



The Pakistan Credit Rating Agency Limited

## FAZAL CLOTH MILLS LIMITED

	NEW [SEP-16]	PREVIOUS [OCT-15]
<b>Entity</b>		
Long Term	A-	A-
Short Term	A2	A2
<b>Outlook</b>	Stable	Stable

REPORT CONTENTS
1. RATING ANALYSES
2. FINANCIAL INFORMATION
3. RATING SCALE
4. REGULATORY AND SUPPLEMENTARY DISCLOSURE

SEPTEMBER 2016

**Profile & Ownership**

- Fazal Cloth, a listed concern incorporated in 1966, is engaged in the manufacturing and marketing of yarn and fabric. The company operates with 190,392 spindles, 224 air jet looms, and 2,220 open-end rotors
- Majority owned by Fazal Group and Fatima Group (~45% each)

**Governance & Management**

- The BoD comprises seven members with equal representation from both the shareholding groups, along with an independent director
- Representation of two families provides adequate challenge to management decisions
- Management control vests with Fazal Group. Involvement of Sheikh Naseem – the CEO, is limited as Mr. Rehman Naseem – the Chairman – primarily manages the company’s affairs
- Management team comprises long associated and experienced individuals

**Operational Risk**

- Sound operational infrastructure
- Deploys oracle based ERP; comprehensive MIS reporting
- International certifications; few prominent certification includes ISO 9001, Lycra assured, Fair Trade and Organic exchange
- Captive power generation (~47MW) to meet energy requirements (~30MW)

**Performance**

- Topline pre-dominated by spinning sales; revenues tilted towards local sales. Top ten customers’ revenue concentration is considered moderate
- During FY15, revenues increased by ~7% on YoY basis – a factor of higher sales volume in both spinning and weaving segment. Margins slightly declined owing to inventory losses
- Dividend income declined significantly. Profit before taxation reduced
- During 9MFY16, topline declined by 19% on YoY basis; attributable to i) dip in sales volume and selling price in spinning segment, and ii) decline in sale price in weaving segment
- Increase in operating expenses further dampened the earnings as reflected from declining margins
- The company received dividend income of PKR 192mln (9MFY15: nil). Moreover, despite reduction in interest expense profit before taxation declined (~15% YoY) – a factor of declining operational performance
- Investment book, constituting ~35% of its equity base at end-Mar16, comprises equity investments and interest bearing debt to group companies
- Fazal Cloth plans to diversify into value-added segment by setting up dyeing and finishing plant (capacity: 2.5mln meters per month). However, expansion is contingent on improvement in the company’s performance
- Going forward, margins are expected to improve on account of better expected industry fundamentals i.e crop size and continued RLNG supply

**Financial Risk**

- Working capital requirements, a function of its receivables and inventory, are met through a mix of internal generation and short term borrowings
- Inventory and receivables as a percentage of sales increased. Resultantly, net working capital days increased (9MFY16: 135days, 9MFY15: 125days)
- Weak debt coverage (end-Mar16: 0.8x, end-Mar15: 0.9x)
- Cushion in short term lines
- Leveraged capital structure (end-Mar16; ~45%; without revaluation surplus: ~63%)
- Fazal Cloth has provided unconditional and irrevocable corporate debt guarantee on all long term loans of its subsidiary – Fazal Weaving. Incorporating subsidiary’s financial liabilities, the financial risk profile largely remain intact

**RATING RATIONALE**

The ratings reflect established business profile emanating from sizeable revenue base and adequate margins. This has helped the entity to sustain its position despite suppressed textile dynamics exerting pressure on prices. With focused marketing efforts, the company has been able to capitalize on additional capacities thereby generating incremental volumes, mainly in spinning segment. Going forward, the management expects improved margins on account of (i) saving in power cost given regular supply of RLNG to industry players, and (ii) better production forecast of cotton crop in FY17. The management is contemplating a gradual entry into value-added segment - dyeing and finishing; once implemented, the decision is likely to further strengthen business risk profile of the entity. Fazal Cloth's financial risk assessment encompasses irrevocable and unconditional inter-corporate debt guarantee provided to wholly owned subsidiary - Fazal Weaving Mills Limited - with fall back on Fazal Cloth's cash flows. Nevertheless, overall financial profile is considered adequate. Although coverages are low, the company's designed financial strategy keeps sizeable cushion in short-term borrowing lines to meet shortfalls in operational cash flows in servicing debt obligations; this provides flexibility in management of financial affairs.

**KEY RATING DRIVERS**

The ratings are dependent on the company's ability to sustain margins. Meanwhile, management of debt (current and planned), thereby impacting coverages, is considered important. Envisaged improvement in business and financial profile along with effective changes in governance framework would be rating positive.



