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
29-Apr-2021	BBB	A2	Stable	Upgrade	-
29-Apr-2020	BBB-	A3	Stable	Maintain	YES
30-Oct-2019	BBB-	A3	Stable	Maintain	-
30-Apr-2019	BBB-	A3	Stable	Upgrade	-
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' or 'the business', a conventional family owned business concern, is operating for over two decades in the towel industry as an export oriented towel manufacturer. It holds a stable position among the top towel exporters of the country, with a strong customer foothold based in European countries. The rating incorporates the operational strength of the business as it is well integrated vertically. The revenues are expected to witness an uptick as there has been a surge in export of textile including towels in the wake of COVID-19 outbreak. Worldwide towel demand has increased especially in hotels and hospitality sector on account of improved hygiene practices. In view of the given opportunity and a vision of growth the entity is extending its existing capacity, additions of 48 looms. As a part of strategic diversification plan, the business has installed a denim production facility with capacity of ~120,000 pieces per month, which is now operational. Towel industry enjoys relatively better margins that are reflected in Rustam Towel's profitability as well. On standalone basis, the business concentration levels – both customer and geographical – are well managed with having a policy of capping revenue through an intermediary. The business was able to achieve growth in revenue of ~13.5% during 1HFY21 due to volumetric increase of sales and enjoys reasonable margins and profitability. The business has improved its working capital management and mismatch at trade level has now resolved. Rustam Towel has a moderately leveraged capital structure, strong coverages and adequate working capital management. The expansion is majorly covered with internal cash and minimal portion of inexpensive financing. The ratings also draw comfort from strong financial strength of sponsors. Rustam Towel is a private limited hence, room for improvement in its governance structure continues to be essential.

The ratings are dependent upon the business ability to improve its volumes, margins and, in turn, profitability. Meanwhile, the ideology to dilute borrowing levels and adherence to sound financial discipline, gives comfort to the ratings. Strengthening of governance structure and financial transparency will lend support to the ratings

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-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Towel(Jan-21)
Rating Analysts	Raniya Tanawar | raniya.tanawar@pacra.com | +92-42-35869504

Profile

Legal Structure Rustam Towel (Pvt.) Limited (Rustam Towel) was incorporated in 1998 as a Private Limited Company.

Background Rustam Towel is a small-scale towel manufacturing concern. Primary business of the Company is to manufacture and export various types of towels. The Company started its business two decades ago and experienced consistent double-digit growth since 1998 by providing quality commercial textiles with competitive pricing. Mr. Arif Dogar – Father of Mr. Sana Ullah Dogar - in 1970s started textile business by setting up a textile mill, Rustam Weaving (Pvt.) Limited in Gujranwala. Mr. Sana Ullah started to work with his father. In 1998, along with his four brothers he formed a towel manufacturing company – Rustam Towel.

Operations Rustam Towel is one of the largest exporters of terry towels in Pakistan. It exports bath products to leading retailers, hospitality and healthcare industries across the world. European countries like United Kingdom, France, Germany and Spain are the main areas of concentration for the Company. Rustam Towel has weaving, dyeing and finishing solutions, all under one roof. The production facility of the Company has been set up near Lahore on 22-acre land with 10,000 spindles and 78 looms. Further, the Company has also diversified its portfolio by adding a denim production facility. Operations at the facility have officially started from August, 2019 with installed capacity of 120,000 pieces per month.

Ownership

Ownership Structure Majority of the shareholding lies with Mr. Sana Ullah (35%) and his son Mr. Sohaib Ali (20%). Mr. Wasim Arif, Mr. Zaka Ullah and Mr. Zia Arif are brothers of Mr. Sana Ullah and hold 20%, 10% and 15% shareholding, respectively.

Stability There is no formal succession plan, the ownership and family businesses are clearly divided mutually among brothers. Formation of documented succession plan would further strengthen stability of the Company.

Business Acumen Dogar family is in textile industry for more than four decades. Mr. Sana Ullah Dogar has been associated with the family business since inception. He has vast experience and knowledge of the towel industry.

Financial Strength The Dogar family owns another towel manufacturing company namely Saif Tex. Apart from textile business, the family has a property business in Gujranwala. The sponsors has invested and got franchises of international food chains in Lahore and Gujranwala.

Governance

Board Structure The overall governance matters are overseen by Sponsors. There is room for improvement as the governance structure lacks independent oversight.

Members' Profile Mr. Sana Ullah Dogar is the Chairman and brings ~40 years of experience to the Board. All other members have sufficient experience of the industry.

