The Pakistan Credit Rating Agency Limited

Rating Report

Tufail Chemical Industries Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
12-Aug-2024	A-	A2	Stable	Maintain	Yes
23-Aug-2023	A-	A2	Stable	Maintain	-
23-Aug-2022	A-	A2	Stable	Maintain	-
23-Aug-2021	A-	A2	Stable	Maintain	-
14-Sep-2020	A-	A2	Stable	Maintain	-
24-Sep-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Tufail Chemical Industries Limited ('TCIL' or 'the Company') is primarily engaged in the production and sale of specialized chemicals in Pakistan. The ratings reflect TCIL's leading position in domestic manufacturing of surfactants (key raw material for detergents & shampoo industry) and strong customer base - mainly MNCs. In FY24, the Tufail family undertook a restructuring of the group, and the two brothers divided the family business. Zubair family and Pervaiz family will now lead separate entities: TCIL and TMIL (Tufail Multichem Industries Pvt. Limited), respectively. The restructuring process is finalized, and court orders regarding the division have been received, and will officially take effect soon. Consequently, after de-merger TCIL's current annual production capacity stands at ~64,788 MT for LABSA, ~42,340 MT for SLS/SLES, and ~48,363 MT for textile chemicals. In the local chemical market, manufacturers are increasingly investing in capacity expansion and market development, leading to a reduction in reliance on imported chemicals. The chemical industry plays a crucial role in supporting forward-linked sectors, such as textiles, detergents, and personal hygiene. Growing demand from these sectors presents a significant opportunity for chemical manufacturers. However, the availability of cheaper raw materials through grey channels creates price competition among industry players. During the review period, the company faced several challenges, primarily due to difficulties in establishing L/Cs for importing key raw materials, delays in the procurement process caused by flooding in the UAE, and the ongoing restructuring within the group. Following the de-merger, the company's sales decreased to PKR ~6.8bln during 9MFY24 (FY23: ~17bln). However, gross margins remained stable at ~14%, and both operating and net profits showed modest improvement due to better cost control and a reduction in finance costs. The company's Board consists primarily of close family members, indicating a lack of independent oversight and highlighting an area for potential improvement. Similarly, establishing a formal internal audit department would further enhance the control environment. Going forward, the company plans to invest in infrastructure, solar energy, plant efficiency, and combining it with the addition of a new product through a mix of equity and debt. Financial risk profile is characterized by modest coverages and cashflows. Capital structure is moderately leveraged, where borrowings are comprised of short-term working capital management.

The ratings are dependent on the Company's ability to sustain its market position. Furthermore, growth in revenues, and improvement in margins, as depicted in financial projections will remain imperative. Moreover, audited financial statements reflecting a seamless transition and a standalone financial position of the entity will remain important.

Disclosure

Name of Rated Entity	Tufail Chemical Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-24),Methodology | Corporate Rating(Jul-23)
Related Research	Sector Study | Chemicals(Jul-24)
Rating Analysts	Sohail Ahmed Qureshi | sohail.ahmed@pacra.com | +92-42-35869504

Profile

Legal Structure Tufail Chemical Industries Limited (Tufail Chemical) was incorporated in 1993 and commenced operations in 1995 as a public unlisted company.

Background Tufail Chemical has an established presence in the local chemical industry. Initially, the family was involved in chemical trading. In 1993, the family transformed its distribution network in the manufacturing business through Tufail Chemical Industries Limited. During Feb-22, another group company, Tufail Chemical & Surfactants (Pvt.) Limited was merged with and into Tufail Chemical Industries Limited. However, in FY24, Tufail Family divided the family business into two groups as Zubair Family and Pervaiz Family. Zubair Family will now lead and own Tufail Chemical Industries Limited (TCIL) while Pervaiz Family will be leading Tufail Multichem Holding Limited (TMHL) as holding company with Tufail Multichem Industries Limited (TMIL), Tufail Starchem Industries Limited (TSIL), and Tufail Chemicals UK (TCUK) as subsidiaries.

Operations After group restructuring, TCIL's current annual production capacity is ~64,788 MT for LABSA, ~42,340 MT for SLS/SLES, and ~48,363 MT textile chemicals after the transfer of LABSA III plant to TMIL with the power requirements of 1.9MW. The power requirements are met through the K-Electric network with the backup of Gas & Diesel generators.

Ownership

Ownership Structure Tufail Chemical is a family-owned and managed business. After de-merger, the total shareholding of TCIL will remain in the Zubair family. As per the proposed shareholding, 45.1% will be transferred to Mr. Zubair Farid Tufail, 25.5% to Mr. Salman Tufail, and 9.8% to Mrs. Ghazala Zubair, Ms. Fariha Nasir, and Syed Azfar Ali Nasir each. However, the official orders are in process.

Stability The formalized distribution of shareholding among two brothers and their family members portrays a clear line of succession. The second generation is already in business, serving as executive director in the Company.

