The Pakistan Credit Rating Agency Limited

Rating Report

Rustam Towel (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Oct-2018	BB+	A3	Stable	Maintain	-
29-Mar-2018	BB+	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Rustam Towel (Pvt.) Limited (Rustam Towel) is small scale export oriented towel manufacturer, a family run business concern. Textile industry overall is witnessing improved margins due to recent rupee devaluation. Furthermore, towel industry continues to surge forward on the back of Pakistan's cotton which is more suitable for coarse counts yarn; resulting into better margins, which is also reflected in Rustam Towel's profitability. On standalone basis, the company's concentration levels – both customer and geographical – are well managed with company having policy of capping revenue from single customer to 20%. The ratings reflect relatively stretched financial risk profile due to higher working capital requirements as compared to industry due to lengthy net cash cycle. Short term borrowings exceeds working capital requirement resulting in asset-liability mismatch. Going forward, in absence of any further debt-driven expansion in the medium-term and better working capital management, financial profile is expected to become better despite higher interest costs.

The ratings are dependent on sustaining margins while improving business volumes. Meanwhile, prudent working capital management and eliminating mismatch would remain critical. Strengthening of governance framework for better oversight of strategic affairs, and appointment of enlisted auditor with SBP, is considered essential.

Disclosure

Name of Rated Entity	Rustam Towel (Pvt.) Limited
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 Rustam Towel (Pvt.) Limited (Rustam Towel) was incorporated in 1998 as a private limited company. Rustam Towel is a small scale towel manufacturing company. Primary business of the company is to manufacture and export various types of towels.

Background Dogar family is in textile industry for more than 4 decades. Mr. Arif Dogar – Father of Sanaullah Dogar, started textile business when he set up a textile mill, Rustam Weaving (Pvt.) Limited in gujranwala in 1970s. Now Rustam Weaving apart from Gujaranwala had a unit in Lahore too. Mr. Sanaullah started to work with his father and in 1998 alongwith his four brothers formed their own towel manufacturing company.

Operations The company has installed spinning units with 7,680 spindles which caters its yarn needs of ~80%. Apart from its spinning unit its weaving department equipped with 73 looms have capacity of producing 18,000 kg of greige fabrics and towel. Company's dyeing and stitching facilities has capacity of processing complete fabric/towel into finished product. The company's power needs are mainly met by NTDC however, it has backup generators with total rated capacity of 4MW.

Ownership

Ownership Structure Rustam Towel is owned by Dogar family through Mr. Sanaullah Dogar along with his son and two brothers. Majority of the shareholding lies with Mr. Sanaullah and his Son Sohaib Ali Dogar i.e. 66%. Dogar family constitutes four brothers who owns equal stake in all of the family businesses.

Stability There is no written shareholder agreement between brothers, however roles of the brothers are defined in the company. All four brothers are equal stake holder in all the businesses however, responsibilities are identified in every business venture.

Business Acumen Dogar Family has over five decade's experience. Dogar family is associated with towel manufacturing and other textile businesses. They have developed towel industry's insight over the years and are one of the leading exporters of towel.

Financial Strength The Dogar family now owns another towel manufacturing company namely Saif Tex. Apart from these textile companies, the dogar family has land at prominent place in Gujranwala. The company has recently invested and got three franchises of an international food chain in Lahore and Gujranwala.

Governance

Board Structure Rustam towel is a private company and it does not comply with code of corporate governance. The board is dominated by Dogar Family members. There are total 4 board members with Mr. Sanaullah Dogar as chairman

Members' Profile Board member's have ample experience in textile sector. Mr. Sanaullah Dogar, chairman, has over three decade's experience. He was associated with his father's textile business before starting his own towel manufacturing unit in 1998.

Board Effectiveness There is no independent director on the board. The board has not formed any board committee. All of the board members are also the shareholders of the company. The board meetings are not conducted formally with no board minutes being maintained. The family members meet regularly in informal way to discuss routine business matters.

Financial Transparency Ahmad Usman Shabbir & Co Chartered Accountants is the external auditor of the company. The auditor is neither in SBP categories nor QCR rated. To ensure financial transparency the company needs to hire better auditors. The company is in the process of hiring better auditors for next financial year.

Management

Organizational Structure Mr. Sanaullah Dogar, heads the management team as Chief Executive Officer of the company. The company has a simple organization structure as it has four major departments (i) Administration, (ii) Finance, (iii) Production and (iv) Marketing.

Management Team Finance and Administration department is overseen by Mr. Zaka Dogar, whereas Marketing Department is headed by Mr. Waseem Dogar. Mr .Sanaullah heads all departments but largely monitors production procedures and cotton procurement. The company has employed over 1500 personnel of which ~50 are management staff rest is labour and daily wagers.

Effectiveness At present, there are no Management Committees formed at Rustam and all deliberations are held at meetings conducted by department heads on "as and when needed" basis.

MIS The company's MIS can be classified into three categories on the basis of periodicity – Daily, Weekly and Monthly. The daily and weekly reports generated for top management mainly scrutinizes liquidity position and mainly cash and stock related reports.

Control Environment Rustam Towel is accredited with International certifications for compliance. It has valid certificates for its products and facilities and is periodically audited by internationally recognized certification bodies including Oeko Tex 100 Class-I and Class-II, BSCI, C-TPAT, Sedex, GOTS, BRC.

Business Risk

Industry Dynamics Towel industry in Pakistan was practically nonexistent prior to 1965. It started on a very small scale in 1965. After covering some stages, the Towel Manufacturing Group was formed initially at Karachi and got recognized by the Ministry of Commerce. Currently Towels contribute 6% in the total textile exports of Pakistan.

