



The Pakistan Credit Rating Agency Limited

## Rating Report

### Interwood Mobil (Pvt.) Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
12-Feb-2019	BBB+	A2	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect Interwood's strong brand name and established presence in the furniture industry of Pakistan. Over the years, the Company has mitigated risks associated with contractual jobs by focusing on the retail market. It has been successful in evolving its business portfolio and enjoys a healthy mix between retail and corporate sales. The ratings take into account the Company's automated production process, national footprint and professional management team. The industry holds promising characteristics on the back of increasing disposable income and growing urban middle class. Recent devaluation of Pakistani Rupee will increase cost of production as a major portion of raw materials are imported. However, the Company can pass some of this cost to consumers as the product becomes more competitive against imported furniture. The ratings are restricted by the Company's stretched financial profile, characterized by weak coverages, significant leveraging and adequate working capital management. Additionally, governance framework requires strengthening.

The ratings are dependent on the Company's ability to maintain its leading position in the industry while sustaining margins. Meanwhile, improved financial profile through better coverages, effective working capital management and maintaining sufficient cushion to borrow, to avoid any mismatch in debt profile, will be critical for rating.

#### Disclosure

<b>Name of Rated Entity</b>	Interwood Mobil (Pvt.) Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Ratings(Jun-18),Methodology   Criteria   Rating Modifier(Jun-18),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
<b>Related Research</b>	Sector Study   Furniture & Fixtures(Feb-19)
<b>Rating Analysts</b>	Adnan Dilawar   adnan@pacra.com   +92-42-35869504



## Profile

**Legal Structure** Interwood Mobel (Private) Limited (the Company) is a private limited company.

**Background** The Company was founded by Mr. Farooq Ahmed Malik and commenced operations in 1974 with a small workshop in Lahore. Over the years the Company has been able to expand operations by investing in state of the art machinery and automation of production lines. Initially, the Company's key area of focus had been accepting and executing contractual jobs. However, post 2002, the Company has developed its business profile by tapping the retail market.

**Operations** The Company is involved in the sale and manufacture of furniture and allied items. The Company's head office and production facility are consolidated in one location at Sultan Mehmood Road, Lahore. The Company has eleven, company operated, retail outlets concentrated in Lahore (4), Karachi (4), Islamabad (2) and Sialkot (1). Additionally, it has established presence in other major cities through dealer networks.

## Ownership

**Ownership Structure** Major shareholding of the Company (99.9%) lies with Farooq Family. Mr. Farooq Ahmed Malik, the founder and his wife Ms. Ghazala Farooq own 17% and 16% of the Company, respectively. Meanwhile their sons Mr. Omar Farooq and Mr. Ali Farooq own 33% of the Company, each. Remaining shareholding (0.1%) is held by close relatives of the family.

**Stability** Ownership structure of the Company is seen as stable as no ownership changes are expected in the coming years.

**Business Acumen** Sponsors are considered to have strong business acumen, giving consideration to industry knowledge of more than forty years with noteworthy positioning in the industry.

**Financial Strength** Since Interwood Mobel is a standalone company, financial strength is gauged by the financial profile of sponsors and their willingness to support the business, which is considered to be adequate.

## Governance

**Board Structure** Board of Directors comprises four members which includes the Chairman and three executive directors. Moreover, it is completely dominated by the sponsoring family, indicating lack of oversight.

**Members' Profile** Members have strong profiles with technical expertise and specialize in production and retail, in addition to furniture.

**Board Effectiveness** The Board has an Audit Committee in place which comprises four members and meets quarterly.

**Financial Transparency** Nazir Chaudri & Co., Chartered Accountants, who are not rated by the SBP but hold a satisfactory QCR rating, are the external auditors of the Company. They have expressed an unqualified opinion on the financial statements of the Company.

## Management

**Organizational Structure** Organizational structure of the Company is defined based on eight departments, including operations, sales and marketing, accounts and internal audit, among others. With the exception of the internal audit department, each departmental head reports to the Chief Executive Officer. Functions of supply chain, pre-production, production, plant maintenance and information technology come under the purview of general manager operations.

