The Pakistan Credit Rating Agency Limited

Rating Report

Al Rahim Textile Industries

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Jan-2019	A-	A2	Stable	Maintain	-
27-Jul-2018	A-	A2	Stable	Maintain	-
17-Jan-2018	A-	A2	Stable	Initial	-
17-Jan-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Al Rahim Textile Industries (Al Rahim) is a family owned textile entity that enjoys a strong position in towel manufacturing followed by gradual entry in processed fabric. Al Rahim's primary business remains towel oriented exports and it is now a leading towel exporter of Pakistan. Al Rahim has managed to strengthen its business profile following expansion at its state of the art production site in Nooriabad, Sindh. It also provides fabric and other processing facilities to its associated company – Al Rahim Retail - and to other local manufacturers. Towel and denim industry continues to surge forward on the back of Pakistan's cotton which is more suitable for coarse counts linked products. However, overall export volumes of the industry have stagnated. Towel industry enjoys relatively better margins that are reflected in Al Rahim's profitability. The financial profile of the Company is categorized by strong coverages and moderate leveraging. Significant increase in inventory levels following increased production requires prudent working capital management. Expansion and increased inventory levels caused build-up of financial risk. Nevertheless, it still carries adequate leveraging with good coverages. Going forward, in absence of any further debt-driven expansion and with better working capital management, financial risk profile is expected to further improve.

The ratings are dependent on sustaining business margins while maintaining strong financial risk profile at manageable level. Prudent management of working capital requirements will remain critical. Strengthening of corporate structure, governance framework and timely completion of related exercise is critical. Any significant delays in this will impact the ratings negatively.

Al Rahim group is in the process of formulating a strong corporate structure. This includes formation of holding company - to bring its business in Pakistan and abroad under one umbrella - and conversion of Al Rahim (Currently under sole propreitor structure) into a limited liability company. Al Rahim has formulated a detailed framkework for this purpose including a leading firm of accountants to review and strengthen accounting and related practices.

Disclosure

Name of Rated Entity	Al Rahim Textile Industries
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 Al Rahim Textile Industries is registered as a sole proprietorship and sole proprietor is Shehzad Rahim Saya – Son of Abdul Rahim Saya.

Background The foundations of Al Rahim Textile Industries were laid down by Mr. Abdul Rahim Saya in 1991.

Operations Al Rahim is involved in manufacturing of terry towels and fabric. Moreover it provides processing services to other weaving companies.

Ownership

Ownership Structure Al Rahim is owned by Saya Family headed by Mr. Abdul Rahim Saya. Mr. Abdul Rahim Saya's two sons, Mr. Faisal Rahim Saya and Mr. Shehzad Rahim Saya own family businesses. However, Al Rahim Textile industries' ownership lies with Mr. Shehzad Rahim Saya as sole proprietor.

Stability The sponsors are in the process of setting up a holding company in Singapore which will hold all the sponsor's businesses. Al Rahim will be brought under umbrella of the holding structure by end of FY19. This will ensure stability and succession of the entity going forward.

Business Acumen Saya family is engaged in textile business for decades. It also owns Al Rahim (Private) Limited and real estate properties at prime locations in Pakistan.

Financial Strength With estimated financial strength of over ~25bln, Saya family is considered a strong financial group which can inject cash into business when needed.

Governance

Board Structure Being a Sole Proprietor the entity does not comply with code of corporate governance. The overall governance matters are overlooked by Abdul Rahim Saya and his sons. Mr. Abdul Rahim Saya has been designated as Chairman whereas Mr. Faisal Rahim Saya is the Deputy Chairman.

Members' Profile The Saya Family have extensive experience in textile. Saya brothers are associated with textile family for more than two decades.

Board Effectiveness Sponsors are actively involved in day to day matters. However, effectiveness of governance function will improve after the planned structural changes to the entity

Financial Transparency The external auditors of the Company are Amir Hussain and Associates. They expressed an unqualified opinion on the company's annual financial statements for the year ended June 30, 2018 .Entity needs to improve its financial transparency. For this perspective it is planning to hire better auditors for financial year ending June 19.

Management

Organizational Structure There are two separate teams at site and at head office. At site management team is headed by Mr. Shehzad Saya and at head office functions are headed by Mr. Faisal Rahim Saya.

Management Team Al Rahim has employed experienced individuals who oversees management functions.

Effectiveness There are no formal committees, however management meets regularly to discuss daily operations.

MIS Management has installed Oracle EBS 12.1.3 as its main ERP software. Variety of MIS reports are generated for senior management especially having emphasis on cash

Control Environment Al Rahim has an internal audit department which ensures proper internal controls within organization.

Business Risk

Industry Dynamics Towels segment in terms of quantity exported grew by ~4%. During FY18 ~205,000 MT of towels were exported (FY17: ~197,000 MT). Whereas, the value of towels exports in FY18 clocked in at USD ~780mln (FY17: USD ~801mln), with a negative change of ~0.3%. In 1HFY19 towels segment exports further declined in terms of quantity and value both. The quantity exported in 1HFY19 was ~93,000 MT (1HFY18: ~103,000) portraying a decline of ~10%. Whereas, the value of towels exports declined by ~2%, as in 1HFY19 the exports value was USD ~378mln (FY17: ~386mln).

Relative Position Al Rahim textile is considered to be the second biggest player of towel industry in Pakistan with the market share of ~10%. Whereas, Feroz 1888 is ranked No.1 in towel industry with the market share of ~25%.

Revenues During FY18 revenues of the Company clocked in at PKR 8,651mln (FY17: PKR 6,239mln), with a positive change of ~40%. Increase in top-line is on account of increased quantity sold and rupee depreciation. In FY18 export sales contributed 82% in the total sales revenue (FY17: 78%). Major region of export for Al Rahim Textile is USA, where 38% of the total exports are concentrated.

