RATING REPORT

Rajby Textiles (Private) Limited

REPORT DATE:
June 03, 2021

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-1	A-	A-1
Rating Date	*June 03, 2021*		*April 24, 2020*	
Rating Outlook	Stable		Rating Watch - Developing	
Outlook Date	*June 03 , 2021*		*Feb 21, 2020*	

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).

Sector Update

- Textile exports comprised 57.1% of Pakistan's total exports as reported in FY20. Following a dip in overall exports of the country, which dropped by 7% in FY20, textile exports also fell by 6% in USD terms.
- The contraction in exports can partly be attributed to significant currency depreciation, with average effective rate for USD being 16% higher in FY20 vis-à-vis FY19.
- Furthermore, some of the contraction emanated from the slowdown in orders in the latter half of FY20, owing to the novel coronavirus outbreak and the ensuing lockdowns across the globe. As a result, textile exports depicted contraction, in quantitative terms, in all categories, except two.
- In the ongoing fiscal year, textile exports have started to post recovery. Even though exports remained sluggish in USD terms, at least in Q1'FY21, the recovery has particularly started to materialize in Q2'FY21, when export proceeds were 4% higher than SPLY.
- During 8M'FY21, the overall exports of textile (in terms of USD) remain intact as compared to last year with a marginal drop of 1% Y/Y.
- The top advancers categories during 8M'FY21 were Tents canvas & tarpaulin (↑47%), Towels (↑14%), Bed wear (↑9%) and other materials (↑6%).
- On the other hand, mainly cotton related products dented the overall textile contribution as 8M'FY21 top decliners include Raw cotton (↓91%), Cotton carded or combed (↓76%), Other yarns (↓44%) and Cotton yarn (↓35%).
- Interviews conducted with senior management of leading textile corporates are indicative of a strong order book in the upcoming period. However, the third wave ensuing lockdown mostly in Europe countries could restrict the textile exports in the on-going period while there is also a prevailing risk of a slower than expected recovery in consumer indices of North America & Europe.

	FY19	FY20	Q1'FY20	Q1'FY21	Q2'FY20	Q2'FY21	8M'FY20	8M'FY21
PAKISTAN EXPORTS (IN USD' MILLIONS)	24,257	22,505	5,832	5,255	6,102	6,160	16,439	16,066
TEXTILE (IN USD' MILLIONS)	13,659	12,851	3,411	3,070	3,408	3,550	9,100	9,007
PKR/USD RATE (AVERAGE)	136.3	158.2	124.4	166.9	134.3	160.8	156.2	161.9
SOURCE: SBP								

Operational Update - RTPL

- RTPL has an installed capacity of 36mn meters per year. No change was witnessed in the installed capacity during the period under review.
- Production has declined during the year FY20, mainly in Q4, due to the pandemic-induced lockdown.
- Resultantly, capacity utilization dropped to 66% during the year FY20 (FY19: 90%, FY18: 89%).
- During 9M'FY21, as demand picked up, production and capacity utilization depicted

improvement while volumetric sales stands at 85% of the total capacity during 9M'FY21.

- In view of the pandemic-induced demand volatility in exports to major markets i.e. EU & North America, capacity expansion plans have been put on hold for the time being.
- Topline & Profitability Margins have come under pressure during the period under review; Going forward, while Q4'FY21 will certainly be better than SPLY, the margins are expected to remain under pressure.
- Overall sales of RTPL declined by 7% YoY in FY20 mainly driven by the decline of 40% in exports volume. Although, in volumetric terms, local sales also declined by 7%, higher pricing in the local market translated in increase of 11% during FY20.

Exports vs Local Sales (%)	FY18	FY19	FY20
Direct Exports	37%	40%	32%
Local	63%	60%	68%

- In H1'FY21, the topline did depict slight improvement. By Mar'21, the company's topline stood at Rs. 8b and the management forecasts FY21 topline to come in at Rs. 10.5b.
- Gross margin, after experiencing a dip in FY20, has depicted improvement in the ongoing year. However, exogenous factors, such as the increase in cotton prices, appreciation in PKR and general inflation-driven increase in cost of doing business is expected to weigh on the company's gross margin during the short term horizon.

