



The Pakistan Credit Rating Agency Limited

Rating Report

Fazal Holdings (Pvt.) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-May-2019	A	A1	Stable	Maintain	-
26-Nov-2018	A	A1	Stable	Maintain	-
07-May-2018	A	A1	Stable	Maintain	-
31-Aug-2017	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Fazal Holdings (Pvt.) Limited ('Fazal Holdings') is a holding company for Fazal Group. It's investment portfolio comprises a combination of strategic investments (long-term investments in subsidiaries and associates) and trading portfolio (with short to medium - term time horizon). As per policy, active trading is minimal. Trading portfolio comprises a combination of blue chip companies, spread across diverse sectors of the economy. Fazal Holdings drives its revenue from dividend income (mainly from strategic investments) and capital gains. The dividend stream were impacted due to recent downturn in capital markets. Sponsors intend to expand Fazal Holdings. Consequently, profits are being retained and any surplus funds, elsewhere in the Group, are also routed through Fazal Holdings. The Company has designed a conservative investment policy accordance with the Company's equity. This should help absorb the effects of volatility in stock market on assets of Fazal Holdings and keep financial risk manageable. Investment decisions are mainly led by Mr. Rehman Naseem with assistance from resources within Fazal Group and certain research/brokerage houses. Herein, institutionalization of investment policies would be beneficial.

Ratings are dependent on management's initiative to strengthen investment making and performance monitoring mechanism of underlying investments. This would facilitate Fazal Holdings assimilation into an effective holding company. Prolonged downturn in the capital market and/or material performance weakening of investee companies would have a negative impact on the ratings. At the same time, adhering to agreed financial matrix and keeping debt coverages at adequate level remains critical.

Disclosure

Name of Rated Entity	Fazal Holdings (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18),Methodology Holding Company (Jun-18)
Related Research	Sector Study Holding Company(Aug-18)
Rating Analysts	Adnan Dilawar adnan@pacra.com +92-42-35869504



Profile

Legal Structure Fazal Holdings (Pvt.) Limited is a private limited company incorporated in Pakistan on April 23, 1995, under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017).

Background After incorporation in 1995, the Company was named Amir Fine Exports (Pvt.) Limited. It was engaged in the trading of yarn and cloth along with listed investments and unlisted securities. In 2016, the Company's name was changed to Fazal Holdings (Pvt.) Limited. The registered office of the Company is in Multan.

Operations Fazal Holdings is principally engaged in making short term investments in quoted and un-quoted securities (trading portfolio), long term (strategic investments) and purchasing investment property for agricultural and rental purposes. The Company's investment book's position (as at Mar'19) is as follows: Trading Portfolio of PKR 2.5bln and Strategic Investments of PKR 7.4bln.

Ownership

Ownership Structure Fazal Holdings is owned by the members of the sponsoring family i.e. Fazal family. Majority shares resides with Mr. Rehman Naseem (49%). Mr. Amir Naseem Sheikh's family owns a stake of 49%; through his sons, Mr Yousaf Amir and Mr. Abdullah Amir, owning 22% each, in the Company. While, remaining shareholding resides with Mr. Sheikh Naseem.

Stability Ownership of the business is seen as stable as the major ownership vests with the sponsors with clear succession.

Business Acumen Fazal Group* was incorporated in 1966 and is a renowned textile Group in Pakistan. Fazal Cloth Mills Ltd. – Groups' flagship Company, was incorporated in 1966 and had set up its first spinning unit in 1972 in Muzaffargarh. Other businesses operated by Fazal Group include Ahmed Fine textile Mills, Fazal Weaving Mills and Fazal Rehman Fabrics Limited among others. (* The term 'Group' may be defined differently in Prudential Regulations for Corporate/Commercial Banking and/or other laws).

Financial Strength As at Dec-18, the Group had an asset base of over PKR 255bln supported by PKR 108bln equity. Group generated a turnover of over PKR 81bln and reaped a bottom-line of PKR 12bln approximately.

