



The Pakistan Credit Rating Agency Limited

Rating Report

Ahmed Fine Weaving Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Dec-2018	BBB+	A2	Stable	Maintain	-
30-May-2018	BBB+	A2	Stable	Maintain	-
11-Oct-2017	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect modest business profile of Ahmed Fine Weaving Limited – independently owned by a family stream belonging to erstwhile Fazal family of Multan. The sponsor’s long association with the textile business is considered positive. During recent years the company’s sales mix has shifted towards local sales. Meanwhile, the company’s declined margins has limited its profitability. Moreover, re-imposition of custom duties and sales tax on cotton & yarn imports, coupled with increasing interest rates has stretched the textile industry. On standalone basis, the rupee devaluation has provided a requisite breather to the company to sustain its business margins, despite declining export sales. The management is cognizant of this and intends to strengthen its performance by expanding volumes. For the purpose the company is continuously in process of BMR activities. The expansion projects have been financed through LTFF, with comfortable debt servicing cycle. Longer tenure and competitive rates of underlying debt should help aligning the impact of these financial obligation with ensuing cash flows. The company currently enjoys good financial risk profile, reflected by (i) relatively efficient working capital cycle, (ii) healthy coverages, and (iii) moderately leveraged capital structure.

The ratings are dependent on the company’s ability to improve its margins and maintain prudent working capital and financial profile. Any negative movement in margins, impacting profitability in turn, cash flows, will negatively impact the ratings. Improvement in governance framework is important.

Disclosure

Name of Rated Entity	Ahmed Fine Weaving 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 Ahmed Fine Weaving Limited (Ahmed Fine Weaving), was incorporated on July 6th 2012 as a public unlisted company.

Background In July 2014 the weaving segment of the company was de-merged from Ahmed Fine Textile Mills into Ahmed Fine Weaving. This separation was done through a scheme of arrangement. All assets, liabilities, agreements, arrangements and other matters relating to the weaving business were transferred to and vested in the company as approved by the High Court of Sindh.

Operations Ahmed Fine Weaving's primary business is sales and marketing of cotton fabric. The company's current operational capacity comprises 260 Looms. The total energy requirement of the company clocks in at ~4.86MW which can be completely met through gas fired generators. Furthermore, the company has acquired diesel generators and NTDC as alternative sources.

Ownership

Ownership Structure The ownership of Ahmed Fine Weaving rests with the family of Mr. Ashar Fazal including his mother and children.

Stability The considerable positions in the company are held by Mr. Ashar Fazal's family. The distribution of shareholding among family members portrays a structured line of succession. Moreover, the transfer of ownership is yet to be seen.

Business Acumen Mr. Ashar is one of the grandsons of Fazal-ur-Rehman. Fazal family is among the pioneers of modern textile industry in Pakistan. The decades long presence in textile industry, while developing credential expertise over time provides sufficient business acumen, in order to sustain through volatile textile industry.

Financial Strength The sponsor's family stream belonging to erstwhile Fazal family, founder of Fatima and Fazal Groups. Ahmed Fine Weaving is the only entity of this family primarily engaged in the weaving business. Given the scale of operations of the company, the sponsor's financial strength to provide requisite support in times of stress remains adequate.

Governance

Board Structure The company's board of directors comprises three members. Two members belong to the sponsoring family, while one member is executive director. Sponsor's dominance and absence of independent oversight indicates room for improvement in the governance framework of the company.

Members' Profile All the board members have more than five years of association with the board and have adequate experience in the textile sector. Mr. Ashar Fazal - the Chairman of board, is also the CEO of the company.

Board Effectiveness Attendance of the members remained strong during the year. The board meeting minutes have been formally recorded; though needs improvement. Moreover, the minutes reflect minimum participation by the board members. The board have Audit and HR committee in place to assist board on relevant matters.

Financial Transparency M/s. Deloitte Yousaf Adil, Chartered Accountants is the external auditor of the company. The auditors have expressed unqualified opinion on the financial reports for the year ended 30th June, 2018.

Management

Organizational Structure Management control vests with Zafar's Family, with defined reporting line to ensure smooth operations and efficiency. Moreover, the company has five functional departments, while all HOD's reports directly to CEO.

Management Team The management team is headed by the CEO Mr. Ashar Fazal who is a management graduate from USA. He is well verse with the textile business and carries strong business acumen. He is supported by a team of seasoned professionals, supplementing his expertise.

Effectiveness The management meetings are held on periodic basis with follow-up points to resolve or pro-actively address operational issues, if any, eventually ensuring smooth flow of operations.

MIS Ahmed Fine Weaving has in place Oracle based Enterprise Resource Planning (ERP) system that provides comprehensive MIS reporting.

Control Environment The company is compliant with multiple safety and quality assurance standard; comprising ISO 9001:2008. In addition, Ahmed Fine's plant is connected with head office through VPN, thereby reporting on the real time basis.

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 FY19 budget, coupled with exclusion of tax rebate on yarn and greige fabric has further stretched the industry margins. However, rupee devaluation in recent times has provided a breather provide breather to textile ventures with net exports.

