



The Pakistan Credit Rating Agency Limited

Rating Report

Khas Textile Mills (Pvt.) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Aug-2019	BB+	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the small yet adequate business profile of Khas Textile Mills (Pvt.) Limited emanating from relatively small revenue base, thin margins and profitability. The Company is associated with Khas Group of Industries. The Company manufactures various types of cotton ring and open end yarn. Despite challenging textile industry dynamics, Khas Textile managed to maintain its volumes. Subsidized gas rates for textile industry have made the local textile industry cost competitive, though withdrawal of zero rating status will affect liquidity of the industry. On standalone basis, the Company's sales volume increased due to capacity enhancement from recently completed BMR and better yarn prices. Increased cotton prices have put pressure on margins and, in turn, profitability. The Company has a highly leveraged capital structure and weak coverages. The Company has stretched its working capital cycle, though in line with the industry average. Limited cash flows from operations and higher finance cost led to stretched coverages. These are expected to improve due to repayment of long term loans in the near future. The debt structure is skewed towards short-term borrowings, which led to asset-liability mismatch. The overall governance framework needs strengthening.

The ratings are dependent upon the management's ability to improve margins, profitability and financial profile of the Company. Improving asset-liability will be critical. Meanwhile, strengthening of governance practices will have a positive impact on the ratings. Any deterioration in debt coverages leading to higher financial risk or substantial losses will have negative impact on ratings. Khas Group of industries has presence in diverse sectors; including textile, aluminium, poultry, socks and knitwear and import of building hardware.

Disclosure

Name of Rated Entity	Khas Textile Mills (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study Textile(Oct-18)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Khas Textile Mills (Pvt.) Limited ("Khas Textile" or "the Company") was incorporated in 2001 as a private limited Company

Background The Company is engaged in the manufacturing of yarn. In 2006, the Company went through a major transformation and started manufacturing cotton ring and open end yarn. Since its incorporation, Khas Textile has significantly increased its production capacity. Khas Group of industries has five companies' engaged in diverse sectors; including textile, aluminium, poultry, socks and knitwear and import of building hardware.

Operations Khas Textile currently operates 19,680 spindles and 840 rotors and has a purpose build manufacturing facility located in the industrial hub – Nooriabad. Khas Textile has a captive electricity generation capacity of 3.5 Megawatt against the requirement of 3.2 Megawatt. The Company has a backup line connection with HESCO.

Ownership

Ownership Structure The Company is entirely owned by Ashfaq family, which includes Mr. Haji Ashfaq Ahmed and his wife (20%) and his two sons (i) Khurram Ashfaq (40%) and (ii) Noman Asahfaq (40%), individually, and through their respective families.

Stability Shareholding between different members' of the family is clearly distributed. However, no formal succession plan has been documented.

Business Acumen Mr. Ashfaq Ahmed – Chairman – has over 45 years of experience in diverse sectors including textile, aluminium, poultry, socks and knitwear and import of building hardware. Mr. Khurram Ashfaq – Managing Director – of the Company has over 23 years of experience in textile sector. Apart from spinning, sponsors also have a socks manufacturing unit.

Financial Strength Khas Group of industries has five companies' engaged in diverse sectors. Apart from national level presence in diverse sectors; sponsors also have a joint venture, KAI-largest aluminium manufacturer- in Bangladesh. The Company's sponsors have reasonable net worth and have demonstrated their commitment to support the Company in times of need.

Governance

Board Structure The Company has a five member board. Three of the members are executive directors and two are non-executive directors. All directors have been affiliated with the Company since its inception.

Members' Profile Mr. Ashfaq Ahmed – Chairman of the board – has vast of experience in diverse industries and provides strategic input. Three board members are active members while the remaining two board members are inactive members.

Board Effectiveness Involvement of the directors in day to day running of the business bodes well with the effectiveness of strategic oversight. However, there are no independent directors or committees formed by the board.

Financial Transparency Shahid Ahmad & Co. Chartered Accountants is the auditor of the Company. The auditor expressed an unqualified opinion on the Company's financial statements for FY18. The auditor is neither categorized by SBP nor QCR rated. Control framework and transparency needs improvement.

Management

Organizational Structure Khas Textile has a well-defined organizational structure. Overall the group management oversees all the operations of the Company. There are clearly delimited reporting lines as well as segregation of duties between top tier management.

Management Team The management roles at group level are defined among family members. Mr. Khurram Ashfaq – Managing Director – is responsible for overseeing all matters related to Khas Textile. The group CFO, Mr. Ashfaq Ali Khan, is a Fellow Chartered Accountant. He has been with the Khas Group of Industries for one and half years but has an overall experience of 23 years. Other members of the Company's top tier management are also seasoned professionals and have been associated with the Company for a considerable amount of time.

