



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
23-Aug-2021	BB+	A3	Stable	Maintain	-
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 and profitability. The Company manufactures various types of the cotton ring and open-end yarn. The Company is associated with Khas Group of Industries where the group has presence in diverse sectors; including textile, aluminum, poultry, socks, and knitwear and import of building hardware. The Company's sales volume increased due to increase in local sales from last year and better yarn prices. The sales value, in 9MFY21, has improved from FY20 – attributable to positive textile industry dynamics. Margins recorded uptick due to better yarn prices. The financial risk profile witnessed improvement since last year due to decline in leveraging and slight improvement in coverage. The debt structure is skewed towards short-term borrowings. The Company's room to borrow improved due to repayment of short-term loans. In addition to long and short-term borrowings, the Company took a loan from its directors worth PKR 1.1bln – a portion of which is intended to be retained as part of equity in the coming years. Going forward, the company intends to enhance the production capacities in coming years. The stretched working capital cycle and overall governance framework needs improvement. Textile exports of the country recorded a double-digit increase of ~23% for FY21 to stand at USD 15.4bln as compared to USD 12.5bln in FY20 due to an increase in demand for textile products internationally, led by good recovery around the globe post-pandemic. Going forward, the textile sector's outlook is expected to stay stable in the medium term where the demand for textile products is expected to increase. The probability of little attrition in demand remains on the horizon attributable to the outbreak of COVID-19 variants.

The ratings are dependent upon the management's ability to improve margins, profitability and financial profile of the Company. 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.

Disclosure

Name of Rated Entity	Khas Textile Mills (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 Spinning(Sep-20)
Rating Analysts	Muhammad 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 rings and open-end yarn. Since its incorporation, Khas Textile has significantly increased its production capacity.

Operations Khas Textile currently operates 19,680 spindles and 1344 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 the 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 the 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 aluminum manufacturer- in Bangladesh. The Company’s sponsors have a 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 The 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 FY20. The auditor is neither categorized 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 professionals 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 a smooth flow of operations.

MIS The Company is currently operating SAP-B1-8.82 which has been customized 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 recorded a double-digit increase of ~23% for FY21 to stand at USD 15.4bln as compared to USD 12.5bln in FY20 due to an increase in demand for textile products internationally, led by good recovery around the globe post-pandemic. Going forward, the textile sector’s outlook is expected to stay stable in the medium term where the demand for textile products is expected to increase. The probability of little attrition in demand remains on the horizon attributable to the outbreak of COVID-19 variants. In the local market, the textile sector has recorded strong performance. The relief measures introduced by the State Bank of Pakistan such as deferment of loan payments for one year, low-interest rates, and salary refinance scheme also provided comfort to the sector.

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

Revenues The majority of the Company’s revenue comes from local sales; whereas a small part comes from the sale of waste material. During 9MFY21, 87.7% of total revenue came from the sale of yarn in the local market. While 11.5% of the total revenue came from export sales. During 9MFY21, the Company recorded revenue of PKR 2.7bln, an increase of 28.4% compared to the same period last year (9MFY20: PKR 2.1bln) due to an increase in local sales.

Margins The gross margin of the Company increased by 3.7% to clock in at 10.1% in 9MFY21 (9MFY20: 6.4%). This is due to an increase in sales volume of the Company in the local market. Similarly, an increase in gross profit margin translated has significantly better operating margins and they clocked in at 7.6% in 9MFY21 (9MFY20: 3.7%). The finance cost of the Company declined and stood at PKR 83mln in 9MFY21 (9MFY20: PKR 80mln). The net profit of the Company stood at PKR 75mln in 9MFY21 (9MFY20: PKR 5mln).

Sustainability The Company planned the BMR this year but due to uncertainty caused by the outbreak of Covid-19, a continuation of planned CAPEX in the following years is uncertain. Internationally, Turkey, the Company’s export market, was highly affected by COVID-19 and consequently, exports declined. Khas textile might find some comfort as China is looking for neighboring countries to produce yarn. The Company has also procured the cotton for the next few months at a cost less than the actual price. The Company availed the facility of deferment of the principal amount of long-term loan by SBP. The Company also availed the salary loan facility by SBP.

Financial Risk

Working Capital During 9MFY21, the Company’s net working capital cycle increased to 136 days (9MFY20: 95 days). However, the average receivable days remained the same (9MFY21: 75 days, 9MFY20: 74 days). During 9MFY21, the Company’s room to borrow stood at 35%, which is similar to last year (9MFY20: 21%).

