



The Pakistan Credit Rating Agency Limited

Rating Report

Fazal Rehman Fabrics Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Aug-2018	A-	A2	Stable	Upgrade	-
28-Feb-2018	BBB+	A2	Stable	Maintain	-
26-Jan-2017	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The rating reflects company's improved business profile which is characterized by sizable revenue base and adequate profitability. The top line grew by ~43% in FY18, facet of recently completed expansion. The company's exports also increased in line with textile industry, followed by improved operating margins on the back of efficiency gains. Overall industry's margins improved, supported by tax rebate packages by government and rupee devaluation. Moreover, recent re-imposition of custom duty and sale tax on cotton imports in FY19 budget, coupled with exclusion of tax rebate on yarn and greige fabric may put pressure on industry margins. The company's financial profile strengthened from efficient working capital management and healthy liquidity position. Improved profitability and cashflows lead to stronger debt service coverages. The leveraging remains relatively high but is expected to improve with no further accumulation of debt in near future and repayment of existing debt. The assigned ratings derive comfort from Fazal Rehman's association with Fazal Group.

The ratings are dependent on the management's ability to uphold the entity's strong business performance. Meanwhile, prudent management of cash flows to fulfill its financial obligations and maintain strong coverages remain critical for the ratings.

Disclosure

Name of Rated Entity	Fazal Rehman Fabrics Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Capital Protection Rating(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale Jun18(Jun-18)
Related Research	Sector Study Textile(Oct-17)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Fazal Rehman Fabrics Limited (Fazal Rehman Ltd.), a public unlisted company, is engaged in the manufacturing and sale of greige fabric.

Background Fazal Rehman Ltd. was incorporated in 2004 and started commercial operations in 2007. Fazal Rehman Ltd. is associated with Fazal Group (FG) since its inception.

Operations The company operates with one weaving unit having 360 air-jet looms. The company caters its power needs via in house production (6MW), as well as MEPCO's connection.

Ownership

Ownership Structure Fazal Rehman Ltd. is a wholly owned subsidiary of Ahmed Fine Textile which is jointly owned by Fazal Group and Hussain Group (~50% each). Both groups belong to the same family descending from Mr. Fazal-ur-Rehman.

Stability The representation of Fazal and Hussain Group's textile ventures in Pakistan's textile industry remains critical. Going forward, succession plane of transfer of ownership is yet to be seen.

Business Acumen Fazal Group has interest in textile, Fertilizer and Power where as, Hussain Group's interest only lies in textile. Moreover, sponsors expertise in textile will remain important in case of any textile industry driven crisis.

Financial Strength Fazal and Hussain Groups maintain dominant position in Multan's textile industry. Furthermore, Fazal Group's interest in fertilizers and textile provide ample room of financial support to Fazal Rehman Ltd., when needed.

Governance

Board Structure The company's board of directors is dominated by Fazal Groups representatives; four members including the Chairman, while remaining three directors are representative of Hussain Group including CEO.

Members' Profile Board members have diversified experience and have reasonably long association with the company, while Mr. Sheikh Naseem is the Chairman of board.

Board Effectiveness Despite the presence of two sponsoring groups on the board, lack of challenge weakens the governance structure of the company. Moreover, independent oversight is lacking indicating room for improvement in the governance framework.

Financial Transparency M/s Shinewing Hameed Chaudhri & Co., Chartered Accountants serves as external auditor for Fazal Rehman Ltd.. They have expressed unqualified opinion for the year ended 30th June, 2017. Moreover, audit of financial statements for the period FY18 is under process.

Management

Organizational Structure Mr. Hussain Fazal is the company's CEO, while Management control vests with Fazal Group with Mr. Rehman Naseem (representative of Fazal Group) having operational control.

Management Team Management team comprises individuals that has extensive expertise in entire textile value chain. Mr. Naveed Amir, company's CFO, has been associated with Fazal Group since 1993.

Effectiveness The management meetings are held periodically, with formal recording of meeting minutes, followed by need based meetings to resolve bottlenecks and ensure smooth operations.

MIS Fazal Rehman Ltd. deploys Oracle based Enterprise Resource Planning (ERP) system that provides comprehensive MIS reporting.

Control Environment The company's plant is connected with head office through VPN, thereby reporting on real time basis. Furthermore, Fazal Rehman Ltd. has received International certifications such as ISO 9001, Lycra assured, Fair Trade and Organic exchange.

