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-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 Fazal Rehman Fabrics Limited’s (Fazal Rehman Fabrics) favorable business profile characterized by sizable revenue base and healthy margins. Despite the lockdowns around the world, including Pakistan, the Company's topline grew by ~5%. Fazal Rehman Fabrics possess a strong financial profile, emanating from robust working capital cycle and exceptional coverages. Whereas, reduction in relatively-high leverage during FY20, also bodes well. The leverage is expected to increase on account of the capacity expansion planned in the next financial year. Moreover, the operations of the Company came to a halt during the last quarter (April-June) of FY20, on account of the COVID-19 outbreak. The entire textile chain suffered due to lockdowns in Pakistan and internationally. Production resumed after a week-long closure; since the Government allowed export-oriented sector to recommence operations, which included Fazal Rehman Fabrics. Nevertheless, Lower demand due to the pandemic, made the last quarter challenging for the Company. However, the demand is recovering of late, as economies around the world reopen. 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 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 and maintaining strong coverage to fulfill financial obligations arising from increased leveraging will be critical, going forward.

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-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Weaving(Sep-19)
Rating Analysts	Adil Kaleem | adil.kaleem@pacra.com | +92-42-35869504

Profile

Legal Structure Fazal Rehman Fabrics Limited (Fazal Rehman), a public unlisted company, was incorporated in 2004 and started commercial operations in 2007.

Background Fazal Rehman is associated with Fazal Group and is a wholly owned subsidiary of Ahmed Fine Textile Mills Limited. The Company's production facility 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 families of Mian Naseem and Mian Farooq. Both of whom branch out from the same family; descending from Mr. Fazal-ur-Rehman.

Stability The considerable positions in the Company are held by Sheikh Naseem's family, where third generation is gradually being inducted into the business. Distribution of responsibilities are clearly defined among family members, portraying structured line of succession. However, the transfer of ownership to the next generation is not documented yet.

Business Acumen The Sponsoring groups have a long presence in local textile industry. Over the period of time, they have developed strong credentials and expertise in textile value chain. This has helped the Company in expanding its operation's despite challenging market.

Financial Strength Fazal Group maintains 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 seven members Board consists of four Fazal Group's representatives, including the Chairman.

Members' Profile Board members have diversified experience and have 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 is the external auditor of the Company.

Management

Organizational Structure Ms. Atiqa 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 the 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 to 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 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 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 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, as non-mill sector continues to dominate the fabric market with almost 90% market share. However, on standalone basis Fazal Rehman Ltd.'s share in local weaving industry is minimal.

Revenues During FY20, revenue of the Company grew by ~5%, standing at PKR 11,335mln (FY19: PKR 10,781mln). Despite the fact that lockdowns on account of the coronavirus pandemic hampered the topline, Fazal Rehman was able to register a growth. This was majorly the result of more than doubled up exports (FY20: PKR 7,988mln; FY19: PKR 3,535mln). The management seek optimum prices, which dictates the nature of the sales mix. Hence, the Company focused more on exports as the orders and prices were more attractive. Export orders also proved beneficial during the pandemic as where most businesses were forced to shutdown operations, Fazal Rehman was able to resume production after just one week of closure. This option was only extended to export oriented businesses.

Margins The Company's gross margin registered an increase (FY20: 13.5%; FY19: 11.3%) due to better pricing. However, the lockdowns did lead to shortage of demand that mounted pressure on the prices as the supply was then in excess in the last quarter. Nevertheless, this increase further translated in to improved operating margin (FY20: 9.7%; FY19: 8.1%). On the other hand, due to increased finance cost (FY20: PKR 330mln; FY19: PKR 266mln), the net income reduced (FY20: PKR 650mln; FY19: PKR 699mln) that ultimately caused the net margin to decrease (FY20: PKR 5.7%; FY19: 6.5%). The Company also received a dividend income of PKR 85mln in FY20 against its short term investments which currently stand at ~PKR 1.3bln as in August, 2020.

Sustainability Going forward, the Company is in the process of adding 110 new looms to its production capacity, The construction work has been completed, whereas, banks have been engaged for importing machinery. The new looms are expected to be operational by Feb-March, 2021, tentatively. Furthermore, the Company remained shut for just one week from 25th March, 2020 onwards, due to the lockdown and later was allowed to resume operations by the government on the basis of export orders in hand. Moreover, Fazal Rehman 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 Fazal Rehman fulfills its working capital needs through a mixture of short term borrowing and internal cash flows. During FY20, net working capital cycle shortened slightly (FY20: 75 days; FY19: 78 days) on the back of higher proportionate increase in payables' cycle. The Company also recorded an increase in net trade assets (FY20: PKR 3,099mln; FY19: PKR 2,658mln) majorly due to higher inventory levels (FY20: PKR 4,157mln; FY19: PKR 3,261mln). This expanded the room-to-borrow (FY20: PKR 1,835mln; FY19: PKR 1,091mln), consequently improving the ST trade leverage adequacy (FY20: ~44%; FY19: ~36%).

