



The Pakistan Credit Rating Agency Limited

## Rating Report

### Basfa Textile (Pvt.) Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Oct-2019	BBB-	A3	Stable	Maintain	-
30-Apr-2019	BBB-	A3	Stable	Maintain	-
28-Dec-2018	BBB-	A3	Stable	Maintain	-
30-Jun-2018	BBB-	A3	Stable	Maintain	-
29-Dec-2017	BBB-	A3	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect adequate business profile of Basfa Textile (Pvt) Ltd. The Company is engaged in the manufacturing and sale of Viscose Yarn and different varieties of cotton yarn. The Company has over the years successfully created its niche market in viscose yarn. Building on these benefits, the management fully shifted to viscose yarn in FY19. The Company being importer of viscose, remains exposed to exchange rate risk. However, the Company was able to pass on impact of exchange rate to its customers to an extent. Since July 2019, withdrawal of zero rating status has impacted the Company as majority of its customers were unregistered. This led to pressure on topline as the Company was not able to make significant sales. Consequently, the management has decided to restart manufacturing of cotton yarn to diversify the risk. The Company has an adequate financial profile characterized by moderate leveraging and good coverages. The Company has largely cash based sales model, which requires less working capital financing. As a result, the Company has a positive room to borrow at net trade assets level depicting adequate ability to borrow, if need arises.

The ratings are dependent on sustaining volumes and margins while maintaining financial risk at low level. Governance framework and financial transparency needs improvement. At the same time, prudent management of short-term liquidity is considered important. Any substantial dip in revenues and/or margins post withdrawal of zero rated duty will have negative impact on ratings.

#### Disclosure

<b>Name of Rated Entity</b>	Basfa Textile (Pvt.) Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Ratings(Jun-19),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria   Rating Modifier(Jun-19)
<b>Related Research</b>	Sector Study   Spinning(Sep-19)
<b>Rating Analysts</b>	Muhammad Hassan   muhammad.hassan@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Basfa Textile (Pvt.) Ltd (Basfa) was incorporated in 2006. However, the commercial operations started in 2008. The corporate office of the Company is located in Lahore.

**Background** The Company was established by Mr Jahangir Saleem. He was involved in the business of car paints and chemical raisins under the name of 'Basfa Industries (Pvt.) Ltd' and 'Crown Chemicals & Motor Co' prior to textile business. The name "BASFA" is titled as per the name of his four sons. Mr. Babar Jahangir, Mr. Sajid Jahangir, Mr. Fahad Jahangir and Mr. Ahmad Jahangir. Basfa Textile started its commercial operations with the initial cost of the investment of PKR ~637mln which was financed with 100% equity.

**Operations** The Company is engaged in the manufacturing and sale of Viscos Yarn (Capacity: 34,632 spindles). Viscos yarn is sold under the brand name of "SuperDiamond" and Cotton yarn – under the brand name of "Super-Gold"., whereas, vicinity of the plant is at 36-KM Ferozepur Road, Lahore.

## Ownership

**Ownership Structure** The controlling stake of the Company is held by Jahangir Saleem Family. Mr Jahangir Saleem (Chairman/CEO) holds 56% shares in the Company, while Mr. Babar Saleem, son of Mr. Jahangir, holds 44.44% shares

**Stability** Although there is no formal succession plan, but the ownership of shares and business roles are equally divided between all the four brothers. Documented succession plan would do well for the sustainability of the Company.

**Business Acumen** Mr. Jahangir Saleem has an overall working experience of ~40 years. His diverse experience in the field of textile sector and chemical raisins brings specialized and comprehensive knowledge to the board.

**Financial Strength** Other than textile business, sponsors are also involved in the business of car paints and chemical raisins that are used in fibre glass industry and steel putty (a product of auto industry).

## Governance

**Board Structure** Board comprises two members including CEO/Chairman and the Managing Director. The CEO and Chairman of the Company is Mr. Jahangir Saleem. Whereas, Mr. Babar Jahangir holds the position of Managing Director of the Company.

