The Pakistan Credit Rating Agency Limited

Rating Report

Fazal Rehman Fabrics Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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 Fazal Rehman Fabrics Limited’s (Fazal Rehman Ltd.) improved business profile which is characterized by sizable revenue base and adequate profitability. The top line grew by ~37% in 1HFY19, facet of recently completed expansion. The lower demand prospects from international market has impacted the Company's exports, in turn, piled up inventory and lower margins. However, this is expected to normalize in near future. The subsidized utilities and relaxation in custom duties for textile sector has made the local textile industry cost competitive. The Company's financial profile strengthened from efficient working capital management and healthy liquidity position. Improved profitability, eventually translating into better cash flows, led to stronger debt coverages. The leveraging remains relatively high but is expected to improve with no plans of further accumulation of debt in near future and repayment of existing debt. The Company has a sizable investment portfolio. Despite the conservative investment approach, the Company is exposed to the stock market volatility. The assigned ratings derive comfort from the Company's association with Fazal Group.

The ratings are dependent on the management’s ability to uphold the entity’s strong business performance. Meanwhile, prudent management of cash flows to fulfill its financial obligations and maintain strong coverages remain critical for the ratings.

Disclosure

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

Profile

Legal Structure Fazal Rehman Fabrics Limited (Fazal Rehman Ltd.), a public unlisted company, was incorporated in 2004 and started commercial operations in 2007.
Background Fazal Rehman Ltd. is associated with Fazal Group since its inception. The Company's Mills are located in the vicinity of Multan, Punjab.
Operations The Company operates with one weaving unit having 358 air-jet looms. The Company caters its power needs via in house production (6MW), as well as MEPCO's connection.

Ownership

Ownership Structure Fazal Rehman Ltd. is a wholly owned subsidiary of Ahmed Fine Textile, which is jointly owned by Fazal Group and Hussain Group (~50% each). Both groups belong to the same family descending from Mr. Fazal-ur-Rehman.
Stability The representation of Fazal and Hussain Group's textile ventures in Pakistan's textile industry remains critical. Going forward, transfer of ownership to the next generation is not documented yet.
Business Acumen Fazal Group has interest in textile, Fertilizer and Power, whereas Hussain Group's interest only lies in textile. Moreover, sponsors expertise in textile will remain important in case of any textile industry driven crisis.
Financial Strength Fazal and Hussain Groups maintain dominant position in Multan's textile industry. Furthermore, Fazal Group's interest in fertilizers and textile provide ample room of financial support to Fazal Rehman Ltd., if needed.

Governance

Board Structure The Company's board of directors is dominated by Fazal Groups representatives; four members including the Chairman, while remaining three directors are representative of Hussain Group including CEO.
Members' Profile Board members have diversified experience and have reasonably long association with the Company, while Mr. Sheikh Naseem is the Chairman of board.
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 Shinewing Hameed Chaudhri & Co., Chartered Accountants serves as external auditor for Fazal Rehman Ltd.. They have expressed unqualified opinion for the year ended 30th June, 2018.

Management

Organizational Structure Mr. Hussain Fazal is the Company's CEO, while Management control vests with Fazal Group with Mr. Rehman Naseem (representative of Fazal Group) primarily managing the Company's operations.
Management Team Management team comprises individuals that have extensive expertise in textile value chain. Mr. Naveed Amir is serving in capacity of CFO, he has been associated with Fazal Group since 1993.
Effectiveness The management meetings are held on periodic basis, with formal recording of meeting minutes, followed by need based meetings to resolve bottlenecks and ensure smooth flow of operations. Additionally, detailed reporting on cash position and inventory is done on regular basis and presented to senior management for performance review; eventually ensuring efficiency.
MIS Fazal Rehman Ltd. deploys Oracle based Enterprise Resource Planning (ERP) system with comprehensive MIS reporting.
Control Environment The Company's plant is connected with head office through VPN, thereby reporting on real time basis. Furthermore, Fazal Rehman Ltd. is compliant with multiple safety and quality assurance standards; majorly including ISO 9001, Lycra assured, Fair Trade and Organic exchange.

