# RATING REPORT

## Rajby Industries

**REPORT DATE:**
December 12, 2019

**RATING ANALYSTS:**

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| RATING DETAILS | | |
|---|---|---|
| **Rating Category** | **Latest Rating** | |
| | **Long-term** | **Short-term** |
| **Entity** | A- | A-2 |
| ***Rating Date*** | *29 November 2019* | |
| **Rating Outlook** | Stable | |
| ***Outlook Date*** | *29 November 2019* | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 1990** | **External auditors:** Muniff Ziauddin & Co. Chartered Accountants |
| **Partnership Firm** | **Chairman of the Board:** Mr. Saleem Sultan<br>**Chief Executive Officer:** Mr. Nafees Sultan |

| APPLICABLE METHODOLOGY(IES) |
|---|
| ***Applicable Rating Criteria: Industrial Corporates (May, 2016) http://www.vis.com.pk/kc-meth.aspx*** |

# Rajby Industries

## OVERVIEW OF THE INSTITUTION

Rajby Industries (RI), the partnership firm was registered in Pakistan on November 15, 1990. The firm is principally engaged in manufacturing of ready-made garments (mostly comprising denim) for exports.

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

## RATING RATIONALE

Rajby Industries belong to the Rajby Group of Companies 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 and is also setting up a spinning unit which will make the group vertically integrated). RI offers one-stop solution offering cutting, stitching, washing, finishing, quality control to clearance and delivery of denim apparels through a number of production facilities. Power requirement of the manufacturing units are met through gas based generators.

RI adheres to various protocols of compliance with utmost focus on environmental safety, hazards, and stringent quality control. In view of the same, the company has compliance with major international safety and quality standards. The company is also in the process of attaining LEED Certification for its upcoming factory site. The company has also installed solar panels at the head office and at a selected production facility in line with its vision of using clean and green energy which is planned to continue. Furthermore, Effluent Treatment Plant (ETPs) has also been installed to minimize soil and water contamination at the washing unit. RI also plans to set up a Product Engineering Center through collaboration with a Spanish company given increasing industry demand to focus on engineering of sustainable products. Focus on sustainability initiatives through continued investments is planned to continue.

*Operations*

During FY17, the company enhanced its denim garments production capacity to an average of 1.5m pieces/month from 1.2m pieces/month translating into an annual installed capacity of 18m pieces. Capacity utilization has been increasing on a timeline basis and was reported at 89% (FY18: 81%) during FY19 owing to improved demand. Going forward, continuous expansion in installed capacity is planned over the rating horizon. Capacity expansion will be undertaken in 3 phases and will be funded through a mix of debt and equity.

*Information Technology*

RI uses Oracle EBS as prime system and platform for strategic and operational decision making. RI has also invested in establishing Cloud Technology especially in ERP Business Model to keep up with the pace of innovation and continuously improve its business operations. An IT Governance Policy is in place, intent of which is to guide the creation, storage, use, archiving and deletion of information. Moreover, the company has also formulated a Business Continuity Plan while regular mock drills are conducted. As per management, the company regularly reviews IT infrastructure so that the same is geared to cater to:

- Monitor and improve on going performance.
- Provide up-to-date information for strategic decision making.
- Verify and demonstrate departmental effectiveness
- Create service-wide checks and balances to safeguard assets and ensure accountability.

**Key Rating Drivers**

**Moderate business risk profile supported by stable and growing demand for denim products; US-China Trade disruption has enhanced sales as major buyers continue to diversify procurement.**

Business risk profile is supported by stable and growing demand for denim products. VIS expects demand for denim products to remain stable over the medium term. Given the favorable policies & incentives of the government on enhancing exports and trade disruption between US and China, there is significant opportunity for local players to enhance exports. However, local and international expansion by major players is expected to keep pricing power and hence margins in check. Moreover, significant investment required by customers as part of sustainability initiative is expected to add to cost pressures for denim manufacturers. Increased expansion by leading denim and non-denim textile players is also on account of favorable demand and expected increase in orders.

