The Pakistan Credit Rating Agency Limited

Rating Report

Allawasaya Textile & Finishing Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Apr-2020	BBB-	A3	Stable	Maintain	YES
30-Oct-2019	BBB-	A3	Stable	Maintain	-
30-Apr-2019	BBB-	A3	Stable	Maintain	-
28-Dec-2018	BBB-	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Allawasaya Textile and Finishing Mills Limited’s (the Company) association with three industrial families of Multan and demonstrated support of sponsors. Sponsors have a presence in the oilseed extraction industry and other segments of textile value-chain. The Company is involved in the manufacturing and sale of cotton yarn and man-made fibers. The Company enhanced its capacity by 8,500 spindles during the year, though it still remains relatively small. The Company’s revenue showed significant increase of ~40% due to increase in production capacity which led to higher sales volume. Similarly, the margins of the Company showed improvement due to increase in topline and better procurement of cotton at reasonable price indicating an improvement in profitability. However, the COVID-19 will have negative impact going forward and the production and the business will be affected overall. The financial profile of the Company is characterized by moderate leveraging and low coverages. The Company took additional debt to finance BMR. Material improvement in cash flows, in line with upcoming debt obligations, remains imperative.

The 'Rating Watch' signifies COVID-19 outbreak and a challenging economic environment. The entire textile chain is expected to be impacted due to the lockdown in Pakistan and major export destinations of the sector. The demand is expected to contract while eventual resumption of operations and recovery of the sector remains uncertain. The Government and SBP have announced several initiatives to provide support. PACRA will monitor the situation and accordingly take action.

The ratings are dependent upon the sponsor support and management's ability to improve margins, profitability and the Company’s competitive position in the industry. This includes keeping the debt levels manageable. Any deterioration in margins or coverages amidst prolonged lockdown will have a negative impact on the ratings.

Disclosure	
Name of Rated Entity	Allawasaya Textile & Finishing Mills 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 | Spinning(Sep-19)
Rating Analysts	Fahad Iqbal | fahad.iqbal@pacra.com | +92-42-35869504

Profile

Legal Structure Allawasaya Textile & Finishing Mills Limited is a public limited company Listed on the Pakistan Stock Exchange.

Background The Company was established in 1958 as a single unit of spinning in Multan. The Company is engaged in the production and sale of cotton yarn and made made fibers.

Operations The Company currently operates with 38,712 spindles under a single spinning unit in Multan and has the capacity to produce 15.3mln kgs of yarn annually. The Company is self-sufficient in energy and has an in-house production capacity of 4.2MW and a 3.5MW total electricity demand.

Ownership

Ownership Structure The Company is owned by three established business families of Multan. Namely i) Tauqir Family (38%) ii) Jamil Family (36%) and Maqbool Family (25%).

Stability The sponsor families are all related and the third generation of the Jamil and Tauqir families has already joined the Company. However, no formal succession plan has been documented.

Business Acumen Besides the Company, sponsor families have investments in seed oil extraction, ginning, value-adding segments of the textile industry and other spinning companies.

Financial Strength Out of three sponsor families, i) Maqbool Family has investments in other textile companies and hospitality sector, ii) Tauqir family has a diverse portfolio of investments in a number of other textile companies and the iii) Jamil family has a 100% stake in Allawasaya Spinning Mills Pvt Ltd. Cumulatively, the sponsors have enough financial strength to support the Company, if a need arises.

Governance

Board Structure Eleven-member board is comprised of representatives from sponsor families and two independent directors. Despite a good mix of executive and non-executive members, sponsor domination on the board undermines the governance structure. Mrs. Nusrat Jamil, a member of Jamil family is the Chairman of the board.

Members' Profile All the board members are highly qualified in different disciplines and carry ample experience in textile as well as other industries. Chairman, Mrs. Nusrat Jahan, has been affiliated with the board for two years. Mian Jamil (Jamil Family) is a textile engineer and carries 45 years of industry experience. Mian Tanvir Ahmad Sheikh (Maqbool Family) has an overall experience of over 36 years. Mian Tauqir Ahmed Sheikh (Tauqir Family) is an MBA and acts as a non-executive director on the board. Other board members also possess years of industry relevant experience.

Board Effectiveness In line with the guidelines of the corporate governance best practices, the board is supported by an i) Audit Committee and ii) HR & Remuneration committee. However, the quality of board minutes still has room for improvement.

