



The Pakistan Credit Rating Agency Limited

Rating Report

Fazal Cloth Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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	-
24-Jul-2018	A-	A2	Stable	Maintain	-
22-Jan-2018	A-	A2	Stable	Maintain	-
29-Jun-2017	A-	A2	Stable	Maintain	-
08-Sep-2016	A-	A2	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

Fazal Cloth Mills Limited (Fazal Cloth) enjoys a strong business profile as a leading producer of yarn and cloth. The Company's large size yielding economies of scale, diverse customer base, and broad product portfolio in spinning & weaving segments provides a competitive advantage. In recent years, the Company has been able to capitalize on additional capacities thereby generating incremental volumes, mainly in spinning segment, eventually translating into improved margins and profitability. Moreover, Fazal Weaving Mills Limited (wholly owned subsidiary of Fazal Cloth) has been merged into its parent company Fazal Cloth Mills Limited, which has further strengthened the Company's positioning in the market. During FY21, Fazal Cloth generated revenue of PKR 52bln along with bottom-line of PKR 5.4bln. The Company enjoys strong equity base of PKR 34.7bln as at Jun-21. Meanwhile prices have also improved on both local and international fronts recently along with increased demand. The Company is expected to benefit from these improved industry dynamics. Fazal Cloth has a moderately leveraged capital structure and strong coverages. COVID-19 pandemic came with huge challenges and ramifications most of which have faded away with time and improved vaccination drives globally. Textile industry dynamics have rebounded with increased exports in many segments of the sector. This is expected to remain healthy in medium term. 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 ratings are dependent on the Company's ability to maintain strong business profile amidst current circumstances. Sustainability of relative position along with improved margins and profitability remain vital.

Disclosure

Name of Rated Entity	Fazal Cloth Mills 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 Composite(Nov-20)
Rating Analysts	Sehar Fatima sehar.fatima@pacra.com +92-42-35869504

Profile

Legal Structure Fazal Cloth Mills Limited (Fazal Cloth) was incorporated in 1966 as public limited company. Moreover, Fazal Weaving Mills Limited (wholly owned subsidiary of Fazal Cloth) has been merged into its parent company Fazal Cloth Mills Limited.

Background The Company operates with eight spinning units (252,564 spindles, 3,660 open-end rotors, 888 MVS spindles and 119 doubling machines) and a weaving unit (224 air jet looms). Fazal Cloth has two gas-fired captive power generation plants, with total capacity of 48MW along with a renewable energy plant (4MW).

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 griegie fabric.

Ownership

Ownership Structure The Company's majority stakes are owned by Fazal Group and Fatima Group (44.6% each). The remaining shareholding rests with financial institutions (~6.0%) and general public (~4.7%).

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 is not documented yet.

Business Acumen The sponsoring Groups have over seven decades of presence in Pakistan's textile industry, developing expertise over time. This has helped the Company to sustain through the volatility of textile industry. Mr. Rehman Naseem is a textile veteran and he is well known among his peers for strong acumen of textile, especially spinning.

Financial Strength The sponsors have a prominent position in Pakistan's corporate sector, with interests in textile, fertilizer, energy and trading. This portrays strong financial strength of the sponsors and provider of financial support to Fazal Cloth, if needed.

Governance

Board Structure The Company's board comprises nine members, including the Chief Executive Officer (CEO). The board includes 3 executive directors, 3 non-executive directors along with three independent directors. Representation of two families provides adequate challenge to operational decision.

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

Board Effectiveness Attendance of board members in meetings remains strong and meeting minutes were appropriately recorded. Moreover, the Company's board have two committees, namely (i) Audit, and (ii) Human Resource & Remuneration, to assist board on relevant matters. Audit Committee, in addition to an independent Chairman, comprises members from sponsoring family (non-executive directors).

Financial Transparency M/s. KPMG Taseer Hadi & Co., Chartered Accountants serves as external auditor for Fazal Cloth. They have expressed unqualified opinion and review report for FY21. Moreover, the Company has an internal audit department which reports directly to Mr. Rehman Naseem (CEO).

Management

Organizational Structure The management control of the Company vests with Fazal family. The Company has six functional departments with 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. Moreover, Fazal Cloth employs a team of experienced professionals which bodes well for the Company's sustainable growth.

Effectiveness The Company has formed three-member executive committee at operational level and it is headed by the CFO. 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 Fazal Cloth is accredited with various International certifications for compliance. The Company is following latest Quality Assurance Standards for yarn and fabric production. Few of the prominent certification includes ISO 9001, Lycra assured, Fair Trade and Organic exchange.

Business Risk

Industry Dynamics Textile exports of the country recorded an increase of 28.6% to stand at USD 2.9bln as compared to USD 2.3bln from July 21 to Aug21 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 Fazal Cloth is one of the largest composite textile unit in Pakistan, with significant spinning capacity, when compared to peers. Post-merger, the spinning capacity of Fazal Cloth will increase, in turn, will cause a healthy growth in revenue. At group level, Fazal Group has a considerable presence in local textile industry.

Revenues Revenues recorded a growth of ~51.5% YoY (FY21: PKR 52,132mln; FY20: PKR 34,416mln) mainly due to merger of the Company's subsidiary Fazal Weaving Mills Limited into Fazal Cloth accompanied with volumetric increase in the sales. During FY21, contribution of exports decreased comprising ~25% of the total revenues (FY20: ~33%). The sales mix depends upon prevailing demand and pricing, where the Company seeks the best mix to optimize revenue.

