The Pakistan Credit Rating Agency Limited

# Rating Report

# Tufail Chemical & Surfactants (Pvt.) Limited

**Report Contents**



**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 30-Dec-2020 | A- | A2 | Stable | Maintain | - |
| 31-Dec-2019 | A- | A2 | Stable | Initial | - |

**Rating Rationale and Key Rating Drivers**

Tufail Chemical & Surfactants (Pvt.) Limited’s (the Company) ratings reflect adequate business profile of the Company, characterized by a relatively limited capacity and modest profitability. The Company is associated with Tufail Chemical Industries Limited and majority of its surfactants (LABSA and SLES) sales are channelled through Tufail Chemical Industries Limited. Thus, the Company's sales remain a factor of overall demand and how it will be benefited at group level. Historically, dumping by various international players has squeezed the margins of the Company. Imposition of anti-dumping for five years on sulphonic acid imports from various countries, since May-17, has helped the Company in sustaining its profitability. The R&D is done at Group level which has helped the Company in commissioning new surfactants variants. This, alongside continuous BMR activities and experienced management team transpires into operational efficiencies, in turn, improved product profile and stable margins despite challenging environment. The demand for the Company's products is expected to remain intact with rising income and hygiene awareness. Meanwhile, the Company has modest financial risk profile, characterized by moderate leveraging, healthy coverages. The Company finances its working capital needs through short term borrowing leading to relatively limited cushion at trade assets level. The assigned ratings incorporates experienced management and the Company’s association with Tufail Group, leading surfactants manufacturer of Pakistan. Strengthening of governance framework will be helpful to the Company.
COVID-19 has impacted the industries all over the world but the Chemical industry sustained really well due to the chemical products being used in this pandemic period. Additionally, growing demand for consumer health products (soaps, etc.) amidst COVID- 19 outbreak has benefited the Company as general hygiene and cleanliness becomes paramount, resulting in increased demand for chemical-based products.

The ratings are dependent on the Company’s ability to sustain its margins, profitability and optimal capacity utilization along with efficiency in working capital cycle. Going forward, continuation of anti-dumping duty will remain critical. Any significant deterioration in margins and/or financial profile will impact the ratings.

**Disclosure**

| | |
|---|---|
| **Name of Rated Entity** | Tufail Chemical & Surfactants (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 \| Chemical(Jul-20) |
| **Rating Analysts** | Sohail Ahmed Qureshi \| sohail.ahmed@pacra.com \| +92-42-35869504 |

## Profile

**Legal Structure** Tufail Chemical & Surfactants (Pvt.) Limited (The Company) was incorporated on September 02, 2009 as a private limited company.

**Background** Tufail Chemical has an established presence in local Chemical industry. Initially, the family was involved in chemical trading. In 1993, the family transformed its distribution network in the manufacturing business through Tufail Chemical Industries Limited. Later on, in 2009 Tufail Group expanded its manufacturing operations through the incorporation of Tufail Chemical & Surfactants.

**Operations** The Company's current capacity stands at 35,000 tones. The power requirements are met internally through gas fired generates. Meanwhile, the Company has coal and diesel based generators as backup. The Company is also in process of procuring line from K-Electric.

## Ownership

**Ownership Structure** The Company is a family owned venture and ~99.6% its shareholding is distributed among members of Tufail family. Out of which, Mr. Zubair Tufail & his family members hold 51% and Mr. Pervez Tufail & his family members own 48.6%. The remaining 0.4% is held by their cousin, Mr. Mubashir Ahmed.

**Stability** The formalized distribution of shareholding among brothers and their family members portrays clear line of succession. The second generation is already in business, serving as executive director in the Company. However, the transfer of ownership to next generation is yet to be seen.

**Business Acumen** Mr. Zubair Tufail inherited a chemical trading company and transformed it into one of the largest manufacturer of surfactants in Pakistan. He was elected as a president of Pakistan Chamber of Commerce and Industry for the year 2017. Mr. Zubair Tufail is well known for his acumen in chemical industry of Pakistan.

**Financial Strength** Tufail family has a collective net worth of over PKR 1bln, portraying adequate financial strength to support the Company, if needed.

## Governance

**Board Structure** The Company's board comprises four-members with the dominance of Tufail Family. Mr. Pervez Tufail is the Chairman of the board and is also the CEO of the Company. All director carries executive roles.

**Members' Profile** Mr. Pervez Tufail – Chairman/CEO – holds a graduate degree and carries with him five decades of experience in the chemical industry. He is a leading businessman with extensive knowledge of chemicals, organic, inorganic solvents, and petrochemicals.

**Board Effectiveness** Member's attendance in board meetings remains strong and meeting minutes are formally documented. The Company's board is dominated by family members with no independent oversight. Thus posing a limited challenge. Independent oversight and formation of board subcommittees are expected to strengthen effective governance.

**Financial Transparency** Naveed Zafar Ashfaq Jaffery & Co. is the external auditor of the Company. The auditor is listed in Category "A" of the State Bank's panel of auditors and audit of the Company's financial statements for FY20 is yet to be concluded.