Relative Position Before the demerger Ahmed Fine Weaving was associated with Fazal Group, as the group has considerable presence in the local textile industry. Currently on standalone basis, Ahmed Fine Weaving has a minimal share in local weaving industry.

Revenues During FY18, the company's topline grew by ~3.5% YoY to PKR 4,055mln (FY17: PKR 3,916mln), mainly on account of better capitalization of local demand. The company's sales mix continues to be dominated by local sales ~69% (FY17: 61%), a factor of better pricing in local market. Top ten customers' revenue concentration in both local (FY18: ~38%, FY17: ~50%) and export markets (FY18: ~44%, FY17: ~50%), is considered high, though at par with other local textile units. Whereas during 1QFY19, revenues increased by ~33.4% on QoQ basis, a factor of recent expansion.

Margins During FY18, Ahmed Fine Weaving's gross margins observed a decline (FY18: 6.4. %, FY17: 7.6%), due to higher than proportionate increase in cost of sales ~ 4.8%, majorly lead by higher energy costs and yarn prices. Despite the rationalization of distribution expense, a factor of declined exports, the operating margins declined (FY18: 2.5%, FY17: 3.0%). Moreover, finance costs increased by ~22%, due to increased interest rates, while on account of taxation the company's net profitability clocked in at (FY18: ~PKR 22mln, FY17: ~PKR 20mln), posting a growth of ~10%. Furthermore, the company's margins slightly improved in 1QFY19 (gross: 7.5%, net: 3.8%), due to recent BMR activities.

Sustainability The company has incurred a BMR of ~PKR 280mln, comprising replacement of 72 obsolete looms with advance air jet looms to secure operational efficiencies, eventually enhancing production capacity. Moreover, 46 looms were added to existing capacity during Aug-18, while financing was secured through LTFF.

Financial Risk

Working Capital Though the company's reliance on STB has increased in FY18 but remain well covered to trade assets (FY18: 41%, FY17: 33%), portraying a sufficient room to borrow. Meanwhile, the considerable increase in inventory days (FY18: 70days, FY17: 58days), lead to higher working capital days (gross - FY18: 99days, FY17, 80days, net - FY18: 78days, FY17 64days). The trend of increasing working capital cycle continued in 1QFY19, reflected from higher net working capital days (1QFY19: 73days, 1QFY18 80days), mainly on account of higher receivables.

Coverages The company's operating cash flows (FCFO) increased by ~47% to stand at (FY18: PKR 193mln, FY17: PKR 131mln). However, the lower than proportionate increase in finance cost has resulted in improved interest coverage (FY18: 3.2x, FY17: 2.7x), while debt coverage slightly deteriorated (FY18: 2.5x, FY17: 2.7x), a factor of CMLTD. The company's coverages marginally declined in 1QFY19 to stand at (interest: 2.9x, debt: 2.3x) owing to decreased profitability. Going forward, rise in interest rate may stretch the company's coverages.

Capitalization Ahmed Fine Weaving has an intermediate leveraged capital structure at end-June 18 ~53.1% (end-June 17: 52.1%). Total debt stood at PKR 1,008mln, mainly comprising current debt ~ 70.3%. The company's financial profile has further stretched in 1QFY19 on account of debt driven expansion.



Ahmed Fine Weaving Limited

BALANCE SHEET

	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
	3M	Annual	Annual	Annual
Non-Current Assets	892	885	963	651
Current Assets	1,907	1,592	1,268	1,138
Inventory	705	847	699	550
Trade Receivables	552	412	236	231
Others	650	333	333	356
Total Assets	2,799	2,477	2,230	1,789
Debt	1,253	1,008	946	591
Short-term	656	691	629	575
Long-term (Inlc. Current Maturity of long-term debt)	597	317	317	16
Other shortterm liabilities	561	514	360	323
Other Longterm Liabilities	67	64	56	36
Shareholder's Equity	917	891	868	838
Total Liabilities & Equity	2,799	2,477	2,230	1,789

INCOME STATEMENT

Turnover	1,219	4,055	3,916	3,347
Gross Profit	92	258	296	299
Other Income	(2)	(3)	0	(5)
Financial Charges	(18)	(60)	(49)	(44)
Net Income	26	22	20	25

Cashflow Statement

Free Cashflow from Operations (FCFO)	52	193	131	138
Net Cash changes in Working Capital	(258)	(224)	(38)	(111)
Net Cash from Operating Activities	(220)	(90)	47	(19)
Net Cash from Investing Activities	(27)	(12)	(373)	(35)
Net Cash from Financing Activities	245	62	365	57
Net Cash generated during the period	(1)	(40)	39	2

Ratio Analysis

Performance

Gross Margin	7.5%	6.4%	7.6%	8.9%
Net Margin	2.2%	0.5%	0.5%	0.7%
ROE	12.2%	2.4%	2.5%	3.1%

Coverages

Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	2.3	2.5	2.7	2.3
Interest Coverage (x) (FCFO/Gross Interest)	2.9	3.2	2.7	3.2
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	4.4	2.4	3.9	0.2

Liquidity

Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	73	78	64	68
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Capital Structure (Total Debt/Total Debt+Equity)	57.7%	53.1%	52.1%	41.4%
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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.

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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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- (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)

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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)

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- (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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