Margins Cost of Sales of the company during FY18 clocked in at PKR 6,115mln (FY17: PKR 4,658mln), portraying an increase of 31% on the back of increased administrative salaries and wages and secondly because of increased brokerage and commission expense. The gross margin of the Company increased to 29.3% (FY17: 25.3%) on the back of currency devaluation and consequently operating margin also increased to 18.2% (FY17: 16.2%).

Sustainability Going forward, the Company have no plans for expansion. The focus will be more on BMR and value added towels, as it will enable Al Rahim to become the only printed towel manufacturer in Pakistan. Further, to improve the entity's structure Al Rahim will be converted into a private limited company by the end of FY19.

Financial Risk

Working Capital Net cash cycle of the Company increased to 181 days during FY18 (FY17: 152 days) because trade debtors days increased to 91 (FY17: 60 days). Despite increase in revenues, the inventory levels remained almost unchanged as compared to the previous year.

Coverages In FY18, Al Rahim's operating cashflows (FCFO) increased to PKR 2,452mln (FY17:1,392) on the back of increased revenues post expansion. Al Rahim procured long term loan in FY17 which caused its interest coverage to deteriorate, though remained strong (FY18: 6.6x, FY17: 8.4x, FY16: 22.7x). Debt coverage remained unchanged during FY18 at 2.6x (FY17: 2.7x, end-Jun15: 22.7x). Despite, hike in interest rates, coverages of the Company are expected to remain strong.

Capitalization The Company's capital structure is moderately levereaged at 33% (FY17: 37%). Leveraging decreased during FY18 as the company was able to repay some of its long-term debt. Whereas, out of total debt, short-term debt constitutes ~88%. In absence of any further expansion, debt leverging is expected to further reduce.

The Pakistan Credit Rating Agency Limited

Financials (Summary)

PKR mln

Al Rahim Textile Industries

BALANCE SHEET	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
	3M	FY	FY	FY
Non-Current Assets	**6,332**	**5,886**	**4,560**	**4,225**
Investments (Incl. Associates)	-	-	-	-
Equity	-	-	-	-
Investment Property	-	-	-	-
Current Assets	**7,045**	**7,103**	**5,860**	**3,225**
Inventory	3,754	3,187	3,033	793
Trade Receivables	2,187	2,159	1,030	1,309
Others	1,104	1,757	1,797	1,123
Total Assets	**13,377**	**12,989**	**10,420**	**7,449**
Debt/Borrowings	**3,465**	**3,858**	**3,232**	**288**
Short-term	3,010	2,827	1,982	288
Long-term (Incl. Current Maturity of Long-Term Debt)	455	1,031	1,250	-
Other short-term liabilities	1,825	1,289	1,650	2,956
Other long-term liabilities	-	-	-	-
Shareholders' Equity	**8,087**	**7,841**	**5,538**	**4,205**
Total Liabilities & Equity	**13,377**	**12,989**	**10,420**	**7,449**
INCOME STATEMENT				
Turnover	**1,876**	**8,651**	**6,239**	**6,149**
Gross Profit	481	2,535	1,581	1,480
Selling and Distribution Expenses	(171)	(963)	(569)	(435)
Net Other Income/(Expense)	8	340	89	88
Financial Charges	(94)	(383)	(182)	(65)
Profit Before Tax	**224**	**1,529**	**919**	**1,069**
Cashflow Statement				
Free Cash Flow from Operations (FCFO)	439	2,452	1,392	1,400
Net Cash changes in Working Capital	(17)	(1,400)	(3,588)	(84)
Net Cash from Operating Activities	328	670	(2,378)	1,251
Net Cash from Investing Activities	61	(1,091)	(212)	(1,288)
Net Cash from Financing Activities	(394)	409	2,562	49
Ratio Analysis				
Performance				
Turnover Growth (vs. SPLY)	-2%	39%	1%	24%
Gross Margin	26%	29%	25%	24%
Net Margin	11%	17%	14%	16%
Coverages				
Interest Coverage (FCFO/Gross Interest)	4.7	6.4	7.6	21.5
Core: (FCFO) / (Gross Interest+CMLTD+Uncovered Total STB)	2.1	2.6	2.5	1.9
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	2.1	2.6	2.5	1.9
Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO- Gross Interest)	0.5	0.5	1.0	0.5
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	192.0	181.5	152.2	-10.9
Capital Structure (Total Debt/Total Debt+Equity)	30%	33%	37%	6%

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.

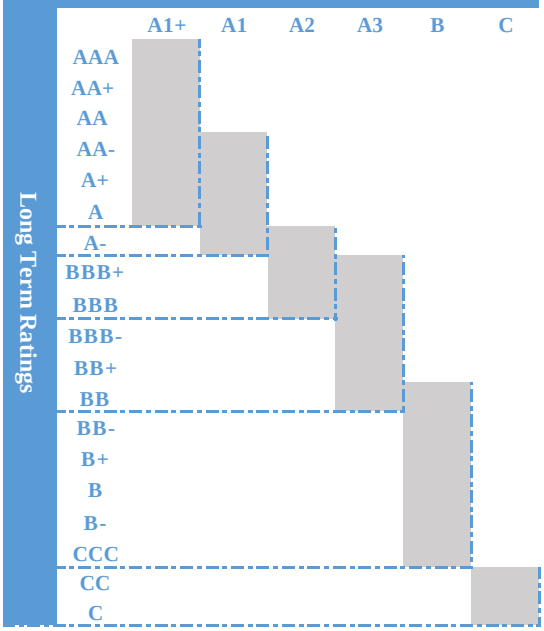
Long Term Ratings

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.

Short Term Ratings



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