The Pakistan Credit Rating Agency Limited

Rating Report

Reliance Weaving Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Apr-2018	BBB	A3	Stable	Maintain	-
30-Jun-2017	BBB	A3	Stable	Upgrade	-
11-Nov-2016	BBB-	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect sound business profile of RWML. The company is focused on expanding into local markets, while maintaining exports. Over the years, the company has sustained overall margins, wherein, the energy cost remains a key challenge. With recent BMR activities in the weaving segment further efficiencies are expected to flow in. Furthermore, the company plans to enhance the capacity of its weaving segment. FG has parked strategic investment book on RWML's books, some of it provides a stable stream of dividend income, while rest are in development stage; requiring cash. The ratings are constrained by stretched financial risk profile. This is reflected in mismatch in short-term debt vis-à-vis self-liquidating current assets. Limited cashflows – a factor of lower profitability – constrained the coverages. Cognizant of these issues, the management is in process of re-profiling its balance sheet – converting short-term debt into long-term at lower rates, financial risk profile lately. RWML's association with Fatima Group, a growing conglomerate, is a key rating factor.

The ratings are dependent on the management's ability to prudently mange the liquidity and debt profile of the company, particularly working capital, while sustaining business margins and the management's ability to uphold the entity's risk profile.

Disclosure	
Name of Rated Entity	Reliance Weaving Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating Methodology(Jul-17),Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17)
Related Research	Sector Study | Textile(Oct-17)
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RELIENCE WEAVING MILLS LIMITED	
Incorporated	1990
Major business lines	Sales of yarn and fabrics
Manufacturing Facilities	Three weaving units, located in Multan and two spinning units in Rawat and Multan.
Capacities	Yarn 20.9mln kgs Grey cloth 81.7mln meters
Legal status	Listed

INDUSTRY SNAPSHOT

- During FY17, total textile exports stood at USD ~ 12,453mln.
- Cotton yarn contributes (10%), cotton cloth (17%), home textile (29%), while garments contributes (38%).
- Pakistan's weaving sector continues to witness suppressed margins.
- High cost of doing business as compared to other countries like Bangladesh, India and Vietnam.

OWNERSHIP

- Reliance Weaving Mills Limited (RWML) – the flagship company of Fatima Group
- Majority stake (78%) held by Fatima Group (FG) directly and indirectly through individuals (21%) and a corporate.
- Late Sheikh Fazal-ur-Rehman, the founder of the Fatima and Fazal Groups, started his journey in 1936 by setting up a vegetable oil and ghee unit. One of his sons, Sheikh Ahmad Mukhtar, was instrumental in establishing Fatima Group (FG). FG is now one of the leading corporate groups in Pakistan with interests in sugar, textiles, fertilizer, packaging, and foreign trade.

GOVERNANCE

- The overall control of the company vests in eight-member board of directors including the Chairman – Mr. Fawad Ahmed Mukhtar, and the CEO – Mr. Fazal Ahmed Sheikh.
- Six directors are Fatima Group's family members, while Mr. Shahid Aziz is independent director. Apart from non-executive Chairman, one of the family director is in executive roles, while the remaining are spouses of two directors.

MANAGEMENT

- The organizational structure of the company is divided into various functions, including: (i) Finance & Accounts, (ii) Production, (iii) Procurement, iv) Marketing, (v) Administration & Human Resource, and (vi) Internal Audit. The head of each function report to the Executive Directors (EDs) who in turn report to the CEO. Mr. Faisal Ahmed Mukhtar – the ED, is the key man who looks after all functional matters through department heads. Mr. Fahd Mukhtar, the other ED, is mainly involved in marketing of fabric and working to expand the export market.
- Cognizant of the importance of real-time information, supplemented by advanced technology infrastructure, RWML continuously strives for improvement. Oracle based ERP solution is deployed