**Members' Profile** Mr. Jahangir Saleem, is the Chairman and founder of the Company. He did his graduation in commerce and started business with his father in Karachi at a young age. Mr. Babar Jahangir holds graduation degree from United Kingdom. He has got an overall experience of ~16 years in his portfolio out of which ~10 years of experience is in Basfa Textile (Pvt.) Ltd.

**Board Effectiveness** The board currently has two committees (i) Audit Committee – who is primarily responsible for supervision of all matters related to audit and finalization of financial accounts. (ii) Corporate Performance and Evaluation Committee – which is primarily responsible for recommending HR policies, succession planning of key management roles and monitoring key performance metrics.

**Financial Transparency** A. Aziz Chaudhury are the external auditors of the Company. They are not listed on any panel of auditors maintained by State Bank of Pakistan but have satisfactory QCR rating. The auditors expressed an unqualified opinion on the Company's annual financial statements for the year ended June 30, 2019.

## Management

**Organizational Structure** The organizational structure of the Company is divided into various functional departments: (i) Marketing, (ii) Finance, (iii) Accounts, (iv) Procurement, (v) Technical operations. Various levels of management hierarchy enables the Company to carry out smooth operations.

**Management Team** The Company's Managing Director - Mr. Babar Jahangir – is one of the sons of Mr. Jahangir Saleem. Mr. Abdul Basit is the CFO of the Company – a Fellow Public Accountant and Fellow Cost and Management Accountant with overall experience of ~22 years. Marketing team is led by the General Manger Marketing, who is also a textile engineer with more than 20 years of experience in yarn sales.

**Effectiveness** Basfa Textile maintains adequate IT infrastructure and related controls. The Company deploys Quick Books – Accounting edition - since 2016 with the license of ~10 corporate user. The operational modules including (i) Payable, (ii) Receivable, (iii) Inventory, (iv) Procurement, (v) Order Management, (vi) General Ledger, (vii) Fixed Assets, and (viii) Cash Management.

**MIS** Various MIS reports are prepared for the management to keep track of all operating activities. Daily reports are generated for the senior management, which help them in day to-day decision making. Apart from daily reporting, the management also receives a more detailed MIS on a monthly basis. This report is used in the monthly meeting of the management.

**Control Environment** Intra-networking is being used within the Company to connect all departments are connected through a common network. User-based controls are in place. Servers are installed where data management and back-up policies are in place.

## Business Risk

**Industry Dynamics** During FY19, exports stagnated despite major segments including cotton cloth, knitwear, garments and bedwear displaying strong quantitative growth. Industry players needed to share the benefit of the currency depreciation with their buyers, which resulted in unit price dip across all major categories, curbing overall growth. This, coupled with cotton yarn displaying double-digit quantitative decline on account of the US-China trade war, as well as, strong domestic demand for yarn, resulted in overall increase in exports of only 0.1% YoY. Recently, withdrawal of textile's zero rated status has impacted the industry's overall liquidity and local sales.

**Relative Position** Basfa Textile has Brand-Based clientele. Ninety percent (90%) of the customer base of Basfa Textile is in Faisalabad, Punjab. Going forward, the Company is planning to expand its customer base in other parts of the country as well to diversify.

**Revenues** The Company has almost doubled its revenues in last three years. During FY19, the Company's revenues grew by ~12% (FY18: ~6%) mainly on the back of increase in yarn prices in local market. This is an industry wide phenomenon but impacted the Company relatively more. The Company's revenue came under pressure during 1QFY20.

**Margins** During FY19, the gross margin improved slightly and stood at ~7% (FY18: 6%). The gross margin increased due to better viscose yarn prices and the Company's ability to pass on some of its higher raw material import cost to its customers. Due to higher finance cost (FY19: 62mln, FY18: 41mln) benefit of better gross margins didn't translate into higher bottom line and the Company posted net margin of 1.8% with slight increase(FY18: 1.7%) while its net profit stood at 56mln (FY18: 46mln).

