The Pakistan Credit Rating Agency Limited

# Rating Report

## Interwood Mobel (Pvt.) Limited

**Report Contents**



**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 09-Aug-2019 | BBB+ | A2 | Stable | Maintain | - |
| 12-Feb-2019 | BBB+ | A2 | Stable | Initial | - |

**Rating Rationale and Key Rating Drivers**

The ratings reflect Interwood's strong brand name and established presence in the furniture industry of Pakistan. Over the years, the Company has mitigated risks associated with contractual jobs by focusing on the retail market. It has been successful in evolving its business portfolio and enjoys a healthy mix between retail and corporate sales. The ratings take into account the Company's automated production process, national footprint and professional management team. Recent devaluation of Pakistani Rupee will increase cost of production as a major portion of raw materials are imported. However, the Company has passed some of this cost to consumers as the product becomes more competitive against imported furniture. The ratings are restricted by the Company's stretched financial profile, characterized by weak coverages, significant leveraging and adequate working capital management. Additionally, governance framework requires strengthening.

The ratings are dependent on the Company's ability to maintain its leading position in the industry while sustaining margins. Meanwhile, improved financial profile through better coverages, effective working capital management and maintaining sufficient cushion to borrow, to avoid any mismatch in debt profile, will be critical for rating.

| Disclosure | |
|---|---|
| **Name of Rated Entity** | Interwood Mobel (Pvt.) Limited |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Entity Rating |
| **Applicable Criteria** | PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19) |
| **Related Research** | Sector Study \| Furniture & Fixtures(Feb-19) |
| **Rating Analysts** | Silwat Malik \| silwat.malik@pacra.com \| +92-42-35869504 |

## Profile

**Legal Structure** Interwood Mobel (Private) Limited (the Company) is a private limited company.

**Background** The Company was founded by Mr. Farooq Ahmed Malik and commenced operations in 1974 with a small workshop in Lahore. Over the years the Company has been able to expand operations by investing in state of the art machinery and automation of production lines. Initially, the Company's key area of focus had been accepting and executing contractual jobs. However, post 2002, the Company has developed its business profile by tapping the retail market.

**Operations** The Company is involved in the sale and manufacture of furniture and allied items. The Company's head office and production facility are consolidated in one location at Sultan Mehmood Road, Lahore. The Company has thirteen, company operated, retail outlets concentrated in Karachi (5), Lahore (3), Islamabad (3), Sialkot (1) and Peshawar (1). Additionally, it has established presence in other major cities through dealer networks.

## Ownership

**Ownership Structure** Major shareholding of the Company (99.9%) lies with Farooq Family. Mr. Farooq Ahmed Malik, the founder and his wife Ms. Ghazala Farooq own 17% and 16% of the Company, respectively. Meanwhile their sons Mr. Omar Farooq and Mr, Ali Farooq own 33% of the Company, each. Remaining shareholding (0.1%) is held by close relatives of the family.

**Stability** Ownership structure of the Company is seen as stable as no ownership changes are expected in the coming years.

**Business Acumen** Sponsors are considered to have strong business acumen, giving consideration to industry knowledge of more than forty years with noteworthy positioning in the industry

**Financial Strength** Since Interwood Mobel is a standalone company, financial strength is gauged by the financial profile of sponsors and their willingness to support the business, which is considered to be adequate.

## Governance

**Board Structure** Board of Directors comprises four members which includes the Chairman and three executive directors. Moreover, it is completely dominated by the sponsoring family, indicating lack of oversight.

**Members' Profile** Members have strong profiles with technical expertise and specialize in production and retail, in addition to furniture.

**Board Effectiveness** The Board has an Audit Committee in place which comprises four members and meets quarterly.

**Financial Transparency** Nazir Chaudri & Co., Chartered Accountants, who are not rated by the SBP but hold a satisfactory QCR rating, are the external auditors of the Company. They have expressed an unqualified opinion on the financial statements of the Company.

## Management

**Organizational Structure** Organizational structure of the Company is defined based on eight departments, including operations, sales and marketing, accounts and internal audit, among others. With the exception of the internal audit department, each departmental head reports to the Chief Executive Officer. Functions of supply chain, pre-production, production, plant maintenance and information technology come under the purview of general manager operations.

**Management Team** Management comprises of experienced individuals, representing a good skill mix. Mr. Omar Farooq, the Chief Executive, holds a BSc in furniture design and manufacturing, he has been associated with the Company for the past 24 years. He is ably supported by a professional management team. During the year Mr. Moiz Kaiser (Chief Financial Officer) resigned from the Company. Subsequently, he was replaced by Mr. Hafiz Muhammad Saleem.

**Effectiveness** In order to ensure efficient operations, the Company has in place three management committees, namely, Procurement Committee, Supply Chain Committee and Human Resources Committee. All three committees are headed by the Chief Executive and comprise relevant department heads.

**MIS** The Company deployed SAP Business One as its Enterprise Resource and Planning system in 2017. The system is close to being fully integrated and data migration is substantially complete.

**Control Environment** The Company has a strong control environment in place through its internal audit department. The scope of the department entails carrying out various tests and activities for identifying vulnerabilities and rectifying them. Activities are conducted on a monthly basis at the Company's factory and showrooms spread across Pakistan.