PERFORMANCE

- Company's topline is dominated by weaving segment (~67%) followed by spinning (~33%), whereas 47% of spinning needs are met in-house. Gross margins of spinning segment improved (FY17: 7.3%, FY16: 5.2%), whereas weaving segment witness declined (FY17:6.3%, FY16 8.3%), however, the company sustained margins on overall basis at 8.7%
- During FY17, the company posted a net profit of PKR 101mln as against profit of PKR 123mln during same period last year.
- The deterioration in company's performance is attributable to higher production costs specially fuel cost due to RLNG,, thereby impacting margins – gross and operating margins declined on YoY basis to 7.4% (FY16: 8%) and 5.5% (FY16: 6.3%), respectively.
- RWML's investment portfolio (PKR 854mln) constitutes ~29% of its equity base at end-Sep17;
- The company invested in FY17 PKR 71mln in Fatima Transmission Company; the first private sector company to get a license from NEPRA to lay down power transmission lines in the country
- Recently, company replaced 63 looms in FY17 with state of art technology, whereas plans further to add 45 looms. This is expected to add efficiency to the company's operation going forward

FINANCIAL RISK

- RWML has a highly leveraged capital structure with debt-equity ratio reported at ~70% at end-Jun17 (end-Jun16: ~69%).
- Significant portion (~65% at end-Sep17) of debt constitutes short-term borrowings. With no major debt-driven CAPEX, the leveraging is likely to reduce gradually with scheduled repayments.
- During FY17 RWML's free cashflows from operation (FCFO) increased by ~10% YoY – a factor of operational gain. Interest coverage improved marginally on YoY basis (interest coverage: end-Jun17: 1.7x, end-Jun16: 1.5x) benefiting from decrease in interest cost.
- RWML has stretched working capital cycle, mainly attributable to days (end-Jun17: 39; end-Jun16: 23). This reflects management's cotton procurement policy, in line with most of industry players. However, warrants management's attention to bring improvement in overall financial profile of the company.

Textile

The Pakistan Credit Rating Agency Limited | Financials (Summary)

PKR mln

Reliance Weaving Mills Limited

BALANCE SHEET	30-Sep-17	30-Jun-16	30-Jun-15	30-Jun-14
	3M	Annual	Annual	Annual
Non-Current Assets	**5,544**	**5,238**	**5,462**	**4,619**
Investments (Incl. associates)	**854**	**906**	**936**	**426**
Equity	854	906	936	426
Debt				
Current Assets	**4,090**	**4,007**	**3,738**	**4,644**
Inventory	2,191	2,346	1,576	2,384
Trade Receivables	693	528	954	1,029
Others	1,207	1,132	1,208	1,232
Total Assets	**10,489**	**10,151**	**10,137**	**9,690**
Debt	**6,565**	**6,250**	**6,396**	**5,848**
Short-term	4,209	3,560	3,564	3,747
Long-term (Inlc. Current Maturity of long-term debt)	2,356	2,691	2,832	2,101
Other shortterm liabilities	866	972	826	850
Other Longterm Liabilities	195	155	170	96
Shareholder's Equity	**2,862**	**2,774**	**2,744**	**2,895**
Total Liabilities & Equity	**10,488**	**10,151**	**10,137**	**9,690**
INCOME STATEMENT				
Turnover	**2,507**	**10,049**	**10,878**	**11,412**
Gross Profit	245	887	842	1,122
Other Income	(6)	(4)	10	97
Financial Charges	(129)	(523)	(682)	(598)
Net Income	**3**	**3**	**(98)**	**219**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	233	809	699	907
Net Cash changes in Working Capital	599	(70)	926	(232)
Net Cash from Operating Activities	727	213	931	197
Net Cash from InvestingActivities	(155)	(11)	(1,515)	(1,135)
Net Cash from Financing Activities	(613)	(196)	540	980
Ratio Analysis				
Performance				
Turnover Growth	15.0%	-7.6%	-4.7%	19.9%
Gross Margin	7.4%	8.8%	7.7%	9.8%
Net Margin	0.1%	0.0%	-0.9%	1.9%
ROE	1.3%	0.1%	-3.7%	8.2%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.4	0.5	0.3	0.9
Interest Coverage (x) (FCFO/Gross Interest)	1.8	1.5	1.0	1.5
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FC	32.2	11.2	206.6	6.8
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	61.1	46.7	47.6	64.3
Capital Structure (Total Debt/Total Debt+Equity)	69.6%	69.3%	70.0%	66.9%

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

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)

Proprietary Information