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
06-Aug-2020	A-	A2	Negative	Maintain	YES
25-Jan-2020	A-	A2	Stable	Maintain	-
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 strong position in towel manufacturing. Overall export volumes of towel industry declined by ~10% in FY20 on YoY basis owing to COVID-19 outbreak in early 2020 and subsequent lockdowns in major export destinations (Europe & USA). Domestic players had to shut down production or remained partially operational during lockdown in 4QFY20 as per Government directives. Resultantly, the industry is facing challenges including low demand, build-up of inventory and receivables and lower capacity utilization. Al Rahim is no exception to this scenario. Moreover, the Company is in corporate transition phase where all assets, liabilities and business of sole proprietorship are transferred to the new corporate entity. The transition is expected to complete as all approvals are in place. During 9MFY20, the top-line of the Company declined by ~12% mainly due to retention of few export contracts on proprietorship accounts. Towel industry enjoys relatively better margins that are reflected in Al Rahim’s profitability. The revenues are expected to remain low due to COVID outbreak and its impact on demand in 4QFY20. The situation has improved to an extent as orders are now being delivered and gradual improvement is seen in international markets. The recent reduction in interest rates and the Company's plan to shift its borrowings to SBP's refinance schemes will lower financial charges, going forward. The Company's financial risk profile is characterized by moderate leveraging and strong coverages. However, the working capital cycle is significantly higher than industry average, creating pressure on liquidity profile and cashflows. High levels of inventory and receivables remain a challenge. The Company has availed the option to defer its long-term principal repayments and is in negotiation with banks to convert short-term borrowings to refinance schemes. This is expected to improve the Company's overall capital structure and provide cushion in cashflows. The assigned ratings incorporate recent corporatization of the entity, experienced management team, and expected sponsor support as demonstrated historically.
The 'Rating Watch' signifies the COVID-19 outbreak and a challenging economic environment. The entire textile chain has been impacted due to the lockdowns across globe. The demand has contracted while the eventual resumption of operations and recovery of the sector remains uncertain. The Government and SBP has announced several initiatives to provide support. PACRA will monitor the situation and accordingly take action.

The ratings are dependent on sustaining business margins while maintaining strong financial risk profile. The timely shift of short-term borrowings to SBP's refinance schemes remain important. Prudent management of working capital requirements, especially inventory dilution and timely realization of receivables will remain critical. Strengthening of corporate structure, governance framework along with timely and smooth transition are important.

Disclosure

Name of Rated Entity	Al Rahim Textile Industries 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 | Towel(Jan-20)
Rating Analysts	Ateeb Riaz | ateeb.riaz@pacra.com | +92-42-35869504

Profile

Legal Structure Al Rahim Textile Industries Limited (Al Rahim or 'the Company') traces its roots to Al Rahim Textile Industries, which was established in 1991 as a sole proprietorship. In order to strengthen the corporate structure, a public unlisted company was formed by the name of Al Rahim Textile Industries Limited in July 2019. As per agreement, all assets and liabilities of sole proprietorship were transferred to Al Rahim Textile Industries Limited. The registered office of the Company is situated in Karachi, with manufacturing facility in Nooriabad, Sindh.

Background The Company was formed by Mr. Abdul Rahim Saya. Al Rahim started its business by providing processing and weaving facilities. The Company established Nooriabad facility in 2005. After 2015 expansion, the Company has become one of the largest manufacturers of towels in Pakistan.

Operations Al Rahim is involved in manufacturing of towels and fabrics. The Company is export oriented and sells its products to large retail chains like, Family Dollar Store Inc., Primark and others. Al Rahim has total capacity of 284 Air-jet looms. After incorporation of new company in FY20, all assets and liabilities (except land and long term borrowing) have been transferred to the newly incorporated entity. It is expected that all business will be shifted to Al Rahim in FY21.

Ownership

Ownership Structure Al Rahim is owned by Saya Family. Mr. Faisal Rahim Saya holds major stake in the Company while rest of the shareholding is split equally between Mr. Moiz Saya (Son of Mr. Faisal Saya) and Mr. Abdul Rahim Saya.

Stability Although both sons of Mr. Abdul Rahim Saya (Mr. Faisal Saya and Mr. Shehzad Saya) are involved in the operations of the Company, most of the shareholding resides with Mr. Faisal Saya. The sponsors have established a holding company in Singapore to bring all group companies under one umbrella. There is no formal succession plan in place but ownership and business roles are clearly divided among family members at group level.

Business Acumen Saya family is involved in textile business for last three decades. The phenomenal growth over the years reflects sponsors' strong business acumen.

Financial Strength The members of Saya family owns adequate wealth, reflecting well on financial strength of the sponsors. The sponsors have supported the Company in the past in the form of equity injections. The family also owns Al Rahim Retail (Pvt.) Limited - Zellbury Brand Stores - and real estate properties in Pakistan.