## Business Risk

**Industry Dynamics** The furniture industry of Pakistan is largely unstructured and comprises of a multitude of small to medium sized players. Moreover, a significant portion of the market sells imported items, however, an upward revision in the regulatory duty imposed on imported furniture items to 45% will negatively affect these players while promoting locally manufactured products. The industry reflects encouraging prospects on the back of growth in the urban middle class and increasing personal disposable income in major cities. This will slowly but steadily improve the consumption pattern relating to non-essential items and luxury goods.

**Relative Position** Interwood Mobel holds a strong position in the market due to its unparalleled production plant and manufacturing capability. Although it has no direct competition, it faces area and product specific competition from numerous small to medium sized players.

**Revenues** The Company sources its revenue from six main product categories, namely, office furniture, home furniture, kitchens, wardrobes, doors and others. Revenue stream is fairly concentrated with the top two product categories (Office and Home furniture) accounting for majority of sales. Revenues during 9MFY19 clocked in at ~PKR 2,512mln (FY18: PKR 2,951mln) on the back of high prices and increased home and office furniture sales.

**Margins** The Company implements a cost-plus pricing strategy. During 9MFY19, an upward revision in margins was observed as the Company increased prices passing impact of rupee depreciation to its customers. Moreover, strategic procurement of raw materials helped augment profitability. Gross and operating profit margin during 9MFY19 increased to ~34% (FY18: 30%) and ~12% (FY18: 9%), respectively. Additionally, the Company's profitability is supported by commission income. Despite high finance costs during 9MFY19, the Company only recorded a minor slow down in net profit margin at ~5%, owing to higher gross margin. The Company witnessed a surged net profit margin during FY18, which stood at ~11% (FY17: ~6%). However, this was due to one-off income booked worth ~PKR 200mln and share of profit from its joint-venture project with Descon.

**Sustainability** Going forward, the Company plans to minimize manual intervention in the production process with the help of conveyor belts. It has recently expanded its polishing unit and has purchased 25 acres of land in Rachna Industrial Park for future expansion. Moreover, the Company is in process of developing its existing locations in Karachi and Islamabad.

## Financial Risk

**Working Capital** The Company's working capital is predominantly a function of its inventories as sufficient stock levels of various products must be maintained to cater to customer demand. However, the Company benefits from advance payments from customers. During 9MFY19, net working capital days remained elevated at 214 days, as compared to 191 days in FY18. This can be explained by lower trade payable days. The Company has been successful in eliminating its short-term debt mismatch through the help of debt restructuring. This creates a cushion to borrow additional funds and reflects positively on the Company.

**Coverages** In line with higher profitability, cashflows witnessed an increase during 9MFY19, standing at PKR 274mln (FY18: PKR 221mln). However, impact of higher cashflows was subdued owing to high finance costs, bearing a negative impact and bringing interest coverage down to 2.1x (FY18: 3.5x). Similarly, owing to higher current maturity of long term debt, total coverage declined to 0.9x (FY18: 1.6x), during the nine month period. Going forward, elevated interest rates are likely to keep coverage ratios suppressed.

**Capitalization** The Company has a significantly leveraged capital structure with a debt to equity ratio of 48% during 9MFY19. A marginal increase of ~3% was observed in total debt during 9MFY19 over FY18, which saw total debt increase to PKR 2,379mln (FY18: PKR 2,304mln). However, a significant change was observed in the debt mix owing to debt restructuring. During 9MFY19, long-term debt represented ~62% of total debt as compared to 51% in FY18. Similarly, composition of short-term debt was reduced to 38% in 9MFY19 as compared to 48% in FY18. Moreover during 9MFY19, issued share capital was increased to ~PKR 1,248mln (FY18: PKR 123mln) through issuance of bonus shares.