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Local Cotton Prices	FY18	FY19	FY20	8M'FY21
Per Maund (Rs.)	6,953	8,770	8,860	9,643
% Change	↑6%	↑26%	↑1%	↑9%

**Prices based on daily average*

- Major risk arises from the local cotton production and its prices. In 7M'FY21, domestic cotton production came at 5.57mn bales vis-à-vis 8.48mn bales in SPLY, i.e. 34% lower (down by 27.4% Y/Y in CY20). This declining cotton production is increasing the local prices while also posing heavy reliance on imported cotton.
- Gross margin of RTPL decline to 10.6% (FY19: 12.25%) owing to higher manufacturing cost and increased prices of yarn. Amid growth in topline, gross margin stood at 11.5% in 1HFY21.
- Although, RTPL has efficiently controlled administrative and distribution expenses during FY20, lower other income on account of minor exchange gain, increased finance cost due to higher interest rates and higher effective tax rate trimmed down the net margin to 0.9% (FY19: 5.4%).
- In the upcoming year, we expect net margins to rebound but to stay marginally lower than FY19 levels on the back of high raw material cost, inflationary pressures and low other income (due to stable USD/PKR).

Key Rating Drivers

RTPL's topline and margin has fallen slightly below the peer median

- RTPL's topline & gross margin stands slightly lower than the median of similar rated companies during the period under review.
- Client concentration remained on the higher side in both exports and local sales. Top 10 clients contributed 68% and 90% of the export and local volumetric sales. (FY19: Export, Local: 78%, 89%).
- Furthermore, at present, geographical concentration is also a concern, given an overreliance

on EU region. Accordingly, specific resource has been hired to diversify the sales mix and increase sales in the US.

- With denim players across the sector experiencing low demand dynamics and a raw material & exchange appreciation driven squeeze on margins, profitability outlook is depressed.

Capitalization indicators are considered manageable

- During FY20, the overall debt of the company declined by Rs. 1.6bn, coupled with a drop of Rs.263mn in loan from directors (taken as equity in VIS calculation). The drop is in tandem with the lower capacity utilization driven decrease in working capital requirement.
- As a result, leverage and gearing ratio of RTPL displayed a minor drop to 1.59x and 1.13x as at FY20. (FY19: 1.84, 1.44x)
- As demand picked up in H1'FY21, short term debt level rose back to FY19 level. This has also increased the gearing and leverage of RTPL to the same levels as of FY19.
- However, as of Dec'20, gearing & leverage were roughly aligned with the peer median.

Balance Sheet (Extract)	FY18	FY19	FY20	1HFY21
Total Equity (Inc. loan from directors)	2,778	3,083	2,916	3,056
Gearing (x)	*1.47*	*1.73*	*1.26*	*1.67*
Leverage (x)	*1.93*	*2.19*	*1.78*	*2.19*

Cash conversion cycle has increased with liquidity indicators effected during FY20, but remained above manageable levels

- In line with the contraction in topline and squeeze on margins, cash flow coverage indicators have come under stress, as illustrated in the table below.

Liquidity Analysis	FY18	FY19	FY20	H1'FY21
FFO (Mn.)	799	962	541	875*
Current Ratio (x)	1.21	1.17	1.19	1.17
Working Capital Cycle (days)	98	120	128	116

- Working capital cycle of the company has increased in FY20 mainly due to Days Inventory Outstanding (DIO) while the company has tried to manage the same by increasing Days Payable Outstanding (DPO). WCC has witnessed an improvement during H1'FY21 on the back of a decrease in DIO as resumption of ports activities after COVID-19 lockdown resulted higher shipments.
- Based on the improved sales performance in H1'FY21, the cash flow coverage indicators have depicted improvement and specifically FFO coverage of debt is aligned with the peers. However the DSCR has been on a declining trend over the years and with the expected pressure on margins, maintenance of DSCR is a concern.
- On the other hand, the company has maintained its historically high current ratio at ~1.2x.

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.

Rajby Textile **Appendix I**

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	**Jun'17**	**Jun'18**	**Jun'19**	**Jun'20**	**Dec'20**
Paid Up Capital	500	500	500	500	500
Total Equity	2,402	2,778	3,083	2,916	3,056
INCOME STATEMENT	**FY17**	**FY18**	**FY19**	**FY20**	**H1'FY21**
Net Sales	4,735	7,904	9,607	8,940	5,306
Profit Before Tax	352	411	566	161	269
Profit After Tax	352	411	520	85	216
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**	**FY20**	**H1'FY21**
FFO	551	799	962	541	438
Gearing	1.42	1.47	1.73	`1.26	1.67
Current Ratio (x)	1.12	1.21	1.17	1.19	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
Rating History	see table below
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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Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
June 03, 2021	A-	A-1	Stable	Reaffirmed
April 24, 2020	A-	A-1	Rating Watch - Developing	Maintained
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	12th April, 2021