RATING REPORT

H.A Fibres (Pvt.) Limited

REPORT DATE:
June 07, 2021

RATING ANALYST:

Tayyaba Ijaz
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	*Positive*		*Rating Watch-Developing*	
Rating Date	*8th Jun'21*		*24th Apr'20*	
Rating Action	*Maintained*		*Maintained*	

COMPANY INFORMATION	
Incorporated in 2006	**External auditors:** Naveed Mukhtar & Co. Chartered Accountants
Private Limited Company	**Chairperson/CEO:** Mrs. Sabeena Husnain
Key Shareholders (with stake 5% or more): Mrs. Sabeena Husnain—100%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (May 2019) ***https://www.vis.com.pk/kc-meth.aspx***

H.A Fibres (Pvt.) Limited

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 located at Sujhan pura 6 km, Off Khanewal Road, Multan.

Profile of Chairperson of Board & CEO: Mrs. Sabeena Husnain serves as chairperson of the board and CEO of the company. She has over 14 years of experience in textile sector. She is also the CEO of associated concern Husnain Textile Mills (Pvt.) Limited.

Financial Snapshot

Tier-1 Equity: end-1HFY21: Rs. 2.4b; end-FY20: Rs. 2.2b; end-FY19: Rs. 2.0b

Assets: end-1HFY21: Rs. 4.8b; end-FY20: Rs. 4.9b; end-FY19: Rs. 4.0b

Profit After Tax: 1HFY21: Rs. 186.3m; FY20: Rs. 272.4m; FY19: Rs. 263.0m

RATING RATIONALE

H.A Fibres (Pvt.) Limited (HAFL) is a spinning unit located at Multan. The company is a part of 'H.A group', other two group companies are Husnain Textile Mills (Pvt.) Limited (HTML) and Palm Villas, an Association of Persons in real estate sector. HAFL holds 30.21% equity in HTML which is a spinning mill with an installed capacity of 75,552 spindles. Presently, HAFL comprises 41,844 spindles and produces pure cotton and blended yarn of various counts.

Ratings assigned to HAFL take into account growth in topline in ongoing year along with improvement in margins. Notable improvement was witnessed in margins during 9MFY21 mainly on the back of higher sale of specialized yarn along with timely procurement of raw material at lower average cost. Meanwhile, debt service coverage has remained sound. Gearing has remained at comfortable level and is projected to remain within acceptable limits despite ongoing capacity enhancement. Ratings also factor in positive outlook of the textile sector due to higher demand in export markets coupled with additional support to the industry on the regulatory front. Meanwhile, the ratings are constrained by vulnerability of spinning sector to raw material prices and any adverse changes in regulatory duties. Ratings would also be dependent upon materialization of the intended capex, achievement of projected sales growth and profitability while maintaining capitalization indicators at adequate level.

Key Rating Drivers

Local cotton production witnessed a declining trend; meanwhile, post-covid textile sector exhibited growth mainly on the back of higher export orders: The local cotton production declined by 27.4% in CY20 compared to CY19 due to several reasons leading to greater reliance on imported cotton which may put pressure on the gross margins of textile industry players. On the other hand, textile sector started to recover on back of increase in exports due to orders shifting from China and other countries due to lockdown. Further, US-China trade war has also aided low cost suppliers including Pakistan in capturing the untapped share since Sep'19. Even though exports remained stagnant in USD terms, at least in 1QFY21, the recovery has particularly started to materialize in 2QFY21, when export proceeds were 4% higher than corresponding period last year. However, alternative data released by Pakistan Bureau of Statistics indicated 10% uptick in textile exports followed by another 10.8% uptick in Jan'21. This has resulted in improvement in gross margins throughout the textile value chain and specifically the players catering to the export industry. Additionally, provision of loans at concessionary rates for economic recovery by State Bank of Pakistan (SBP) amid pandemic and government efforts to boost export industry by giving subsidies for power cost and local taxes may provide positive momentum to revenues and profitability of the textile sector, going forward.

Capacity utilization remained high amid pandemic: HAFL has 41,844 spindles with an installed capacity of 18.076m Kgs at 20/s count. Capacity utilization as measured by conversion into 20/s count, was recorded slightly lower at 88% (FY19: 95.4%%) during FY20 in line with some decrease in demand and due to closure of mill due to Covid-19 for fifteen days in Mar-Apr'20. However, with increase in demand during 1HFY21, production remained virtually optimal at 96% capacity utilization.

