The Pakistan Credit Rating Agency Limited

Rating Report

Fazal Cloth Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Sep-2024	A	A1	Stable	Maintain	-
07-Sep-2023	A	A1	Stable	Maintain	-
07-Sep-2022	A	A1	Stable	Upgrade	-
05-Nov-2021	A	A2	Stable	Upgrade	-
25-Jul-2021	A-	A2	Positive	Maintain	-
25-Jul-2020	A-	A2	Stable	Maintain	-
26-Jul-2019	A-	A2	Stable	Maintain	-
24-Jan-2019	A-	A2	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect the appreciable presence of Fazal Cloth Mills Limited (“FCML” or “the Company”) in the competitive textile landscape. FCML is the flagship Company of the Fazal Group - one of the oldest textile conglomerates in Pakistan. The Company has a vision to establish a vertically integrated textile business producing value-added products. FCML specializes in producing greige fabric and a variety of yarns which include; multi-count/multi-twist, double, zero-twist, Organic, Supima, Lycra, Giza and USA cotton yarns. The Company is equipped with state-of-the-art machinery in its spinning and weaving units, ensuring high-quality production and efficiency. During 9MFY24, the Company maintained its growth trajectory, and the topline reached PKR 72.09bln (9MFY23: PKR 56.60bln); 80.8% of the contribution was driven by local sales, while ~19.2% was parked in the export segment. China is FCML's prime export destination in terms of business volumes along with the USA, Portugal and others. In terms of segment-wise business contribution, spinning is the foremost segment contributing PKR 61.16bln in revenue generation and PKR 1.06bln in profitability followed by the weaving segment contributing PKR 10.92bln in sales during 9MFY24. The continuous BMR activities and capital investments for additional capacities in preceding years have enabled the Company to expand its business volumes and strengthen its market presence. The slight dilution in margins is primarily due to expensive raw material procurement to maintain the premium quality of the product. The availability of low energy tariffs from associate companies and installed ~10 Mega Watt solar as an alternate energy source has created a buffer in the cost of production. Further, the installation of a ~5.639 Mega Watt solar is in the process which would be financed through the conventional borrowings. The Company’s top clients and suppliers are well-established entities which strengthen the sustainability profile. The Company’s financial risk profile is considered moderate with stretched working capital management depicting the industry norm. The Company’s working capital requirements are met through short-term borrowings and internally generated cashflows. The management of FCML is mindful to optimize its leveraging and working capital cycle by devising a strategy specific to the timing of the cotton procurement. The Company has maintained a leveraged capital structure along with stable cashflows.

The ratings are dependent upon the sustainability of the profitability matrix while expanding business volumes. The improvement in coverages and stable generation of cashflows from core business remains critical. Adherence to the debt matrix at an optimal level is a prerequisite for assigned ratings.

Disclosure

Name of Rated Entity	Fazal Cloth Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Rating Modifiers(Apr-24),Methodology | Corporate Rating(Jul-24),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-24)
Related Research	Sector Study | Composite and Garments(Dec-23)
Rating Analysts	Tasveeb Idrees | Tasveeb.Idrees@pacra.com | +92-42-35869504

Profile

Legal Structure Fazal Cloth Mills Limited was incorporated in 1966 as a public limited company.

Background The Company is operating with eight spinning units (274,524 spindles, 8,820 open-end rotors, 1,752 MVS spindles/rotors, and 119 doubling machines) and a weaving unit (224 air jet looms). The Company has two gas-fired captive power generation plants, with a total capacity of 51MW and 7.2MW diesel-powered plants as a backup along with a renewable energy plant (11.53MW).

Operations Fazal Cloth is the flagship company of Fazal Group. The Company is engaged in the manufacturing and marketing of different varieties of yarn and greige fabric.

Ownership

Ownership Structure The Company's majority stakes are owned by Fazal Group and Fatima Group (44.6% each). The remaining shareholding vests with financial institutions (6.8%) and general public (4%). Herein "Group means members of the family without reference to any law of Pakistan"

Stability The considerable positions in the Company are held by Sheikh Naseem's family, where the third generation is gradually being inducted into the business. The Group has a holding company in place and the responsibilities are clearly defined among family members. However, the transfer of ownership to the next generation has not been documented yet.

Business Acumen The sponsoring groups possess seven decades of presence in the local textile industry, developing expertise over time. This has helped the Company to sustain through the volatility of the respective industry. Mr. Rehman Naseem is a textile veteran and he is well-known among his peers for his strong acumen in the textile industry.

Financial Strength The sponsors hold a prominent position in the country's corporate sector, with interests in textile, fertilizer, energy and trading. This portrays the strong financial muscle of the sponsors.

Governance

Board Structure The overall control of the board is vested with nine members, including the Chief Executive Officer (CEO). The board has an equal representation of executive directors, non-executive directors and independent directors.

Members' Profile Mr. Sheikh Naseem Ahmad – the Chairman – is a graduate and carries over five decades of experience in the textile industry. Moreover, the board members have vast knowledge and extensive experience in the textile value chain. The directors' expertise in the textile industry benefits the board in effective decision making.

