



The Pakistan Credit Rating Agency Limited

Rating Report

Rustam Towel (Pvt.) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Apr-2020	BBB-	A3	Stable	Maintain	YES
30-Oct-2019	BBB-	A3	Stable	Maintain	-
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 a small scale export oriented towel manufacturer. The Company mainly derives its revenue from manufacturing and sale of towel. Recently, the Company has installed a denim production facility, capacity of ~120,000 pieces per month, to diversify its portfolio. Towel industry enjoys relatively better margins that are reflected in Rustam Towel's profitability on the back of Pakistan's cotton, which is more suitable for manufacturing towels. On standalone basis, the Company's concentration levels – both customer and geographical – are well managed with the Company having a policy of capping revenue from single customer to 20%. The Company was able to achieve strong growth in revenue of ~15% on the back of rupee depreciation and enjoys good margins and profitability. The Company has improved its working capital management. However, it continues to have slight mismatch at trade level. The Company's has a moderately leveraged capital structure, strong coverages and adequate working capital management. The ratings also draw comfort from strong financial strength of sponsors. The Company remains partially operational as it is exempted from shutdown, being an export oriented unit

The 'Rating Watch' signifies COVID-19 outbreak and challenging economic environment. The entire textile chain is expected to be impacted due to the lockdown in Pakistan and major export destinations of the sector. The demand is expected to contract while eventual resumption of operations and recovery of the sector remains uncertain. The Government and SBP has announced several initiatives to provide support. PACRA will monitor the situation and accordingly take action.

The ratings are dependent on sustaining operations amidst prevailing tough conditions. Full resumption of operations, maintaining sales and margins is crucial. Meanwhile, prudent working capital management and eliminating mismatch would remain critical. Strengthening of governance framework and sponsor support, especially in the short-term, will be important.

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-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Towel(Jan-20)
Rating Analysts	Ateeb Riaz ateeb.riaz@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. The Company has recently setup Denim stitching facility as well.

Background The Company started its business twenty years ago and experienced consistent double-digit growth since 1998 by providing quality commercial textiles with competitive pricing. Mr. Arif Dogar – Father of Mr. 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 he 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 and Spain are the main areas of concentration for the Company. Rustam Towel has 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 10,000 spindles and 78 looms. Further, the Company has also diversified its portfolio by adding a denim production facility. Operations at the facility have officially started from August, 2019 with installed capacity of 120,000 pieces per month.

Ownership

Ownership Structure Majority of the shareholding lies with Mr. Sana Ullah (35%) and his son Mr. Sohaib Ali (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 brothers. Formation of a group holding company or documented succession plan would further strengthen stability of the Company.

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 owns another towel manufacturing company namely Saif Tex. Apart from textile business, the family has land at prominent place in Gujranwala. The sponsors has invested and got franchises of international food chains in Lahore and Gujranwala.

Governance

Board Structure The overall governance matters are looked over 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 Board. All other members have sufficient experience of the industry.

Board Effectiveness There is no independent director on the board. The board has not formed any board committees. All 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 Ale Imran & Co., Chartered Accountants are the external auditors of the Company. The auditors are QCR rated by ICAP but they are not on the SBP's panel of auditors. Auditors have given unqualified audit opinion on Company's financial statements for the year ending 30th June 2019. To improve financial transparency, the Company has decided to engage S.M. Suhail & Co. They are QCR rated and fall under Category "C" of SBP's Panel of auditors.

Management

Organizational Structure Mr. 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 function of the business. Mr. Zia Dogar is involved in spinning segment of the Company along with overseeing administrative affairs.

Effectiveness Rustam Towel has SQL based system to automate key business functions in finance, operations and HR. MIS generated reports are reviewed by senior management on regular basis.

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 scrutinize liquidity position, cash and stock related reports. The Company is using an SQL based system. A new ERP (SAP B1) is in parallel testing phase and will be fully implemented in the future.