Governance

Board Structure BoD comprises three members; two directors and CEO of the Company. Limited size of the Board, dominance of sponsoring family and absence of independent oversight indicates room for improvement in the overall governance framework.

Members' Profile Mr. Rehman Naseem, member of BoD, is a Columbia University graduate. He is CEO of Ahmed Fine Textile Mills Limited, Rehman Amir Fabrics Ltd and Fazal Cloth Mills. The BoD members experience is mostly concentrated towards textile and fertilizer industry.

Board Effectiveness There were three board meetings held during 9MFY19, with majority attendance. Minutes of these meetings are formally documented. Keeping in view the investment book of the Company, absence of Board sub-committees indicates a room for improvement in effective governance.

Financial Transparency M/s Shინewing Hameed Chaudhri & Co were been appointed as external auditors during FY18. The auditors have expressed unqualified opinion on the financial reports for FY18.

Management

Organizational Structure Fazal Holdings is headed by the CEO, Mr. Rehman Naseem. There are two main functions, Finance and MIS, headed by the Company's CFO, who reports to the CEO. Company Secretary looks after compliance related matters and reports to CEO & CFO, both.

Management Team Mr. Sheikh Naseem Ahmed, CEO of Fazal Holdings, has over 50 years of experience in textile and in fertilizer sector. He has the directorship of other Fazal Group companies. Mr. Azam, Group CFO, is an FCA and FCMA with a long association of over a decade with Fazal Group of Companies.

Effectiveness Various reports are generated on daily, weekly and monthly basis highlighting the performance of the investment portfolio.

MIS The Company has implemented Investment Management and Accounting Software and has adopted parallel changeover method for the implementation of new system.

Control Environment The internal audit function is placed at Group level. The risk management is handled by the management and Director, Mr Rehman Naseem, has set the investment management procedures and developed risk management policies and procedures. These practices suggest a need for improvement in the control environment of Fazal holdings.

Business Risk

Industry Dynamics Holding companies are an emerging phenomena in Pakistan. Some operating companies diversified and grew by gradually making strategic investments. Eventually, they de-merged their operations and structured themselves as a holding company to focus on existing and new investments.

Relative Position Fazal Holdings has an investment book of PKR 10.6bln comprising of Strategic Investments (PKR 7.4bln), Trading Investments (PKR 2.5bln) and Investment Properties (PKR 0.8bln). Strategic Investments comprise Fazal Group's flagship Company - Fazal Cloth (maintains a prominent position in spinning sector on a standalone basis), Fatima Energy Limited, Fatima Transmission Company Limited, Reliance Weaving Mills and Pakarab Fertilizers Limited. Trading Investments include primarily blue chip companies that keeps the business risk of the Company (exposure to stock market) relatively in check.

Revenues Fazal Holdings maintains two investment books, Long Term – Strategic Investment Book and Short Term – Trading Portfolio, to receive dividend incomes. The Company's strategic investments book is divided into listed and unlisted entities from textile, fertilizer and energy infrastructure sectors. Valuation of the book increased by 5% in 9MFY19 supported by share of profits from associates, mainly from Fazal Cloth. From the Short Term – Trading Portfolio, the Company's dividend income posted a dip of 63% due to volatile and uncertain economic conditions. The Company increased its stake in mutual funds and commercial banking sector. The Company has diluted its stake in fertilizer and power sectors. In comparison to the return on KSE-100 Index, return on the Company's trading book has outperformed. On standalone basis, the Company's top-line declined by 94% (9MFY19: PKR 13mln, 9MFY18: PKR 237mln), mainly due to 63% dip in the dividend income (9MFY19: PKR 52mln, 9MFY18: PKR 141mln); as the Company currently receives dividends from short term - trading portfolio only. However, Capital gains of PKR 28mln (9MFY18: 16mln) were realized during 9MFY19. Finance costs increased by 35% (9MFY19: PKR 173mln, 9MFY18: PKR 127mln) owing to an increase in the short-term running finance obtained to support the Company's trading book. Share of profits from associates – Fazal Cloth, helps to curtail the increase in the finance costs.

