The Pakistan Credit Rating Agency Limited

Rating Report

Ahmed Fine Weaving Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Nov-2019	A-	A2	Stable	Upgrade	-
30-May-2019	BBB+	A2	Positive	Maintain	-
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 of Ahmed Fine Weaving Limited (Ahmed Fine Weaving) reflect its improving business profile emanating from growth in revenues and profitability. Ahmed Fine Weaving is a family owned public unlisted company with adequate weaving capacity. Currency devaluation and subsidized rates for electricity and gas, boded well for the core operations resulting in better margins. The management's focus on efficiency has strengthened performance by expanding volumes and diversifying its product profile. This has been achieved through consistent BMR activities in recent years. The Company's management is cognizant of textile industrys volatility and has planed phase wise up gradation of machinery to remain competitive. The Company enjoys strong financial profile characterized by, efficient working capital cycle, strong coverages and intermediately leveraged capital structure. The governance framework can be further strengthened. The expansion projects have been financed through SBP loans with concessionary rates, which provides comforts amidst high interest rate scenario.

The ratings are dependent on the management's ability to uphold the entity's performance trend. Meanwhile, maintaining strong margins and coverages to fulfill financial obligations will remain critical. Improvement in governance framework is considered 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-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Weaving(Sep-19)
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 Jan 2016, weaving segment of the Company was de-merged form Ahmed Fine Textile Mills into Ahmed Fine Weaving. This separation was done through a scheme of arrangements. 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 to manufacture and sale cotton fabric in local and international market. The Company operates two weaving units with a total of 264 Air Jet looms. Weaving Unit-1 is located at Basti Malook - Multan and Weaving Unit-2 is located at Qadir Pur Rawan - Multan. The Company's total power requirement is ~5MW which is met through gas fired generators. The Company has acquired diesel generators and MEPCO connections 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 members. The distribution of shareholding among family members portrays a structured line of succession.

Business Acumen Mr. Ashar Fazal is one of the grandsons of Fazal-ur-Rehman. Fazal family is among the pioneers of modern textile industry in Pakistan. He has decade's long presence in textile industry, developing credential expertise over time which provides sufficient acumen, in order to sustain any upcoming challenge.

Financial Strength Ahmed Fine Weaving is the only entity of the Fazal 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 an 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, as minutes reflect minimum participation by the board members. The board has Audit and HR committee in place to assist board on relevant matters.

Financial Transparency M/s. Deloitte Yousaf Adil, Chartered Accountants, are the external auditor of the Company. The auditor has expressed unqualified opinion on the financial reports for the period FY19. The auditors fall under category'A' of SBP's panel of auditors.

Management

Organizational Structure Management control vests with Mr. Ashar Fazal, with defined reporting line to ensure smooth operations and efficiency. The company has five functional departments, namely (i) Finance & Commercial, (ii) Marketing, (iii) Weaving, (iv) IT and (v) Internal Audit. All HODs report directly to the CEO.

Management Team The management team is headed by the CEO, Mr. Ashar Fazal, who is a management graduate from USA. He is well versed with the textile business and carries strong business acumen. He is supported by a team of seasoned professionals which supplements 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 real time basis.

Business Risk

Industry Dynamics The export performance of Pakistan's textile industry remained stagnated during FY19, despite ~34% currency devaluation and incentives introduced by the government to promote exports. Meanwhile, cotton yarn exports witnessed a ~18% decline driven by US-China trade war. Cotton crop for the year is expected to be lower than last last year due to crop diseases. The revised target of cotton crop for FY20 is 10mln bales, down by 7% from FY19. This will result in the need to import 4-5mln bales, making for much costlier input, given the current duty structure on imported cotton. Meanwhile, higher interest rates along with withdrawal of zero-rating status has put the overall liquidity of textile industry under pressure. These factors are likely to further impact margins of textile companies, going forward.

