The Pakistan Credit Rating Agency Limited

Rating Report

Al Rahim Textile Industries Limited

Report Contents

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

Rating Rationale and Key Rating Drivers

Al Rahim Textile Industries Limited (Al Rahim) is a family owned textile company 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 one of the leading towel exporters of Pakistan. Al Rahim has managed to strengthen its business profile following expansion at its 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 local cotton which is more suitable for coarse counts linked products. However, overall export volumes of the towel 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. However, working capital management still needs improvement. Going forward, governance framework of the Company is expected to further strengthen. 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.

Al Rahim group is in the process of formulating a strong corporate structure. This also includes formation of a holding company - to bring its business in Pakistan and abroad under one umbrella. 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 Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Towel(Jul-19)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure Al Rahim Textile Industries Limited (Al Rahim), a Public Unlisted Company, is engaged in manufacturing and marketing of different varieties of towels and fabric. Al Rahim provides processing services to other traders. It has installed state of art manufacturing facility at Nooriabad, Sindh.

Background The entity was registered as a sole proprietorship and its foundations were laid down by Mr. Abdul Rahim Saya in 1991. In 2016, a Single Member Company - Al Rahim Textile Industries (SMC-Pvt.) Limited - was incorporated to convert the entity into a corporate. In continuation of structural changes, SMC's status was changed to a public unlisted company and renamed Al Rahim Textile Industries Limited at the end of FY19. All the assets and liabilities of the sole proprietorship are now purchased by Al Rahim Textile Industries Limited.

Operations Al Rahim is involved in manufacturing of terry towels and fabric. Moreover it provides processing services to other textile companies. Currently, the Company has 144 air jet looms for towels manufacturing and 120 air jet looms for fabric. The current capacity utilization stands at ~75% (FY18: 85%).

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 run the family businesses. Moeed Saya, son of Faisal Rahim Saya has now also joined the family business. Majority of the shareholding lies with Faisal Rahim Saya (~90%).

Stability The sponsors are in the process of setting up a holding company in Singapore which will hold all the sponsor’s businesses. This will ensure stability and succession of the entity going forward.

Business Acumen Saya family is engaged in textile business for decades. The business acumen is considered strong as the Sponsors were able to maintain the growth of the Company from the start.

Financial Strength With estimated financial strength of over ~25bln, Saya family is considered financially sound. Support from sponsors is expected if needed. The family also owns Al Rahim (Private) Limited and owns real estate properties at prime locations in Pakistan.

Governance

Board Structure The Company has formed a three member board, all represent Saya Family. The board members are Abdul Rahim Saya, Faisal Rahim Saya and Moiz Faisal Saya. The overall board structure can be improved through expanding board size and induction of independent directors.

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 successful implementation and maturity of corporation process.

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. The current auditors are not QCR rated and the Company is planning to improve the quality of auditors by taking QCR rated auditors on board.

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 head office functions are headed by Mr. Faisal Rahim Saya. All the department heads report to the Sponsors, accordingly.

Management Team Faisal Rahim Saya leads the management team of the entity. Mr. Faisal Rahim Saya is associated with Al Rahim since 1998. He oversees all the business matters. However, production related functions are headed by Mr. Shahzad Rahim Saya – younger brother of Faisal Saya. Mr. Faisal oversees the operations from the Head office, whereas, Mr. Shahzad from the plant site i.e. at Nooriabad. Mr. Muhammad Ali has recently joined the Company as Director Finance at the group level.

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

MIS Al Rahim is using Oracle EBS 12.1.3 as its main ERP software. Oracle was fully implemented in 2015. Al Rahim uses six modules of Oracle which includes i) financial (ii) Inventory (iii) Procurement (iv) Payable (v) Receivable and (vi) manufacturing modules.

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

Business Risk

Industry Dynamics During FY19, total exports of the country witnessed a decline of ~1%. Textile sector continued to contribute ~58% in the total exports of the country, whereas, towels contribution in the textile exports remained stagnant at ~6%. Pakistan was able to export 188,511 MTs (FY18: 203,169 MTs) of towels amounting to US$ 786mln in FY19 (FY18: US$ 797mln). Quantity exported showed a decrease of ~7.2%, whereas, the value decreased by 1.4% in dollar terms.

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 9MFY19, the Company's top line clocked in at PKR 7,087mln (9MFY18: PKR 6,107mln), portraying an increase of over 16%. Sales mainly increased on the back of increased quantity exported. During the period, export sales contribution stood at ~80%, whereas, the rest was contributed by local sales.

Margins Al Rahim's cost of goods sold increased to PKR 5,168mln during 9MFY19 (9MFY18: 4,777), an increase of ~8%. Consequently, the gross margins increased to 27% in 9MFY19 (9MFY18: 22%). The Company was also able to keep administrative and selling expenses under control, due to which the operating margins increased to 19% (9MFY18: 13.5%). Despite higher interest rates, the net margins of the Company improved to 14.5% during the period under review (9MFY18: 9.5%). The Company's overall profit increased to PKR 1,032mln in 9MFY19 (9MFY18: PKR 586mln), an increase of 76% YoY.

Sustainability Going forward, the Company's focus will be on BMR and value added towels, as it will enable Al Rahim to become the only printed towel manufacturer in Pakistan. The Company intend to achieve higher capacity utilization, which currently stands at 75%.