The Pakistan Credit Rating Agency Limited

*Financial Summary*
*PKR mln*

| Interwood Mobel (Private) Limited<br>Furniture & Fixtures | Mar-19<br>9M | Jun-18<br>12M | Jun-17<br>12M | Jun-16<br>12M |
|---|---|---|---|---|
| **A BALANCE SHEET** | | | | |
| 1 Non-Current Assets | 3,619 | 3,463 | 3,056 | 2,645 |
| 2 Investments | 78 | 255 | 44 | - |
| 3 Related Party Exposure | 4 | 469 | 48 | 41 |
| 4 Current Assets | 3,222 | 3,201 | 2,107 | 1,829 |
| *a Inventories* | *1,683* | *1,848* | *1,375* | *1,185* |
| *b Trade Receivables* | *484* | *506* | *336* | *268* |
| **5 Total Assets** | 6,922 | 7,390 | 5,256 | 4,515 |
| 6 Current Liabilities | 1,613 | 2,290 | 1,597 | 1,367 |
| *a Trade Payables* | *440* | *406* | *611* | *386* |
| 7 Borrowings | 2,379 | 2,051 | 972 | 618 |
| 8 Related Party Exposure | 5 | 253 | 236 | 221 |
| 9 Non-Current Liabilities | 337 | 337 | 319 | 331 |
| **10 Net Assets** | 2,588 | 2,458 | 2,132 | 1,978 |
| **11 Shareholders' Equity** | 2,588 | 2,458 | 2,132 | 1,978 |
| **B INCOME STATEMENT** | | | | |
| **1 Sales** | 2,512 | 2,915 | 2,603 | 2,265 |
| *a Cost of Good Sold* | *(1,654)* | *(2,041)* | *(1,834)* | *(1,741)* |
| **2 Gross Profit** | 858 | 873 | 769 | 523 |
| *a Operating Expenses* | (558) | (624) | (536) | (324) |
| **3 Operating Profit** | 300 | 249 | 232 | 199 |
| *a Non Operating Income or (Expense)* | *19* | *389* | *55* | *13* |
| **4 Profit or (Loss) before Interest and Tax** | 319 | 639 | 287 | 212 |
| *a Total Finance Cost* | *(147)* | *(164)* | *(83)* | *(76)* |
| *b Taxation* | *(43)* | *(148)* | *(57)* | *(53)* |
| **6 Net Income Or (Loss)** | 130 | 326 | 147 | 84 |
| **C CASH FLOW STATEMENT** | | | | |
| *a Free Cash Flows from Operations (FCFO)* | *274* | *221* | *301* | *276* |
| *b Net Cash from Operating Activities before Working Capital Changes* | *120* | *267* | *264* | *203* |
| *c Changes in Working Capital* | *(4)* | *(816)* | *(36)* | *(110)* |
| **1 Net Cash provided by Operating Activities** | 116 | (548) | 229 | 92 |
| **2 Net Cash (Used in) or Available From Investing Activities** | (27) | (405) | (550) | (178) |
| **3 Net Cash (Used in) or Available From Financing Activities** | (84) | 948 | 329 | 81 |
| **4 Net Cash generated or (Used) during the period** | 5 | (5) | 8 | (5) |
| **D RATIO ANALYSIS** | | | | |
| **1 Performance** | | | | |
| *a Sales Growth (for the period)* | 14.9% | 12.0% | 14.9% | N/A |
| *b Gross Profit Margin* | 34.1% | 30.0% | 29.5% | 23.1% |
| *c Net Profit Margin* | 5.2% | 11.2% | 5.7% | 3.7% |
| *d Cash Conversion Efficiency (EBITDA/Sales)* | 19.2% | 14.0% | 14.9% | 15.5% |
| *e Return on Equity (ROE)* | 6.9% | 14.2% | 7.2% | 4.2% |
| **2 Working Capital Management** | | | | |
| *a Gross Working Capital (Average Days)* | 259 | 255 | 222 | 155 |
| *b Net Working Capital (Average Days)* | 212 | 191 | 152 | 93 |
| *c Current Ratio (Total Current Assets/Total Current Liabilities)* | 2.0 | 1.4 | 1.3 | 1.3 |
| **3 Coverages** | | | | |
| *a EBITDA / Finance Cost* | 3.6 | 6.5 | 5.8 | 5.4 |
| *b FCFO / Finance Cost+CMLTB+Excess STB* | 0.9 | 0.8 | 2.4 | 2.2 |
| *c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)* | 7.9 | 7.5 | 3.5 | 1.8 |
| **4 Capital Structure (Total Debt/Total Debt+Equity)** | | | | |
| *a Total Borrowings / Total Borrowings+Equity* | 48% | 48% | 36% | 30% |
| *b Average Borrowing Rate* | 7.6% | 3.6% | 6.6% | 7.7% |

# Rating Scale | Corporate

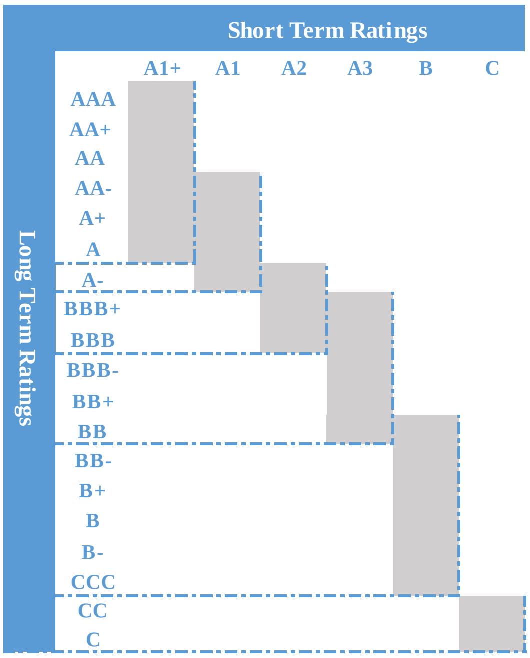
2019

## Credit Rating Scale & Definitions

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

| Long Term Ratings | |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>C | **Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default. |
| D | Obligations are currently in default. |

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




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

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

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

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

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

## Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

**Rating Team Statements**

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

**Restrictions**

(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

**Conduct of Business**

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

**Independence & Conflict of interest**

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

**Monitoring and review**

(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

**Probability of Default**

(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

**Proprietary Information**