Governance

Board Structure The board comprises three members and is chaired by Mr. Abdul Rahim Saya. It includes two executive (including the CEO) and one non-executive director. All members represent Saya Family. There is room for improvement at board level through induction of more members, including independent directors.

Members' Profile Saya family is in textile business since 1991 and has vast experience of textile industry. Board members possess strong acumen in textile manufacturing and towel industry as reflected in the growth of the Company.

Board Effectiveness Board members are actively involved in the Company's operations. Board meetings are held on as and when required basis. The board has not formed any committees. There is no formal policy of recording board minutes.

Financial Transparency Reanda Haroon Zakaria & Company, Chartered Accountants, are the external auditors of the Company. They gave an unqualified opinion on financial statements for the year end June 30, 2019. The firm is QCR rated by ICAP and is classified in Category 'B' in the panel of auditors maintained by SBP.

Management

Organizational Structure The Company's management structure is divided into divisions and functional departments with clear lines of responsibilities. Head office and site management functions are headed by Mr. Faisal Saya, the CEO.

Management Team Mr. Faisal Saya (CEO) leads the management team. He has been associated with the family business for last 27 years and has played a key role in the success of the Company. The CEO is supported by an able and professional team.

Effectiveness The Company has no management committees in place. However, senior management members meet on daily basis to discuss ongoing issues and plans.

MIS Al Rahim is using Oracle EBS 12.1.3 as its main ERP software. Oracle was fully implemented in 2015. Al Rahim uses three modules of Oracle. Regular MIS reports are submitted to top management relating to liquidity and profitability profile of the Company.

Control Environment Sponsors of the Company are part of both the Board and management. Al Rahim has established internal audit department, which is an integral part of the management control system. Further, the Company has rigorous quality control procedures in place. The Company has valid certificates from Oeko Tex 100 Class-I and Class-II, BSCI, C-TPAT, Sedex, GOTS and BRC, reflecting well on overall control environment.

Business Risk

Industry Dynamics During FY20, towels export declined by ~10% YoY and clocked in at ~USD 711mln (FY19: ~USD 786mln), owing to COVID-19 outbreak in early 2020, which has impacted the entire textile industry's exports. Export orders were deferred or cancelled as the USA and Europe (major towel export destinations) were in lock-down to contain the virus. Several domestic players were either closed or partially operational during countrywide lock-down in 4QFY20 as per Government's directives. This resulted in various challenges for the sector including low demand and liquidity pressure. However, lately demand for towels is rebounding slowly as buyers/stores replenish their inventories. Further, greater hygiene consciousness and demand from medical industry amid COVID-19 may boost demand. The recent partial reopening of export markets is a positive sign but it remains fragile and will take time to gain traction.

Relative Position Al Rahim is one of the biggest players of the towel industry in Pakistan with ~8% share in total towel exports of the Country. Whereas, Feroze 1888 is considered as a leader in towel industry with a share of ~27%.

Revenues The Company derives its revenue mainly from manufacturing and sales of towels. During 9MFY20, The Company's topline clocked in at ~PKR 6,253mln (9MFY19: ~PKR 7,087mln), reflecting a decline of ~12%. The decline in revenue is mainly because the Company is still channeling some business through the Sole Proprietorship due to nature of contracts. It is expected that all business will be shifted to Al Rahim Textile Industries Limited in FY21. Further, revenues are mostly derived from exports and are expected to remain under pressure due to the COVID-19 outbreak and low demand in 4QFY20.

Margins During 9MFY20, the gross margin of the Company fell to ~23% (9MFY19: ~27%), as the input cost increased considerably. However, the Company was able to contain pressure on operating margin (9MFY20: ~17%; 9MFY19: ~19%) on the back of better control on operating costs. However, the net profit margin remained intact in 9MFY20 and stood at ~14% (9MFY19: ~15%) on account of lower finance cost. The long term borrowings of the Company are still in the books of Sole Proprietorship, resulting in lower finance cost. The bottom-line of the Company stood at ~PKR 880mln (FY19: ~PKR 1,032mln).

Sustainability Due to COVID-19, the Company was forced to close its operations for a limited time but resumed partial production after 15th of April. Lower demand and deferment/cancellation of export orders is expected to impact the performance and liquidity profile in the short-term. Recent SBP measures in the shape of interest rate cuts, restructuring and deferment of loan repayments will provide some respite, going forward.

Financial Risk

Working Capital During 9MFY20, the Company's gross working capital days increased substantially to 319 days (9MFY19: 243 days), mainly because of significant surge in inventory days to 194 days (9MFY19: 138 days). The Company has also lengthened its trade payable days, which clocked in at 109 days (9MFY19: 53 days) mainly to alleviate the liquidity crunch. This resulted in net working capital days of 210 days in 9MFY20 (9MFY19: 211 days). The Company's working capital cycle is significantly higher than industry average. The COVID outbreak and delay in orders has worsened the already stretched working capital cycle, creating liquidity pressure. However, Al Rahim has adequate cushion at trade level (~29%), showing room to borrow, if needed.

