The Pakistan Credit Rating Agency Limited

Rating Report

Interwood Mobel (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
04-Aug-2021	BBB+	A2	Stable	Maintain	-
07-Aug-2020	BBB+	A2	Stable	Maintain	-
09-Aug-2019	BBB+	A2	Stable	Maintain	-
12-Feb-2019	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Interwood Mobel (Private) Limited’s (Interwood Mobel or 'the Company') reputable 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 operations of the industry have been impacted due to spread of COVID-19 pandemic and subsequent countrywide lockdown. The demand for retail segment has been impacted due to closure of retail markets. However, during FY21 the Company managed to increase its top-line with increased online sales and contractual sales. The diversified product and segment mix bodes well for the Company in these circumstances. The Company enjoys healthy margins on the back of targeting mid to high end market segments. The Company invested considerably to acquire latest manufacturing technologies to achieve operational efficiencies and to reduce overheads. These are essential given the competition encountered by the Company from largely unregulated market participants and continuous increase in input costs on the back of frequent rounds of rupee depreciation as the Company imports majority of its raw materials. The financial profile of the Company is characterized by moderately leveraged capital structure, adequate coverages and working capital management. The receivables increased but remain at moderate levels. The measures introduced by SBP in the wake of the COVID-19 pandemic, principal deferment and rate cut of 625bps, have provided relief to cashflows. Governance framework needs strengthening.

The ratings are dependent on the Company’s ability to maintain its leading position in the industry while sustaining top-line and margins in prevailing scenario. Meanwhile, improved financial profile through effective working capital management, maintaining strong coverages and sufficient cushion to borrow at trade level will be critical for ratings.

Disclosure

Name of Rated Entity	Interwood Mobel (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 | Furniture & Fixtures(Feb-21)
Rating Analysts	Sohail Ahmed Qureshi | sohail.ahmed@pacra.com | +92-42-35869504

Profile

Legal Structure Interwood Mobel (Private) Limited (Interwood Mobel or '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 manufacture and sale 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 fourteen, company operated, retail outlets concentrated in Karachi (3), Lahore (2), Islamabad (3), Peshawar (1) and Gujranwala (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 near future.

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 independent oversight.

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

Board Effectiveness The Board has an Audit Committee in place which comprises four members and meets bi-annually.

Financial Transparency Nazir Chaudhri & Co., Chartered Accountants, have been replaced by Crowe Hussain Chaudhury & Co as external auditors of the Company which holds QCR rating of ICAP and falls in category A of SBP. Audit of financial statements of the Company for the year ended June 30, 2021 is yet to be conducted.

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 Officer, 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. The Company has recently hired Mr. Muhammad Ilyas, as Head of Financial Planning and Advisor to CEO who is an experienced professional with experience of more than 25 years.

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 improves the flow of information and facilitates the generation of reports required by management.

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. As a result, there is a high level of competition with unregulated players. 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. However, the recent COVID-19 pandemic and resulting lockdown significantly hampered retail sales, however, during FY21 the recovery has been observed in demand leading to growth in sales. The measures introduced by SBP, including rate cut of 625bps, have provided some relief.

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 earns its revenues from six main product categories, which include, office furniture, home furniture, kitchens, wardrobes, doors and others. The revenue stream is fairly concentrated with office and home furniture accounting for majority of sales. During FY21, the Company's top-line clocked in at PKR 3,704mln (FY20: 3,112mln). Increase of ~19% YoY basis on account of contract based projects with provincial educational institutes. Moreover, there was an effect of recovery phase in FY21 that countered the decline in retail sales during 4QFY20.

Margins During FY21, Interwood Mobel's gross margin decreased by 0.9% and stand at 37.7% (FY20: ~38.6%) partly as a result of additional depreciation on the back of capital expenditure and BMR activities occurred last year. Meanwhile, operating margin also declined by 0.7% to ~17.8% (FY20: ~18.5%) on account of inflated costs. In FY21, the Company's finance cost decreased to PKR 335mln (FY20: PKR 459mln) on the back of lower interest rates. However, the Company's net profit margin declined to ~8.2% (FY20: ~9.5%) while net profit clocked in at PKR 305mln (FY20: PKR 296mln).

Sustainability The Company is focusing on spacious model of its retail outlet, in this regard two small retail outlets in Lahore have been closed and one sizeable outlet has been opened in Gujranwala with the area of 25,000 Square ft. Going forward, the Company will continue its planned capital expenditure in order to improve manufacturing efficiency. Moreover, the Company also intends to improve its e-commerce capabilities to cater to the growing online market.

Financial Risk

Working Capital The Company's working capital is predominantly a function of its inventories as sufficient stock levels of various products must be maintained to cater to customer demand. Company's inventory days improved in FY21 to 245 days (FY20: 262 days). Meanwhile, the Company benefits from advance payments from customers due to which trade receivable days stood at 49 days (FY20: 39 days). Therefore, gross working capital days stood at 294 days (FY20: 300 days). The Company's trade payable days decreased to 56 days in FY21 (FY20: 64 days) and thus, net working capital days clocked in at 238 days (FY20: 237 days). The Company's short term trade leverage declined to 9.8% (FY20: 15.6%), still showing adequate room to borrow against working capital requirements.