Business Acumen Mr. Zubair Tufail inherited a chemical trading company and transformed it into one of the largest manufacturers of surfactants in Pakistan. He was elected as the president of the Pakistan Chamber of Commerce and Industry for the year 2017. Mr. Zubair Tufail is well-known for his acumen in the chemical industry of Pakistan.

Financial Strength Tufail Chemical has expanded its footing in the entertainment business through PEG (Pvt.) Limited. The family has a collective net worth of over PKR 1.0bln, portraying adequate financial strength to support the Company if needed.

Governance

Board Structure Tufail Chemical's board comprises five members with the dominance of the Tufail Family. Mr. Zubair Tufail is the Chairman of the board and he is also the CEO of the Company. Additionally, there are three executive directors, while the remaining members are non-executive directors.

Members' Profile Mr. Zubair Tufail – Chairman/CEO. He has been associated with the Company since its inception. He holds a B.Com degree and carries over five decades of experience in the chemical sector.

Board Effectiveness During FY24, members' attendance remained strong, and meeting minutes were formally documented. The Company's board is dominated by family members with no independent oversight. However, the Company is planning to induct independent directors in the near future.

Financial Transparency M/S Naveed Zafar Ashfaq Jaffery & Co. are the external auditors of the Company. The auditor is listed in Category "A" of the SBP's panel of auditors and expressed an unqualified opinion on the Company's financial statements for the period ended June 30th, 2023.

Management

Organizational Structure The Company operates with five functional departments, each headed by an experienced HoD. All HoDs report to the Senior Executive Director - who manages the day-to-day operations of the business.

Management Team Mr. Salman Tufail is the procurement director of the Company. He has been associated with company since 2004 and carries over two decades of experience in the industry.

Effectiveness The Company's production facility is equipped with multiple quality control labs with real-time surveillance by the Director of Technical Operations to ensure optimal monitoring. The key management personnel meet on a weekly and monthly basis to proactively address operational issues.

MIS The Company implemented ER Manager in 2012 as an ERP solution having 15 modules that can be mixed and matched as per business needs. The Company successfully upgraded its ERP by implementing the latest version of SAP which went live in May 2020.

Control Environment The Company has in place a European automated system to control & monitor the Sulphonation process. Moreover, filling area surveillance is done through a dedicated system. The production details related to yield & quality for each product are shared with the senior management on a real-time basis.

Business Risk

Industry Dynamics The chemical industry is broadly divided into four categories namely: i) Basic Chemicals, ii) Life Science, iii) Specialty Chemicals, and iv) Consumer Products. Among all, Tufail Group's products largely fall in basic chemicals. Pakistan's reliance on imported chemicals has been reduced over the years as the local companies invested more to increase their production capacity and hence market share. The chemical sector of Pakistan contributes around ~4.6% in exports and its share in imports is ~16%. The sector is considered a backbone in the development of forward-linked industries. In FY24, the current local chemical market size is approximately 1,333,000 tons and market size of LABSA/SLES is approximately 165,000 metric tons (company sources). Also, there has been an increase in demand for health & safety products post-pandemic crisis.

Relative Position Tufail Group is one of the leading chemical manufacturers in Pakistan and the leader in the surfactants segment. Tufail Chemical has the largest manufacturing facility of surfactants in Pakistan. Meanwhile, the Company caters to the needs of MNCs along with local manufacturers.

Revenues During FY23, the revenue of the company reached at PKR 17,004 million owing merger & acquisition in Feb-22. However, revenue declined significantly and cloaked at PKR 6,821 million in 9MFY24. This was attributed to factors such as the ongoing restructuring of group, LC challenges, and procurement delays caused by flooding in the UAE. The company derives the majority of its revenue (~96.83%) from domestic sales, with surfactants (LABSA, SLS, and SLES) accounting for approximately 80% of this total. Notably, the company supplies surfactant products to prominent multinational corporations including Procter & Gamble Pakistan and Unilever Pakistan. Additionally, the company offers toll manufacturing services.

Margins During 9MFY24, the gross margin sustained at 14.0% (FY23: 13.3%). However, the operating and net margin of the company improved and reached at 8% and 1.5% in 9MFY24, which is primarily attributable to a decrease in finance cost. During 9MFY24, the bottom line of the company clocked in at PKR 106mln (FY23: PKR ~153mln).

Sustainability Tufail Chemical regularly invests in R&D which has yielded a specialized product range, especially variants of surfactants. The Company has sufficient orders in hand due to a niche customer base consisting mostly of MNCs.

Financial Risk

Working Capital During 9MFY24, the gross working capital days of the company increased to 73 days (FY23: 68 days). However, the net working capital days reduced to 32 days (FY23: 42 days) due to increased trade payable days.