Board Effectiveness There is no independent director on the board. The board has not formed any board committees. All board members are also the shareholders of the Company. The board meetings are not conducted formally but family members meet regularly to discuss business developments and challenges.

Financial Transparency Akhter Mahmood Mian, Chartered Accountants are the external auditors of the Company. The auditors are not QCR rated by ICAP nor falls in the list of SBP's panel of auditors. Auditors, have given unqualified audit opinion on Company's financial statements for the year ending 30th June 2020.

Management

Organizational Structure Mr. Sana Ullah 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 Mr. Wasim Dogar, the youngest brother, is mainly responsible for the overall towel business affairs and heads the operations of the business, accompanied by his brother Mr. Zia Dogar.

Effectiveness Rustam Towel has SQL based system to automate key business functions in finance, operations and HR. MIS generated reports are reviewed by senior management on regular basis.

MIS The Company's MIS can be classified into three categories based on periodicity – Daily, Weekly and Monthly. The daily and weekly reports generated for top management mainly scrutinize liquidity position, cash and stock related reports. The Company is using an SQL based system. A new ERP (SAP B1) is in parallel testing phase and will be fully implemented in the future.

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 In Pakistan, there are approximately 10,000 towel looms, including shuttle and shuttle less looms operating in both organized and unorganized sector. The towel sector is predominantly export oriented. During FY20, exports clocked in at PKR~112bln (USD~711mln) as compared to PKR~107bln (USD~786) in FY19. However, this increase of ~5% YoY was largely attributable to currency depreciation. During FY20, the towel sector's contribution to overall textile exports was ~6%. Meanwhile, contribution to total country exports was ~3%. During 1HFY20, towel exports increased in both quantitative and values terms and stood at PKR~72bln (USD~446mln) as compared to PKR~59bln (USD~379mln) in FY19. This exhibited a growth of ~23% in PKR terms. Meanwhile, there was ~9% growth in quantitative terms. The growth reflected Pakistan's recovery from COVID-19 pandemic, as it was able to attract export orders when regional players were still struggling due to the pandemic and unable to meet demand. In regional terms globally, Europe and USA are the largest importers of towels. The top 5 exporters consist of China, India, Pakistan Turkey and Vietnam and together they account for approximately ~80% of the total export market.

Relative Position The business has a stable position and place itself among top towel exporters with ~4% market share in the country's towel exports.

Revenues The topline of the Company is majorly export oriented. Majority of the Company's exports are concentrated in Europe. During FY20, the Company's revenue clocked in at ~PKR 4,490mln (FY19: ~PKR 4,275mln), reflecting an increase of ~5%. The trend continued in the 1HFY21 when the revenues grew by 13.5%.The growth in revenue emanated from rupee depreciation and demand uptick due to COVID-19. The trend of incremental revenues is expected to continue in future as the pandemic posed more focus towards hygiene and healthy practices, hence resulting in growing demand. In addition to this, expansion in business existing capacity will further strengthen the revenue base

Margins During FY20, gross margin of the Company remained stable at ~17% (FY19: 17.9%), whereas operating expenses remained intact in FY20 and clocked in at ~PKR 324mln (FY19: ~PKR 310mln), resulting in operating margin of ~10% (FY19: ~10.5%). Finance cost was near to the same as last year. The Company's net profit margin stood at 7% as it posted net profit of ~PKR 320mln in FY20 (FY19: ~PKR 318mln). During 1HFY21 the gross margins remained unchanged from the year end and Net margins locked at 6.6%

Sustainability Since mid-march 2020, COVID-19 pandemic has been spreading rapidly in Pakistan and resulted in countrywide lockdown. However, the government has eased the lockdown from 15th April, 2020, and has allowed textile industry to resume production. Post ease of lockdown, the business is fully operational now. SBP initiatives/support to the industry remains important. However, outcome of third & fourth wave of the virus is still hazy. Rustam Towel is in the phase of expansion. At present, 48 looms are being added to the current capacity. The business is also moving towards energy efficient mode of operations.

