RATING REPORT

H.A Fibres (Pvt.) Limited (HAFL)

REPORT DATE:
April 24, 2020

RATING ANALYSTS:

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RATING DETAILS				
	Latest Rating		Initial Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A-	A-2
Rating Outlook	Rating Watch – Developing		Stable	
Rating Action	Maintained		Initial	
Rating Date	*24th April 2020*		*3rd April 2019*	

COMPANY INFORMATION	
Incorporated in May 2006	**External auditors:** EY Ford Rhodes – Chartered Accountants
Private Limited Company	**Chairperson of the Board:** Mrs. Sabeena Husnain
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mrs. Sabeena Husnain
Mrs. Sabeena Husnain – 100%	

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria: Corporates (May 2019)

https://www.vis.com.pk/kc-meth.aspx

H.A Fibres (Pvt.) Limited (HAFL)

OVERVIEW OF THE INSTITUTION

H.A Fibres (Pvt.) Limited was incorporated as a private limited company in May 2006 under the Companies Ordinance 1984 (now Companies Act 2017). Registered office of the company is situated at DHA Lahore while plant is situated at Sujhan pura 6 km, Off Khanewal Road, Multan.

Profile of Chairperson of Board & Chief Executive Officer

Mrs. Sabeena Husnain serves as chairperson of the board and Chief Executive Officer of the company. She has over 13 years' of experience in textile sector. She is also the Chief Executive Officer of associated concern "Husnain Textile Mills (Pvt.) Limited".

RATING RATIONALE

H.A Fibres (Pvt.) Limited (HAFL) belongs to H.A group which comprises three companies, other two companies being "Husnain Textile Mills (Pvt.) Limited" & "Palm Villas", an AOP in Real Estate sector. HAFL holds 30.21% equity in "Husnain Textile Mills (Pvt.) Limited" which is also a spinning mill with capacity of 92,424 spindles. The company produces yarn of different qualities and sells it both in local & international market.

The assigned ratings take into account a gradual improvement in topline and margins mainly supported by higher yarn prices. Overall liquidity indicators have remained adequate. The ratings also factor in improving cash flows, despite elevated finance cost, and sound coverages. A decreasing trend has been witnessed in leverage indicators.

With the advent of corona virus pandemic, the demand outlook for textile products in general including yarn for both local and international consumption looks weak. The demand compression emerging from ongoing global crisis and continued lockdown situation will virtually impact the entire textile value chain. The ratings are dependent upon maintenance of sales, profit margin, debt service coverage, and gearing ratios at an adequate level.

Product Portfolio – focused on manufacturing of cotton yarn

HAFL manufactures 100% cotton carded compact yarn from imported and locally procured cotton with counts ranging from 10/S to 60/S for multiple uses. The coarser yarn mainly caters to denim, towel and socks while fine carded compact yarn caters to shirt fabric etc.

Spinning Products			
Yarn Type	**Count Range**	**Composition**	**End Use**
Carded Compact	10/S - 60/S	100% cotton yarn	Denim, Upholstery, Apparel, Towels, Garments, Home Textile

Operational Capabilities & Performance – Increasing capacity on a timeline basis

HAFL has 41,844 spindles with production capacity to produce 17.39m kg of yarn during FY19 converted to 20/S count. Average capacity utilization has remained high on a timeline basis.

Spinning	FY18	FY19
Total Spindles	41,844	41,844
Installed Capacity Converted to 20/S Count (Mn Kgs)	17.39	17.39
Actual Production (Mn Kgs)	16.48	16.59
Capacity Utilization %	94.76%	95.40%

The cumulative power requirement of the unit is 4.8 MW which is met through gas fired generators of 5.4 MW along with 4.9 MW electricity connection from WAPDA.

Sales growth emanating from increase of yarn prices

During FY19, the company reported net sales of Rs. 4.42b (FY18: Rs. 4.12b, FY17: Rs. 3.21b) driven by increase in average selling prices of yarn in the local & international market. The company generated export sales of Rs. 690m (FY18: Rs. 1.74b) during FY19 from China while sales of Rs. 3.73b (FY18: Rs. 2.38b) was generated from sales of yarn in the local market. The company was able to sell 11.8m Kgs (FY18: 13.4m Kgs) of yarn during FY19 while average price of yarn increased to Rs. 370/Kg (FY18: Rs. 304/Kg). Sales to top 10 customers increased on a timeline basis to 45% (FY18: 26%) during FY19 on account of 10% sales to one local institutional client. Gross profit of the company increased to Rs. 581m (FY18: Rs. 463m); gross margins stood higher at 13.1% (FY18: 11.2%) on the back of higher product prices and better production efficiencies. Although average cost of raw material increased to Rs. 221/Kg (FY18: Rs. 185/Kg), reduction in fuel & power expenses, salaries & depreciation expenses resulted in better gross margins. Salaries decreased on account of automation carried out by the company which reduced average number of employees to 753 (FY18: 942) during FY19. Operating expenses of the company stood slightly higher at Rs. 113m (FY18: Rs. 108m) on account of higher administration expenses of Rs. 35m (FY18: Rs. 30m) & other operating expenses of Rs. 24m (FY18: Rs. 13m) despite lower selling & distribution expenses of Rs. 54m (FY18: Rs. 64m).