**Management Team** Management comprises of experienced individuals, representing a good skill mix. Mr. Omar Farooq, the Chief Executive, holds a BSc in furniture design and manufacturing, he has been associated with the Company for the past 24 years. He is ably supported by a professional management team.

**Effectiveness** In order to ensure efficient operations, the Company has in place three management committees, namely, Procurement Committee, Supply Chain Committee and Human Resources Committee. All three committees are headed by the Chief Executive and comprise relevant department heads.

**MIS** The Company deployed SAP Business One as its Enterprise Resource and Planning system in 2017. The system is close to being fully integrated and data migration is substantially complete.

**Control Environment** The Company has a strong control environment in place through its internal audit department. The scope of the department entails carrying out various tests and activities for identifying vulnerabilities and rectifying them. Activities are conducted on a monthly basis at the Company's factory and showrooms spread across Pakistan.

## Business Risk

**Industry Dynamics** The furniture industry of Pakistan is largely unstructured and comprises of a multitude of small to medium sized players. Moreover, a significant portion of the market sells imported items, however, an upward revision in the regulatory duty imposed on imported furniture items to 45% will negatively affect these players while promoting locally manufactured products. The industry reflects encouraging prospects on the back of growth in the urban middle class and increasing personal disposable income in major cities. This will slowly but steadily improve the consumption pattern relating to non-essential items and luxury goods.

**Relative Position** Interwood Mobel holds a strong position in the market due to its unparalleled production plant and manufacturing capability. Although it has no direct competition, it faces area and product specific competition from numerous small to medium sized players.

**Revenues** The Company sources its revenue from six main product categories, namely, office furniture, home furniture, kitchens, wardrobes, doors and others. Revenue stream is fairly concentrated as the top two product categories (Office and Home furniture) accounted for ~71% of sales in FY18. During FY18, the Company posted revenues worth ~PKR 2,915mln, depicting 12% growth over the corresponding period on the back of increased home and office furniture sales. Revenues during 1HFY19 clocked in at ~PKR 1,675mln, with home furniture gaining overall share in revenue composition.

**Margins** The Company implements cost-plus pricing and maintains gross and operating margin at ~30% and ~9% respectively. Additionally, the Company's profitability is supported by commission income and share of profit from its joint venture with Descon Engineering Limited. During FY18, net profit margin surged to ~11% (FY17: ~6%). However, this was due to one-off income booked under the Amnesty Scheme worth ~PKR 200mln. Excluding this would have resulted in a net profit margin of ~6%. During 1HFY19, the Company improved margins as prices were revised upwards adjusting for rupee depreciation. Strategic procurement of raw materials, foreseeing the current scenario, helped the Company improve profitability. Gross and operating margin elevated to ~34% and ~9%, respectively during the six month period. Going forward, margins are expected to normalize back to previous levels as impact of strategic procurement erodes.

**Sustainability** Going forward, the Company plans to minimize manual intervention in the production process with the help of conveyer belts. Additionally, it is in the process of expanding its polishing unit, which is due to be completed in FY19. Furthermore, the Company has purchased 25 acres of land in Rachna Industrial Park. The location will serve as a platform for future expansion.

## Financial Risk

**Working Capital** The Company's working capital is largely a function of its inventories. Since sales are booked on advance payments, the Company benefits from a negative balance of average trade receivables. However, inflated inventory levels to cater to customer demand, strategic procurement of raw materials and declining trend of average trade payable days, owing to strict terms of international suppliers, have contributed towards elevated net working capital days. During 1HFY19, net working capital days stood at 86 days (FY18: 69 days; FY17: 54 days). Additionally, a mismatch in the debt mix was observed in FY18 indicating short-term borrowings were utilized for capital expenditure. However, the Company was able to restructure its debt mix in 1HFY19.

**Coverages** The Company had been able to post good coverages in the past owing to growing cash flows, improved profitability and low finance costs. However recently, coverages have remained weak amid a surge in debt levels and related finance costs. During FY18, interest coverage fell down to 1.3x from 3.6x in the preceding year. Similarly, total coverage fell to 1.1x in FY18 (FY17: 2.5x). Moreover, the Company also suffered from a rising debt payback period. The situation improved during 1HFY19 which saw interest and debt coverage climb to 2.6x and 1.2x, respectively.