Effectiveness There are no formal management committees. However, key management members meet on regular basis to resolve and pro-actively address operational issues, if any, eventually ensuring smooth flow of operations.

MIS The Company is currently operating SAP-BI-8.82 which has been customised by Abacus Consulting (Pvt.) Limited according to the Company's needs. Reports are generated and reviewed regularly by the top management.

Control Environment The Company has an updated technological infrastructure in all its manufacturing and support functions, to ensure quality and cost effectiveness. The Company also has an internal audit department.

Business Risk

Industry Dynamics During FY19, even though major textile segments including cotton cloth, knitwear, garments and bedwear displayed strong quantitative growth, overall growth stagnated. Industry players had to share the benefit of the currency depreciation with their buyers which resulted in a unit price dip across all major categories, curbing overall growth. This, coupled with cotton yarn displaying double-digit quantitative decline on account of the US-China trade war as well as strong domestic demand for yarn, resulted in overall increase in exports of only ~0.1% YoY. Going forward, withdrawal of textile's zero rated status will impact industry's liquidity and overall performance, especially domestic sales.

Relative Position With 19,680 spindles and 840 rotors, the Company's share in the spinning sector of textile industry is small. In term of margins, the Company falls in lower tier of spinning sector.

Revenues During 9MFY19, the Company recorded revenue of PKR 2,488mln, an increase of 52% (9MFY18: PKR 1,628mln) due to capacity enhancement and better yarn prices. During 9MFY19, 98% of total revenue came from the sale of yarn in local market. While 2% of the total revenue came from the sale of waste material. Export during the period was non-existent; However, in the last quarter of FY19, the Company has again started exporting yarn.

Margins The gross profit of the Company rose by 61% during 9MFY19 to PKR 156mln (9MFY18: PKR 97mln), primarily due to sizable increase in the Company's revenue. However, profitability in absolute terms remained limited because of greater increase in cost of sale due to high cotton prices and finance cost. The Company's gross profit margin during 9MFY19 clocked in at 6.3% (9MFY18: 6.0%), operating profit margin at 4.1% (9MFY18: 3.8%), while net margin was just 0.4% (9MFY18: 0.3%).

Sustainability Khas Textile went through a BMR in recent years, which increased its spindle capacity to 19,680 spindles from 10,560 spindles, thus brought in efficiency gains and improved margins. The Company's management is planning a CAPEX in FY20, which will help the Company to sustain its margins. Exploring export avenues is important with imposition of sales tax on domestic front, which could compromise local sales.

Financial Risk

Working Capital The Company largely meets its working capital requirements through short-term borrowings and the remainder is met through internally generated cash reserves. During 9MFY19, the Company's net working capital cycle decreased to 85days (9MFY18: 128days) due to significant decrease in average inventory days (9MFY19: 66days, 9MFY18: 104days). The Company's short term borrowings stood at PKR 848mln and net trade assets at PKR 743mln, which led to asset-liability mismatch of around -12%.

Coverages During 9MFY19, the Company's Free Cash Flow from operations (FCFO) fell by 26% to PKR 92mln (9MFY18: PKR 124mln) due to higher amount of tax paid. Decrease in FCFO and higher finance cost resulted in lower coverages. During 9MFY19, interest coverage ratio fell to 1.1x (9MFY18: 2.2x) and debt coverage ratio to 1.1x (9MFY18: 2.2x). Going forward, the coverages are expected to improve due to the repayment of long term loans.

Capitalization During 9MFY19, the Company's capital structure remained highly leveraged at 71% (9MFY18: 74%). Total borrowings during the period stood at PKR 1,078mln, (9MFY18: PKR 1,417mln). Short-term borrowings made up 79% of the total borrowings at PKR 848mln and were used to meet working capital needs and peaked during the cotton procurement season. Long-term borrowings at the end of the period clocked in at PKR 230mln and were utilized for CAPEX purpose. Long-term borrowings are expected to decrease in the future, since the Company plans to retire some of its debt. The Company's borrowings include a PKR 572mln loan from directors and a further PKR 258mln from related parties. The sponsors plan on converting this loan into equity. In that case, the Company's leveraging will drop to 40.1%.