Coverages The Company's free cashflows (FCFO) declined to ~PKR 1,505mln (9MFY19: ~PKR 1,709mln) on the back of lower profitability. Meanwhile, the interest coverage ratio and debt coverage ratio increased significantly as impact of long-term borrowings is still not reflected on books from the proprietorship. The Company has availed SBP measure of deferring its principal repayments on long-term loans. This, coupled with lower interest rates, will provide relief to cashflows.

Capitalization The Company has a moderately leveraged capital structure. In 9MFY20, the leveraging stood at ~26% (9MFY19: ~31%). The short term borrowings increased to ~PKR 2,854mln (9MFY19: ~PKR 2,293mln) to finance the higher working capital requirements. The leveraging is expected to come around ~40%, once the long term borrowings are shifted to the Company.

PKR mln

Al Rahim Textile Industries Limited	Mar-20	Jun-19	Jun-18	Jun-17
Towels	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	5,870	6,584	5,886	4,560
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	242	294
4 Current Assets	8,334	9,278	6,860	5,566
a Inventories	*4,453*	*4,420*	*3,187*	*3,033*
b Trade Receivables	*2,511*	*3,184*	*2,159*	*1,030*
5 Total Assets	14,204	15,863	12,989	10,420
6 Current Liabilities	3,032	2,851	1,289	1,650
a Trade Payables	*2,684*	*2,282*	*1,045*	*1,461*
7 Borrowings	2,854	3,666	3,858	3,232
8 Related Party Exposure	-	-	-	0
9 Non-Current Liabilities	17	36	-	-
10 Net Assets	8,301	9,310	7,841	5,538
11 Shareholders' Equity	8,301	9,310	7,841	5,539
B INCOME STATEMENT				
1 Sales	6,253	9,720	8,743	6,308
a Cost of Good Sold	*(4,788)*	*(7,111)*	*(6,115)*	*(4,658)*
2 Gross Profit	1,465	2,609	2,627	1,650
a Operating Expenses	(396)	(821)	(963)	(569)
3 Operating Profit	1,069	1,789	1,664	1,081
a Non Operating Income	*(22)*	*136*	*248*	*20*
4 Profit or (Loss) before Interest and Tax	1,047	1,925	1,912	1,101
a Total Finance Cost	*(105)*	*(510)*	*(382)*	*(182)*
b Taxation	*(62)*	*(96)*	*(87)*	*(62)*
6 Net Income Or (Loss)	880	1,319	1,443	857
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,505*	*2,525*	*2,452*	*1,392*
b Net Cash from Operating Activities before Working Capital Changes	*1,413*	*2,015*	*2,070*	*1,210*
c Changes in Working Capital	*(3,056)*	*(639)*	*(1,400)*	*(3,588)*
1 Net Cash provided by Operating Activities	(1,642)	1,377	670	(2,378)
2 Net Cash (Used in) or Available From Investing Activities	(138)	(1,315)	(1,091)	(212)
3 Net Cash (Used in) or Available From Financing Activities	1,864	(43)	409	2,562
4 Net Cash generated or (Used) during the period	84	19	(12)	(28)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-14.2%	11.2%	38.6%	2.6%
b Gross Profit Margin	23.4%	26.8%	30.1%	26.2%
c Net Profit Margin	14.1%	13.6%	16.5%	13.6%
d Cash Conversion Efficiency (EBITDA/Sales)	24.4%	27.1%	28.7%	24.1%
e Return on Equity (ROE)	13.3%	15.4%	21.6%	17.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	319	243	196	178
b Net Working Capital (Average Days)	210	181	144	71
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.7	3.3	5.3	3.4
3 Coverages				
a EBITDA / Finance Cost	18.4	5.9	7.6	10.3
b FCFO / Finance Cost+CMLTB+Excess STB	18.1	5.7	2.7	2.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.8	0.5	1.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	25.6%	28.3%	33.0%	36.8%
b Short-Term Borrowings / Total Borrowings	1.0	0.5	0.7	0.6
c Average Borrowing Rate	3.4%	11.8%	9.4%	8.3%

Credit Rating

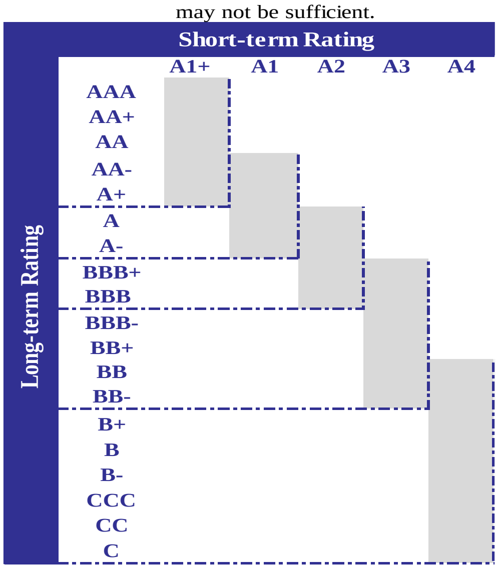
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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