Board Effectiveness Attendance of board members remained strong and meeting minutes were formally documented. Moreover, the Company's board has three committees, namely (i) Audit, (ii) Human Resource & Remuneration, and (iii) Strategic Planning Committee to assist the board on relevant matters. The Audit Committee, in addition to an independent Chairman, comprises members from the sponsoring family (non-executive directors).

Financial Transparency KPMG Taseer Hadi & Co. Chartered Accountants were the external auditors of the Company. They expressed an unqualified opinion on the Company's financial statements for the period ended June 30th, 2023. During the period under review, Shinewing Hameed Chaudhri & Co. Chartered Accountants have been appointed as external auditors of the Company.

Management

Organizational Structure The management control of the Company vests with the Fazal Group. The Company has six functional departments with a well-defined organizational structure and clear segregation of responsibilities.

Management Team Mr. Rehman Naseem – the CEO – is a Columbia University graduate and carries over two decades of experience in the textile sector. He is supported by a team of highly qualified and experienced professionals.

Effectiveness The Company has a three-member executive committee at the operational level and it is headed by the CFO, Mr. Muhammad Azam serving as the group's CFO. He brings with him an extensive experience of over two decades. Routine management issues are discussed in these meetings to proactively address and resolve financial and legal bottlenecks. Additionally, reports on pre-determined key indicators are prepared for the senior management for ad-hoc reviews.

MIS The Company is using fully integrated ERP software from Oracle Corporation upgraded to version R-12.2.7. Modules implemented are Payables, Receivables, Fixed Assets, Cash Management, General Ledger, Purchase, Inventory, Cost Management, Order Management, Human Resource, and Payroll.

Control Environment FCML is accredited with various international certifications for compliance. The Company is following the latest Quality Assurance Standards for yarn and fabric production. A few of the prominent certification includes ISO 9001, Lycra assured, Fair Trade, and Organic Exchange.

Business Risk

Industry Dynamics The country's textile exports reached USD 15.2bln during 11MFY24 compared to USD 14.7bln in the same corresponding period, indicating a modest growth of ~0.03% on a YoY basis. In value terms, the Composite & Garments segment had the highest contribution of USD 8.5bln, followed by Weaving segment at USD 5.7bln and Spinning segment at USD 0.9bln. This growth is primarily attributed to a surge in the exports of Cotton Yarn, Towels, Readymade garments, Bed wear and Made-up articles. However, the exports of Combed cotton, Knitwear, Cotton cloth and Tents, canvas & tarpaulins reflected a dip YoY. The global economic slowdown subdued the demand patterns and consumption trends in the international market. The factors affecting the textile industry are escalated energy tariffs and challenges in the procurement of raw materials on account of lower local cotton yield impacting the finished product margins. However, the gradual decline in the interest rates is anticipated to provide comfort to the local industry.

Relative Position FCML holds a considerable position in the respective industry with 274,524 spindles, 8,820 open-end rotors, 1,752 MVS spindles/rotors,119 doubling machines and 224 air jet looms.

Revenues The Company generates a major portion of its revenue from local sales. While the remaining portion is derived from the export sales. During 9MFY24, the local sales constituted ~66.7% of the topline recorded at PKR 53.8bln (9MFY23: PKR 50.6bln) up by 6.3% on a YoY basis. Despite a fall in demand, the export sales indicated a healthy growth of ~24% YoY clocking at PKR 13.8bln (9MFY23: PKR 11.1bln). Indirect sales comprise ~48.3% of the total exports. The Company majorly sells to China, America, Portugal, Italy, Bangladesh, Turkey, Colombia and others.

Margins During 9MFY24, the Company's gross margin inched down to 11.2% (9MFY23: 13.9%) on the back of the inflated cost of production. The operating margin stood at 9.8% (9MFY23: 12.5%). The dividend income provided a cushion to the net profitability. The finance cost increased manifold reported at PKR 6.6bln (9MFY23: PKR 3.1bln) due to higher interest rates. The Company's bottom line reflected a sizeable dilution and clocked at PKR 61mln (9MFY23: PKR 533mln). Hence, the Company's net profit margin stood at 0.1% (9MFY23: 0.9%).

Sustainability The Company has achieved operational efficiency through continuous expansion and BMR activities executed during the preceding years. The management is mindful of the escalated energy cost risk and it is in the process of implementation of ~5.639 Mega Watt Solar.

Financial Risk

Working Capital The Company meets its working capital requirements through short-term borrowings and internally generated cashflows. As of end-Mar24, the Company's net working capital cycle improved to 157 days (end-Jun23: 118 days) due to the optimization of the inventory days recorded at 118 days (end-Jun23: 137 days).

Coverages The free cash flows from operations (FCFO) illustrated a sizeable improvement clocking at PKR 10.9bln (end-Jun23: PKR 7.2bln). Despite this incline, the Company's interest coverage inched down to 1.7x (end-Jun23: 1.5x) attributable to higher working capital requirements.