Financial Transparency Deloitte M/S Yousaf Adil & Co, Chartered Accountants are the external auditors of the Company. The auditors have issued an unqualified opinion on the company's financial statements for the periods ended on 30th June 2019 and December 2019. The auditor has an 'A' QCR rating.

Management

Organizational Structure The organization structure of the Company is divided into four main departments namely i) Finance, Admin & Procurement ii) Audit & Planning iii) Sales & Marketing and iv) Production. The Chairman oversees production while the CEO looks after finance, admin & procurement. All other departments are headed by executive directors.

Management Team Mian Tanvir, the Company's CEO did his MBA from the USA and has diverse professional experience, spanning over 38 years. All other members of the management team are also well qualified and experienced.

Effectiveness All department heads have access to MIS to generate reports, relevant to their departments. Management frequently meets to discuss any issues affecting the smooth flow of business operations, however, there are no management committees.

MIS The Company has developed an in-house ERP system to cater to the needs of the business. Senior management, including the CEO and Chairman monitor the business performance through certain key MIS reports.

Control Environment Production is completely order-driven. The QC and HSE departments seem appropriate. The Company is ISO 9001 and ISO 14001 certified. Certifications ensure quality production and control over the production.

Business Risk

Industry Dynamics During 8MFY20, textile exports increased by 5.30% period on period. The US-China trade war earlier in the year disrupted cotton prices across the globe. Considering that China accounts for more than 50% of Pakistan's cotton yarn exports, lesser demand from China negatively impacted the spinning industry. Yarn exports reduced by 0.86% in 8MFY20. Additionally, the withdrawal of zero rated sales tax status from textile sector, coupled with the high interest rates, has impacted liquidity and profitability. The COVID-19 outbreak in early 2020 has affected the entire textile chain. Export orders have been postponed or cancelled as major export destinations remain in lockdown to contain the virus. Several domestic players have shutdown production or are partially operational. Recent government initiatives are expected to provide some relief. However, prevailing uncertainty due to global lockdown will have implications for the industry dynamics.

Relative Position With 38,712 operational Spindles, Allawasaya Textile and Finishing's position in Pakistan Spindle capacity is considered small.

Revenues During 1HFY20, the Company's revenue showed significant increase of ~40% and clocked in at PKR 1,397mln (1HFY19: PKR 997mln) due to increase in production capacity which led to higher sales volume.

Margins During 1HFY20, the Company's gross profit margin improved to 7.2% (1HFY19: 3.7%) and operating profit margin to 4.4% (1HFY19: 0.2%) due to increase in topline and better procurement of cotton at a reasonable price. The finance cost the Company increased significantly to ~PKR 37mln in 1HFY20 (1HFY19 ~PKR 9mln) due to an increase in short term borrowings. The Company recorded a net profit of PKR 19mln during 1HFY20 (1HFY19: PKR -21mln), indicating an improving trend in profitability.

Sustainability The Company had to shut down its operations as per government directive. However, the government has eased the lockdown and has allowed the Company to resume production recently. However, full resumption of operations and recovery in sales of the Company remains unclear. The eventual easing and opening up of domestic and global lockdowns is important in this regard, although its timeline is not certain. The Company may opt to avail SBP initiatives to seek support in the short-term.

Financial Risk

Working Capital During 1HFY20, the Company's net working capital days decreased to 56 days (1HFY19: 71 days). The improvement is primarily driven by higher topline and the receivables were also net off by high increase in payables reducing the working capital days. The Company's room to borrow came down to 1% during 1HFY20 (1HFY19: 18%), depicting a disproportionate rise in short term borrowings against net trade assets.

Coverages The Company's FCFO witnessed significant improvement and clocked in at PKR 71mln in 1HFY20 (1HFY19: PKR -8mln) because the Company made a profit in the period. Similarly, coverages improved, with interest coverage ratio clocking at to 1.9x in 1HFY20 (1HFY19: -0.9x) and debt coverage ratio to 1.3x (1HFY19: -0.9x).

Capitalization The Company's leverage increased during 1HFY20 to 39.9% (1HFY19: 35.7%), mainly due to an increase in short term borrowings. Short-term borrowings, which make up ~73% of the total borrowings (1HFY20: PKR 735mln, 1HFY19: PKR 446mln) increased to PKR 540mln in 1HFY20 (1HFY19: PKR 350mln) and long term borrowings clocked in at PKR 164mln in 1HFY20 (1HFY19: PKR 96mln).

