The Pakistan Credit Rating Agency Limited

Rating Report

Azhar Corporation (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Dec-2021	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan's personal and homecare product market has shown an annual growth rate of ~2-3%. There is less gap in demand and supply position, as sufficient production capacities are available to cater in case of any unforeseen demand and/or exports. Over the years within the homecare and laundry products, a gradual switch has been observed from soaps towards liquids and powdered detergents. The market for soap bars posts an annual dip of ~7-10%, whereas, the market for powder detergents posted an annual growth of ~10-12%.
The ratings reflect Azhar Corporation's diversified revenue stream and strong presence in the laundry soap segment with their established brand 'Gai Soap'. Being a market leader in this segment, the Company generates most of its revenue from local sales, while nominal exports are made to Afghanistan. Following the industry trend, the Company has a presence in the detergent market (Powder detergent - Gai Powerwash and Xtra Neat). In 2014, the Company entered the branded Vegetable Ghee/Edible Oil segment, with- Gai Banaspati and Gai Cooking Oil. The Company’s Oil/ Ghee business is in a challenging phase and portrays a fluctuating trend, impacting the overall performance. The topline is dominated by the laundry soap division, as the Company has maintained a strong network of dealers in the suburbs. Margins have experienced a recovery, supplemented by lower cost of borrowings. Financial profile of the Company remains stable owing to moderately leveraged capital structure; consisting of short-term debt only, obtained to finance the working capital requirement. The Company's coverage ratios remain strong. Over the years, demonstrated support from sponsors bodes well for the ratings.

The ratings are dependent on the management's ability to prudently manage its market share, while maintaining business margins. Pressure on business volume and margins owing to the high input costs and market conditions may negatively impact the ratings.

Disclosure

Name of Rated Entity	Azhar Corporation (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 | Edible Oil(Feb-21)
Rating Analysts	Shayan Farooq | shayan.farooq@pacra.com | +92-42-35869504

Profile

Legal Structure Azhar Corporation (Pvt.) Limited (Azhar Corporation) is a private limited company, incorporated in 1979.

Background Azhar Corporation (Pvt.) Limited started commercial production of Laundry Soap in 1979 under the brand name of Gai Soap. In 1999, the Company diversified its product base and introduced Toilet Soap, named Hoor in the market. In Jan-14, the Company backwardly integrated and set up a Vegetable Ghee and Cooking Oil refining unit. In FY18, two new products (Xtra Neat and Gai Powerwash) were introduced in the market.

Operations Azhar Corporation is primarily involved in manufacturing and sale of Personal and Homecare products, with an installed capacity of 126,000 MT/annum. These include laundry soap, toilet soap, detergent bar and detergent powder. The Company is also involved in manufacturing of Vegetable Ghee and Cooking Oil and has an installed capacity of 45,000 MT/annum. For this, the Company imports palm oil and palm olein. Azhar Corporation (Pvt.) Limited's manufacturing units and Head Office are located in Faisalabad.

Ownership

Ownership Structure Ownership stake is held equally by the families of Mr. Azhar Iqbal and Mr. Hassan Munawwar (50% each). Mr. Hassan Munawwar, CEO of the Company holds 36.5%, while his wife Ms. Saba Hassan (8.1%) and mother holds Ms. Nasreen Bano 6.8%. Mr. Azhar holds 28.3% stake, while his wife Ms. Samina Kausar and daughters hold 8.1% and 13.6% respectively.

Stability Previously, the shareholding was held by Mr. Hassan and Mr. Azhar solely. During FY21, family members of both sponsors were also included.

Business Acumen For four decades, the Sponsoring family has been in the business arena of Personal and Homecare products, indicating their relevant experience and expertise. Moreover, the third generation has also been inducted during FY21.

Financial Strength Azhar Corporation is a stable business entity. The Sponsors have adequate financial strength to support the Company.

Governance

Board Structure Azhar Corporation has a two-member Board. Both members are from sponsoring family and are executive directors.

Members' Profile Mr. Hassan Munawwar, the CEO of the Company, is attached to this business for more than 17 years. Mr. Azhar Iqbal is a director and is leading the operational front.

Board Effectiveness Board meeting minutes are prepared formally. Meeting minutes are fairly captured in details, with the resolutions being signed by both directors after every meeting. Keeping in view the status of the Company, absence of sub-committees may not impact Board's effectiveness. During FY21, 4 Board meetings, with majority attendance, were held to discuss pertinent matters.

Financial Transparency The Company's external auditors, Parker Russell-A.J.S. Chartered Accountants, have expressed an unqualified opinion on the financial statements of FY21. The firm has been QCR rated by ICAP and is in the 'B' category of SBP's auditor's panel.