Finance cost of the company increased considerably to Rs. 219m (FY18: Rs. 116m) on account of both higher average amount of borrowings and increase in interest rates during the year. Other income increased to Rs. 27m (FY18: Rs. 0.4m) on account of exchange gain on realization of foreign debtors while company earned profit of Rs. 61.2m (FY18: Rs. 61.5m) on investment in associate concern "Husnain Textile Mills (Pvt.) Ltd". After accounting for taxes of Rs. 73m (FY18: Rs. 28m), the company was able to generate net profit of Rs. 264m (FY18: Rs. 274m) while net profit margin decreased to 6.0% (FY18: 6.6%).

As per 1HFY20, the company generated sales of Rs. 2.55b (FY19: Rs. 4.42b) which is 15% increase on an annualized basis. The net income stood at Rs. 179m (FY19: Rs. 264m) while net profit margin increased to 7.0% (FY19: 6.0%) mainly on account of lower fuel, salary & depreciation expenses. In line with half year sales growth, the company has projected sales of Rs. 5.11b during FY20 and a net profit of Rs. 298m. Given ongoing situation particularly related to the textile sector due to worldwide pandemic, the projected numbers may not be achieved.

The company has planned a CAPEX of around Rs. 713m for FY21 which is projected to be financed through debt to equity of Rs. 450m to Rs. 163m for replacement of old machinery mainly spindles with new ones in order to enhance efficiency. The leverage indicators are projected to remain low.

Net fixed assets decreased on account of depreciation while stock in trade increased mainly due to higher raw material inventory

The fixed assets of the company stood slightly lower at Rs. 1.27b (FY18: Rs. 1.37b) owing to depreciation charge, despite capex of Rs. 26m (FY18: Rs. 154m) during FY19. The company holds 10 million shares (30.21% shareholding) in associated concern "Husnain Textile Mills (Pvt.) Ltd amounting to Rs. 100m which has increased to Rs. 226m (FY18: Rs. 184m) by end-FY19 on account of company's share of profit. Trade debts increased slightly to Rs. 650m (FY18: Rs. 629m) during FY19 out of which Rs. 86m (FY18: Rs. 337m) are secured against LCs while remaining amount of Rs. 564m (FY18: Rs. 292m) are due from local customers. As per receivable ageing, 95% receivables are due within 60 days while remaining 5% are due with 90 days. The company provides credit of 60-90 days to its clients. The company follows the practice of procuring local cotton between July and Dec and imported cotton between January and June while maintaining a buffer stock of around six to eight months. At end-FY19, HAFL held inventory of Rs. 1.56b (FY18: Rs. 1.04b) out of which raw material inventory constituted Rs. 1.42b (FY18: Rs. 960m).

As per management, the company decided to keep high cotton inventory to avoid further price hike as average cotton price increased to Rs. 237/Kg (FY18: Rs. 185/Kg) during FY19. Tax refund from government increased to Rs. 167m (FY18: Rs. 139m) which mainly constituted sales tax refundable of Rs. 85m (FY18: Rs. 61m) and income tax refundable of Rs. 83m (FY18: Rs. 78m). Overall trade & other payables of the company increased to Rs. 398m (FY18: Rs. 283m) which mainly included trade payable of Rs. 188m (FY18: Rs. 104m), accrued expenses of Rs. 117m (FY18: Rs. 126m) & accrued markup of Rs. 57m (FY18: Rs. 27m). Trade payables increased on account of higher cotton purchase. The company takes around average 30 days to pay its trade creditors. Other liabilities also increased to Rs. 46m (FY18: Rs. 2m) during FY19 on account of deferred taxation of Rs. 43m.

As of 1HFY20, the fixed assets of the company decreased to Rs. 1.24b (FY19: Rs. 1.27b) on account of depreciation charge despite CAPEX of Rs. 28m (FY19: Rs. 26m). Trade debts of the company increased to Rs.782m (FY19: Rs. 650m) by end-1HFY20. As per receivable ageing, 89% receivables are due within 60 days while remaining 11% are due with 90 days. The inventory of the company decreased to Rs. 1.15b (FY19: Rs. 1.56b) out of which raw material inventory constituted Rs. 915m (FY19: Rs. 1.42b). Other assets of the company increased to Rs. 370m (FY19: Rs. 79m) mainly on account of interest free advances due from associated concern amounting Rs. 290m. Trade & other payables of the company decreased to Rs. 343m (FY19: Rs. 398m) which mainly included trade payable of Rs. 80m (FY19: Rs.

188m) and accrued expenses of Rs. 144m (FY19: Rs. 117m).