**Capitalization** The Company has a significantly leveraged capital structure with a debt-to-equity ratio of ~51% in FY18. Total borrowings stood at ~PKR 2,558mln in FY18, depicting an increase of ~77% as compared to the corresponding period. Surge in borrowings can be attributed to high short-term borrowings, which represent 52% of total debt. During 1HFY19, leveraging registered a slight decrease, standing at 48%. Moreover, debt restructuring lowered the composition of short-term borrowings, which now account for 36% of total debt.



**Interwood Mobil (Private) Limited**

**Balance Sheet**

	<b>Dec-18</b>	<b>Jun-18</b>	<b>Jun-17</b>	<b>PKR mln</b>
	<b>Annual</b>	<b>Annual</b>	<b>Annual</b>	<b>Jun-16</b>
	<i>Unaudited</i>	<i>Audited</i>	<i>Audited</i>	<i>Audited</i>
<b>Non-Current Assets</b>	<b>3,647</b>	<b>3,463</b>	<b>3,056</b>	<b>2,645</b>
<b>Investments</b>	<b>241</b>	<b>259</b>	<b>50</b>	<b>6</b>
Equity	241	259	50	6
Debt	-	-	-	-
<b>Current Assets</b>	<b>3,225</b>	<b>3,667</b>	<b>2,150</b>	<b>1,864</b>
Inventory	1,834	1,848	1,375	1,185
Trade Receivables	526	506	336	268
Others	866	1,314	438	412
<b>Total Assets</b>	<b>7,113</b>	<b>7,390</b>	<b>5,256</b>	<b>4,515</b>
<b>Debt</b>	<b>1,878</b>	<b>2,051</b>	<b>972</b>	<b>618</b>
Short-term	671	1,114	391	452
Long-term (Incl. Current Maturity of long-term debt)	1,207	938	581	166
Other Shortterm Liabilities	2,019	2,290	1,597	1,367
Other Longterm Liabilities	600	590	555	552
<b>Shareholder's Equity</b>	<b>2,615</b>	<b>2,458</b>	<b>2,132</b>	<b>1,978</b>
<b>Total Liabilities &amp; Equity</b>	<b>7,113</b>	<b>7,390</b>	<b>5,256</b>	<b>4,515</b>

**Income Statement**

<b>Turnover</b>	<b>1,675</b>	<b>2,915</b>	<b>2,603</b>	<b>2,265</b>
Gross Profit	568	873	769	523
Net Other Income	9	389	56	13
Financial Charges	(83)	(164)	(83)	(76)
<b>Net Income</b>	<b>157</b>	<b>326</b>	<b>148</b>	<b>83</b>

**Cashflow Statement**

Free Cashflow from Operations (FCFO)	219	221	301	276
Net Cash changes in Working Capital	294	(816)	(36)	(110)
Net Cash from Operating Activities	433	(548)	229	92
Net Cash from Investing Activities	(181)	(405)	(550)	(178)
Net Cash from Financing Activities	(245)	948	329	81
Net Cash generated during the period	7	(5)	8	(5)

**Ratio Analysis**

**Performance**

Turnover Growth	N/A	12.0%	14.9%	26.4%
Gross Margin	33.9%	30.0%	29.5%	23.1%
Net Margin	9.4%	11.2%	5.7%	3.7%
ROE	11.6%	15.5%	7.5%	6.7%

**Coverages**

Interest Coverage (FCFO/Gross Interest)	2.6	1.3	3.6	3.6
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	1.2	0.6	2.1	2.0
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	1.2	1.1	2.5	2.0
Debt Payback (Total LT Debt Including UnCovered Total STBs) /	6.4	25.2	4.8	3.0

**Liquidity**

Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	86	69	54	34
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**Capital Structure**

Leveraging (Total Debt/Total Debt+Equity)	47.9%	51.0%	40.4%	34.9%
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**Interwood Mobil (Private) Limited**

Feb-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)

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- 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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- (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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- (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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- (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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