



The Pakistan Credit Rating Agency Limited

Rating Report

Khas Textile Mills (Pvt.) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Aug-2020	BB+	A3	Stable	Maintain	-
29-Aug-2019	BB+	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the small yet adequate business profile of Khas Textile Mills (Pvt.) Limited emanating from a relatively small revenue base, thin margins, and profitability. The Company is associated with Khas Group of Industries. The Company manufactures various types of the cotton ring and open-end yarn. Despite challenging textile industry dynamics, Khas Textile managed to maintain its volumes. Subsidized gas rates for the textile industry have made the local textile industry cost-competitive, though the withdrawal of zero-rating status will affect the liquidity of the industry. On a standalone basis, the Company's sales volume increased due to capacity enhancement from last year's completed BMR and better yarn prices. Increased cotton prices have put pressure on margins and, in turn, profitability. The Company has a highly leveraged capital structure and weak coverages. The Company has stretched its working capital cycle, though in line with the industry average. Limited cash flows from operations and higher finance cost led to stretched coverages. These are expected to improve due to the repayment of long term loans in the near future. The debt structure is skewed towards short-term borrowings, which led to an asset-liability mismatch. The overall governance framework needs strengthening.

COVID-19 has impacted the entire textile chain as demand contracts due to shutdown in domestic and global markets and tough economic conditions. Recent SBP measures will provide some respite in this regard. The Company's production facilities were shut down in line with the provincial Government's directive of lockdown and now the situation is becoming normal day by day.

The ratings are dependent upon the management's ability to improve margins, profitability, and financial profile of the Company. Improving asset-liability will be critical. Meanwhile, strengthening of governance practices will have a positive impact on the ratings. Any deterioration in debt coverages leading to higher financial risk or substantial losses will have a negative impact on ratings. Khas Group of industries has a presence in diverse sectors; including textile, aluminum, poultry, socks, and knitwear and import of building hardware.

Disclosure

Name of Rated Entity	Khas Textile Mills (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-20),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria Rating Modifier(Jun-20)
Related Research	Sector Study Spinning(Sep-19)
Rating Analysts	Fahad Iqbal fahad.iqbal@pacra.com +92-42-35869504

Profile

Legal Structure Khas Textile Mills (Pvt.) Limited (Khas Textile) was incorporated in 2001 as a private limited Company.

Background The Company is engaged in the manufacturing of yarn. In 2006, the Company went through a major transformation and started manufacturing cotton ring and open-end yarn. Since its incorporation, Khas Textile has significantly increased its production capacity.

Operations Khas Textile currently operates 19,680 spindles and 840 rotors and has a purpose build manufacturing facility located in the industrial hub – Nooriabad. Khas Textile has a captive electricity generation capacity of 3.5 Megawatt against the requirement of 3.2 Megawatt. The Company has a backup line connection with HESCO.

Ownership

Ownership Structure The Company is entirely owned by Ashfaq family, which includes Mr. Haji Ashfaq Ahmed and his wife (20%), his two sons (i) Khurram Ashfaq (40%) and (ii) Noman Asahfaq (40%) individually and through their respective families.

Stability Shareholding between different members of the family is clearly distributed. However, no formal succession plan has been documented.

Business Acumen Mr. Ashfaq Ahmed –chairman- has over 45 years of experience in diverse sectors including textile, aluminium, poultry, socks and knitwear and import of building hardware. Mr. Khurram Ashfaq –managing director- of the Company has over 23 years of experience in textile sector. Apart from spinning, sponsors also have a socks manufacturing unit.

Financial Strength Khas Group of industries has five companies' involved engaged in diverse sectors. Apart from national level presence in diverse sectors; sponsors also have a joint venture, KAI-largest aluminium manufacturer- in Bangladesh. The Company's sponsors have reasonable net worth and have demonstrated their commitment to support the Company in times of need.

Governance

Board Structure The Company has a five member board. Three of the members are executive directors and two are non-executive directors. All directors have been affiliated with the Company since its inception.

Members' Profile Mr. Ashfaq Ahmed –Chairman of the board- has over 45 years of experience in diverse industries including Textile. Three board members are active members while the remaining two board members are inactive members.

Board Effectiveness Involvement of the directors in day to day running of the business bodes well with the effectiveness of strategic oversight. However, there are no committees formed by the board.

Financial Transparency Shahid Ahmad & Co. Chartered Accountants is the auditor of the Company. The auditor expressed an unqualified opinion on the Company's financial statements for FY19 and December 2019. The auditor is neither categorised by SBP nor QCR rated.

