile chain came to a halt due to lockdowns in Pakistan and internationally. Production resumed since the Government allowed export-oriented sector to recommence operations, which included Ahmed Fine. The last quarter (April-June) of FY20 remained a challenge as demand was low and yarn prices had plummeted due to the pandemic. Evidently, as per the unaudited management accounts for FY20, Ahmed Fine experienced a decline in sales of ~5% and reduced gross margin (FY20: 12.7%; FY19:13.3%). However, the demand is recovering of late, as economies around the world reopen. Meanwhile prices have also improved on both local and international fronts recently. Nevertheless, in order to relieve pressure on cashflows caused by the pandemic and economic slowdown, the Company availed SBP's moratorium relief and deferred principal repayments for one year. Reduction of 625bps in interest rates by SBP shall also provide respite in this regard.

The ratings are dependent on maintaining business operations under the current economic conditions; and a strong financial profile with healthy coverages and moderate 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	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-19)
Rating Analysts	Adil Kaleem | adil.kaleem@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 46,128spindles - manufacturing coarser count yarn. The Company caters its power needs via in-house production (6MW), as well as MEPCO's connection.

Ownership

Ownership Structure Structure The Company is jointly owned by families of Mian Naseem and Mian Farooq. Both 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 documented.

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 Group maintains 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 CEO

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 documented.

Financial Transparency M/s Deloitte Yousuf Adil & Co., Chartered Accountants are the external auditor of the Company.

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 Textile exports of the country dropped by ~8% for 11MFY20 to stand at ~USD 11.6bln as compared to ~USD 12.6bln in 11MFY19 due to slowdown in demand for textile products internationally, instigated by Covid-19 led lock downs in major export destinations. Going forward, prevailing uncertainty in the dynamics of textile sector due to Covid-19 outbreak globally, lifting of lock downs in most countries, contraction in local and international demand is expected to affect the entire textile value chain. Locally, textile sector will find 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 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 During FY20, revenues decreased by 5.4% (FY20: PKR 4,590mln; FY19: PKR 4,851mln) due to the pandemic; since majority of the business activities remained shut for the most part as per government's directive, which slowed down sales in the fourth quarter. Moreover, the sales mix was dominated by local sales, however its contribution reduced when compared with the same period last year (FY20: ~70%; FY19: ~85%). Additionally, the operations of the Company were shut for the first week of the lockdown. However, to support country's exports, the government allowed export oriented business to resume operations, which included Ahmed Fine.

Margins Ahmed Fine recorded a decline in gross margin (FY20: 12.7%; FY19: 13.3%) as the prices reduced in the last quarter due to shortage of demand, coupled with excess supply resulting from lockdowns. This translated in to an insignificant drop in the operating margins (FY20: 11.0%; FY19: 11.1%). Subsequently, the pandemic along with the higher finance cost (FY20: PKR 210mln; FY19: PKR 155mln) contracted net income, and ultimately shrunk net margin (FY20: 4.3%; FY19: 7.2%).

Sustainability Ahmed Fine had planned an expansion of its production facilities, which came to a halt due to the coronavirus pandemic. However, going forward, the Company is looking to resume the process of expanding its facilities by 50,000 spindles which will be done in two phases. In first phase, 32,000 spindles will be installed at an estimated cost of PKR 4bln. Moreover, the Company also deferred principle repayments for one year under SBP's moratorium relief package and also availed SBP-backed loan to cover 3 months worth of employees' salaries and wages at a nominal rate.

Financial Risk

Working Capital During FY20, net working capital cycle increased (FY20: 124 days; FY19: 97 days) on the back of both; widened inventory cycle and magnified receivables cycle. This occurred as the lockdown amidst coronavirus pandemic led to reduced business activities across the world including Pakistan, specifically in the textile sector. Furthermore, Ahmed Fine registered an increase in net trade assets (FY20: PKR 1,966mln; FY19: PKR 1,399mln) due to higher inventory level (FY20: PKR 931mln; FY19: PKR 630mln) and receivables (FY20: PKR 1,030mln; FY19: PKR 693mln). This expanded the room-to-borrow which was equivalent to net trade assets as Ahmed Fine's working capital needs are fulfilled through internal cash flows with no short term borrowing at year end. This resulted in healthy ST trade leverage (FY20: 95%; FY19: 96%)

Coverages The Company experienced a sharp decline in operational cash flows (FY20: PKR 553mln; FY19: PKR 731mln); courtesy of diminished profitability. The aforementioned reduction in cash flows and a higher finance cost (FY20: PKR 210mln; FY19: PKR 155mln) culminated in the deterioration of interest coverage (FY20: 3.3x; FY19: 5.1x), however, it remained healthy. On the contrary, debt coverage improved (FY20: 2.1x; FY19: 1.7x) on account of lower maturing debt (FY20: PKR 89mln; FY19: PKR 281mln).