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 Towel exports showed only a meagre increase of ~0.6% during 9MFY20 and clocked in at ~USD 591mln (9MFY20: ~588mln). Despite significant rupee depreciation and favorable government policies towards textile, the industry was unable to boost export volumes. The COVID-19 outbreak in early 2020 has impacted the entire textile chain. Export orders have been postponed or cancelled as USA and Europe (major towel export destinations) are in lockdown to contain the virus. Several domestic players are partially operational and facing severe liquidity pressure. Recent government initiatives are expected to provide some relief. However, prevailing uncertainty due to global lockdown will have implications for the industry dynamics.

Relative Position The Company has adequate positioning among towel exporters as it has ~4% market share in the country's towel exports.

Revenues The topline of the Company is entirely export oriented. Majority of the Company's exports are concentrated in Europe. During 1HFY20, the Company's revenue clocked in at ~PKR 2,178mln (1HFY19: ~PKR 1,887mln), reflecting an increase of ~15%. The growth in revenue emanated from rupee depreciation, while the volumes remained largely in-line with 1HFY19.

Margins During 1HFY20, gross margin of the Company remained stable at ~18% (1HFY19: 17.9%). Further, operating expenses of the Company remained intact in 1HFY20 and clocked in at ~PKR 162mln (1HFY19: ~PKR 151mln), resulting in operating margin of ~10% (1HFY19: ~10%). Finance cost increased to ~PKR 53mln (1HFY19: ~PKR 31mln) due to higher short-term borrowings. The Company's net profit margin stood at 7.5% as it posted net profit of ~PKR 163mln in 1HFY20 (1HFY19: ~PKR 141mln).

Sustainability Since mid-march, COVID-19 pandemic has been spreading rapidly in Pakistan and resulted in countrywide lockdown. However, the government has eased the lockdown from 15th April, 2020, and has allowed textile industry to resume production. The Company remains partially operational to complete orders in hand. However, full resumption of operations and recovery in sales remains unclear. The eventual easing and opening up of global lockdowns is important in this regard and its timeline is not certain. Several SBP initiatives to support the industry will provide support in the short-term.

Financial Risk

Working Capital During 1HFY20, the gross working capital days slightly improved to 130 days (1HFY19: 138 days) on the back of better inventory management. The Company's working capital remained in-line with the industry average. The Company's short-term borrowing remained higher than its trade assets depicting negative room to borrow ~7% (1HFY19: ~5%). This mismatch puts pressure on the Company's financial profile.

Coverages In 1HFY20, the FCFD of the Company remained strong and increased to ~PKR 251mln (1HFY19: ~PKR 215mln) on the back of higher profitability. Finance cost of the Company increased as a result of higher borrowings and stood at ~PKR 53mln (1HFY19: ~PKR 31mln). Resultantly, the interest coverage ratio and debt coverage ratio declined to 5.1x (1HFY19: 6.9x) and 5.1x (1HFY19: 6.9x), respectively. However, coverages of the Company are still considered strong. Majority of the Company's borrowings are subsidized financing from SBP, further reducing the financial risk.

Capitalization Rustam Towel has moderately leveraged capital structure (1HFY20: ~45%, 1HFY19: ~40%). The leveraging increased due to higher short-term borrowings. The Company does not have long term debt and short term borrowings constitute 100% of the Company's total borrowings. Sponsors have also injected money in form of loans to support capitalization.