## Management

**Organizational Structure** The Company operates with five functional departments, each headed by an experienced HoD. All HoD's report to the Senior Executive director - who manages the day to day operations of the business. Mr. Zubair Tufail focuses more on longer-term business development and strategic relationships. In order to rationalize costs, all business functions are shared at Group level, except production.

**Management Team** Mr. Zubair Tufail is the Senior Executive Director of the Company. He is associated with the Company since its inception. Prior to this, he had a prominent role in Tufail Trading Company (Tufail Family's venture). He holds a B.Com degree and carries over five decades of experience in the chemical sector. Mr. Zubair Tufail is assisted by an experienced and professional management team.

**Effectiveness** The Company's production facility is equipped with multiple quality control labs with real time surveillance by GM production to ensure optimal monitoring. The key management personnel meet on weekly and monthly basis to proactively address operational issues.

**MIS** The Company has implemented ER Manager in 2012 as ERP solutions. The ERP has 15 modules which can be mixed and matched as per business needs. The Company has successfully upgraded its ERP by implementing latest version of SAP which went live in May 2020.

**Control Environment** The Company has in-place a European automated system to control & monitor the Sulphonation process. Moreover, filling area surveillance is done through dedicated system. The production details related to yield and quality for each product is shared with the senior management on real-time basis.

## Business Risk

**Industry Dynamics** Pakistan is a net importer of chemicals and related products with ~18%-20% share in the country import bill. The current size of detergents and shampoo industry is approximately 500,000 tones. The annual consumption of surfactants for stated capacity is at 115,000 tones (company sources). Due to an increase in demand for health and safety products, the chemical industry is able to manufacture and sell products despite lockdown situation all around the globe.

**Relative Position** Tufail Group is one of the leading chemical manufacturers of Pakistan and market leader in the surfactants segment. Tufail Chemical & Surfactant (Pvt.) limited channels its surfactants sales to renowned MNCs, through its associated company. Engro and Sitara chemicals, both have announced the plant capacity of 20,000tpd and 30,000tpd LABSA plant, respectively, the competition will increase.

**Revenues** The Company derives its revenues from local sales. Of this, ~67% is contributed by Surfactants (LABSA, SLS & SLES), sold predominantly to its associated company – Tufail Chemical Industries Limited. During FY20, the Company's revenues clocked-in at PKR 3,534mln with growth of 26% (FY19: 2,809mln) due to an increase in demand. Similarly, more comfort can be drawn from its majority sales to its associated company and MNC's. In addition to surfactants, Sodium Sulphate has a notable share (28%) in the Company's top-line.

**Margins** In FY20, the gross margin reduced to 9.5% from 10.8% in FY19 due to the increase in raw material despite higher revenues. Similarly, the Company's operating margin has declined (FY20: 8.1%, FY19: 9.3%). The finance cost increased on account of higher STB and borrowing form associated company and stood at ~PKR 102mln in FY20 (FY19: ~PKR 86mln). Collectively, these factors have translated into declining net margins (FY20: ~2.5%, FY19: ~4.1%). The Company's net profit stood at ~PKR 88mln in FY20 (FY19: ~PKR 116mln).

**Sustainability** The Company regularly invests in R&D which has yielded specialized products range, especially variants of surfactants. Although, many industries were impacted due to COVID-19 pandemic, the chemical industry related to essential items has managed to do well. Despite lockdown and tough situation, most chemical producing Companies started manufacturing the health and safety related products and the production was not much affected. Tufail Chemical and Surfactants is running smoothly at 85-90% capacity and have sufficient orders in hand due to niche customer base consisting mostly of MNC's. Government has allowed the Company to claim tax refunds during the pandemic situation, which, if approved, will be a major cash inflow for the Company.

## Financial Risk

**Working Capital** In FY20, the Company's inventory days have inclined to 21 days (FY19: 15 days). This was followed by an increase in receivables days (FY20: 92 days, FY19: 84 days). Consequently, resulting in considerably higher net working capital days (FY20: 103 days, FY19: 98 days). However, the Company's short-term trade leverage improved to 34% in FY20 (FY19: 10.3%).

**Coverages** During FY20, the Company's operating cash flows (FCFO) declined to ~PKR 146mln (FY19: ~PKR 265mln). Similarly, interest coverage reduced to 1.5x in FY20 (FY19: 3.1x) due to high increase in interest cost. Similarly, debt coverage has declined to 1.5x in FY20 (FY19: 3.1x).

**Capitalization** Leveraging of the company has increased from 54.6% in FY19 to ~64.5% at end FY20 on account of increase in borrowings. The Company's borrowing comprises only short-term borrowings, utilized, in order to fill the gap created by significant receivables. Short term borrowings also consist of loan form associated company, Tufail Chemical Industries Limited ~PKR 450mln in FY20 consisting of ~33.5% of STB's.

