The Pakistan Credit Rating Agency Limited

Rating Report

Fazal Rehman Fabrics Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Feb-2022	A	A2	Stable	Upgrade	-
25-Aug-2021	A-	A2	Positive	Maintain	-
28-Aug-2020	A-	A2	Stable	Maintain	-
29-Aug-2019	A-	A2	Stable	Maintain	-
28-Feb-2019	A-	A2	Stable	Maintain	-
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 ratings reflect Fazal Rehman Fabrics Limited’s (Fazal Rehman Fabrics) favorable business profile characterized by sizable revenue base and healthy margins. The upgrade incorporates the Company's improving business profile plus its strong financial risk matrix reflected by reasonable working capital cycle; healthy coverages. The ratings incorporate consolidated position of the parent and that of the wholly owned subsidiary. The Company achieved commendable profitability in FY21 of more than PKR 1bln. The momentum was maintained in the subsequent quarter. The company has a sizable pool of short-term investments, which supplement the ratings in terms of available liquidity and also resulting non-core income. During 1QFY22, the Company's topline witnessed 69% YOY growth to stand at PKR 5.5bln. Furthermore, improved margins strengthened bottom-line to stand at PKR 543mln. The financial matrix reveals increase in leveraging, during the period, on account of capacity enhancements financed through long-term borrowing. Healthy coverage and reduced debt payback are displaying comfortable picture. The management is positive about sustaining the growth momentum, going forward. Furthermore, the Company is planning to establish towel unit with capacity of 10 tons production per day. During the period July-December FY21-22, textile exports of the country surged 26 percent YoY, fielding $9.39 billion in total export remittances, as compared to $7.44 billion in the same period last year. This is attributable to increase in demand for textile products internationally and channeling of export orders towards Pakistani market. On a YoY basis, the exports of value-added textile items increased in both quantity and value in December 2021. Going forward, the textile sector’s outlook is expected to stay positive in the medium term where the demand for textile products is expected to sustain. In the local market, the textile sector has recorded strong performance. The relief measures introduced by the State Bank of Pakistan such as deferment of loan payments for one year, low-interest rates, and salary refinance scheme also provided comfort to the sector. Many players have also availed the TERF scheme announced by the Central Bank. This will lead to overall leverage of the sector to increase; however, on relaxed financing rates. The sustainability of demand pattern for the current higher orders from Europe and USA remains essential for the feasible utilization of added capacity by textile players.

The ratings are dependent on the management’s ability to uphold the entity’s strong business performance. The assigned ratings derive comfort from the Company's association with Fazal Group. Meanwhile, prudent management of cash flows and maintaining strong coverage to fulfill financial obligations arising from increased leveraging will be critical, going forward.

Disclosure

Name of Rated Entity	Fazal Rehman Fabrics Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Weaving(Aug-21)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure Fazal Rehman Fabrics Limited (Fazal Rehman), a public unlisted company, was incorporated in 2004 and started commercial operations in 2007.

Background Fazal Rehman is associated with Fazal Group and is a wholly-owned subsidiary of Ahmed Fine Textile Mills Limited. The Company's production facility is located in the vicinity of Multan, Punjab.

Operations The Company operates with one weaving unit having 475 air-jet looms. The Company caters to its power needs via in-house production ~8MW, 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 families of Mian Naseem and Mian Farooq. Both of whom branch out from the same family; descending from Mr. Fazal-ur-Rehman.

Stability The considerable positions in the Company are held by Sheikh Naseem's family, where the third generation is gradually being inducted into the business. The distribution of responsibilities is clearly defined among family members, portraying a structured line of succession. However, the transfer of ownership to the next generation is not documented yet.

Business Acumen The Sponsoring groups have a long presence in the local textile industry. Over the period of time, they have developed strong credentials and expertise in the textile value chain. This has helped the Company in expanding its operations despite the challenging market

Financial Strength Fazal Group maintains 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., if needed.

Governance

Board Structure The Company's seven members Board consists of four Fazal Group's representatives, including the Chairman.

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

Board Effectiveness The Board has Audit Committee in place to assist the board on relevant matters. Additionally, attendance of board members in meetings remained strong and meeting minutes are appropriately documented.

Financial Transparency M/s Shinewing Hameed Chaudhri & Co., Chartered Accountants is the external auditor of the Company.

Management

Organizational Structure Ms. Atiqa Hussain Fazal is the Company's CEO, while Management control vests with Fazal Group with Mr. Rehman Naseem (representative of Fazal Group) primarily managing the Company's operations.

