RATING REPORT

Rajby Industries

REPORT DATE

June 07, 2022

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 07, 2022*		*June 03, 2021*	
Rating Outlook	Stable		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 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.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 belongs 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 is 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. In addition to the installation of solar panels at head office and a production facility, the company has recently obtained LEED Certification for one of its factory sites, in line with its vision of using green energy and becoming resource efficient. 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.

Due to the slowdown in business activity caused by COVID-19, the management revised its strategy and opted to reduce the overall production capacity.

Capacity Utilization (Pieces)	FY20	FY21	HY22
Installed Capacity	19,200,000	16,800,000	16,800,000
Available Capacity (annualized)	19,200,000	16,800,000	16,800,000
Actual Production	13,888,918	11,204,649	5,010,865
	72%	**67%**	**70%**

Before COVID-19, RI comprised 6 units with 3 units having monthly capacity of 400k pieces and the remaining units had monthly production capacity of 200k units adding to a total of 1.8m pieces per month. In FY20, the company also achieved monthly production of around 2m pieces. As the pandemic hit the economy, the company permanently shut down two facilities having capacity of 200k pieces per month and kept one unit of 200k peieces/month on stand-by. Consequenly, installed capacity of the company reduced to 1.4m pieces per month in FY21. In the case of increased demand, the stand-by plant of 200k pieces can be operational. Going forward, management envisages gradual increase in installed capacity to 1.5m pieces/month by FY25. The same can be achieved earlier if international demand improves.

Business risk profile is supported by industry wide growth in exports over the last year

Surge in textile exports has continued in FY22 as COVID-19 related restriction are lifted across the globe. In the period July-January 2022, businesses in Pakistan earned $10.9b from the export of textile and apparel products, an increase of 26% year-on-year. With an investment plan of $3.5b in place for the sector, exports are projected to reach a figure of $21b for FY22, which will be a 40% increase over the last year. There has been a noticeable improvement in the exports of denim apparels as well. Sales to USA based businesses in the period Jan-Sep'21 went up by 63% YoY and were reported $275.9m, enabling Pakistan to narrowly overtake China in this particular segment and close the gap on Vietnam.

The margins of textile operators have broadly depicted improvement despite the uptick in raw material costs, given that the same was offset by exchange rate movement. Nevertheless, higher raw material pricing has increased the working capital requirements for textile operators, which is likely to weigh on the liquidity of textile players. The order book for the industry is expected to remain adequate in the ongoing year along with transfer orders of neighboring countries, easing our business risk concerns. Rising costs of raw material and freight continue to pose a challenge for the sector; however the same was offset by influx of international orders of regional players. Due to relatively high demand in comparison to the supply, cotton prices in Pakistan have depicted a rise of around 50% over the last six months.

Topline of the company shrank in FY21 due to closure of production units, but showed signs of recovery in 1HFY22.

Revenue of the entity fell by about 10% and was reported at Rs. 13.5b in FY21 due to reduced overall capacity and in response to the implications of COVID-19 along with increased focus more on long-term customers consequently ending relationships with loss making clients. The objective of the redefined strategy was to prioritize quality and prices over quantity. As a result of the same, sales volumes for the review period declined. In 1HFY22, revenue base was reported at Rs. 7.6b primarily led by a rise in average selling prices contributed by currency devaluation. Customer wise concentration remains on the higher side, with top 10 customers accounting for more than 90% of total sales. However, comfort is drawn from long-term relationships with these clients.

Going forward, RI plans expansion in the US market in comparison to European countries. In this regard, the company has reached agreements with some new customers, including some of the top global brands. The expected growth in volumes because of additional orders from these customers is expected to push up the capacity requirement to 1.5m pieces per month. Timely materialization of the same is considered important.

Profitability indicators have improved post COVID-19, however the same are lower than pre-COVID levels. Net margins compare lower than the peers.

Gross margin improvement to 19.3% (FY20: 16.5%) is attributable to inventory gains supported by higher average selling price per piece led by the depreciation of PKR. Margins were also bolstered by the change in product offerings whereby the company focused more on value added products that offer better margins. Although gross margins improved post COVID-19, the same compare lower than pre-COVID levels. Administrative and selling expenses remained at similar level and finance cost was lower as compared to FY20. In HY22, the company's administrative and selling expenses were on the higher side at Rs. 1b contributed by higher export forwarding charges and charity & donations. Net margins to the tune of 1.4% in FY21 and 2.6% in HY22 compare lower than the peers. The redefined strategy of the company involves prioritizing better prices over sales volumes. In line with the same, management projects gross margins to clock in the range of 19%-20% over the rating horizon.

