The Pakistan Credit Rating Agency Limited

Rating Report

Rustam Towel (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Apr-2019	BBB-	A3	Stable	Upgrade	-
30-Oct-2018	BB+	A3	Stable	Maintain	-
29-Mar-2018	BB+	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Rustam Towel (Pvt.) Limited (Rustam Towel), a family run business concern, is an export oriented towel manufacturer. Currency devaluation has boded well for export oriented textile companies. The towel and denim industry continues to surge forward on the back of Pakistan's cotton, which is more suitable for coarse count yarn. Towel industry enjoys good margins, which is also reflected in the Rustam Towel's profitability. On standalone basis, the Firm's revenue has increased by almost 11% on YoY basis and margins are in line with the industry. The Firm's concentration levels - both customer and geographical - are well managed with the Company having a policy of capping revenue from a single customer to 20%. The ratings reflect adequate financial risk profile of the Company. The working capital management has improved but needs further strengthening. The ratings further incorporate improved governance framework of the Company backed by appointment of SBP enlisted auditors.

The ratings are dependent on sustaining business margins and improving working capital management. Project completion and revenue generation of denim manufacturing facility are also critical to the ratings.

Disclosure

Name of Rated Entity	Rustam Towel (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Textile(Oct-18)
Rating Analysts	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure Rustam Towel (Pvt.) Limited (Rustam Towel) was incorporated in 1998 as a Private Limited Company. Rustam Towel is a small-scale towel manufacturing concern. Primary business of the Company is to manufacture and export various types of towels.

Background The Company started its business sixteen years ago and experienced consistent double-digit growth since 1998 by providing quality commercial textiles with competitive pricing. Mr. Arif Dogar – Father of Sana Ullah Dogar in 1970s started textile business by setting up a textile mill, Rustam Weaving (Pvt.) Limited in Gujranwala. Mr. Sana Ullah started to work with his father in 1998 along with his four brothers and formed a towel manufacturing company – Rustam Towel.

Operations Rustam Towel is one of the largest exporters of terry towels in Pakistan. It exports bath products to leading retailers, hospitality and healthcare industries across the world. European countries like United Kingdom, France, Germany, Spain and Italy are the main areas of concentration for the Company. Rustam Towel have weaving, dyeing and finishing solutions, all under one roof. The production facility of the Company has been set up near Lahore on 22-acre land with 7,680 spindles and 73 looms.

Ownership

Ownership Structure Majority of the shareholding lies with Mr. Sana Ullah i.e. 35% and his son Sohaib Ali Dogar 20%. Mr. Wasim Arif, Mr. Zaka Ullah and Mr. Zia Arif are brothers of Mr. Sana Ullah and hold 20%, 10% and 15% shareholding respectively. Mr. Zia Arif was added to the Shareholding of the Company in October 2018.

Stability Although there is no formal succession plan, the ownership and business roles are clearly divided among the brothers. Formation of a group holding company or documented succession plan would further strengthen stability of the Firm.

Business Acumen Dogar family is in textile industry for more than four decades. Mr. Sana Ullah Dogar has been associated with the family business since inception. He has vast experience and knowledge of the towel industry

Financial Strength The Dogar family now owns another towel manufacturing company namely Saif Tex. Apart from these textile companies, the dogar family has land at prominent place in Gujranwala. The Company has recently invested and got franchises of international food chains in Lahore and Gujranwala.

Governance

Board Structure The overall governance matters are overlooked by Sponsors. There is room for improvement as the governance structure lacks independent oversight.

Members' Profile Mr. Sana Ullah Dogar is the Chairman and brings ~40 years of experience to the Firm. All other members also have sufficient experience of the industry.

Board Effectiveness There is no independent director on the board. The board has not formed any board committee. All the board members are also the shareholders of the Company. The board meetings are not conducted formally but family members meet regularly to discuss business developments and challenges.

Financial Transparency Ahmad Usman Shabbir & Co Chartered Accountants are the external auditors of the Company. The auditors are neither in SBP categories nor QCR rated. Auditors have given unqualified audit opinion on Company's financial statements for the year ending 30th June 2018. To improve financial transparency of the business the Company has decided to change the auditors. The new auditors will be S.M. Suhail & Co, they are QCR rated and fall under Cateogory "C" of SBP's Panel of auditors.