Coverages In FY20, the Company experienced a slight increase in operating cash flows (FY20: PKR 1,300mln; FY19: PKR 1,279mln) due to improved profitability at operating level. However, higher finance cost (FY20: PKR 330mln; FY19: PKR 266mln) led to reduced interest coverage (FY20: PKR 4.6x; FY19: 5.3x). On the contrary, debt coverage improved (FY20: 3.3x; FY19: 2.5x) as a result of lower maturing debt (FY20: PKR 109mln; FY19: PKR 272mln).

Capitalization During the period under review, Fazal Rehman's leverage decreased (FY20: ~55%; FY19: ~59%) as the equity base increased on account of profit retention. The total borrowing, contrarily climbed (FY20: PKR 3,713mln; FY19: PKR 3,636mln), majorly due to an increase in long term borrowing (FY20: PKR 2,339mln; FY19: PKR 1,797mln). Out of the total borrowing, short term debt constitutes ~34% whereas 31% was borrowed at SBP's concessionary rates.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Fazal Rehman Fabrics Limited Textile	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET			
1 Non-Current Assets	3,000	3,141	3,265
2 Investments	1,178	932	617
3 Related Party Exposure	-	-	23
4 Current Assets	4,638	3,529	3,010
a Inventories	*2,357*	*1,959*	*1,370*
b Trade Receivables	*948*	*1,011*	*1,136*
5 Total Assets	8,816	7,603	6,916
6 Current Liabilities	1,831	1,205	839
a Trade Payables	*1,058*	*575*	*300*
7 Borrowings	3,713	3,636	3,947
8 Related Party Exposure	-	-	-
9 Non-Current Liabilities	232	226	199
10 Net Assets	3,040	2,537	1,930
11 Shareholders' Equity	3,040	2,537	1,930
B INCOME STATEMENT			
1 Sales	11,335	10,781	7,746
a Cost of Good Sold	*(9,806)*	*(9,568)*	*(6,856)*
2 Gross Profit	1,529	1,214	889
a Operating Expenses	(427)	(341)	(295)
3 Operating Profit	1,102	873	594
a Non Operating Income	*8*	*165*	*21*
4 Profit or (Loss) before Interest and Tax	1,110	1,038	615
a Total Finance Cost	*(330)*	*(266)*	*(199)*
b Taxation	*(130)*	*(73)*	*(35)*
6 Net Income Or (Loss)	650	699	381
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*1,300*	*1,279*	*802*
b Net Cash from Operating Activities before Working Capital Changes	*1,003*	*1,030*	*597*
c Changes in Working Capital	*(474)*	*(110)*	*(1,144)*
1 Net Cash provided by Operating Activities	529	920	(546)
2 Net Cash (Used in) or Available From Investing Activities	(550)	(590)	(972)
3 Net Cash (Used in) or Available From Financing Activities	77	(311)	1,525
4 Net Cash generated or (Used) during the period	55	19	6
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	5.1%	39.2%	42.3%
b Gross Profit Margin	13.5%	11.3%	11.5%
c Net Profit Margin	5.7%	6.5%	4.9%
d Cash Conversion Efficiency (EBITDA/Sales)	12.7%	12.6%	11.5%
e Return on Equity (ROE)	23.3%	31.3%	21.9%
2 Working Capital Management			
a Gross Working Capital (Average Days)	101	93	115
b Net Working Capital (Average Days)	75	78	93
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.5	2.9	3.6
3 Coverages			
a EBITDA / Finance Cost	5.0	5.6	5.2
b FCFO / Finance Cost+CMLTB+Excess STB	3.3	2.5	3.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.4	2.0	3.4
4 Capital Structure (Total Debt/Total Debt+Equity)			
a Total Borrowings / Total Borrowings+Equity	55.0%	58.9%	67.2%
b Short-Term Borrowings / Total Borrowings	0.3	0.4	0.5
c Average Borrowing Rate	7.7%	6.4%	5.3%

Credit Rating

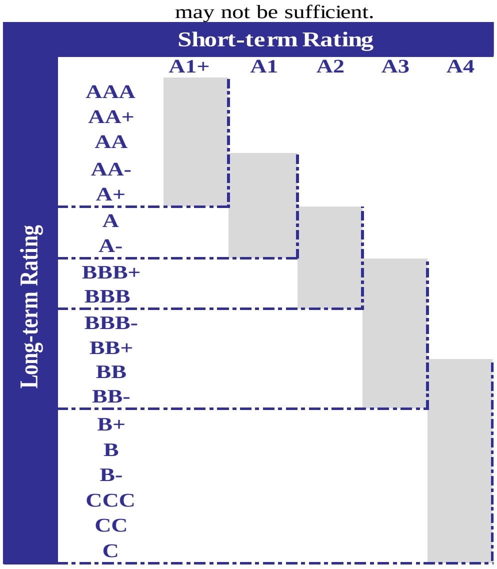
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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