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Financial Summary
PKR mln

Allawasaya Textile and Finishing Spinning	Dec-19 6M	Jun-19 12M	Jun-18 12M	Jun-17 12M
A BALANCE SHEET				
1 Non-Current Assets	1,433	1,435	854	885
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	767	650	506	380
a Inventories	*343*	*292*	*263*	*161*
b Trade Receivables	*279*	*215*	*127*	*143*
5 Total Assets	2,200	2,085	1,360	1,265
6 Current Liabilities	227	326	173	137
a Trade Payables	*102*	*174*	*19*	*33*
7 Borrowings	735	521	262	214
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	130	149	96	107
10 Net Assets	1,108	1,089	828	807
11 Shareholders' Equity	1,108	1,089	828	807
B INCOME STATEMENT				
1 Sales	1,397	2,091	2,168	1,966
a Cost of Good Sold	*(1,296)*	*(1,992)*	*(2,044)*	*(1,917)*
2 Gross Profit	101	99	125	49
a Operating Expenses	(40)	(71)	(65)	(58)
3 Operating Profit	62	27	60	(9)
a Non Operating Income	*(2)*	-	*(3)*	*(2)*
4 Profit or (Loss) before Interest and Tax	59	27	57	(12)
a Total Finance Cost	*(38)*	*(37)*	*(21)*	*(21)*
b Taxation	*(2)*	*(7)*	*(18)*	*(8)*
6 Net Income Or (Loss)	19	(16)	18	(40)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*71*	*20*	*62*	*(11)*
b Net Cash from Operating Activities before Working Capital Changes	*35*	*(3)*	*42*	*(12)*
c Changes in Working Capital	*(240)*	*10*	*(66)*	*95*
1 Net Cash provided by Operating Activities	(204)	7	(24)	83
2 Net Cash (Used in) or Available From Investing Activities	(22)	(270)	-	(28)
3 Net Cash (Used in) or Available From Financing Activities	213	256	48	(57)
4 Net Cash generated or (Used) during the period	(13)	(7)	25	(2)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	33.7%	-3.6%	10.3%	17.5%
b Gross Profit Margin	7.2%	4.7%	5.8%	2.5%
c Net Profit Margin	1.4%	-0.8%	0.8%	-2.1%
d Cash Conversion Efficiency (EBITDA/Sales)	6.5%	3.4%	4.5%	0.8%
e Return on Equity (ROE)	3.5%	-1.7%	2.2%	-4.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	74	78	58	79
b Net Working Capital (Average Days)	56	61	54	74
c Current Ratio (Total Current Assets/Total Current Liabilities)	3.4	2.0	2.9	2.8
3 Coverages				
a EBITDA / Finance Cost	2.5	2.0	4.9	0.8
b FCFO / Finance Cost+CMLTB+Excess STB	1.3	0.3	3.1	-0.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.9	-12.8	0.0	0.0
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	39.9%	32.4%	24.1%	20.9%
b Short-Term Borrowings / Total Borrowings	0.7	0.6	1.0	1.0
c Average Borrowing Rate	11.8%	9.0%	8.4%	8.0%

Credit Rating Scale & Definitions

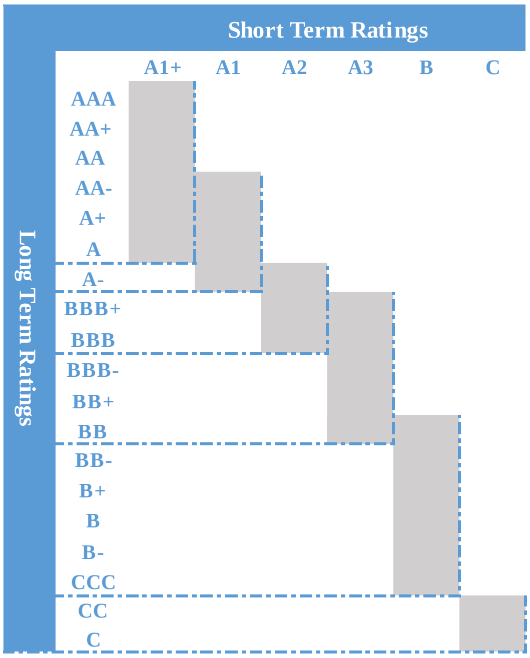
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

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