The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Khas Textile Mills Limited Textile	Mar-19 9M	Jun-18 12M	Mar-18 9M	Jun-17 12M	Jun-16 12M
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A BALANCE SHEET

1 Non-Current Assets	1,494	1,677	1,677	1,798	1,499
2 Investments	8	8	8	5	-
3 Related Party Exposure	62	190	85	139	81
4 Current Assets	1,317	1,526	1,369	1,039	965
a Inventories	504	701	748	490	326
b Trade Receivables	400	292	350	217	190
5 Total Assets	2,880	3,400	3,138	2,980	2,546
6 Current Liabilities	193	229	280	133	131
a Trade Payables	162	192	192	91	93
7 Borrowings	1,078	1,745	1,417	1,386	1,076
8 Related Party Exposure	829	655	689	699	579
9 Non-Current Liabilities	4	4	5	5	8
10 Net Assets	776	766	747	757	752
11 Shareholders' Equity	776	766	747	757	752

B INCOME STATEMENT

1 Sales	2,488	2,790	1,628	2,256	2,009
a Cost of Good Sold	(2,332)	(2,626)	(1,531)	(2,122)	(1,874)
2 Gross Profit	156	164	97	134	135
a Operating Expenses	(54)	(55)	(35)	(52)	(43)
3 Operating Profit	102	110	62	82	92
a Non Operating Income	(4)	(1)	(1)	(3)	2
4 Profit or (Loss) before Interest and Tax	98	109	61	79	94
a Total Finance Cost	(87)	(100)	(56)	(74)	(82)
b Taxation	-	-	-	-	-
6 Net Income Or (Loss)	11	9	5	5	11

C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	92	152	124	125	138
b Net Cash from Operating Activities before Working Capital Changes	92	152	124	125	138
c Changes in Working Capital	422	(422)	(117)	(137)	(405)
1 Net Cash provided by Operating Activities	514	(270)	7	(12)	(267)
2 Net Cash (Used in) or Available From Investing Activities	1	(36)	(13)	(480)	(59)
3 Net Cash (Used in) or Available From Financing Activities	(430)	305	15	459	542
4 Net Cash generated or (Used) during the period	85	(0)	9	(33)	216

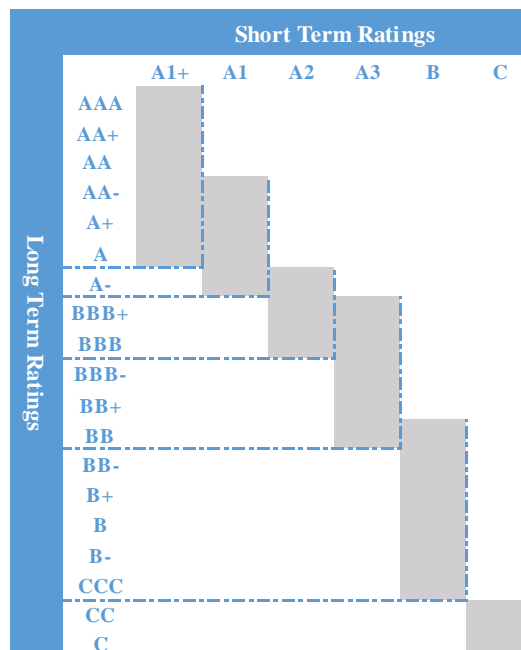
D RATIO ANALYSIS

1 Performance					
a Sales Growth (for the period)	18.9%	23.7%	-3.8%	12.3%	88.5%
b Gross Profit Margin	6.3%	5.9%	6.0%	5.9%	6.7%
c Net Profit Margin	0.4%	0.3%	0.3%	0.2%	0.6%
d Cash Conversion Efficiency (EBITDA/Sales)	5.1%	6.3%	7.8%	6.9%	7.9%
e Return on Equity (ROE)	1.9%	1.1%	0.9%	0.7%	1.5%
2 Working Capital Management					
a Gross Working Capital (Average Days)	104	111	152	99	80
b Net Working Capital (Average Days)	85	93	128	84	63
c Current Ratio (Total Current Assets/Total Current Liabilities)	6.8	6.7	4.9	7.8	7.4
3 Coverages					
a EBITDA / Finance Cost	1.5	1.8	2.3	2.2	1.9
b FCFO / Finance Cost+CMLTB+Excess STB	1.1	0.5	2.2	0.5	0.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	99.2	20.8	12.5	24.0	21.1
4 Capital Structure (Total Debt/Total Debt+Equity)					
a Total Borrowings / Total Borrowings+Equity	71.1%	75.8%	73.8%	73.4%	68.8%
b Short-Term Borrowings / Total Borrowings	0.4	0.6	0.5	0.4	0.3
c Average Borrowing Rate	5.2%	4.4%	3.5%	3.9%	5.0%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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)

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