Liquidity indicators weakened in FY21; however improved in HY22. Debt servicing coverage ratio and current ratio compare lower than the peers.

Funds from operations (FFO) of the entity improved to Rs. 371m for 1HFY22 (FY21: Rs. 323m, Rs.

341m) after declining in FY21. Consequently, cash flow coverages improved, as relevant indicators (FFO to Total Debt, FFO to Long Term Debt, and Debt Servicing Coverage) rose to 16.7% (FY21: 7.0%, FY20: 8.2%), 50.8% (FY21: 19.3%, FY20: 19.1%), and 1.39x (FY21: 1.13x, FY20: 1.72x), respectively. Stock in trade and trade debts provide adequate coverage against short-term debt at end-Dec'21, while cash conversion cycle for the period also remained at a reasonable level (28 days) in HY22. Assigned ratings are constrained with current ratio nearing 1.00x and DSCR comparing lower than peers reflecting higher liquidity risk.

Leverage indicators remain at elevated levels. Support is drawn from long-term interest free loan from associated company.

Quantum of debt increased by about Rs. 300 m in the period July'20-Dec'21. The change was mainly attributable to a higher level of short-term borrowings to finance the working capital needs. Partners' capital (excluding interest free loan from associated company amounting Rs. 636m) reflected limited growth on account of subdued net margins and consequent bottom line, along with drawings of Rs. 87m in FY21 and Rs. 94m in HY22. However, incorporating loan from RTPL, leverage and gearing ratios were reported at 2.33x (FY21: 2.23x, FY20: 2.99x) and 1.37x (FY21: 1.47, FY20: 1.72), respectively. It is important to consider that the quantum of debt reduced by Rs. 1.3b in the period Jan'22-May'22. Hence, despite the projected increase in short-term financing to meet rising cost of raw materials going forward, leverage indicators are expected to remain within manageable levels.

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 experienced 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.

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**1HFY22**
Total Assets	6,475	8,930	9,569	10,155	10,783
Total Liabilities	4,256	6,447	7,170	7,651	8,177
Partners' Capital (including loan from associated company)	2,219	2,483	2,399	3,140	3,243
INCOME STATEMENT					
Net Sales	11,120	15,713	14,968	13,494	7,611
Gross Profit	2,740	3,812	2,468	2,601	1,520
Profit Before tax	1,321	1,678	571	612	419
Profit After Tax	1,072	1,208	(15)	193	197

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.

<table>
<tr><th>REGULATORY DISCLOSURES</th><th colspan="5">Appendix III</th></tr>
<tr><td>Name of Rated Entity</td><td colspan="5">Rajby Industries</td></tr>
<tr><td>Sector</td><td colspan="5">Textile Industry</td></tr>
<tr><td>Type of Relationship</td><td colspan="5">Solicited</td></tr>
<tr><td>Purpose of Rating</td><td colspan="5">Entity Rating</td></tr>
<tr><td rowspan="6">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"><u>RATING TYPE: ENTITY</u></td></tr>
<tr><td>June 07, 2022</td><td>A-</td><td>A-2</td><td>Stable</td><td>Maintained</td></tr>
<tr><td>June 03, 2021</td><td>A-</td><td>A-2</td><td>Negative</td><td>Maintained</td></tr>
<tr><td>April 23, 2020</td><td>A-</td><td>A-2</td><td>Rating Watch-Negative</td><td>Maintained</td></tr>
<tr><td>November 29, 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>
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<tr><td rowspan="4">Due Diligence Meetings Conducted</td><td colspan="2">Name</td><td colspan="2">Designation</td><td>Date</td></tr>
<tr><td colspan="2">Mr. Tauseef Karim</td><td colspan="2">Director Finance</td><td>22-April-2022</td></tr>
<tr><td colspan="2">Mr. Adnan Feroze</td><td colspan="2">GM Marketing</td><td>22-April-2022</td></tr>
<tr><td colspan="2">Mr. Muhammad Ilyas</td><td colspan="2">GM Accounts</td><td>22-April-2022</td></tr>
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