Management

Organizational Structure Azhar Corporation has an evolving organizational structure, which is divided into six key functions, namely; (i) Production, (ii) Marketing & Sales, (iii) Human Resource & Admin, (iv) Accounts, (v) Finance, and (vi) Procurement. All departmental heads are managing and supervising the work of their relevant departments and reporting all the necessary information to both CEO and Director.

Management Team The CEO, Mr. Mr. Hassan Munawwar, has experience of more than 17 years, and is a graduate of B. Com. He has been associated with the Company since 2004 after completing his education. Mr. Azhar Iqbal is B.A graduate and on his name the Company was established by his father.

Effectiveness Keeping in view the size and operations of the Company, management lacks effectiveness as there are no management committees in place. Thus, indicating a room for improvement.

MIS An in-house developed software generates reports for each function of the Company, on daily basis. These reports assist the senior management to monitor actual against targeted performance.

Control Environment The Company lacks an internal audit function. Regular reviews are undertaken internally to overlook the Company's operational control.

Business Risk

Industry Dynamics Pakistan's personal and homecare product market has shown an annual growth rate of ~2-3%. There is less gap in demand and supply position, as sufficient production capacities are available to cater in case of any unforeseen demand and/or exports. Over the years within the homecare and laundry products, a gradual switch has been observed from soaps towards liquids and powdered detergents. The market for soap bars posts an annual dip of ~7-10%, whereas, the market for powder detergents posted an annual growth of ~10-12%.

Relative Position Azhar Corporation (Pvt.) Limited has an estimated share of ~14%, followed by Sufi Soap (8%) in the laundry soap market.

Revenues The Company generates revenue from two divisions: Soap (laundry soap, beauty soap, detergent bars and detergent powder) ~ 76% and Edible Oil (Vegetable Ghee and Cooking Oil) ~ 24%. Topline portrayed a fluctuating trend over the years, as the Company revised its credit policies and faced a dip in sales during FY20 as a result. During FY21, topline increased by 26% to PKR 5,050mln (FY20: PKR 4,018mln). This was on the back of better volumes and marketing strategies, by higher geographical presence in the southern (22%) and northern (24%) regions.

Margins During FY21, the Company's gross margins (FY21: 13%, FY20: 15%) showed a slight decline due to an increase in the raw material costs. As the Company imports Tallow (animal fat), fragrances and chemicals from China, Indonesia and Malaysia, thus rupee devaluation made the imports relatively costly. Operating margins remained stable (FY21: 8%, FY20: 8%), as the Company minutely increased the admin and selling expenditure (FY21: PKR 274mln, FY20: PKR 262mln). Financial charges were reduced to PKR 110mln (FY20: PKR 174mln) on the back of lower policy rate, despite higher borrowings. The net income stood at PKR 177mln (FY20: PKR 91mln), translating into a net margin of 4% (FY20: 2%).

Sustainability The Company is striving to diversify by entering the cosmetics market through the brand name of Hoor. New products include beauty creams, shampoos, toothpastes and facewash.

Financial Risk

Working Capital Azhar Corporation's working capital requirements are a function of high inventory and receivable days. During FY21, the net cash cycle improved to 179 days (FY20: 234 days), on account of strict management of receivables which resulted in lower debtors days; 65 days (FY20: 107 days). As per the Company's norm, inventory level remained high consisting of raw materials used for soap and ghee/oil manufacturing (FY21: 144 days, FY20: 151 days). Payable days improved to 30, from 24 days during FY20. The Company meets working capital requirements through internal cashflows as well as the short term borrowings. Short term trade and total leverage of the Company remained comfortable (FY21: 47% and 41%, FY20: 51% and 44%).

Coverages Interest coverage (FY21: 3.8x, FY20: 2x) is a function of 17% higher free cashflows from operations (FY21: PKR 410mln, FY20: PKR 350mln), achieved from better profitability, and lower finance cost incurred (FY21: PKR 110mln, FY20: PKR 174mln) due to lower policy rate during the period.