Capitalization The Company has a moderately leveraged capital structure. The Company's gearing ratio inched down to 49.1% (end-Jun23: 50.5%) on the back of a decrease in total borrowings recorded at PKR 43.5bln (end-Jun23: PKR 45.6bln. The equity base stood at PKR 45.1bln (end-Jun23: PKR 44.6bln).

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Fazal Cloth Mills Limited Textile | Composite	Mar-24 9M	Jun-23 12M	Jun-22 12M	Jun-21 12M
A BALANCE SHEET				
1 Non-Current Assets	52,649	52,858	41,544	38,440
2 Investments	40	40	-	-
3 Related Party Exposure	6,824	6,142	7,716	6,105
4 Current Assets	46,048	48,734	38,283	22,578
a Inventories	*30,652*	*31,318*	*26,813*	*15,470*
b Trade Receivables	*11,007*	*11,369*	*7,268*	*4,738*
5 Total Assets	105,561	107,774	87,543	67,124
6 Current Liabilities	9,525	10,363	8,149	5,039
a Trade Payables	*799*	*976*	*3,399*	*2,211*
7 Borrowings	43,534	45,637	34,077	22,432
8 Related Party Exposure	0	0	-	-
9 Non-Current Liabilities	7,327	7,128	4,787	4,956
10 Net Assets	45,175	44,647	40,529	34,697
11 Shareholders' Equity	45,175	44,647	40,529	34,697
B INCOME STATEMENT				
1 Sales	72,089	77,697	65,406	52,132
a Cost of Good Sold	*(64,011)*	*(67,611)*	*(54,238)*	*(44,127)*
2 Gross Profit	8,078	10,086	11,168	8,005
a Operating Expenses	(987)	(1,113)	(1,113)	(776)
3 Operating Profit	7,091	8,973	10,055	7,229
a Non Operating Income or (Expense)	*537*	*(2,304)*	*(1,233)*	*128*
4 Profit or (Loss) before Interest and Tax	7,628	6,669	8,821	7,357
a Total Finance Cost	*(6,650)*	*(5,074)*	*(2,923)*	*(1,795)*
b Taxation	*(917)*	*(1,009)*	*(1,288)*	*(131)*
6 Net Income Or (Loss)	61	586	4,610	5,432
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*10,950*	*7,249*	*9,240*	*7,952*
b Net Cash from Operating Activities before Working Capital Changes	*4,637*	*2,667*	*6,338*	*5,950*
c Changes in Working Capital	*(1,165)*	*(8,718)*	*(12,445)*	*448*
1 Net Cash provided by Operating Activities	3,472	(6,052)	(6,107)	6,398
2 Net Cash (Used in) or Available From Investing Activities	(1,302)	(5,056)	(4,993)	(1,474)
3 Net Cash (Used in) or Available From Financing Activities	(2,111)	12,309	11,331	(5,066)
4 Net Cash generated or (Used) during the period	59	1,201	230	(143)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	23.7%	18.8%	25.5%	--
b Gross Profit Margin	11.2%	13.0%	17.1%	15.4%
c Net Profit Margin	0.1%	0.8%	7.0%	10.4%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	13.6%	-1.9%	-4.9%	16.1%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	0.2%	1.4%	12.3%	15.7%
2 Working Capital Management				
a Gross Working Capital (Average Days)	160	180	185	N/A
b Net Working Capital (Average Days)	157	170	170	18
c Current Ratio (Current Assets / Current Liabilities)	4.8	4.7	4.7	4.5
3 Coverages				
a EBITDA / Finance Cost	1.5	1.9	4.4	5.4
b FCFO / Finance Cost+CMLTB+Excess STB	1.2	0.9	1.6	1.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.3	8.5	2.9	2.6
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	49.1%	50.5%	45.7%	39.3%
b Interest or Markup Payable (Days)	73.6	95.1	74.3	65.1
c Entity Average Borrowing Rate	18.5%	12.8%	8.6%	7.5%

Credit Rating

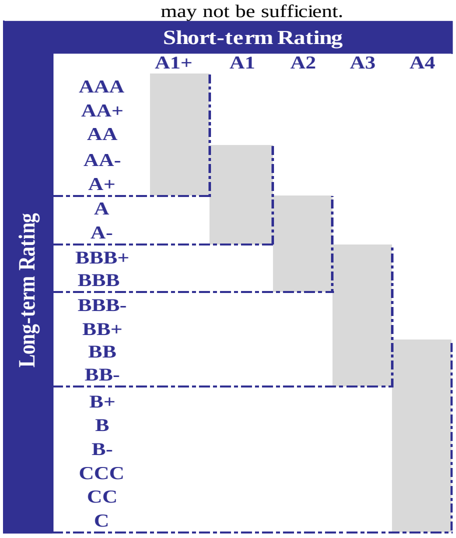
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 17-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument;| Chapter III | 17-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past; | Chapter III | 14-3(f)(vii)
Proprietary Information