RATING REPORT

Rajby Industries

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-2	A-	A-2
Rating Date	*June 03, 2021*		*April 23, 2020*	
Rating Outlook	Negative		Rating Watch-Negative	
Rating Action	*Maintained*		*Maintained*	

COMPANY INFORMATION

Incorporated in 1990	**External auditors:** Muniff Ziauddin & Co. Chartered Accountants
Partnership Firm	**Chairman of the Board:** Mr. Saleem Sultan **Chief Executive Officer:** Mr. Nafees Sultan

APPLICABLE METHODOLOGY(IES)

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

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). 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 and is expected to get it by Jun'21. 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. The construction phase has been completed while the project is on hold due to COVID-19. Focus on sustainability initiatives through continued investments is planned to continue.

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 8MFY21, 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 8MFY21 were Tents canvas & tarpaulin (↑47%), Towels (↑14%), Bed wear (↑9%), Other materials (↑6%).
- On the other hand, mainly cotton related products dented the overall textile contribution as 8MFY21 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	157.9	166.9	155.5	160.8	156.2	161.9

SOURCE: SBP

Operational Update

- During FY20, the company enhanced its denim garments production capacity to an average of 1.8m pieces/month from 1.4m pieces/month, translating into an annual installed capacity of 21.6m pieces/ annum vis-à-vis 16.8 pieces/ annum previously.

- However, the onset of the Covid-19 pandemic in Q4'FY20, resulted in halted shipments and order cancellations, as a result of which capacity utilization was affected. Overall production in FY20 fell from 15m pieces to 13.9m pieces.

- The increased capacity and decrease in production suppressed the utilization levels to 64% in FY20 vis-à-vis 89% in FY19.

- Capacity utilization during H1'FY21 further deteriorated to 55% given a further drop in production. However, utilization level is forecasted to come around ~75% for full year, on account of a stronger order book in H2'FY21.

- The operational capacity of the company has declined to 1.3m pieces at Dec'21 from 1.8m pieces at Jun'20 as the company removed some older inefficient production lines.

- Topline of the company displayed a CAGR of 16% from FY15-FY19, however, FY20 sales witnessed a drop of 5% as a result of the pandemic-induced slowdown.

- This drop in topline was a result of 12% decline in volumetric sales. Average selling price increased by 11% during FY20.

- The sales of RI is entirely export-oriented whereas the highest country-wise share of revenue emanates from USA (25%) followed by Spain (21%) and Germany (19%). Cumulatively, these 3 markets contributed ~65% in revenue of FY20. (H1'FY21: 70%).

- Total sales in FY21 is expected to come around at Rs. 13.5b, i.e. a further 10% YoY decline. However, it is expected to subsequently pick up over the medium term horizon.

- The company's gross margin dropped to FY17 level and came under further stress in H1'FY21, as illustrated in the table above. Drop in FY20 margin was mainly a factor of higher production costs, which could not be passed on to the buyers given international market's pricing dynamics.

- Higher admin and finance cost due to high prevailing inflation and interest rates during FY20 suppressed the operating margin and net margin to 3.8% and -0.1% (FY19: 10.7%, 7.7%).

- Absence of exchange gain due to strengthening of rupee by 5% from August 2020 to Dec 2020 along with inflationary pressures and higher finance cost paid by the company further deteriorated operating and net margins to -1.9% and -5.4% in H1'FY21.

Key Rating Drivers

Gross Margin has fallen below the peer median

- RI's gross margin has come under stress during the period under review, falling below the peer median. This pressure on margin is expected to continue in the ongoing half, given inflation driven increase in cost of production, and a stronger rupee.

- On April 14, ECC has withdrawn the customs duty on import of cotton yarn till Jun'2021, subject to cabinet approval. This has mainly been done by GoP in order to minimize supply demand gap while it will have no major impact on cost structure as the companies locks their prices for next 3-6 months.

- In order to recoup margins, management is deploying a multidimensional strategy to reduce cost and increase production efficiency by achieving maximum utilization of newer more efficient production lines. This will be the key challenge for RIs profitability indicators and remain an important factor from rating perspective.