Relative Position Rustam Towel has been associated with the textile business for years. It has long term relations with customers outside Pakistan. It exports 100% of its final product barring some of its waste sales. It exports its products to international store chains and international towel companies in Europe and USA. The company has policy of catering big customers but with lesser concentration. It's share in overall towel industry is considered minimal.

Revenues Revenues of Rustam Towel in FY18 somehow remained stable. Sales revenue increased by 7% (FY18: PKR~3,166mln, FY17: PKR2,954mln). Increase in topline is on account of increased value of exports. The main reasons for this increase is rupee devaluation.

Margins During FY18, company's cost of sales increased by PKR 190mln majorly due to increased cost of raw material as it contributes 70% to the total cost of goods sold. Gross margin of the company somehow remained stable at 18% on YoY basis. Whereas operating expenses of the company have decreased by ~9 % mainly due to decrease in selling and marketing expenses by ~12%. As a result net profit margins on YoY basis increased to 7.3% in FY18 (FY17 ~6.5 %). During the period finance cost also increased by ~9 % and in value it has increased to PKR ~70mln (FY17 PKR ~64mln).

Sustainability Going forward, the company is looking forward to unlock new opportunities in the international market where they can export their final product. It expects to increase its revenues further by improving its production facilities by replacing old machines with new efficient machines.

Financial Risk

Working Capital The company meets its higher inventory needs through short term borrowings, that has increased in recent years FY18 1,563mln, FY17 1,335mln. The company's short term borrowing remained on the higher side but still there is room to borrow.

Coverages In FY18, Rustam Towel's operating cashflows (FCFO) remained strong (FY18: 361mln,FY17: 324mln) relative to their financial needs. Increase in finance cost lead by higher short term borrowing caused the coverages to deteriorate a little but somehow remained stable (FY18 5.2x, FY17 5.3x).

Capitalization Rustam Towel has relatively less leveraged capital structure and unchanged as compared to the previous year (end-Jun18 ~41% end Jun17 ~41%). On the other hand company does not carry any long-term debts in its profile. Going forward, in absence of any major capacity expansion and with the gradual payments of long-term loans the leveraging is expected to further reduce over time.

Rustam Towel (Pvt.) Limited

PKR mln

BALANCE SHEET	30-Jun-18	30-Jun-17	30-Jun-16
	FY18	FY17	FY16
Non-Current Assets	**2,126**	**2,025**	**1,753**
Investments (incl. Associates)	-	-	-
Equity	-	-	-
Debt Securities (incl. income funds)	-	-	-
Current Assets	**1,689**	**1,375**	**1,216**
Trade Receivables	491	382	312
Others	271	123	76
Total Assets	**3,815**	**3,400**	**2,968**
Debt/Borrowings	**1,563**	**1,355**	**1,026**
Short-Term	1,563	1,355	1,026
Long-Term (incl. Current Maturity of Long-Term Debt)	-	-	-
Other Short-Term Liabilities	66	90	180
Other Long-Term Liabilities	-	-	-
Shareholder's Equity	**2,186**	**1,955**	**1,763**
Total Liabilities & Equity	**3,815**	**3,400**	**2,968**
Cash Flow Statement			
Free Cash Flows from Operations (FCFO)	361	324	390
Net Cash changes in Working Capital	(335)	142	(83)
Net Cash from Operating Activities	(7)	409	255
Net Cash from InvestingActivities	(199)	(348)	(247)
Net Cash from Financing Activities	208	(34)	-
Net Cash generated during the period	2	28	8
Ratio Analysis			
Performance			
Turnover Growth (v.s same period last year)	7.2%	-11.0%	5.1%
Gross Margin	18.3%	18.9%	19.3%
Net Margin	7.3%	6.5%	7.9%
ROE	21.1%	10.4%	16.0%
Coverages			
Debt Service Coverage (times) (FCFO/Gross Interest+CMLTD+Uncovered STB)	5.2	2.4	7.6
Interest Coverage (times) (FCFO/Gross Interest)	5.2	5.1	7.6
Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO - Gross Interest)	0.0	0.3	0.0
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	178	166	127
Leveraging (Total Debt/Total Debt+Equity)*	41.7%	40.9%	36.8%

**Total Debt = Long-Term Debt + Short-Term Debt*

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.

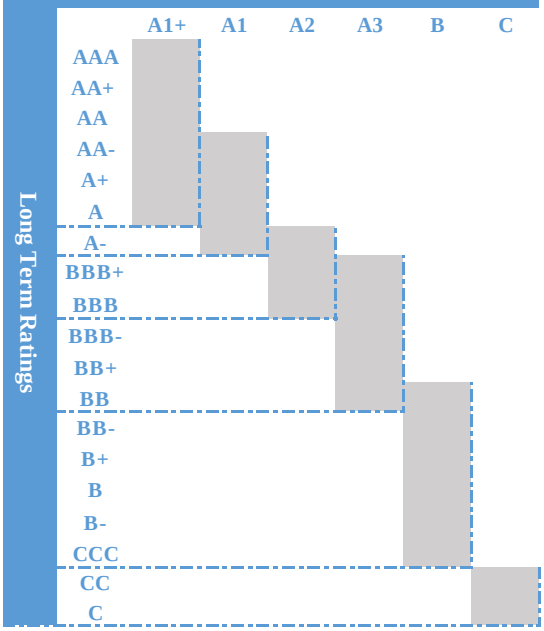
Long Term Ratings

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.

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(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**
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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.
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(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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(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)
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(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)
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(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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