The Pakistan Credit Rating Agency Limited

Rating Report

Basfa Textile (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
02-Mar-2023	BBB	A2	Stable	Maintain	-
02-Mar-2022	BBB	A2	Stable	Upgrade	-
29-Mar-2021	BBB-	A3	Stable	Maintain	Yes
30-Apr-2020	BBB-	A3	Negative	Maintain	Yes
30-Oct-2019	BBB-	A3	Stable	Maintain	-
30-Apr-2019	BBB-	A3	Stable	Maintain	-
28-Dec-2018	BBB-	A3	Stable	Maintain	-
30-Jun-2018	BBB-	A3	Stable	Maintain	-
29-Dec-2017	BBB-	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Basfa Textile (Pvt.) Ltd (The Company) was incorporated in 2006. However, commercial operations started in 2008. The corporate office of the Company is located at 20-KM Ferozepur Road, Lahore. The Company is engaged in the manufacturing and sale of Viscose Yarn and different varieties of cotton yarn. Prior to the textile business, the sponsor’s primary business was car paints and chemical raisins that are used in the fiberglass industry and steel putty (a product of the auto industry). Being an importer of viscose, the Company remains exposed to exchange rate risk. The governance framework lacks independent oversight. The assigned ratings incorporate the Company’s good operating track record with an adequate business profile. The company has 60,156 spindles currently installed. The Company’s revenue base is dominated by local sales and has reflected growth over the years to stand at PKR 4.6bln in FY22 (FY21: PKR 3bln). Profitability exhibited a YoY growth of 39% (FY22: PKR 146mln, FY21: PKR 105mln). However, during 1HFY23, the Company’s performance was diluted and high finance costs impacted the net profitability. Interest coverage recorded a steep decline whilst leveraging remained largely the same. Rebounding of coverage and margins remains essential, going forward. During 7MFY23, the textile exports were valued at $10.08bln compared to $10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand for yarn in international markets is also a challenge. The analysis of 5MFY23 reveals that among value-added items, bedwear has witnessed the largest decline of 19 (on an MoM basis), down to $217 million. Knitwear remained on the downward path in October 2022 and declined by 10% to $392 million. Among non-value-added items, the cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is prevailing in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries. The demand pattern is expected to improve post-Jun-23.

The ratings are dependent upon the management's ability to operate at an optimal level and improve profitability, margins, and coverage, going forward. The governance framework and independent oversight need improvement. At the same time, prudent management of short-term liquidity remains vital.

Disclosure

Name of Rated Entity	Basfa Textile (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Spinning(Sep-22)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure Basfa Textile (Pvt.) Ltd ("Basfa Textile", "The Company") was incorporated in 2006. However, commercial operations started in 2008. The corporate office of the Company is located at 20-KM Ferozepur Road, Lahore.

Background The Company was established by Mr. Jahangir Saleem. He was engaged in the business of car paints and chemical raisins under the name of 'Basfa Industries Pvt. Ltd' and 'Auto Coatings Pvt. Limited' prior to textile business. The name "BASFA" is titled as per the name of his four sons. Mr. Babar Jahangir, Mr. Sajid Jahangir, Mr. Fahad Jahangir and Mr. Ahmad Jahangir.

Operations The Company is engaged in the manufacturing and sale of Viscos Yarn. Viscose yarn is sold under the brand name "SuperDiamond" and Cotton yarn under the brand name "Super-Gold", whereas, location of the plant is at 36-KM Ferozepur Road, Lahore, and the second plant is located at Feroz Watwan Road, Chandi Kot Stop, Sheikhupura.

Ownership

Ownership Structure The controlling stake in the Company is held by Jahangir Saleem Family. Mr. Babur Jahangir (Chairman/CEO) holds 44.40% shares in the Company, while Mr. Ahmed Jahangir and Mr. Fahad Jahangir, son of Mr. Jahangir Saleem, hold 30.0% and 25.60% shares respectively.

Stability The Formation of a group holding Company or documented succession plan has been very much in place as Mr. Jahangir Saleem has divided the ownership of the Company between his sons. This division provides clarity as to the future of the businesses.

Business Acumen Mr. Babur Jahangir has an overall working experience of more than one decade. His innovative technological skills in the field of the textile sector bring specialized and comprehensive knowledge to the board.

Financial Strength The financial strength of the sponsor family is categorized as adequate.

Governance

Board Structure The board comprises two members including CEO/Chairman and the Managing director. The CEO and Chairman of the Company are Mr. Babur Jahangir. Whereas, Mr. Ahmed Jahangir holds the position of Director of the Company.