Management

Organizational Structure Sana Ullah Dogar, heads the management team as Chief Executive Officer of the Company. The Company has a simple organization structure as it has four major departments i) Administration, (ii) Finance, (iii) Production and (iv) Marketing.

Management Team Mr. Sana Ullah himself oversees cotton procurement. Mr. Wasim Dogar, youngest brother is responsible for marketing functions of the business. Mr. Zia Dogar is involved in spinning segment of the Company along with overseeing administrative affairs.

Effectiveness Rustam Towel planned to install new ERP (SAP B1) to automate key business functions in financials, operations and HR. MIS generated reports are reviewed by senior management on regular basis. The new ERP is expected to be fully operational in June 2019.

MIS The Company's MIS can be classified into three categories based on periodicity – Daily, Weekly and Monthly. The daily and weekly reports generated for top management mainly scrutinizes liquidity position and mainly cash and stock related reports. MIS is expected to further improve after installation SAP.

Control Environment Rustam Towel is accredited with International certifications for compliance. It has valid certificates for its products and facilities and is periodically audited by internationally recognized certification bodies including Oeko Tex 100 Class-I and Class-II, BSCI, C-TPAT, Sedex, GOTS, BRC.

Business Risk

Industry Dynamics During 9MFY19, towels segment in terms of quantity exported, declined to 137,318 MTs (9MFY18: 154,237 MTs). Portraying a negative change of ~11% YoY. The value of towel exports during the period under review clocked in at USD ~588mln (9MFY18: ~599mln USD), a decline of ~2%. Towel sector exports in terms of value and quantity both showcased a negative trend.

Relative Position The Company has ~4% market share in country's towel exports. The industry has a competitive market structure and the Company's share is considered adequate.

Revenues Top-line of the Company clocked in at PKR 1,887mln in 1HFY19 (1HFY18: PKR 1,694mln), portraying a growth of 11.4% on YoY basis. The increase in sales revenue was mainly on the back of Rupee depreciation.

Margins Cost of goods sold of the Company increased to PKR 1,549mln in 1HFY19 (1HFY18: PKR 1,429mln), showing an increase of 8.4% on YoY basis on the back of increase in raw material prices. As a result, improvement in gross margins was nullified and they stood at ~18%. Operating margins decreased from 10.6% to 9.9% in 1HFY19, on the back of increase in Administrative and General Expenses. Finance cost was kept under control by the Company, because the entity was able to avail ERF II at concessional rates. Consequently, the net margins improved to 7.5% in 1HFY19 (1HFY18: 6.2%).

Sustainability Going forward, Rustam Towel is planning to increase its revenues and production capacity by adding up to date Toyota's 36 Air Jet looms in 2020, these looms can run up to 800 RPMs. The cost of this investment is expected to be ¥ 400mln. The Company is also planning to diversify its product portfolio by erecting a new denim production facility. The construction of the facility is under process and the Company has set production target at 10,000 denim garments per day, starting from 3,500 garments per day.

Financial Risk

Working Capital The Company has higher inventory needs in different times of year. During cotton procurement season the Company's working capital needs increase and are met through short term borrowings (1HFY19: 1,536mln, 1HFY18: 1,339mln). The Company's short-term borrowing remained higher than its trade assets depicting the fact that the Company has a negative room to borrow. The Company's net working capital days in 1HFY19 decreased to 130 (1HFY18: 145 days), the situation improved on the back of decreased inventory held days.

Coverages In 1HFY19, Rustam Towel's operating cashflows (FCFO) remained strong and increased to PKR 215mln in 1HFY19 (1HFY18: PKR 175mln), an increase of ~23% due to increase in sales revenue. Finance cost was kept under control as the Company was able to avail EFR II. Finance cost stood at PKR 31mln (1HFY18: 32mln). Consequently, interest coverages improved to 7.5x in 1HFY19 (1HFY18: 5.5x), whereas, debt coverages improved to 7x (1HFY18: 5.2x).

Capitalization Rustam Towel have a moderate leveraged capital structure (1HFY19: ~40%, 1HFY18: 39%). The Company does not rely on long term debt for expansion and rather rely on equity injection through loan from Sponsors. The Company's debt constitutes 100% short term borrowing and no long-term debt. Rustam Towel does not plan to borrow long term debt and its leveraging is expected to stay at current level in future.