Coverages During FY20, the Company experienced an 82.1% increase in its Free Cash Flow from operations (FCFO) which clocked in at PKR 173mln (FY19: PKR 95mln). The improvement in FCFO is due to an increase in profitability. An increase in FCFO and lower finance cost resulted in better interest coverage. During FY20, the interest coverage ratio improved to 1.3x (FY19: 0.9x). However, the debt coverage ratio slightly declined to 0.9x (FY19: 0.5x).

Capitalization During 9MFY21, the Company’s capital structure is moderately leveraged at 59.6% (9MFY21: 69.4%). The Company’s total borrowings during the period stood at PKR 1.1bln, with a 19.07% increase from the same period last year (9MFY20: PKR 991mln). Short-term borrowings made up 74.3% of the total borrowings. Long-term borrowings at the end of the period clocked in at PKR 254mln and were utilized for CAPEX purpose. Long-term borrowings are expected to decrease in the future since the Company does not plan on undertaking another BMR anytime soon. In addition to long- and short-term borrowings, the Company took a loan from its directors worth PKR 1.1bln.



Khas Textile Mills Limited Textile	Mar-21 9M	Jun-20 12M	Jun-19 12M	Jun-18 12M
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A BALANCE SHEET

1 Non-Current Assets	2,226	1,781	1,890	1,677
2 Investments	-	8	8	8
3 Related Party Exposure	60	50	118	190
4 Current Assets	1,855	1,681	1,086	1,526
<i>a Inventories</i>	672	776	372	701
<i>b Trade Receivables</i>	831	667	466	292
5 Total Assets	4,140	3,519	3,102	3,400
6 Current Liabilities	154	187	291	229
<i>a Trade Payables</i>	101	122	240	192
7 Borrowings	1,180	1,395	999	1,745
8 Related Party Exposure	1,195	1,035	913	655
9 Non-Current Liabilities	1	1	1	4
10 Net Assets	1,610	901	899	766
11 Shareholders' Equity	1,610	901	899	766

B INCOME STATEMENT

1 Sales	2,748	2,548	3,319	2,790
<i>a Cost of Good Sold</i>	(2,471)	(2,336)	(3,136)	(2,626)
2 Gross Profit	277	212	183	164
<i>a Operating Expenses</i>	(68)	(48)	(56)	(55)
3 Operating Profit	209	164	127	110
<i>a Non Operating Income or (Expense)</i>	(7)	2	2	(1)
4 Profit or (Loss) before Interest and Tax	202	167	129	109
<i>a Total Finance Cost</i>	(83)	(136)	(115)	(100)
<i>b Taxation</i>	(40)	(28)	-	-
6 Net Income Or (Loss)	79	2	14	9

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	297	173	95	152
<i>b Net Cash from Operating Activities before Working Capital (</i>	297	173	95	152
<i>c Changes in Working Capital</i>	(276)	(648)	688	(422)
1 Net Cash provided by Operating Activities	21	(474)	783	(270)
2 Net Cash (Used in) or Available From Investing Activities	245	(51)	(311)	(36)
3 Net Cash (Used in) or Available From Financing Activities	(179)	505	(427)	305
4 Net Cash generated or (Used) during the period	87	(21)	46	(0)

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	43.8%	-23.2%	18.9%	23.7%
<i>b Gross Profit Margin</i>	10.1%	8.3%	5.5%	5.9%
<i>c Net Profit Margin</i>	2.9%	0.1%	0.4%	0.3%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Ca</i>	0.8%	-18.6%	23.6%	-9.7%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (To</i>	7.1%	0.2%	1.5%	1.2%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	147	163	101	111
<i>b Net Working Capital (Average Days)</i>	136	137	77	93
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	12.1	9.0	3.7	6.7
3 Coverages				
<i>a EBITDA / Finance Cost</i>	4.1	1.6	1.6	1.8
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	2.5	0.9	0.5	0.5
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fin.</i>	5.2	36.1	-84.4	20.8
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity,</i>	59.6%	73.0%	68.0%	75.8%
<i>b Interest or Markup Payable (Days)</i>	0.0	0.0	164.1	134.6
<i>c Entity Average Borrowing Rate</i>	4.9%	6.4%	5.3%	4.5%

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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(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

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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.
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- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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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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