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

Revenues The Company revenues are on growing trajectory since 2016. The trend magnified in FY19, as the Company managed to book revenues of PKR 5,560mln (FY18: PKR 4,055mln), posting ~37% YoY growth. Revenue growth is driven by, i) completion of BMR, yielding volumetric growth, ii) upsurge in local prices and, iii) increased quantum of exports, given notable YoY rupee devaluation. Despite absence of rebates scheme and suppressed international demand for textile products in FY19, the Company managed to increase its exports (~46% YoY growth) on account of prudent sales efforts. In 1QFY20, revenues grew by ~34% and reported at PKR 1,641mln on account of partial completion of recent BMR. Going forward, the Company sales mix will be managed on account of feasibility of orders.

Margins The Company's gross margin slightly improved in FY19 (FY19: 6.7. %, FY18: 6.4%), on the back of efficiency gains through recent BMR and subsidized rates of utilities (since Jan-19). Likewise, operating margin improved (FY19: 3.1 %, FY18: 2.5%) despite notably higher distribution expense, a factor of increased exports. Meanwhile, significant exchange gains (PKR 125mln) mitigated the impact of higher finance cost, eventually leading to improved net margins (FY19: 2.5 %, FY18: 0.5%) as net profit reported at PKR 132mln (FY18: PKR 22mln), posting multifold increase. Furthermore, the Company's margins considerably improved (gross - 1QFY20: 11%, operating - 1QFY20: 6.7%)on account of BMR, which has yielded high valued products. The Company's profitability improved threefold as net profit landed at PKR 77mln (1QFY19: PKR 26mln).

Sustainability The Company is consistently incurring BMR in recent years, largely comprising mechanical up gradation through replacement of its existing looms. This has yielded efficiency and flexibility in its product profile, eventually adding to the Company margins and, in turn, better profitability. Going forward, the Company intends to upgrade the remaining outdated looms in phases which will eventually add to the Company's bottom line.

Financial Risk

Working Capital In FY19, the Company's reliance on STB increased (FY19: PKR 878mln, FY18: PKR 691mln) due to YoY hike in yarn prices along with higher working capital requirements, a factor of recent expansion. Despite this the Company's short term trade leverage slightly improved, portraying improved liquidity position. Inventory position largely remained stagnant, however, increased revenue led to lower YoY inventory days in FY19. This impact was nullified by proportional increase in receivable days. Eventually restricting the gross working capital at same level (FY19: 98days, FY18: 99 days). Similarly, net working capital days stood at (FY19: 76days, FY18: 78 days). Likewise, the working capital was maintained in 1QFY20. Going forward, the Company plans to have a net working capital cycle of less than 90 days, so that the quantum of short-term borrowing would remain in the manageable limit.

Coverages During FY19, the Company's operating cash flows (FCFO) increased towfold (FY19: PKR 376mln, FY18: PKR 170mln), led by higher profitability. However, the interest expense increased in lower proportion to FCFO, eventually strengthening interest coverages (FY19: 4.4x, FY18: 3.3x). Likewise, debt coverage witnessed an improvement (FY19: 2.8x, FY18: 2.5x), though improved in lower proportion due to higher debt servicing. Coverages were slightly lower in 1QFY20 (interest - 1QFY20: 3.8x, debt - 1QFY20: 2.7x) though remained strong. LTB for expansion wholly comprises SBP subsidized loan with comfortable debt servicing, which has kept the interest exposure quiet low amidst high interest rate scenario.

Capitalization The Company has an intermediately leveraged capital structure ~58.8% (FY18: 53.1%) in FY19. The total debt stood at PKR 1.46bln with STB constituting 60%. Long term borrowing is wholly availed at the State Bank's concessionary rates. During 1QFY19, the Company's largely remained stagnated at ~57.3%.