Coverages During 9MFY24, the Company's operating cash flows (FCFO) was PKR 626mln (FY23: 859mln, FY22: PKR 1,308mln). However, interest coverage ratio increased to 1.9x in 9MFY24 (FY23: 1.4x, FY22: 3.0x). Similarly, debt coverage has also increased to 1.3x in 9MFY24 (FY23: 1.2x, FY22: 2.4x).

Capitalization The Company has a leveraged capital structure as reflected by the gearing ratio of 34.5% in 9MFY24 (FY23: 27.3%, FY22: 46.6%). The Company's borrowings are exclusively short-term in nature and are largely utilized to fill working capital needs.

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Financial Summary
PKR mln

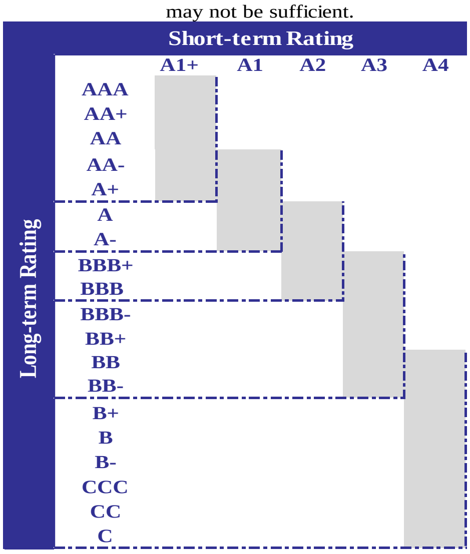
Tufail Chemical Industries Limited	Mar-24	Jun-23	Jun-22	Jun-21
Chemical	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	3,474	3,540	3,872	2,633
2 Investments	-	94	-	-
3 Related Party Exposure	1,272	1,278	1,218	1,196
4 Current Assets	3,443	2,924	5,927	2,757
a Inventories	*673*	*818*	*1,717*	*1,189*
b Trade Receivables	*1,236*	*898*	*2,865*	*972*
5 Total Assets	8,189	7,835	11,017	6,586
6 Current Liabilities	1,251	1,647	2,303	1,405
a Trade Payables	*1,181*	*833*	*1,523*	*1,081*
7 Borrowings	2,191	1,440	3,631	1,352
8 Related Party Exposure	-	84	-	340
9 Non-Current Liabilities	584	604	927	558
10 Net Assets	4,164	4,060	4,156	2,931
11 Shareholders' Equity	4,164	4,060	4,156	2,931
B INCOME STATEMENT				
1 Sales	6,821	17,004	17,243	9,367
a Cost of Good Sold	*(5,868)*	*(14,743)*	*(14,492)*	*(7,813)*
2 Gross Profit	953	2,261	2,751	1,555
a Operating Expenses	(405)	(1,149)	(1,539)	(1,049)
3 Operating Profit	548	1,111	1,212	506
a Non Operating Income or (Expense)	*(5)*	*(83)*	*(190)*	*29*
4 Profit or (Loss) before Interest and Tax	543	1,028	1,022	534
a Total Finance Cost	*(329)*	*(663)*	*(457)*	*(271)*
b Taxation	*(110)*	*(212)*	*(242)*	*(79)*
6 Net Income Or (Loss)	104	153	322	184
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*626*	*859*	*1,308*	*906*
b Net Cash from Operating Activities before Working Capital Changes	*237*	*156*	*899*	*646*
c Changes in Working Capital	*(658)*	*2,344*	*(1,867)*	*1,683*
1 Net Cash provided by Operating Activities	(420)	2,500	(968)	2,329
2 Net Cash (Used in) or Available From Investing Activities	(130)	(99)	516	(1,097)
3 Net Cash (Used in) or Available From Financing Activities	(14)	(2,375)	607	383
4 Net Cash generated or (Used) during the period	(563)	26	154	1,615
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-46.5%	-1.4%	84.1%	4.9%
b Gross Profit Margin	14.0%	13.3%	16.0%	16.6%
c Net Profit Margin	1.5%	0.9%	1.9%	2.0%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-0.5%	18.8%	-3.2%	27.6%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	3.4%	3.7%	9.1%	6.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	73	68	71	129
b Net Working Capital (Average Days)	32	42	44	88
c Current Ratio (Current Assets / Current Liabilities)	2.8	1.8	2.6	2.0
3 Coverages				
a EBITDA / Finance Cost	2.4	1.9	3.7	4.3
b FCFO / Finance Cost+CMLTB+Excess STB	1.3	1.2	2.4	3.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.5	0.7	0.4	0.5
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	34.5%	27.3%	46.6%	36.6%
b Interest or Markup Payable (Days)	58.5	34.3	83.4	48.8
c Entity Average Borrowing Rate	19.5%	24.5%	12.6%	11.9%

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):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies 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 | Clause 11-(A)(p).
(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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)

Proprietary Information