PKR mln

| Tufail Chemical & Surfactants (Pvt.) Limited<br>Chemical | Jun-20<br>12M | Jun-19<br>12M | Jun-18<br>12M |
|---|---|---|---|
| **A BALANCE SHEET** | | | |
| 1 Non-Current Assets | 750 | 691 | 659 |
| 2 Investments | - | - | - |
| 3 Related Party Exposure | - | - | - |
| 4 Current Assets | 1,756 | 1,029 | 1,009 |
| *a Inventories* | *302* | *112* | *120* |
| *b Trade Receivables* | *1,213* | *561* | *736* |
| **5 Total Assets** | 2,506 | 1,720 | 1,668 |
| 6 Current Liabilities | 301 | 99 | 75 |
| *a Trade Payables* | *174* | *19* | *6* |
| 7 Borrowings | 892 | 729 | 769 |
| 8 Related Party Exposure | 450 | 91 | 136 |
| 9 Non-Current Liabilities | 123 | 120 | 121 |
| **10 Net Assets** | 740 | 681 | 567 |
| **11 Shareholders' Equity** | 740 | 681 | 567 |
| **B INCOME STATEMENT** | | | |
| **1 Sales** | 3,534 | 2,809 | 2,820 |
| *a Cost of Good Sold* | *(3,197)* | *(2,506)* | *(2,560)* |
| **2 Gross Profit** | 337 | 303 | 259 |
| *a Operating Expenses* | (49) | (44) | (40) |
| **3 Operating Profit** | 288 | 260 | 220 |
| *a Non Operating Income or (Expense)* | *(44)* | *(12)* | *22* |
| **4 Profit or (Loss) before Interest and Tax** | 244 | 248 | 242 |
| *a Total Finance Cost* | *(102)* | *(86)* | *(95)* |
| *b Taxation* | *(54)* | *(46)* | *(46)* |
| **6 Net Income Or (Loss)** | 88 | 116 | 101 |
| **C CASH FLOW STATEMENT** | | | |
| *a Free Cash Flows from Operations (FCFO)* | *146* | *265* | *278* |
| *b Net Cash from Operating Activities before Working Capital Changes* | *30* | *166* | *210* |
| *c Changes in Working Capital* | *(599)* | *182* | *191* |
| **1 Net Cash provided by Operating Activities** | (569) | 348 | 401 |
| **2 Net Cash (Used in) or Available From Investing Activities** | (107) | (79) | 72 |
| **3 Net Cash (Used in) or Available From Financing Activities** | 493 | (85) | (470) |
| **4 Net Cash generated or (Used) during the period** | (183) | 185 | 3 |
| **D RATIO ANALYSIS** | | | |
| **1 Performance** | | | |
| *a Sales Growth (for the period)* | 25.8% | -0.4% | 60.1% |
| *b Gross Profit Margin* | 9.5% | 10.8% | 9.2% |
| *c Net Profit Margin* | 2.5% | 4.1% | 3.6% |
| *d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)* | -12.8% | 15.9% | 16.6% |
| *e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Sh* | 14.1% | 17.2% | 16.1% |
| **2 Working Capital Management** | | | |
| *a Gross Working Capital (Average Days)* | 113 | 99 | 125 |
| *b Net Working Capital (Average Days)* | 103 | 98 | 123 |
| *c Current Ratio (Current Assets / Current Liabilities)* | 5.8 | 10.4 | 13.4 |
| **3 Coverages** | | | |
| *a EBITDA / Finance Cost* | 3.1 | 3.6 | 2.9 |
| *b FCFO / Finance Cost+CMLTB+Excess STB* | 1.5 | 3.1 | 3.0 |
| *c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)* | 9.9 | 0.5 | 0.7 |
| **4 Capital Structure** | | | |
| *a Total Borrowings / (Total Borrowings+Shareholders' Equity)* | 64.5% | 54.6% | 61.5% |
| *b Interest or Markup Payable (Days)* | 108.7 | 187.7 | 222.0 |
| *c Entity Average Borrowing Rate* | 10.7% | 11.2% | 8.3% |

## Credit Rating

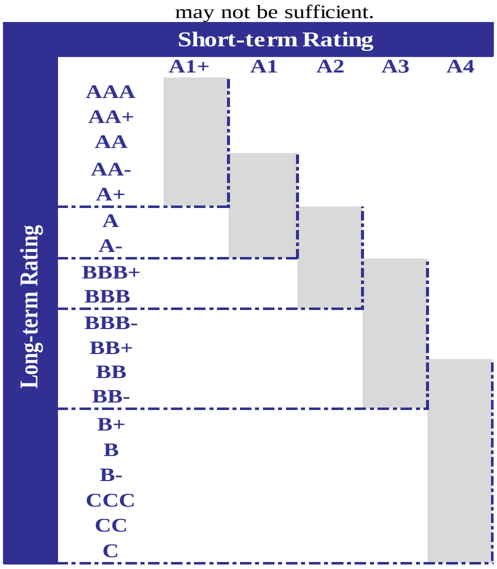
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

**Long-term Rating**

| Scale | Definition |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+ <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 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**