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-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

The ratings demonstrate Tufail Chemical Industries Limited's (the Company) leading position in domestic manufacturing of surfactants (key raw material for detergent and shampoo industry), strong customer base - mainly MNC's - stable margins and generation of persistent profitability. After series of expansions combine capacity of LABSA has now reached up to 100,000 metric tons per annum in Tufail group. The Company also produces Formic acid (for the textile industry) and offers tolling services. 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, since May-17, has helped the Company in sustaining its market share and profitability. Cognizant of growing demand, the Company has continuously invested in R&D and BMR, which has enhanced automation and yielded specialized product range. This, alongside an experienced management team, transpires into operational efficiencies and stable margins despite challenging environment. The Company has strengthened its distribution network by adding new dealers across the country and also managed to pass on the increase in raw material costs effectively. Going forward the Company is emphasizing to increase export sales through established links with renowned MNCs. The Company has a modest financial risk profile, characterized by intermediate leveraging, good coverages, and relatively stretched working capital cycle. . The leveraging is expected to sustain on current levels. The assigned ratings drive comfort from demonstrated sponsor support and commitment. Strengthening of governance framework is considered positive.
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 position, margins, profitability, and optimal capacity utilization along with prudent management of the working capital cycle. Going forward, the 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 Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Chemical(Jul-21)
Rating Analysts	Sohail Ahmed Qureshi | sohail.ahmed@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. Over the course of its operations, Tufail Chemical has developed MNCs based clientele.
Operations The Company's current capacity stands at 150,000 tones with power requirements of 1.9MW. 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 form 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% stakes, Mr. Pervez Tufail and his family members hold 47% and the remaining 2% shareholding is owned by Mr. Mubashir Ahmed, cousin of both brothers.
Stability The formalized distribution of shareholding among two brother 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 Chemical has expanded its footing in the entertainment business through PEG (Pvt) Limited. The family has a collective net worth of over PKR 1bln, portraying adequate financial strength to support the Company, if needed.

Governance

Board Structure Tufail Chemical's board comprises six-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 two members are spouses of 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 FY20, 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 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 has expressed an unqualified opinion on the Company's financial statements for FY20.

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 the day to day operations of the business. Mr. Zubair Tufail focusses more on longer term business development and strategic relationships.
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. 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 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 and 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 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 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 The Company posted a revenue of ~PKR 6,601mln in 9MFY21 as compared to PKR 6,594mln in 9MFY20. The Company majorly derives its revenues from local sales. Of this, large chunk 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 more than 30% of the Company's top-line, followed by Procter & Gamble. The Company's sales also include toll manufacturing services which are provided on demand basis. Top 10 customer concentration is high. However, comforts can be drawn from long established relationships with the leading customers.
Margins In 9MFY21, the gross margin significantly improved to 17.3% from 13.2% in 9MFY20 on the basis of controlled overheads, operational efficiencies and long-term agreements with vendors on favourable terms due to bulk buying. However, the Company's operating margin remained stagnant at 8% on account of higher operating cost including higher export related cost. The finance cost decreased on account of lower interest rates and stood at ~PKR 198mln in 9MFY21 (9MFY20: ~PKR 378mln). It has translated into higher net margins (9MFY21: 3.4%, 9MFY20: ~1.8%). The Company's net profit stood at ~PKR 224mln in 9MFY21 (9MFY20: ~PKR 119mln).
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. The Company is running smoothly at 80-90% capacity and have sufficient orders in hand due to niche customer base consisting mostly of MNC's.

Financial Risk

Working Capital In 9MFY21, the Company's inventory days have inclined to 39 days (9MFY20: 29 days). Receivables days increased to 135 days (9MFY20: 132 days). Consequently, resulting in lower net working capital days (9MFY21: 129 days, 9MFY20: 140 days). However, the Company's short-term trade leverage declined to 29% in 9MFY21 (9MFY20: 35.8%). Meanwhile, the Company's room to borrow at trade assets level clocked in at 14%.
Coverages During 9MFY21, the Company's operating cash flows (FCFO) improved to ~PKR 750mln (9MFY20: ~PKR 518mln) on account of increased profitability. Interest coverage considerably improved to 4.2x in 9MFY21 (9MFY20: 1.4x) due to lower interest cost and higher FCFO. Similarly, debt coverage has improved to 4.2x in 9MFY21 (9MFY20: 1.4x).
Capitalization Tufail Chemicals has an intermediately leveraged (9MFY21: 46.8%) capital structure. The Company's borrowings are primarily 100% Short-term in nature and are largely utilized to fill working capital needs.