Rustam Towel (Pvt.) Limited Towel	Dec-19	Jun-19	Jun-18	Jun-17
	6M	12M	12M	12M

A BALANCE SHEET

1 Non-Current Assets	2,372	2,334	2,126	2,025
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	2,501	2,195	1,689	1,375
a Inventories	615	587	927	871
b Trade Receivables	1,030	865	491	382
5 Total Assets	4,874	4,529	3,815	3,400
6 Current Liabilities	46	45	66	90
a Trade Payables	46	45	66	90
7 Borrowings	2,161	1,980	1,563	1,355
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	2,667	2,504	2,186	1,955
11 Shareholders' Equity	2,667	2,504	2,186	1,955

B INCOME STATEMENT

1 Sales	2,178	4,275	3,166	2,954
a Cost of Good Sold	(1,793)	(3,516)	(2,586)	(2,395)
2 Gross Profit	385	759	580	559
a Operating Expenses	(162)	(310)	(244)	(269)
3 Operating Profit	223	448	336	290
a Non Operating Income	13	16	2	1
4 Profit or (Loss) before Interest and Tax	236	464	338	291
a Total Finance Cost	(53)	(101)	(70)	(65)
b Taxation	(21)	(44)	(37)	(34)
6 Net Income Or (Loss)	163	318	231	193

C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	251	608	361	324
b Net Cash from Operating Activities before Working Capital Changes	199	709	329	267
c Changes in Working Capital	(341)	(368)	(335)	142
1 Net Cash provided by Operating Activities	(143)	341	(7)	409
2 Net Cash (Used in) or Available From Investing Activities	(87)	(707)	(109)	(348)
3 Net Cash (Used in) or Available From Financing Activities	180	417	117	(34)
4 Net Cash generated or (Used) during the period	(50)	51	1	28

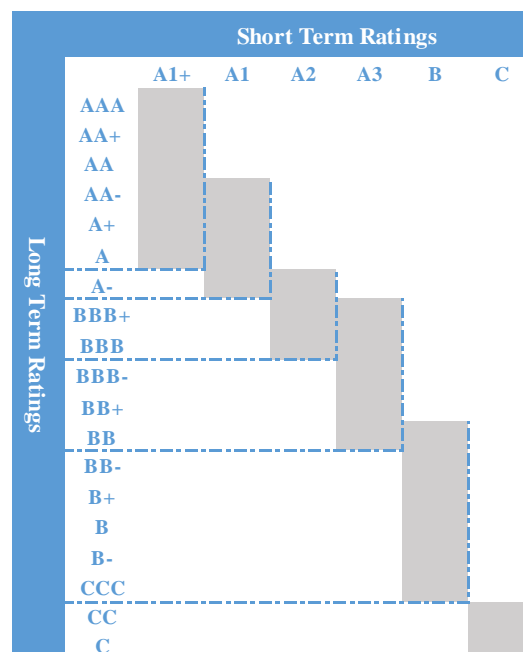
D RATIO ANALYSIS

1 Performance				
a Sales Growth (for the period)	1.9%	35.1%	7.2%	-11.0%
b Gross Profit Margin	17.7%	17.7%	18.3%	18.9%
c Net Profit Margin	7.5%	7.4%	7.3%	6.5%
d Cash Conversion Efficiency (EBITDA/Sales)	12.5%	13.2%	11.9%	12.1%
e Return on Equity (ROE)	12.6%	13.6%	11.1%	10.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	130	122	154	186
b Net Working Capital (Average Days)	126	118	145	172
c Current Ratio (Total Current Assets/Total Current Liabilities)	54.4	48.6	25.7	15.3
3 Coverages				
a EBITDA / Finance Cost	5.6	6.0	5.4	5.5
b FCFO / Finance Cost+CMLTB+Excess STB	5.1	6.5	5.1	2.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.0	0.0	0.3
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	44.8%	44.2%	41.7%	40.9%
b Short-Term Borrowings / Total Borrowings	1.0	1.0	1.0	1.0
c Average Borrowing Rate	4.7%	5.3%	4.8%	5.4%

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+	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.
AA		A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
AA-		A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
A		C	An inadequate capacity to ensure timely repayment.
A-			
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.		
BBB			
BBB-			
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.		
BB			
BB-			
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.		
B			
B-			
CCC	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.		
CC			
C			
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.
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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

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- (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.
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- (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)

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- (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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