Financials (Summary) in PKR mln
PKR mln

Rustam Towel (Pvt.) Limited
Private Limited

BALANCE SHEET	Dec-18	Jun-18	Jun-17	Jun-16
	6M	12M	12M	12M
a Non-Current Assets	2,172	2,126	2,025	1,753
b Investments (Incl. Associates)	-	-	-	-
Equity Instruments	-	-	-	-
Debt Instruments	-	-	-	-
c Current Assets	1,786	1,689	1,375	1,216
Inventory	910	927	871	827
Trade Receivables	526	491	382	312
Others	350	271	123	76
d Total Assets	3,958	3,815	3,400	2,968
e Debt/Borrowings	1,536	1,563	1,355	1,026
Short-Term	1,536	1,563	1,355	1,026
Long-Term (Incl. Current Maturity of Long-Term Debt)	-	-	-	-
Other Short-Term Liabilities	95	66	90	180
Other Long-Term Liabilities	-	-	-	-
f Shareholder's Equity	2,326	2,186	1,955	1,763
g Total Liabilities & Equity	3,958	3,815	3,400	2,968

INCOME STATEMENT				
a Turnover	1,887	3,166	2,954	3,321
b Gross Profit	339	580	559	640
c Net Other Income	2	2	1	2
d Financial Charges	(31)	(70)	(64)	(51)
e Net Income	141	231	194	264

CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	215	361	324	390
b Total Cashflows (TCF)	215	361	324	390
c Net Cash changes in Working Capital	348	(335)	142	(83)
d Net Cash from Operating Activities	532	(7)	409	255
e Net Cash from InvestingActivities	(89)	(109)	(348)	(247)
f Net Cash from Financing Activities	(427)	(1,727)	(1,059)	(559)
g Net Cash generated during the period	16	(1,843)	(997)	(551)

RATIO ANALYSIS				
a Performance				
Turnover Growth	19%	7%	-11%	0%
Gross Margin	18%	18%	19%	19%
Net Margin	7%	7%	7%	8%
ROE	12%	11%	10%	15%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+U	6.9	5.2	2.4	7.6
Interest Coverage (X) (FCFO/Gross Interest)	6.9	5.2	5.1	7.6
Debt Payback (Years) (Total Debt (excluding Covered Short T	0.0	0.0	0.3	0.0
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable D	130	145	133	77
d **Capital Structure** (Total Debt/Total Debt+Equity)	40%	42%	41%	37%

Rating Scale

Credit Rating Scale & Definitions

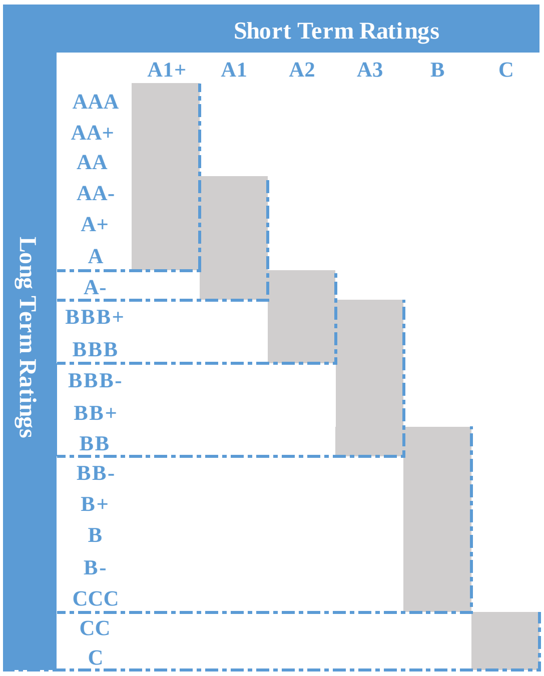
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ 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 Ratings

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



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.	**Rating Watch** Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.	**Suspension** It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.	**Withdrawn** A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.	**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

Rating Team Statements

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

2) **Conflict of Interest**

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

Restrictions

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

Conduct of Business

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

Independence & Conflict of interest

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

Monitoring and review

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

Probability of Default

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

Proprietary Information