Financial Risk

Working Capital During FY20, the gross working capital days slightly increased to 135 days (FY19: 122 days) on the back of receivables. The increasng trend continued in 1HFY21. The Company's working capital remained in-line with the industry average. The Company's short-term borrowing remained higher than its trade assets depicting negative room to borrow ~4% (FY19: ~21%) which reverted in the period 1HFY21(~12%)

Coverages In FY20, the FCFO of the Company dropped yet remained optimum at PKR 522mln(FY19: PKR 608mln). Consequently the interest coverage ratio declined to 5.4x(FY19: 6.8x). However the coverages of the entity is still considered strong. Majority of the financing is subsidized from SBP, further reducing the financial risk,

Capitalization Rustam Towel has moderately leveraged capital structure (FY20: ~44%, FY19: ~40%). The leveraging increased with a negligible amount. There is no long term borrowings except for SBP Salary refinancing on the books of Rustam Towel as on 1HFY21. The expansion is being largely sourced from internal cash.

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Financial Summary
PKR mln

Rustam Towel (Pvt.) Limited	Dec-20	Jun-20	Jun-19	Jun-18
Towel	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	2,690	2,747	2,634	2,126
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	2,650	2,310	1,895	1,689
a Inventories	*871*	*851*	*587*	*927*
b Trade Receivables	*1,333*	*1,029*	*865*	*491*
5 Total Assets	5,340	5,057	4,529	3,815
6 Current Liabilities	51	58	45	66
a Trade Payables	*51*	*58*	*45*	*66*
7 Borrowings	2,297	2,175	1,980	1,563
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	2,992	2,824	2,504	2,186
11 Shareholders' Equity	2,992	2,824	2,504	2,186
B INCOME STATEMENT				
1 Sales	2,547	4,490	4,275	3,166
a Cost of Good Sold	*(2,108)*	*(3,726)*	*(3,516)*	*(2,586)*
2 Gross Profit	439	764	759	580
a Operating Expenses	(205)	(324)	(310)	(244)
3 Operating Profit	234	440	448	336
a Non Operating Income or (Expense)	*12*	*23*	*16*	*2*
4 Profit or (Loss) before Interest and Tax	247	463	464	338
a Total Finance Cost	*(55)*	*(101)*	*(101)*	*(70)*
b Taxation	*(24)*	*(43)*	*(44)*	*(37)*
6 Net Income Or (Loss)	168	320	318	231
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*261*	*522*	*608*	*361*
b Net Cash from Operating Activities before Working Capital Chc	*206*	*421*	*709*	*329*
c Changes in Working Capital	*(401)*	*(487)*	*(368)*	*(335)*
1 Net Cash provided by Operating Activities	(195)	(66)	341	(7)
2 Net Cash (Used in) or Available From Investing Activities	(93)	(113)	(707)	(109)
3 Net Cash (Used in) or Available From Financing Activities	316	195	417	117
4 Net Cash generated or (Used) during the period	28	15	51	1
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	13.5%	5.0%	35.1%	7.2%
b Gross Profit Margin	17.2%	17.0%	17.7%	18.3%
c Net Profit Margin	6.6%	7.1%	7.4%	7.3%
d Cash Conversion Efficiency (FCFO adjusted for Working Capit	-5.5%	0.8%	5.6%	0.8%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total*	11.5%	12.0%	13.8%	11.2%
2 Working Capital Management				
a Gross Working Capital (Average Days)	146	135	122	193
b Net Working Capital (Average Days)	142	131	118	184
c Current Ratio (Current Assets / Current Liabilities)	51.7	39.7	42.0	25.7
3 Coverages				
a EBITDA / Finance Cost	5.9	5.9	6.0	5.4
b FCFO / Finance Cost+CMLTB+Excess STB	5.4	5.4	2.7	5.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Financ	0.3	0.1	0.3	0.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	43.4%	43.5%	44.2%	41.7%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0
c Entity Average Borrowing Rate	4.4%	4.6%	5.5%	4.9%

Credit Rating

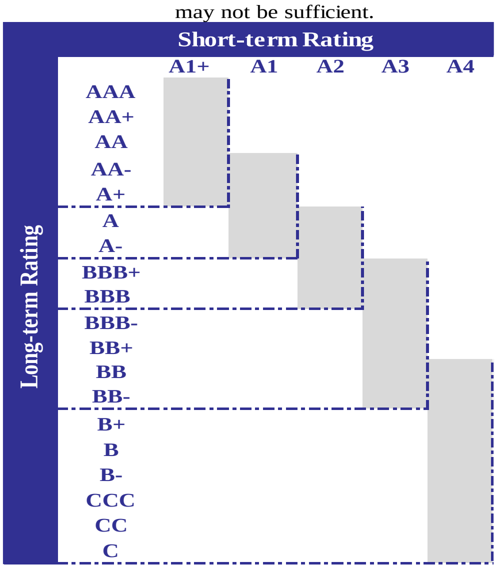
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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