Management

Organizational Structure Khas Textile has a well-defined organizational structure. Overall the group management oversees all the operations of the Company. There are clearly delimited reporting lines as well as segregation of duties between top tier management.

Management Team Mr. Khurram Ashfaq –managing director- is responsible for overseeing all matters related to Khas Textile .The group CFO, Mr. Ashfaq Ali Khan is a Fellow Chartered Accountant. He has been with the Khas Group of Industries for one and half years but has an overall experience of 23 years. Other members of the Company's top tier management are also comprised of seasoned professional and have been associated with the Company for a considerable amount of time.

Effectiveness There are no formal management committees; however, key management members meet on regular basis to resolve and pro-actively address operational issues, if any, eventually ensuring smooth flow of operations.

MIS The Company is currently operating SAP-BI-8.82 which has been customised by Abacus Consulting (Pvt.) Limited according to the Company's needs. Reports are generated and reviewed regularly by the top management.

Control Environment The Company has an updated technological infrastructure in all its manufacturing and support functions, to ensure quality and cost effectiveness. The Company also has an internal audit department.

Business Risk

Industry Dynamics Textile exports of the country declined by ~5% for June 2020 to stand at ~USD 9.5bln as compared to ~USD 10.1bln in June 2019, backed by devaluation of the rupee, bailout package from the government and GSP Plus Scheme of the EU. This growth was led mainly by the value-added segment, including knitwear, home textile and readymade garments. Going forward, removal of zero-rated status, prevailing uncertainty in the dynamics of textile sector due to Covid-19 outbreak globally, prolonged nationwide lockdown, contraction in local and international demand is expected to affect the entire textile value chain.

Relative Position With 19,680 spindles and 1,344 rotors, the Company's share in the spinning sector of textile industry is small. In term of margins, the Company falls in lower tier of spinning sector.

Revenues Majority of the Company's revenue comes from local sales; whereas a small part comes from the sale of waste material. During 9MFY20, 62% of total revenue came from the sale of yarn in local market. While 37% of the total revenue came from the export sales. Export during the period FY17 to FY18 was nonexistent, due to the Company ceasing export sales after FY17. However, in the last quarter of FY19, the Company has started exporting yarn again, with China as the first export destination. Now Company's export destinations also included Turkey.

Margins The gross margin of the Company increased slightly by 1% to clock in at 6.4% in 9MFY20 (9MFY19: 6.3%). This is due to decline in cost of sales due to better yarn prices in local market despite increase in revenues. However, increase in gross profit margin did not translate into significantly better operating margins and they clocked in at 3.7% in 9MFY20 (9MFY19: 4.1%). Finance cost of the Company declined and stood at ~PKR 80mln in 9MFY20 (9MFY19: ~PKR 87mln). The decrease in finance cost is due to decrease in short term borrowings but still remained high due to increase in interest cost. The net profit of the Company stood at ~PKR 5mln in 9MFY20 (9MFY19: ~PKR 11mln).

Sustainability The Company planned the BMR this year but due to uncertainty caused by the outbreak of Covid-19, continuation of planned CAPEX in following years is uncertain. Moreover, the revenue is expected to be further affected by the outbreak of Covid-19 pandemic. Prolonged nationwide lockdown is likely to affect demand for yarn in the local market. Internationally, Turkey, the Company's export market, was highly affected by COVID-19 and consequently exports are bound to suffer. Khas textile might find some comfort in reopening of market in China, the Company's other major export market. The Company's margins are also expected to suffer. The Company availed the facility of deferment of principal amount of long-term loan by SBP. The Company also availed the salary loan facility by SBP.

Financial Risk

Working Capital The Company meets roughly 85% of its inventory finance requirements through short-term borrowings and the remainder is met through internally generated cash reserves. During 9MFY20, the Company's net working capital cycle increased to 95 days (9MFY19: 85 days) due to significant increase in average receivable days (9MFY20: 74 days, 9MFY19: 38 days). During 9MFY20, the Company's room to borrow stood at 21%, which is quite higher than last year (9MFY19: -12%) due to decrease in short term borrowings.

Coverages During 9MFY20, the Company experienced a 22% increase in its Free Cash Flow from operations (FCFO) which clocked in at PKR 112mln (9MFY19: PKR 92mln). Increase in FCFO and lower finance cost resulted in better interest coverage. During 9MFY20, interest coverage ratio improved to 1.5x (9MFY19: 1.1x). However, debt coverage ratio slightly declined to 0.9x (9MFY19: 1.1x). Going forward, the coverages are expected to improve due to the repayment of long-term loans.