Management Team Management team comprises individuals that have extensive expertise in textile value chain. Mr. Naveed Amir is serving in capacity of CFO. He has been associated with the Fazal Group since 1993.

Effectiveness The management meetings are held on periodic basis, with formal recording of meeting minutes, followed by need based meetings to resolve bottlenecks and to ensure smooth flow of operations. Additionally, detailed reporting on cash position and inventory is done on regular basis and presented to senior management for performance review; eventually ensuring efficiency.

MIS Fazal Rehman deploys Oracle based Enterprise Resource Planning (ERP) system with 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. is compliant with multiple safety and quality assurance standards; majorly including ISO 9001, Lycra assured, Fair Trade and Organic exchange.

Business Risk

Industry Dynamics During the period July-December FY21-22, textile exports surged 26 percent YoY, fielding $9.39 billion in total export remittances, as compared to $7.44 billion in the same period last year. This is attributable to increase in demand for textile products internationally and channeling of export orders towards Pakistani market. On a YoY basis, the exports of value-added textile items increased in both quantity and value in December 2021. Going forward, the textile sector's outlook is expected to stay positive in the medium term where the demand for textile products is expected to sustain. In the local market, the textile sector has recorded strong performance. The relief measures introduced by the State Bank of Pakistan such as deferment of loan payments for one year, low-interest rates, and salary refinance scheme also provided comfort to the sector. Many players have also availed the TERF scheme announced by the Central Bank. This will lead to overall leverage of the sector to increase; however, on relaxed financing rates. The sustainability of demand pattern for the current higher orders from Europe and USA remains essential for the feasible utilization of added capacity by textile players.

Relative Position Fazal Rehman Ltd. is associated with Fazal Group. The Group is one of the largest yarn exporters of Pakistan; though it has limited share in fabric sale on both local and export front. However, on standalone basis Fazal Rehman Ltd.'s share in local weaving industry is minimal

Revenues During FY21, revenue of the Company grew by 25%, standing at PKR 14,017mln (FY20: PKR 11,221mln). This was majorly the result of more than doubled up local sales (FY21: PKR 5,831mln; FY20: PKR 3,913mln). Exports increased by 15% (FY21: PKR 9,653mln; FY20: PKR 8,392mln). The management seek optimum prices, which dictates the nature of the sales mix. Hence, the Company focused more on local sales as the orders and prices were more attractive. During 1QFY22 Topline was recorded at PKR 5,517mln.

Margins The Company's gross margin increased to (FY21: 14.7%; FY20: 13.6%). This increase further translated into improved operating margin (FY21: 11%; FY20: 9.7%). Furthermore, due to ~14% decrease in finance cost (FY21: PKR 301mln; FY20: PKR 348mln), the net income augmented to (FY21: PKR 1,071mln; FY20: PKR 671mln). Subsequently, the net profit margin improved (FY21: 7.6%; FY20: 6.0%). At end-Sept21 net profit margin increased to 9.8%.

Sustainability The company is in process of installing 25 towel looms including dying and finishing with the production capacity up to 15 tonnes per day. Total project cost is PKR 1,500 million, About PKR 1,150 million is covered by bank loan. The Towel Production unit will be operational by May 2022.

Financial Risk

Working Capital Fazal Rehman fulfills its working capital needs through a mixture of short term borrowing and internal cash flows. During FY21, net working capital cycle shortened to 67 days (FY20: 77 days) on the back of improved inventories' cycle. The Company also recorded an increase in trade assets (FY21: PKR 4,922mln; FY20: PKR 4,075mln) majorly due to higher receivables' levels (FY21: PKR 1,254mln; FY20: PKR 897mln). ST trade leverage adequacy stood at 33.7% (FY20: 42.3%). At end-Sept21, net working capital days decreased to 53 days.

Coverages During FY21, the Company recorded 43% increase in FCFO PKR 1,874mln (FY20: PKR 1,314mln) due to improved profitability at operating level. Finance cost increased to PKR 312mln (FY20: PKR 300mln). Interest coverage improved to 7.2x (FY20: 4.5x). Debt coverage increased to 2.6x; FY20: 2.4x). At end Sept-21, FCFO Clocked in at PKR 649mln and interest coverage recorded at 7.5x.

Capitalization During the period under review, Fazal Rehman's leverage increased to 58.5% during FY21 (FY20: 54.6%) as the total borrowing, climbed to PKR 6,157mln (FY20: PKR 3,688mln), majorly due to an increase in long term borrowing (FY21: PKR 3,778mln; FY20: PKR 2,326mln). Out of the total borrowing, short term debt constitutes 37.2%. At end-Sept21, leverage inched down to 57.2% and total borrowings stood at PKR 6,568mln, Equity base of the company stood at PKR 4,911mln.

