The Pakistan Credit Rating Agency Limited

Rating Report

Basfa Textile (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
02-Mar-2022	BBB	A2	Stable	Upgrade	-
29-Mar-2021	BBB-	A3	Stable	Maintain	Yes
30-Apr-2020	BBB-	A3	Negative	Maintain	Yes
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

Basfa Textile (Pvt.) limited is engaged in the manufacturing and sale of Viscose Yarn and different varieties of cotton yarn. Basfa group also has presence in chemical sector under the name of Basfa Industries (Pvt.) Limited and AutoCoatings (Pvt.) Limited. Company has over the years successfully established its niche market in viscose yarn. Being importer of viscose, the Company remains exposed to exchange rate risk. However, the Company was able to pass on impact of exchange rate to its customers to an extent. Furthermore, the Company is also involved in the process of regenerated yarn at small scale through Auto Couru Titan. This recently added unit produced courser count yarn through the waste of yarn. Governance framework lacks independent oversight. The assigned ratings incorporate the Company’s good operating track record with an adequate business profile. Over the years the Company’s revenue base reflected growth to stand at PKR 3bln in FY21 (FY20: PKR 2.5bln). Margins displayed improvement and profitability recorded growth of 91 % (FY21: PKR 105mln, FY20: PKR 55mln). The Company has an adequate financial profile characterized by moderate leveraging and adequate coverages. Regular BMR and establishment of second plant has increased the need of working capital financing. Despite of this, the Company has still a positive room to borrow at net trade assets level depicting adequate ability to borrow, if need arises. The management has expressed intention redeploy the bulk of profitability generated through the business for future expansion of second plant. During the period July-December FY21-22, textile exports surged 26 percent YoY, fielding $9.39 billion in total export remittances, as compared to $7.44 billion in the same period last year. This is attributable to increase in demand for textile products internationally and channeling of export orders towards Pakistani market. On a YoY basis, the exports of value-added textile items increased in both quantity and value in December 2021.

The ratings depend on sustaining operations, profitability and ensuing cash flows. Governance framework and independent oversight needs improvement. At the same time, prudent management of short-term liquidity is considered important. Sustaining business margins while maintaining strong financial profile remains critical.

Disclosure

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

Profile

Legal Structure Basfa Textile (Pvt.) Ltd ("Basfa Textile", "The Company") incorporated in 2006. However, the commercial operations started in 2008. The corporate office of the Company is located at 20-KM Ferozepur Road, 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 'Auto Coatings Pvt. Limited' 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.

Operations The Company is engaged in the manufacturing and sale of Viscos Yarn (Capacity: 60,156 spindles). Viscose 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 and second plant is located at Feroz Watwan Road, Chandi Kot Stop, Sheikhupura.

Ownership

Ownership Structure The controlling stake of the Company is held by Jahangir Saleem Family. Mr. Babar Jahangir (Chairman/CEO) holds 44.40% shares in the Company, while Mr. Ahmed Jahangir and Mr. Fahad Jahangir, son of Mr. Jahangir Saleem, holds 30.0% and 25.60% shares respectively.

Stability The Formation of a group holding Company or documented succession plan has been very much in place as Mr. Jahangir Saleem has divided the ownership of the Company between his sons. This division portrays a clear picture of succession.

Business Acumen Mr. Babur Jahangir has an overall working experience of more than one decade. His innovative technological skills in the field of textile sector brings specialized and comprehensive knowledge to the board.

Financial Strength Prior to textile business, sponsor's primary business was of car paints and chemical raisins that are used in fiber glass industry and steel putty (a product of auto industry).

Governance

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

Members' Profile Mr. Babar Jahangir, is the chairman and CEO of the Company. Mr. Babar Jahangir holds graduation degree from United Kingdom. He has got an overall experience of 15 years in his portfolio out of which 10 years of experience is in Basfa Textile Pvt Ltd. Induction of independent director would improve governance framework of the Company.

Board Effectiveness The board is currently heading two committees (i) Audit Committee – who is primarily responsible for supervision of all matters related to audit and finalization of financial accounts. Internal audit department is predominantly engaged in the operations of this committee (ii) Corporate performance and evaluation committee – who is primarily responsible for recommending HR policies, succession planning of key management roles, monitoring key performance metrics.

Financial Transparency Suriya Nauman Rehan Co are the external auditors of the Company –listed on panel of auditors maintained by State Bank of Pakistan and have satisfactory QCR rating. They expressed an unqualified opinion on the Company's annual financial statements for the year ended June 30, 2021.

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 helps the Company to carry out smooth operations.

Management Team The Company's CEO - Mr. Babar Jahangir – is one of the sons of Mr. Jahangir Saleem. Mr. Abdul Basit, CFO of the Company – a Fellow Public Accountant and Fellow Cost and Management Accountant with an overall experience of ~29 years. The marketing team is led by the General Manager Marketing, who is also a textile engineer with more than 27 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 license of ~10 corporate users. 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 helps them in day-to-day decision-making. Apart from daily reporting, the management also receives a more detailed MIS on a monthly basis.

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

Relative Position Basfa Textile has Brand-Based clientele. Final product is sold through intermediary with no direct sales mechanism – following the industry norms. Traders are given the commission between 0.5% and 1% of the sales amount. Ninety percent (90%) of the customer base of Basfa Textile is in Faisalabad, Punjab.

Revenues Over the years the Company's revenue has followed an uncertain trend, however Company has managed to increase its top-line as it clocked at PKR 3.6bln in FY21 (FY:20: PKR 2.5bln) increased by 44% YoY. Company's primary source of revenue is from local sales and they contribute 99% of total sales. Revenue in 1HFY22 is PKR 2.3bln (1HFY21: PKR 1.3bln).