**Fazal Cloth Mills Limited**

**BALANCE SHEET**

	31-Mar-16	30-Jun-15	30-Jun-14	30-Jun-13
	9MFY16	Annual	Annual	Annual
<b>Non-Current Assets</b>	<b>16,999</b>	<b>17,489</b>	<b>13,557</b>	<b>12,294</b>
<b>Investments (Incl. associates)</b>	<b>5,393</b>	<b>5,546</b>	<b>3,057</b>	<b>2,258</b>
Equity	4,064	4,653	2,557	2,258
Debt	1,329	894	500	
<b>Current Assets</b>	<b>10,073</b>	<b>9,670</b>	<b>10,735</b>	<b>8,851</b>
Inventories	5,663	4,446	5,363	5,929
Trade Receivables	3,085	3,805	2,885	1,996
Others	1,325	1,419	2,487	927
<b>Total Assets</b>	<b>32,464</b>	<b>32,705</b>	<b>27,349</b>	<b>23,402</b>
<b>Debt</b>	<b>12,629</b>	<b>12,912</b>	<b>12,954</b>	<b>9,942</b>
Short-term	4,684	5,742	5,636	4,337
Long-term (Incl. Current Maturity of long-term debt)	7,945	7,171	7,318	5,605
Other shortterm liabilities	2,341	2,112	1,988	1,852
Other Longterm Liabilities	2,181	2,163	1,532	1,811
<b>Shareholder's Equity</b>	<b>15,314</b>	<b>15,518</b>	<b>10,875</b>	<b>9,798</b>
<b>Total Liabilities &amp; Equity</b>	<b>32,464</b>	<b>32,705</b>	<b>27,349</b>	<b>23,402</b>

**INCOME STATEMENT**

<b>Turnover</b>	<b>15,624</b>	<b>25,419</b>	<b>23,780</b>	<b>20,559</b>
Gross Profit	1,323	2,409	2,420	2,890
Other Income (net of other expenses)	222	91	192	102
Financial Charges	(709)	(1,275)	(1,282)	(1,059)
<b>Net Income</b>	<b>310</b>	<b>511</b>	<b>878</b>	<b>1,180</b>

**Cashflow Statement**

Free Cashflow from Operations (FCFO)	1,589	2,352	2,111	2,629
Net Cash changes in Working Capital	(898)	(92)	(1,163)	(1,466)
Net Cash from Operating Activities	223	1,172	(289)	248
Net Cash from Investing Activities	241	(1,232)	(2,357)	(1,792)
Net Cash from Financing Activities	(433)	(116)	2,837	1,628

**Ratio Analysis**

**Performance**

Turnover Growth	-19.0%	6.9%	15.7%	4.1%
Gross Margin	8.5%	9.5%	10.2%	14.1%
Net Margin	2.0%	2.0%	3.7%	5.7%
ROE	2.8%	3.6%	8.7%	13.1%

**Coverages**

Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.8	0.9	0.9	1.4
Interest Coverage (x) (FCFO/Gross Interest)	2.2	1.8	1.6	2.5
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) /FCFO - Gross Interest)	6.8	6.7	8.8	3.6

**Liquidity**

Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	135	124	134	126
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**Capital Structure (Total Debt/Total Debt+Equity)**

	45%	45%	54%	50%
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## STANDARD RATING SCALE & DEFINITIONS

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 RATINGS		SHORT TERM RATINGS
<b>AAA</b>  <b>AA+</b> <b>AA</b> <b>AA-</b>  <b>A+</b> <b>A</b> <b>A-</b>	<p><b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.</p> <p><b>Very high credit quality.</b> 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.</p> <p><b>High credit quality.</b> 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.</p>	<p><b>A1+:</b> The highest capacity for timely repayment.</p> <p><b>A1:</b> A strong capacity for timely repayment.</p> <p><b>A2:</b> A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>A3:</b> An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>B:</b> The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>C:</b> An inadequate capacity to ensure timely repayment.</p>
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<p><b>Good credit quality.</b> 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.</p>	
<b>BB+</b> <b>BB</b> <b>BB-</b>	<p><b>Speculative.</b> Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.</p>	
<b>B+</b> <b>B</b> <b>B-</b>	<p><b>Highly speculative.</b> Significant 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.</p>	
<b>CCC</b> <b>CC</b> <b>C</b>	<p><b>High default risk.</b> 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.</p>	
<b>D</b>	<p>Obligations are currently in default.</p>	

<p><b>Rating Watch</b> Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved with in foreseeable future, but may continue if underlying circumstances are not settled.</p>	<p><b>Outlook (Stable, Positive, Negative, Developing)</b> 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’.</p>	<p><b>Suspension</b> 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.</p>	<p><b>Withdrawn</b> A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.</p>
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**Name of Rated Entity**  
**Sector**  
**Type of Relationship**  
**Purpose of the Rating**

Fazal Cloth Mills Ltd  
 Textile  
 Solicited  
 Independent Risk Assessment

**Rating History**

Dissemination Date	Long Term	Short Term	Outlook	Action
7-Sep-16	A-	A2	Stable	Maintain
09-Oct-15	A-	A2	Stable	Maintain
10-Oct-14	A-	A2	Stable	Maintain
22-Oct-13	A-	A2	Stable	Maintain
19-Nov-12	A-	A2	Positive	Maintain

**Related Criteria and Research**

Rating Methodology  
 Sector Research

Corporate Rating Methodology  
 Textile Sector - Viewpoint | Sep-15

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[Rating Team Statement](#)

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