Capitalization Azhar Corporation has a deteriorating leveraged capital structure (FY21: 46%, FY20: 39%). Equity base of the Company is seen to be improving (FY21: PKR 1,768mln, FY20: PKR 1,529mln), on the back of accumulated profits. However, the Company's total borrowing stood at PKR 1,440mln as at FY21, rising from PKR 894mln as at FY20. This was attributable to short-term borrowing (FY21: PKR 1,378mln, FY20: PKR 850mln) availed from different financial institution to fund the working capital requirements.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Azhar Corporation (Pvt.) Limited Food & Allied	Sep-21 3M	Jun-21 12M	Sep-20 3M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET					
1 Non-Current Assets	594	565	598	611	671
2 Investments	-	-	-	-	-
3 Related Party Exposure	-	-	-	-	-
4 Current Assets	3,952	3,513	3,167	2,692	3,610
a Inventories	*2,402*	*2,225*	*1,880*	*1,755*	*1,575*
b Trade Receivables	*1,182*	*1,104*	*798*	*702*	*1,647*
5 Total Assets	4,546	4,077	3,766	3,304	4,281
6 Current Liabilities	773	711	476	658	484
a Trade Payables	*458*	*451*	*187*	*370*	*149*
7 Borrowings	1,843	1,440	1,392	894	2,220
8 Related Party Exposure	22	80	158	77	-
9 Non-Current Liabilities	80	78	144	146	168
10 Net Assets	1,828	1,768	1,596	1,529	1,409
11 Shareholders' Equity	1,828	1,768	1,596	1,529	1,409
B INCOME STATEMENT					
1 Sales	1,339	5,050	1,182	4,018	5,824
a Cost of Good Sold	*(1,137)*	*(4,381)*	*(1,003)*	*(3,416)*	*(4,891)*
2 Gross Profit	202	669	178	602	933
a Operating Expenses	(78)	(274)	(58)	(262)	(529)
3 Operating Profit	124	395	121	339	404
a Non Operating Income or (Expense)	*(3)*	*(37)*	*(0)*	*(12)*	*(13)*
4 Profit or (Loss) before Interest and Tax	121	358	120	328	391
a Total Finance Cost	*(43)*	*(110)*	*(36)*	*(174)*	*(247)*
b Taxation	*(18)*	*(71)*	*(18)*	*(62)*	*(117)*
6 Net Income Or (Loss)	60	177	67	91	27
C CASH FLOW STATEMENT					
a Free Cash Flows from Operations (FCFO)	*122*	*410*	*116*	*350*	*309*
b Net Cash from Operating Activities before Working Capital	*79*	*300*	*80*	*176*	*62*
c Changes in Working Capital	*(387)*	*(827)*	*(656)*	*964*	*220*
1 Net Cash provided by Operating Activities	(308)	(527)	(575)	1,141	282
2 Net Cash (Used in) or Available From Investing Activities	(42)	(3)	1	2	(6)
3 Net Cash (Used in) or Available From Financing Activities	344	549	579	(1,249)	(204)
4 Net Cash generated or (Used) during the period	(6)	20	5	(107)	71
D RATIO ANALYSIS					
1 Performance					
a Sales Growth (for the period)	6.1%	25.7%	17.6%	-31.0%	-19.7%
b Gross Profit Margin	15.1%	13.2%	15.1%	15.0%	16.0%
c Net Profit Margin	4.5%	3.5%	5.7%	2.3%	0.5%
d Cash Conversion Efficiency (FCFO adjusted for Working C	-19.8%	-8.2%	-45.7%	32.7%	9.1%
*e Return on Equity [Net Profit Margin * Asset Turnover * (T*	13.3%	10.7%	17.1%	6.2%	1.9%
2 Working Capital Management					
a Gross Working Capital (Average Days)	236	209	198	258	180
b Net Working Capital (Average Days)	205	179	177	234	171
c Current Ratio (Current Assets / Current Liabilities)	5.1	4.9	6.7	4.1	7.5
3 Coverages					
a EBITDA / Finance Cost	3.3	4.0	3.7	2.4	2.0
b FCFO / Finance Cost+CMLTB+Excess STB	2.4	2.7	3.3	1.9	1.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fir	0.2	0.5	0.7	0.7	0.0
4 Capital Structure					
a Total Borrowings / (Total Borrowings+Shareholders' Equity	50.5%	46.2%	49.3%	38.8%	61.2%
b Interest or Markup Payable (Days)	85.0	87.9	73.9	40.6	101.1
c Entity Average Borrowing Rate	10.4%	8.1%	11.2%	10.8%	11.1%

Credit Rating

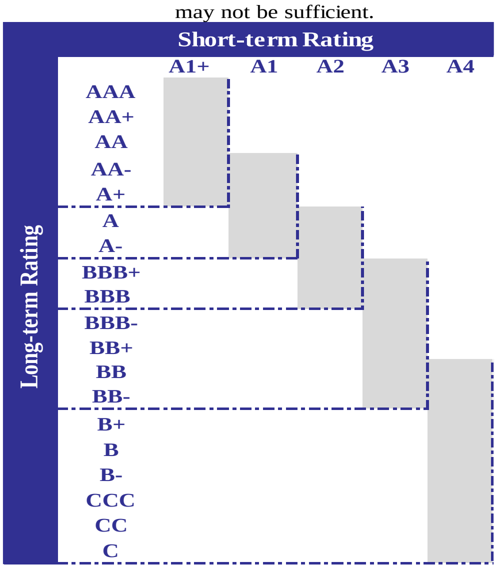
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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