



The Pakistan Credit Rating Agency Limited

Rating Report

Rainbow Hosiery (Pvt.) Limited

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Rating History

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|--------------------|------------------|-------------------|---------|---------|--------------|
| 15-May-2023 | BBB- | A2 | Stable | Initial | - |

Rating Rationale and Key Rating Drivers

Rainbow Hosiery (Pvt.) Limited ('RHPL' or 'the Company') is a manufacturer and exporter of home textiles and garments. The Company utilizes modern technology to produce primarily high-quality fitted bedsheets of different specifications. Recently the Company has diversified its revenue stream and created a garment division, manufacturing jersey apparel i.e., hooded jackets, creepers, polo shirts, zippers, and jogging suits. The processes of the Company are vertically integrated to enhance production efficiencies and to implement better cost control. Over the period Rainbow Hosiery has gone through different phases of capacity expansions in dyeing, knitting, and CMT (cut, make, trim). RHPL's major exports diverted to Europe followed by the USA. The Company has diversified its portfolio by adding newer customers to reduce its concentration risk as the revenue is coming from numerous customers as opposed to dependency on a single customer. There are committees in-place for different matters of the company including but not limited to Emergency Response Committees, Health & Safety Committee, Environment & Waste Management Committee, Work Council & Labor Committee, and Fire Drill & Fighting Committee, all the committees are headed by an independent committee member. The governance structure depicts room for improvement due to the absence of a formal board structure, board committees, and independent oversight, furthermore, external auditors are only QCR-rated. The Company is in transition to adopt a better financial and internal control system. The Company has valid certifications for its products and facilities and is periodically audited by internationally recognized certification bodies i.e. OEKO Tex, Sedex, SANFOR KNIT Certificate, and Made in Green. During FY22 revenues depicted ~41.7% growth mainly due to volumetric increase, whereas gross profit margins sustained around ~8.3%, though net margin improved to ~3.4% due to foreign exchange gain. Financial risk profile of the Company is comprised of low equity, however, cashflows are sufficient and the working capital cycle is adequate. The operations of the Company are managed through internally generated cash flows and there is no plan to obtain short-term and long-term borrowing facilities in the future. The Company has availed non-funded facilities from financial institutions.

The ratings are dependent on the firm's ability to sustain its position amidst changing business environment and management's ability to run the operations of the Company optimally. With the upcoming growth in the firm's business & volumes; prudent financial discipline and implementation of a stringent control environment shall remain imperative.

Disclosure

| | |
|------------------------------|--|
| Name of Rated Entity | Rainbow Hosiery (Pvt.) Limited |
| Type of Relationship | Solicited |
| Purpose of the Rating | Entity Rating |
| Applicable Criteria | Methodology Corporate Rating(Jun-22),Methodology Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology Rating Modifiers(Jun-22) |
| Related Research | Sector Study Composite and Garments(Dec-22) |
| Rating Analysts | Sohail Ahmed Qureshi sohail.ahmed@pacra.com +92-42-35869504 |

Profile

Legal Structure Rainbow Hosiery Private Limited (“Rainbow Hosiery”, “the Company” or “RHPL”) was established in the year 1992. The company registered office is in sector-16b Malik Anwar Goth, and this office consists of four floors.

Background The company has been in operation for more than 30 years. Initially, the company was only involved in local dyeing for exporters. However, after 2010, the company expanded its operations and began exporting its products to several countries including Europe, Germany, US, UK, South Africa, and Australia. This expansion in the company's operations likely allowed for growth opportunities for the company.

Operations The company is involved in the home textile and garments section. Rainbow Hosiery is known for its high-quality products, innovative designs, and competitive pricing. The company has five textile manufacturing units, all are Fully equipped with high-tech and modern state-of-the-art machinery which makes the manufacturing process efficient and smooth. RHPL products in the garment section include sweatshirts, polo shirts, creepers, hooded jackets, and other high-end products. Their garments are made of cotton, blended, and mixed quality fabric that can be modified by size or color to our customers' demands. While in home textiles they deal with Jersey, terry, micro terry, micro interlock, and brushed terry.

Ownership

Ownership Structure Being a family-owned venture, all of the shareholdings are held by the Lodhia Family. Mr. Shahid Lodhia owns 32% ownership of the company and his wife Mrs. Maimona Lodhia holds 33.3% ownership of the company. The rest of the shares are split between Mr. Mohammad Lodhia (son of Mr. Shahid Lodhia) family.

Stability The ownership structure is expected to remain stable with clear representation on the governance side. The Company's operations are majorly met by Mr. Shahid Lodhia (CEO) He is associated with the company since its inception. He has diversified knowledge and expertise.

Business Acumen The sponsors have decades of textile experience. They comprise qualified and experienced professionals with a diversified range of skills.

Financial Strength Rainbow Hosiery is the primary business of the family. However, they don't have any strategic stake in other companies. The good financial profile of sponsors and willingness to support the business in terms of director loans adds strength to the Company's profile.