**Double-digit sales growth led by volumetric growth in garments division and higher average selling prices. In line with industry trend, geographical concentration risk is considered on the higher side; however the same is mitigated with long term association with major clients. Healthy order pipeline along with increase in prices is expected to translate into continued sales growth, going forward.**

Sales revenue of the company has grown at a CAGR of 16% over the past four years (FY15-FY19) on the back of improving demand dynamics. Sales revenue entirely comprises exports sales. Sales growth was recorded at 39% in FY19 and was on account of a 6% increase in quantity sold and 30% higher average selling prices (largely due to currency devaluation). Product wise sales breakup depicts higher concentration towards bottoms with management now focusing on higher margin garments. Product portfolio also includes sales of jackets, chinos, and twills etc. which represents around one-tenth of total revenues. In terms of geographical concentration in revenues, sales generated from top 3 countries represented around three-fourths of total sales. While client concentration is currently manageable, management plans to enhance proportion of sales to top-tier high margin clients (where long-term relationship will be beneficial for RI) as part of a deliberate strategy which might result in some increase in client concentration. Client concentration risk is largely mitigated given long term association with major customers. Going forward, the management has booked orders for almost 95% of its capacity translating into higher projected sales revenue supported by higher expected average selling prices.

**Overall profitability profile of the Company has depicted improvement over the last 2 years. Net margins remain on the lower side vis-à-vis peers.**

Gross margins (GMs) of the company have remained elevated over the last 2 years due to increasing per unit dollar prices, rupee devaluation and sizeable DLTL rebate. Despite significant jump expected in power cost, management expects to sustain margins on the back of increase in selling prices. Elevated administrative, general and selling expenses in FY19 were on account of higher export forwarding cost, commission on sales, and freight charges which are denominated in foreign currency. Going forward, management expects momentum in profitability growth to improve given enhanced capacities, higher prices and continued focus on value addition.

**Strong liquidity profile bolstered by healthy cash flow coverages against outstanding obligations**

Liquidity profile of the company is considered strong in view of healthy cash flows. Given higher debt drawdown during FY19, cash flow coverage of total and long-term debt witnessed decline to 33% (FY18: 51%) and 126% (FY18: 666%), respectively. Working capital cycle of the company necessitates utilization of short term borrowing which noticed sizeable increase during FY19. Trade debts at end-June 2019 depicted an increase on account of major sales undertaken in the month of June 2019 and due to increase in rupee dollar parity. Total capex projected for expansion will be financed through a mix of Islamic LTFF and internal cash generation. VIS expects liquidity profile of the company to remain satisfactory over the rating horizon.

**Elevated leverage indicators. Leverage indicators are projected to improve over the rating horizon due to healthy internal capital generation**

Equity base of the company has grown at a CAGR of 22% over the last 4 years on account of healthy internal capital generation. Increase in equity base has been significantly higher over the last 2 years due to healthy profitability. Nevertheless, the size of equity base is low vis-à-vis other peer companies. Leverage indicators were reported on the higher side on account of higher debt drawdown in the outgoing year to fund expansion and to finance working capital requirements. Going forward, with limited debt drawdown and projected increase in equity base, leverage indicators are projected to improve.

**Corporate Governance framework has room for improvement**

Ratings of RTPL are constrained by the current corporate infrastructure given Company's status as a private limited company. Corporate governance framework can also be strengthened through improvement in board composition and oversight and documentation of a succession plan. Senior management team comprises experience professionals who have had a lengthy association with the Company. Recently, management has made strategic changes in organizational structure and has inducted qualified professionals to oversee operations and sales function and implement a revised business strategy. External auditors of the company lie in Category 'A' of the SBP Panel of Auditors.

**Rajby Industries** **Appendix I**

| FINANCIAL SUMMARY *(amounts in PKR millions)* | | | | | |
|---|---|---|---|---|---|
| **BALANCE SHEET** | **FY15** | **FY16** | **FY17** | **FY18** | **FY19** |
| Partners' Capital | 1,345 | 1,810 | 1,307 | 2,219 | 3,014 |
| | | | | | |
| **INCOME STATEMENT** | | | | | |
| Net Sales | 8,652 | 8,642 | 9,198 | 11,120 | 15,493 |
| Profit Before tax | 398 | 345 | 345 | 1,172 | 1,118 |
| Profit After Tax | 308 | 262 | 256 | 1,072 | 963 |
| | | | | | |
| **RATIO ANALYSIS** | | | | | |
| FFO | 452 | 390 | 405 | 1,260 | 1,257 |
| Current Ratio (x) | 1.06 | 1.29 | 1.0 | 1.2 | 1.1 |
| Gearing (x) | 0.56 | 0.44 | 1.44 | 1.11 | 1.28 |

# 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 Industries |
| **Sector** | Textile Industry |
| **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. |
| **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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Rating History:

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| November 29, 2019 | A- | A-2 | Stable | Initial |