Negative net margin has adversely affected the cash flow coverage indictors

- Deteriorating profitability from operations has weakened the cash flow coverage indicators of RI during the period under review.

Liquidity Analysis	FY18	FY19	FY20	1HFY21
FFO (Mn.)	1,260	1,527	341	(248)
Current Ratio (x)	1.18	1.07	0.96	0.91
Working Capital Cycle (days)	37	37	30	18

- FFO significantly declined in FY20 and slipped into the negative territory during H1'FY21. As a result cash flow coverage indicators and FFO to Debt have been affected and stand below the threshold for the assigned rating.

- Due to Covid-19 led lockdown, Days Inventory Outstanding (DIO) has increased in FY20 while the management has efficiently managed this and increase their Days Payable Outstanding (DPO) for a smooth Working Capital Cycle (WCC). WCC witnessed further improvement in H1'FY21.

- Liquidity profile has weakenbed as reflected by low stock of cash & bank balances at Rs. 49m as of Dec'20 (Jun'20: Rs. 132m; Jun'19: Rs. 292m). At the same time, current ratio has also dropped to its lowest at 0.91 (Jun'20: 0.96; Jun'19: 1.07). Management is also renegotiating credit terms with major credit supplier in order to create reasonable cushion in working capital.

Amidst drop in capacity utilization, debt has conversely increased translating in heightened leverage.

- Despite losses incurred during the period under review (July'19-Dec'20), amounting to Rs. 402m, we have not noted any change in shareholder drawings, which amounted to Rs. 69m in FY20 and Rs. 65m in H1'FY21. Resultantly, equity erosion during the period stood at 22%.

Balance Sheet (Extract)	FY18	FY19	FY20	H1'FY21
Total Equity	2,219	2,483	2,399	1,948
Gearing (x)	1.11	1.55	1.72	2.58
Leverage (x)	1.92	2.60	2.99	4.17

- Conversely, the total debt has increased by 30% during the period, resulting in an increase in gearing & leverage, which exceed the peers. Furthermore, equity base, in absolute terms is considered to be weaker than peers.

- Short term debt is expected to decline as at Jun'21 as management is focusing to efficiently manage working capital cycle taking the total debt forecast of Jun'21 to 3.96b (Dec'20: 4.5b). Further, equity injection by under discussion, albeit nothing conclusive has been determined so far.

Corporate Governance framework has room for improvement

- Ratings of RI are constrained by the current corporate infrastructure given Company's status as a partnership 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.
- External auditors of the company lie in Category 'A' of the SBP Panel of Auditors.
- The company is in adherence to various international compliance protocols with utmost focus on environmental safety and quality controls.
- RI also uses Oracle EBS for strategic and operational decision making while also have a cloud technology in ERP business model to smoothly run day to day operations.

Rajby Industries **Appendix I**

FINANCIAL SUMMARY

(amounts in PKR millions)

BALANCE SHEET	FY15	FY16	FY17	FY18	FY19	FY20	1HFY21
Partners' Capital	1,345	1,810	1,307	2,219	2,483	2,399	1,948
INCOME STATEMENT							
Net Sales	8,652	8,642	9,198	11,120	15,713	14,968	7,203
Profit Before tax	599	451	429	1,321	1,678	571	(140)
Profit After Tax	308	262	256	1,072	1,208	(15)	(387)
RATIO ANALYSIS							
FFO	452	390	405	1,260	1,527	341	(248)
Current Ratio (x)	1.06	1.29	1.01	1.18	1.07	0.96	0.91
Gearing (x)	0.56	0.44	1.44	1.11	1.55	1.72	2.58

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	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
June 03, 2021	A-	A-2	Negative	Maintained
April 23, 2020	A-	A-2	Rating Watch-Negative	Maintained
November 29, 2019	A-	A-2	Stable	Initial

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	**Name**	**Designation**	**Date**
	Muhammad Ilyas	GM Accounts	06-May-2021