Governance

Board Structure The company has only two members on the board. Mr. Shahid Lodhia, the CEO of the company, and Mr. Mohammad Lodhia, the managing director of the company. Mr. Mohammad Lodhia is the son of Mr. Shahid Lodhia.

Members' Profile Mr. Shahid Lodhia is the Chief Executive Officer and possesses more than 30 years of business experience. All other members are professionally qualified with extensive professional experience and a diversified skill mix.

Board Effectiveness The Board met once in FY22 with the presence of all members and with representatives of committee members to discuss different matters of the company

Financial Transparency Clarkson Hyde Saud Ansari Chartered Accountants are the external auditors of the Company. Auditors are QCR-rated (till period Dec.21). They gave an unqualified opinion on the company's financial statements for the year ending June 2022.

Management

Organizational Structure The Company has established a well-defined management structure divided into functional departments with clear lines of responsibilities.

Management Team Mr. Syed Shamim Raza Zaidi is the Technical Director of the company. He is associated with the firm since its inception & holds an industrial experience of more than three decades. He is assisted by a qualified team. Mr. Adeel Qamar is a CFO with versatile experience. All other team members are professionals operating under the supervision of the senior management.

Effectiveness Rainbow Hosiery maintains adequate IT infrastructure and related controls by regularly presenting reports to senior management. There are committees in place for different matters of the company including not limited to Emergency Response Committees, Health & Safety Committee, Environment & Waste Management Committee, Work Council & Labor Committee, and Fire Drill & Fighting Committee, all the committees are head by independent committee member.

MIS The company is currently in process of introducing new locally built software G-Tech. This will provide reliable and valuable result that will improve decision making process and achieve goals more effectively.

Control Environment The company uses Microsoft Office (licensed) including Excel, Word, and Outlook for its functioning. The reports are presented regularly to the senior management including vendor payable reports (three months payable tenor), PDC reports (cashflow position and projections), aging reports (receivables), and job costing reports. Implementation of software ensures the timely availability of information for efficient decision-making. However, the absence of an internal audit function further creates room for improvement in the corporate management framework. The company has valid certifications from Organic Content Standard Certificate, Quality Registrar System Certificate, SANFOR KNIT Certificate, Sedex Certificate Services, Global Organic Standard Certificate, Made in Green Standard Certificate, Step by OEKO Tex Certificate, OEKO Tex Inspiring Confidence Certificate & listed in REX – Registered Exporter system GSP of the EU.

Business Risk

Industry Dynamics During 7MFY23, the textile exports were valued at \$10.08bln compared to \$10.93bln, reflecting an 8% decline YoY – the declining trend has been recorded in the last few months. The decline in exports is driven by attrition in the demand pattern of export avenues. The hike in cotton prices and low demand for yarn in international markets is also a challenge. The analysis of 5MFY23 reveals that among value-added items, bedwear has witnessed the largest decline of 19% (on a MoM basis), down to \$217 million. Knitwear remained on the downward path in October 2022 and declined by 10% to \$392 million. Among non-value-added items, cotton yarn has shown the largest decline of 35%. Moreover, a slowdown is expected in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries.

Relative Position Rainbow Hosiery has a good presence in the international market, with exports to countries such as United States, Canada, Netherlands, Germany, Poland, Denmark, and other European Countries The company has received numerous awards and accolades for its excellence in manufacturing and exporting. The company faces competition from peers in home textile and garment makers including Pakeeza Dyeing & Bleaching, Style Textiles (Pvt.) Limited and MNH Textile, are also export-oriented units focusing on value-added products, particularly garments, and home textiles.

Revenues Rainbow Hosiery Private Limited is involved in the export of home textiles and garments. During FY22, the company's top line increased to PKR 5.7bln (FY21: PKR 4bln) attributable to good demand and additional capacity launched. In FY22, the company's net profitability enhanced to PKR 201mln (FY21: PKR62mln)

Margins The Company's gross margin remained consistent at 8.3% in FY22 and FY21. The operating margins also displayed a rise and stood at 3.5% in FY22 (FY21: 1.5%) due to foreign exchange gain. The company booked a profit of PKR 201mln in FY22 (FY22: PKR 62mln) on the back of revenue growth.

Sustainability Rainbow Hosiery's management has provided forecasts that reflect their strategy and demonstrate the feasibility of their approach. The company intends to continue investing in capital expenditure to improve manufacturing efficiency and enhance its e-commerce capabilities, in order to cater to the growing online market. A well-defined roadmap for five years business plan is placed. They are also planning for the next five years, which indicates a focus on long-term planning and sustainability. The company is taking action to remain competitive and adapt to changing market conditions.

Financial Risk

Working Capital The Company's net working capital cycle is good and stood at 30 days during FY22. Due to frequent and significant cost escalations of yarn prices, the company decided to bulk buy and increased its inventory levels during HFY23, resultantly inventory days increased to 66 days from 37. However, trade payable days have reflected a declining trend (FY22:73 days, FY21:83 days).