Members' Profile Mr. Babur Jahangir holds a graduation degree from the United Kingdom. He has got an overall experience of 15 years in his portfolio out of which 10 years of experience is in the company. The induction of an independent director would improve the governance framework of the Company.

Board Effectiveness The board is currently heading two committees (i) Audit Committee: which is primarily responsible for the supervision of all matters related to audit and finalization of financial accounts. The internal audit department is predominantly engaged in the operations of this committee (ii) Corporate performance and evaluation committee: primarily responsible for recommending HR policies, succession planning of key management roles, and monitoring key performance metrics.

Financial Transparency Suriya Nauman Rehan Co, are the external auditors of the Company, listed on the panel of auditors maintained by the State Bank of Pakistan, and have a satisfactory QCR rating. They expressed an unqualified opinion on the Company's annual financial statements for the year ended June 30, 2022.

Management

Organizational Structure The organizational structure of the Company is divided into various functional departments: (i) Marketing, (ii) Finance, (iii) Accounts, (iv) Procurement, (v) Technical operations.

Management Team The Company's CEO is Mr. Babar Jahangir. Mr. Abdul Basit, CFO of the Company, is a Fellow Public Accountant and Fellow Cost and Management Accountant with an overall experience of 29 years. The marketing team is led by the General Manager of Marketing, who is also a textile engineer with more than 27 years of experience in yarn sales.

Effectiveness Basfa Textile maintains adequate IT infrastructure and related controls. The Company deploys Quick Books, Accounting edition, in 2016 with the license of 10 corporate users. The operational modules include (i) Payable, (ii) Receivable, (iii) Inventory, (iv) Procurement, (v) Order Management, (vi) General Ledger, (vii) Fixed Assets, and (viii) Cash Management.

MIS Several MIS reports are prepared for the management to keep track of all operating activities. Daily reports are generated for the senior management, which helps them in day-to-day decision-making. Apart from daily reporting, the management also receives a more detailed MIS on a monthly basis.

Control Environment Intra-networking is being used within the Company to connect all departments though a common network. User-based controls are in place. Servers are installed where data management and back-up policies are in place.

Business Risk

Industry Dynamics During 7MFY23, the textile exports were valued at $10.08bln compared to $10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand for yarn in international markets is also a challenge. The analysis of 5MFY23 reveals that among value-added items, bedwear has witnessed the largest decline of 19% (on an MoM basis), down to $217 million. Among non-value-added items, the cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is prevailing in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries. The demand pattern is expected to improve post-Jun-23.

Relative Position The installed capacity of the Company is 60,156 spindles. The Company's final product is sold through an intermediary with no direct sales mechanism. Ninety percent (90%) of the customer base of Basfa Textile is in Faisalabad, Punjab

Revenues Over the years, the Company's revenue has followed a growing trend. During FY22, the Company's top line clocked at PKR 4.6bln (FY21: PKR 3bln); reflecting growth of 54.1%. This is mainly attributable to improved industry dynamics, especially for the spinning segment, during FY22 due to improved yarn prices and growth in demand patterns. During 1HFY23, the topline clocked in at PKR 2.7bln.

Margins During FY22, the Company's cost of sales reflected a general increase. Raw materials are 72.2% of the total cost of goods sold. Other than that, Fuel and Power costs also increased to PKR 686mln (FY21: PKR 370mln). The gross margins of the Company inched down to 7.9% in FY22 (FY21: 8.6%). A similar trend was witnessed in operating margins (FY22: 7%, FY21: 7.6%). Meanwhile, the net margins of the Company stood at 3.1% in FY22 (FY21: 3.5%). During 1HFY23, net profit remained largely the same at PKR 55mln YoY (1HFY22: PKR 55mln).

Sustainability The Company has shifted its focus on viscose yarn completely and discontinued the production of other types of yarn. Lately, the Company has set up a second plant which is located at Feroze Watwan Road, Chandi Kot Stop, Sheikhupura.

Financial Risk

Working Capital The working capital needs emanate from financing inventories and trade receivables for which the Company relies on both internal cash flows as well as short-term borrowings (STBs). During FY22, the Company's working capital cycle reflected an increase (end-Jun22: 71 days end-Jun21: 69 days) primarily due to an increase in inventory days. At end-Dec22, net working capital days stood at 83 days. Meanwhile, short-term trade leverage remained largely the same (end-Dec22: 10%, end-Jun22: 12%, end-Jun21: 11%).