Financial Risk

Working Capital Al Rahim Textile’s working capital requirements are a function of its inventory and receivables, for which the company relies on a mix of internal generation and short term borrowings. Despite an increase in net cash cycle (9MFY19: 211days, 9MFY18: 124days) on account of increased receivable days, the Company's borrowing cushion remained strong as it manages its working capital through utilization of internally generated cash.

Coverages Al Rahim's free cash flows displayed strong YoY growth (~48%) on account of higher profitability. This translated into improved interest coverage (9MFY19: 5.1x, 9MFY18: 4.1x) while core debt coverage amounted to 1.9x, showing no significant change YoY.

Capitalization The Company is moderately leveraged (9MFY19: ~31%, 9MFY18: ~30%). Overall borrowing declined during the year due to repayment of short-term debt while long-term debt increased YoY to finance capex during the year. The Sponsors injected equity into the Company, maintaining the leveraging at a moderating level. Going forward, finance cost may witness an increase given the rising interest rate environment.

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Financial Summary
PKR mln

Al Rahim Textile Industries Limited	Mar-19	Jun-18	Jun-17	Jun-16
Towels	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	6,281	5,886	4,560	4,225
2 Investments	-	-	-	-
3 Related Party Exposure	244	242	294	23
4 Current Assets	8,627	6,860	5,566	3,202
a Inventories	*3,943*	*3,187*	*3,033*	*793*
b Trade Receivables	*3,293*	*2,159*	*1,030*	*1,309*
5 Total Assets	15,152	12,989	10,420	7,449
6 Current Liabilities	925	1,289	1,650	2,956
a Trade Payables	*615*	*1,045*	*1,461*	*2,286*
7 Borrowings	4,396	3,858	3,232	288
8 Related Party Exposure	-	-	0	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	9,831	7,841	5,538	4,205
11 Shareholders' Equity	9,831	7,841	5,538	4,205
B INCOME STATEMENT				
1 Sales	7,087	8,651	6,239	6,149
a Cost of Good Sold	*(5,168)*	*(6,115)*	*(4,658)*	*(4,668)*
2 Gross Profit	1,919	2,535	1,581	1,480
a Operating Expenses	(578)	(963)	(569)	(435)
3 Operating Profit	1,341	1,572	1,012	1,046
a Non Operating Income	*98*	*340*	*89*	*88*
4 Profit or (Loss) before Interest and Tax	1,439	1,912	1,101	1,134
a Total Finance Cost	*(338)*	*(383)*	*(182)*	*(65)*
b Taxation	*(69)*	*(87)*	*(62)*	*(61)*
6 Net Income Or (Loss)	1,032	1,443	857	1,007
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,709*	*2,452*	*1,392*	*1,400*
b Net Cash from Operating Activities before Working Capital Changes	*1,371*	*2,070*	*1,210*	*1,335*
c Changes in Working Capital	*(1,953)*	*(1,400)*	*(3,588)*	*(84)*
1 Net Cash provided by Operating Activities	(582)	670	(2,378)	1,251
2 Net Cash (Used in) or Available From Investing Activities	215	(1,091)	(212)	(1,288)
3 Net Cash (Used in) or Available From Financing Activities	363	409	2,562	49
4 Net Cash generated or (Used) during the period	(4)	(12)	(28)	12
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	9.2%	38.6%	1.5%	23.9%
b Gross Profit Margin	27.1%	29.3%	25.3%	24.1%
c Net Profit Margin	14.6%	16.7%	13.7%	16.4%
d Cash Conversion Efficiency (EBITDA/Sales)	27.2%	29.0%	24.4%	24.0%
e Return on Equity (ROE)	15.6%	21.6%	17.6%	31.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	243	198	180	126
b Net Working Capital (Average Days)	211	146	71	17
c Current Ratio (Total Current Assets/Total Current Liabilities)	9.3	5.3	3.4	1.1
3 Coverages				
a EBITDA / Finance Cost	5.7	6.6	8.4	22.7
b FCFO / Finance Cost+CMLTB+Excess STB	1.9	2.6	2.5	13.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.2	0.5	1.0	0.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	30.9%	33.0%	36.8%	6.4%
b Short-Term Borrowings / Total Borrowings	0.5	0.7	0.6	1.0
c Average Borrowing Rate	10.9%	10.8%	10.3%	25.2%

PACRA

Rating Scale | Corporate

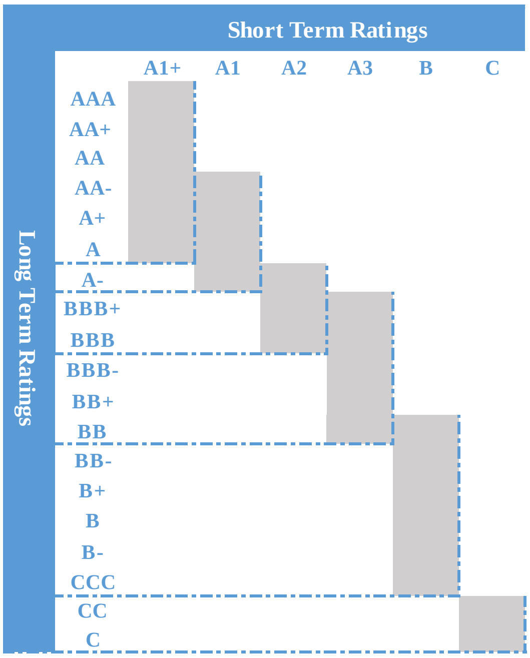
2019

Credit Rating Scale & Definitions

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

Long Term Ratings	
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings	
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

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

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