Capitalization During 9MFY20, the Company's capital structure remained highly leveraged at ~69% (9MFY19: ~71%). The Company's total borrowings during the period stood at PKR 991mln, with a ~8% decrease from the same period last year (9MFY19: PKR 1,078mln). Short-term borrowings made up 67% of the total borrowings at PKR 667mln. The Company's short-term borrowings are mostly used to meet working capital needs and peak during the cotton procurement season.



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Financial Summary

PKR mln

Khas Textile Mills Limited Textile	Mar-20 9M	Jun-19 12M	Mar-19 9M	Jun-18 12M	Mar-18 9M	Jun-17 12M
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A BALANCE SHEET

1 Non-Current Assets	1,764	1,890	1,494	1,677	1,677	1,798
2 Investments	8	8	8	8	8	5
3 Related Party Exposure	74	118	62	190	85	139
4 Current Assets	1,342	1,086	1,317	1,526	1,369	1,039
<i>a Inventories</i>	385	372	504	701	748	490
<i>b Trade Receivables</i>	688	466	400	292	350	217
5 Total Assets	3,188	3,102	2,880	3,400	3,138	2,980
6 Current Liabilities	230	291	193	229	280	133
<i>a Trade Payables</i>	190	240	162	192	192	91
7 Borrowings	991	999	1,078	1,745	1,417	1,386
8 Related Party Exposure	1,061	913	829	655	689	699
9 Non-Current Liabilities	2	1	4	4	5	5
10 Net Assets	903	899	776	766	747	757
11 Shareholders' Equity	903	899	776	766	747	757

B INCOME STATEMENT

1 Sales	2,139	3,319	2,488	2,790	1,628	2,256
<i>a Cost of Good Sold</i>	(2,001)	(3,136)	(2,332)	(2,626)	(1,531)	(2,122)
2 Gross Profit	138	183	156	164	97	134
<i>a Operating Expenses</i>	(58)	(56)	(54)	(55)	(35)	(52)
3 Operating Profit	80	127	102	110	62	82
<i>a Non Operating Income</i>	4	2	(4)	(1)	(1)	(3)
4 Profit or (Loss) before Interest and Tax	84	129	98	109	61	79
<i>a Total Finance Cost</i>	(80)	(115)	(87)	(100)	(56)	(74)
<i>b Taxation</i>	-	-	-	-	-	-
6 Net Income Or (Loss)	5	14	11	9	5	5

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	112	95	92	152	124	125
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	112	95	92	152	124	125
<i>c Changes in Working Capital</i>	(257)	688	422	(422)	(117)	(137)
1 Net Cash provided by Operating Activities	(145)	783	514	(270)	7	(12)
2 Net Cash (Used in) or Available From Investing Activities	(3)	(311)	1	(36)	(13)	(480)
3 Net Cash (Used in) or Available From Financing Activities	140	(427)	(430)	305	15	459
4 Net Cash generated or (Used) during the period	(7)	46	85	(0)	9	(33)

D RATIO ANALYSIS

1 Performance						
<i>a Sales Growth (for the period)</i>	-14.1%	18.9%	18.9%	23.7%	-3.8%	12.3%
<i>b Gross Profit Margin</i>	6.4%	5.5%	6.3%	5.9%	6.0%	5.9%
<i>c Net Profit Margin</i>	0.2%	0.4%	0.4%	0.3%	0.3%	0.2%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	6.4%	5.2%	5.1%	6.3%	7.8%	6.9%
<i>e Return on Equity (ROE)</i>	0.7%	1.7%	1.9%	1.1%	0.9%	0.7%
2 Working Capital Management						
<i>a Gross Working Capital (Average Days)</i>	122	101	104	111	152	116
<i>b Net Working Capital (Average Days)</i>	95	77	85	93	128	101
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	5.8	3.7	6.8	6.7	4.9	7.8
3 Coverages						
<i>a EBITDA / Finance Cost</i>	1.8	1.6	1.5	1.8	2.3	2.2
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	0.9	0.5	1.1	0.5	2.2	0.5
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	29.6	-84.4	99.2	20.8	12.5	24.0
4 Capital Structure (Total Debt/Total Debt+Equity)						
<i>a Total Borrowings / Total Borrowings+Equity</i>	69.4%	68.0%	71.1%	75.8%	73.8%	73.4%
<i>b Short-Term Borrowings / Total Borrowings</i>	0.3	0.3	0.4	0.6	0.5	0.4
<i>c Average Borrowing Rate</i>	5.2%	5.1%	5.2%	4.4%	3.5%	3.9%

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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):

<p>Entities</p> <ul style="list-style-type: none"> 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 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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- 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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- (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.
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- (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)
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- (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)

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- (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)

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