Margins During FY21, the Company's cost of sales has shown a general increase. Despite of this, Gross margins of the Company increased to 8.6% in FY21 (FY20: 6.7%). Similarly, operating margins also improved and stood at 7.6% in FY21 (FY20: 5.6%). Net margins of the Company got improved to 3.5% in FY21 (FY20: 2.2%).

Sustainability The Company has shifted its focus on viscose yarn completely and discontinued the production of other types of yarn. During FY21, the Company has set-up a second plant which is located at Feroze Watwan Road, Chandi Kot Stop, Sheikhupura. The factory is modern because of the high technology plants.

Financial Risk

Working Capital Basfa Textile's working capital needs emanate from financing inventories and trade receivables for which the Company relies on both internal cash flows as well as short term borrowings (STBs). During FY21, the Company's working capital management has improved which is evident from decreased in net working capital days (end-Jun21: 69 days end-Jun20: 97 days) primarily due to decrease in inventory days. Both interest and debt coverage in 1HFY22 are 2.2x and 1.1x respectively.

Coverages The Company's cash flows remain a function of its profitability. During FY21, the Company's cash flows (FCFO) increased on a YoY basis (FY21: 285mln; FY20: 185mln) due to increase in profitability but on the other hand, finance cost increased to PKR 56mln in FY21 (FY20: PKR 44mln) due to which interest coverage ratio has shown a slight improvement (FY21: 5.1x; FY20: 4.2x) and whereas debt coverage ratio has declined (FY21: 2.3x, FY20: 4.2x). Leveraging in 1HFY22 is 55.8%.

Capitalization Basfa leveraging ratio has shown an increase over the years, as it stood at 44.3% in end-June'21 (end-June'20: 24.8%) due to increase in long-term term borrowings to stand at PKR 576mln in FY21. During 1HFY22, the total debt comprised of 53.6% of Short-term borrowings and 46.4% of long-term debt.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Basfa Textile (Pvt.) Ltd Spinning	Dec-21 6M	Jun-21 12M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET				
1 Non-Current Assets	1,766	1,702	707	671
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	1,291	867	785	866
a Inventories	*1,125*	*629*	*604*	*620*
b Trade Receivables	*2*	*1*	-	*75*
5 Total Assets	3,056	2,568	1,492	1,537
6 Current Liabilities	377	530	111	97
a Trade Payables	*38*	*73*	*23*	*6*
7 Borrowings	1,485	892	336	467
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	16	23	27	22
10 Net Assets	1,178	1,123	1,018	951
11 Shareholders' Equity	1,178	1,123	1,018	951
B INCOME STATEMENT				
1 Sales	1,918	3,019	2,542	3,046
a Cost of Good Sold	*(1,754)*	*(2,759)*	*(2,372)*	*(2,834)*
2 Gross Profit	164	261	170	211
a Operating Expenses	(23)	(31)	(28)	(44)
3 Operating Profit	141	230	141	167
a Non Operating Income or (Expense)	*(3)*	*(6)*	*(5)*	*(6)*
4 Profit or (Loss) before Interest and Tax	138	224	136	162
a Total Finance Cost	*(44)*	*(61)*	*(46)*	*(62)*
b Taxation	*(38)*	*(58)*	*(35)*	*(43)*
6 Net Income Or (Loss)	55	105	55	56
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*94*	*285*	*185*	*208*
b Net Cash from Operating Activities before Working Capital Changes	*94*	*228*	*139*	*154*
c Changes in Working Capital	-	*269*	*76*	*(81)*
1 Net Cash provided by Operating Activities	94	497	216	73
2 Net Cash (Used in) or Available From Investing Activities	-	(1,121)	(35)	(98)
3 Net Cash (Used in) or Available From Financing Activities	-	557	(128)	22
4 Net Cash generated or (Used) during the period	94	(67)	52	(3)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	27.0%	18.8%	-16.6%	11.9%
b Gross Profit Margin	8.5%	8.6%	6.7%	6.9%
c Net Profit Margin	2.9%	3.5%	2.2%	1.8%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	4.9%	18.3%	10.3%	4.2%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sl*	9.6%	9.8%	5.6%	6.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	84	75	99	78
b Net Working Capital (Average Days)	78	69	97	77
c Current Ratio (Current Assets / Current Liabilities)	3.4	1.6	7.1	8.9
3 Coverages				
a EBITDA / Finance Cost	2.2	6.4	5.3	4.3
b FCFO / Finance Cost+CMLTB+Excess STB	1.1	2.3	4.2	3.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	6.7	2.8	0.0	0.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	55.8%	44.3%	24.8%	32.9%
b Interest or Markup Payable (Days)	84.5	102.7	95.0	222.7
c Entity Average Borrowing Rate	8.6%	8.1%	11.0%	12.0%

Credit Rating

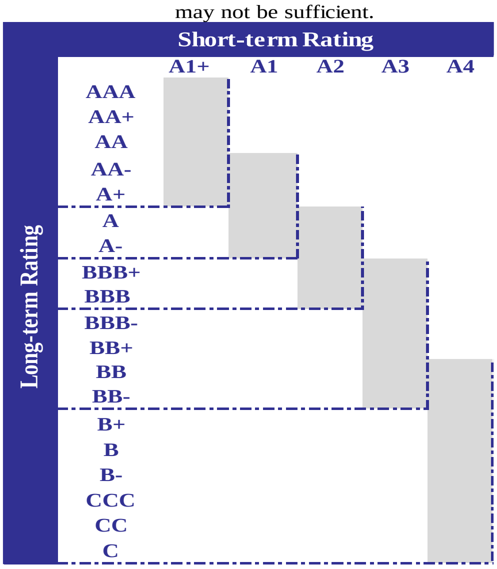
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



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

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

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

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

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

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

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

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information