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Financial Summary
PKR mln

Ahmed Fine Weaving Limited	Sep-19	Jun-19	Jun-18	Jun-17
Weaving	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	1,166	1,165	885	963
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	2,263	2,107	1,593	1,268
a Inventories	*882*	*885*	*847*	*699*
b Trade Receivables	*891*	*843*	*412*	*236*
5 **Total Assets**	3,428	3,272	2,478	2,230
6 Current Liabilities	783	701	514	360
a Trade Payables	*467*	*401*	*276*	*176*
7 Borrowings	1,478	1,462	1,008	946
8 Related Party Exposure	1	1	1	1
9 Non-Current Liabilities	63	82	64	56
10 **Net Assets**	1,103	1,026	891	868
11 **Shareholders' Equity**	1,103	1,026	891	868
B INCOME STATEMENT				
1 **Sales**	1,641	5,560	4,055	3,916
a Cost of Good Sold	*(1,461)*	*(5,190)*	*(3,797)*	*(3,620)*
2 **Gross Profit**	180	371	258	296
a Operating Expenses	(70)	(200)	(156)	(178)
3 **Operating Profit**	110	171	102	117
a Non Operating Income	*20*	*122*	*(3)*	*0*
4 **Profit or (Loss) before Interest and Tax**	130	293	98	117
a Total Finance Cost	*(35)*	*(97)*	*(60)*	*(49)*
b Taxation	*(19)*	*(64)*	*(17)*	*(48)*
6 **Net Income Or (Loss)**	77	132	22	20
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*124*	*376*	*170*	*131*
b Net Cash from Operating Activities before Working Capital Changes	*93*	*287*	*111*	*85*
c Changes in Working Capital	*(89)*	*(349)*	*(200)*	*(38)*
1 **Net Cash provided by Operating Activities**	4	(62)	(89)	47
2 **Net Cash (Used in) or Available From Investing Activities**	(31)	(381)	(12)	(373)
3 **Net Cash (Used in) or Available From Financing Activities**	16	455	62	365
4 **Net Cash generated or (Used) during the period**	(11)	12	(39)	39
D RATIO ANALYSIS				
1 **Performance**				
a Sales Growth (for the period)	18.0%	37.1%	3.5%	17.0%
b Gross Profit Margin	11.0%	6.7%	6.4%	7.6%
c Net Profit Margin	4.7%	2.4%	0.5%	0.5%
d Cash Conversion Efficiency (EBITDA/Sales)	10.1%	7.8%	5.1%	5.1%
e Return on Equity (ROE)	28.8%	13.8%	2.5%	2.4%
2 **Working Capital Management**				
a Gross Working Capital (Average Days)	97	98	99	118
b Net Working Capital (Average Days)	73	76	78	103
c Current Ratio (Total Current Assets/Total Current Liabilities)	2.9	3.0	3.1	3.5
3 **Coverages**				
a EBITDA / Finance Cost	5.0	5.1	4.0	5.0
b FCFO / Finance Cost+CMLTB+Excess STB	2.7	2.8	2.5	3.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.6	2.0	2.7	3.5
4 **Capital Structure (Total Debt/Total Debt+Equity)**				
a Total Borrowings / Total Borrowings+Equity	57.3%	58.8%	53.1%	52.2%
b Short-Term Borrowings / Total Borrowings	0.6	0.6	0.7	0.7
c Average Borrowing Rate	9.0%	6.9%	5.3%	5.2%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

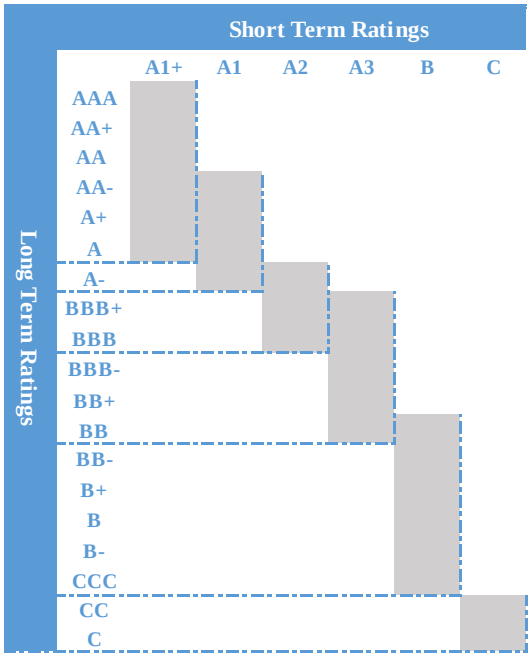
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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