Coverages During FY21, the Company's FCFO clocked in at PKR 1,099mln (FY20: PKR 848mln). Meanwhile, finance cost decreased to PKR 335mln (FY20: PKR 459mln) on the back of lower interest rates. During FY21, the Company's interest coverage ratio improved to 3.5x (FY20: 2x) and the debt coverage ratio remained stagnant at 1.1x (FY20: 1.1x).

Capitalization During FY21, Interwood Mobel's leveraging decreased to 40.2% (FY20: 40.8%) despite the increase in total borrowings(FY21: 3,676mln, FY20: PKR 3,564mln, FY19: PKR 2,608mln) on account of better profitability. Meanwhile, short term borrowings constituted 48.9% of total borrowings (FY20: ~36.9%) as short term borrowings increased to PKR 1,796mln in FY21 (FY20: PKR 1,314mln).

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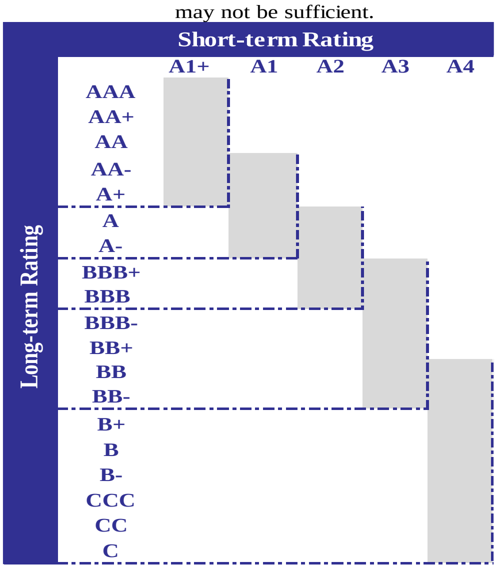
Interwood Mobel (Pvt.) Limited Furniture & Fixtures	Jun-21 12M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET			
1 Non-Current Assets	7,139	7,455	4,063
2 Investments	-	-	203
3 Related Party Exposure	-	73	108
4 Current Assets	4,404	3,469	3,120
a Inventories	*2,644*	*2,334*	*2,127*
b Trade Receivables	*582*	*406*	*256*
5 Total Assets	11,543	10,996	7,494
6 Current Liabilities	1,463	1,224	1,986
a Trade Payables	*620*	*521*	*570*
7 Borrowings	3,676	3,244	2,326
8 Related Party Exposure	5	324	286
9 Non-Current Liabilities	922	1,033	344
10 Net Assets	5,477	5,172	2,552
11 Shareholders' Equity	5,477	5,172	2,552
B INCOME STATEMENT			
1 Sales	3,704	3,112	3,064
a Cost of Good Sold	*(2,306)*	*(1,910)*	*(1,981)*
2 Gross Profit	1,398	1,202	1,082
a Operating Expenses	(738)	(626)	(656)
3 Operating Profit	660	577	426
a Non Operating Income or (Expense)	*33*	*20*	*(57)*
4 Profit or (Loss) before Interest and Tax	693	597	369
a Total Finance Cost	*(335)*	*(459)*	*(228)*
b Taxation	*(53)*	*159*	*(53)*
6 Net Income Or (Loss)	305	296	89
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*1,099*	*848*	*461*
b Net Cash from Operating Activities before Working Capital Changes	*764*	*485*	*242*
c Changes in Working Capital	*(950)*	*(1,035)*	*266*
1 Net Cash provided by Operating Activities	(186)	(550)	508
2 Net Cash (Used in) or Available From Investing Activities	(200)	(56)	(663)
3 Net Cash (Used in) or Available From Financing Activities	447	582	180
4 Net Cash generated or (Used) during the period	61	(24)	26
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	19.0%	1.6%	5.1%
b Gross Profit Margin	37.7%	38.6%	35.3%
c Net Profit Margin	8.2%	9.5%	2.9%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	4.0%	-6.0%	23.7%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	5.7%	6.8%	3.5%
2 Working Capital Management			
a Gross Working Capital (Average Days)	294	300	282
b Net Working Capital (Average Days)	238	237	224
c Current Ratio (Current Assets / Current Liabilities)	3.0	2.8	1.6
3 Coverages			
a EBITDA / Finance Cost	3.5	2.2	3.1
b FCFO / Finance Cost+CMLTB+Excess STB	1.1	1.1	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.4	5.4	6.6
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	40.2%	40.8%	50.5%
b Interest or Markup Payable (Days)	121.5	69.7	49.1
c Entity Average Borrowing Rate	8.6%	13.9%	8.3%

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