Capitalization In FY20, Ahmed Fine's leverage decreased favorably (FY20: 39%; FY19: 42%) as equity base improved (FY20: PKR 2,198mln; FY19: PKR 2,000mln) on account of profit retention. The Company historically pays off any short-term debt within the financial year through internal cash flows, hence, total borrowing only constitutes of long term debt (FY20: PKR 1,409mln; FY19: PKR 1,453mln). Out of the total debt, ~40% was borrowed at SBP's concessionary rates in FY20.

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Ahmed Fine Textile Mills Limited	Jun-20	Jun-19	Jun-18
Textile	12M	12M	12M
A BALANCE SHEET			
1 Non-Current Assets	1,806	1,796	1,510
2 Investments	-	-	-
3 Related Party Exposure	355	355	355
4 Current Assets	2,324	2,052	1,860
a Inventories	*931*	*630*	*674*
b Trade Receivables	*1,030*	*693*	*662*
5 Total Assets	4,485	4,203	3,726
6 Current Liabilities	714	587	539
a Trade Payables	*104*	*57*	*26*
7 Borrowings	1,409	1,453	1,392
8 Related Party Exposure	-	-	-
9 Non-Current Liabilities	163	163	141
10 Net Assets	2,198	2,000	1,655
11 Shareholders' Equity	2,198	2,000	1,655
B INCOME STATEMENT			
1 Sales	4,590	4,851	3,952
a Cost of Good Sold	*(4,005)*	*(4,204)*	*(3,514)*
2 Gross Profit	584	647	438
a Operating Expenses	(81)	(108)	(118)
3 Operating Profit	503	539	319
a Non Operating Income	*(33)*	*36*	*(4)*
4 Profit or (Loss) before Interest and Tax	470	575	315
a Total Finance Cost	*(210)*	*(155)*	*(109)*
b Taxation	*(62)*	*(69)*	*(32)*
6 Net Income Or (Loss)	198	351	174
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*553*	*731*	*430*
b Net Cash from Operating Activities before Working Capital Changes	*362*	*584*	*315*
c Changes in Working Capital	*(442)*	*(28)*	*(15)*
1 Net Cash provided by Operating Activities	(80)	556	301
2 Net Cash (Used in) or Available From Investing Activities	(165)	(433)	(71)
3 Net Cash (Used in) or Available From Financing Activities	(44)	61	(116)
4 Net Cash generated or (Used) during the period	(288)	185	114
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	-5.4%	22.7%	23.2%
b Gross Profit Margin	12.7%	13.3%	11.1%
c Net Profit Margin	4.3%	7.2%	4.4%
d Cash Conversion Efficiency (EBITDA/Sales)	13.9%	15.1%	12.5%
e Return on Equity (ROE)	9.4%	19.2%	11.1%
2 Working Capital Management			
a Gross Working Capital (Average Days)	131	100	120
b Net Working Capital (Average Days)	124	97	117
c Current Ratio (Total Current Assets/Total Current Liabilities)	3.3	3.5	3.5
3 Coverages			
a EBITDA / Finance Cost	3.8	5.1	5.0
b FCFO / Finance Cost+CMLTB+Excess STB	2.1	1.7	1.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.7	2.5	4.2
4 Capital Structure (Total Debt/Total Debt+Equity)			
a Total Borrowings / Total Borrowings+Equity	39.1%	42.1%	45.7%
b Short-Term Borrowings / Total Borrowings	0.0	0.0	0.0
c Average Borrowing Rate	11.9%	10.1%	6.8%

Credit Rating

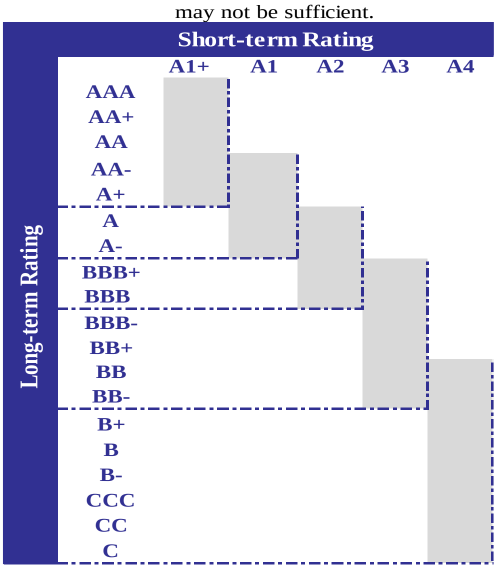
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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