Coverages During FY22, the Company's cash flows (FCFO) increased on a YoY basis (FY22: PKR 391mln; FY21: PKR 285mln) due to an increase in profitability but on the other hand, total finance cost reflected a sharp increase to PKR 117mln in FY22 (FY21: PKR 61mln) due to which interest coverage ratio witnessed decline (FY22: 3.5x; FY21: 5.1x). A similar trend was recorded in the core operating coverage ratio (FY22: 1.5x, FY21: 2.3x). In IHFY23, interest coverage and core operating ratio stood at 1.0x and 0.7x respectively.

Capitalization The leveraging ratio has reflected an increase (end-June'22: 55.3%, end-June'21: 44.3%) due to an increase in total borrowings to stand at PKR 1.56bln. At end-Dec'22, leveraging moved to 54%. The equity base of the Company has remained largely the same over the years (end-Dec22: PKR 1.3bln, end-Jun22: 1.2bln, end-Jun21: PKR 1.1bln). The strengthening of the equity base to enhance risk absorption capacity remains essential.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Basfa Textile Textile	Dec-22 6M	Jun-22 12M	Jun-21 12M	Jun-20 12M
A BALANCE SHEET				
1 Non-Current Assets	1,711	1,790	1,702	707
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	1,556	1,592	867	785
a Inventories	*1,304*	*1,342*	*629*	*604*
b Trade Receivables	*1*	*1*	*1*	-
5 Total Assets	3,267	3,382	2,568	1,492
6 Current Liabilities	360	523	530	111
a Trade Payables	*71*	*94*	*73*	*23*
7 Borrowings	1,553	1,569	892	336
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	30	22	23	27
10 Net Assets	1,324	1,268	1,123	1,018
11 Shareholders' Equity	1,324	1,268	1,123	1,018
B INCOME STATEMENT				
1 Sales	2,733	4,652	3,019	2,542
a Cost of Good Sold	*(2,527)*	*(4,284)*	*(2,759)*	*(2,372)*
2 Gross Profit	207	368	261	170
a Operating Expenses	(23)	(41)	(31)	(28)
3 Operating Profit	184	327	230	141
a Non Operating Income or (Expense)	*(5)*	*(10)*	*(6)*	*(5)*
4 Profit or (Loss) before Interest and Tax	179	317	224	136
a Total Finance Cost	*(90)*	*(117)*	*(61)*	*(46)*
b Taxation	*(34)*	*(55)*	*(58)*	*(35)*
6 Net Income Or (Loss)	55	146	105	55
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*90*	*391*	*285*	*185*
b Net Cash from Operating Activities before Working Capital Changes	*90*	*284*	*228*	*139*
c Changes in Working Capital	-	*(703)*	*269*	*76*
1 Net Cash provided by Operating Activities	90	(419)	497	216
2 Net Cash (Used in) or Available From Investing Activities	-	(210)	(1,121)	(35)
3 Net Cash (Used in) or Available From Financing Activities	-	678	557	(128)
4 Net Cash generated or (Used) during the period	90	48	(67)	52
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	17.5%	54.1%	18.8%	--
b Gross Profit Margin	7.6%	7.9%	8.6%	6.7%
c Net Profit Margin	2.0%	3.1%	3.5%	2.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	3.3%	-6.7%	18.3%	10.3%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	8.6%	12.2%	9.8%	5.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	88	77	75	87
b Net Working Capital (Average Days)	83	71	69	83
c Current Ratio (Current Assets / Current Liabilities)	4.3	3.0	1.6	7.1
3 Coverages				
a EBITDA / Finance Cost	1.0	4.1	6.4	5.3
b FCFO / Finance Cost+CMLTB+Excess STB	0.7	1.5	2.3	4.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	115.3	2.3	2.8	0.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	54.0%	55.3%	44.3%	24.8%
b Interest or Markup Payable (Days)	63.8	87.3	102.7	95.0
c Entity Average Borrowing Rate	11.7%	8.5%	8.1%	13.2%

Credit Rating

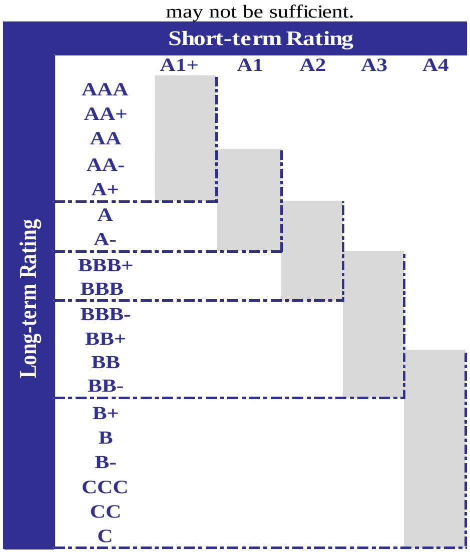
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

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

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(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 | Clause 11-(A)(p).
(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)

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(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)
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