Capex of Rs. 33.3m (FY20: Rs. 76.8; FY19: Rs. 27.5m) was conducted in 1HFY21 to improve operational efficiencies. Property, plant and equipment stood at Rs. 1.2b (FY20: 1.2b; FY19: 1.3b) at end-1HFY21. Investment in associate recorded at carrying value stood at Rs. 307.5m (FY20: Rs. 307.5m; FY19: Rs. 226.3m). The investment represents long-term investment in Husnain Textile Mills (Pvt.) Limited, with an equity share of 30.2%.

Capital expenditure to increase installed capacity: To enhance production capacity, the management intends to add 16 Ring Frames comprising 25,440 spindles along with 16 Autocones, two blowroom machines and four carding machines in 2HFY21 and FY22.

Additionally, to improve process efficiencies and quality of yarn, two MVS machines (Vortex spinning system) would also be installed. Vortex spinning system entails higher spinning speed than traditional spinning system for a number of count ranges and materials. The yarn produced in this method is spun directly from slivers and wound to packages. Total capex is estimated at Rs. 1.8b out of which Rs. 1.2b would be financed through SBP Temporary Economic Refinance Scheme (TERF) out of which Rs. 240m has been mobilized at rate of 4% and 1.0b at rate of 5% while the rest would be funded through own sources. Out of aforementioned capex, five ring frames have been installed in March'21 and five winding machines would be installed in May'21. Six ring frames and winding machines would be installed by end-June'21 while rest of the ring frames would be installed by end-Dec'21. Installation of MVS would be completed by end-Dec'22.

Sales decreased marginally in the outgoing year; however, growth has been witnessed in the same during 1HFY21: Revenues have remained largely stagnant at Rs. 4.3b (FY19: Rs. 4.4b) in FY20 on account of lower volumetric sales of 228,736 bags (FY19: 260,106 bags). Exports sales largely constituting coarser yarn were made only to China and the same witnessed a decline on timeline basis to Rs. 86.7m (FY19: Rs. 689.9m) in FY20. Concentration risk is considered high as sales to top ten customers accounted for 73% (FY19: 45%) of the topline in FY20. According to the management, the associated risk is considered manageable as most of the large clients are recurring in nature due to specific quality yarn produced by the company. Kings Apparels, Umar Garments, Fashion Knit Industries, Masood Textile, Bari Textile , Al Hadi Textile and Gul Ahmad Textile Mills are some of the major clients of HAFL.

Gross margins increased to 14.1% (FY19: 13.1%) in FY20 mainly on account of higher average yarn prices of Rs. 19,078/bag vis-à-vis Rs. 16,838/bag in the preceding year. Cost of sales was slightly lower at Rs. 3.7b (FY19: Rs. 3.8b) primarily due to decrease in raw material consumed; meanwhile, its proportion in total cost of goods manufactured remained at 77% in FY20. Moreover, stores and spares consumed and depreciation charges were also recorded lower. Raw material procurement in the outgoing year was lower at 12.5m Kgs (FY19: 14.9m Kgs). Around 47% (FY19: 25%) of raw material purchased was imported due to prevailing shortage and quality related issues of cotton in the local market. The company procured cotton at slightly lower average rate of Rs. 233/Kg (FY19: Rs. 237/Kg) during FY20. Administrative expenses amounted to Rs. 37.3m (FY19: Rs. 35.5m) while marketing and distribution expenses decreased slightly to Rs. 48.3m (FY20: Rs. 54.0m) mainly due to lower export related expenses. Other income amounted to Rs. 1.3m (FY19: Rs. 36.5m) during FY20. Finance cost was recorded higher at Rs. 246.5m (FY19: Rs. 219.3m) in line with higher average short-term borrowings. Unrealized share of profit from associate of Rs. 104.0m (FY19: Rs. 61.3m) has supported the bottomline. Accounting for taxation, the company recorded net profit of Rs. 272.2m (FY19: Rs. 263.0m) in FY20.

Sales during 1HFY21 amounted to Rs. 2.7b. Improvement in gross margins to 15.4% was mainly a function of higher product prices. In 1HFY21, the company purchased cotton at average rate of Rs. 235/Kg; around 63% of the cotton was imported due to favorable rates and better quality available in the international markets. The company sold 139,276 bags of yarn at an average rate of Rs. 18,628 /bag. No direct export sales were made in 1HFY21 while around 100% of the revenue emanated from sales to export-oriented textile units.