Margins During FY21, gross margin of the Company improved (FY21: 15.4%; FY20: 11.9%) on the back of better prices of yarn and fabric in both local and international market. This translated in to improved operating margin (FY21: 12.6%; FY20: 10.1%), Net margin experienced a sharp hike as well (FY21: 10.4%; FY20: 1.2%), as net income increased (FY21: PKR 5,432mln; FY20: PKR 401mln).

Sustainability Going forward, prevailing uncertainty in the dynamics of textile sector due to Covid-19 outbreak globally, slow pace of vaccination in the country, fluctuations in local and international demand is expected to affect the entire textile value chain. The Company continued its operations uninterrupted during the period FY21 as per the relaxation given by the authorities to export oriented entities. The Company has availed SBP's deferment of principal repayments of certain long-term loans and financing facilities for payment of salaries and loans.

Financial Risk

Working Capital In FY21 net working capital cycle shortened (FY21: 117 days; FY20: 161 days) mainly due to lower inventory days (FY21: 96 days FY20: 121 days). Increased inventory levels augmented the trade assets (FY21: PKR 20,971mln; FY20: PKR 17,287mln), resulting in significantly larger room-to-borrow (FY21: PKR 12,602mln; FY20: PKR 6,401mln). The increase in trade assets led to increased ST trade leverage adequacy (FY21: 60%; FY20: 37%).

Coverages During FY21, the Company built up its free cash flows (FY21: PKR 7,951mln; FY20: PKR 4,590mln) on the back of improved profitability. Lower finance cost (FY21: PKR 1,795mln; FY20: PKR 2,558mln) led to a growth in interest coverage (FY21: 4.7x; FY20: 1.9x). Debt coverage also slightly improved (FY21: 1.5x; FY20: 1.4x) on the back of significantly increased equity (FY21: PKR 34,697mln; FY20: PKR 20,842mln).

Capitalization In FY21, the leverage of the Company decreased (FY21: ~39%; FY20: ~53%) on the back of significantly higher equity (FY21: PKR 34,697mln; FY20: PKR 20,842mln). Out of the total debt, ST borrowing constitutes ~27%.



Fazal Cloth Mills Limited Composite	Jun-21 12M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET				
1 Non-Current Assets	38,440	25,137	24,024	22,356
2 Investments	-	-	-	-
3 Related Party Exposure	6,105	7,959	6,985	5,717
4 Current Assets	22,578	18,569	18,667	15,119
<i>a Inventories</i>	15,470	11,844	10,942	8,124
<i>b Trade Receivables</i>	4,738	4,827	5,432	4,842
5 Total Assets	67,124	51,665	49,676	43,192
6 Current Liabilities	5,039	3,787	3,746	2,772
<i>a Trade Payables</i>	2,211	1,363	1,411	689
7 Borrowings	22,432	23,643	21,723	17,884
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	4,956	3,392	3,278	2,521
10 Net Assets	34,697	20,842	20,930	20,015
11 Shareholders' Equity	34,697	20,842	20,930	20,015
B INCOME STATEMENT				
1 Sales	52,132	34,416	36,341	31,288
<i>a Cost of Good Sold</i>	(44,127)	(30,315)	(31,999)	(28,553)
2 Gross Profit	8,005	4,101	4,342	2,735
<i>a Operating Expenses</i>	(1,462)	(631)	(541)	(564)
3 Operating Profit	6,543	3,470	3,801	2,171
<i>a Non Operating Income or (Expense)</i>	814	51	457	414
4 Profit or (Loss) before Interest and Tax	7,357	3,521	4,258	2,585
<i>a Total Finance Cost</i>	(1,795)	(2,558)	(1,894)	(1,144)
<i>b Taxation</i>	(131)	(562)	(849)	(228)
6 Net Income Or (Loss)	5,432	401	1,516	1,214
C CASH FLOW STATEMENT				
<i>a Free Cash Flows from Operations (FCFO)</i>	7,952	4,590	5,020	3,226
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	5,950	2,087	3,225	2,180
<i>c Changes in Working Capital</i>	448	(1,009)	(3,226)	(1,464)
1 Net Cash provided by Operating Activities	6,398	1,078	(2)	716
2 Net Cash (Used in) or Available From Investing Activities	(1,474)	(2,534)	(3,493)	(2,280)
3 Net Cash (Used in) or Available From Financing Activities	(5,066)	1,545	3,587	1,515
4 Net Cash generated or (Used) during the period	(143)	89	93	(48)
D RATIO ANALYSIS				
1 Performance				
<i>a Sales Growth (for the period)</i>	51.5%	-5.3%	16.1%	17.8%
<i>b Gross Profit Margin</i>	15.4%	11.9%	11.9%	8.7%
<i>c Net Profit Margin</i>	10.4%	1.2%	4.2%	3.9%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	16.1%	10.4%	4.9%	5.6%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/STB)]</i>	17.7%	2.0%	7.7%	6.6%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	129	175	147	159
<i>b Net Working Capital (Average Days)</i>	117	161	137	153
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	4.5	4.9	5.0	5.5
3 Coverages				
<i>a EBITDA / Finance Cost</i>	5.4	1.8	3.1	3.4
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.5	1.4	1.3	1.1
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	2.6	6.8	3.7	4.6
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	39.3%	53.1%	50.9%	47.2%
<i>b Interest or Markup Payable (Days)</i>	65.1	66.8	82.4	95.0
<i>c Entity Average Borrowing Rate</i>	6.9%	10.4%	9.0%	6.0%

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+	
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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- 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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- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (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)
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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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