Adequate liquidity and sound coverages

Funds from operations (FFO) improved to Rs. 427m (FY18: Rs. 369m) in line with higher profit before tax and positive difference between incurred and paid taxation and finance cost during FY19. Resultantly, FFO to total debt and FFO to long-term debt improved to 0.27x (FY18: 0.23x) and 2.28x (FY18: 1.28x), respectively. The debt service coverage ratio decreased to 2.12x (FY18: 3.60x), though remained adequate. The current ratio and inventory plus trade receivables to short-term borrowings ratio improved to 1.34x (FY18: 1.20x) and 1.58x (FY18: 1.30x), respectively. Cash flow and coverages have improved further during 1HFY20.

Manageable leverage indicators

Total equity of the company increased to Rs. 1.95b (FY18: 1.69b) by end-FY19 on the back of profit retention. The company also converted share deposit money of Rs. 255m into paid up capital during FY19. With scheduled repayment, long term borrowing continued to decrease to Rs. 187m (FY18: Rs. 288m). Short term loan of the company increased to Rs. 1.39b (FY18: Rs. 1.28b) by end-FY19 to finance increase in working capital requirements. The gearing ratio decreased to 0.81x (FY18: 0.93x) owing to increase in equity while debt leverage also stood lower at 1.04x (FY18: 1.10x) by end-FY19.

As of 1HFY20, total equity of the company increased to Rs. 2.13b (FY19: Rs. 1.95b) on account of profit retention. Long term borrowings decreased further to Rs. 134m (FY19: Rs. 187m) while short term decreased to Rs. 1.21b (FY19: Rs. 1.39b). The gearing and leverage ratios decreased to 0.63x (FY19: 0.81x) and 0.81x (FY19: 1.04x), respectively.

Imapact of Corona Virus

The revision in rating outlook reflects prevailing uncertainty in textile sector dynamics due to coronavirus outbreak, prolonged lockdown, overall contraction in demand and challenging economic environment. It is expected that the entire value chain of the textile industry will be effected by these developments. Status of the assigned rating is therefore uncertain as an event of deviation from expected trend has occurred; additional information will be necessary to take any further rating action. Given that company has largely stable financial risk profile, it is expected that ratings will remain stable post-recovery of the ongoing situation; nevertheless as scenario is evolving rapidly, VIS will closely monitor and will accordingly take action to resolve the outlook status.

Governance & Audit

The external auditors of the company are “EY Ford Rhodes” which has ‘A’ rating on SBP panel of auditors. The company has internal audit department comprising three members. The company also utilizes locally developed ERP system specifically designed for textile spinning industry having different modules. The company has developed in-house expertise to periodically review and upgrade the ERP system.

FINANCIAL SUMMARY

(amounts in PKR millions)

BALANCE SHEET	30-June-17	30-June-18	30-June-19	31-Dec-19
Non-Current Assets	1,393	1,375	1,271	1,240
Investment in Associates	140	184	226	226
Stock-in-Trade	1,026	1,041	1,565	1,152
Trade Debts	260	629	650	782
Tax Receivable from Government	121	139	167	52
Other Assets	37	146	79	370
Cash & Bank Balances	20	37	29	51
Total Assets	2,997	3,551	3,987	3,873
Trade and Other Payables	399	283	398	343
Short Term Borrowings	855	1,284	1,399	1,214
Long Term Borrowings	310	288	187	134
Total Interest Bearing Debt	1,165	1,572	1,586	1,348
Other Liabilities	13	2	46	46
Total Liabilities	1,577	1,857	2,030	1,737
Total Equity	1,420	1,694	1,957	2,136
Paid Up Capital	200	200	455	455
INCOME STATEMENT	**30-June-17**	**30-June-18**	**30-June-19**	**31-Dec-19**
Net Sales	3,216	4,127	4,421	2,557
Gross Profit	289	463	581	392
Finance Cost	110	116	219	113
Profit Before Tax	128	301	337	214
Net Profit	71	274	264	179
RATIO ANALYSIS	**30-June-17**	**30-June-18**	**30-June-19**	**31-Dec-20**
Gross Margin (%)	9.0	11.2	13.1	15.3
Net Profit Margin (%)	2.2	6.6	6.0	7.0
Current Ratio (x)	1.09	1.20	1.34	1.53
Debt Leverage (x)	1.11	1.10	1.04	0.81
Gearing (x)	0.82	0.93	0.81	0.63
FFO	211	369	427	566*
FFO to Total Debt (x)	0.18	0.23	0.27	0.42*
FFO to Long Term Debt (x)	0.68	1.28	2.28	4.22*
Debt Servicing Coverage Ratio (x)	2.53	3.60	2.12	2.34
Inventory + Receivables/Short-term Borrowings (x)	1.50	1.30	1.58	1.59

*Annualized.

ISSUE/ISSUER RATING SCALE & DEFINITIONS — 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	H.A Fibres (Pvt.) Limited (HAFL)
Sector	Textiles
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	
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.
Probability of Default	VIS ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meetings Conducted	

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
24/04/2020	A-	A-2	Rating Watch-Developing	Maintain
03/04/2019	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Muhammad Ismail	CFO	26-March-2020