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Financial Summary
PKR mln

Tufail Chamical Industries Limited	Mar-21	Jun-20	Jun-19	Jun-18
Chemical	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	1,253	1,341	1,337	1,331
2 Investments	-	-	-	-
3 Related Party Exposure	1,250	550	91	386
4 Current Assets	4,285	5,120	4,445	3,970
a Inventories	*888*	*998*	*809*	*805*
b Trade Receivables	*3,014*	*3,485*	*3,049*	*2,653*
5 Total Assets	6,788	7,010	5,873	5,687
6 Current Liabilities	1,448	1,509	625	775
a Trade Payables	*1,120*	*1,047*	*437*	*649*
7 Borrowings	1,712	2,596	2,225	2,349
8 Related Party Exposure	654	-	218	-
9 Non-Current Liabilities	286	266	288	310
10 Net Assets	2,688	2,639	2,516	2,253
11 Shareholders' Equity	2,688	2,639	2,516	2,253
B INCOME STATEMENT				
1 Sales	6,601	8,930	8,479	7,407
a Cost of Good Sold	*(5,458)*	*(7,626)*	*(7,374)*	*(6,542)*
2 Gross Profit	1,142	1,305	1,105	865
a Operating Expenses	(617)	(580)	(450)	(374)
3 Operating Profit	526	725	655	491
a Non Operating Income or (Expense)	*60*	*(5)*	*33*	*32*
4 Profit or (Loss) before Interest and Tax	585	720	688	523
a Total Finance Cost	*(198)*	*(459)*	*(337)*	*(254)*
b Taxation	*(163)*	*(95)*	*(98)*	*(61)*
6 Net Income Or (Loss)	224	166	253	207
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*750*	*747*	*729*	*528*
b Net Cash from Operating Activities before Working Capital Changes	*589*	*290*	*452*	*293*
c Changes in Working Capital	*993*	*(188)*	*(720)*	*(378)*
1 Net Cash provided by Operating Activities	1,582	101	(267)	(85)
2 Net Cash (Used in) or Available From Investing Activities	(1,148)	(207)	126	(132)
3 Net Cash (Used in) or Available From Financing Activities	(401)	103	95	265
4 Net Cash generated or (Used) during the period	33	(3)	(46)	48
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-1.4%	5.3%	14.5%	3.1%
b Gross Profit Margin	17.3%	14.6%	13.0%	11.7%
c Net Profit Margin	3.4%	1.9%	3.0%	2.8%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	26.4%	6.3%	0.1%	2.0%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	10.9%	6.8%	10.2%	9.7%
2 Working Capital Management				
a Gross Working Capital (Average Days)	174	170	157	160
b Net Working Capital (Average Days)	129	140	134	132
c Current Ratio (Current Assets / Current Liabilities)	3.0	3.4	7.1	5.1
3 Coverages				
a EBITDA / Finance Cost	4.5	2.1	2.5	2.6
b FCFO / Finance Cost+CMLTB+Excess STB	4.2	1.1	1.9	1.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.9	0.7	0.7	0.5
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	46.8%	49.6%	49.3%	51.0%
b Interest or Markup Payable (Days)	55.9	19.3	42.0	39.0
c Entity Average Borrowing Rate	9.9%	19.2%	14.1%	11.4%

Credit Rating

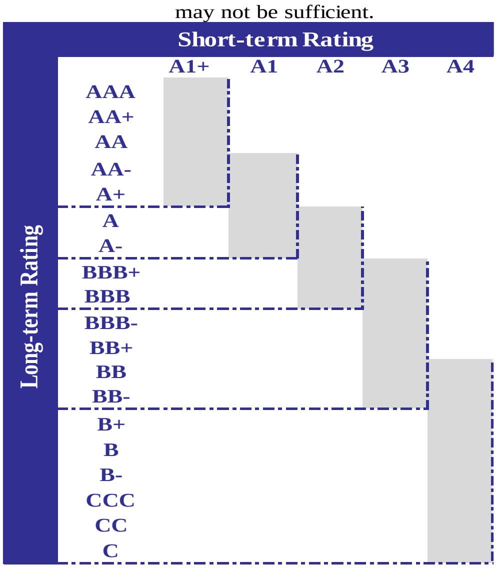
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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