The Pakistan Credit Rating Agency Limited

Rating Report

Tufail Chemical Industries Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Aug-2023	A-	A2	Stable	Maintain	-
23-Aug-2022	A-	A2	Stable	Maintain	-
23-Aug-2021	A-	A2	Stable	Maintain	-
14-Sep-2020	A-	A2	Stable	Maintain	-
24-Sep-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Tufail Chemical Industries Limited ('TCIL' or 'the Company') is primarily engaged in the production and sale of specialized chemicals in Pakistan. The ratings reflect TCIL's leading position in domestic manufacturing of surfactants (key raw material for detergents & shampoo industry), strong customer base - mainly MNC's, & generation of sustained profitability matrix. Pakistan's reliance on imported chemicals is reducing with time as local manufacturers are injecting investments in lifting import substitution by enhancing production capacities and improving market base. The chemical industry is linked with other sectors of the economy and embodies a large number of products. Thus, key opportunity is generically available to the industry in terms of rising demand from forward linked sectors; including textile, detergent, personal hygiene, etc. However, continuous adoption of advanced technology is indispensable to drive industry's growth. At this time, fluctuating prices of materials and exchange rate exposure pose challenging business environment. Historically, dumping by various international players has squeezed the margins of the industry. The imposition of anti-dumping for five years on sulphonic acid imports from various countries has helped the Company in ensuring its market share and profitability. The Company has strengthened its distribution network by adding new dealers across the country. As of end 9MFY23, the Company managed to witness slow growth (~7.3%) in topline owing to economic challenges faced related to opening of LCs for the import of core materials during review period as a result of depletion in country's FX reserves. Similarly, TCIL's profitability matrix also reduced which can be attributed to higher operating costs and increase in finance costs. In near future, the Company intends to emphasize on export sales through established links with renowned MNCs to ensure higher sales volume and superior margins. As a whole, Tufail Chemical Industries Limited has achieved operational efficiency, economies of scale, and competitive edge post-merger with its associated concern 'Tufail Chemical & Surfactants (Pvt.) Limited'. Financial risk profile is characterized by intermediate leveraging, adequate coverages, and reasonable working capital cycle. The assigned ratings drive comfort from demonstrated sponsors' support and commitment. Further, implementation of good governance and efficient control environment is required to ensure compliance at all levels.

The ratings are dependent on the Company's ability to sustain its leading position while improving topline growth, profitability margins, and optimal capacity utilization post-merger integration. Better financial profile through effective working capital management, maintaining strong coverages and sufficient cushion to borrow at trade level is critical. Meanwhile, audited financial statements reflecting seamless transition and financial position of the combined entity in the coming time will have a positive impact on future trajectory of ratings.

Disclosure

Name of Rated Entity	Tufail Chemical Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Chemical(Jul-23)
Rating Analysts	Iqra Toqeer | iqra.toqeer@pacra.com | +92-42-35869504

Profile

Legal Structure Tufail Chemical Industries Limited (Tufail Chemical) was incorporated in 1993 and commenced operations in 1995 as a public unlisted company.

Background Tufail Chemical has an established presence in the 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. During Feb-22, other group Company, Tufail Chemical & Surfactants (Pvt.) Limited was merged with and into Tufail Chemical Industries Limited.

Operations The Company's current capacity stands at ~150,000 tones with power requirements of 1.9MW. However, post-merger & acquisition activity, ~35,000 tones capacity was added to the Company. The power requirements are met internally through gas-fired generators. Meanwhile, the Company has coal and diesel-based generators as backup. The Company is also in the process of procuring lines from K-Electric.

Ownership

Ownership Structure Tufail Chemical is a family-owned and managed business. Out of total shareholding, Mr. Zubair Tufail along with his family members own ~51% stake, Mr. Pervez Tufail and his family members hold ~47.5% and the remaining ~1.5% shareholding is owned by Mr. Mubashir Ahmed, cousin of both brothers.

Stability The formalized distribution of shareholding among two brothers and their family members portrays clear line of succession. The second generation is already in business, serving as executive director in the Company.

Business Acumen Mr. Zubair Tufail inherited a chemical trading company and transformed it into one of the largest manufacturers 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 Chemical has expanded its footing in the entertainment business through PEG (Pvt) Limited. The family has a collective net worth of over PKR 1.0bln, portraying adequate financial strength to support the Company, if needed.

Governance

Board Structure Tufail Chemical's board comprises five-members with dominance of Tufail Family. Mr. Zubair Tufail is the Chairman of board and he is also the CEO of the Company. Additionally, there are three executive directors, while remaining members are non-executive directors.

