RATING REPORT

Rajby Textiles (Private) Limited

REPORT DATE:
February 21, 2020

RATING ANALYSTS:
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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-1	A-	A-1
Rating Date	*Feb 21, 2020*		*Dec 26, 2018*	
Rating Outlook	Stable		Stable	
Outlook Date	*Feb 21, 2020*		*Dec 26, 2018*	

COMPANY INFORMATION

Incorporated in 2014	**External auditors:** M/s Muniff Ziauddin & Co, Chartered Accountants
Private Limited Company	**Chairman:** Mr. Saleem Sultan
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Nafees Sultan
Mr. Saleem Sultan – 50.0% Mr. Nafees Sultan – 50.0%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (April, 2019) https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Rajby Textiles (Private) Limited

OVERVIEW OF THE INSTITUTION

Rajby Textiles (Private) Limited (RTPL) is a private limited company incorporated on December 29, 2014 to takeover business operations of Rajby Textiles; an Associations of Persons (AOP) set up in February 2005.

Shareholding of RTPL is split between two brothers, namely Mr. Saleem Sultan (Director) and Mr. Nafees Sultan (Chief Executive Officer) who are also the owners of Rajby Industries (RI) under the umbrella of Rajby Group.

RATING RATIONALE

Rajby Textiles (Private) Limited (RTPL) is a part of Rajby Group, which has extensive experience in the textile sector (over 4 decades) and has been operating in the denim manufacturing business since 1988. The group operates through two different companies Rajby Industries (RI) (involved in manufacturing of denim garments) and Rajby Textiles (Private) Limited (RTPL) (involved in manufacturing of denim fabric).

Operations

RTPL has an installed capacity of 3.2m meters per month. No change was witnessed in the installed capacity in FY19 vis-à-vis the preceding year. However, higher actual production due to increased demand resulted in higher capacity utilization (FY19: 90%; FY18: 89%). Going forward, the management has plans to set up a spinning unit in two phases which will allow the operations of the group to become vertically integrated. First phase of the proposed expansion in the spinning segment will cater to around 40% of the total internal existing yarn requirement, while the second phase will cater to another 40%. However, this expansion plan is currently on hold and timeline for execution of the same is dependent on demand outlook and orders in hand. Power requirement of the plant is being met through a combination of gas and diesel generators. Adequate back-up arrangements are also in place.

Key Rating Drivers

Demand outlook is favorable but competitive pressures due to induction of additional capacities are expected to keep margins in check

Business risk profile of the company is supported by stable and growing demand for denim products. The global denim market was valued at approximately 13.1b USD in 2018 and is expected to reach 16.2b USD by end-2025, depicting a CAGR of 3.1% during 2019-2025[1]. Moreover, pressure on global cotton production, a key raw material, has also allowed the market players to pass on the increase in cotton prices to the end consumers, thereby resulting in upward trend in prices. However, the market has witnessed induction of many new players over the past few years, while existing market players have also expanded their capacities both locally and internationally. Further capacities are expected to come online over the next few years, which are expected to keep margins of existing players in check.

RTPL's operations are currently concentrated with exposure to the denim industry which might significantly impact business risk profile in case of change in demand patterns or any other industry specific factors. Therefore, continuous focus on research and development is considered important from growth perspective. VIS expects demand for denim products to remain stable over the medium term. Favorable policies & incentives of the government on enhancing exports and ongoing diversification efforts of major international brands to reduce geographic concentration are expected to bode well for the denim industry.

Healthy growth witnessed in topline on account of higher average selling prices

Net sales of the company increased to Rs. 9.6b (FY18: Rs. 7.9b) in FY19, thereby depicting growth of 21.5%. Growth in sales was a function of increase in average selling prices as volumes sold were reported lower vis-à-vis the preceding year. Revenues are a mix of exports and local sales. Given increased marketing efforts and focus towards enhancing exports, proportion of export sales in total sales rose to 40% (FY17: 37%) during FY19. Turkey and Bangladesh continue to remain the largest

[1] http://www.digitaljournal.com/pr/3816001

export markets for the company. Associate concern, RI, constitutes the largest proportion (66%) of total local sales. With considerable orders in hand and anticipated increase in average selling prices on account of increase in raw material prices, management expects to post double digit growth in net sales in FY20.

Rupee devaluation contributed to improvement in profitability profile

Gross Margin (GM) registered increase to 12.2% (FY18: 11.4%), primarily on account of increase in average selling prices due to currency devaluation. Margins were supported by export rebate and drawback of local taxes and levies; albeit the quantum of drawback of local taxes and levies was lower vis-à-vis the preceding year. Higher finance costs as a result of increase in utilization of borrowings and incurrence of tax expense due to expiration of tax credit tempered the increase in net margins. Going forward, the management expects gross margins to remain at existing levels as sales and costs are expected to move in tandem. Net margins may witness slight decrease due to higher finance costs and taxation expense.

Working capital cycle has increased during the outgoing year but overall liquidity profile is manageable

With improvement in profitability profile, fund flow from operations (FFO) was also reported higher. However, the company has an extended working capital cycle with time to taken to convert inventory into cash being higher than time required for payment to trade creditors. Working capital cycle of the company further increased during the outgoing year necessitating higher utilization of short term borrowing. Resultantly, FFO to total debt decreased to 18.1% (FY18: 19.5%). Debt servicing cushion also declined as DSCR ratio was reported lower at 2.73x (FY18: 3.33x) but overall debt servicing ability is considered adequate. Sizeable receivables from related party continue to act as a constraint on the company's liquidity profile. Improvement in Days Receivables Outstanding from RI will augment liquidity profile of RTPL.

Capitalization indicators are considered sound

Equity base strengthened during FY19 on account of profit retention; however, this increase was subdued due to repayment of sponsor loan. Given significant increase in short term borrowings to fund higher trade debts, gearing and leverage indicators trended upwards to 1.49x (FY18: 1.14x) and 1.84x (FY17: 1.44x) at end-FY19. Reliance on short term borrowings is expected to continue in future as sizeable sales revenue is generated from RI, which has an extended repayment period. Maintaining leverage indicators within benchmarks for the assigned ratings is considered important.

Corporate Governance depicts room for improvement

Ratings of RTPL are constrained by the current governance structure where authority is concentrated with two family members. The same can be strengthened through improvement in board composition and oversight. Management team includes seasoned professionals. External auditors of the company lie in Category 'A' on the SBP Panel of Auditors.

FINANCIAL SUMMARY *(amounts in PKR millions)* Appendix I

BALANCE SHEET	FY17	FY18	FY19
Paid Up Capital	500	500	500
Total Equity	3,254	3,600	3,687
INCOME STATEMENT			
Net Sales	4,735	7,904	9,607
Profit Before Tax	352	411	566
Profit After Tax	352	411	520
RATIO ANALYSIS			
FFO	551	799	962
Gearing (x)	1.05	1.14	1.44
Current Ratio (x)	1.12	1.21	1.17

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Rajby Textiles (Private) Limited
Sector	Textiles
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
February 21, 2020	A-	A-1	Stable	Reaffirmed
December 26, 2018	A-	A-1	Stable	Reaffirmed
December 29, 2017	A-	A-1	Stable	Reaffirmed
October 27, 2016	A-	A-1	Stable	Initial

Due Diligence Meetings Conducted

	Name	Designation	Date
1.	Mr. Zubair Kazi	CFO	January 29, 2020