Business Risk

Industry Dynamics During 1HFY19, textile exports clocked in at PKR ~858bln (1HFY18: PKR 703bln), portraying an increase of ~22% on the back of volumetric increase in segments of knitwear (20%), ready-made garments (24%) and bed-wear (12%). New government and its exports promoting policies in order to reduce trade deficit have brought a positive affect on the textile exports of Pakistan.
Relative Position Fazal Rehman Ltd. is associated with Fazal Group. The Group is one of the largest yarn exporters of Pakistan; though it has limited share in fabric sale on both local and export front. However, on standalone basis Fazal Rehman Ltd. share in local weaving industry is minimal.
Revenues In FY18, the Company's top-line reported at PKR 7,821mln (FY17: PKR 5,453mln), posting a growth of ~43%, owing to recent expansion coupled with favorable market. The Company's exports picked up during the year (FY18: 54%, FY17: 40%), a factor of rupee devaluation making exports more feasible. With regard to exports European region remained the key market. The top ten customers' revenue concentration in local market is considered high (FY18: ~51%). Meanwhile, top ten customers' concentration on export front is low (~FY18: 20%). Whereas during 1HFY19, revenues increased by ~37% on half year basis. This is attributable to complete translation of CAPEX in the period under review, which was partially achieved in previous year.
Margins During FY18, Fazal Rehmnan's gross margins improved (FY18: 12.3%, FY17: 8.3%), on the back of higher export sales coupled with rupee devaluation. Despite the higher in operating expense, the Company's operating margins increased (FY18: 8.6%, FY17: 5.2%), largely led by better gross profit. The finance cost increased by ~53%, on account of higher STB, as recent expansion has resulted in higher working capital needs. Additionally, the Company received a dividend income amounting to ~PKR 39mln (FY18) supplementing its bottom-line. While on account of taxation the Company's net profit more than doubled (FY18: ~PKR 381mln, FY17: ~PKR 152mln). In 1HFY19, the Company's margins declined (gross – 9.9, net – 7.1), on account of declined exports. The Company received a dividend income of ~PKR 26mln. despite decreased margins the Company's bottom-line have considerably increased and reported at PKR 198mln, on account of increased revenues, a factor of recent expansion.
Sustainability The dividend inflow from investment in equity (constituting PKR 722mln) along with capital gains is considered important. Moreover, Fazal Rehman Ltd. has recently completed expansion project; comprising installation of 120 modern-technology looms. Going forward, the focus will be on exploring potential export markets, to capitalize on increased production capacity.

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 borrowings. In FY18, the Company's reliance on STB has increased, owing to increased inventory requirement. Resultantly, the Company's room to borrow has squeezed (FY18: 23%, FY17: 36%); though remained comfortable. Additionally, higher raw material and finished goods stocks has resulted in increased inventory days (FY18: 48days, FY17: 45days). This was followed by higher debtor days (FY18: 38days, FY17 25days), eventually translating into increased net working capital days (FY18: 74days, FY17 54days). The working capital cycle continued the same trend in 1HFY19, reflected from increased working capital days (gross – 1HFY19: 90days, net – 1HFY19: 74days). Which is attributable to higher inventory levels and receivables.
Coverages The Company's operating cash flows (FCFO) almost doubled in FY18, on account of higher profitability. The finance cost increased in a lower proportion of FCFO, resultantly interest and debt coverages strengthened (FY18: 4.0x, FY17: 3.5x) and (FY18: 2.7x, FY17: 1.3) respectively. In 1HFY19, the Company's coverages slightly deteriorated due to higher than proportionate increase in finance cost (interest – 1HFY19: 3.1x, debt – 1HFY19: 2.2x); though remained strong. Going forward, despite the increase in interest rate, the Company's coverages are expected to remain stable as considerable portion of the Company's LTB constitutes LTFF.
Capitalization Fazal Rehman has a highly leveraged capital structure (~67.7%) at end-June 18 (end-June 17: 63.8%). Total debt stood at PKR 4,054mln, mainly comprising non-current debt ~ 55%. During 1HFY19, the Company's leveraging decreased (~62.8%), largely led by declined STB.