Members' Profile Mr. Zubair Tufail – Chairman/CEO – holds a graduate degree and carries with him five decades of experience in chemical industry. Apart from Tufail Chemical, he is the Chairman of Tufail Group of Companies.

Board Effectiveness During FY23, members attendance has remained strong and meeting minutes were formally documented. The Company's board is dominated by family members with no independent oversight. However, the Company is planning to induct independent director in near future.

Financial Transparency M/S Naveed Zafar Ashfaq Jaffery & Co. is the external auditor of the Company. The auditor is listed in Category "A" of the SBP's panel of auditors and expressed an unqualified opinion on the Company's financial statements for the period ended June 30th, 2022. Audit for FY23 is yet to be conducted.

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 - Mr. Pervez Tufail - who manages day-to-day operations of the business.

Management Team Mr. Pervez 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 four decades of experience in chemical sector.

Effectiveness The Company's production facility is equipped with multiple quality control labs with real time surveillance by Director Technical Operations 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 having 15 modules which can be mixed and matched as per business needs. The Company successfully upgraded its ERP by implementing latest version of SAP which went live in May 2020.

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

Business Risk

Industry Dynamics The chemical industry is broadly divided into four categories namely: i) Basic Chemical, ii) Life Science, iii) Specialty Chemicals, and iv) Consumer Products. Among all, Tufail Group's products largely falls in basic chemicals. Pakistan's reliance on imported chemical is reduced over the years as the local companies invested more to increase their production capacity and hence market share. Chemical sector of Pakistan contributes around ~4.6% in exports and its share in imports is ~11.2%. The sector is considered as a backbone in the development of forward-linked industries. The current size of detergents & shampoo industry is approximately ~500,000 tones. The annual consumption of surfactants for stated capacity is at ~115,000 tones (company sources). Also, there has been an increase in demand for health & safety products post pandemic crisis.

Relative Position Tufail Group is one of the leading chemical manufacturers of Pakistan and leader in surfactants segment. Tufail Chemical has the largest manufacturing facility of surfactants in Pakistan. In terms of revenues, Tufail Chemical falls in top five chemical manufacturing of Pakistan. Meanwhile, the Company caters to the needs of MNCs along with local manufacturers, strengthening its market position.

Revenues Owing to merger & acquisition conducted with Tufail Chemical Surfactant (group Co.) during Feb-22, the revenue figure significantly ramped by ~84.1% growth, where topline clocked at PKR 17,243mln during FY22 (FY21: PKR 9,367mln). The Company majorly derives its revenues (~90%) from local sales. Of this, approx. 80% is contributed by Surfactants (LABSA, SLS & SLES). The Company largely supplies its surfactant products to renowned MNC's, of which sales to Unilever (Pak) Limited comprises around ~21% of topline. The Company's sales also include toll manufacturing services which are provided on demand basis. Top 10 customer concentration is high. However, comfort can be drawn from long established relationships with the leading customers. During 3QFY23, the Company recorded a total revenue of PKR 13,872mln, registering 7.3% growth year-on-year basis.

Margins During FY22, gross margin slightly reduced to 16.0% from 16.6% owing to increased cost of imported materials. However, the Company's operating margin improved to 7.0% in FY22 (FY21: 5.4%) on account of better operating profit. Further, net margin of the Company slightly reduced to 1.9% from 2.0% in FY21. At end Mar'23, bottom-line locked at PKR 52mln whereas gross and net margins stood at 13.0% & 0.4%, respectively.

Sustainability Tufail Chemical regularly invests in R&D which has yielded specialized products range, especially variants of surfactants. The Company has sufficient orders in hand due to niche customer base consisting mostly of MNC's.

Financial Risk

Working Capital During 3QFY23, the Company's gross and net working capital cycle stood at 78 and 44 days, respectively (FY22: 71 and 44 days, respectively).

Coverages During FY22, the Company's operating cash flows (FCFO) improved to PKR 1,308mln (FY21: PKR 906mln) on account of increased profitability. Due to increased borrowings and more finance cost post merger, interest coverage ratio reduced to 3.0x in FY22 (FY21: 3.4x). Similarly, debt coverage has also decreased to 2.4x in FY22 (FY21: 3.4x). In 3QFY23, interest and debt coverage ratios stood at 1.6x and 1.3x.

Capitalization The Company has a leveraged (FY22: ~46.6%) capital structure. The Company's borrowings are primarily (~99%) short-term in nature and are largely utilized to fill working capital needs. At end Mar'23, the Company's leverage ratio decreased to ~39.1% owing to reduced long term debt book.