The company exhibited notable improvement in gross margins to 22.7% in 9MFY21 with net sales recorded at Rs. 4.0b. The increase in margins was mainly on account of higher sales of specialized yarn along with timely procurement of raw material at lower average cost. Management expects revenues to increase to Rs. 5.4b in FY21 and the margins to remain around current levels or even increase on back of increase in average yarn rates. Meanwhile, improvement in margins seems optimistic as cost of raw may also increase in tandem with product prices. Cognizant of the additional capacity coming online in FY22, the management projects the topline to grow by around 60% mainly on the back of higher sales volume. Sustainability of revenue growth and profit margins would be a key rating driver, going forward.

Adequate coverage ratios: Funds from operations (FFO) were recorded at Rs. 305.9m (FY20: Rs. 353.3m; FY19: Rs. 427.0m) in 1HFY21 and exhibited an increase on annualized basis on back of higher profitability. As a result of improvement in cash flows and overall lower debt levels, annualized FFO to total debt and FFO to long-term debt increased to 0.31x and 2.71x

(FY20: 0.15x and 2.11x; FY19: 0.27x and 2.29x). Furthermore, debt service coverage ratio improved to 3.60x (FY20: 2.14x; FY19: 2.12x) during 1HFY21.

Stock in trade stood at Rs. 1.7b (FY20: Rs. 1.9b; FY19: Rs. 1.6b) at end-1HFY21. Higher inventories at end-FY20 were mainly on account of stocking of raw material at favorable rates and also higher finished goods. Raw material inventory remained high at around 1.6b (FY20: Rs. 1.7b; FY18: Rs. 1.4b) to meet production requirements while finished stock decreased to Rs. 64.1m (FY20: Rs. 209.5m; FY19: Rs. 115.2m) at end-1HFY21. Trade debts amounted to Rs. 693.2mb (FY20: Rs. 829.2m; FY19: Rs. 649.8m) at end-1HFY21. Aging of the receivables is considered satisfactory given around 97% of the trade debts fall under one-month credit bracket. Loans and advances stood higher at Rs. 756.1m (FY20: Rs. 357.8m; FY19: Rs. 12.0m) at end-1HFY21. Loans and advances mainly comprised advances to suppliers amounting Rs. 359.8m (FY20: Rs. 355.8m; FY19: Rs. 10.5m) and unsecured and interest free loan extended to associated undertaking amounting Rs. 380.9m (FY19 & FY20: Nil). Meanwhile, tax refunds due from government have been recovered in full (FY20: Rs. 130.4; FY19: Rs. 167.4m) at end-1HFY21. Current ratio and coverage of short-term borrowings via trade debts and inventory remained sound at 1.55x and 1.36x (FY20: 1.37x and 1.29x; FY19: 1.34x and 1.58x) at end-1HFY21.

Equity base strengthened on back of profit retention: Tier-1 equity increased to Rs. 2.4b (FY20: Rs. 2.2b; FY19: Rs. 2.0b) at end-1HFY21 on back of profit retention. Long-term borrowings including current portion at Rs. 225.8m (FY20: Rs. 158.8m; FY19: Rs. 186.8m). The company mobilized a loan of Rs. 111.6m (FY20: Rs. 35.8m; FY19: Nil) in 1HFY21 against sanctioned facility of Rs. 132.2m (FY20: Rs. 70.2m; FY19: Nil) under refinance scheme by SBP for payment of salaries and wages. The facility carries markup at a flat rate of 3% and will be repaid in 8 equal quarterly installments starting from Jan'21. Another loan facility amounted to Rs. 114.2m (FY20: Rs. 123.2m; FY19: Rs. 186.8m) at end-1HFY21. The loan carries markup at rate of SBP *plus* 3% all in 5% per annum and would be fully retired by end-Nov'27. Short-term borrowings stood at Rs. 1.8b (FY20: Rs. 2.1b; FY19: Rs. 1.4b) at end-1HFY21. Increase in outstanding short-term loans at end-FY20 was rationalized with higher working capital requirements. Gearing and leverage decreased to 0.82x and 0.99x (FY20: 1.02x and 1.18x; FY19: 0.81x and 1.04x) by end-1HFY21 on back of higher equity base and lower overall borrowings. Going forward, leverage indicators are projected to remain comfortable despite mobilization of additional long-term borrowings on account of augmentation in equity base due to higher profitability.