Coverages The Company's free cashflows (FCFO) as of FY22 increased to PKR ~217mln (FY21:94mln) owing to the overall increase in sales of the company. Meanwhile, the Company's finance cost clocked at PKR 9mln as of FY22 (FY21: PKR 8mln).

Capitalization Rainbow Hosiery is a debt-free company. The company has more control over its finances, and business decisions and is considered self-reliant.



| RAINBOW HOSIERY PRIVATE LIMITED COMPOSITE & GARMENTS | Jun-22 12M | Jun-21 12M | Jun-20 12M |
|---|---------------|---------------|---------------|
|---|---------------|---------------|---------------|

A BALANCE SHEET

| | | | |
|--------------------------------|--------------|--------------|--------------|
| 1 Non-Current Assets | 269 | 322 | 281 |
| 2 Investments | - | - | - |
| 3 Related Party Exposure | - | - | - |
| 4 Current Assets | 2,943 | 1,485 | 1,071 |
| <i>a Inventories</i> | 1,499 | 875 | 632 |
| <i>b Trade Receivables</i> | 680 | 215 | 251 |
| 5 Total Assets | 3,212 | 1,807 | 1,353 |
| 6 Current Liabilities | 2,823 | 1,619 | 1,209 |
| <i>a Trade Payables</i> | 1,257 | 1,059 | 804 |
| 7 Borrowings | - | - | - |
| 8 Related Party Exposure | 4 | 4 | 21 |
| 9 Non-Current Liabilities | - | - | - |
| 10 Net Assets | 385 | 184 | 123 |
| 11 Shareholders' Equity | 385 | 184 | 123 |

B INCOME STATEMENT

| | | | |
|---|------------|------------|------------|
| 1 Sales | 5,790 | 4,087 | 3,339 |
| <i>a Cost of Good Sold</i> | (5,308) | (3,749) | (3,087) |
| 2 Gross Profit | 482 | 338 | 252 |
| <i>a Operating Expenses</i> | (272) | (204) | (182) |
| 3 Operating Profit | 210 | 134 | 70 |
| <i>a Non Operating Income or (Expense)</i> | 56 | (24) | 1 |
| 4 Profit or (Loss) before Interest and Tax | 266 | 110 | 71 |
| <i>a Total Finance Cost</i> | (9) | (8) | - |
| <i>b Taxation</i> | (57) | (40) | (21) |
| 6 Net Income Or (Loss) | 201 | 62 | 50 |

C CASH FLOW STATEMENT

| | | | |
|--|-----------|-------------|--------------|
| <i>a Free Cash Flows from Operations (FCFO)</i> | 217 | 94 | 72 |
| <i>b Net Cash from Operating Activities before Working Capital</i> | 217 | 94 | 72 |
| <i>c Changes in Working Capital</i> | (181) | 26 | 172 |
| 1 Net Cash provided by Operating Activities | 36 | 120 | 244 |
| 2 Net Cash (Used in) or Available From Investing Activities | 26 | (64) | (159) |
| 3 Net Cash (Used in) or Available From Financing Activities | 0 | (18) | (1) |
| 4 Net Cash generated or (Used) during the period | 63 | 39 | 84 |

D RATIO ANALYSIS

| | | | |
|---|-------|-------|-------|
| 1 Performance | | | |
| <i>a Sales Growth (for the period)</i> | 41.7% | 22.4% | 13.3% |
| <i>b Gross Profit Margin</i> | 8.3% | 8.3% | 7.5% |
| <i>c Net Profit Margin</i> | 3.5% | 1.5% | 1.5% |
| <i>d Cash Conversion Efficiency (FCFO adjusted for Working C</i> | 0.6% | 2.9% | 7.3% |
| <i>e Return on Equity [Net Profit Margin * Asset Turnover * (T</i> | 70.4% | 40.2% | 51.7% |
| 2 Working Capital Management | | | |
| <i>a Gross Working Capital (Average Days)</i> | 103 | 88 | 71 |
| <i>b Net Working Capital (Average Days)</i> | 30 | 5 | 7 |
| <i>c Current Ratio (Current Assets / Current Liabilities)</i> | 1.0 | 0.9 | 0.9 |
| 3 Coverages | | | |
| <i>a EBITDA / Finance Cost</i> | N/A | N/A | N/A |
| <i>b FCFO / Finance Cost+CMLTB+Excess STB</i> | N/A | 0.7 | 0.5 |
| <i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fi</i> | 0.0 | 1.5 | 2.2 |
| 4 Capital Structure | | | |
| <i>a Total Borrowings / (Total Borrowings+Shareholders' Equit</i> | 1.0% | 2.0% | 14.9% |
| <i>b Interest or Markup Payable (Days)</i> | N/A | N/A | N/A |
| <i>c Entity Average Borrowing Rate</i> | 0.0% | 0.0% | 0.0% |

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+ | 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 | |
| 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 | Very high credit risk. Substantial credit risk "CCC" Default is a real possibility. |
| CC | 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):
 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

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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

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(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 | 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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