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Financial Summary
PKR mln

Fazal Rehman Fabrics Textile | Weavings	Sep-21 3M	Jun-21 12M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET				
1 Non-Current Assets	5,379	5,350	3,026	3,141
2 Investments	1,920	1,900	1,178	932
3 Related Party Exposure	-	-	146	-
4 Current Assets	7,172	5,703	4,541	3,529
a Inventories	*3,712*	*2,854*	*2,474*	*1,959*
b Trade Receivables	*1,899*	*1,254*	*897*	*1,011*
5 Total Assets	14,472	12,953	8,892	7,603
6 Current Liabilities	2,734	2,110	1,948	1,205
a Trade Payables	*2,022*	*1,270*	*1,057*	*575*
7 Borrowings	6,568	6,157	3,710	3,636
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	260	318	175	226
10 Net Assets	4,911	4,367	3,059	2,537
11 Shareholders' Equity	4,911	4,367	3,081	2,537
B INCOME STATEMENT				
1 Sales	5,517	14,017	11,221	10,781
a Cost of Good Sold	*(4,546)*	*(11,961)*	*(9,695)*	*(9,568)*
2 Gross Profit	971	2,056	1,526	1,214
a Operating Expenses	(247)	(520)	(432)	(341)
3 Operating Profit	723	1,536	1,094	873
a Non Operating Income or (Expense)	*(20)*	*73*	*30*	*165*
4 Profit or (Loss) before Interest and Tax	704	1,609	1,123	1,038
a Total Finance Cost	*(98)*	*(301)*	*(348)*	*(266)*
b Taxation	*(62)*	*(237)*	*(104)*	*(73)*
6 Net Income Or (Loss)	543	1,071	671	699
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*649*	*1,874*	*1,314*	*1,279*
b Net Cash from Operating Activities before Working Capital Changes	*534*	*1,562*	*1,014*	*1,030*
c Changes in Working Capital	*(743)*	*(811)*	*(417)*	*(110)*
1 Net Cash provided by Operating Activities	(209)	750	597	920
2 Net Cash (Used in) or Available From Investing Activities	(178)	(3,146)	(579)	(590)
3 Net Cash (Used in) or Available From Financing Activities	411	2,479	52	(311)
4 Net Cash generated or (Used) during the period	24	84	70	19
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	57.4%	24.9%	4.1%	39.2%
b Gross Profit Margin	17.6%	14.7%	13.6%	11.3%
c Net Profit Margin	9.8%	7.6%	6.0%	6.5%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-1.7%	7.6%	8.0%	10.8%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	46.8%	28.8%	23.9%	31.3%
2 Working Capital Management				
a Gross Working Capital (Average Days)	80	97	103	93
b Net Working Capital (Average Days)	53	67	77	78
c Current Ratio (Current Assets / Current Liabilities)	2.6	2.7	2.3	2.9
3 Coverages				
a EBITDA / Finance Cost	9.7	7.6	5.0	5.6
b FCFO / Finance Cost+CMLTB+Excess STB	3.5	2.6	3.2	2.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.9	2.6	2.4	2.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	57.2%	58.5%	54.6%	58.9%
b Interest or Markup Payable (Days)	68.3	114.4	117.2	69.3
c Entity Average Borrowing Rate	6.8%	5.7%	8.1%	6.8%

Credit Rating

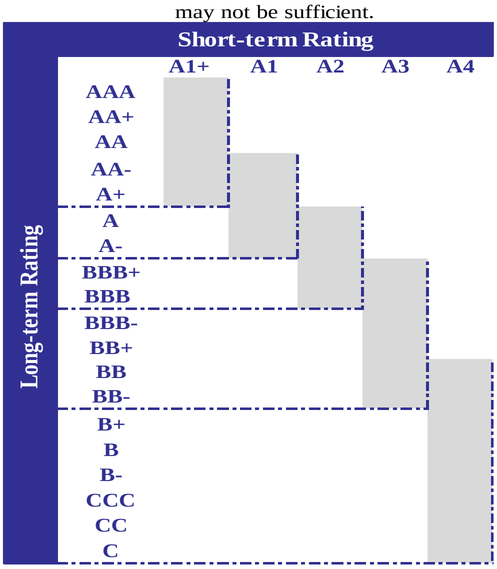
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



The correlation shown is indicative and, in certain cases, may not hold.

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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