PKR mln

Fazal Rehman Fabric Limited

Unlisted Public Limited

BALANCE SHEET	Dec-18	Jun-18	Jun-17	Jun-16
	6M	12M	12M	12M
a Non-Current Assets	**3,153**	**3,265**	**2,515**	**1,772**
b Investments (Incl. Associates)	**772**	**617**	**645**	**-**
Equity	772	617	645	-
Fixed Income	-	-	-	-
c Current Assets	**3,393**	**3,034**	**1,984**	**1,468**
Inventory	1,794	1,370	685	660
Trade Receivables	980	1,136	494	258
Others	619	528	805	550
d Total Assets	**7,317**	**6,916**	**5,145**	**3,240**
e Debt/Borrowings	**3,589**	**4,054**	**2,714**	**1,178**
Short-Term	1,496	1,824	628	140
Long-Term (Incl. Current Maturity of Long-Term Debt)	2,093	2,231	2,086	1,038
Other Short-Term Liabilities	1,398	732	726	545
Other Long-Term Liabilities	203	199	167	140
f Shareholder's Equity	**2,128**	**1,930**	**1,538**	**1,378**
g Total Liabilities & Equity	**7,317**	**6,916**	**5,145**	**3,240**

INCOME STATEMENT	Dec-18	Jun-18	Jun-17	Jun-16
a Turnover	**5,349**	**7,821**	**5,459**	**5,604**
b Gross Profit	531	965	454	472
c Net Other Income	7	(54)	36	(11)
d Financial Charges	(126)	(199)	(130)	(126)
e Net Income	**198**	**381**	**152**	**83**

CASH FLOW STATEMENT	Dec-18	Jun-18	Jun-17	Jun-16
a Free Cash Flow from Operations (FCFO)	501	802	459	430
b Total Cashflows (TCF)	501	802	459	430
c Net Cash changes in Working Capital	56	(1,144)	(52)	383
d Net Cash from Operating Activities	554	(546)	310	691
e Net Cash from InvestingActivities	(191)	(972)	(612)	(88)
f Net Cash from Financing Activities	(358)	1,525	284	(581)
g Net Cash generated during the period	5	6	(17)	22

RATIO ANALYSIS	Dec-18	Jun-18	Jun-17	Jun-16
a Performance				
Turnover Growth (vs SPLY)	37%	43%	-3%	-5%
Gross Margin	10%	12%	8%	8%
Net Margin	4%	5%	3%	1%
ROE	19%	22%	10%	6%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+U	2.2	2.7	1.3	1.3
Interest Coverage (X) (FCFO/Gross Interest)	3.1	4.0	3.5	3.4
Debt Payback (Years) (Total Debt (excluding Covered Short T	6.9	6.7	8.2	3.9
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable D	74	74	54	65
d **Capital Structure** (Total Debt/Total Debt+Equity)	63%	68%	64%	46%

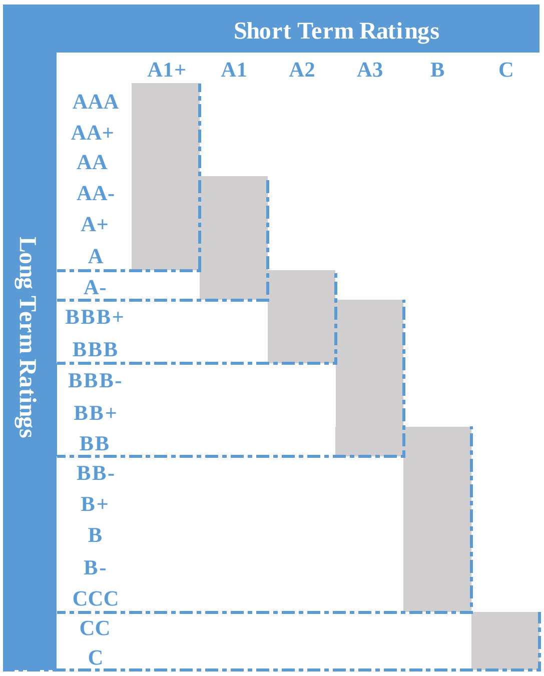
Rating Scale

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.

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