**Sustainability** Since July 2019, withdrawal of zero rated status has negatively impacted the Company as many unregistered customers stopped purchase of viscose yarn, consequently the Company has changed its product mix and started to manufacture some cotton yarn again as it can be sold to registered customers. The Company's profitability is expected to remain subdued going forward.

## Financial Risk

**Working Capital** The Company's working capital needs emanate from funding its inventory only as most of its sales are on cash. For FY19, the Company's net working capital days largely remained same (FY19 : 77days, FY18: 79days). The Company meets its working capital needs from both internal cash flows and short term borrowing depicted from healthy room to borrow of 36% at trade assets level.

**Coverages** During FY19, FCFO remained stagnant at ~PKR 208mln despite better profitability due to higher tax payments. Interest coverage of the Company decreased (FY19: 4.3x, FY18: 5.2x) due to higher finance cost. On the other hand, debt coverage ratio (FY19: 3.5x, FY18: 2.7x) improved due to repayment of long term debt. Coverages may deteriorate on the back of higher finance cost and lower profitability in FY20.

**Capitalization** Basfa has moderately leveraged capital structure with 33% leveraging, with all of the debt comprising short term borrowing. Going forward, in absence of any major capacity expansion, the leveraging is expected to remain at moderate level.



**Basfa Textile (Private) Limited**

**Private Limited**

**BALANCE SHEET**

	Jun-19 12M	Jun-18 12M	Jun-17 12M
<b>a Non-Current Assets</b>	<b>671</b>	<b>665</b>	<b>617</b>
<b>b Investments (Incl. Associates)</b>	-	-	-
Equity Instruments	-	-	-
Debt Instruments	-	-	-
<b>c Current Assets</b>	<b>866</b>	<b>745</b>	<b>778</b>
Inventory	620	549	570
Trade Receivables	75	55	51
Others	171	140	32
<b>d Total Assets</b>	<b>1,537</b>	<b>1,410</b>	<b>1,395</b>
<b>e Debt/Borrowings</b>	<b>467</b>	<b>446</b>	<b>451</b>
Short-Term	467	410	417
Long-Term (Incl. Current Maturity of Long-Term Debt)	-	36	34
Other Short-Term Liabilities	97	61	76
Other Long-Term Liabilities	20	7	18
<b>f Shareholder's Equity</b>	<b>953</b>	<b>896</b>	<b>850</b>
<b>g Total Liabilities &amp; Equity</b>	<b>1,537</b>	<b>1,410</b>	<b>1,395</b>

**CASH FLOW STATEMENT**

a Free Cash Flow from Operations (FCFO)	208	208	185
b Total Cashflows (TCF)	208	208	185
c Net Cash changes in Working Capital	(81)	(1)	(178)
d Net Cash from Operating Activities	73	169	(18)
e Net Cash from Investing Activities	(98)	(144)	(121)
f Net Cash from Financing Activities	22	(4)	136
g Net Cash generated during the period	(3)	21	(4)

**RATIO ANALYSIS**

**a Performance**

Turnover Growth	12%	6%	62%
Gross Margin	7%	6%	7%
Net Margin	2%	2%	2%
ROE	6%	5%	7%

**b Coverages**

Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	3.5	2.7	4.5
Interest Coverage (X) (FCFO/Gross Interest)	3.5	5.1	7.2
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	0.0	0.2	0.2

**c Capital Structure (Total Debt/Total Debt+Equity)**

Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	77	79	72
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**d Capital Structure (Total Debt/Total Debt+Equity)**

	33%	33%	35%
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**Basfa Textile (Private) Limited**

**Oct-19**

## 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	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <b>AA</b> <b>AA-</b>	<b>Very high credit quality.</b> 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.	<b>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</b> <b>A-</b>	<b>High credit quality.</b> 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.	<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<b>Good credit quality.</b> 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.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</b> <b>BB-</b>	<b>Moderate risk.</b> 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>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</b> <b>B-</b>	<b>High credit risk.</b> 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.	<b>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> 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.		
<b>D</b>	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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(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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- (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)

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- (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)

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(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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