H.A Fibres (Pvt.) Limited — Annexure I

FINANCIAL SUMMARY				(amounts in PKR millions)
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**1HFY21**
Property, Plant & Equipment	1,364	1,260	1,217	1,197
Investment in Associate	184	226	308	308
Stock in Trade	1,041	1,565	1,905	1,701
Trade Receivables	629	650	829	693
Loans and Advances	50	12	358	756
Tax Refunds Due from Government	139	167	130	-
Other Assets	107	78	89	85
Cash & Bank Balance	37	29	28	59
Total Assets	**3,551**	**3,987**	**4,864**	**4,799**
Trade & Other Payables	283	398	288	320
Short-Term Borrowings	1,284	1,399	2,121	1,767
Long-Term Borrowings *(Including current maturity)*	288	187	159	226
Other Liabilities	2	46	66	70
Total Liabilities	**1,857**	**2,030**	**2,634**	**2,383**
Paid-Up Capital	200	455	455	455
Tier-1/Total Equity	1,695	1,958	2,230	2,416
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**1HFY21**
Net Sales	4,127	4,421	4,261	2,715
Gross Profit	463	581	607	417
Operating Profit	417	494	501	352
Finance Cost	116	219	247	102
Profit Before Tax	301	336	359	250
Profit After Tax	274	263	272	186
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**1HFY21**
Gross Margin (%)	11.2	13.1	14.1	15.4
Net Margin (%)	6.6	5.9	6.4	6.9
Net Working Capital	333	630	892	1,162
FFO	369	427	335	306
FFO to Long-Term Debt (x)	1.28	2.29	2.11	2.71
FFO to Total Debt (x)	0.23	0.27	0.15	0.31
Debt Servicing Coverage Ratio (x)	3.60	2.12	2.14	3.60
ROAA (%)	8.4	7.0	12.9	8.5
ROAE (%)	17.6	14.4	27.8	17.0
Gearing (x)	0.93	0.81	1.02	0.82
Debt Leverage (x)	1.10	1.04	1.18	0.99
Current Ratio (x)	1.20	1.34	1.37	1.55
Inventory+Receivables to Short-term Borrowings (x)	1.30	1.58	1.29	1.36

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.

<table>
<tr><th colspan="6">REGULATORY DISCLOSURES — Appendix III</th></tr>
<tr><td>Name of Rated Entity</td><td colspan="5">H.A Fibres (Pvt.) Limited</td></tr>
<tr><td>Sector</td><td colspan="5">Textile</td></tr>
<tr><td>Type of Relationship</td><td colspan="5">Solicited</td></tr>
<tr><td>Purpose of Rating</td><td colspan="5">Entity Ratings</td></tr>
<tr><td rowspan="5">Rating History</td><td>Rating Date</td><td>Medium to Long Term</td><td>Short Term</td><td>Rating Outlook</td><td>Rating Action</td></tr>
<tr><td colspan="5">RATING TYPE: ENTITY</td></tr>
<tr><td>06/07/2021</td><td>A-</td><td>A-2</td><td>Positive</td><td>Maintained</td></tr>
<tr><td>04/24/2020</td><td>A-</td><td>A-2</td><td>Rating-Watch Developing</td><td>Maintained</td></tr>
<tr><td>04/03/2019</td><td>A-</td><td>A-2</td><td>Stable</td><td>Initial</td></tr>
<tr><td>Instrument Structure</td><td colspan="5">N/A</td></tr>
<tr><td>Statement by the Rating Team</td><td colspan="5">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.</td></tr>
<tr><td>Probability of Default</td><td colspan="5">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.</td></tr>
<tr><td>Disclaimer</td><td colspan="5">Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.
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<tr><td rowspan="3">Due Diligence Meetings Conducted</td><td></td><td>Name</td><td colspan="2">Designation</td><td>Date</td></tr>
<tr><td>1.</td><td>Mr. Muhammad Ismail</td><td colspan="2">Chief Financial Officer</td><td>15th March, 2021</td></tr>
<tr><td>2.</td><td>Mr. Muhammad Naeem</td><td colspan="2">Finance Manager</td><td>15th March, 2021</td></tr>
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