Business Risk

Industry Dynamics During FY18, total textile exports of Pakistan stood at USD ~ 13.53bln, a 9% YoY growth. Re-imposition of custom duty and sales tax on cotton imports in FY 19 budget, coupled with exclusion of tax rebate on yarn and greig fabric may put pressure on the industry margins.

Relative Position Fazal Rehman Ltd. is associated with Fazal Group, which maintains a prominent position in Pakistan's textile industry. However, on standalone basis Fazal Rehman Ltd. share in weaving industry is minimal.

Revenues Sales mix (local: export) has shifted from local sales to exports in recent years. Out of 55% exports during FY18, European region remained the key export market comprising ~70% of export revenues. During FY18, top line increased by ~43% to PKR 7.83bln as a result of volumetric growth through expansion, coupled with increase in export sales and rupee devaluation.

Margins The gross margins significantly improved (FY18: 12.1%, FY17: 8.3%), followed by improved operating margin (FY18: 8.6%, FY17: 5.2%) on account of efficiency gains through expansion. Despite the increase in finance cost by ~45%, improved company margins helped to post net profit (FY18: PKR 324mln, FY17: PKR 152mln), with an increase of ~113%.

Sustainability The dividend inflow from investment in equity (constituting PKR 597mln) will be important. Moreover, Fazal Rehman Ltd. has recently completed expansion project; comprising installation of 120 modern-technology looms. Going forward, the focus remains on enhancing cost efficiencies.

Financial Risk

Working Capital Working capital requirements, a function of inventory and receivables, are historically met through a mix of internal cash generation and short-term borrowings. Net cash cycle marginally increased (9MFY18: 75days, 9MFY17: 72days), on account of increased inventory requirement – a factor of recent expansion.

Coverages Operating cash flows significantly increased (~74%) on YoY basis, on the back of higher pre-tax profitability. Consequently, interest coverages and debt coverages improved (FY18: 4.2x, FY17: 3.5x) and (FY18: 2.9x, FY17: 1.3x) respectively; though remains strong. Going forward, no debt driven expansion in near future will provide comfort to cash flows.

Capitalization Fazal Rehman Ltd. has highly leveraged capital structure. The company's debt to debt plus equity ratio stands at ~68.1% at end- June18 (end- June17: ~61.2%). Out of total loan, 50% represents current debt at end- June18 (end- June17: 35%).



Fazal Rehman Fabrics Limited

BALANCE SHEET	30-Jun-18	30-Jun-17	30-Jun-16
	Annual*	Annual	Annual
Non-Current Assets	3,088	2,515	1,772
Investments (Incl. associates)	597	645	-
Equity	-	-	-
Mutual funds	597	645	-
Current Assets	3,381	1,984	1,468
Inventory	1,083	685	660
Trade Receivables	1,611	494	258
Others	687	805	550
Total Assets	7,066	5,145	3,240
Debt	3,971	2,423	1,168
Short-term	1,919	628	140
Long-term (Incl. Current Maturity of long-term debt)	2,052	1,795	1,028
Other shortterm liabilities	1,067	1,016	554
Other Longterm Liabilities	165	167	140
Shareholder's Equity	1,863	1,538	1,378
Total Liabilities & Equity	7,066	5,145	3,240

INCOME STATEMENT

Turnover	7,830	5,459	5,604
Gross Profit	946	454	472
Other Income	(70)	36	(11)
Financial Charges	(191)	(130)	(126)
Net Income	324	152	83

Cashflow Statement

Free Cashflow from Operations (FCFO)	799	459	430
Net Cash changes in Working Capital	(1,338)	(52)	383
Net Cash from Operating Activities	(732)	310	691
Net Cash from InvestingActivities	(786)	(612)	(88)
Net Cash from Financing Activities	1,549	284	(581)
Net Cash generated during the period	30	(17)	22

Ratio Analysis

Performance			
Gross Margin	12.1%	8.3%	8.4%
Net Margin	4.1%	2.8%	1.5%
ROE	18.3%	11.2%	5.7%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	2.9	1.3	1.3
Interest Coverage (x) (FCFO/Gross Interest)	4.2	3.5	3.4
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	3.4	5.4	3.4
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	75	72	59
Capital Structure (Total Debt/Total Debt+Equity)	68.1%	61.2%	45.9%

*un audited financilas

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

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- (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.
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- (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)

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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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