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Financial Summary
PKR mln

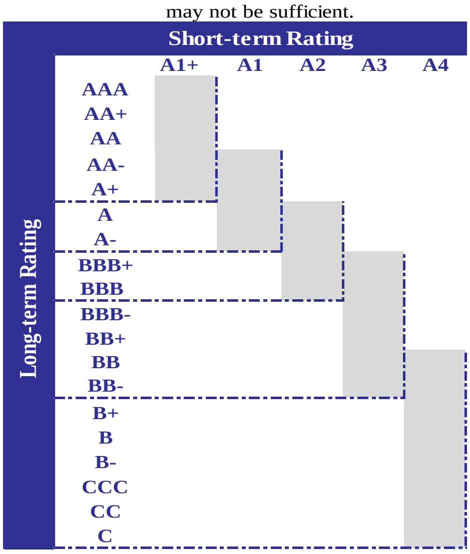
Tufail Chemical Industries Limited	Mar-23	Jun-22	Jun-21	Jun-20
Chemical	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	3,632	3,872	2,633	1,341
2 Investments	-	-	-	-
3 Related Party Exposure	1,272	1,218	1,196	550
4 Current Assets	5,511	5,927	2,757	5,120
a Inventories	*838*	*1,717*	*1,189*	*998*
b Trade Receivables	*2,443*	*2,865*	*972*	*3,485*
5 Total Assets	10,415	11,017	6,586	7,010
6 Current Liabilities	2,805	2,303	1,405	1,509
a Trade Payables	*1,868*	*1,523*	*1,081*	*1,047*
7 Borrowings	2,602	3,631	1,352	2,596
8 Related Party Exposure	-	-	340	-
9 Non-Current Liabilities	961	927	558	266
10 Net Assets	4,048	4,156	2,931	2,639
11 Shareholders' Equity	4,048	4,156	2,931	2,639
B INCOME STATEMENT				
1 Sales	13,872	17,243	9,367	8,930
a Cost of Good Sold	*(12,064)*	*(14,492)*	*(7,813)*	*(7,626)*
2 Gross Profit	1,808	2,751	1,555	1,305
a Operating Expenses	(841)	(1,539)	(1,049)	(580)
3 Operating Profit	967	1,212	506	725
a Non Operating Income or (Expense)	*(196)*	*(190)*	*29*	*(5)*
4 Profit or (Loss) before Interest and Tax	772	1,022	534	720
a Total Finance Cost	*(521)*	*(457)*	*(271)*	*(459)*
b Taxation	*(199)*	*(242)*	*(79)*	*(95)*
6 Net Income Or (Loss)	52	322	184	166
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*780*	*1,308*	*906*	*747*
b Net Cash from Operating Activities before Working Capital Changes	*264*	*899*	*646*	*290*
c Changes in Working Capital	*1,016*	*(1,867)*	*1,683*	*(188)*
1 Net Cash provided by Operating Activities	1,280	(968)	2,329	101
2 Net Cash (Used in) or Available From Investing Activities	(32)	516	(1,097)	(207)
3 Net Cash (Used in) or Available From Financing Activities	(1,189)	607	383	103
4 Net Cash generated or (Used) during the period	59	154	1,615	(3)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	7.3%	84.1%	4.9%	5.3%
b Gross Profit Margin	13.0%	16.0%	16.6%	14.6%
c Net Profit Margin	0.4%	1.9%	2.0%	1.9%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	13.0%	-3.2%	27.6%	6.3%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	1.7%	9.1%	6.6%	6.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	78	71	129	170
b Net Working Capital (Average Days)	44	44	88	140
c Current Ratio (Current Assets / Current Liabilities)	2.0	2.6	2.0	3.4
3 Coverages				
a EBITDA / Finance Cost	2.1	3.7	4.3	2.1
b FCFO / Finance Cost+CMLTB+Excess STB	1.3	2.4	3.4	1.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.5	0.4	0.5	0.7
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	39.1%	46.6%	36.6%	49.6%
b Interest or Markup Payable (Days)	57.0	83.4	48.8	19.3
c Entity Average Borrowing Rate	17.6%	12.6%	11.9%	19.2%

Credit Rating

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

Long-term Rating	
Scale	**Definition**
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ **AA** **AA-**	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ **A** **A-**	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ **BBB** **BBB-**	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ **BB** **BB-**	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ **B** **B-**	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC **CC** **C**	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating	
Scale	**Definition**
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

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

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

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

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

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

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 | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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