Margins Despite a reduction in the bottom-line, the Company's net profit margin improved as compared to 9MFY18. This improvement is primarily driven by markup received from associates i.e. Fatima Energy Limited and Fatima Transmission Company Limited.

Sustainability Sponsors intend to expand Fazal Holdings. During 9MFY19, Fazal Holdings has acquired Investment Property worth PKR 251mln. Fazal Holdings has also issued advance of PKR 291mln to Fatima Energy Limited and PKR 22mln to Fatima Transmission Company Limited.

Financial Risk

Working Capital Fazal Holdings obtains long term and short term debt to finance strategic investments (Investment Property and Investments in Associates) and trading portfolio. In 9MFY18, long term debt obtained in previous years was fully repaid. Short term debt increased to PKR 2.5bln (9MFY18: PKR 1.8bln). Dividend inflows from these investments provides comfort and buffers the risk absorption capacity of the Company.

Coverages During 9MFY19, EBITDA/Interest Coverage Ratio stood at 0.7x. The deterioration is due to the lower dividends and increase in revaluation deficit on short term investments. Short term debt to Trading Portfolio was maintained at 60% as at end Mar'19 (including Fatima Fertilizer Company Limited). In the current rising interest rate scenario, the Company's interest cover is under pressure unless both investment books are monitored to perform well.

Capitalization In 9MFY19, Fazal Holdings debt:equity ratio moderately deteriorated 40% owing to increase in the Company's debt. Equity base mainly represents profits accumulated over the years. The Company has paid off its entire long term obligations. Thus, the debt emanates from short-term borrowings only, obtained to finance the trading portfolio of the Company.



Fazal Holdings (Pvt.) Limited

BALANCE SHEET	31-Mar-19	30-Jun-18	30-Jun-17	30-Jun-16
	9MFY19	Annual	Annual	Annual
Investments	10,680	10,110	9,836	8,587
Strategic Investments	7,403	7,050	6,031	5,782
Trading Investments	2,514	2,548	3,335	2,342
Investment Property	763	512	470	463
Other Assets	526	430	189	135
Total Assets	11,206	10,540	10,025	8,722
Borrowings	2,539	2,218	2,866	2,325
Long Term	-	188	263	300
Short Term	2,539	2,030	2,604	2,025
Total Liabilities (Excluding Borrowings)	2,241	1,999	1,837	1,448
Shareholder's Equity	6,425	6,323	5,321	4,949
Total Liabilities & Equity	11,206	10,540	10,025	8,722
INCOME STATEMENT				
Total Operating Revenue	216	514	745	25
Gain on Sale of Investment	28	16	211	(168)
Dividend Income	52	260	341	157
Share of Profits from Associates	202	280	91	36
Financial Charges	(173)	(171)	(205)	(161)
Net Income	48	154	412	(111)
Ratio Analysis				
Profitability				
ROA	0.4%	1.5%	2.2%	-1.3%
ROE	1.2%	4.1%	11.9%	-3.3%
Capital Structure				
Total Debt/Total Equity	39.5%	35.1%	53.9%	47.0%
Total Debt/Total Debt+Equity	28.3%	26.0%	35.0%	32.0%
Total Debt/Pure Equity	64.1%	56.9%	77.8%	71.9%
Coverage				
EBITDA/Interest Coverage	0.7	1.6	2.7	0.0
FCFO/Interest Coverage	(0.3)	1.3	2.7	-
Short Term Debt/Trading Investment *	0.6	0.5	0.5	0.5

* Including Shares of Fatima Fertilizer Company Limited classified as Held for Trading by Client

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)
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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)
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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)
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- (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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